

NATIONAL INSTRUMENTS CORP
Form 10-Q
August 01, 2017
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: June 30, 2017 or

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____

Commission file number: 0-25426

NATIONAL INSTRUMENTS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

74-1871327

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification Number)

11500 North MoPac Expressway

Austin, Texas

78759

(address of principal executive offices)

(zip code)

Registrant's telephone number, including area code: (512) 683-0100

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

Indicate by check mark whether the registrant has submitted electronically 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, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer”, “accelerated filer”, “smaller reporting company”, and “emerging growth company” in Rule 12b-2 of the Exchange Act. (Check one):

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

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

Class	Outstanding at July 25, 2017
Common Stock - \$0.01 par value	130,493,232

NATIONAL INSTRUMENTS CORPORATION

INDEX

<u>PART I. FINANCIAL INFORMATION</u>		Page No.
Item 1	Financial Statements:	
	<u>Consolidated Balance Sheets</u> June 30, 2017 (unaudited) and December 31, 2016	3
	<u>Consolidated Statements of Income</u> (unaudited) for the three and six month periods ended June 30, 2017 and 2016	4
	<u>Consolidated Statements of Comprehensive Income</u> (unaudited) for the three and six month periods ended June 30, 2017 and 2016	5
	<u>Consolidated Statements of Cash Flows</u> (unaudited) for the six month periods ended June 30, 2017 and 2016	6
	<u>Notes to Consolidated Financial Statements</u>	7
Item 2	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	24
Item 3	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	36
Item 4	<u>Controls and Procedures</u>	36
<u>PART II. OTHER INFORMATION</u>		
Item 1	<u>Legal Proceedings</u>	36
Item 1A	<u>Risk Factors</u>	36
Item 2	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	46
Item 5	<u>Other Information</u>	46
Item 6	<u>Exhibits</u>	46

2

PART I - FINANCIAL INFORMATION

ITEM 1. Financial Statements

NATIONAL INSTRUMENTS CORPORATION

CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

	June 30, 2017 (unaudited)	December 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	\$ 263,150	\$ 285,283
Short-term investments	105,284	73,117
Accounts receivable, net	230,958	228,686
Inventories, net	186,155	193,608
Prepaid expenses and other current assets	52,568	53,953
Total current assets	838,115	834,647
Property and equipment, net	256,761	260,456
Goodwill	261,411	253,197
Intangible assets, net	120,327	108,663
Other long-term assets	28,700	39,601
Total assets	\$ 1,505,314	\$ 1,496,564
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 54,214	\$ 48,800
Accrued compensation	36,672	27,743
Deferred revenue - current	120,212	115,577
Accrued expenses and other liabilities	15,341	32,997
Other taxes payable	28,743	34,958
Total current liabilities	255,182	260,075
Long-term debt	25,000	25,000
Deferred income taxes	35,561	45,386
Liability for uncertain tax positions	12,438	11,719
Deferred revenue - long-term	31,665	29,752
Other long-term liabilities	7,420	10,413
Total liabilities	367,266	382,345

Commitments and contingencies

Stockholders' equity:

Preferred stock: par value \$0.01; 5,000,000 shares authorized; none issued and outstanding	-	-
Common stock: par value \$0.01; 360,000,000 shares authorized; 130,493,232 shares and 129,202,979 shares issued and outstanding, respectively	1,305	1,292
Additional paid-in capital	800,774	771,346
Retained earnings	359,088	376,202
Accumulated other comprehensive loss	(23,119)	(34,621)
Total stockholders' equity	1,138,048	1,114,219
Total liabilities and stockholders' equity	\$ 1,505,314	\$ 1,496,564

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

NATIONAL INSTRUMENTS CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share data)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net sales:				
Product	\$ 289,817	\$ 278,530	\$ 561,328	\$ 537,963
Software maintenance	28,792	27,575	57,386	55,319
Total net sales	318,609	306,105	618,714	593,282
Cost of sales:				
Product	79,153	75,194	154,349	149,404
Software maintenance	3,307	2,314	4,635	4,250
Total cost of sales	82,460	77,508	158,984	153,654
Gross profit	236,149	228,597	459,730	439,628
Operating expenses:				
Sales and marketing	124,414	116,361	241,674	229,568
Research and development	56,913	59,839	115,175	119,179
General and administrative	26,191	25,130	51,933	49,770
Total operating expenses	207,518	201,330	408,782	398,517
Operating income	28,631	27,267	50,948	41,111
Other income:				
Interest income	509	258	852	511
Net foreign exchange gain (loss)	447	(1,285)	529	(711)
Other gain (loss), net	(235)	53	197	(2,353)
Income before income taxes	29,352	26,293	52,526	38,558
Provision for income taxes	4,197	6,493	9,223	9,460
Net income	\$ 25,155	\$ 19,800	\$ 43,303	\$ 29,098

Edgar Filing: NATIONAL INSTRUMENTS CORP - Form 10-Q

Basic earnings per share	\$ 0.19	\$ 0.15	\$ 0.33	\$ 0.23
Weighted average shares outstanding - basic	130,197	128,282	129,820	127,938
Diluted earnings per share	\$ 0.19	\$ 0.15	\$ 0.33	\$ 0.23
Weighted average shares outstanding - diluted	131,117	128,746	130,619	128,429
Dividends declared per share	\$ 0.21	\$ 0.20	\$ 0.42	0.40

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

4

NATIONAL INSTRUMENTS CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(unaudited)

	Three Months Ended June 30, 2017		Six Months Ended June 30, 2016	
Net income	\$ 25,155	\$ 19,800	\$ 43,303	\$ 29,098
Other comprehensive income, before tax and net of reclassification adjustments:				
Foreign currency translation adjustment	11,702	(6,191)	15,664	8,166
Unrealized gain on securities available-for-sale	34	211	26	549
Unrealized (loss) gain on derivative instruments	(3,522)	138	(6,334)	3,565
Other comprehensive (loss) gain, before tax	8,214	(5,842)	9,356	12,280
Tax (benefit) expense related to items of other comprehensive income	(1,186)	(1,436)	(2,146)	3,275
Other comprehensive (loss) gain, net of tax	9,400	(4,406)	11,502	9,005
Comprehensive income	\$ 34,555	\$ 15,394	\$ 54,805	\$ 38,103

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

NATIONAL INSTRUMENTS CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Six Months Ended June 30,	
	2017	2016
Cash flow from operating activities:		
Net income	\$ 43,303	\$ 29,098
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	35,915	38,217
Stock-based compensation	13,726	13,497
Tax expense from deferred income taxes	(875)	(2,927)
Changes in operating assets and liabilities	(7,284)	2,659
Net cash provided by operating activities	84,785	80,544
Cash flow from investing activities:		
Capital expenditures	(15,727)	(20,970)
Capitalization of internally developed software	(24,816)	(15,406)
Additions to other intangibles	(1,124)	(689)
Acquisitions, net of cash received	-	(549)
Purchases of short-term investments	(52,807)	(5,008)
Sales and maturities of short-term investments	21,017	31,734
Net cash used in investing activities	(73,457)	(10,888)
Cash flow from financing activities:		
Proceeds from revolving line of credit	-	15,000
Principal payments on revolving line of credit	-	(12,000)
Proceeds from issuance of common stock	15,407	14,830
Repurchase of common stock	-	(5,635)
Dividends paid	(54,595)	(51,273)
Net cash used in financing activities	(39,188)	(39,078)
Effect of exchange rate changes on cash	5,727	3,554
Net change in cash and cash equivalents	(22,133)	34,132
Cash and cash equivalents at beginning of period	285,283	251,129

Cash and cash equivalents at end of period

\$ 263,150 \$ 285,261

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

6

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, 2016, 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 June 30, 2017 and December 31, 2016, the results of our operations and comprehensive income for the three and six month periods ended June 30, 2017 and 2016, and the cash flows for the six month periods ended June 30, 2017 and 2016. Our operating results for the three and six month periods ended June 30, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017. These financial statements have been prepared in accordance with accounting principles generally accepted in the United States.

Starting January 1, 2017, we began separately presenting the effect of exchange rate changes on cash and cash equivalents in our condensed consolidated statements of cash flows due to growing operations in foreign currency environments. Amounts in the comparable prior period have been reclassified to conform to the current period presentation. The reclassifications resulted in the disaggregation of the amount attributable to the “Effect of exchange rate changes on cash” of \$3.6 million, with a corresponding decrease to “Net cash provided by operating activities” for the six month period ended June 30, 2016. We believe the reclassification is immaterial to the consolidated financial statements.

Recently Adopted Accounting Pronouncements

In October 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-16, Income Taxes – Intra-Entity Transfers of Assets Other Than Inventory. The standard is intended to address diversity in practice and complexity in financial reporting, particularly for intra-entity transfers of intellectual property. We early adopted ASU 2016-16 effective January 1, 2017. Using the modified retrospective method, the impact of the adoption of the standard was to increase deferred tax assets by \$0.4 million, decrease other assets, net by \$6.2 million and decrease retained earnings by \$5.8 million. The adoption of the amendments had the effect of increasing our diluted earnings per share by \$0.01 and \$0.02 for the three and six month periods ended June 30, 2017, respectively.

Recently Issued Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which supersedes ASC840, Leases. The guidance requires lessees to recognize most lease liabilities on their balance sheets but recognize the expenses on their income statements in a manner similar to current practice. The update states that a lessee would recognize a lease liability for the obligation to make lease payments and a right-to-use asset for the right to use the underlying asset for the lease term. The update is effective for interim and annual periods beginning after December 15, 2018, and early adoption is permitted. We are currently evaluating the effect that the updated standard will have on our Consolidated Financial Statements and related disclosures. We do not expect to adopt the new standard prior to the required effective date.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). The update is a comprehensive new revenue recognition model that requires a company to recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services. ASU 2014-09 also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. As currently issued and amended, ASU 2014-09 is effective for annual reporting periods, and interim periods within that period, beginning after December 15, 2017 and early adoption is permitted for annual reporting periods, and interim periods within that period, beginning after December 31, 2016. We intend to adopt this standard as of January 1, 2018 by applying the modified retrospective transition method. Consequently, the cumulative effect of applying the new standard to existing contracts as of January 1, 2018 will be recognized as an adjustment to the opening balance of equity in the first quarter of 2018.

We anticipate ASU 2014-09, as amended, could have a material impact on our consolidated financial statements and disclosures. We have reached initial conclusions on our key accounting matters related to the new standard and believe adoption of the new standard will generally result in revenue recognition earlier or at the same time as existing US GAAP. The most significant impact of the standard relates to our accounting for certain software arrangements. We primarily license software on a perpetual basis. However, we also license software under enterprise agreements which includes an unlimited quantity of certain software licenses for a fixed-term bundled with software maintenance, technical support, and a specified amount of training and service credits. Currently, we defer revenue for software licensed under our enterprise agreements and certain perpetual arrangements due to a lack of vendor specific objective evidence (“VSOE”) for certain elements in the contract. Under the new standard, we are no longer required to establish VSOE to recognize software license revenue separately from the other elements, and we will be able to recognize software license revenue once the customer obtains control of the license, which will generally occur at the start of each license term. Due to the complexity of our enterprise agreement contracts, the actual revenue recognition treatment required under the new standard will be dependent on contract-specific terms, and may vary in some instances from recognition at the time of billing. Additionally, we expect the new standard will impact the way we allocate the transaction price for arrangements with separately-priced extended warranty offerings. We will continue to monitor and assess the impact of changes to the standard and interpretations as they become available.

Other Updates

The FASB also issued the following ASUs which are not expected to have a material impact on our financial condition, results of operations or cash flows upon adoption:

- ASU 2017-11—Earnings Per Share (Topic 260); Distinguishing Liabilities from Equity (Topic 480); Derivatives and Hedging (Topic 815): (Part I) Accounting for Certain Financial Instruments with Down Round Features, (Part II) Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests with a Scope Exception
- ASU 2017-10—Service Concession Arrangements (Topic 853): Determining the Customer of the Operation Services (a consensus of the FASB Emerging Issues Task Force)
- ASU 2017-09—Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting
- ASU 2017-08—Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities
- ASU 2017-07 —Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost
- ASU 2017-06—Plan Accounting: Defined Benefit Pension Plans (Topic 960), Defined Contribution Pension Plans (Topic 962), Health and Welfare Benefit Plans (Topic 965): Employee Benefit Plan Master Trust Reporting (a

consensus of the Emerging Issues Task Force)

- ASU 2017-05—Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets
- ASU 2016-18—Statement of Cash Flows (Topic 230): Restricted Cash (a consensus of the FASB Emerging Issues Task Force)

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 includes restricted stock units (“RSUs”), is computed using the treasury stock method.

The reconciliation of the denominators used to calculate basic EPS and diluted EPS for the three and six month periods ended June 30, 2017 and 2016, are as follows:

	Three Months Ended June 30, (In thousands) (Unaudited)		Six Months Ended June 30, (In thousands) (Unaudited)	
	2017	2016	2017	2016
Weighted average shares outstanding-basic	130,197	128,282	129,820	127,938
Plus: Common share equivalents				
RSUs	920	464	799	491
Weighted average shares outstanding-diluted	131,117	128,746	130,619	128,429

Stock awards to acquire 6,800 shares and 51,000 shares for the three months ended June 30, 2017 and 2016, respectively, and 13,500 shares and 333,000 shares for the six month periods ended June 30, 2017 and 2016, respectively, were excluded in the computations of diluted EPS because the effect of including the stock awards would have been anti-dilutive.

