

COGNEX CORP
Form 10-K
February 16, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2016 or

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from _____ to _____.

Commission File Number 001-34218

COGNEX CORPORATION

(Exact name of registrant as specified in its charter)

Massachusetts 04-2713778

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

One Vision Drive

Natick, Massachusetts 01760-2059

(508) 650-3000

(Address, including zip code, and telephone number, including area code, of principal executive offices)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Exchange on Which Registered
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Common Stock, par value \$.002 per share	The NASDAQ Stock Market LLC
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Preferred Stock Purchase Rights	The NASDAQ Stock Market LLC
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Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

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 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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Large accelerated filer Accelerated filer
 Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Aggregate market value of voting stock held by non-affiliates of the registrant as of July 3, 2016: \$3,486,705,000

Common stock, par value \$.002 per share, outstanding as of January 29, 2017: 86,053,044 shares

DOCUMENTS INCORPORATED BY REFERENCE:

The registrant intends to file a Definitive Proxy Statement pursuant to Regulation 14A within 120 days of the end of the fiscal year ended December 31, 2016. Portions of such Proxy Statement are incorporated by reference in Part III of this report.

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 FOR THE YEAR ENDED DECEMBER 31, 2016
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PART I

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the Federal Securities Laws. Readers can identify these forward-looking statements by our use of the words “expects,” “anticipates,” “estimates,” “believes,” “projects,” “intends,” “plans,” “will,” “may,” “shall,” “could,” “should,” and similar words and other statements of sense. Our future results may differ materially from current results and from those projected in the forward-looking statements as a result of known and unknown risks and uncertainties. Readers should pay particular attention to considerations described in the section captioned “Risk Factors,” appearing in Part I - Item 1A of this Annual Report on Form 10-K. We caution readers not to place undue reliance upon any such forward-looking statements, which speak only as of the date made. We disclaim any obligation to subsequently revise forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date such statements are made.

Unless the context otherwise requires, the words “Cognex®,” the “Company,” “we,” “our,” “us,” and “our company” refer to Cognex Corporation and its consolidated subsidiaries.

ITEM 1: BUSINESS

Corporate Profile

Cognex Corporation was incorporated in Massachusetts in 1981. Our corporate headquarters are located at One Vision Drive, Natick, Massachusetts 01760 and our telephone number is (508) 650-3000.

Cognex is a leading worldwide provider of machine vision products that capture and analyze visual information in order to automate tasks, primarily in manufacturing processes, where vision is required. Machine vision products are used to automate the manufacture and tracking of discrete items, such as mobile phones, aspirin bottles, and automobile tires, by locating, identifying, inspecting, and measuring them during the manufacturing or distribution process. Machine vision is important for applications in which human vision is inadequate to meet requirements for size, accuracy, or speed, or in instances where substantial cost savings are obtained through the reduction of labor or improved product quality. Today, many types of manufacturing equipment require machine vision because of the increasing demands for speed and accuracy in manufacturing processes, as well as the decreasing size of items being manufactured.

What is Machine Vision?

Since the beginning of the Industrial Revolution, human vision has played an indispensable role in the process of manufacturing products. Human eyes did what no machines could do themselves: locating and positioning work, tracking the flow of parts, and inspecting output for quality and consistency. Today, however, the requirements of many manufacturing processes have surpassed the limits of human eyesight. Manufactured items often are produced too quickly or with tolerances too small to be analyzed by the human eye. In response to manufacturers’ needs, “machine vision” technology emerged, providing manufacturing equipment with the gift of sight. Machine vision systems were first widely embraced by manufacturers of electronic components who needed this technology to produce computer chips with decreasing geometries. However, advances in technology and ease-of-use, combined with the decreasing cost of implementing vision applications, have made machine vision available to a broader range of users.

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Machine vision products combine cameras with intelligent software to collect images and then answer questions about these images, such as:

Question	Description	Example
GUIDANCE		
Where is it?	Determining the exact physical location and orientation of an object.	Determining the position of a printed circuit board so that a robot can automatically be guided to place electronic components.
IDENTIFICATION		
What is it?	Identifying an object by analyzing its physical appearance or by reading a serial number or symbol.	Reading a two-dimensional barcode directly marked on an automotive airbag so that it can be tracked and processed correctly through manufacturing.
INSPECTION		
How good is it?	Inspecting an object for flaws or defects.	Checking for debris to ensure that foreign objects are not present in a product before shipping to consumers.
GAUGING		
What size is it?	Determining the dimensions of an object.	Determining the diameter of a bearing prior to final assembly.

Machine Vision Market

Cognex machine vision is primarily used in the manufacturing sector, where the technology is widely recognized as an important component of automated production and quality assurance. In this sector, the Company's customers are primarily in the factory automation market. Factory automation customers purchase Cognex vision products and incorporate them into their manufacturing processes. Virtually every manufacturer can achieve better quality and manufacturing efficiency by using machine vision, and therefore, this market includes a broad base of customers across a variety of industries, including consumer electronics, automotive, consumer products, food and beverage, medical devices, and pharmaceuticals. Factory automation customers also purchase Cognex products for use outside of the assembly process, such as using ID products in logistics automation for package sorting and distribution. Sales to factory automation customers represented 96% of total revenue in 2016 compared to 95% of total revenue in 2015. A small percentage of our customers are in the semiconductor and electronics capital equipment market. These customers purchase Cognex vision products and integrate them into the automation equipment that they manufacture and then sell to their customers to either make semiconductor chips or assemble printed circuit boards. Demand from these customers has been relatively flat on an annual basis for the past several years. Sales to semiconductor and electronics capital equipment manufacturers represented only 4% of total revenue in 2016 compared to 5% of total revenue in 2015.

In 2016, 2015, and 2014, direct and indirect revenue from Apple Inc. accounted for 19%, 18%, and 16% of total revenue, respectively. In 2016, reported revenue from this customer included \$7,944,000 related to shipments from prior years for which revenue was deferred until 2016 when revenue recognition criteria were met.

Business Strategy

Our goal is to expand our position as a leading worldwide provider of machine vision products. We are selective in choosing growth opportunities that we believe will maintain our historically high gross margin percentages, which have ranged from the mid-to-high 70s for the past several years and reflect the value our customers place on our innovative products. Our strong and unique corporate culture reinforces our values of customer first and innovation, and enables us to attract and retain smart, highly-educated, experienced talent who are motivated to solve the most challenging vision tasks.

We invest heavily in research and development in order to maintain our position as a technology leader in machine vision. We invest in technology that makes vision easier to use and more affordable, and therefore, available to a broader base of customers, such as our vision sensor products that enable customers with a lower budget to use machine vision without the help of sophisticated engineers. We also invest in technology that addresses the most challenging vision applications, such as our 3D vision products that solve applications where a height or volume measurement is required. We identify large customers with high-volume applications and offer them collaborative

development to deliver solutions to solve their complex vision problems.

We continue to invest in our core markets, such as consumer electronics and automotive, where we are a leading provider of vision and ID products for factory automation, while we seek opportunities to expand into adjacent markets

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for vision, such as logistics, airport baggage handling, mobile terminals, life science, and collaborative robotics. We invest through internal development, as well as the acquisition of businesses and technologies.

We reach a broad base of customers through our worldwide direct sales force that sells to large, strategic customers, as well as through our network of distributors and integrators that sell to smaller customers who may be more geographically remote. We invest in emerging, high-growth regions where many manufacturers can benefit from incorporating machine vision into their production processes. This includes investment in our fast-growing region, China, where rising wages for assembly workers and a greater focus on product quality are driving assembly automation, particularly in the consumer electronics industry.

Acquisitions and Divestitures

Our business strategy includes selective expansion into new machine vision applications and markets through the acquisition of businesses and technologies. In 2016 and 2015, we completed five small business acquisitions, which were not material individually or in the aggregate. The total purchase price for each business ranged from \$2.5 million to \$8 million. In addition to completed technology and customer relationships, these acquisitions included engineering talent expected to help accelerate the development of future products. Management considers business acquisitions to be an important part of our growth strategy, and although we continue to actively seek out acquisition opportunities, we are selective in choosing businesses that we believe will enhance our long-term growth rate and profitability. We plan to continue to seek opportunities to expand our product lines, customer base, distribution network, and technical talent through acquisitions in the machine vision industry.

On July 6, 2015, we completed the sale of our Surface Inspection Systems Division (SISD) to AMETEK, Inc. for \$156 million in cash. The after-tax gain associated with this sale was \$78 million. SISD specialized in machine vision products that inspect the surfaces of materials processed in a continuous fashion. SISD did not meet our long-term objectives and its divestiture was a strategic decision for us. With this sale, we are focusing our efforts on discrete manufacturing where we see the greatest growth potential. The financial results of SISD are reported as a discontinued operation in this Annual Report on Form 10-K and all prior period comparative financial data have been reported excluding SISD.

We had previously reported SISD as one of our two segments. Given the disposition of the SISD segment, management reviewed its segment reporting and concluded that the Company now operates in one segment, machine vision technology. We offer a variety of machine vision products that have similar economic characteristics, have the same production processes, and are distributed by the same sales channels to the same types of customers. Information about segments may be found in Note 18 to the Consolidated Financial Statements, appearing in Part II - Item 8 of this Annual Report on Form 10-K.

Products

Cognex offers a full range of vision and ID products designed to meet customer needs at different performance and price points. Our products range from low-cost vision sensors that are easily integrated, to PC-based systems for users with more experience or more complex requirements. Our products also have a variety of physical forms, depending upon the user's needs. For example, customers can purchase vision software to use with their own camera and processor, or they can purchase a standalone unit that combines camera, processor, and software into a single package.

Vision Software

Vision software provides users with the most flexibility by combining the full general-purpose library of Cognex vision tools with the cameras, frame grabbers, and peripheral equipment of their choice. The vision software may run on the customer's PC, which enables easy integration with PC-based data and controls. Applications based upon Cognex vision software perform a wide range of vision tasks, including part location, identification, measurement, assembly verification, and robotic guidance. Cognex's VisionPro® software offers an extensive suite of patented vision tools for advanced programming, while Cognex Designer allows customers to build complete vision applications with the simplicity of a graphical, flowchart-based programming environment. Cognex also offers a series of displacement sensors that are sold with vision software for use in highly demanding 3D applications.

Vision Systems

Vision systems combine camera, processor, and vision software into a single, rugged package with a simple and flexible user interface for configuring applications. These general-purpose vision systems are designed to be easily

programmed to perform a wide range of vision tasks including part location, identification, measurement, assembly verification, and robotic guidance. Cognex offers the In-Sight[®] product line of vision systems in a wide range of models to meet various price and performance requirements.

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Vision Sensors

Unlike general-purpose vision systems that can be programmed to perform a wide variety of vision tasks, vision sensors are designed to deliver very simple, low-cost, reliable solutions for a limited number of common vision applications such as checking the presence and size of parts. Cognex offers the In-Sight 2000 Series, which combines the power of an In-Sight vision system with the simplicity and affordability of a vision sensor.

ID Products

ID products quickly and reliably read codes (e.g., one-dimensional barcodes or two-dimensional data matrix codes) that have been applied to, or directly marked on, discrete items during the manufacturing process. Manufacturers of goods ranging from automotive parts, pharmaceutical items, aircraft components, and medical devices are increasingly using direct part mark (DPM) identification to ensure that the appropriate manufacturing processes are performed in the correct sequence and on the right parts. In addition, DPM is used to track parts from the beginning of their life to the end, and is also used in supply chain management and repair.

Cognex also offers applications in the automatic identification market outside of the manufacturing sector, such as using ID products in logistics automation for package sorting and distribution. As shipping volumes grow and more retail sales occur through ecommerce, more distribution centers are choosing to upgrade their traditional laser-based scanners to image-based barcode readers, which will cost-effectively increase package sorter efficiency and throughput by improving read rates. Cognex offers the DataMan® product line of barcode readers, which includes both hand-held and fixed-mount models, and barcode verifiers, as well as the MX-1000 Series of vision-enabled Mobile Terminals that allow customers to leverage the latest mobile device technology for industrial barcode reading applications.

Research, Development, and Engineering

Cognex engages in research, development, and engineering (RD&E) to enhance our existing products and to develop new products and functionality to meet market opportunities. In addition to internal research and development efforts, we intend to continue our strategy of gaining access to new technology through strategic relationships and acquisitions where appropriate.

As of December 31, 2016, Cognex employed 387 professionals in RD&E, many of whom are software developers. Cognex's RD&E expenses totaled \$78,269,000 in 2016, \$69,791,000 in 2015, and \$55,831,000 in 2014, or approximately 15%, 15%, and 13% of revenue, respectively. We believe that a continued commitment to RD&E activities is essential in order to maintain or achieve product leadership with our existing products and to provide innovative new product offerings, as well as to provide engineering support for large customers. In addition, we consider our ability to accelerate time-to-market for new products to be critical to our revenue growth. Therefore, we expect to continue to make significant RD&E investments in the future. At any point in time, we have numerous research and development projects underway. Although we target our annual RD&E spending to be between 10% and 15% of total revenue, this percentage is impacted by revenue levels and investing cycles.

Manufacturing and Order Fulfillment

Cognex's products are manufactured utilizing a turnkey operation whereby the majority of component procurement, system assembly, and initial testing are performed by third-party contract manufacturers. Cognex's primary contract manufacturer is located in Indonesia. The contract manufacturers use specified components sourced from a vendor list approved by Cognex and assembly/test documentation created and controlled by Cognex. Certain components are presently sourced from a single vendor that is selected based upon price and performance considerations. In the event of a supply disruption from a single-source vendor, these components may be purchased from an alternative vendor. After the completion of initial testing, a fully assembled product from the contract manufacturers is routed to our facility in Cork, Ireland or Natick, Massachusetts, USA, where trained Cognex personnel load the software onto the product and perform quality control procedures. Finished product for customers in the Americas is then shipped from our Natick, Massachusetts facility, while finished product for customers outside of the Americas is shipped from our Cork, Ireland facility.

