

NATIONAL INSTRUMENTS CORP /DE/

Form 10-Q

April 30, 2012

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended: March 31, 2012 or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 0-25426

NATIONAL INSTRUMENTS CORPORATION  
(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of incorporation or organization)

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

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

78759  
(zip code)

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

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

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

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

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

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

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

| Class                           | Outstanding at April 26, 2012 |
|---------------------------------|-------------------------------|
| Common Stock - \$0.01 par value | 121,041,612                   |

NATIONAL INSTRUMENTS CORPORATION

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## PART I - FINANCIAL INFORMATION

## ITEM 1.

## Financial Statements

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

|   | March 31,<br>2012<br>(unaudited) | December<br>31,<br>2011 |
|---|----------------------------------|-------------------------|
| Assets  |                                  |                         |
| Current assets:   |                                  |                         |
| Cash and cash equivalents   | \$238,510                        | \$142,608               |
| Short-term investments  | 138,896                          | 223,504                 |
| Accounts receivable, net  | 155,386                          | 157,056                 |
| Inventories, net  | 140,408                          | 131,995                 |
| Prepaid expenses and other current assets   | 32,911                           | 38,082                  |
| Deferred income taxes, net  | 27,767                           | 26,304                  |
| Total current assets  | 733,878                          | 719,549                 |
| Property and equipment, net   | 192,944                          | 190,148                 |
| Goodwill  | 130,975                          | 130,747                 |
| Intangible assets, net  | 81,042                           | 83,866                  |
| Other long-term assets  | 31,916                           | 29,984                  |
| Total assets  | \$1,170,755                      | \$1,154,294             |
| Liabilities and stockholders' equity  |                                  |                         |
| Current liabilities:  |                                  |                         |
| Accounts payable  | \$41,629                         | \$41,111                |
| Accrued compensation  | 24,656                           | 29,616                  |
| Deferred revenue  | 95,448                           | 90,074                  |
| Accrued expenses and other liabilities  | 34,619                           | 37,612                  |
| Other taxes payable   | 20,047                           | 24,507                  |
| Total current liabilities   | 216,399                          | 222,920                 |
| Deferred income taxes   | 43,058                           | 43,186                  |
| Liability for uncertain tax positions   | 20,270                           | 19,494                  |
| Other long-term liabilities   | 15,714                           | 16,683                  |
| Total liabilities   | 295,441                          | 302,283                 |
| Commitments and contingencies   |                                  |                         |
| Stockholders' equity:   |                                  |                         |
| Preferred stock: par value \$0.01; 5,000,000 shares authorized; none issued and outstanding | -                                | -                       |
|   | 1,210                            | 1,207                   |

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|  |             |             |
|--|-------------|-------------|
| Common stock: par value \$0.01; 180,000,000 shares authorized; 121,041,331 and 120,677,143 shares issued and outstanding, respectively |             |             |
| Additional paid-in capital   | 485,989     | 471,830     |
| Retained earnings  | 384,147     | 382,474     |
| Accumulated other comprehensive income (loss)  | 3,968       | (3,500 )    |
| Total stockholders' equity   | 875,314     | 852,011     |
| Total liabilities and stockholders' equity   | \$1,170,755 | \$1,154,294 |

The accompanying notes are an integral part of these financial statements

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

|   | Three Months Ended<br>March 31, |           |
|---|---------------------------------|-----------|
|   | 2012                            | 2011      |
| Net sales:                                    |                                 |           |
| Product                                       | \$239,335                       | \$218,610 |
| Software maintenance                          | 21,798                          | 19,240    |
| Total net sales                               | 261,133                         | 237,850   |
| Cost of sales:                                |                                 |           |
| Product                                       | 59,791                          | 50,958    |
| Software maintenance                          | 1,557                           | 1,518     |
| Total cost of sales                           | 61,348                          | 52,476    |
| Gross profit                                  | 199,785                         | 185,374   |
| Operating expenses:                           |                                 |           |
| Sales and marketing                           | 100,052                         | 87,155    |
| Research and development                      | 54,015                          | 42,868    |
| General and administrative                    | 21,374                          | 18,839    |
| Total operating expenses                      | 175,441                         | 148,862   |
| Operating income                              | 24,344                          | 36,512    |
| Other income:                                 |                                 |           |
| Interest income                               | 230                             | 341       |
| Net foreign exchange (loss)                   | (888 )                          | (223 )    |
| Other income, net                             | 104                             | 446       |
| Income before income taxes                    | 23,790                          | 37,076    |
| Provision for income taxes                    | 5,148                           | 6,615     |
| Net income                                    | \$18,642                        | \$30,461  |
| Basic earnings per share                      | \$0.15                          | \$0.26    |
| Weighted average shares outstanding - basic   | 120,908                         | 118,693   |
| Diluted earnings per share                    | \$0.15                          | \$0.25    |
| Weighted average shares outstanding - diluted | 121,972                         | 120,443   |
| Dividends declared per share                  | \$0.14                          | \$0.10    |