Note 3 – Short-term investments

The following tables summarize unrealized gains and losses related to our short-term investments designated as available-for-sale:

(In thousands)	As of June 30, 2017 (Unaudited)		
	Gross	Gross	Cumulative

Edgar Filing: NATIONAL INSTRUMENTS CORP - Form 10-Q

	Adjusted Cost	Unrealized Gain	Unrealized Loss	Translation Adjustment	Fair Value
Corporate bonds	92,561	78	(145)	(1,466)	91,028
U.S. treasuries and agencies	12,496	-	-	-	12,496
Time deposits	1,760	-	-	-	1,760
Short-term investments	\$ 106,817	\$ 78	\$ (145)	\$ (1,466)	\$ 105,284

(In thousands)	December 31, 2016				
	Adjusted Cost	Gross Unrealized Gain	Gross Unrealized Loss	Cumulative Translation Adjustment	Fair Value
Corporate bonds	72,986	89	(182)	(1,536)	71,357
Time deposits	1,760	-	-	-	1,760
Short-term investments	\$ 74,746	\$ 89	\$ (182)	\$ (1,536)	\$ 73,117

Edgar Filing: NATIONAL INSTRUMENTS CORP - Form 10-Q

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

(In thousands)	As of June 30, 2017 (Unaudited)	
	Adjusted Cost	Fair Value
Due in less than 1 year	\$ 29,189	\$ 29,180
Due in 1 to 5 years	77,628	76,104
Total available-for-sale debt securities	\$ 106,817	\$ 105,284
Due in less than 1 year	Adjusted Cost	Fair Value
Corporate bonds	\$ 14,933	\$ 14,924
U.S. treasuries and agencies	12,496	12,496
Time deposits	1,760	1,760
Total available-for-sale debt securities	\$ 29,189	\$ 29,180
Due in 1 to 5 years	Adjusted Cost	Fair Value
Corporate bonds	\$ 77,628	\$ 76,104
Total available-for-sale debt securities	\$ 77,628	\$ 76,104

Note 4 – Fair value measurements

We define fair value to be the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required or permitted to be recorded at fair value, we consider the principal or most advantageous market that market participants may use when pricing the asset or liability.

We follow a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. Fair value measurement is determined based on the lowest level input that is significant to the fair value measurement. The three values of the fair value hierarchy are the following:

Level 1 – Quoted prices in active markets for identical assets or liabilities

Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly

Level 3 – Inputs that are not based on observable market data

Assets and liabilities measured at fair value on a recurring basis are summarized below:

(In thousands)	Fair Value Measurements at Reporting Date Using (Unaudited)			
	June 30, 2017	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Description				
Assets				
Cash and cash equivalents available for sale:				
Money Market Funds	\$ 15,951	\$ 15,951	\$ -	\$ -
U.S. treasuries and agencies	42,348	-	42,348	
Short-term investments available for sale:				
Corporate bonds	91,028	-	91,028	-
U.S. treasuries and agencies	12,496	-	12,496	
Time deposits	1,760	1,760	-	-
Derivatives	5,665	-	5,665	-
Total Assets	\$ 169,248	\$ 17,711	\$ 151,537	\$ -

Edgar Filing: NATIONAL INSTRUMENTS CORP - Form 10-Q

Liabilities				
Derivatives	\$ (7,371)	\$ -	\$ (7,371)	\$ -
Total Liabilities	\$ (7,371)	\$ -	\$ (7,371)	\$ -

(In thousands)	Fair Value Measurements at Reporting Date Using			
	December 31, 2016	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Cash and cash equivalents available for sale:				
Money Market Funds	\$ 68,577	\$ 68,577	\$ -	\$ -
Short-term investments available for sale:				
Corporate bonds	71,357	-	71,357	-
Time deposits	1,760	1,760	-	-
Derivatives	15,113	-	15,113	-
Total Assets	\$ 156,807	\$ 70,337	\$ 86,470	\$ -
Liabilities				
Derivatives	\$ (8,199)	\$ -	\$ (8,199)	\$ -
Total Liabilities	\$ (8,199)	\$ -	\$ (8,199)	\$ -

We value our available-for-sale short-term investments based on pricing from third party pricing vendors, who may use quoted prices in active markets for identical assets (Level 1 inputs) or inputs other than quoted prices that are observable either directly or indirectly (Level 2 inputs) in determining fair value. We classify all of our fixed income available-for-sale securities as having Level 2 inputs. The valuation techniques used to measure the fair value of our financial instruments having Level 2 inputs were derived from non-binding market consensus prices that are corroborated by observable market data, quoted market prices for similar instruments, or pricing models, such as discounted cash flow techniques. We believe all of these sources reflect the credit risk associated with each of our available-for-sale short-term investments. Short-term investments available-for-sale consists of debt securities issued by states of the U.S. and political subdivisions of the U.S., corporate debt securities and debt securities issued by U.S. government organizations and agencies. All of our short-term investments available-for-sale have contractual maturities of less than 60 months.

Derivatives include foreign currency forward 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 similar instruments. We consider counterparty credit risk in the valuation of our derivatives. However, counterparty credit risk did not impact the valuation of our derivatives during the six month period ended June 30, 2017. There were no transfers in or out of Level 1 or Level 2 during the six month period ended June 30, 2017.

As of June 30, 2017, our short-term investments did not include sovereign debt from any country other than the United States.

We did not have any items that were measured at fair value on a nonrecurring basis at June 30, 2017 and December 31, 2016. The carrying value of net accounts receivable, accounts payable, and long-term debt contained in the Consolidated Balance Sheets approximates fair value.

Note 5 – Derivative instruments and hedging activities

We recognize all of our derivative instruments as either assets or liabilities in our statement of financial position at fair value. The accounting for changes in the fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, we designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, cash flow hedge, or a hedge of a net investment in a foreign operation.

We have operations in over 50 countries. Sales outside of the Americas accounted for approximately 62% and 63% of our net sales during the three month periods ended June 30, 2017 and 2016, respectively, and approximately 61% and 62% of our net sales during the six month periods ended June 30, 2017 and 2016, 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, in that exchange rate changes may affect our profitability and cash flow, and the business or pricing strategies of our non-U.S. based competitors.

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

We designate foreign currency forward and purchased option contracts as cash flow hedges of forecasted net sales or forecasted expenses. In addition, we hedge our foreign currency denominated balance sheet exposures using foreign currency forward contracts that are not designated as hedging instruments. None of our derivative instruments contain a credit-risk-related contingent feature.

Cash flow hedges

To help protect against the reduction in value caused by a fluctuation in foreign currency exchange rates of forecasted foreign currency cash flows resulting from international sales over the next one to three years, we have instituted a foreign currency cash flow hedging program. We hedge portions of our forecasted net sales and forecasted expenses denominated in foreign currencies with forward 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." We purchase foreign currency forward and option contracts for up to 100% of our forecasted exposures in selected currencies (primarily in Euro, Japanese yen, Hungarian forint, British pound, Malaysian ringgit and Chinese yuan) 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 the following notional amounts:

(In thousands)	US Dollar Equivalent	
	As of June 30, 2017 (Unaudited)	As of December 31, 2016
Chinese yuan	\$ 41,860	\$ 27,414
Euro	137,059	123,522
Japanese yen	30,334	44,982
Hungarian forint	55,671	57,077
Malaysian ringgit	36,513	42,510
Total forward contracts notional amount	\$ 301,437	\$ 295,505

The contracts in the foregoing table had contractual maturities of 36 months or less at June 30, 2017 and December 31, 2016.

At June 30, 2017, we expect to reclassify \$0.7 million of losses on derivative instruments from accumulated OCI to net sales during the next twelve months when the hedged international sales occur, \$0.3 million of losses on derivative instruments from accumulated OCI to cost of sales during the next twelve months when the cost of sales are incurred and \$0.3 million of losses 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 June 30, 2017. Actual results may vary materially as a result of changes in the corresponding exchange rates subsequent to this date.

The gains and losses recognized in earnings due to hedge ineffectiveness were not material for each of the six month periods ended June 30, 2017 and 2016 and are included as a component of net income under the line item “net foreign exchange gain (loss).”

Other Derivatives

Other derivatives not designated as hedging instruments consist primarily of foreign currency forward contracts that we use to hedge our foreign denominated net receivable or net payable positions to help protect against the change in value caused by a fluctuation in foreign currency exchange rates. We typically attempt to hedge up to 90% of our outstanding foreign denominated net receivables or net payables and typically limit the duration of these foreign currency forward contracts to approximately 120 days or less. The gain or loss on the derivatives as well as the offsetting gain or loss on the hedge item attributable to the hedged risk is recognized in current earnings under the line item “net foreign exchange gain (loss).” As of June 30, 2017 and December 31, 2016, we held foreign currency forward contracts with a notional amount of \$46 million and \$60 million, respectively.

Edgar Filing: NATIONAL INSTRUMENTS CORP - Form 10-Q

The following tables present the fair value of derivative instruments on our Consolidated Balance Sheets at June 30, 2017 and December 31, 2016, respectively.

(In thousands)	Asset Derivatives June 30, 2017 (Unaudited)		December 31, 2016	
	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	\$ 3,014		\$ 9,378
Foreign exchange contracts - LT forwards	Other long-term assets	2,427		3,866
Total derivatives designated as hedging instruments		\$ 5,441		\$ 13,244
Derivatives not designated as hedging instruments				
Foreign exchange contracts - ST forwards	Prepaid expenses and other current assets	\$ 224		\$ 1,869
Total derivatives not designated as hedging instruments		\$ 224		\$ 1,869
Total derivatives		\$ 5,665		\$ 15,113

(In thousands)	Liability Derivatives June 30, 2017 (Unaudited)		December 31, 2016	
	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	\$ (4,343)		\$ (4,672)
Foreign exchange contracts - LT forwards	Other long-term liabilities	(2,304)		(3,352)
Total derivatives designated as hedging instruments		\$ (6,647)		\$ (8,024)

Derivatives not designated as hedging instruments

Foreign exchange contracts - ST forwards	Accrued expenses and other liabilities	\$ (724)	\$ (175)
Total derivatives not designated as hedging instruments		\$ (724)	\$ (175)
Total derivatives		\$ (7,371)	\$ (8,199)

Edgar Filing: NATIONAL INSTRUMENTS CORP - Form 10-Q

The following tables present the effect of derivative instruments on our Consolidated Statements of Income for three month periods ended June 30, 2017 and 2016, respectively:

June 30, 2017
(In thousands)
(Unaudited)

	Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion)	Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion)
Derivatives in Cash Flow Hedging Relationship Foreign exchange contracts - forwards and options	\$ (9,488)	Net sales	\$ 669	Net foreign exchange gain/(loss)	\$ -
Foreign exchange contracts - forwards and options	3,171	Cost of sales	(428)	Net foreign exchange gain/(loss)	-
Foreign exchange contracts - forwards and options	2,795	Operating expenses	(416)	Net foreign exchange gain/(loss)	-
Total	\$ (3,522)		\$ (175)		\$ -

June 30, 2016
(In thousands)
(Unaudited)

	Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion)	Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion)
Derivatives in Cash Flow Hedging Relationship					

Foreign exchange contracts - forwards and options	\$ 2,764	Net sales	\$ (904)	Net foreign exchange gain/(loss)	\$ -
Foreign exchange contracts - forwards and options	(1,442)	Cost of sales	(382)	Net foreign exchange gain/(loss)	-
Foreign exchange contracts - forwards and options	(1,184)	Operating expenses	(360)	Net foreign exchange gain/(loss)	-
Total	\$ 138		\$ (1,646)		\$ -

(In thousands)

Derivatives not Designated as Hedging Instruments	Location of Gain (Loss) Recognized in Income	Amount of Gain (Loss) Recognized in Income June 30, 2017 (Unaudited)	Amount of Gain (Loss) Recognized in Income June 30, 2016 (Unaudited)
Foreign exchange contracts - forwards	Net foreign exchange gain/(loss)	\$ (632)	2,063
Total		\$ (632)	\$ 2,063

Edgar Filing: NATIONAL INSTRUMENTS CORP - Form 10-Q

The following tables present the effect of derivative instruments on our Consolidated Statements of Income for the six month periods ended June 30, 2017 and 2016, respectively:

June 30, 2017
(In thousands)
(Unaudited)

	Gain or (Loss) Recognized in	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Location of Gain or (Loss) Recognized in	Gain or (Loss) Recognized in
Derivatives in Cash Flow Hedging Relationship	OCI on Derivative (Effective Portion)			Income on Derivative (Ineffective Portion)	Income on Derivative (Ineffective Portion)
Foreign exchange contracts - forwards and options	\$ (14,797)	Net sales	\$ 2,749	Net foreign exchange gain/(loss)	\$ -
Foreign exchange contracts - forwards and options	4,480	Cost of sales	(978)	Net foreign exchange gain/(loss)	-
Foreign exchange contracts - forwards and options	3,983	Operating expenses	(979)	Net foreign exchange gain/(loss)	-
Total	\$ (6,334)		\$ 792		\$ -

June 30, 2016
(In thousands)
(Unaudited)

	Gain or (Loss) Recognized in	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Location of Gain or (Loss) Recognized in	Gain or (Loss) Recognized in
Derivatives in Cash Flow Hedging Relationship	OCI on Derivative (Effective Portion)			Income on Derivative (Ineffective Portion)	Income on Derivative (Ineffective Portion)

Foreign exchange contracts - forwards and options	\$ (276)	Net sales	\$ (1,141)	Net foreign exchange gain/(loss)	\$ -
Foreign exchange contracts - forwards and options	1,597	Cost of sales	(953)	Net foreign exchange gain/(loss)	-
Foreign exchange contracts - forwards and options	2,244	Operating expenses	(889)	Net foreign exchange gain/(loss)	-
Total	\$ 3,565		\$ (2,983)		\$ -

(In thousands)

Derivatives not Designated as Hedging Instruments	Location of Gain (Loss) Recognized in Income	Amount of Gain (Loss) Recognized in Income June 30, 2017 (Unaudited)	Amount of Gain (Loss) Recognized in Income June 30, 2016 (Unaudited)
Foreign exchange contracts - forwards	Net foreign exchange gain/(loss)	\$ (3,178)	(191)
Total		\$ (3,178)	\$ (191)

Note 6 – Inventories, net

Inventories, net consist of the following:

(In thousands)	June 30, 2017 (Unaudited)	December 31, 2016
Raw materials	\$ 93,345	\$ 92,906
Work-in-process	7,805	9,125
Finished goods	85,005	91,577
	\$ 186,155	\$ 193,608

Note 7 – Intangible assets, net

Intangible assets at June 30, 2017 and December 31, 2016 are as follows:

(In thousands)	June 30, 2017 (Unaudited)			December 31, 2016		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Capitalized software development costs	\$ 110,565	\$ (30,911)	\$ 79,654	\$ 103,887	\$ (39,180)	\$ 64,707
Acquired technology	95,443	(83,578)	11,865	94,124	(79,485)	14,639
Patents	32,497	(18,872)	13,625	31,513	(17,573)	13,940
Other	44,484	(29,301)	15,183	42,848	(27,471)	15,377
	\$ 282,989	\$ (162,662)	\$ 120,327	\$ 272,372	\$ (163,709)	\$ 108,663

Software development costs capitalized for the three month periods ended June 30, 2017 and 2016 were \$13.7 million and \$7.6 million, respectively, and related amortization expense was \$5.5 million and \$4.3 million, respectively. For the six month periods ended June 30, 2017 and 2016, capitalized software development costs were \$26 million and \$16 million, respectively, and related amortization expense was \$10.8 million and \$8.6 million, respectively. Capitalized software development costs for the three month periods ended June 30, 2017 and 2016 included costs related to stock based compensation of \$528,000 and \$200,000, respectively. For the six month periods ended June

30, 2017 and 2016, capitalized software development costs included costs related to stock based compensation of \$954,000 and \$525,000 respectively. The related amounts in the table above are net of fully amortized assets.