Sales Channels and Support Services

Cognex sells its products through a worldwide direct sales force that focuses on the development of strategic accounts that generate or are expected to generate significant sales volume, as well as through a global network of integration

and distribution partners. Our integration partners are experts in vision and complementary technologies that can provide turnkey solutions for complex automation projects using vision, and our distribution partners provide sales and local support to help Cognex reach the many prospects for our products in factories around the world.

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As of December 31, 2016, Cognex's sales force consisted of 540 professionals, and our partner network consisted of 468 active integrators and authorized distributors. Sales engineers call directly on targeted accounts, with the assistance of application engineers, and manage the activities of our partners within their territories in order to provide the most advantageous sales model for our products. The majority of our sales engineers are degreed engineers. Cognex has sales and support personnel located throughout the Americas, Europe, and Asia.

Cognex has sales and support personnel located throughout the Americas, Europe, and Asia.

Sales to customers based outside of the United States represented approximately 74% of total revenue in 2016 compared to approximately 73% of total revenue in 2015. In 2016, approximately 45% of our total revenue came from customers based in Europe, 12% from customers based in Greater China, 6% from customers based in Japan, and 11% from customers based in other regions outside the United States. Sales to customers based in Europe are denominated in Euros and U.S. Dollars, sales to customers based in Greater China are denominated in Yuan for sales within Mainland China and U.S. Dollars in other territories, sales to customers based in Japan are predominantly denominated in Yen, and sales to customers based in other regions are denominated in U.S. Dollars. Financial information about geographic areas may be found in Note 18 to the Consolidated Financial Statements, appearing in Part II - Item 8 of this Annual Report on Form 10-K.

Cognex's service offerings include maintenance and support, consulting, and training services. Maintenance and support programs include hardware support programs that entitle customers to have failed products repaired, as well as software support programs that provide customers with application support and software updates on the latest software releases. Application support is provided by technical support personnel located at Cognex regional offices, as well as by field service engineers that provide support at the customer's production site. We provide consulting services that range from a specific area of functionality to a completely integrated vision application or installed ID application. Training services include a variety of product courses that are available at our offices worldwide, at customer facilities, and on computer-based tutorials, video, and the internet.

Intellectual Property

We rely on the technical expertise, creativity, and knowledge of our personnel, and therefore, we utilize patent, trademark, copyright, and trade secret protection to maintain our competitive position and protect our proprietary rights in our products and technology. While our intellectual property rights are important to our success, we believe that our business as a whole is not materially dependent on any particular patent, trademark, copyright, or other intellectual property right.

As of December 31, 2016, Cognex had been granted, or owned by assignment, 571 patents issued worldwide and had another 415 patent applications pending worldwide. Cognex has used, registered, or applied to register a number of trademark registrations in the United States and in other countries. Cognex's trademark and servicemark portfolio includes various registered marks, including, among others, Cognex[®], VisionPro[®], In-Sight[®], and DataMan[®], as well as many common-law marks.

Compliance with Environmental Provisions

Cognex's capital expenditures, earnings, and competitive position are not materially affected by compliance with federal, state, and local environmental provisions which have been enacted or adopted to regulate the distribution of materials into the environment.

Competition

The machine vision market is fragmented and our competitors are typically other vendors of machine vision systems, controllers, and components; manufacturers of image processing systems, sensors, and components; and system integrators. In addition, in the semiconductor and electronics capital equipment market, and with respect to machine builders in the factory automation market, we compete with the internal engineering departments of current or prospective customers. In the identification and logistics market, we compete with manufacturers of automatic identification systems. Key competitors with a global presence include Keyence Corporation, Sick AG, and Omron Corporation. Any of these competitors may have greater financial and other resources than Cognex. Although we consider Cognex to be one of the leading machine vision companies in the world, reliable estimates of the machine vision market and the number of competitors are not available.

Cognex's ability to compete depends upon our ability to design, manufacture, and sell high-quality products, as well as our ability to develop new products and functionality that meet evolving customer requirements. The primary

competitive factors affecting the choice of a machine vision or ID system include vendor reputation, product functionality and performance, ease of use, price, and post-sales support. The importance of each of these factors varies depending upon the specific customer's needs.

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Backlog

As of December 31, 2016, backlog, which includes deferred revenue, totaled \$39,335,000, compared to \$27,020,000 as of December 31, 2015. Backlog reflects customer purchase orders for products scheduled for shipment primarily within 120 days for customers in the logistics industry and primarily within 60 days for customers in all other industries. The level of backlog at any particular date is not necessarily indicative of future revenue. Delivery schedules may be extended and orders may be canceled at any time subject to certain cancellation penalties.

Employees

As of December 31, 2016, Cognex employed 1,421 persons, including 731 in sales, marketing, and service activities; 387 in research, development, and engineering; 140 in manufacturing and quality assurance; and 163 in information technology, finance, and administration. Of our 1,421 employees, 786 are based outside of the United States. None of our employees are represented by a labor union and we have experienced no work stoppages. We believe that our employee relations are good.

Available Information

Cognex maintains a website on the World Wide Web at www.cognex.com. We make available, free of charge, on our website in the "Company" section under the caption "Investor Information" followed by "Financial Information" and then "SEC Filings," our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, and Current Reports on Form 8-K, including exhibits, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after such reports are electronically filed with, or furnished to, the SEC. Cognex's reports filed with, or furnished to, the SEC are also available at the SEC's website at www.sec.gov. Information contained on our website is not a part of, or incorporated by reference into, this Annual Report on Form 10-K.

ITEM 1A: RISK FACTORS

The risks and uncertainties described below are not the only ones that we face. Additional risks and uncertainties that we are unaware of, or that we currently deem immaterial, also may become important factors that affect our company in the future. If any of these risks were to occur, our business, financial condition, or results of operations could be materially and adversely affected. This section includes or refers to certain forward-looking statements. We refer you to the explanation of the qualifications and limitations on such forward-looking statements, appearing under the heading "Forward-Looking Statements" in Part II - Item 7 of this Annual Report on Form 10-K.

The loss of a large customer could have an adverse effect on our business.

Revenue from a single customer accounted for 19%, 18%, and 16% of total revenue in 2016, 2015, and 2014, respectively. Customers of this size may divert management's attention from other operational matters and pull resources from other areas of the business, resulting in potential loss of revenue from other customers. In addition, customers of this size may receive preferred pricing and a higher level of post-sale support, which may lower our gross margin percentage. Furthermore, we have extended credit terms to this customer, resulting in large expenditures for inventory months in advance of cash collection, as well as large accounts receivable balances denominated in U.S. Dollars on our Irish subsidiary's Euro-denominated books that exposes us to foreign currency gains or losses while these receivables are outstanding. In certain instances due to long supplier lead times, we have purchased inventory in advance of receipt of a customer purchase order, which exposes us to an increased risk of excess or obsolete inventory and resulting charges.

As a large portion of our sales are through resellers however, there may be end customers of our resellers that are large consumers of our products. Furthermore, there may be industry leaders that are able to exert purchasing power over their vendors' supply chains, particularly in the automotive and consumer electronics industries. Our expansion within the factory automation marketplace has reduced our reliance upon the revenue from any one customer. Nevertheless, the loss of, or significant curtailment of purchases by, any one or more of our larger customers could have a material adverse effect on our operating results.

Global economic conditions may negatively impact our operating results.

Our revenue levels are impacted by global economic conditions, as we have a significant business presence in many countries throughout the world. If global economic conditions were to deteriorate, our revenue and our ability to generate operating profits could be materially adversely affected.

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As a result of global economic conditions, our business is subject to the following risks, among others:

- our customers may not have sufficient cash flow or access to financing to purchase our products,
- our customers may not pay us within agreed upon terms or may default on their payments altogether,
- our vendors may be unable to fulfill their delivery obligations to us in a timely manner,
- lower demand for our products may result in charges for excess and obsolete inventory if we are unable to sell inventory that is either already on hand or committed to purchase,
- lower cash flows may result in impairment charges for acquired intangible assets or goodwill,
- a decline in our stock price may make stock options a less attractive form of compensation and a less effective form of retention for our employees, and
- the trading price of our common stock may be volatile.

As of December 31, 2016, the Company had \$745 million in cash and investments. In addition, Cognex has no long-term debt and we do not anticipate needing debt financing in the near future. We believe that our strong cash position puts us in a relatively good position to weather another economic downturn. Nevertheless, our operating results have been materially adversely affected in the past, and could be materially adversely affected in the future, as a result of unfavorable economic conditions and reduced capital spending by manufacturers worldwide.

A downturn in the consumer electronics or automotive industries may adversely affect our business.

In 2016, the largest industries that we served in the factory automation market were the consumer electronics and automotive industries. Our business is impacted by the level of capital spending in these industries, as well as the product design cycles of our major customers in these industries. The market leaders in these industries are able to exert purchasing power over their vendors' supply chains, and our large customers in these industries may decide to purchase fewer products from Cognex or stop purchasing from Cognex altogether. As a result, our operating results could be materially and adversely affected by declining sales in these industries.

Our inability to penetrate new markets may impede our revenue growth.

We are pursuing applications in the automatic identification market outside of the manufacturing sector, such as using ID products in logistics automation for package sorting and distribution. As shipping volumes grow, more distribution centers are choosing to upgrade their traditional laser-based scanners to image-based barcode readers, which will cost-effectively increase package sorter efficiency and throughput by improving read rates. Cognex has introduced image-based barcode readers in order to penetrate the ID logistics market and grow our ID Products business beyond the traditional manufacturing sector that we currently serve. Our growth plan is dependent upon successfully penetrating the ID logistics market and we are making significant investments in this area. Therefore, our failure to generate revenue in this new market in the amounts or within the time periods anticipated may have a material adverse impact on our revenue growth and operating results.

Economic, political, and other risks associated with international sales and operations could adversely affect our business and operating results.

Recent political developments, including the Brexit vote in the U.K. and the presidential election in the U.S., may impact global economic conditions, and in turn, our revenue levels. In 2016, approximately 74% of our revenue was derived from customers located outside of the United States. We anticipate that international sales will continue to account for a significant portion of our revenue. In addition, certain of our products are assembled by third-party contract manufacturers, primarily located in Indonesia. We intend to continue to expand our sales and operations outside of the United States and expand our presence in international emerging markets. As a result, our business is subject to the risks inherent in international sales and operations, including, among other things:

- various regulatory and statutory requirements,
- difficulties in injecting and repatriating cash,
- export and import restrictions,
- transportation delays,
- employment regulations and local labor conditions,
- difficulties in staffing and managing foreign sales operations,
- instability in economic or political conditions,

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difficulties protecting intellectual property,
business systems connectivity issues, and
potentially adverse tax consequences.

Any of these factors could have a material adverse effect on our operating results.

Fluctuations in foreign currency exchange rates and the use of derivative instruments to hedge these exposures could adversely affect our reported results, liquidity, and competitive position.

We face exposure to foreign currency exchange rate fluctuations, as a significant portion of our revenues, expenses, assets, and liabilities are denominated in currencies other than the functional currencies of our subsidiaries or the reporting currency of our company, which is the U.S. Dollar. In certain instances, we utilize forward contracts to hedge against foreign currency fluctuations. These contracts are used to minimize foreign currency gains or losses, as the gains or losses on the derivative are intended to offset the losses or gains on the underlying exposure. We do not engage in foreign currency speculation. If the counterparty to any of our hedging arrangements experiences financial difficulties, or is otherwise unable to honor the terms of the contract, we may experience material losses.

Our foreign currency hedging program includes foreign currency cash flow hedges that protect our budgeted revenues and expenses against foreign currency exchange rate changes compared to our budgeted rates. These derivatives are designated for hedge accounting, and therefore, the effective portion of the forward contract's gain or loss is reported in shareholders' equity as other comprehensive income (loss) and is reclassified into current operations as the hedged transaction impacts current operations. Should these hedges fail to qualify for hedge accounting or be ineffective, the gain or loss on the forward contract would be reported in current operations immediately as opposed to when the hedged transaction impacts current operations. This may result in material foreign currency gains or losses.

The success of our foreign currency risk management program depends upon forecasts of transaction activity denominated in various currencies. To the extent that these forecasts are overstated or understated during periods of currency volatility, we could experience unanticipated foreign currency gains or losses that could have a material impact on our results of operations. Furthermore, our failure to identify new exposures and hedge them in an effective manner may result in material foreign currency gains or losses.

A significant portion of our revenues and expenses are denominated in the Euro, the Japanese Yen, and the Chinese Yuan, also known as Renminbi. Our predominant currency of sale is the U.S. Dollar in the Americas, the Euro and U.S. Dollar in Europe, the Yuan in Mainland China, the Yen in Japan, and the U.S. Dollar in other regions. We estimate that approximately 43% of our sales in 2016 were invoiced in currencies other than the U.S. Dollar, and we expect sales denominated in foreign currencies to continue to represent a significant portion of our total revenue.

While we also have expenses denominated in these same foreign currencies, the impact on revenues has historically been, and is expected to continue to be, greater than the offsetting impact on expenses. Therefore, in times when the U.S. Dollar strengthens in relation to these foreign currencies, we would expect to report a net decrease in operating income. Conversely, in times when the U.S. Dollar weakens in relation to these foreign currencies, we would expect to report a net increase in operating income. Thus, changes in the relative strength of the U.S. Dollar may have a material impact on our operating results.

Information security breaches or business system disruptions may adversely affect our business.