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

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NATIONAL INSTRUMENTS CORPORATION  
 STATEMENT OF CONSOLIDATED COMPREHENSIVE INCOME  
 (in thousands)  
 (unaudited)

|   | Three Months Ended<br>March 31, |           |
|---|---------------------------------|-----------|
|   | 2012                            | 2011      |
| Net income  | \$ 18,642                       | \$ 30,461 |
| Other comprehensive income, before tax and net of reclassification adjustments: |                                 |           |
| Foreign currency translation adjustment   | 3,382                           | 5,275     |
| Unrealized gain (loss) on securities available-for-sale, net                    | 1,013                           | (424 )    |
| Unrealized gain on derivative instruments, net                                  | 3,885                           | 2,846     |
| Other comprehensive income, before tax  | 8,280                           | 7,697     |
| Tax provision related to items of other comprehensive income                    | (812 )                          | (477 )    |
| Other comprehensive income, net of tax  | 7,468                           | 7,220     |
| Comprehensive income  | \$ 26,110                       | \$ 37,681 |

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

NATIONAL INSTRUMENTS CORPORATION  
CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)  
(unaudited)

|   | Three Months Ended<br>March 31, |            |
|---|---------------------------------|------------|
|   | 2012                            | 2011       |
| Cash flow from operating activities:  |                                 |            |
| Net income  | \$ 18,642                       | \$ 30,461  |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                 |            |
| Depreciation and amortization   | 14,115                          | 10,973     |
| Stock-based compensation  | 6,303                           | 4,590      |
| Tax (benefit) from deferred income taxes  | (1,567 )                        | (560 )     |
| Tax (benefit) from stock option plans   | (246 )                          | (1,327 )   |
| Changes in operating assets and liabilities:                                      |                                 |            |
| Accounts receivable   | 1,671                           | (4,933 )   |
| Inventories   | (8,413 )                        | (16,643 )  |
| Prepaid expenses and other assets   | 9,468                           | 14,995     |
| Accounts payable  | 518                             | 3,071      |
| Deferred revenue  | 5,374                           | 6,137      |
| Taxes and other liabilities   | (12,361 )                       | (5,134 )   |
| Net cash provided by operating activities   | 33,504                          | 41,630     |
| Cash flow from investing activities:  |                                 |            |
| Capital expenditures  | (9,054 )                        | (9,580 )   |
| Capitalization of internally developed software                                   | (3,740 )                        | (3,731 )   |
| Additions to other intangibles  | (333 )                          | (436 )     |
| Purchases of short-term investments   | -                               | (27,176 )  |
| Sales and maturities of short-term investments                                    | 84,608                          | 27,931     |
| Net cash provided/(used) by investing activities                                  | 71,481                          | (12,992 )  |
| Cash flow from financing activities:  |                                 |            |
| Proceeds from issuance of common stock  | 7,605                           | 17,050     |
| Dividends paid  | (16,934 )                       | (11,868 )  |
| Tax benefit from stock option plans   | 246                             | 1,327      |
| Net cash (used)/provided by financing activities                                  | (9,083 )                        | 6,509      |
| Net change in cash and cash equivalents   | 95,902                          | 35,147     |
| Cash and cash equivalents at beginning of period                                  | 142,608                         | 219,447    |
| Cash and cash equivalents at end of period  | \$ 238,510                      | \$ 254,594 |

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



NATIONAL INSTRUMENTS CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 – Basis of presentation

The accompanying unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2011, included in our annual report on Form 10-K, filed with the Securities and Exchange Commission. In our opinion, the accompanying consolidated financial statements reflect all adjustments (consisting only of normal recurring items) considered necessary to present fairly our financial position at March 31, 2012 and December 31, 2011, and the results of our operations, comprehensive income, and cash flows for the three month periods ended March 31, 2012 and March 31, 2011. Operating results for the three month period ended March 31, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. These financial statements have been prepared in accordance with accounting principles generally accepted in the United States.