Amortization of capitalized software development costs is computed on an individual product basis for those products available for market and is recognized based on the product's estimated economic life, generally three to six years. Acquired technology and other intangible assets are amortized over their useful lives, which range from three to eight years. Patents are amortized using the straight-line method over their estimated period of benefit, generally 10 to 17 years. Total intangible assets amortization expenses were \$8.6 million and \$9.2 million for the three months ended June 30, 2017 and 2016, respectively, and \$17.0 million and \$18.5 million for the six month periods ended June 30, 2017 and 2016, respectively.

Note 8 – Goodwill

The carrying amount of goodwill as of June 30, 2017, was as follows:

	Amount (In thousands)
Balance as of December 31, 2016	\$ 253,197
Acquisitions	-
Foreign currency translation impact	8,214
Balance as of June 30, 2017 (unaudited)	\$ 261,411

The excess purchase price over the fair value of assets acquired is recorded as goodwill. As we have one operating segment comprised of components with similar economic characteristics, we allocate goodwill to one reporting unit for goodwill impairment testing. Goodwill is tested for impairment on an annual basis, and between annual tests if indicators of potential impairment exist, using a fair-value-based approach based on the market capitalization of the reporting unit. Our annual impairment test was performed as of February 28, 2017. No impairment of goodwill was identified during 2017 or 2016.

Note 9 – Income taxes

We account for income taxes under the asset and liability method. Deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts. Valuation allowances are established when necessary to reduce deferred tax assets to amounts which are more likely than not to be realized. We had a valuation allowance of \$62 million at June 30, 2017 and December 31, 2016, and \$102 million at December 31, 2015. A majority of the valuation allowance is related to the deferred tax assets of National Instruments Hungary Kft. (“NI Hungary”). The decrease in the valuation allowance from 2015 to 2016 was primarily due to the revaluation of NI Hungary’s gross deferred tax assets following the reduction in the Hungarian corporate income tax rate from 19% to 9%.

We account for uncertainty in income taxes recognized in our financial statements using prescribed recognition thresholds and measurement attributes for financial statement disclosure of tax positions taken or expected to be taken on our tax returns. We had \$12.4 million and \$11.7 million unrecognized tax benefits at June 30, 2017 and December 31, 2016, respectively, all of which would affect our effective income tax rate if recognized. We recorded a gross increase in unrecognized tax benefits of \$0.3 million and \$0.5 million for the three and six month periods ended June 30, 2017, respectively, as a result of the tax positions taken during these periods. As of June 30, 2017, it is reasonably possible that we will recognize tax benefits in the amount of \$3.7 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 June 30, 2017, we had approximately \$1.4 million accrued for interest related to uncertain tax positions. The tax years 2008 through 2017 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 25% for the three month periods ended June 30, 2017 and 2016, respectively, and 18% and 25% for the six month periods ended June 30, 2017 and 2016, respectively. For the three and six month periods ended June 30, 2017, our effective tax rate was lower than the U.S. federal statutory rate of 35% as a result of an enhanced deduction for certain research and development expenses, profits in foreign jurisdictions with reduced income tax rates, the research and development tax credit, a tax benefit from disqualifying dispositions of equity awards that do not ordinarily result in a tax benefit, and excess tax benefits from share-based compensation. For the three and six month periods ended June 30, 2016, our effective tax rate was lower than the U.S. federal statutory rate of 35% as a result of an enhanced deduction for certain research and development expenses, profits in foreign jurisdictions with reduced income tax rates, the research and development tax credit, and a tax benefit from disqualifying dispositions of equity awards that do not ordinarily result in a tax benefit.

Our earnings in Hungary are subject to a statutory tax rate of 9%. In addition, our research and development activities in Hungary benefit from a tax law in Hungary that provides for an enhanced deduction for qualified research and development expenses. The tax position of our Hungarian operations resulted in income tax benefits of \$4.4 million and \$3.9 million for the three month periods ended June 30, 2017 and 2016, respectively, and \$7.3 million and \$5.8 million for the six month periods ended June 30, 2017 and 2016, respectively.

Earnings from our operations in Malaysia are free of tax under a tax holiday effective January 1, 2013. This tax holiday expires in 2027. If we fail to satisfy the conditions of the tax holiday, this tax benefit may be terminated early. The income tax benefits of the tax holiday for the three and six month periods ended June 30, 2017 were approximately \$0.6 and \$1.1 million, respectively. The impact of the tax holiday on a per share basis for each of the three and six months ended June 30, 2017 was a benefit of \$0.01 per share. The income tax benefits of the tax holiday for the three and six month periods ended June 30, 2016 were approximately \$0.7 million and \$1.1 million, respectively. The impact of the tax holiday on a per share basis for each of the three and six months ended June 30, 2016 was a benefit of \$0.01 per share.

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

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 securities classified as available-for-sale. The accumulated OCI, net of tax, for the six month periods ended June 30, 2017 and 2016, consisted of the following:

(In thousands)	June 30, 2017 (Unaudited) Currency translation adjustment	Investments	Derivative instruments	Accumulated other comprehensive income/(loss)
Balance as of December 31, 2016	\$ (37,174)	\$ (669)	3,222	\$ (34,621)
Current-period other comprehensive income	15,664	26	(5,542)	10,148
Reclassified from accumulated OCI into income	-	-	(792)	(792)
Income tax (benefit) expense	120	(17)	(2,249)	(2,146)
Balance as of June 30, 2017	\$ (21,630)	\$ (626)	\$ (863)	\$ (23,119)

(In thousands)	June 30, 2016 (Unaudited) Currency translation adjustment	Investments	Derivative instruments	Accumulated other comprehensive income/(loss)
Balance as of December 31, 2015	\$ (31,871)	\$ (857)	(5,362)	\$ (38,090)
Current-period other comprehensive (loss) income	8,166	549	582	9,297
Reclassified from accumulated OCI into income	-	-	2,983	2,983
Income tax (benefit) expense	1,944	134	1,197	3,275
Balance as of June 30, 2016	\$ (25,649)	\$ (442)	\$ (2,994)	\$ (29,085)

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

Authorized shares of common and preferred stock

Following approval by the Company's Board of Directors and stockholders, on May 14, 2013, the Company's certificate of incorporation was amended to increase the authorized shares of common stock by 180,000,000 shares to a total of 360,000,000 shares. As a result of this amendment, the total number of shares which the Company is authorized to issue is 365,000,000 shares, consisting of (i) 5,000,000 shares of preferred stock, par value \$.01 per share, and (ii) 360,000,000 shares of common stock, par value \$.01 per share.

Restricted stock plan

Our stockholders approved our 2005 Incentive Plan (the "2005 Plan") in May 2005. At the time of approval, 4,050,000 shares of our common stock were reserved for issuance under this plan, as well as the number of shares which had been reserved but not issued under our 1994 Incentive Plan which terminated in May 2005 (the "1994 Plan"), and any shares that returned to the 1994 Plan as a result of termination of options or repurchase of shares issued under such plan. The 2005 Plan, administered by the Compensation Committee of the Board of Directors, provided for granting of incentive awards in the form of restricted stock and RSUs to directors, executive officers and employees of the Company and its subsidiaries. Awards vest over a three, five or ten-year period, beginning on the date of grant. Vesting of ten year awards may accelerate based on the Company's previous year's earnings and growth but ten year awards cannot accelerate to vest over a period of less than five years. The 2005 Plan terminated on May 11, 2010, except with respect to outstanding awards previously granted thereunder. There were 3,362,304 shares of common stock that were reserved but not issued under the 2005 Plan as of May 11, 2010.

Our stockholders approved our 2010 Incentive Plan (the “2010 Plan”) on May 11, 2010. At the time of approval, 3,000,000 shares of our common stock were reserved for issuance under this plan, as well as the 3,362,304 shares of common stock that were reserved but not issued under the 1994 Plan and the 2005 Plan as of May 11, 2010, and any shares that are returned to the 1994 Plan and the 2005 Plan as a result of the forfeiture or termination of options or RSUs or repurchase of shares issued under these plans. The 2010 Plan, administered by the Compensation Committee of the Board of Directors, provides for granting of incentive awards in the form of restricted stock and RSUs to employees, directors and consultants of the Company and employees and consultants of any parent or subsidiary of the Company. Awards vest over a three, five or ten-year period, beginning on the date of grant. Vesting of ten year awards may accelerate based on the Company’s previous year’s earnings and growth but ten year awards cannot accelerate to vest over a period of less than five years. The 2010 Plan terminated on May 12, 2015, except with respect to the outstanding awards previously granted thereunder. There were 2,518,416 shares of common stock that were reserved but not issued under the 2010 Plan as of May 12, 2015.

Our stockholders approved our 2015 Equity Incentive Plan (the “2015 Plan”) on May 12, 2015. At the time of approval, 3,000,000 shares of our common stock were reserved for issuance under this plan, as well as the 2,518,416 shares of common stock that were reserved but not issued under the 2010 Plan as of May 12, 2015, and any shares that were returned to the 1994, 2005, and the 2010 Plans as a result of the forfeiture or termination of options or RSUs or repurchase of shares issued under these plans. The 2015 Plan, administered by the Compensation Committee of the Board of Directors, provides for the granting of incentive awards in the form of restricted stock and RSUs to employees, directors and consultants of the Company and employees and consultants of any parent or subsidiary of the Company. Awards vest over a three, four, five or ten-year period, beginning on the date of grant. Vesting of ten year awards may accelerate based on the Company’s previous year’s earnings and growth but ten year awards cannot accelerate to vest over a period of less than five years. There were 3,848,687 shares available for grant under the 2015 Plan at June 30, 2017.

During the three month period ended June 30, 2017, we did not make any changes in accounting principles or methods of estimates related to the 2005, 2010 and 2015 Plans.

Employee stock purchase plan

Our employee stock purchase plan permits substantially all domestic employees and employees of designated subsidiaries to acquire our common stock at a purchase price of 85% of the lower of the market price at the beginning or the end of the purchase period. The plan has quarterly purchase periods generally beginning on February 1, May 1, August 1 and November 1 of each year. Employees may designate up to 15% of their compensation for the purchase of common stock under this plan. On May 9, 2017, our stockholders approved an additional 3,000,000 shares for issuance under our employee stock purchase plan. At June 30, 2017, we had 3,321,448 shares of common stock reserved for future issuance under this plan. We issued 611,603 shares under this plan in the six month period ended June 30, 2017 and the weighted average purchase price of the employees’ purchase rights was \$25.19 per share. During the six month period ended June 30, 2017, we did not make any changes in accounting principles or methods of estimates with respect to such plan.

Authorized Preferred Stock and Preferred Stock Purchase Rights Plan

We have 5,000,000 authorized shares of preferred stock. On January 21, 2004, our Board of Directors designated 750,000 of these shares as Series A Participating Preferred Stock in conjunction with the adoption of a Preferred Stock Rights Agreement which expired on May 10, 2014. There were no shares of preferred stock issued and outstanding at June 30, 2017.

Stock repurchases and retirements

From time to time, our Board of Directors has authorized various programs for our repurchase of shares of our common stock depending on market conditions and other factors. Under the current program, we did not make any share repurchases during the six month period ended June 30, 2017. We repurchased a total of 35,990 shares of our common stock at a weighted average price per share of \$27.59 during the three month period ended June 30, 2016. We repurchased a total of 206,780 shares of our common stock at a weighted average price per share of \$27.25 during the six month period ended June 30, 2016. At June 30, 2017, there were 1,134,247 shares remaining available for repurchase under this program. This repurchase program does not have an expiration date.

Note 12 – Segment and geographic information

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

We sell our product in three geographic regions which consist of Americas; Europe, Middle East, India, and Africa (EMEA); and Asia-Pacific (APAC). Our sales to these regions share similar economic characteristics, similar product mix, similar customers, and similar distribution methods. Revenue from the sale of our products, which are similar in nature, and software maintenance is reflected as total net sales in our Consolidated Statements of Income.

Total net sales by the major geographic areas in which we operate, are as follows:

(In thousands)	Three Months Ended June 30, (Unaudited)		Six Months Ended June 30, (Unaudited)	
	2017	2016	2017	2016
Net sales:				
Americas	\$ 121,648	\$ 114,243	\$ 240,087	\$ 225,095
EMEA	100,549	94,533	195,288	186,384
APAC	96,412	97,329	183,339	181,803
	\$ 318,609	\$ 306,105	\$ 618,714	\$ 593,282

Based on the billing location of the customer, total sales outside the U.S. for the three month periods ended June 30, 2017 and 2016 were \$204 million and \$198 million, respectively, and \$393 million and \$381 million for the six month periods ended June 30, 2017 and 2016, respectively.

Total property and equipment, net, outside the U.S. was \$133 million as of June 30, 2017 and December 31, 2016.

Note 13 - Debt

On May 9, 2013, we entered into a Loan Agreement (the “Loan Agreement”) with Wells Fargo Bank (the “Lender”). The Loan Agreement provided for a \$50 million unsecured revolving line of credit with a scheduled maturity date of May 9, 2018 (the “Maturity Date”). On October 29, 2015, we entered into a First Amendment to Loan Agreement (the

“Amendment”) with the Lender, which amended our Loan Agreement to among other things, (i) increase the unsecured revolving line of credit from \$50.0 million to \$125.0 million, (ii) extend the Maturity Date of the line of credit from May 9, 2018 to October 29, 2020, and (iii) provide us with an option to request increases to the line of credit of up to an additional \$25.0 million in the aggregate, subject to consent of the Lender and terms and conditions to be mutually agreed between us and the Lender.