We rely on our information technology infrastructure and management information systems to effectively run our business. We may be subject to information security breaches caused by hacking, malicious software, or acts of vandalism or terrorism. Our security measures or those of our third-party service providers may not detect or prevent such breaches. Any such compromise to our information security could result in theft of our intellectual property, a misappropriation of our cash or other assets, an interruption in our operations, the unauthorized publication of our confidential business or proprietary information, the unauthorized release of customer, vendor, or employee data, the violation of privacy or other laws, and the exposure to litigation, any of which could harm our business and operating results.

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Disruptions with our management information systems may cause significant business disruption. In 2017, we expect to begin work to replace our Enterprise Resource Planning (ERP) system, which is the management information system that integrates our manufacturing, order fulfillment, and financial activities. We expect the new system to be placed into service either late in 2017 or early in 2018. Replacing an ERP system is a significant investment in terms of both time and money, and may divert management's attention from other operational matters. The conversion from the old system to the new system may result in significant business disruption, including our ability to process orders, ship products, invoice customers, process payments, and otherwise run our business. Any disruption occurring with our ERP system, or any of our other management information systems, may have a material adverse effect on our operating results.

Our business could suffer if we lose the services of, or fail to attract, key personnel.

We are highly dependent upon the management and leadership of Robert J. Shillman, our Chairman of the Board of Directors and Chief Culture Officer, and Robert J. Willett, our President and Chief Executive Officer, as well as other members of our senior management team. Although we have many experienced and qualified senior managers, the loss of key personnel could have a material adverse effect on our company. Our continued growth and success also depends upon our ability to attract and retain skilled employees and on the ability of our officers and key employees to effectively manage the growth of our business through the implementation of appropriate management information systems and internal controls.

We have historically used stock options as a key component of our employee compensation program in order to align employee interests with the interests of our shareholders, provide competitive compensation and benefits packages, and encourage employee retention. We are limited as to the number of options that we may grant under our stock option plans. Accordingly, we may find it difficult to attract, retain, and motivate employees, and any such difficulties could materially adversely affect our business.

The failure of a key supplier to deliver quality product in a timely manner or our inability to obtain components for our products could adversely affect our operating results.

A significant portion of our product is manufactured by a third-party contractor located in Indonesia. This contractor has agreed to provide Cognex with termination notification periods and last-time-buy rights, if and when that may be applicable. We rely upon this contractor to provide quality product and meet delivery schedules. We engage in extensive product quality programs and processes, including actively monitoring the performance of our third-party manufacturers; however, we may not detect all product quality issues through these programs and processes.

Certain components are presently sourced from a single vendor that is selected based on price and performance considerations. In the event of a supply disruption from a single-source vendor, these components may be purchased from an alternative vendor, which may result in manufacturing delays based on the lead time of the new vendor.

Certain key electronic and mechanical components that are purchased from strategic suppliers, such as processors or imagers, are fundamental to the design of Cognex products. A disruption in the supply of these key components, such as a last-time-buy announcement, natural disaster, financial bankruptcy, or other event, may require us to purchase a significant amount of inventory at unfavorable prices resulting in lower gross margins and higher risk of carrying excess inventory.

We are subject to the requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act that obligates companies to inquire into the origin of conflict minerals in their supply chains. We are working with our supply chain partners to take reasonable steps to assure conflict minerals are not sourced by Cognex or our supply chain partners. These steps may include purchasing supply from alternative vendors. If we are unable to secure adequate supply from alternative vendors, we may have to redesign our products, which may lead to a delay in manufacturing and a possible loss of sales. Although we are taking certain actions to mitigate supply risk, an interruption in, termination of, or material change in the purchase terms of any key components could have a material adverse effect on our operating results.

Our failure to effectively manage product transitions or accurately forecast customer demand could result in excess or obsolete inventory and resulting charges.

Because the market for our products is characterized by rapid technological advances, we frequently introduce new products with improved ease-of-use, improved hardware performance, additional software features and functionality,

or lower cost that may replace existing products. Among the risks associated with the introduction of new products are difficulty predicting customer demand and effectively managing inventory levels to ensure adequate supply of the new product and avoid excess supply of the legacy product.

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We may strategically enter into non-cancelable commitments with vendors to purchase materials for our products in advance of demand to take advantage of favorable pricing or address concerns about the availability of future supplies or long lead times. This practice may expose us to an increased risk of excess or obsolete inventory and resulting charges if actual demand is lower than anticipated. Our failure to effectively manage product transitions or accurately forecast customer demand, in terms of both volume and configuration, has led to, and may again in the future lead to, an increased risk of excess or obsolete inventory and resulting charges.

Our products may contain design or manufacturing defects, which could result in reduced demand, significant delays, or substantial costs.

If flaws in either the design or manufacture of our products were to occur, we could experience a rate of failure in our products that could result in significant delays in shipment and material repair or replacement costs. Our release-to-market process may not be robust enough to detect significant design flaws or software bugs. While we engage in extensive product quality programs and processes, including actively monitoring and evaluating the quality of our component suppliers and contract manufacturers, these actions may not be sufficient to avoid a product failure rate that results in:

- substantial delays in shipment,
- significant repair or replacement costs,
- product liability claims or lawsuits, or
- potential damage to our reputation.

Any of these results could have a material adverse effect on our operating results.

Our failure to introduce new products in a successful and timely manner could result in the loss of our market share and a decrease in our revenues and profits.

The market for our products is characterized by rapidly changing technology. Accordingly, we believe that our future success will depend upon our ability to accelerate time-to-market for new products with improved functionality, ease-of-use, performance, or price. There can be no assurance that we will be able to introduce new products in accordance with scheduled release dates or that new products will achieve market acceptance. Our ability to keep pace with the rapid rate of technological change in the high-technology marketplace could have a material adverse effect on our operating results.

Product development is often a complex, time-consuming, and costly process involving significant investment in research and development with no assurance of return on investment. Our strong balance sheet allows us to continue to make significant investments in research, development, and marketing for new products and technologies. Research is by its nature speculative and the ultimate commercial success of a product depends upon various factors, many of which are not under our control. We may not achieve significant revenue from new product investments for a number of years, if at all. Moreover, new products may not generate the operating margins that we have experienced historically.

Our failure to properly manage the distribution of our products and services could result in the loss of revenues and profits.

We utilize a direct sales force, as well as a network of integration and distribution partners, to sell our products and services. Successfully managing the interaction of our direct and indirect sales channels to reach various potential customers for our products and services is a complex process. In addition, our reliance upon indirect selling methods may reduce visibility to demand and pricing issues. Each sales channel has distinct risks and costs, and therefore, our failure to implement the most advantageous balance in the sales model for our products and services could adversely affect our revenue and profitability.

If we fail to successfully protect our intellectual property, our competitive position and operating results could suffer. We rely on our proprietary software technology and hardware designs, as well as the technical expertise, creativity, and knowledge of our personnel to maintain our position as a leading provider of machine vision products. Software piracy and reverse engineering, specifically from companies in Russia and Asia, may result in counterfeit products that are misrepresented in the market as Cognex products. Although we use a variety of methods to protect our intellectual property, we rely most heavily on patent, trademark, copyright, and trade secret protection, as well as non-disclosure agreements with customers, suppliers, employees, and consultants. We also attempt to protect our

intellectual property by restricting access to our proprietary information by a combination of technical and internal security measures. These measures, however, may not be adequate to:
protect our proprietary technology,

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- protect our patents from challenge, invalidation, or circumvention, or ensure that our intellectual property will provide us with competitive advantages.

Any of these adverse circumstances could have a material adverse effect on our operating results.

Our Company may be subject to time-consuming and costly litigation.

From time to time, we may be subject to various claims and lawsuits by competitors, customers, or other parties arising in the ordinary course of business, including lawsuits charging patent infringement, or claims and lawsuits instituted by us to protect our intellectual property or for other reasons. We may be a party to actions that are described in the section captioned "Legal Proceedings," appearing in Part I - Item 3 of this Annual Report on Form 10-K. These matters can be time-consuming, divert management's attention and resources, and cause us to incur significant expenses. Furthermore, the results of any of these actions may have a material adverse effect on our operating results.

Increased competition may result in decreased demand or prices for our products and services.

The machine vision market is fragmented and Cognex's competitors are typically other vendors of machine vision systems, controllers, and components; manufacturers of image processing systems, sensors, and components; and system integrators. Any of these competitors may have greater financial and other resources than we do. Ease-of-use and product price are significant competitive factors in the factory automation marketplace. We may not be able to compete successfully in the future and our investments in research and development, sales and marketing, and support activities may be insufficient to enable us to maintain our competitive advantage. In addition, competitive pressures could lead to price erosion that could have a material adverse effect on our gross margins and operating results. We refer you to the section captioned "Competition," appearing in Part I - Item 1 of this Annual Report on Form 10-K for further information regarding the competition that we face.

Implementation of our acquisition strategy may not be successful, which could affect our ability to increase our revenue or profitability and result in the impairment of acquired intangible assets.

We have in the past acquired, and will in the future consider the acquisition of, businesses and technologies in the machine vision industry. Our business may be negatively impacted by risks related to those acquisitions. These risks include, among others:

- the inability to find or close attractive acquisition opportunities,
- the diversion of management's attention from other operational matters,
- the inability to realize expected synergies resulting from the acquisition,
- difficulties or delays in integrating the personnel, operations, technologies, products and systems of acquired businesses,
- the failure to retain key customers or employees, and
- the impairment of acquired intangible assets resulting from lower-than-expected cash flows from the acquired assets.

Acquisitions are inherently risky and the inability to effectively manage these risks could have a material adverse effect on our operating results.

We are at risk for impairment charges with respect to our investments or for acquired intangible assets or goodwill, which could have a material adverse effect on our results of operations.

As of December 31, 2016, our investment portfolio of debt securities totaled \$666 million. These debt securities are reported at fair value, with unrealized gains and losses, net of tax, recorded in shareholders' equity as other comprehensive income (loss) since these securities are designated as available-for-sale securities. As of December 31, 2016, our portfolio of debt securities had a net unrealized gain of \$65,000. Included in this net gain, were gross unrealized losses totaling \$848,000, of which \$814,000 were in a loss position for less than twelve months and \$34,000 were in a loss position for greater than twelve months. As of December 31, 2016, these unrealized losses were determined to be temporary. However, if conditions change and future unrealized losses were determined to be other-than-temporary, we would be required to record an impairment charge.

Management monitors the carrying value of its debt securities compared to their fair value to determine whether an other-than-temporary impairment has occurred. In considering whether a decline in fair value is other-than-temporary, we consider many factors, both qualitative and quantitative. Management considers the type of security, the credit

rating of the security, the length of time the security has been in a loss position, the size of the loss position, our ability and intent to hold the security to expected recovery of value, and other meaningful information. If a decline in fair value is determined to be other-than-temporary, an impairment charge would be recorded in current operations to

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reduce the carrying value of the investment to its fair value. Should the fair value of investments decline in future periods below their carrying value, management will need to determine whether this decline is other-than-temporary and future impairment charges may be required.

As of December 31, 2016, we had \$95 million in acquired goodwill. The fair value of goodwill is susceptible to changes in the fair value of the reporting segment in which the goodwill resides, and therefore, a decline in our market capitalization or cash flows relative to our net book value may result in future impairment charges.

As of December 31, 2016, we had \$8 million in acquired intangible assets, consisting primarily of acquired completed technologies and customer relationships. These assets are susceptible to changes in fair value due to a decrease in the historical or projected cash flows from the use of the asset, which may be negatively impacted by economic trends. A decline in the cash flows generated by these assets, such as the revenue we are able to generate through our distribution network, may result in future impairment charges.

If we determine that any of these investments, goodwill, or intangible assets is impaired, we would be required to take a related charge to earnings that could have a material adverse effect on our results of operations.

We may have additional tax liabilities, which could adversely affect our operating results and financial condition.

We are subject to income taxes in the United States, as well as numerous foreign jurisdictions. Significant judgment is required in determining our worldwide provision for income taxes. In the ordinary course of business, there are many transactions and calculations where the ultimate tax determination is uncertain. We are regularly under audit by tax authorities. Although we believe our tax positions are reasonable, the final determination of tax audits and any related litigation could be materially different than that which is reflected in our financial statements and could have a material adverse effect on our income tax provision, net income, or cash flows in the period in which the determination is made.

ITEM 1B: UNRESOLVED STAFF COMMENTS

None

ITEM 2: PROPERTIES

In 1994, Cognex purchased and renovated a 100,000 square-foot building located in Natick, Massachusetts that serves as our corporate headquarters and is occupied by employees primarily in research, development and engineering, manufacturing and quality assurance, and information technology, finance and administration functions. In 1997, Cognex completed construction of a 50,000 square-foot addition to this building.

In 1995, Cognex purchased an 83,000 square-foot office building adjacent to our corporate headquarters that is partially occupied by employees primarily in sales, marketing, and service functions. The remainder of this building is occupied by a tenant who has a lease agreement that expires in 2021.

In 1997, Cognex purchased a three and one-half acre parcel of land adjacent to our corporate headquarters. This land is being held for future expansion.

In 2007, Cognex purchased a 19,000 square-foot building adjacent to our corporate headquarters. A portion of this facility serves as the distribution center for customers in the Americas. The remainder of this building is occupied by a tenant who has a lease agreement that expires in 2017 with a renewal option to extend the lease for five additional years.

In 2014, Cognex purchased the 50,000 square foot building in Cork, Ireland where we had previously leased space for several years. This facility serves as the distribution center for customers outside of the Americas.

Cognex conducts certain of its operations in leased facilities. These lease agreements expire at various dates through 2024. Certain of these leases contain renewal options, retirement obligations, escalation clauses, rent holidays, and leasehold improvement incentives.