Note 2 – Earnings per share

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

The reconciliation of the denominators used to calculate basic EPS and diluted EPS for the three month periods ended March 31, 2012 and 2011, respectively, are as follows:

|   | Three months ended<br>March 31,<br>(In thousands)<br>(Unaudited) |         |
|---|--|---------|
|   | 2012   | 2011    |
| Weighted average shares outstanding-basic   | 120,908  | 118,693 |
| Plus: Common share equivalents              |  |         |
| Stock options, restricted stock units       | 1,064  | 1,750   |
| Weighted average shares outstanding-diluted | 121,972  | 120,443 |

Stock awards to acquire 719,158 shares for the three month period ended March 31, 2012 were excluded in the computations of diluted EPS because the effect of including the stock awards would have been anti-dilutive. There were no shares excluded in the computation for the three month period ended March 31, 2011.

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

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

| (In thousands)               | As of March 31, 2012<br>(Unaudited) |                             |                             |   |            |
|------------------------------|-------------------------------------|-----------------------------|-----------------------------|---|------------|
|                              | Adjusted<br>Cost                    | Gross<br>Unrealized<br>Gain | Gross<br>Unrealized<br>Loss | Cumulative<br>Translation<br>Adjustment | Fair Value |
| Cash                         | \$99,152                            | \$-                         | \$-                         | \$-                                     | \$99,152   |
| Money Market Accounts        | 129,359                             | -                           | -                           | -                                       | 129,359    |
| Municipal bonds              | 5,111                               | 6                           | -                           | -                                       | 5,117      |
| Corporate bonds              | 9,225                               | 9                           | (3)                         | -                                       | 9,231      |
| U.S. treasuries and agencies | 98,433                              | -                           | (6)                         | -                                       | 98,427     |
| Foreign government bonds     | 36,381                              | 179                         | (11)                        | (3,504)                                 | 33,045     |
| Time deposits                | 3,075                               | -                           | -                           | -                                       | 3,075      |
| Total short-term investments | \$380,736                           | \$194                       | \$(20)                      | \$(3,504)                               | \$377,406  |

| (In thousands)               | As of December 31, 2011 |                             |                             |   |            |
|------------------------------|-------------------------|-----------------------------|-----------------------------|---|------------|
|                              | Adjusted<br>Cost        | Gross<br>Unrealized<br>Gain | Gross<br>Unrealized<br>Loss | Cumulative<br>Translation<br>Adjustment | Fair Value |
| Cash                         | \$106,431               | \$-                         | \$-                         | \$-                                     | \$106,431  |
| Money Market Accounts        | 22,677                  | -                           | -                           | -                                       | 22,677     |
| Municipal bonds              | 12,381                  | 11                          | -                           | -                                       | 12,392     |
| Corporate bonds              | 18,631                  | -                           | (67)                        | -                                       | 18,564     |
| U.S. treasuries and agencies | 170,926                 | 2                           | (9)                         | -                                       | 170,919    |
| Foreign government bonds     | 36,460                  | 240                         | (1)                         | (4,482)                                 | 32,217     |
| Time deposits                | 2,912                   | -                           | -                           | -                                       | 2,912      |
| Total short-term investments | \$370,418               | \$253                       | \$(77)                      | \$(4,482)                               | \$366,112  |

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

| (in thousands)                           | As of March 31, 2012<br>(Unaudited) |            |
|--|-------------------------------------|------------|
|  | Adjusted<br>Cost                    | Fair Value |
| Due in less than 1 year                  | \$142,186                           | \$139,594  |
| Due in 1 to 5 years                      | 10,039                              | 9,301      |
| Total available-for-sale debt securities | \$152,225                           | \$148,895  |

|  | Adjusted  |            |
|--|-----------|------------|
|  | Cost      | Fair Value |
| Due in less than 1 year                  |           |            |
| Municipal bonds                          | \$5,111   | \$5,117    |
| Corporate bonds                          | 8,200     | 8,209      |
| U.S. treasuries and agencies             | 98,434    | 98,427     |
| Foreign government bonds                 | 27,366    | 24,766     |
| Time deposits                            | 3,075     | 3,075      |
| Total available-for-sale debt securities | \$142,186 | \$139,594  |

|                     | Adjusted |            |
|---------------------|----------|------------|
|                     | Cost     | Fair Value |
| Due in 1 to 5 years |          |            |