The loans bear interest, at our option, at a base rate determined in accordance with the Loan Agreement, plus a spread of 0.0% to 0.5%, or a LIBOR rate plus a spread of 1.125% to 2.0%, in each case with such spread determined based on a ratio of consolidated indebtedness to EBITDA, determined in accordance with the Loan Agreement. Principal, together with all accrued and unpaid interest, is due and payable on the Maturity Date. We are also obligated to pay a quarterly commitment fee, payable in arrears, based on the available commitments at a rate of 0.175% to 0.300%, with such rate determined based on the ratio described above. The Loan Agreement contains customary affirmative and negative covenants. The affirmative covenants include, among other things, delivery of financial statements, compliance certificates and notices; payment of taxes and other obligations; maintenance of existence; maintenance of properties and insurance; and compliance with applicable laws and regulations. The negative covenants include, among other things, limitations on indebtedness, liens, mergers, consolidations, acquisitions and sales of assets, investments, changes in the nature of the business, affiliate transactions and certain restricted payments. The Loan Agreement also requires us to maintain a ratio of consolidated indebtedness to EBITDA equal to or less than 3.25 to 1.00, and a ratio of consolidated EBITDA to interest expense greater than or equal to 3.00 to 1.00, in each case determined in accordance with the Loan Agreement. As of June 30, 2017, we were in compliance with all covenants in the Loan Agreement.

The Loan Agreement contains customary events of default including, among other things, payment defaults, breaches of covenants or representations and warranties, cross-defaults with certain other indebtedness, bankruptcy and insolvency events, judgment defaults and change in control events, subject to grace periods in certain instances. Upon an event of default, the lender may declare all or a portion of the outstanding obligations payable by us to be immediately due and payable and exercise other rights and remedies provided for under the Loan Agreement. Under certain circumstances, a default interest rate will apply on all obligations during the existence of an event of default under the Loan Agreement at a per annum rate of interest equal to 2.00% above the otherwise applicable interest rate.

Proceeds of loans made under the Loan Agreement may be used for working capital and other general corporate purposes. We may prepay the loans under the Loan Agreement in whole or in part at any time without premium or penalty. Certain of our existing and future material domestic subsidiaries are required to guaranty our obligations under the Loan Agreement.

As of June 30, 2017, we had outstanding \$25 million in borrowings under this line of credit. During the three month periods ended June 30, 2017 and June 30, 2016, we incurred interest expense related to our outstanding borrowings of \$179,000 and \$162,000, respectively. During the six month periods ended June 30, 2017 and June 30, 2016, we incurred interest expense related to our outstanding borrowings of \$343,000 and \$343,000, respectively. As of June 30, 2017 and June 30, 2016, the weighted-average interest rate on the revolving line of credit was 2.3% and 1.6%, respectively. These charges are included in "Other income (loss), net" in our Consolidated Statements of Income.

Note 14 – Commitments and contingencies

We offer a one-year limited warranty on most hardware products which is included in the terms of sale of such products. We also offer optional extended warranties on our hardware products for which the related revenue is recognized ratably over the warranty period. Provision is made for estimated future warranty costs at the time of the sale for the estimated costs that may be incurred under the standard warranty. Our estimate is based on historical experience and product sales during the period. The warranty reserve for the six month periods ended June 30, 2017 and 2016 was as follows:

(In thousands)	Six Months	
	Ended June 30, (Unaudited)	
	2017	2016
Balance at the beginning of the period	\$ 2,686	\$ 1,755
Accruals for warranties issued during the period	1,288	1,097
Accruals related to pre-existing warranties	161	291
Settlements made (in cash or in kind) during the period	(1,330)	(1,376)
Balance at the end of the period	\$ 2,805	\$ 1,767

As of June 30, 2017, we had non-cancelable purchase commitments with various suppliers of customized inventory and inventory components totaling approximately \$7.1 million over the next twelve months.

As of June 30, 2017, we had outstanding guarantees for payment of customs and foreign grants totaling approximately \$3.0 million, which are generally payable over the next twelve months.

Note 15 – Restructuring

We are taking steps to reduce our overall employee headcount by approximately 2% by the end of 2017 in an effort to minimize job duplication or evaluate where we should shift and centralize activities, improve efficiencies, and rebalance our resources on higher return activities. The timing and scope of our headcount reductions will vary. A summary of the charges in the consolidated statement of operations resulting from our restructuring activities is shown below:

(In thousands)	Three Months Ended June 30, (Unaudited)		Six Months Ended June 30, (Unaudited)	
	2017	2016	2017	2016
Cost of sales	\$ 574	-	\$ 907	-
Research and development	1,042	-	1,296	-
Sales and marketing	4,024	-	6,379	-
General and Administration	419	-	594	-
Total restructuring and other related costs	\$ 6,059	-	\$ 9,176	-

A summary of balance sheet activity related to the restructuring activity is shown below:

	Restructuring Liability (in thousands)
Balance as of December 31, 2016	\$ -
Income statement expense	9,176
Cash payments	(4,856)
Balance as of June 30, 2017	\$ 4,320

The restructuring liability of \$4.3 million at June 30, 2017 relating to the restructuring activity is recorded in the “accounts payable” line item of the consolidated balance sheet.

Note 16 – Litigation

We are not currently a party to any material litigation. However, in the ordinary course of our business, we are involved in a limited number of legal actions, both as plaintiff and defendant, and could incur uninsured liability in any one or more of them. We also periodically receive notifications from various third parties related to alleged infringement of patents or intellectual property rights, commercial disputes or other matters. No assurances can be given with respect to the extent or outcome of any future litigation or dispute.

Note 17 – Subsequent events

On July 26, 2017, our Board of Directors declared a quarterly cash dividend of \$0.21 per common share, payable on September 5, 2017, to stockholders of record on August 14, 2017.

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

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Any statements contained herein regarding our future financial performance, operations or other matters (including, without limitation, statements to the effect that we "believe," "expect," "plan," "may," "will," "intend to," "project," "anticipate," "continue," or "estimate" or other variations thereof or comparable terminology or the negative thereof) should be considered forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements as a result of a number of important factors, including those set forth under the heading "Risk Factors" beginning on page 36, and in the discussion below. Readers are also encouraged to refer to the documents regularly filed by us with the Securities and Exchange Commission, including our Annual Report on Form 10-K for the year ended December 31, 2016, for further discussion of our business and the risks attendant thereto.

Overview

National Instruments Corporation (the "Company", "we", "us" or "our") designs, manufactures and sells systems to engineers and scientists that accelerate productivity, innovation and discovery. Our platform-based approach to engineering provides an integrated software and hardware platform that speeds the development of systems needing measurement and control. We believe that our long-term vision and focus on technology supports the success of our customers, employees, suppliers and stockholders. We sell to a large number of customers in a wide variety of industries. We have been profitable in every year since 1990.

The key strategies that we focus on in running our business are the following:

Expanding our broad customer base

We strive to increase our already broad customer base and to grow our large order business by serving a large market on many computer platforms, through a global marketing and distribution network. We also seek to acquire new technologies and expertise from time to time 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 to preserve the customer's investment in our products. In this time of intense global competition, we believe that it is crucial that we continue to offer products with high quality and reliability, and that our products provide cost-effective solutions for our customers.

Leveraging external and internal technology

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

We sell into test and measurement and industrial/embedded applications in a broad range of industries and are subject to the economic and industry forces that drive those markets. It has been our experience that the performance of these industries and our performance are impacted by general trends in industrial production for the global economy and by the specific performance of certain vertical markets that are intensive consumers of measurement technologies. Examples of these markets are advanced research, automotive, automated test equipment, consumer electronics, commercial aerospace, computers and electronics, continuous process manufacturing, education, government/defense, medical research/pharmaceutical, power/energy, semiconductors, and telecommunications.

Leveraging a worldwide sales, distribution and manufacturing network

We distribute and sell our software and hardware products primarily through a direct sales organization. We also use independent distributors, OEMs, VARs, system integrators, and consultants to market and sell our products. We have sales offices in the U.S. and sales offices and distributors in key international markets. Sales outside of the Americas accounted for approximately 62% and 63% of our net sales during the three month periods ended June 30, 2017 and 2016, respectively. The vast majority of our foreign sales are denominated in the customers' local currency, which exposes us to the effects of changes in foreign currency exchange rates. We expect that a significant portion of our total net sales will continue to be derived from international sales. (See "Note 12 – Segment and geographic information" of Notes to Consolidated Financial Statements for details concerning the geographic breakdown of our net sales).

We manufacture substantially all of our product volume at our facilities in Debrecen, Hungary and Penang, Malaysia. In the remainder of 2017, our site in Malaysia is expected to produce approximately 35% of our global production and our site in Hungary is expected to produce approximately 65% of our global production. Our product manufacturing operations can be divided into four areas: electronic circuit card and module assembly; chassis and cable assembly; technical manuals and product support documentation; and software duplication. Most of our electronic circuit card assemblies, modules and chassis are manufactured in house, although subcontractors are used from time to time. The majority of our electronic cable assemblies are produced by subcontractors; however, we do manufacture some on an exception basis. Our software duplication, technical manuals and product support documentation is primarily produced by subcontractors.

Delivering high quality, reliable products

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

Our operating results fluctuate from period to period due to changes in global economic conditions and a number of other factors. As a result, we believe our historical results of operations should not be relied upon as indications of future performance. There can be no assurance that our net sales will grow or that we will remain profitable in future periods.

Current business outlook

Many of the industries we serve have historically been cyclical and have experienced periodic downturns. In assessing our business, we consider the trends in the Global Purchasing Managers' Index ("PMI"), global industrial production as well as industry reports on the specific vertical industries that we target. Historically, our business cycles have generally followed the expansion and contraction cycles in the global industrial economy as measured by the Global PMI. In the three month period ended June 30, 2017, the average of the Global PMI was 52.6 and the average of the new order element of the Global PMI was 53.5. During the quarter ended June 30, 2017, the PMI in the U.S. and the Eurozone maintained readings at or above 50. Although these readings are indicative of expansion in the industrial sector we are unable to predict whether the industrial economy, as measured by the PMI, will remain above the neutral reading of 50, strengthen or contract during the remainder of 2017.

We are pleased with our disciplined execution which allowed us to deliver record revenue for a second quarter while improving our operating profitability during the second quarter of 2017 compared to the second quarter of 2016. We are taking steps to reduce our overall employee headcount by approximately 2% by the end of 2017 in an effort to reduce job duplication or evaluate where we should shift and centralize activities, improve efficiencies, and rebalance our resources on higher return activities. We expect to incur \$7 million to \$8 million in charges, net of tax, in 2017, as a result of these actions. We remain concerned about the geopolitical instability in the Middle East and the Korean peninsula, the ongoing uncertainty created by the execution of the exit by the U.K. from the European Union ("Brexit") as well as uncertainty created by the various policy proposals by the new administration in the U.S. While we remain cautious in the short-term due to uncertain economic conditions, we are optimistic about our long-term position in the industry through the sustained differentiation we deliver to our customers through our platform-based approach. In the second quarter of 2017, we saw a less than 1% year over year increase from orders under \$20,000, a 1% year over year increase from orders between \$20,000 and \$100,000, and a 21% year over year increase from orders over \$100,000. Excluding our largest customer, orders over \$100,000 were up 42% year over year. The timing and amount of orders from our largest customer are unpredictable and therefore can cause unusual variations in the results and trends of our business. See "Results of Operations" below for additional discussion on the impact of orders from our largest customer on our business for the three month period ended June 30, 2017.

During the second quarter of 2017, we continued to see a strong U.S. dollar in many of the currency markets where we have exposure, although the year over year impact of the strong dollar was not significant to our results of operations. As of the date of this filing, the U.S. dollar index, as tracked by the St. Louis Federal Reserve, remains near a ten year high. See “Results of Operations” below for additional discussion on the impact of foreign exchange rates on our business for the three month period ended June 30, 2017. See “Our Revenues are Subject to Seasonal Variations” under “Risk Factors” for additional discussion of potential fluctuations in our net sales.

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

Results of Operations

The following table sets forth, for the periods indicated, the percentage of net sales represented by certain items reflected in our Consolidated Statements of Income:

	Three Months Ended June 30, (Unaudited) 2017		Six Months Ended June 30, (Unaudited) 2016	
Net sales:				
Americas	38.2	% 37.3	% 38.8	% 38.0
EMEIA	31.6	30.9	31.6	31.4
APAC	30.2	31.8	29.6	30.6
Total net sales	100.0	100.0	100.0	100.0
Cost of sales	25.9	25.3	25.7	25.9
Gross profit	74.1	74.7	74.3	74.1
Operating expenses:				
Sales and marketing	39.0	38.0	39.1	38.7
Research and development	17.9	19.5	18.6	20.1
General and administrative	8.2	8.2	8.4	8.4
Total operating expenses	65.1	65.8	66.1	67.2
Operating income	9.0	8.9	8.2	6.9
Other income (expense):				
Interest income	0.2	0.1	0.1	0.1
Net foreign exchange loss	0.1	(0.4)	0.1	(0.1)
Other income, net	0.0	0.0	0.0	(0.4)
Income before income taxes	9.2	8.6	8.4	6.5

Edgar Filing: NATIONAL INSTRUMENTS CORP - Form 10-Q

Provision for income taxes	1.3	2.1	1.4	1.6
Net income	7.9	% 6.5	% 7.0	% 4.9 %

Figures may not sum due to rounding.

Results of Operations for the three and six month periods ended June 30, 2017 and 2016

Net Sales. The following table sets forth our net sales for the three and six month periods ending June 30, 2017 and 2016 along with the changes between the corresponding periods.

(In millions)	Three Months Ended June 30, (Unaudited)				Six Months Ended June 30, (Unaudited)			
	2017	2016	Change Dollars	Percentage	2017	2016	Change Dollars	Percentage
Product sales	289.8	278.5	11.3	4%	561.3	538.0	23.3	4%
Software maintenance sales	28.8	27.6	1.2	4%	57.4	55.3	2.1	4%
Total net sales	\$ 318.6	\$ 306.1	12.5	4%	\$ 618.7	\$ 593.3	25.4	4%

Large orders, defined as orders with a value greater than \$100,000, increased by 21% year over year during the three months ended June 30, 2017, compared to the year over year increase of 2% in the three month period ended June 30, 2016. In the six month period ended June 30, 2017, large orders increased by 19% year over year compared to the year over year increase of 3% during the six month period ended June 30, 2016. A significant factor in the continued expansion of our large orders in the three and six month periods ended June 30, 2017, compared to the comparable periods in 2016 was strong demand for our RF products and semiconductor test systems. Year over year, orders from our largest customer decreased by 35% in the three months ended June 30, 2017. Excluding the impact of our largest customer, large orders increased by 42% year over year during the three month period ended June 30, 2017, and increased by 31% year over year during the six month period ended June 30, 2017. Orders from our largest customer are discussed in more detail below. During the three month periods ended June 30, 2017 and 2016, large orders were 27% and 23% of our total orders, respectively, and for the six month periods ended June 30, 2017 and 2016, large orders were 26% and 23% of our total orders, respectively. Large orders are more volatile, are subject to greater discount variability and may contract at a faster pace during an economic downturn compared to our other orders.