ITEM 3: LEGAL PROCEEDINGS

Various claims and legal proceedings generally incidental to the normal course of business are pending or threatened on behalf of or against the Company. While we cannot predict the outcome of these matters, we believe that any liability arising from them will not have a material adverse effect on our financial position, liquidity, or results of operations.

ITEM 4: MINE SAFETY DISCLOSURES

Not applicable.

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ITEM 4A: EXECUTIVE OFFICERS OF THE REGISTRANT

The following table sets forth the names, ages, and titles of Cognex's executive officers as of December 31, 2016:

Name	Age	Title
Robert J. Shillman	70	Chairman of the Board of Directors and Chief Culture Officer
Robert J. Willett	49	President and Chief Executive Officer
Richard A. Morin	67	Executive Vice President of Finance and Administration and Chief Financial Officer

Executive officers are elected annually by the Board of Directors. There are no family relationships among the directors and executive officers of the Company.

Dr. Shillman, Mr. Willett, and Mr. Morin have been employed by Cognex for no less than the past five years.

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PART II

ITEM 5: MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

The Company's common stock is traded on The NASDAQ Stock Market LLC, under the symbol CGNX. As of January 29, 2017, there were approximately 725 shareholders of record of the Company's common stock. The Company believes the number of beneficial owners of the Company's common stock on that date was substantially greater.

The high and low sales prices of the Company's common stock as reported by the NASDAQ Stock Market for each quarter in 2016 and 2015 were as follows:

	First	Second	Third	Fourth
2016				
High	\$41.58	\$45.23	\$53.46	\$65.95
Low	28.01	35.15	41.93	49.68
2015				
High	\$50.57	\$52.48	\$48.56	\$38.06
Low	36.12	44.84	32.35	32.40

The Company's Board of Directors declared and paid cash dividends of \$0.07 per share in the second, third, and fourth quarters of 2015, as well as in the first quarter of 2016. The dividend was increased to \$0.075 per share in the second, third, and fourth quarters of 2016. The cash dividend in the second quarter of 2015 was the first dividend declared and paid since the fourth quarter of 2012 when the Company's Board of Directors accelerated dividends in advance of an increase in the federal tax on dividends paid after December 31, 2012. Future dividends will be declared at the discretion of the Company's Board of Directors and will depend upon such factors as the Board deems relevant, including, among other things, the Company's ability to generate positive cash flow from operations.

In November 2015, the Company's Board of Directors authorized the repurchase of \$100,000,000 of the Company's common stock. Purchases under this program began in the third quarter of 2016 when the prior program was completed. During the fourth quarter of 2016, the Company repurchased 480,000 shares at a cost of \$28,208,000 under this program. The Company may repurchase shares under this program in future periods depending on a variety of factors, including, among other things, the impact of dilution from employee stock options, stock price, share availability, and cash requirements.

The following table sets forth information with respect to purchases by the Company of shares of its common stock during the fourth quarter of 2016:

	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
October 3 - October 30, 2016	—	—	—	\$ 97,123,000
October 31 - November 27, 2016	210,000	55.43	210,000	85,481,000
November 28 - December 31, 2016	270,000	61.35	270,000	68,915,000
Total	480,000	58.76	480,000	\$ 68,915,000

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Set forth below is a line graph comparing the annual percentage change in the cumulative total shareholder return on the Company’s common stock, based upon the market price of the Company’s common stock, with the total return on companies within the Nasdaq Composite Index and the Research Data Group, Inc. Nasdaq Lab Apparatus & Analytical, Optical, Measuring & Controlling Instrument (SIC 3820-3829 US Companies) Index (the “Nasdaq Lab Apparatus Index”). The performance graph assumes an investment of \$100 in each of the Company and the two indices, and the reinvestment of any dividends. The historical information set forth below is not necessarily indicative of future performance. Data for the Nasdaq Composite Index and the Nasdaq Lab Apparatus Index was provided to the Company by Research Data Group, Inc.

*\$100 invested on 12/31/2011 in stock or index, including reinvestment of dividends. Fiscal year ended December 31.

	12/11	12/12	12/13	12/14	12/15	12/16
Cognex Corporation	100.00	107.14	222.37	240.72	197.74	374.87
NASDAQ Composite	100.00	116.41	165.47	188.69	200.32	216.54
NASDAQ Stocks (SIC 3820-3829 U.S. Companies) Lab Apparatus & Analyt,Opt, Measuring, and Controlling Instr	100.00	123.10	172.11	206.60	206.13	213.94

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ITEM 6: SELECTED FINANCIAL DATA

Year Ended December 31,
2016 2015 2014 2013 2012
(In thousands, except per share amounts)

Statement of Operations Data:

Revenue	\$520,753	\$450,557	\$426,449	\$307,651	\$273,696
Cost of revenue (1)	115,590	102,571	94,067	62,889	56,161
Gross margin	405,163	347,986	332,382	244,762	217,535
Research, development, and engineering expenses (1)	78,269	69,791	55,831	44,315	37,975
Selling, general, and administrative expenses (1)	166,110	156,674	148,699	123,509	108,670
Operating income	160,784	121,521	127,852	76,938	70,890
Non-operating income	8,011	5,441	3,904	1,518	3,223
Income from continuing operations before income tax expense	168,795	126,962	131,756	78,456	74,113
Income tax expense on continuing operations	18,968	19,298	20,915	11,273	14,386
Net income from continuing operations	149,827	107,664	110,841	67,183	59,727
Net income (loss) from discontinued operations (1)	(255)	79,410	10,644	6,390	8,371
Net income	\$149,572	\$187,074	\$121,485	\$73,573	\$68,098

Basic earnings per weighted-average common and common-equivalent share (2):

Net income from continuing operations	\$1.76	\$1.25	\$1.28	\$0.77	\$0.70
Net income (loss) from discontinued operations	\$(0.01)	\$0.92	\$0.12	\$0.08	\$0.09
Net income	\$1.75	\$2.17	\$1.40	\$0.85	\$0.79

Diluted earnings per weighted-average common and common-equivalent share (2):

Net income from continuing operations	\$1.72	\$1.22	\$1.24	\$0.76	\$0.68
Net income (loss) from discontinued operations	\$—	\$0.91	\$0.12	\$0.07	\$0.10
Net income	\$1.72	\$2.13	\$1.36	\$0.83	\$0.78

Weighted-average common and common-equivalent shares outstanding (2):

Basic	85,338	86,296	86,858	86,946	85,666
Diluted	87,072	87,991	89,071	88,901	87,280

Cash dividends per common share (2)	\$0.30	\$0.21	\$—	\$—	\$0.77
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(1) Amounts include stock-based compensation expense, as follows:

Cost of revenue	\$1,052	\$1,515	\$1,116	\$820	\$637
Research, development, and engineering	6,271	5,194	3,709	2,502	2,107
Selling, general, and administrative	13,235	13,032	9,234	6,461	5,216
Discontinued operations	—	1,533	1,099	837	560
Total stock-based compensation expense	\$20,558	\$21,274	\$15,158	\$10,620	\$8,520

(2) Prior period results have been adjusted to reflect the two-for-one stock split effected in the form of a stock dividend which occurred in 2013.

December 31,
2016 2015 2014 2013 2012

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(In thousands)

Balance Sheet Data:

Working capital	\$460,571	\$390,806	\$182,252	\$270,549	\$190,761
Total assets	1,038,604	887,756	821,734	709,699	627,605
Shareholders' equity	962,599	825,667	736,437	643,912	572,285

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ITEM 7: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

Certain statements made in this report, as well as oral statements made by the Company from time to time, constitute 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. Readers can identify these forward-looking statements by our use of the words "expects," "anticipates," "estimates," "believes," "projects," "intends," "plans," "will," "may," "could," "should," and similar words and other statements of a similar sense. These statements are based upon our current estimates and expectations as to prospective events and circumstances, which may or may not be in our control and as to which there can be no firm assurances given. These forward-looking statements, which include statements regarding business and market trends, future financial performance, customer order rates, expected areas of growth, emerging markets, future product mix, research and development activities, investments, and strategic plans, involve known and unknown risks and uncertainties that could cause actual results to differ materially from those projected. Such risks and uncertainties include: (1) the loss of a large customer; (2) current and future conditions in the global economy; (3) the reliance on revenue from the consumer electronics or automotive industries; (4) the inability to penetrate new markets; (5) the inability to achieve significant international revenue; (6) fluctuations in foreign currency exchange rates and the use of derivative instruments; (7) information security breaches or business system disruptions; (8) the inability to attract and retain skilled employees; (9) the reliance upon key suppliers to manufacture and deliver critical components for our products; (10) the failure to effectively manage product transitions or accurately forecast customer demand; (11) the inability to design and manufacture high-quality products; (12) the technological obsolescence of current products and the inability to develop new products; (13) the failure to properly manage the distribution of products and services; (14) the inability to protect our proprietary technology and intellectual property; (15) our involvement in time-consuming and costly litigation; (16) the impact of competitive pressures; (17) the challenges in integrating and achieving expected results from acquired businesses; (18) potential impairment charges with respect to our investments or for acquired intangible assets or goodwill; and (19) exposure to additional tax liabilities. The foregoing list should not be construed as exhaustive and we encourage readers to refer to the detailed discussion of risk factors included in Part I - Item 1A of this Annual Report on Form 10-K. The Company cautions readers not to place undue reliance upon any such forward-looking statements, which speak only as of the date made. The Company disclaims any obligation to subsequently revise forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date such statements are made.

EXECUTIVE OVERVIEW

Cognex Corporation is a leading worldwide provider of machine vision products that capture and analyze visual information in order to automate tasks, primarily in manufacturing processes, where vision is required. On July 6, 2015, the Company completed the sale of its Surface Inspection Systems Division (SISD) that specialized in machine vision products that inspect the surfaces of materials processed in a continuous fashion. The financial results of SISD are reported as a discontinued operation for all periods presented.

In addition to product revenue derived from the sale of machine vision products, the Company also generates revenue by providing maintenance and support, consulting, and training services to its customers; however, service revenue accounted for less than 10% of total revenue for all periods presented.

The Company's customers are predominantly in the factory automation market. Factory automation customers purchase Cognex products and incorporate them into their manufacturing processes. Customers in the consumer electronics and automotive industries contribute the largest percentage to the Company's factory automation revenue. Virtually every manufacturer can achieve better quality and manufacturing efficiency by using machine vision, and therefore, this market also includes a broad base of customers across a variety of other industries, including consumer products, food and beverage, medical devices, and pharmaceuticals. Factory automation customers also purchase Cognex products for use outside of the manufacturing process, such as using ID products in logistics automation for package sorting and distribution. Sales to factory automation customers represented 96% of total revenue in 2016 compared to 95% of total revenue in 2015.

A small percentage of the Company's customers are in the semiconductor and electronics capital equipment market. These customers purchase Cognex products and integrate them into the automation equipment that they manufacture and then sell to their customers to either make semiconductor chips or assemble printed circuit boards. Demand from these customers has been relatively flat on an annual basis for the past several years. Sales to semiconductor and electronics capital equipment manufacturers represented only 4% of total revenue in 2016 compared to 5% of total revenue in 2015.

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Revenue for the year ended December 31, 2016 totaled \$520,753,000, representing an increase of \$70,196,000, or 16%, from the prior year. Revenue increased from 2015 in all major regions across a variety of industries, including the consumer electronics, automotive, and logistics industries. Gross margin was 78% of revenue in 2016 compared to 77% of revenue in 2015. Operating expenses increased by \$17,914,000, or 8%, from the prior year due to higher incentive compensation plan accruals and higher personnel-related costs resulting primarily from headcount additions. Operating income was \$160,784,000, or 31% of revenue, in 2016 compared to \$121,521,000, or 27% of revenue, in 2015; net income from continuing operations was \$149,827,000, or 29% of revenue, in 2016 compared to \$107,664,000, or 24% of revenue, in 2015; and net income from continuing operations per diluted share was \$1.72 in 2016 compared to \$1.22 in 2015.

The following table sets forth certain consolidated financial data for continuing operations as a percentage of revenue:

	Year Ended		
	December 31,		
	2016	2015	2014
Revenue	100%	100%	100%
Cost of revenue	22	23	22
Gross margin	78	77	78
Research, development, and engineering expenses	15	15	13
Selling, general, and administrative expenses	32	35	35
Operating income	31	27	30
Non-operating income	1	1	1
Income from continuing operations before income tax expense	32	28	31
Income tax expense on continuing operations	3	4	5
Net income from continuing operations	29 %	24 %	26 %

RESULTS OF OPERATIONS

As foreign currency exchange rates are a factor in understanding period-to-period comparisons, we believe the presentation of results on a constant-currency basis in addition to reported results helps improve investors' ability to understand our operating results and evaluate our performance in comparison to prior periods. We also use results on a constant-currency basis as one measure to evaluate our performance. Constant-currency information compares results between periods as if exchange rates had remained constant period-over-period. We generally refer to such amounts calculated on a constant-currency basis as excluding the impact of foreign currency exchange rate changes. Results on a constant-currency basis are not in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) and should be considered in addition to, and not as a substitute for, results prepared in accordance with U.S. GAAP.

Year Ended December 31, 2016 Compared to Year Ended December 31, 2015**Revenue**

Revenue for the year ended December 31, 2016 increased by \$70,196,000, or 16%, from the prior year. Changes in foreign currency exchange rates did not have a material impact on revenue. Revenue from factory automation customers increased by \$70,737,000, or 17%, while revenue from semiconductor and electronics capital equipment manufacturers, which represented only 4% of revenue in 2016 and 5% of revenue in 2015, decreased by \$541,000, or 2%, from the prior year.

The increase in factory automation revenue was due in part to higher revenue from a material customer in the consumer electronics industry. Revenue from all other factory automation customers increased from the prior year by 15% due to a higher volume of machine vision products sold. This increase from all other factory automation customers came from all major regions, including a 12% increase from customers based in the Americas, a 17% increase from customers based in Europe, and a 19% increase from customers based in Asia.