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|  |          |         |
|--|----------|---------|
| Corporate bonds                          | \$1,025  | \$1,022 |
| Foreign government bonds                 | 9,014    | 8,279   |
| Total available-for-sale debt securities | \$10,039 | \$9,301 |

Note 4 – Fair value measurements

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

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

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

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

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

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

| (In thousands)                                | Fair Value Measurements at Reporting Date Using<br>(Unaudited) |  |   |  |
|---|--|--|---|--|
|   | March 31,<br>2012  | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs (Level<br>3) |
| Description                                   |  |  |   |  |
| Assets  |  |  |   |  |
| Cash and cash equivalents available for sale: |  |  |   |  |
| Money Market Funds                            | \$129,359  | \$129,359  | \$-   | \$ -   |
| U.S. treasuries and agencies                  | 9,999  | -  | 9,999   | -  |
| Short-term investments available for sale:    |  |  |   |  |
| Municipal bonds                               | 5,117  | -  | 5,117   | -  |
| Corporate bonds                               | 9,231  | -  | 9,231   | -  |
| U.S. treasuries and agencies                  | 88,428   | -  | 88,428  | -  |
| Foreign government bonds                      | 33,045   | -  | 33,045  | -  |
| Time deposits                                 | 3,075  | 3,075  | -   | -  |
| Derivatives                                   | 4,823  | -  | 4,823   | -  |
| Total Assets                                  | \$283,077  | \$132,434  | \$150,643   | \$ -   |
| Liabilities                                   |  |  |   |  |
| Derivatives                                   | \$(1,932)  | \$-  | \$(1,932)   | \$ -   |
| Total Liabilities                             | \$(1,932)  | \$-  | \$(1,932)   | \$ -   |

(In thousands)

Fair Value Measurements at Reporting Date Using

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| Description                                   | December<br>31, 2011 | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs (Level<br>3) |
|---|----------------------|--|---|--|
| <b>Assets</b>                                 |                      |  |   |  |
| Cash and cash equivalents available for sale: |                      |  |   |  |
| Money Market Funds                            | \$22,677             | \$22,677   | \$-   | \$ -   |
| U.S. Treasuries and Agencies                  | 13,500               | -  | 13,500  | -  |
| Short-term investments available for sale:    |                      |  |   |  |
| Municipal bonds                               | 12,392               | -  | 12,392  | -  |
| Corporate bonds                               | 18,564               | -  | 18,564  | -  |
| U.S. treasuries and agencies                  | 157,419              | -  | 157,419   | -  |
| Foreign government bonds                      | 32,217               | -  | 32,217  | -  |
| Time deposits                                 | 2,912                | 2,912  | -   | -  |
| Derivatives                                   | 4,297                | -  | 4,297   | -  |
| <b>Total Assets</b>                           | <b>\$263,978</b>     | <b>\$25,589</b>  | <b>\$238,389</b>  | <b>\$ -</b>  |
| <b>Liabilities</b>                            |                      |  |   |  |
| Derivatives                                   | \$(4,542 )           | \$-  | \$(4,542 )  | \$ -   |
| <b>Total Liabilities</b>                      | <b>\$(4,542 )</b>    | <b>\$-</b>   | <b>\$(4,542 )</b>   | <b>\$ -</b>  |

We value our available-for-sale short term investments based on pricing from third party pricing vendors, who may use quoted prices in active markets for identical assets (Level 1 inputs) or inputs other than quoted prices that are observable either directly or indirectly (Level 2 inputs) in determining fair value. We classify all of our fixed income available-for-sale securities as having Level 2 inputs. The valuation techniques used to measure the fair value of our financial instruments having Level 2 inputs were derived from non-binding market consensus prices that are corroborated by observable market data, quoted market prices for similar instruments, or pricing models, such as discounted cash flow techniques. We believe all of these sources reflect the credit risk associated with each of our available for sale short term investments. Short-term investments available-for-sale consists of debt securities issued by states of the U.S. and political subdivisions of the U.S., corporate debt securities and debt securities issued by U.S. government corporations and agencies as well as debt securities issued by foreign governments. All short-term investments available-for-sale have contractual maturities of less than 24 months.