During the three month periods ended June 30, 2017 and 2016, we received \$12 million and \$18 million, respectively, in orders from our largest customer. During the six month periods ended June 30, 2017 and 2016, we received \$17 million and \$25 million, respectively, in orders from our largest customer. In the three month periods ended June 30, 2017 and 2016, we recognized net sales of \$10 million and \$14 million, respectively, from orders from our largest customer, and in the six month periods ended June 30, 2017 and 2016, we recognized net sales of \$15 million and \$23 million, respectively, from these orders.

The following table sets forth our net sales by geographic region for the three and six month periods ending June 30, 2017 and 2016 along with the changes between the corresponding periods and the region's percentage of total net sales.

(In millions)	Three Months Ended June 30, (Unaudited)				Six Months Ended June 30, (Unaudited)			
	2017	2016	Change Dollars	Percentage	2017	2016	Change Dollars	Percentage
Americas	\$ 121.7	\$ 114.2	7.5	6%	\$ 240.1	\$ 225.1	15.0	7%
Percentage of total net sales	38.2%	37.3%			38.8%	38.0%		
EMEIA	\$ 100.5	\$ 94.5	6.0	6%	\$ 195.3	\$ 186.4	8.9	5%
Percentage of total net sales	31.6%	30.9%			31.6%	31.4%		
APAC	\$ 96.4	\$ 97.3	(0.9)	(1%)	\$ 183.3	\$ 181.8	1.5	0.8%
Percentage of total net sales	30.2%	31.8%			29.6%	30.6%		

We expect sales outside of the Americas to continue to represent a significant portion of our net sales. We intend to continue to expand our international operations by increasing our presence in existing markets, adding a presence in

some new geographical markets and continuing the use of distributors to sell our products in some countries. Almost all of the sales made by our direct sales offices in the Americas (excluding the U.S.), EMEIA, and APAC are denominated in local currencies, and accordingly, the U.S. dollar equivalent of these sales is affected by changes in foreign currency exchange rates. In order to provide a framework for assessing how our underlying business performed excluding the effects of foreign currency fluctuations between periods, we compare the percentage change in our results from period to period using constant currency disclosure. To calculate the change in constant currency, current and comparative prior period results for entities reporting in currencies other than U.S. Dollars are converted into U.S. Dollars at constant exchange rates (i.e., the average rates in effect during the three and six month periods ended June 30, 2016). The following tables present this information, along with the impact of changes in foreign currency exchange rates on sales denominated in local currencies, for the three and six month periods ended June 30, 2017.

Three Months ended June 30, 2016		Change in Constant Dollars		Impact of changes in foreign currency exchange rates on net sales		Three Months ended June 30, 2017
GAAP						GAAP
(In thousands)	Net Sales	Dollars	Percentage	Dollars	Percentage	Net Sales
Americas	\$ 114.3	7.3	6.4%	0.1	0.1%	121.7
EMEIA	\$ 94.5	9.3	9.8%	(3.3)	(3.5%)	100.5
APAC	\$ 97.3	0.3	0.3%	(1.2)	(1.2%)	96.4
Total net sales	\$ 306.1	16.9	5.5%	(4.4)	(1.4%)	318.6

Six Months ended June 30, 2016		Change in Constant Dollars		Impact of changes in foreign currency exchange rates on net sales		Six Months ended June 30, 2017
GAAP						GAAP
(In thousands)	Net Sales	Dollars	Percentage	Dollars	Percentage	Net Sales
Americas	\$ 225.1	14.7	7%	0.3	0%	240.1
EMEIA	\$ 186.4	13.6	7.3%	(4.7)	(2.5%)	195.3
APAC	\$ 181.8	2.5	1.4%	(1.0)	(0.5%)	183.3
Total net sales	\$ 593.3	30.8	5.2%	(5.4)	(0.9%)	618.7

Figures may not sum due to rounding.

To help protect against changes in U.S. dollar equivalent value caused by fluctuations in foreign currency exchange rates of forecasted foreign currency cash flows resulting from international sales, we have instituted a foreign currency cash flow hedging program. We hedge portions of our forecasted net sales denominated in foreign currencies with average rate forward contracts. During the three month periods ended June 30, 2017 and 2016, these hedges had the effect of increasing our net sales by \$0.7 million and decreasing our net sales by \$0.9 million respectively. During the six month periods ended June 30, 2017 and 2016, these hedges had the effect of increasing our net sales by \$2.7 million and decreasing our net sales by \$1.1 million, respectively. (See "Note 5 - Derivative instruments and hedging activities" of Notes to Consolidated Financial Statements for further discussion regarding our cash flow hedging program and its related impact on our net sales for 2017 and 2016).

Gross Profit. Our gross profit as a percentage of sales is impacted by many factors including changes in the amount of revenues from our largest customer and changes in the foreign currency exchange markets. We continue to focus on cost control and cost reduction measures throughout our manufacturing cycle. The following table sets forth our gross profit and gross profit as a percentage of net sales for the three and six month periods ending June 30, 2017 and 2016 along with the percentage changes in gross profit for the corresponding periods.

	Three Months Ended June 30, (Unaudited)		Six Months Ended June 30, (Unaudited)	
	2017	2016	2017	2016
(In millions)				
Gross Profit	\$ 236.1	\$ 228.6	\$ 459.7	\$ 439.6
% change compared with prior period	3.3%		4.6%	
Gross Profit as a percentage of net sales	74.1%	74.7%	74.3%	74.1%

For the three month periods ended June 30, 2017 and 2016, the change in exchange rates had the effect of decreasing our cost of sales by \$1 million and \$0.7 million, respectively. For the six month periods ended June 30, 2017 and 2016, the change in exchange rates had the effect of decreasing our cost of sales by \$1.4 million and \$2.7 million, respectively. To help protect against changes in our cost of sales caused by a fluctuation in foreign currency exchange rates of forecasted foreign currency cash flows, we have a foreign currency cash flow hedging program. We hedge portions of our forecasted costs of sales denominated in foreign currencies with average rate forward contracts. During each of the three month periods ended June 30, 2017 and 2016, these hedges had the effect of increasing our cost of sales by \$0.4 million. During each of the six month periods ended June 30, 2017 and 2016, these hedges had the effect of increasing our cost of sales by \$1.0 million. (See “Note 5 - Derivative instruments and hedging activities” of Notes to Consolidated Financial Statements for further discussion regarding our cash flow hedging program and its related impact on our cost of sales for 2017 and 2016).

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

Operating Expenses. The following table sets forth our operating expenses for the three and six month periods ending June 30, 2017 and 2016 along with the percentage changes between the corresponding periods and the line item as a percentage of total net sales.

(In thousands)	Three Months Ended June 30, (Unaudited)			Six Months Ended June 30, (Unaudited)		
	2017	2016	Change	2017	2016	Change
Sales and marketing	\$ 124,414	\$ 116,361	7%	\$ 241,674	\$ 229,568	5%
Percentage of total net sales	39%	38%		39%	39%	
Research and development	\$ 56,913	59,839	(5%)	115,175	119,179	(3%)
Percentage of total net sales	18%	20%		19%	20%	
General and Administrative	\$ 26,191	25,130	4%	51,933	49,770	4%
Percentage of total net sales	8%	8%		8%	8%	
Total operating expenses	\$ 207,518	201,330	3%	408,782	398,517	3%
Percentage of total net sales	65%	66%		66%	67%	

During the three month period ending June 30, 2017, the year over year increase in operating expenses was primarily the result of \$5.5 million in severance and other related costs associated with our restructuring initiative in addition to an increase of other personnel related expenses of \$5.9 million primarily related to increased variable compensation in regions with strong sales growth, accrual of a potential payment under our annual company profit sharing program, and an increase in our employer matching contribution for our defined contribution retirement plan. In addition, travel, marketing and outside services costs increased by \$1.9 million and building and equipment costs increased by \$1.3

million. These increases were partially offset by a \$5.8 million decrease in software development costs due to an increase in capitalization of software development costs compared to the three month period ended June 30, 2016. The year over year change in exchange rates also had the effect of decreasing our operating expenses by \$2.5 million.

During the six month period ending June 30, 2017, the year over year increase in operating expenses was primarily the result of \$8.3 million in severance and other related costs associated with our restructuring initiative in addition to an increase in personnel related expenses of \$12.8 million primarily related to increased variable compensation in regions with strong sales growth, accrual of a potential payment under our annual company profit sharing program, and an increase in our employer matching contribution for our defined contribution retirement plan. In addition, building and equipment costs increased by \$2.8 million. These increases were partially offset by a decrease in software development costs of \$9.4 million due to an increase in capitalization of software development costs compared to the six month period ending June 30, 2016. During the six month period ending June 30, 2017, the year over year change in exchange rates had the effect of decreasing our operating expenses by \$4.0 million.

We believe that our long-term growth and success depends on developing high quality software and hardware products on a timely basis. We are focused on leveraging recent investments in research and development and in our field sales force and taking actions to help ensure that those resources are concentrated in areas and on initiatives that will contribute to future growth in our business. The decreases in our research and development expenses for the three and six month periods ended June 30, 2017, compared to the three and six month periods ended June 30, 2016 were primarily driven by an increase in capitalized software development from expenditures related to LabVIEW NXG, a redesign of the software platform underlying our flagship application, LabVIEW. The increase in our sales and marketing expenses for the three and six month periods ended June 30, 2017, compared to the three and six month periods ended June 30, 2016, was primarily driven by increased variable compensation in regions with strong sales growth and the timing of our annual global sales conference and NIWeek conference in May 2017. Previously, these events were held in the third quarter.

Operating Income. For the three month periods ended June 30, 2017 and 2016, operating income was \$29 million and \$27 million, respectively, an increase of 5%. As a percentage of net sales, operating income was 9% for each of the three month periods ended June 30, 2017 and 2016, respectively. For the six month periods ended June 30, 2017 and 2016, operating income was \$51 million and \$41 million, respectively, an increase of 24%. As a percentage of net sales, operating income was 8% and 7% for the six month periods ended June 30, 2017 and 2016, respectively. The increases in operating income in absolute dollars for the three month period ended June 30, 2017, compared to the three month period ended June 30, 2016, and for the six month period ended June 30, 2017, compared to the six month period ended June 30, 2016, are attributable to the factors discussed in Net Sales, Gross Profit and Operating Expenses above.

Interest Income. For the three month periods ended June 30, 2017 and 2016, interest income was \$0.5 million and \$0.3 million, respectively. For the six month periods ended June 30, 2017 and 2016, interest income was \$0.9 million and \$0.5 million, respectively. We are seeing improving yields for high quality investment alternatives that comply with our corporate investment policy. We expect yields in these types of investments to increase moderately during the remainder of 2017.

Net Foreign Exchange Gain/(Loss). For the three month periods ended June 30, 2017 and 2016, net foreign exchange gain/(loss) was \$0.4 million and \$(1.3) million, respectively. During the six month periods ended June 30, 2017 and 2016, net foreign exchange gain/(loss) was \$0.5 million and \$(0.7) 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 second quarter of 2017, we continued to see broad volatility in the foreign currency exchange markets and a strong U.S. dollar in many of the currency markets where we have exposure, with the trade-weighted U.S. dollar index, as tracked by the St. Louis Federal Reserve, near a ten year high. In addition, the announcement of Brexit caused significant short-term volatility in the foreign currency markets and an approximately 12% devaluation of the GBP against the U.S. dollar. The ongoing uncertainty surrounding the implementation of Brexit, including the conditions and timing of the exit negotiation period, and uncertainty in relation to the relationship of the U.K. with the remaining members of the E.U. (including in relation to trade) has caused and is likely to continue to cause continued volatility in the foreign currency markets. We cannot predict the direction or degree of future volatility in the foreign exchange markets or the impact the impending implementation of the Brexit U.K. referendum will have in future periods. In the past, we have noted that significant volatility in the foreign currency exchange markets in which we do business has had a significant impact

on the revaluation of our foreign currency denominated firm commitments, on our ability to forecast our U.S. dollar equivalent net sales and expenses and on the effectiveness of our hedging programs. In the past, these dynamics have also adversely affected our net sales growth in international markets and may pose similar challenges in the future. We recognize the local currency as the functional currency in virtually all of our international subsidiaries.

We utilize foreign currency forward contracts to hedge our foreign denominated net foreign currency balance sheet positions to help protect against the change in value caused by a fluctuation in foreign currency exchange rates. We typically hedge up to 90% of our outstanding foreign denominated net receivable or payable positions and typically limit the duration of these foreign currency forward contracts to approximately 90 days. The gain or loss on these derivatives as well as the offsetting gain or loss on the hedged item attributable to the hedged risk is recognized in current earnings under the line item "Net foreign exchange gain (loss)." Our hedging strategy decreased our foreign exchange gains by \$0.6 million and decreased our foreign exchange losses by \$2.1 million in the three month periods ended June 30, 2017 and June 30, 2016, respectively. Our hedging strategy decreased our foreign exchange gains by \$3.2 million and increased our foreign exchange losses by \$0.2 million in the six month periods ended June 30, 2017 and 2016, respectively. (See "Note 5 - Derivative instruments and hedging activities" of Notes to Consolidated Financial Statements for a further description of our derivative instruments and hedging activities).

Edgar Filing: NATIONAL INSTRUMENTS CORP - Form 10-Q

Provision for Income Taxes. For the three month periods ended June 30, 2017 and 2016, our provision for income taxes reflected an effective tax rate of 14% and 25%, respectively. For the six month periods ended June 30, 2017 and 2016, our provision for income taxes reflected an effective tax rate of 18% and 25%, respectively. The factors that caused our effective tax rate to change year over year are detailed in the table below:

	Three Months Ended June 30, 2017 (Unaudited)		Six Months Ended June 30, 2017 (Unaudited)	
Effective tax rate at June 30, 2016	25	%	25	%
Change in profit in foreign jurisdictions with reduced tax rates	(6)		(5)	
Change in enhanced deduction for certain research and development expenses	5		5	
Change in intercompany prepaid tax asset	(3)		(3)	
Change in unrecognized tax benefits	(1)		(1)	
Change in tax benefit from equity awards	(6)		(3)	
Effective tax rate at June, 2017	14	%	18	%

(See “Note 9 – Income taxes” of Notes to Consolidated Financial Statements for further discussion regarding our effective tax rate).