Gross Margin

Gross margin as a percentage of revenue was 78% in 2016 compared to 77% in 2015. The increase in gross margin was due primarily to the favorable impact of material cost reductions and volume purchasing, as well as manufacturing efficiencies achieved from a higher revenue level as fixed manufacturing costs were spread over a larger revenue base. These increases were partially offset by a trend toward higher hardware content in our product sales as we

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move away from software-only solutions, higher inventory charges, and an increased level of projects in the logistics industry that require installation services with lower margins.

Operating Expenses

Research, Development, and Engineering Expenses

Research, development, and engineering (RD&E) expenses in 2016 increased by \$8,478,000, or 12%, from the prior year as detailed in the table below (in thousands).

RD&E expenses in 2015	\$69,791
Personnel-related costs	3,615
Incentive compensation plans	3,014
Stock-based compensation expense	1,067
Other	782
RD&E expenses in 2016	\$78,269

RD&E expenses increased due to higher personnel-related costs resulting primarily from headcount additions to support new product initiatives and the higher business level. These headcount additions included engineering talent from four business acquisitions completed in the last few months of 2016 that are expected to help accelerate the development of future products. In addition, higher incentive compensation plan accruals were recorded in 2016 as a result of higher achievement levels based upon the Company's performance. Stock-based compensation expense was also higher than the prior year.

RD&E expenses as a percentage of revenue were 15% in both 2016 and 2015. We believe that a continued commitment to RD&E activities is essential in order to maintain or achieve product leadership with our existing products and to provide innovative new product offerings, as well as to provide engineering support for large customers. In addition, we consider our ability to accelerate time to market for new products to be critical to our revenue growth. Therefore, we expect to continue to make significant RD&E investments in the future, and we target our annual RD&E spending to be between 10% and 15% of revenue. This percentage is impacted by revenue levels and investing cycles.

Selling, General, and Administrative Expenses

Selling, general, and administrative (SG&A) expenses in 2016 increased by \$9,436,000, or 6%, from the prior year as detailed in the table below (in thousands).

SG&A expenses in 2015	\$156,674
Incentive compensation plans	6,388
Personnel-related costs	4,232
Sales demonstration equipment	1,159
Depreciation expense	1,500
Microscan legal fees and settlement	(5,023)
Other	1,180
SG&A expenses in 2016	\$166,110

SG&A expenses increased due to higher incentive compensation plan accruals, including sales commission plans and bonus plans as a result of higher achievement levels based upon the Company's performance. In addition, personnel-related costs were higher in 2016 resulting from headcount additions, principally sales personnel. The Company also increased its spending on sales demonstration equipment related to new products and incurred higher depreciation expense related primarily to information technology and facilities investments. Offsetting these increases was the settlement of patent litigation actions with Microscan Systems, Inc. in 2015. The company recorded legal fees of \$3,190,000 and a settlement expense of \$1,833,000 related to these actions in 2015.

Non-operating Income (Expense)

The Company recorded foreign currency gains of \$101,000 in 2016 and \$1,122,000 in 2015. The foreign currency gains in each period resulted primarily from the revaluation and settlement of accounts receivable, accounts payable, and intercompany balances that are reported in one currency and collected in another.

Investment income increased by \$3,365,000, or 92%, from the prior year. In 2016, the Company received \$2,257,000 in cash distributions from its limited partnership investment, of which \$942,000 was accounted for as a return of

capital, reducing the carrying value of this investment to zero, with the remaining \$1,315,000 recorded as investment income. As of December 31, 2016, the fair value of this investment was approximately \$5,700,000. Future distributions will

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be recorded as investment income as they occur. The remaining increase in investment income was due to increased funds available for investment, as well as higher yields on the Company's portfolio of debt securities.

The Company recorded other income of \$871,000 in 2016 and \$645,000 in 2015. Other income included a benefit of \$463,000 in 2016 and \$790,000 in 2015 resulting from a decrease in the fair value of the contingent consideration liability that arose from a 2015 business acquisition (refer to Note 20 to the Consolidated Financial Statements in Part II - Item 8 of this Annual Report on Form 10-K for further information). Other income also included a foreign government subsidy of \$422,000 in 2016 and \$268,000 in 2015. In addition, other income (expense) included rental income, net of associated expenses, from leasing space in buildings adjacent to the Company's corporate headquarters. Rental expenses declined from the prior year, while rental income was relatively flat.

Income Tax Expense

The Company's effective tax rate was 11% of the Company's pre-tax income in 2016 compared to 15% in 2015.

The effective tax rate for 2016 included a decrease in tax expense of \$11,889,000 from the excess tax benefit arising from the difference between the deduction for tax purposes and the compensation cost recognized for financial reporting purposes from stock option exercises. In 2016, the Company adopted Accounting Standards Update 2016-09, "Improvements to Employee Share-Based Payment Accounting," which was issued by the Financial Accounting Standards Board in March 2016. This Update requires excess tax benefits to be recognized as income tax benefit in the income statement. Previous guidance required excess tax benefits to be recognized as additional paid-in-capital in shareholders' equity on the balance sheet. The effective tax rate for 2016 also included the impact of the following additional discrete tax events: (1) a decrease in tax expense of \$893,000 from the expiration of the statutes of limitations for certain reserves for income tax uncertainties, (2) a decrease in tax expense of \$439,000 from the final true-up of the prior-year's tax accrual upon filing the actual tax returns, (3) an increase in tax expense of \$547,000 from a 5% withholding tax triggered by the movement of intellectual property purchased as part of a foreign business acquisition, and (4) an increase in tax expense of \$1,260,000 from the write-off of a deferred tax asset related to foreign branches resulting from an IRS rule change.

The effective tax rate for 2015 included the impact of the following discrete tax events: (1) a decrease in tax expense of \$1,105,000 from the final true-up of the prior year's tax accrual upon filing the actual tax returns, (2) a decrease in tax expense of \$975,000 from the expiration of statutes of limitations for certain reserves for income tax uncertainties, (3) a decrease in tax expense, net of reserves, of \$910,000 from the retroactive application of the 2015 research and development tax credit passed by Congress in December 2015 and applied retroactively to January 1, 2015, and (4) an increase in tax expense of \$65,000 from the write down of a deferred tax asset.

Excluding the impact of these discrete tax events, the Company's effective tax rate was 18% in both 2016 and 2015.

The majority of income earned outside of the United States is permanently reinvested to provide funds for international expansion. The Company is tax resident in numerous jurisdictions around the world and has identified its major tax jurisdictions as the United States, Ireland and China. The statutory tax rate is 12.5% in Ireland and 25% in China, compared to the U.S. federal statutory corporate tax rate of 35%. International rights to certain of the Company's intellectual property are held by a subsidiary whose legal jurisdiction does not tax this income, resulting in a foreign effective tax rate lower than the above mentioned statutory rates.

Discontinued Operations

On July 6, 2015, the Company completed the sale of its Surface Inspection Systems Division (SISD) that specialized in machine vision products that inspect the surfaces of materials processed in a continuous fashion. The financial results of SISD are reported as a discontinued operation for all periods presented. Net loss from discontinued operations was \$255,000 in 2016 compared to net income of \$79,410,000 in 2015. Net income in 2015 included a gain on the sale of SISD, net of tax, of \$78,182,000. Refer to Note 19 to the Consolidated Financial Statements in Part II - Item 8 of this Annual Report on Form 10-K for further information.

A binding arbitration was concluded in the second quarter of 2016 with respect to certain product performance claims made by an SISD customer, for which the Company remained responsible under the indemnity provisions of the sale transaction. In that proceeding, the tribunal ordered the Company to pay the customer approximately \$326,000, primarily representing a refund of the product purchase price. The tribunal also ordered the customer to pay the Company approximately \$45,000, primarily representing reimbursement of legal fees. The net settlement of \$281,000

was recorded in discontinued operations in the second quarter of 2016, along with \$123,000 of legal fees. The tax benefit related to this expense was \$149,000, resulting in a net loss from discontinued operations of \$255,000.

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Year Ended December 31, 2015 Compared to Year Ended December 31, 2014

Revenue

Revenue for the year ended December 31, 2015 increased by \$24,108,000, or 6%, from the prior year. Excluding the impact of foreign currency exchange rate changes, revenue increased by \$46,718,000, or 11%, as sales denominated in foreign currencies, primarily the Euro and Japanese Yen, were translated into U.S. Dollars at a lower rate. Revenue from factory automation customers increased by \$48,682,000, or 12%, on a constant-currency basis due primarily to a higher volume of machine vision products sold, with the highest growth coming from Greater China and Europe. Factory automation revenue in the Americas was relatively flat. Revenue from semiconductor and electronics capital equipment manufacturers decreased by \$1,964,000, or 7%, on a constant-currency basis from the prior year, with the majority of the decline coming from Japan.

Gross Margin

Gross margin as a percentage of revenue was 77% in 2015 compared to 78% in 2014. Changes in foreign currency exchange rates had a negative impact on gross margin, as a significant amount of revenue is denominated in Euros while inventories are predominantly purchased in U.S. Dollars. A shift in revenue mix to relatively-lower margin products and services also had a negative impact on gross margin. These gross margin decreases were partially offset by lower inventory charges in 2015 as compared to 2014.

Operating Expenses

Research, Development, and Engineering Expenses

Research, development, and engineering (RD&E) expenses in 2015 increased by \$13,960,000, or 25%, from the prior year as detailed in the table below (in thousands).

RD&E expenses in 2014	\$55,831
Outsourced engineering costs	6,952
Personnel-related costs	6,559
Stock-based compensation expense	1,579
Foreign currency exchange rate changes	(2,226)
Other	1,096
RD&E expenses in 2015	\$69,791

RD&E expenses increased due to higher personnel-related costs resulting from headcount additions, such as salaries and fringe benefits, as well as modest salary increases granted early in 2015. The Company also incurred higher spending on outsourced engineering costs, primarily related to the development of engineering prototypes for anticipated customer orders. In addition, stock-based compensation expense increased due to a higher valuation of stock options granted early in 2015. Offsetting these increases was the favorable impact on expenses of changes in foreign currency exchange rates, which resulted in lower U.S. Dollar expenses when expenses denominated in foreign currencies, primarily the Euro, were translated into U.S. Dollars.

Selling, General, and Administrative Expenses

Selling, general, and administrative (SG&A) expenses in 2015 increased by \$7,975,000, or 5%, from the prior year as detailed in the table below (in thousands).

SG&A expenses in 2014	\$148,699
Personnel-related costs	15,420
Stock-based compensation expense	4,082
Microscan settlement and legal fees	2,405
Incentive compensation plans	(6,226)
Foreign currency exchange rate changes	(7,896)
Other	190
SG&A expenses in 2015	\$156,674

SG&A expenses increased due to higher personnel-related costs resulting from headcount additions, such as salaries, fringe benefits, sales commissions, and travel expenses, as well as modest salary increases granted early in 2015. In addition, stock-based compensation expense increased due to a higher valuation of stock options granted early in 2015. Offsetting these increases were lower expenses related to incentive compensation plans, such as company

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bonuses and sales commissions, resulting from lower achievement levels on plans that were set at the beginning of the year. In addition, changes in foreign currency exchange rates resulted in lower U.S. Dollar expenses when expenses denominated in foreign currencies, primarily the Euro, were translated into U.S. Dollars.

In the second quarter of 2015, the Company reached a settlement of outstanding patent litigation with Microscan Systems, Inc. for \$3,500,000. The settlement included a patent license agreement valued at \$1,667,000 that allows the Company to continue producing current models of its handheld barcode readers, which was recorded as an asset and is being amortized to cost of revenue over the five year life of the patent starting in the third quarter of 2015. The remaining \$1,833,000 of the settlement was recorded as SG&A expense in the second quarter of 2015. Legal fees related to this litigation were \$572,000 higher in 2015 than the prior year.

Non-operating Income (Expense)

The Company recorded foreign currency gains of \$1,122,000 in 2015 and \$1,031,000 in 2014. The foreign currency gains in each period resulted primarily from the revaluation and settlement of accounts receivable, accounts payable, and intercompany balances that are reported in one currency and collected in another.

Investment income increased by \$518,000, or 16%, from the prior year due to increased funds available for investment.

The Company recorded other income of \$645,000 in 2015 compared to other expense of \$283,000 in 2014. Other income in 2015 included a \$790,000 benefit resulting from a decrease in the fair value of the contingent consideration liability that arose from a business acquisition completed earlier in 2015 (refer to Note 20 to the Consolidated Financial Statements in Part II - Item 8 of this Annual Report on Form 10-K). Other income (expense) also included rental income, net of associated expenses, from leasing space in buildings adjacent to the Company's corporate headquarters.

Income Tax Expense

The Company's effective tax rate was 15% of the Company's pre-tax income in 2015 compared to 16% in 2014.

The effective tax rate for 2015 included the impact of the following discrete tax events: (1) a decrease in tax expense of \$1,105,000 from the final true-up of the prior year's tax accrual upon filing the actual tax returns, (2) a decrease in tax expense of \$975,000 from the expiration of statutes of limitations for certain reserves for income tax uncertainties, (3) a decrease in tax expense, net of reserves, of \$910,000 from the retroactive application of the 2015 research and development tax credit passed by Congress in December 2015 and applied retroactively to January 1, 2015, and (4) an increase in tax expense of \$65,000 from the write down of a deferred tax asset.