Derivatives include foreign currency forward and option contracts. Our foreign currency forward contracts are valued using an income approach (Level 2) based on the spot rate less the contract rate multiplied by the notional amount. Our foreign currency option contracts are valued using a market approach based on the quoted market prices which are derived from observable inputs including current and future spot rates, interest rate spreads as well as quoted market prices of similar instruments. We consider counterparty credit risk in the valuation of our derivatives. However, counterparty credit risk did not impact the valuation of our derivatives during the three month period ended March 31, 2012. There were not any transfers in or out of Level 1 or Level 2 during the three month period ended March 31, 2012.

We did not have any items that were measured at fair value on a nonrecurring basis at March 31, 2012 and December 31, 2011.

The carrying value of net accounts receivable and accounts payable contained in the Consolidated Balance Sheet approximates fair value.

Note 5 – Derivative instruments and hedging activities

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

We have operations in over 40 countries. Sales outside of the Americas accounted for approximately 59% of our revenues during each of the three month periods ended March 31, 2012 and March 31, 2011. Our activities expose us to a variety of market risks, including the effects of changes in foreign currency exchange rates. These financial risks are monitored and managed by us as an integral part of our overall risk management program.

We maintain a foreign currency risk management strategy that uses derivative instruments (foreign currency forward and purchased option contracts) to help protect our earnings and cash flows from fluctuations caused by the volatility in currency exchange rates. Movements in foreign currency exchange rates pose a risk to our operations and competitive position, since exchange rate changes may affect our profitability and cash flow, and the business or pricing strategies of our non-U.S. based competitors.

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

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

Cash flow hedges

To help protect against the reduction in value caused by a fluctuation in foreign currency exchange rates of forecasted foreign currency cash flows resulting from international sales over the next one to two years, we have instituted a foreign currency cash flow hedging program. We hedge portions of our forecasted revenue and forecasted expenses denominated in foreign currencies with forward and purchased option contracts. For forward contracts, when the dollar strengthens significantly against the foreign currencies, the change in the present value of future foreign currency cash flows may be offset by the change in the fair value of the forward contracts designated as hedges. For option contracts, when the dollar strengthens significantly against the foreign currencies, the change in the present value of future foreign currency cash flows may be offset by the change in the fair value of the option contracts net of the premium paid designated as hedges. Our foreign currency purchased option contracts are purchased "at-the-money" or "out-of-the-money". We purchase foreign currency forward and option contracts for up to 100% of our forecasted exposures in selected currencies (primarily in Euro, Japanese yen, British pound sterling, Korean won and Hungarian forint) and limit the duration of these contracts to 40 months or less.

For derivative instruments that are designated and qualify as a cash flow hedge, the effective portion of the gain or loss on the derivative is reported as a component of accumulated other comprehensive income ("OCI") and reclassified



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

We held forward contracts with the following notional amounts:

| (In thousands)                          | US Dollar Equivalent                      |                                  |
|---|---|----------------------------------|
|   | As of<br>March 31,<br>2012<br>(Unaudited) | As of<br>December<br>31,<br>2011 |
| Euro                                    | \$44,385                                  | \$60,992                         |
| Japanese yen                            | 34,497                                    | 43,569                           |
| Korean won                              | 1,833                                     | 3,309                            |
| Hungarian forint                        | 31,589                                    | 28,189                           |
| Total forward contracts notional amount | \$112,304                                 | \$136,059                        |

The contracts in the foregoing table had contractual maturities of 24 months or less at March 31, 2012 and December 31, 2011, respectively.

At March 31, 2012, we expect to reclassify \$1.6 million of gains on derivative instruments from accumulated other comprehensive income to net sales during the next twelve months when the hedged international sales occur, \$355,000 of gains on derivative instruments from accumulated OCI to cost of sales when the cost of sales are incurred and \$166,000 of gains on derivative instruments from accumulated OCI to operating expenses during the next twelve months when the hedged operating expenses occur. Expected amounts are based on derivative valuations at March 31, 2012. Actual results may vary as a result of changes in the corresponding exchange rate subsequent to this date.