Other operational metrics

We believe that the following additional unaudited operational metrics assist investors in assessing our operational performance relative to others in our industry and to our historical results. The following tables provide details with respect to the amount of GAAP charges related to stock-based compensation, amortization of acquisition-related intangibles, acquisition-related transaction costs, restructuring charges, foreign exchange loss on acquisitions, and taxes levied on the transfer of acquired intellectual property that were recorded in the line items indicated below (in thousands).

(In thousands)	Three Months Ended June 30, (Unaudited)		Six Months Ended June 30, (Unaudited)	
	2017	2016	2017	2016
Stock-based compensation				
Cost of sales	\$ 650	\$ 539	\$ 1,226	1,087
Sales and marketing	2,884	2,851	5,509	5,787

Edgar Filing: NATIONAL INSTRUMENTS CORP - Form 10-Q

Research and development	2,170	2,369	4,224	4,718
General and administrative	1,620	935	2,844	1,843
Provision for income taxes	(3,344)	(2,016)	(5,020)	(4,110)
Total	\$ 3,980	\$ 4,678	\$ 8,783	\$ 9,325

(In thousands)	Three Months		Six Months	
	Ended June 30, (Unaudited)		Ended June 30, (Unaudited)	
	2017	2016	2017	2016
Amortization of acquired intangibles				
Cost of sales	\$ 1,556	\$ 2,980	\$ 3,146	6,022
Sales and marketing	486	820	964	1,639
Research and development	267	278	531	539
Provision for income taxes	(556)	237	(1,110)	458
Total	\$ 1,753	\$ 4,315	\$ 3,531	\$ 8,658

(In thousands)	Three Months		Six Months	
	Ended June 30, (Unaudited)		Ended June 30, (Unaudited)	
	2017	2016	2017	2016
Acquisition transaction costs, restructuring charges, and other				
Cost of sales	\$ 574	\$ 74	\$ 909	179
Sales and marketing	4,024	42	6,399	99
Research and development	1,182	153	1,581	411
General and administrative	419	190	596	220
Foreign exchange gain (loss) 1	-	-	-	94
Other income (loss), net ²	-	-	-	2,475
Provision for income taxes	(1,870)	(160)	(2,934)	(1,202)
Total	\$ 4,329	\$ 299	\$ 6,551	\$ 2,276

(1) Foreign exchange losses on acquisitions were \$0 and \$94 for the six month periods ended June 30, 2017 and 2016, respectively

(2) Taxes levied on the transfer of acquired intellectual property were \$0 and \$2,475 for the six months ended June 30, 2017 and 2016, respectively

Liquidity and Capital Resources

Overview

At June 30, 2017, we had \$368 million in cash, cash equivalents and short-term investments. 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 short-term investments that are located outside of the U.S. are denominated in the U.S. dollar with the exception of \$4.8 million U.S. dollar equivalent of corporate bonds that are denominated in Euro. Approximately \$42 million or 11% of these amounts were held in domestic accounts with various financial institutions and \$326 million or 89% was held in accounts outside of the U.S. with various financial institutions. At June 30, 2017, we had cash and cash equivalents of \$263 million, of which \$42 million or 16% was held in domestic accounts and \$221 million or 84% was held in various accounts of our foreign subsidiaries. At June 30, 2017, we had short-term investments of \$105 million, all of which was held in investment accounts of our foreign subsidiaries. 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. 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 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.

The following table presents our working capital, cash and cash equivalents and short-term investments:

Edgar Filing: NATIONAL INSTRUMENTS CORP - Form 10-Q

(In thousands)	June 30, 2017 (unaudited)	December 31, 2016	Increase/ (Decrease)
Working capital	\$ 582,933	\$ 574,572	\$ 8,361
Cash and cash equivalents (1)	263,150	285,283	(22,133)
Short-term investments (1)	105,284	73,117	32,167
Total cash, cash equivalents and short-term investments	\$ 368,434	\$ 358,400	\$ 10,034

(1) Included in working capital

Our principal sources of liquidity include cash, cash equivalents, and marketable securities, as well as the cash flows generated from our operations. We also have additional borrowing capacity under our Loan Agreement. Proceeds of loans made under the Loan Agreement may be used for working capital and other general corporate purposes. (See “Note 13 – Debt” of Notes to Financial Statements for additional information on our revolving line of credit).

The primary drivers of the net increase in working capital between December 31, 2016 and June 30, 2017 were:

- o Accounts receivable increased by \$2 million. Days sales outstanding (“DSO”) increased to 67 days at June 30, 2017, compared to 66 days at December 31, 2016.
- o Accounts payable increased by \$5 million which can primarily be attributed to the severance costs arising from our restructuring initiative.
- o Prepaid expenses and other current assets decreased by \$1 million which was primarily related to an \$8 million decrease in the fair value of our foreign currency forward exchange contracts offset by \$7 million related to the timing of prepaid insurance and maintenance.
- o The current portion of deferred revenue increased by \$5 million, primarily due to increases in amounts received for software maintenance renewals and growth in our enterprise licensing agreements.
- o Other taxes payable decreased by \$6 million primarily related to the timing of payments for VAT and other indirect taxes.
- o Cash, cash equivalents, and short-term investments increased by \$10 million. Additional analysis of the changes in our cash flows for the six month period ended June 30, 2017 compared to the six month period ended June 30, 2016 are discussed below.
- o Inventory decreased by \$7 million to \$186 million at June 30, 2017, from \$194 million at December 31, 2016. Inventory turns were 1.7 at June 30, 2017 and December 31, 2016.
- o Accrued expenses and other liabilities decreased by \$18 million which was primarily related to income tax payments.

Analysis of Cash Flow

The following table summarizes our cash flow results for the six month periods ended June 30, 2017 and 2016.

(In thousands)	Six Months Ended June 30, (unaudited)	
	2017	2016

Edgar Filing: NATIONAL INSTRUMENTS CORP - Form 10-Q

Cash provided by operating activities	\$ 84,785	\$ 80,544
Cash used in investing activities	(73,457)	(10,888)
Cash used in financing activities	(39,188)	(39,078)
Effect of exchange rate changes on cash	5,727	3,554
Net change in cash and cash equivalents	(22,133)	34,132
Cash and cash equivalents at beginning of year	285,283	251,129
Cash and cash equivalents at end of period	\$ 263,150	\$ 285,261

Operating Activities Cash provided by operating activities for the six month period ended June 30, 2017 improved by \$4 million compared to the same period in 2016. This increase was due to a \$14 million increase in net income offset by a \$10 million decrease in cash provided by operating assets and liabilities. The decrease in cash provided by operating assets was primarily related to the timing of payments to tax authorities and vendors compared to the same period in 2016.

Investing Activities Cash used for investing activities for the six month period ended June 30, 2017 increased by \$63 million compared to the same period in 2016. This was primarily attributable to a net purchase of short-term investments of \$32 million compared to a net sale of short-term investments of \$27 million during the same period in 2016, driven by favorable increases in the yields offered by our short-term investments. Cash outflows related to capitalized software development also increased by \$9 million which was partially offset by a decrease in capital expenditures of \$5 million compared to the same period in 2016.

Financing Activities Cash used by financing activities was flat for the six month period ended June 30, 2017 compared to the same period in 2016. This was primarily due to a \$6 million decrease in cash outflows related to 2016 repurchases of our common stock, offset by a \$3 million increase in cash outflows related to the increase in our quarterly dividend and \$3 million decrease in cash inflows related to net borrowing under our Loan Agreement. From time to time, our Board of Directors has authorized various programs for our repurchase of shares of our common stock depending on market conditions and other factors. Under the current program, we did not repurchase any shares during the six months ended June 30, 2017. (See “Note 11 – Authorized shares of common and preferred stock and stock-based compensation plans” of Notes to Consolidated Financial Statements for additional discussion about our equity compensation plans and share repurchase program).

Contractual Cash Obligations. Information related to our contractual obligations as of December 31, 2016 can be found in “Management’s Discussion and Analysis of Financial Condition and Results of Operations-Contractual Obligations,” in Part II-Item 7 of our Annual Report on Form 10-K for the fiscal year ended December 31, 2016 filed with the SEC on February 16, 2017 (the “2016 Form 10-K”). At June 30, 2017, there were no material changes outside the ordinary course of business to our contractual obligations (including non-cancellable operating leases) from those reported in our 2016 Form 10-K.

Loan Agreement. On May 9, 2013, we entered into a Loan Agreement (the “Loan Agreement”) with Wells Fargo Bank (the “Lender”). On October 29, 2015, we entered into a First Amendment to Loan Agreement (the “Amendment”) with the Lender, which amended our Loan Agreement to among other things, (i) increase the unsecured revolving line of credit from \$50.0 million to \$125.0 million, (ii) extend the maturity date of the line of credit from May 9, 2018 to October 29, 2020, and (iii) provide us with an option to request increases to the line of credit of up to an additional \$25.0 million in the aggregate, subject to consent of the Lender and terms and conditions to be mutually agreed between us and the Lender. Proceeds of loans made under the Loan Agreement may be used for working capital and other general corporate purposes. We may prepay the loans under the Loan Agreement in whole or in part at any time without premium or penalty. Certain of our existing and future material domestic subsidiaries are required to guaranty our obligations under the Loan Agreement. We may choose to borrow additional funds against this line of credit in future periods to have sufficient domestic cash to fund continued dividends to our stockholders, to fund potential acquisitions or repurchases of shares of our common stock, or other domestic general corporate purposes without the need to repatriate foreign earnings. (See “Note 13 – Debt ” of Notes to Consolidated Financial Statements for additional details on our revolving line of credit).

Off-Balance Sheet Arrangements. We do not have any off-balance sheet debt. At June 30, 2017, 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 short-term investments, together with cash generated from operations as well as from the purchase of common stock through our employee stock purchase plan, and available borrowings under our Loan Agreement 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, although the use of certain of our funds for domestic purposes may require us to repatriate foreign earnings which would be subject to the U.S. federal statutory tax rate of 35%. We may also seek to pursue additional financing or to raise additional funds by selling equity or debt to the public or in private transactions. 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 our 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 it is our intent to permanently reinvest our undistributed earnings for the foreseeable future, we may also choose to repatriate foreign earnings which would be subject to the U.S. federal statutory tax rate of 35% and therefore, would likely have a material adverse effect on our effective tax rate and on our net income and earnings per share. We could also choose to reduce certain expenditures or payments of dividends or suspend our program to repurchase shares of our common stock.

Although we believe that we have sufficient capital to fund our operating 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:

- payment of dividends to our stockholders;

- difficulties and the high tax costs associated with the repatriation of earnings;
- required levels of research and development and other operating costs;
- our business, product, capital expenditure and research and development plans, and product and technology roadmaps;
- acquisitions of other businesses, assets, products or technologies;
- the overall levels of sales of our products and gross profit margins;
- the levels of inventory and accounts receivable that we maintain;
- general economic and political uncertainty and specific conditions in the markets we address, including any volatility 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, which may lead them to reduce their level of purchases or to seek credit or other accommodations from us;
- capital improvements for facilities;
- repurchases of our common stock;
- our relationships with suppliers and customers; and
- the level of stock purchases under our employee stock purchase plan.

Recently Issued Accounting Pronouncements

See “Note 1 – Recently issued accounting pronouncements” in Notes to Consolidated Financial Statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Changes in currency exchange rates and interest rates are our primary financial market risks. Quantitative and qualitative disclosures about market risk appear in “Item 7A. Quantitative and Qualitative Disclosures About Market Risk” in Part II of our 2016 Form 10-K and there were no material changes during the six months ended June 30, 2017 to this information reported in our 2016 Form 10-K.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Based on an evaluation under the supervision and with the participation of our management, our principal executive officer and our principal financial officer have concluded that our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act were effective as of June 30, 2017, to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms and (ii) accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the second quarter of 2017, which were identified in connection with management’s evaluation required by paragraph (d) of Rules 13a-15 and 15d-15 under the Exchange Act, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are not currently a party to any material litigation. However, in the ordinary course of our business, we are involved in a limited number of legal actions, both as plaintiff and defendant, and could incur uninsured liability in any one or more of them. We also periodically receive notifications from various third parties related to alleged infringement of patents or intellectual property rights, commercial disputes or other matters. No assurances can be given with respect to the extent or outcome of any future litigation or dispute.

ITEM 1A. RISK FACTORS

In addition to the other information set forth in this Form 10-Q, you should carefully consider the risk factors discussed below. The risks described below are not the only risks that we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition, or operating results.

Uncertain Global Economic Conditions Could Materially Adversely Affect Our Business and Results of Operations. Our operations and performance are sensitive to fluctuations in general economic conditions, both in the U.S. and globally. We remain concerned about the geopolitical instability in the Middle East and the Korean peninsula, the ongoing uncertainty created by the execution of Brexit as well as uncertainty created by the various policy proposals by the new administration in the U.S. These factors as well as others we may not contemplate could have a material adverse effect on the spending patterns of businesses including our current and potential customers which could have a material adverse effect on our net sales and our results of operations. See “Current business outlook” in this Form 10-Q for information regarding recent business conditions.

We Have Established a Budget and Variations From Our Budget Will Affect Our Financial Results. We have an operating budget for 2017. Our budget was established based on the estimated revenue from sales of our products which are based on anticipated 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 during the remainder of 2017 is less than the demand we anticipated in setting our 2017 budget, our operating results could be negatively impacted.

If we exceed our budgeted level of expenses or if we cannot reduce expenditures in response to a decrease in net sales, our operating results could be adversely affected. Our spending could exceed our budget due to a number of factors, including, but not limited to:

- continued foreign currency fluctuations;
- less than expected capacity utilization of our manufacturing facility in Penang, Malaysia;
- increased manufacturing costs resulting from component supply shortages or component price fluctuations;
- additional marketing costs for new product introductions or for conferences and tradeshows;
- the timing, cost or outcome of any future intellectual property litigation or commercial disputes;
- additional unanticipated costs related to our acquisitions; or
- increased component costs resulting from vendors increasing their sales price.