The effective tax rate for 2014 included the impact of the following discrete tax events: (1) a decrease in tax expense of \$652,000 from the final true-up on the prior year's tax accrual upon filing the actual tax returns, (2) a decrease in tax expense, net of reserves, of \$645,000 from the retroactive application of the 2014 research and development tax credit passed by Congress in December 2014 and applied retroactively to January 1, 2014, (3) a decrease in tax expense of \$418,000 from the closing of the Internal Revenue Service audit of the Company for tax years 2010 and 2011, and (4) a decrease in tax expense of \$217,000 from the expiration of the statutes of limitations for certain reserves for income tax uncertainties.

Excluding the impact of these discrete tax events, the Company's effective tax rate was relatively consistent for 2015 and 2014 at approximately 17.5%.

Discontinued Operations

On July 6, 2015, the Company completed the sale of its Surface Inspection Systems Division (SISD) that specialized in machine vision products that inspect the surfaces of materials processed in a continuous fashion. The financial results of SISD are reported as a discontinued operation for all periods presented. Income from discontinued operations, net of tax, was \$1,228,000 for the six-month period ended July 5, 2015 and was \$10,644,000 for the year ended December 31, 2014. The gain on the sale of SISD, net of tax, recorded in 2015 was \$78,182,000. Refer to Note 19 to the Consolidated Financial Statements in Part II - Item 8 of this Annual Report on Form 10-K for further information.

LIQUIDITY AND CAPITAL RESOURCES

The Company has historically been able to generate positive cash flow from operations, which has funded its operating activities and other cash requirements and has resulted in an accumulated cash and investment balance of

\$745,170,000 as of December 31, 2016. The Company has established guidelines relative to credit ratings, diversification, and maturities of its investments that maintain liquidity.

The Company's cash requirements in 2016 were met with positive cash flows from operations, investment maturities, and the proceeds from stock option exercises. Cash requirements consisted of operating activities, investment purchases, the repurchase of common stock, the payment of dividends, cash paid for business acquisitions, and capital expenditures. Capital expenditures totaled \$12,816,000 in 2016 and consisted primarily of computer hardware and

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software, improvements made to the Company's headquarters building in Natick, Massachusetts, and manufacturing test equipment related to new product introductions.

The following table summarizes the Company's material contractual obligations, both fixed and contingent (in thousands):

Year Ended December 31,	Inventory Purchase Commitments	Leases	Total
2017	\$ 3,352	\$5,054	\$8,406
2018	—	3,303	3,303
2019	—	2,164	2,164
2020	—	1,853	1,853
2021	—	1,735	1,735
Thereafter	—	1,498	1,498
	\$ 3,352	\$15,607	\$18,959

In addition to the obligations described above, the following items may also result in future material uses of cash:

Stock Repurchases

In August 2015, the Company's Board of Directors authorized the repurchase of \$100,000,000 of the Company's common stock. As of December 31, 2016, the Company repurchased 2,666,000 shares at a cost of \$100,000,000 under this program, including 355,000 shares at a cost of \$16,064,000 in 2016. Stock repurchases under this August 2015 program are now complete. In November 2015, the Company's Board of Directors authorized the repurchase of an additional \$100,000,000 of the Company's common stock. Purchases under this November 2015 program commenced in 2016 upon completion of the August 2015 program. As of December 31, 2016, the Company repurchased 539,000 shares at a cost of \$31,085,000 under this program, leaving a remaining authorized balance of \$68,915,000. Total stock repurchases in 2016 amounted to \$47,149,000. The Company may repurchase shares under this program in future periods depending on a variety of factors, including, among other things, the impact of dilution from employee stock options, stock price, share availability, and cash requirements.

Dividends

The Company's Board of Directors declared and paid cash dividends of \$0.07 per share in the first quarter and \$0.075 per share in the second, third, and fourth quarters of 2016. Total cash dividends paid in 2016 amounted to \$25,213,000. Future dividends will be declared at the discretion of the Company's Board of Directors and will depend upon such factors as the Board deems relevant, including, among other things, the Company's ability to generate positive cash flow from operations.

Acquisitions

The Company's business strategy includes selective expansion into new machine vision markets and applications through the acquisition of businesses and technologies, which may result in significant cash outlays in the future.

On August 21, 2015, the Company acquired selected assets of Manatee Works, Inc. The Company paid \$1,023,000 in cash upon closing and \$337,000 in cash in 2016 that was contingent upon reaching a milestone revenue level. The Company may pay additional contingent cash consideration of up to \$1,700,000 in 2017 and up to \$2,200,000 in 2018 based upon reaching certain milestone revenue levels.

On August 30, 2016, the Company acquired selected assets and assumed selected liabilities of AQSense, S.L. The Company paid \$2,519,000 in cash and there are no contingent payments related to this transaction.

On October 27, 2016, the Company acquired all of the outstanding shares of EnShape, GmbH. The Company paid \$5,395,000 in cash and is expected to pay additional contingent cash consideration of \$1,362,000 in the first half of 2017 and a deferred cash payment of \$1,144,000 in 2018 representing a holdback for potential indemnification claims.

On November 30, 2016, the Company acquired selected assets and assumed selected liabilities of Chiaro Technologies LLC. The Company paid \$3,538,000 in cash and may pay additional contingent cash consideration of up to \$1,250,000 in 2018 based upon reaching certain milestone revenue levels.

On December 9, 2016, the Company acquired selected assets and assumed selected liabilities of Webscan, Inc. The Company paid \$3,000,000 in cash upon closing and paid \$176,000 in cash upon calculation of a working capital adjustment in January 2017. There are no contingent payments related to this transaction.

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The Company believes that its existing cash and investment balances, together with cash flow from operations, will be sufficient to meet its operating, investing, and financing activities for the next twelve months. As of December 31, 2016, the Company had \$745,170,000 in cash and investments. In addition, Cognex has no long-term debt and does not anticipate needing debt financing in the near future. We believe that our strong cash position has put us in a relatively good position with respect to our longer-term liquidity needs.

OFF-BALANCE SHEET ARRANGEMENTS

As of December 31, 2016, the Company has no off-balance sheet arrangements as defined in Item 303(a)(4)(ii) of Regulation S-K.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of the Company's financial condition and results of operations are based upon the consolidated financial statements included in this Annual Report on Form 10-K, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue, and expenses, and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and various other assumptions believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from these estimates under different assumptions or circumstances resulting in charges that could be material in future reporting periods. We believe the following critical accounting policies require the use of significant estimates and judgments in the preparation of our consolidated financial statements.

Revenue Recognition

The Company's product revenue is derived from the sale of machine vision systems, which can take the form of hardware with embedded software or software-only, and related accessories. The Company also generates revenue by providing maintenance and support, consulting, and training services to its customers. Certain of the Company's arrangements include multiple deliverables that provide the customer with a combination of products or services. In order to recognize revenue, the Company requires that a signed customer contract or purchase order is received, the fee from the arrangement is fixed or determinable, and collection of the resulting receivable is probable. Assuming that these criteria have been met, product revenue is generally recognized upon delivery, revenue from maintenance and support programs is recognized ratably over the program period, and revenue from consulting and training services is recognized when the services have been provided. When customer-specified acceptance criteria exist that are substantive, product revenue is deferred, along with associated incremental direct costs, until these criteria have been met and any remaining performance obligations are inconsequential or perfunctory.

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

The majority of the Company's product offerings consist of hardware with embedded software. Under the revenue recognition rules for tangible products, the fee from a multiple-deliverable arrangement is allocated to each of the deliverables based upon their relative selling prices as determined by a selling-price hierarchy. A deliverable in an arrangement qualifies as a separate unit of accounting if the delivered item has value to the customer on a stand-alone basis. A delivered item that does not qualify as a separate unit of accounting is combined with the other undelivered items in the arrangement and revenue is recognized for those combined deliverables as a single unit of accounting.

The selling price used for each deliverable is based upon vendor-specific objective evidence (VSOE) if available, third-party evidence (TPE) if VSOE is not available, and management's best estimate of selling price (BESP) if neither VSOE nor TPE are available. VSOE is the price charged for a deliverable when it is sold separately. TPE is the price of the Company's or any competitor's largely interchangeable products or services in stand-alone sales to similarly-situated customers. BESP is the price at which the Company would sell the deliverable if it were sold regularly on a stand-alone basis, considering market conditions and entity-specific factors.

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The Company reports revenue for certain of its product accessory sales on a net basis, by reducing the gross sale amount by the related costs, when certain factors in the arrangement with the customer indicate that the Company is acting as an agent, rather than as a principal.

Management exercises judgment in connection with the determination of the amount of revenue to be recognized each period. Such judgments include, but are not limited to, determining whether separate contracts with the same customer that are entered into at or near the same time should be accounted for as a single arrangement, identifying the various elements in an arrangement, determining if delivered items have stand-alone value, determining the relative selling prices of the arrangement's deliverables, determining whether options to buy additional products or services in the future are substantive and should be accounted for as a deliverable in the original arrangement, assessing whether the fee is fixed or determinable, determining the probability of collecting the receivable, determining whether customer-specified acceptance criteria are substantive in nature, determining whether remaining performance obligations are inconsequential or perfunctory, assessing whether vendor-specific objective evidence of fair value has been established for undelivered elements, and determining whether the Company is acting as a principal or an agent in an arrangement.

Investments

As of December 31, 2016, the Company's investment portfolio of debt securities totaled \$665,529,000. The debt securities are reported at fair value, with unrealized gains and losses, net of tax, recorded in shareholders' equity as other comprehensive income (loss) since these securities are designated as available-for-sale securities. As of December 31, 2016, the Company's portfolio of debt securities had a net unrealized gain of \$65,000.

The Company applies a three-level valuation hierarchy for fair value measurements. The categorization of assets and liabilities within the valuation hierarchy is based upon the lowest level of input that is significant to the measurement of fair value. Level 1 inputs to the valuation methodology utilize unadjusted quoted market prices in active markets for identical assets and liabilities. Level 2 inputs to the valuation methodology are other observable inputs, including quoted market prices for similar assets and liabilities, quoted prices for identical and similar assets and liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data. Level 3 inputs to the valuation methodology are unobservable inputs based upon management's best estimate of the inputs that market participants would use in pricing the asset or liability at the measurement date, including assumptions about risk. Changes in the valuation methodology, interest rates, credit rates, or the market for these investments could result in changes to their fair values. Changes to the Level of an investment within the fair value hierarchy are determined at the end of the reporting period.

The Company's debt securities are reported at fair value based upon model-driven valuations in which all significant inputs are observable or can be derived from or corroborated by observable market data for substantially the full term of the asset, and are therefore classified as Level 2. Management is responsible for estimating the fair value of these financial assets and liabilities, and in doing so, considers valuations provided by a large, third-party pricing service. This service maintains regular contact with market makers, brokers, dealers, and analysts to gather information on market movement, direction, trends, and other specific data. They use this information to structure yield curves for various types of debt securities and arrive at the daily valuations.

Management monitors the carrying value of its debt securities compared to their fair value to determine whether an other-than-temporary impairment has occurred. In considering whether a decline in fair value is other-than-temporary, we consider many factors, both qualitative and quantitative in nature, including the type of security, the credit rating of the security, the length of time the security has been in a loss position, the size of the loss position, our ability and intent to hold the security to expected recovery of value, and other meaningful information. If a decline in fair value is determined to be other-than-temporary, an impairment charge would be recorded in current operations to reduce the carrying value of the investment to its fair value. There were no other-than-temporary impairments of investments in 2016, 2015, or 2014.

Accounts Receivable

The Company maintains reserves against its accounts receivable for potential credit losses. Ongoing credit evaluations of customers are performed and the Company has historically not experienced significant losses related to the collection of its accounts receivable. Allowances for specific accounts determined to be at risk for collection are

estimated by management taking into account the length of time the receivable has been outstanding, the customer's current ability to pay its obligations to the Company, general economic and industry conditions, as well as various other factors. Global economic uncertainty may result in longer payment cycles and challenges in collecting accounts receivable balances, which make these estimates more judgmental. An adverse change in any of these factors could result in higher than expected customer defaults and may result in the need for additional bad debt provisions. As of December 31, 2016, the Company's reserve against accounts receivable was \$873,000, or 2% of the gross accounts

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receivable balance. A 10% difference in the reserve against accounts receivable as of December 31, 2016 would have affected net income by approximately \$72,000.

Inventories

Inventories are stated at the lower of cost or market. Management estimates excess and obsolescence exposures based upon assumptions about future demand, product transitions, and market conditions, and records reserves to reduce the carrying value of inventories to their net realizable value. Volatility in the global economy makes these assumptions about future demand more judgmental. Among the risks associated with the introduction of new products are difficulty predicting customer demand and effectively managing inventory levels to ensure adequate supply of the new product and avoid excess supply of the legacy product. In addition, we may strategically enter into non-cancelable commitments with vendors to purchase materials for products in advance of demand to take advantage of favorable pricing or address concerns about the availability of future supplies and long lead times. As of December 31, 2016, the Company's reserve for excess and obsolete inventory totaled \$3,317,000, or 11% of the gross inventory balance. A 10% difference in inventory reserves as of December 31, 2016 would have affected net income by approximately \$272,000.

Long-lived Assets

The Company has long-lived assets, including property, plant, and equipment and acquired intangible assets. These assets are susceptible to shortened estimated useful lives and changes in fair value due to changes in their use, market or economic changes, or other events or circumstances. The Company evaluates the potential impairment of these long-lived assets whenever events or circumstances indicate their carrying value may not be recoverable. Factors that could trigger an impairment review include historical or projected results that are less than the assumptions used in the original valuation of an acquired asset, a change in the Company's business strategy or its use of an acquired asset, or negative economic or industry trends.

If an event or circumstance indicates the carrying value of long-lived assets may not be recoverable, the Company assesses the recoverability of the assets by comparing the carrying value of the assets to the sum of the undiscounted future cash flows that the assets are expected to generate over their remaining economic lives. If the carrying value exceeds the sum of the undiscounted future cash flows, the Company compares the fair value of the long-lived assets to the carrying value and records an impairment loss for the difference. The Company generally estimates the fair value of its long-lived assets using the income approach based upon a discounted cash flow model. The income approach requires the use of many assumptions and estimates including future revenues and expenses, discount factors, income tax rates, the identification of groups of assets with highly independent cash flows, and assets' economic lives. Volatility in the global economy makes these assumptions and estimates more judgmental. No impairment losses were recorded in 2016, 2015, or 2014. Actual future operating results and the remaining economic lives of our long-lived assets could differ from those used in assessing the recoverability of these assets and could result in an impairment of long-lived assets in future periods.

Goodwill

Management evaluates the potential impairment of goodwill annually each fourth quarter and whenever events or circumstances indicate their carrying value may not be recoverable. On July 6, 2015, the Company completed the sale of its Surface Inspection Systems Division (SISD). The Company had previously identified SISD, along with its Modular Vision Systems Division (MVSD), as reporting units for purposes of its goodwill impairment test. Given the disposition of SISD, management reviewed its reporting units and concluded that the Company now has one reporting unit. Determining the Company's reporting units requires judgments regarding what constitutes a business and at what level discrete financial information is available and reviewed by management.

The Company performs a qualitative assessment of goodwill (commonly known as "step zero") to determine whether further impairment testing is necessary. If this qualitative assessment indicates that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, the entity would proceed to a two-step process. Step one compares the fair value of the reporting unit with its carrying value, including goodwill. If the carrying amount exceeds the fair value of the reporting unit, step two is required to measure the amount of impairment loss. Step two compares the implied fair value of the reporting unit goodwill to the carrying amount of the goodwill. The Company estimates the fair value of its reporting unit using the income approach based upon a discounted cash flow model. In

addition, the Company uses the market approach, which compares the reporting unit to publicly-traded companies and transactions involving similar businesses, to support the conclusions based upon the income approach. The income approach requires the use of many assumptions and estimates including future revenues, expenses, capital expenditures, and working capital, as well as discount factors and income tax rates.

Factors that management considered in the qualitative assessment include macroeconomic conditions, industry and market considerations, overall financial performance (both current and projected), changes in management or strategy,

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and changes in the composition or carrying amount of net assets. In addition, management took into consideration the goodwill valuation as of October 4, 2010, which was the last time it was performed under the two-step process. At that time, this analysis indicated that the fair value of the MVSD reporting unit exceeded its carrying value by approximately 208%. Based on the qualitative assessment, management does not believe that it is more likely than not that the carrying value of its reporting unit exceeds its fair value. No impairment losses were recorded in 2016, 2015, or 2014.

Warranty Obligations

The Company records the estimated cost of fulfilling product warranties at the time of sale based upon historical costs to fulfill claims. Obligations may also be recorded subsequent to the time of sale whenever specific events or circumstances impacting product quality become known that would not have been taken into account using historical data. While we engage in extensive product quality programs and processes, including actively monitoring and evaluating the quality of our component suppliers and third-party contract manufacturers, the Company's warranty obligation is affected by product failure rates, material usage, and service delivery costs incurred in correcting a product failure. An adverse change in any of these factors may result in the need for additional warranty provisions. As of December 31, 2016, the Company's accrued warranty obligations amounted to \$4,335,000. A 10% difference in accrued warranty obligations as of December 31, 2016 would have affected net income by approximately \$355,000.

Contingencies

Estimated losses from contingencies are accrued by management based upon whether a loss is probable and whether management has the ability to reasonably estimate the amount of the loss. Estimating potential losses, or even a range of losses, is difficult and involves a great deal of judgment. Management relies primarily on assessments made by its internal and external legal counsel to make the determination as to whether a loss contingency arising from litigation should be recorded or disclosed. This analysis is performed on a quarterly basis or when facts and circumstances dictate. Should the resolution of a contingency result in a loss that we did not accrue because management did not believe that the loss was probable or capable of being reasonably estimated, then this loss would result in a charge to income in the period the contingency was resolved. The Company did not have any significant accrued contingencies as of December 31, 2016.

Stock-Based Compensation

Compensation expense is recognized for all stock option and restricted stock grants. Determining the appropriate valuation model and estimating the fair values of these grants requires the input of subjective assumptions, including expected stock price volatility, dividend yields, expected term, and forfeiture rates. The expected volatility assumption is based partially upon the historical volatility of the Company's common stock, which may or may not be a true indicator of future volatility, particularly as the Company continues to seek to diversify its customer base. The assumptions used in calculating the fair values of stock option grants represent management's best estimates, but these estimates involve inherent uncertainties and the application of judgment. As a result, if factors change and different assumptions are used, stock-based compensation expense could be significantly different from what the Company recorded in the current period.

Income Taxes

Significant judgment is required in determining worldwide income tax expense based upon tax laws in the various jurisdictions in which the Company operates. The Company has established reserves for income taxes by applying the "more likely than not" criteria, under which the recognition threshold is met when an entity concludes that a tax position, based solely on its technical merits, is more likely than not to be sustained upon examination by the relevant tax authority. All tax positions are analyzed periodically and adjustments are made as events occur that warrant modification, such as the completion of audits or the expiration of statutes of limitations, which may result in future charges or credits to income tax expense.

As part of the process of preparing consolidated financial statements, management is required to estimate income taxes in each of the jurisdictions in which the Company operates. This process involves estimating the current tax liability, as well as assessing temporary differences arising from the different treatment of items for financial statement and tax purposes. These differences result in deferred tax assets and liabilities, which are recorded on the Consolidated Balance Sheets.

The Company has net deferred tax assets primarily resulting from temporary differences between the financial statement and tax bases of assets and liabilities. Management has evaluated the realizability of these deferred tax assets and has determined that it is more likely than not that these assets will be realized, net of any valuation allowance. In reaching this conclusion, we have evaluated relevant criteria, including the Company's historical profitability, current projections of future profitability, and the lives of tax credits, net operating and capital losses, and other carryforwards,

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certain of which have indefinite lives. Should the Company fail to generate sufficient pre-tax profits in future periods, we may be required to record material adjustments to these deferred tax assets, resulting in a charge to income in the period of determination.

Derivative Instruments

In certain instances, the Company enters into forward contracts to hedge against foreign currency fluctuations. The Company's forward contracts are reported at fair value based upon model-driven valuations in which all significant inputs are observable or can be derived from or corroborated by observable market data for substantially the full term of the asset or liability, and are therefore classified as Level 2. The Company's forward contracts are typically traded or executed in over-the-counter markets with a relatively high degree of pricing transparency. The market participants are generally large commercial banks.

Currently, the Company enters into two types of hedges to manage foreign currency exchange rate risk. The first are economic hedges which utilize foreign currency forward contracts to manage the exposure to fluctuations in foreign currency exchange rates arising primarily from foreign-denominated receivables and payables. The gains and losses on these derivatives are intended to be offset by the changes in the fair value of the assets and liabilities being hedged. These economic hedges are not designated as effective hedges, and therefore, do not qualify for effective hedge accounting. The second are cash flow hedges which utilize foreign currency forward contracts to protect our budgeted revenues and expenses against foreign currency exchange rate changes compared to our budgeted rates. These cash flow hedges are designated for hedge accounting, and therefore, the effective portion of the forward contract's gain or loss is reported in shareholders' equity as other comprehensive income (loss) and is reclassified into current operations as the hedged transaction impacts current operations. Should these hedges fail to qualify for hedge accounting or be ineffective, the gain or loss on the forward contract would be reported in current operations immediately as opposed to when the hedged transaction impacts current operations. This may result in material foreign currency gains or losses.

NEW PRONOUNCEMENTS

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

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

In March 2016, ASU 2016-08, "Principal versus Agent Considerations (Reporting Revenue Gross versus Net)," was issued, in April 2016, ASU 2016-10, "Identifying Performance Obligations and Licensing," was issued, in May 2016, ASU 2016-12, "Narrow-Scope Improvements and Practical Expedients" was issued, and in December 2016, ASU 2016-20, "Technical Corrections and Improvements," was issued. These Updates do not change the core principle of the guidance under ASU 2014-09, but rather provide implementation guidance. ASU 2015-14, "Deferral of the effective date," amended the effective date of ASU 2014-09 for public companies to annual reporting periods beginning after December 15, 2017. Early adoption is permitted, but only beginning after December 15, 2016. The Financial Accounting Standards Board may release additional implementation guidance in future periods.

We expect to adopt this standard using the full retrospective method to present all periods reported on a consistent basis. Upon adoption, revenue for software-only products sold as part of multiple-deliverable arrangements will no longer be deferred when vendor-specific objective evidence of fair value does not exist for undelivered elements of the arrangement. This change will result in earlier recognition of revenue. In addition, we expect certain of the Company's product accessory sales, which are currently reported on a net basis, to be reported on a gross basis as a result of applying the expanded guidance in the new standard related to principal versus agent considerations. This change will result in the Company reporting higher revenue and higher cost of revenue when these sales are reported on a gross basis, although the gross margin dollars will not change. We do not expect either of these changes to have a

material impact on total revenue. Management will continue to evaluate the impact of this standard.

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

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

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

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

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

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

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

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

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

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

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

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Accounting Standards Update (ASU) 2016-16, "Income Taxes - Intra-Entity Transfers of Assets Other than Inventory"

ASU 2016-16 applies to all reporting entities with intra-entity transfers of assets other than inventory. The amendments in this Update allow the recognition of deferred income taxes for an intra-entity transfer of an asset other than inventory when the transfer occurs, as opposed to when the asset has been sold to an outside party under current U.S. GAAP. Two common examples of assets included in the scope of this Update are intellectual property and property, plant, and equipment. For public companies, the amendments in ASU 2016-16 are effective for annual reporting periods beginning after December 15, 2017, and interim reporting periods within those annual periods. Early adoption is permitted for all entities as of the beginning of an annual reporting period for which financial statements (interim or annual) have not been issued or made available for issuance. This ASU should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. Management is in the process of evaluating the impact of this Update.

ITEM 7A: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to certain risks relating to its ongoing business operations, including foreign currency exchange rate risk and interest rate risk. The Company currently mitigates certain foreign currency exchange rate risks with derivative instruments. The Company does not currently manage its interest rate risk with derivative instruments.

Foreign Currency Risk

The Company faces exposure to foreign currency exchange rate fluctuations, as a significant portion of its revenues, expenses, assets, and liabilities are denominated in currencies other than the functional currencies of the Company's subsidiaries or the reporting currency of the Company, which is the U.S. Dollar. In certain instances, we utilize forward contracts to hedge against foreign currency fluctuations. These contracts are used to minimize foreign gains or losses, as the gains or losses on the derivative are intended to offset the losses or gains on the underlying exposure. We do not engage in foreign currency speculation.

The Company's foreign currency risk management strategy is principally designed to mitigate the potential financial impact of changes in the value of transactions and balances denominated in foreign currencies resulting from changes in foreign currency exchange rates. Currently, the Company enters into two types of hedges to manage this risk. The first are economic hedges which utilize foreign currency forward contracts with maturities of up to 45 days to manage the exposure to fluctuations in foreign currency exchange rates arising primarily from foreign-denominated receivables and payables. The gains and losses on these derivatives are intended to be offset by the changes in the fair value of the assets and liabilities being hedged. The second are cash flow hedges which utilize foreign currency forward contracts with maturities of up to 18 months to hedge specific forecasted transactions of the Company's foreign subsidiaries with the goal of protecting our budgeted revenues and expenses against foreign currency exchange rate changes compared to our budgeted rates.

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The Company had the following outstanding forward contracts (in thousands):

Currency	December 31, 2016				December 31, 2015			
	Notional Value	USD Equivalent	High Rate	Low Rate	Notional Value	USD Equivalent	High Rate	Low Rate
Derivatives Designated as Hedging Instruments:								
U.S. Dollar	—	\$ —	—	—	16,720	\$ 16,720	1.1462	1.0903
Japanese Yen	342,500	2,960	132.28	113.98	942,500	7,605	147.82	129.08
Hungarian Forint	39,000	130	316.62	316.13	547,000	1,893	319.87	301.10
Singapore Dollar	150	97	1.6328	1.6293	2,063	1,425	1.6451	1.5063
Canadian Dollar	—	—	—	—	41	37	1.1155	1.1145
British Pound	—	—	—	—	25	34	0.8039	0.8021
Derivatives Not Designated as Hedging Instruments:								
Japanese Yen	650,000	\$ 5,554	123.12	123.12	700,000	\$ 5,800	131.07	131.07
British Pound	1,350	1,658	0.8567	0.8567	1,650	2,441	0.7342	0.7342
Korean Won	1,750,000	1,450	1,270	1,270	1,400,000	1,187	1,281	1,281
Hungarian Forint	425,000	1,448	308.79	308.79	250,000	857	316.95	316.95
Singapore Dollar	1,350	929	1.5287	1.5287	1,525	1,074	1.5422	1.5422
Taiwanese Dollar	26,000	802	34.12	34.12	26,425	800	35.85	35.85

A change in foreign currency exchange rates could materially impact the fair value of these contracts; however, if this occurred, the fair value of the underlying exposures hedged by the contracts would change by a similar amount.

Accordingly, management does not believe that a material change in foreign currency exchange rates used in the fair value of our derivative instruments would materially impact operations or cash flows.

The success of our foreign currency risk management program depends upon forecasts of transaction activity denominated in various currencies. To the extent that these forecasts are overstated or understated during periods of currency volatility, we could experience unanticipated foreign currency gains or losses that could have a material impact on our results of operations. Furthermore, our failure to identify new exposures and hedge them in an effective manner may result in material foreign currency gains or losses.