Our Financial Performance is Subject to Risks Associated with Changes in the Value of the U.S. Dollar versus Local Currencies. The vast majority of our sales outside of the U.S. 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. If the local currencies in which we sell our products strengthen against the U.S. dollar, we have in the past, and in the future may need to, lower our prices in the local currency to remain competitive in our international markets. This 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. We cannot predict to what degree or how long the recent volatility in the foreign currency exchange markets will continue. In the past, we have noted that significant volatility in foreign currency exchange rates in the markets in which we do business has had a significant impact on the revaluation of our foreign currency denominated firm commitments, on our ability to forecast our U.S. dollar equivalent net sales and expenses and on the effectiveness of our hedging programs. In the past, these dynamics have also adversely affected our net sales growth in international markets and may pose similar challenges in the future. See “Results of Operations” in this Form 10-Q for further discussion on the effect that changes in the foreign currency exchange rates have had on our operating results. See “Current business outlook” in this Form 10-Q for information regarding recent business conditions.

In addition, the announcement of Brexit caused significant short-term volatility in the foreign currency markets and an approximately 12% devaluation of the GBP against the U.S. dollar. During the first quarter of 2017, the British Parliament voted in favor of allowing the government to begin the formal process of Brexit and discussions with the E.U. began on March 29, 2017. The continuing uncertainty during the negotiations between the U.K and E.U. may lead to broader negative business sentiment resulting in less demand for our products which would negatively impact our net sales and results of operations.

Our Current Domestic Cash Position May Not Be Sufficient to Fund our Domestic Cash Needs in the Next Twelve Months and We May Need to Borrow Additional Amounts Under our Loan Agreement, Seek Funding from External Sources or Repatriate Foreign Earnings. Our Loan Agreement with Wells Fargo Bank provides for a \$125 million unsecured revolving line of credit. Proceeds of loans made under the Loan Agreement may be used for working capital and other general corporate purposes. (See “Note 13—Debt” in Notes to Consolidated Financial Statements for additional discussion of the Loan Agreement). We may choose to borrow additional funds against our line of credit in future periods to have sufficient domestic cash to fund continued dividends to our stockholders, to fund potential acquisitions, to purchase shares under our board authorized share repurchase program or other domestic general

corporate purposes without the need to repatriate foreign cash, as we intend to permanently reinvest our undistributed earnings for the foreseeable future. Future dividends are subject to approval and declaration by our Board of Directors, and our share repurchase program does not obligate us to acquire any specific number of shares.

We may also seek to pursue additional financing or to raise additional funds by selling equity or debt to the public or in private transactions. 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 our 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. We may also choose to repatriate foreign earnings which would be subject to the U.S. federal statutory tax rate of 35% and therefore would likely have a material adverse effect on our effective tax rate and on our net income and earnings per share. We could also choose to reduce certain expenditures or payments of dividends or suspend our program to repurchase shares of our common stock.

We are Subject to Various Risks Associated with International Operations and Foreign Economies. Our international sales are subject to inherent risks, including, but not limited to:

- fluctuations in foreign currencies relative to the U.S. dollar;
- unexpected changes to currency policy or currency restrictions in foreign jurisdictions;
- delays in collecting trade receivable balances from customers in developing economies;
- unexpected changes in regulatory requirements;
- difficulties and the high tax costs associated with the repatriation of earnings;
- fluctuations in local economies;
- disparate and changing employment laws in foreign jurisdictions;
- difficulties in staffing and managing foreign operations;
- costs and risks of localizing products for foreign countries;
- unexpected changes in regulatory requirements;
- government actions throughout the world;
- tariffs and other trade barriers; and,
- the burdens of complying with a wide variety of foreign laws.

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.

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 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.

Orders With a Value of Greater than One Million Dollars Expose Us to Significant Additional Business and Legal Risks that Could Have a Material Adverse Impact on our Business, Results of Operations and Financial Condition. We continue to make a concentrated effort to increase our net sales through the pursuit of orders with a value greater than \$1.0 million. These types of orders expose us to significant additional business and legal risks compared to smaller orders. Our very large customers frequently require contract terms that vary substantially from our standard terms of sale. At times these orders include terms that impose critical delivery commitments and severe contractual liabilities if we fail to provide the required quantity of products at the required delivery times, impose product acceptance requirements and product performance evaluation requirements which create uncertainty with respect to the timing of our ability to recognize revenue from such orders, allow the customers to cancel or delay orders without

liability, require us to develop specific product mitigation plans for product delivery constraints caused by unexpected or catastrophic situations to help assure quick production recovery, and that require most favored customer pricing, significant discounts, extended payment terms and volume rebates. At times these customers require broad indemnity obligations and large direct and consequential damage provisions in the event we breach our contracts with them. At times these contracts have supply constraint requirements which mandate that we allocate large product inventories for a specific contract. These inventory requirements expose us to higher risks of inventory obsolescence and can adversely impact our ability to provide adequate product supply to other customers.

While we attempt to limit the number of contracts that contain the non-standard terms of sale described above and attempt to contractually limit our potential liability under such contracts, we have been and expect to be required to agree to some or all of such provisions to secure orders from these customers and to continue to grow our business. These arrangements expose us to significant additional legal and operational risks which could result in a material adverse impact on our business, results of operations and financial condition. In addition, these larger orders are more volatile, are subject to greater discount variability and may contract at a faster pace during an economic downturn. We attempt to manage these risks but there can be no assurance that we will be successful in our efforts.

Revenue Derived from Large Orders Could Adversely Affect our Gross Margin and Could Lead to Greater Variability in our Quarterly Results. We define our large order business as orders with a value greater than \$100,000. These orders have been and may continue to be more sensitive to changes in the global industrial economy, subject to greater discount variability, lower gross margins, and such orders may be pushed-out or reduced at a faster pace during an economic downturn compared to orders valued at less than \$100,000. To the extent that the amount of our net sales derived from large orders increases in future periods, either in absolute dollars or as a percentage of our overall business, our gross margins could decline, and we could experience greater volatility and see a greater negative impact from future downturns in the global industrial economy. This dynamic may also have an impact on the historical seasonal pattern of our net sales and our results of operations. These types of orders also make managing inventory levels more difficult as we have in the past and may have to in the future build large quantities of inventory in anticipation of future demand that may not materialize.

Our Product Revenues are Dependent on Certain Industries and Contractions in these Industries Could Have a Material Adverse Effect on Our Results of Operations. Sales of our products are dependent on customers in certain industries, particularly the telecommunications, semiconductor, consumer electronics, automotive, energy, 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. We cannot predict when and to what degree contractions in these industries may occur; however, any sharp or prolonged contraction in one or more of these industries could have a material adverse effect on our business and results of operations.

We Make Significant Investments in New Products that May Not Be Successful or Achieve Expected Returns. We plan to continue to make significant investments in research, development, and marketing for new and existing products and technologies. For example, we recently launched LabVIEW NXG, the next generation of our flagship software application. We have made and will continue to make significant investments in software development related to the new and enhanced features of this product. These investments involve a number of risks as the commercial success of such efforts depend on many factors, including our ability to anticipate and respond to innovation, achieve the desired technological fit, and be effective with our marketing and distribution efforts. If our existing or potential customers do not perceive our latest product offerings as providing significant new functionality or value, or if we are late to market with a new product or technology, we may not achieve our expected return on our investments or be able to recover the costs expended to develop new product offerings, which could have a material adverse effect on our operating results. Even if our new products are profitable, our operating margins for new products may not be as high as the margins we have experienced historically.

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 our 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.

Our Reported Financial Results May be Adversely Affected by Changes in Accounting Principles Generally Accepted in the U.S. 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 (“FASB”) and the Securities and Exchange Commission. A change in these policies or interpretations could have a significant effect on our reported financial results, may retroactively affect previously reported results, could cause unexpected financial reporting fluctuations, and may require us to make costly changes to our operational processes and accounting systems. For example, in May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers which supersedes nearly all existing U.S. GAAP revenue recognition guidance and which will be effective for us for our fiscal year beginning January 1, 2018. (See “Note 1 – Operations and summary of significant accounting policies” for additional discussion of the accounting changes).

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 Keysight Technologies Inc. (“Keysight”) which was part of Agilent until November 2014. Keysight offers hardware and software products that provide solutions that directly compete with our virtual instrumentation products including its own line of PXI based hardware. Keysight is aggressively advertising and marketing products that are competitive with our products. Because of Keysight’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, but not limited to:

- general market and economic conditions;
- our ability to maintain and grow our business with our current largest customer;
- our ability to meet the volume and service requirements of our large customers;
- industry consolidation, including acquisitions by us or our competitors;
- capacity utilization and the efficiency of manufacturing operations;
- success in developing new products;
- timing of our new product introductions;
- new product introductions by competitors;
- the ability of competitors to more fully leverage low cost geographies for manufacturing or distribution;
- product pricing, including the impact of currency exchange rates;
- effectiveness of sales and marketing resources and strategies;
- adequate manufacturing capacity and supply of components and materials;
 - strategic relationships with our suppliers;
- product quality and performance;
- protection of our products by effective use of intellectual property laws;
- the financial strength of our competitors;
- the outcome of any future litigation or commercial dispute;
 - barriers to entry imposed by competitors with significant market power in new markets;
 - and,
- government actions throughout the world.

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

Our Quarterly Results are Subject to Fluctuations Due to Various Factors that May Adversely Affect Our Business and Result of Operations. Our quarterly operating results have fluctuated in the past and may fluctuate significantly in the future due to a number of factors, including, but not limited to:

- fluctuations in foreign currency exchange rates;
- changes in global economic conditions;
- changes in the amount of revenue derived from very large orders (including orders from our largest customer) and the pricing, margins, and other terms of such orders;

- changes in the capacity utilization including at our facility in Malaysia;
- changes in the mix of products sold;
- the availability and pricing of components from third parties (especially limited sources);
- the difficulty in maintaining margins, including the higher margins traditionally achieved in international sales;
- changes in pricing policies by us, our competitors or suppliers;
- the timing, cost or outcome of any future intellectual property litigation or commercial disputes;
- delays in product shipments caused by human error or other factors; or,
- 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 as well as the timing of new product introductions or any acquisitions. In addition, revenue derived from very large orders, including those from our largest customer, have had a significant impact on our historical seasonal trends as these orders may be more sensitive to changes in the global industrial economy, may be subject to greater volatility in timing and amount, greater discount variability, lower gross margins, and may contract at a faster pace during economic downturns.

Our Acquisitions are Subject to a Number of Related Costs and Challenges that Could Have a Material Adverse Effect on Our Business and Results of Operations. In recent years, we have completed several acquisitions. 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 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. Our inability to successfully integrate any of our acquisitions could harm our business. The existing products previously sold by entities we have acquired may be of a lesser quality than our products 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 transactions.

Our Tax Returns and Other Tax Matters are Subject to Examination by the U.S. Internal Revenue Service and Other Tax Authorities and Governmental Bodies and the Results of These Examinations Could Have a Material Adverse Effect on Our Financial Condition. We account for uncertainty in income taxes recognized in our financial statements using prescribed recognition thresholds and measurement attributes for financial statement disclosure of tax positions taken or expected to be taken on our tax returns. These uncertain tax positions are subject to examination by the U.S. Internal Revenue Service and other tax authorities. There can be no assurance as to the outcome of any future examinations. If the ultimate determination of our taxes owed is for an amount in excess of amounts previously accrued, our operating results, cash flows, and financial condition could be materially adversely affected. Our tax years 2008 through 2017 remain open to examination by the major taxing jurisdictions to which we are subject.

Tax Law Changes in Hungary Could Have a Negative Impact on our Effective Tax Rate, Earnings and Results of Operations. The profit from our Hungarian operation benefits from the fact that it is subject to an effective income tax rate that is lower than the U.S. federal statutory tax rate of 35%. Our earnings in Hungary are subject to a statutory tax rate of 9%. In addition, effective January 1, 2010, certain qualified research and development expenses in Hungary became eligible for an enhanced tax deduction. These tax benefits may not be available in future years due to changes in political conditions in Hungary or changes in tax laws in Hungary or in the U.S. The reduction or elimination of these benefits in Hungary or future changes in U.S. law pertaining to the 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. (See “Note 9 – Income taxes” of Notes to Consolidated Financial Statements for additional discussion regarding the impact of these matters on our income taxes).

Our Income Tax Rate could be Adversely Affected by the Expiration of a Tax Holiday in Malaysia. Profits from our manufacturing facility in Penang, Malaysia are free of tax under a 15 year tax holiday effective January 1, 2013. If we fail to satisfy the conditions of the tax holiday, this tax benefit may be terminated early. The expiration of the tax holiday in Malaysia or future changes in U.S. law pertaining to the taxation of foreign earnings could have a material adverse effect on our operating results. (See “Note 9 – Income taxes” of Notes to Consolidated Financial Statements for

additional discussion regarding the impact of this tax holiday on our income taxes).

Our Manufacturing Capacity, and a Substantial Majority of our Warehousing and Distribution Capacity is Located Outside of the U.S. We manufacture substantially all of our product volume at our facilities in Debrecen, Hungary and Penang, Malaysia. In order to enable timely shipment of products to our customers we maintain the substantial majority of our inventory at our international locations. In addition to being subject to the risks of maintaining such a concentration of manufacturing capacity and global inventory, these facilities and their operations are also subject to risks associated with doing business internationally, including, but not limited to:

- the volatility of the Hungarian forint and the Malaysian ringgit relative to the U.S. dollar;
- changing and potentially unstable political environments;
- significant and frequent changes in corporate tax laws;
- difficulty in managing manufacturing operations in foreign countries;
- 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;
- restrictive labor codes; and,
- increasing labor costs.

No assurance can be given that our efforts to mitigate these risks will be successful. Any failure to effectively deal with the risks above could result in an interruption in the operations of our facilities in Hungary or Malaysia which could have a material adverse effect on our operating results.

Our centralization of inventory and distribution from a limited number of shipping points is subject to inherent risks, including:

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

Difficulties arising from the centralization of our 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 facilities in Hungary and Malaysia could have a material adverse effect on our operating results.

Our Manufacturing Facility in Penang, Malaysia Could Adversely Affect our Gross Margin, Results of Operations and Earnings if Anticipated Demand is Not Achieved. Our facility in Malaysia is intended to support our long term manufacturing and warehousing capacity needs. If demand for our products does not grow as expected or if it contracts in future periods, we will have excess warehousing and manufacturing capacity which will cause an increase in overhead that will likely negatively impact our gross margins and results of operations in future periods.