The Company's functional currency/reporting currency exchange rate exposures result from revenues and expenses that are denominated in currencies other than the U.S. Dollar. A significant portion of our revenues and expenses are denominated in the Euro, the Japanese Yen, and the Chinese Yuan, also known as Renminbi. Our predominant currency of sale is the U.S. Dollar in the Americas, the Euro and U.S. Dollar in Europe, the Yuan in Mainland China, the Yen in Japan, and the U.S. Dollar in other regions. We estimate that approximately 43% of our sales in 2016 were invoiced in currencies other than the U.S. Dollar, and we expect sales denominated in foreign currencies to continue to represent a significant portion of our total revenue. While we also have expenses denominated in these same foreign currencies, the impact on revenues has historically been, and is expected to continue to be, greater than the offsetting impact on expenses. Therefore, in times when the U.S. Dollar strengthens in relation to these foreign currencies, we would expect to report a net decrease in operating income. Conversely, in times when the U.S. Dollar weakens in relation to these foreign currencies, we would expect to report a net increase in operating income. Thus, changes in the relative strength of the U.S. Dollar may have a material impact on our operating results.

Interest Rate Risk

The Company's investment portfolio of debt securities includes corporate bonds, treasury bills, asset-backed securities, a Euro liquidity fund, agency bonds, sovereign bonds and municipal bonds. Debt securities with original maturities greater than three months are designated as available-for-sale and are reported at fair value. As of December 31, 2016, the fair value of the Company's portfolio of debt securities amounted to \$665,529,000 with principal amounts totaling \$665,464,000, maturities that do not exceed five years, and a yield to maturity of 1.08%. Differences between the fair value and principal amounts of the Company's portfolio of debt securities are primarily attributable to discounts and premiums arising at the acquisition date, as well as unrealized gains and losses as of the balance sheet date.

Although it is the Company's policy to invest in debt securities with effective maturities that do not exceed ten years, 97% of the investment portfolio as of December 31, 2016 has effective maturity dates of less than three years. Given the relatively short maturities and investment-grade quality of the Company's portfolio of debt securities as of

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December 31, 2016, a sharp rise in interest rates should not have a material adverse effect on the fair value of these instruments. As a result, the Company does not currently hedge these interest rate exposures.

The following table presents the hypothetical change in the fair value of the Company's portfolio of debt securities arising from selected potential changes in interest rates (in thousands). This modeling technique measures the change in fair value that would result from a parallel shift in the yield curve plus or minus 50 and 100 basis points (BP) over a twelve-month time horizon.

Type of security	Valuation of securities given an interest rate decrease		No change in interest rates	Valuation of securities given an interest rate increase	
	(100 BP)	(50 BP)		50 BP	100 BP
Corporate bonds	\$ 313,739	\$ 312,440	\$ 311,140	\$ 309,841	\$ 308,541
Treasury bills	160,785	160,120	159,455	158,790	158,125
Asset-backed securities	97,366	96,963	96,560	96,157	95,754
Euro liquidity fund	46,778	46,638	46,499	46,359	46,220
Sovereign bonds	31,140	31,011	30,883	30,754	30,625
Agency bonds	13,352	13,297	13,242	13,187	13,132
Municipal bonds	7,815	7,783	7,750	7,718	7,686
	\$ 670,975	\$ 668,252	\$ 665,529	\$ 662,806	\$ 660,083

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ITEM 8: FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of Cognex Corporation:

We have audited the accompanying consolidated balance sheets of Cognex Corporation (a Massachusetts corporation) and subsidiaries (the “Company”) as of December 31, 2016 and 2015, and the related consolidated statements of operations, comprehensive income, cash flows, and shareholders’ equity for each of the three years in the period ended December 31, 2016. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Cognex Corporation and subsidiaries as of December 31, 2016 and 2015, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2016 in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company’s internal control over financial reporting as of December 31, 2016, based on criteria established in the 2013 Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 16, 2017 expressed an unqualified opinion.

/s/ GRANT THORNTON LLP

Boston, Massachusetts

February 16, 2017

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COGNEX CORPORATION – CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended December 31,		
	2016	2015	2014
	(In thousands, except per share amounts)		
Revenue	\$520,753	\$450,557	\$426,449
Cost of revenue	115,590	102,571	94,067
Gross margin	405,163	347,986	332,382
Research, development, and engineering expenses	78,269	69,791	55,831
Selling, general, and administrative expenses	166,110	156,674	148,699
Operating income	160,784	121,521	127,852
Foreign currency gain	101	1,122	1,031
Investment income	7,039	3,674	3,156
Other income (expense)	871	645	(283)
Income from continuing operations before income tax expense	168,795	126,962	131,756
Income tax expense on continuing operations	18,968	19,298	20,915
Net income from continuing operations	149,827	107,664	110,841
Net income (loss) from discontinued operations (Note 19)	(255)	79,410	10,644
Net income	\$149,572	\$187,074	\$121,485
Basic earnings per weighted-average common and common-equivalent share:			
Net income from continuing operations	\$1.76	\$1.25	\$1.28
Net income (loss) from discontinued operations	\$(0.01)	\$0.92	\$0.12
Net income	\$1.75	\$2.17	\$1.40
Diluted earnings per weighted-average common and common-equivalent share:			
Net income from continuing operations	\$1.72	\$1.22	\$1.24
Net income (loss) from discontinued operations	\$—	\$0.91	\$0.12
Net income	\$1.72	\$2.13	\$1.36
Weighted-average common and common-equivalent shares outstanding:			
Basic	85,338	86,296	86,858
Diluted	87,072	87,991	89,071
Cash dividends per common share	\$0.30	\$0.21	\$—

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

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COGNEX CORPORATION – CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Year Ended December 31,		
	2016	2015	2014
	(In thousands)		
Net income	\$ 149,572	\$ 187,074	\$ 121,485
Other comprehensive income (loss), net of tax:			
Cash flow hedges:			
Net unrealized gain (loss), net of tax of (\$22), \$22, and \$0 in 2016, 2015, and 2014, respectively	(567)	(27)	(118)
Reclassification of net realized (gain) loss into current operations	398	201	46
Net change related to cash flow hedges	(169)	174	(72)
Available-for-sale investments:			
Net unrealized gain (loss), net of tax of \$248, (\$279), and \$40 in 2016, 2015, and 2014, respectively	1,672	(939)	579
Reclassification of net realized (gain) loss into current operations	(191)	(344)	(673)
Net change related to available-for-sale investments	1,481	(1,283)	(94)
Foreign currency translation adjustments:			
Foreign currency translation adjustments, net of tax of (\$228), (\$711) and (\$870) in 2016, 2015, and 2014, respectively	(5,616)	(11,616)	(9,400)
Net change related to foreign currency translation adjustments	(5,616)	(11,616)	(9,400)
Other comprehensive income (loss), net of tax	(4,304)	(12,725)	(9,566)
Total comprehensive income	\$ 145,268	\$ 174,349	\$ 111,919

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

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COGNEX CORPORATION – CONSOLIDATED BALANCE SHEETS

	December 31,	
	2016	2015
	(In thousands)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$79,641	\$51,975
Short-term investments	341,194	296,468
Accounts receivable, less reserves of \$873 and \$736 in 2016 and 2015, respectively	55,438	42,846
Unbilled revenue	2,217	24
Inventories	26,984	37,334
Prepaid expenses and other current assets	20,870	15,847
Total current assets	526,344	444,494
Long-term investments	324,335	273,088
Property, plant, and equipment, net	53,992	53,285
Goodwill	95,280	81,448
Intangible assets, net	8,312	6,315
Deferred income taxes	28,022	26,517
Other assets	2,319	2,609
Total assets	\$1,038,604	\$887,756
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$9,830	\$7,860
Accrued expenses	42,539	33,272
Accrued income taxes	5,193	985
Deferred revenue and customer deposits	8,211	11,571
Total current liabilities	65,773	53,688
Deferred income taxes	—	319
Reserve for income taxes	5,361	4,830
Other non-current liabilities	4,871	3,252
Total liabilities	76,005	62,089
Commitments and contingencies (Note 10)		
Shareholders' equity:		
Common stock, \$.002 par value – Authorized: 200,000 and 140,000 shares in 2016 and 2015, respectively, issued and outstanding: 85,939 and 84,856 shares in 2016 and 2015, respectively	172	170
Additional paid-in capital	375,030	311,008
Retained earnings	643,825	566,613
Accumulated other comprehensive loss, net of tax	(56,428)	(52,124)
Total shareholders' equity	962,599	825,667
	\$1,038,604	\$887,756

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

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COGNEX CORPORATION – CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2016	2015	2014
	(In thousands)		
Cash flows from operating activities:			
Net income	\$149,572	\$187,074	\$121,485
Adjustments to reconcile net income to net cash provided by operating activities:			
(Gain) loss on sale of discontinued business	255	(78,182)	—
Stock-based compensation expense	20,558	20,168	15,158
Depreciation of property, plant, and equipment	11,678	9,868	8,443
Amortization of intangible assets	3,391	4,250	4,024
Amortization of discounts or premiums on investments	383	690	1,823
Realized (gain) loss on sale of investments	(1,506)	(344)	(673)
Revaluation of contingent consideration	(463)	(790)	—
Change in deferred income taxes	(1,908)	(1,409)	(2,364)
Changes in operating assets and liabilities:			
Accounts receivable	(13,251)	(3,950)	(915)
Unbilled revenue	(2,308)	(242)	(563)
Inventories	10,409	(9,457)	(11,750)
Accounts payable	2,087	(8,872)	10,896
Accrued expenses	7,771	(2,831)	7,812
Accrued income taxes	2,110	9,957	7,700
Deferred revenue and customer deposits	(3,188)	1,527	5,893
Other	(3,509)	870	(3,128)
Net cash provided by operating activities	182,081	128,327	163,841
Cash flows from investing activities:			
Purchases of investments	(751,868)	(686,650)	(422,633)
Maturities and sales of investments	657,250	601,441	339,470
Purchases of property, plant, and equipment	(12,816)	(18,228)	(20,934)
Cash paid for acquisition of business, net of cash acquired	(14,285)	(1,023)	—
Cash paid for purchased technology	—	(10,475)	—
Net cash received (paid) from sale of discontinued business	(113)	104,388	—
Net cash used in investing activities	(121,832)	(10,547)	(104,097)
Cash flows from financing activities:			
Issuance of common stock under stock plans	43,468	27,582	16,930
Repurchase of common stock	(47,149)	(126,351)	(59,673)
Payment of dividends	(25,213)	(18,062)	—
Payment of contingent consideration	(337)	—	—
Net cash used in financing activities	(29,231)	(116,831)	(42,743)
Effect of foreign exchange rate changes on cash and cash equivalents	(3,352)	(4,668)	(1,951)
Net change in cash and cash equivalents	27,666	(3,719)	15,050
Cash and cash equivalents at beginning of year	51,975	55,694	40,644
Cash and cash equivalents at end of year	\$79,641	\$51,975	\$55,694
Non-cash items related to discontinued operations:			
Stock-based compensation expense	\$—	\$1,533	\$1,099
Depreciation and amortization expense	—	566	1,141
Capital expenditures	—	482	631

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

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COGNEX CORPORATION – CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(In thousands)	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
	Shares	Par Value				
Balance as of December 31, 2013	86,831	\$ 174	\$ 211,440	\$ 462,131	\$ (29,833)	\$ 643,912
Issuance of common stock under stock plans	1,245	2	16,928	—	—	16,930
Repurchase of common stock	(1,534)	(3)	—	(59,670)	—	(59,673)
Stock-based compensation expense	—	—	15,158	—	—	15,158
Excess tax benefit from stock option exercises	—	—	7,871	—	—	7,871
Tax benefit for research and development credits as a result of stock options	—	—	320	—	—	320
Net income	—	—	—	121,485	—	121,485
Net unrealized loss on cash flow hedges net of tax of \$0	—	—	—	—	(118)	(118)
Reclassification of net realized loss on cash flow hedges	—	—	—	—	46	46
Net unrealized gain on available-for-sale investments, net of tax of \$40	—	—	—	—	579	579
Reclassification of net realized gain on the sale of available-for-sale investments	—	—	—	—	(673)	(673)
Foreign currency translation adjustment, net of tax of (\$870)	—	—	—	—	(9,400)	(9,400)
Balance as of December 31, 2014	86,542	\$ 173	\$ 251,717	\$ 523,946	\$ (39,399)	\$ 736,437
Issuance of common stock under stock plans	1,520	3	27,579	—	—	27,582
Repurchase of common stock	(3,206)	(6)	—	(126,345)	—	(126,351)
Stock-based compensation expense	—	—	21,274	—	—	21,274
Excess tax benefit from stock option exercises	—	—	9,964	—	—	9,964
Tax benefit for research and development credits as a result of stock options	—	—	474	—	—	474
Payment of dividends	—	—	—	(18,062)	—	(18,062)
Net income	—	—	—	187,074	—	187,074
Net unrealized loss on cash flow hedges, net of tax of \$22	—	—	—	—	(27)	(27)
Reclassification of net realized loss on cash flow hedges	—	—	—	—	201	201
Net unrealized loss on available-for-sale investments, net of tax of (\$279)	—	—	—	—	(939)	(939)
Reclassification of net realized gain on the sale of available-for-sale investments	—	—	—	—	(344)	(344)
Foreign currency translation adjustment, net of tax of (\$711)	—	—	—	—	(11,616)	(11,616)
Balance as of December 31, 2015	84,856	\$ 170	\$ 311,008	\$ 566,613	\$ (52,124)	\$ 825,667
Issuance of common stock under stock plans	1,977	4	43,464	—	—	43,468
Repurchase of common stock	(894)	(2)	—	(47,147)	—	(47,149)
Stock-based compensation expense	—	—	20,558	—	—	20,558