Our Business is Dependent on Key Suppliers and Distributors and Disruptions in these Businesses Could Adversely Affect our Business and Results of Operations. Our manufacturing processes use large volumes of high-quality components and subassemblies supplied by outside sources. Several of these components are only available through limited sources. Limited source components purchased include custom 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 net sales and operating results. In the event that any of our limited source 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.

In some countries, we use distributors to support our sales channels. In the event that any of our distributors experience significant financial or operational difficulties due to adverse global economic conditions or if we experience disruptions in the use of these distributors, our business and operating results would likely be adversely impacted until we are able to secure another distributor or establish direct sales capabilities in the affected market.

We May Experience Component Shortages that May Adversely Affect Our Business and Result of Operations. 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, or an increase in manufacturing costs, any of which would have a material adverse impact on our operating results.

Concentrations of Credit Risk and Uncertain Conditions in the Global Financial Markets May Adversely Affect Our Business and Result of Operations. By virtue of our holdings of cash, 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 continue to monitor the stability of the financial markets, particularly those in the emerging markets. We can give no assurance that we will not be negatively impacted by any adverse outcomes in those markets. There can be no assurance 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.

We Rely on Management Information Systems and Interruptions in our Information Technology Systems or Cyber-Attacks on our Systems Could Adversely Affect our Business. We rely on the efficient and uninterrupted operation of complex information technology systems and networks to operate our business. During the past year, we devoted significant resources to the consolidation and migration of our existing ERP systems into a global single instance of the ERP software. During the remainder of 2017, we plan to devote significant resources to completing this transition. Although the transition has proceeded to date without any material disruption in our business systems, the possibility exists that our migration to the new ERP system could adversely affect our operating results, internal controls over financial reporting, and other business processes. 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. A significant system or network disruption could be the result of new system implementations, computer viruses, cyber-attacks, security breaches, facility issues or energy blackouts. Threats to our information technology security can take a variety of forms and individuals or groups of hackers or sophisticated organizations including state-sponsored organizations, may take steps that pose threats to our customers and our infrastructure. If we were to experience a shutdown, disruption or attack, it would adversely impact our product shipments and net sales, as order processing and product distribution are heavily dependent on our management information systems. Such an interruption could also result in a loss of our intellectual property or the release of sensitive competitive information or partner, customer or employee personal data. Any loss of such information could harm our competitive position, result in a loss of customer confidence, and cause us to incur significant costs to remedy the damages caused by the disruptions or security breaches. In addition, changing laws and regulations governing our responsibility to safeguard private data could result in a significant increase in operating or capital expenditures needed to comply with these new laws or regulations. Accordingly, our operating results in such periods would be adversely impacted. From time to time, we have experienced attempts to breach our security and attempts to introduce malicious software into our information technology systems; however, such attacks have not previously resulted in any material damage to us.

We are continually working to maintain reliable systems to control costs and improve our ability to deliver our products in our markets worldwide. Our efforts include, but are not limited to the following: firewalls, antivirus protection, patches, log monitors, routine backups with offsite retention of storage media, system audits, data partitioning and routine password modifications. Our internal information technology systems environment continues to evolve and our business policies and internal security controls may not keep pace as new threats emerge. No assurance can be given that our efforts to continue to enhance our systems will be successful.

We are Subject to Risks Associated with Our Website. We devote significant resources to maintaining our website, ni.com, as a key marketing, sales and support tool and expect to continue to do so in the future. During the past year, we devoted significant resources to implementing new platforms for ni.com and these efforts will continue during the remainder of 2017. There can be no assurance that we will be successful in our attempt to leverage the Web to increase sales. Failure to properly maintain our Website may interrupt 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 which would have a material adverse effect on our results of operations. We host our Website internally. Any failure to successfully maintain our Website or any significant downtime or outages affecting our Website could have a material adverse impact on our operating results.

Adoption of Complex Health Care Legislation and Related Regulations and Financial Reform Have Increased our Operating Costs and Adversely Affected Our Result of Operations. The 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 have increased the costs of providing health care to our employees as well as caused us to incur additional administrative burdens and costs to comply with certain provisions of this legislation. Additionally, the Dodd-Frank Wall Street Reform and Consumer Protection Act has resulted in increased costs to us as a result of fees as well as incremental efforts we have had to undertake to comply with provisions of this law which are applicable to our derivative contracts or other financial instruments. In addition to the fees and efforts we have already incurred and undertaken to comply with the Dodd-Frank Wall Street Reform and Consumer Protection Act, we may incur additional costs in future periods as new rules are published and become effective.

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 or cause our support costs to increase, either of which could have a material adverse impact on our operating results.

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 management's certification of adequate disclosure controls and procedures as of June 30, 2017. 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, 2016. Our most recent annual report on 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. 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 very costly and very 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 Our Proprietary Rights and We Have Been 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 future intellectual property dispute or litigation will not result in significant 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 Business Depends on the Continued Service of Our 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 Alex Davern, our President and Chief Executive Officer, and other members of our senior management and key technical personnel. In connection with his promotion to Chief Executive Officer in January 2017, we entered into an employment agreement with Mr. Davern. We have no other 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. The market for hiring and retaining certain technical personnel, including software engineers, has become more competitive and intense in recent years. Failure to attract and retain a sufficient number of qualified technical personnel, including software engineers or retain our key personnel could have a material adverse effect on our operating results.

Our Operations are Subject to a Variety of Environmental Regulations and Costs that May Have a Material Adverse Effect on our Business and Results of our Operations. 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 operations in the U.S., Hungary, and Malaysia. 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, bodily harm or property damage. 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” and electronically displayed 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.

Provisions in Our Charter Documents and Delaware Law 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 our 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.

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

At June 30, 2017, there were 1,134,247 shares available for repurchase under a repurchase plan approved on April 21, 2010. This repurchase plan does not have an expiration date. The following table provides information as of June 30, 2017 with respect to the shares of our common stock that we repurchased during the second quarter of 2017.

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)
April 1, 2017 to April 30, 2017	-	-	-	1,134,247
May 1, 2017 to May 31, 2017	-	-	-	1,134,247
June 1, 2017 to June 30, 2017	-	-	-	1,134,247
Total	-	\$ -	-	1,134,247

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.

On July 26, 2017, our Board of Directors appointed John C. Roiko as our Chief Accounting Officer effective August 1, 2017. Mr. Roiko, age 59, joined us as worldwide Corporate Controller in 1998, has served as our Vice President of Finance since 2008 and served as our Interim Chief Financial Officer from January 1, 2017 to May 9, 2017. Prior to joining NI, Mr. Roiko worked as a product line Controller for the Defense Division at Honeywell before moving to Emerson Process Management as the North Americas Accounting Manager. Mr. Roiko then pursued start-up opportunities as the Chief Financial Officer for Columbia Scientific and Director of Accounting for Arrowsmith Technologies. Mr. Roiko holds a Bachelor's degree in finance with a minor in accounting from St. Cloud State University and a Master's degree from Minnesota State University. There are no family relationships between Mr. Roiko and any director or executive officer of our company. Mr. Roiko has no direct or indirect material interest in any transaction required to be disclosed pursuant to Item 404(a) of Regulation S-K.

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.
- 10.1(4) Form of Indemnification Agreement.
- 10.2(5) 1994 Employee Stock Purchase Plan, as amended.*
- 10.3(5) National Instruments Corporation Annual Incentive Program, as amended.*
- 10.4(6) 2005 Incentive Plan.*
- 10.5(7) 2005 Form of Restricted Stock Unit Award Agreement (Non-Employee Director).*
- 10.6(8) 2005 Form of Restricted Stock Unit Award Agreement (Performance Vesting).*
- 10.7(9) 2005 Form of Restricted Stock Unit Award Agreement (Current Employee).*
- 10.8(10) 2005 Form of Restricted Stock Unit Award Agreement (Newly Hired Employee).*
- 10.9(11) 2010 Incentive Plan.*
- 10.10(12) 2010 Form of Restricted Stock Unit Award Agreement (Non-Employee Director).*
- 10.11(13) 2010 Form of Restricted Stock Unit Award Agreement (Performance Vesting).*
- 10.12(14) 2010 Form of Restricted Stock Unit Award Agreement (Current Employee).*
- 10.13(15) 2010 Form of Restricted Stock Unit Award Agreement (Newly Hired Employee).*
- 10.14(16) 2010 Form of Restricted Stock Unit Award Agreement (Performance Vesting).*
- 10.15(17) RSU Vesting Acceleration Agreement between the Company and Alexander M. Davern, effective as of October 28, 2014.*
- 10.16(18) Loan Agreement, dated as of May 9, 2013, by and among National Instruments Corporation, the guarantors from time to time party thereto and Wells Fargo Bank, National Association, as lender.
- 10.17(19) 2015 Equity Incentive Plan.*
- 10.18(20) 2015 Form of Restricted Stock Unit Award Agreement (Non-Employee Director).*
- 10.19(21) 2015 Form of Restricted Stock Unit Award Agreement (Performance Vesting).*
- 10.20(22) 2015 Form of Restricted Stock Unit Award Agreement (Current Employee).*
- 10.21(23) 2015 Form of Restricted Stock Unit Award Agreement (Newly Hired Employee).*
- 10.22(24) 2015 Form of Restricted Stock Unit Award Agreement (Performance Vesting – Threshold Performance Goal).*
- 10.23(25) 2015 Form of Restricted Stock Unit Award Agreement (Employee-Time Based Vesting).*
- 10.24(26) Performance Cash Incentive Plan.*
- 10.25(27) First Amendment to Loan Agreement, dated as of October 29, 2015, by and among National Instruments Corporation, the guarantors party thereto and Wells Fargo Bank, National Association, as lender
- 10.26(28) RSU Vesting Acceleration Agreement between the Company and Eric H. Starkloff, effective as of February 26, 2016.*
- 10.27(29) RSU Vesting Acceleration Agreement between the Company and Scott A. Rust, effective as of February 26, 2016.*
- 10.28(30) Employment Agreement between the Company and Alexander M. Davern, dated August 29, 2016 and effective January 1, 2017.*†
- 10.29(31) Offer Letter between the Company and Karen Rapp dated March 22, 2017.*
- 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.DEF XBRL Taxonomy Extension Definition 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 Form 10-K for the fiscal year ended December 31, 2013.
- (2) Incorporated by reference to the same-numbered exhibit filed with the Company's Form 10-K for the fiscal year ended December 31, 2007 (File No. 000-25426).
- (3) Incorporated by reference to the same-numbered exhibit filed with the Company's Form 8-A on April 27, 2004 (File No. 000-25426).
- (4) Incorporated by reference to the Company's Form S-1 (Reg. No. 33-88386) declared effective March 13, 1995.

Edgar Filing: NATIONAL INSTRUMENTS CORP - Form 10-Q

- (5) Incorporated by reference to the same-numbered exhibit filed with the Company's Form 10-K for the fiscal year ended December 31, 2016.
 - (6) Incorporated by reference to exhibit A of the Company's Proxy Statement filed on April 4, 2005 (File No. 000-25426).
 - (7) Incorporated by reference to exhibit 10.8 filed with the Company's Form 10-Q on August 2, 2006 (File No. 000-25426).
 - (8) Incorporated by reference to exhibit 10.9 filed with the Company's Form 10-Q on August 2, 2006 (File No. 000-25426).
 - (9) Incorporated by reference to exhibit 10.10 filed with the Company's Form 10-Q on August 2, 2006 (File No. 000-25426).
 - (10) Incorporated by reference to exhibit 10.11 filed with the Company's Form 10-Q on August 2, 2006 (File No. 000-25426).
 - (11) Incorporated by reference to exhibit 10.1 filed with the Company's Form 8-K filed on May 17, 2010 (File No. 000-25426).
 - (12) Incorporated by reference to exhibit 10.2 filed with the Company's Form 8-K filed on June 24, 2010 (File No. 000-25426).
 - (13) Incorporated by reference to exhibit 10.3 filed with the Company's Form 8-K filed on June 24, 2010 (File No. 000-25426).
 - (14) Incorporated by reference to exhibit 10.4 filed with the Company's Form 8-K filed on June 24, 2010 (File No. 000-25426).
 - (15) Incorporated by reference to exhibit 10.5 filed with the Company's Form 8-K filed on June 24, 2010 (File No. 000-25426).
 - (16) Incorporated by reference to exhibit 10.1 filed with the Company's Form 8-K filed on April 25, 2014.
 - (17) Incorporated by reference to exhibit 10.16 filed with the Company's Form 10-K for the fiscal year ended December 31, 2014.
 - (18) Incorporated by reference to exhibit 10.1 filed with the Company's Form 8-K filed on May 13, 2013.
 - (19) Incorporated by reference to exhibit B of the Company's Proxy Statement filed on April 1, 2015.
 - (20) Incorporated by reference to exhibit 10.18 filed with the Company's Form 10-Q filed on July 31, 2015.
 - (21) Incorporated by reference to exhibit 10.19 filed with the Company's Form 10-Q filed on July 31, 2015.
 - (22) Incorporated by reference to exhibit 10.20 filed with the Company's Form 10-Q filed on July 31, 2015.
 - (23) Incorporated by reference to exhibit 10.21 filed with the Company's Form 10-Q filed on July 31, 2015.
 - (24) Incorporated by reference to exhibit 10.22 filed with the Company's Form 10-Q filed on July 31, 2015.
 - (25) Incorporated by reference to exhibit 10.1 filed with the Company's Form 8-K filed on December 16, 2016.
 - (26) Incorporated by reference to exhibit C of the Company's Proxy Statement filed on April 1, 2015.
 - (27) Incorporated by reference to exhibit 10.1 filed with the Company's Form 8-K filed on October 30, 2015.
 - (28) Incorporated by reference to exhibit 10.25 filed with the Company's Form 10-Q filed on May 2, 2016.
 - (29) Incorporated by reference to exhibit 10.26 filed with the Company's Form 10-Q filed on May 2, 2016.
 - (30) Incorporated by reference to exhibit 10.27 filed with the Company's Form 10-Q filed on October 31, 2016.
 - (31) Incorporated by reference to exhibit 10.29 filed with the Company's Form 10-Q filed on May 1, 2017.
- * Management Contract or Compensatory Plan or Arrangement
- † Confidential treatment has been granted for portions of this exhibit. These portions have been omitted and submitted separately with the Securities and Exchange Commission.

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.

Dated: August 1, 2017

NATIONAL INSTRUMENTS CORPORATION

By: /s/ Karen Rapp

Karen Rapp

EVP, Chief Financial Officer

(Principal Financial Officer)