We did not record any ineffectiveness from our hedges during the three month periods ended March 31, 2012 and 2011.

#### Other Derivatives

Other derivatives not designated as hedging instruments consist primarily of foreign currency forward contracts that we use to hedge our foreign denominated net receivable or net payable positions to protect against the change in value caused by a fluctuation in foreign currency exchange rates. We typically attempt to hedge up to 90% of our outstanding foreign denominated net receivables or net payables and typically limit the duration of these foreign currency forward contracts to approximately 120 days. The gain or loss on the derivatives as well as the offsetting gain or loss on the hedge item attributable to the hedged risk is recognized in current earnings under the line item “net foreign exchange gain (loss)”. As of March 31, 2012 and December 31, 2011, we held foreign currency forward contracts with a notional amount of \$52.5 million and \$53.8 million, respectively.

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

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Fair Values of Derivative Instruments:

| (In thousands)  | Asset Derivatives                         |            |   |            |
|---|---|------------|---|------------|
|   | March 31, 2012<br>(Unaudited)             |            | December 31, 2011                         |            |
|   | Balance Sheet Location                    | Fair Value | Balance Sheet Location                    | Fair Value |
| Derivatives designated as hedging instruments           |   |            |   |            |
| Foreign exchange contracts - ST forwards                | Prepaid expenses and other current assets | \$2,558    | Prepaid expenses and other current assets | \$2,500    |
| Foreign exchange contracts - LT forwards                | Other long-term assets                    | 1,247      | Other long-term assets                    | 190        |
| Total derivatives designated as hedging instruments     |   | \$3,805    |   | \$2,690    |
| Derivatives not designated as hedging instruments       |   |            |   |            |
| Foreign exchange contracts - ST forwards                | Prepaid expenses and other current assets | \$1,018    | Prepaid expenses and other current assets | \$1,607    |
| Total derivatives not designated as hedging instruments |   | \$1,018    |   | \$1,607    |
| Total derivatives                                       |   | \$4,823    |   | \$4,297    |

| (In thousands)  | Liability Derivatives                  |            |  |            |
|---|--|------------|--|------------|
|   | March 31, 2012<br>(Unaudited)          |            | December 31, 2011                      |            |
|   | Balance Sheet Location                 | Fair Value | Balance Sheet Location                 | Fair Value |
| Derivatives designated as hedging instruments           |  |            |  |            |
| Foreign exchange contracts - ST forwards                | Accrued expenses and other liabilities | \$(422 )   | Accrued expenses and other liabilities | \$(2,007 ) |
| Foreign exchange contracts - LT forwards                | Other long-term liabilities            | (731 )     | Other long-term liabilities            | (1,770 )   |
| Total derivatives designated as hedging instruments     |  | \$(1,153 ) |  | \$(3,777 ) |
| Derivatives not designated as hedging instruments       |  |            |  |            |
| Foreign exchange contracts - ST forwards                | Accrued expenses and other liabilities | \$(779 )   | Accrued expenses and other liabilities | \$(765 )   |
| Total derivatives not designated as hedging instruments |  | \$(779 )   |  | \$(765 )   |

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Total derivatives \$(1,932 ) \$(4,542 )

Effect of derivative instruments on our Consolidated Statements of Income for the three month periods ended March 31, 2012 and 2011, respectively:

| March 31, 2012<br>(In thousands)<br>(Unaudited)     |  |  |  |  |  |
|---|--|--|--|--|--|
| Derivatives in Cash<br>Flow Hedging<br>Relationship | Gain or<br>(Loss)<br>Recognized<br>in OCI on<br>Derivative<br>(Effective<br>Portion) | Location of Gain or<br>(Loss) Reclassified from<br>Accumulated OCI into<br>Income (Effective<br>Portion) | Gain or<br>(Loss)<br>Reclassified<br>from<br>Accumulated<br>OCI into<br>Income<br>(Effective<br>Portion) | Location of Gain or<br>(Loss) Recognized in<br>Income on Derivative<br>(Ineffective Portion) | Gain or<br>(Loss)<br>Recognized<br>in Income<br>on<br>Derivative<br>(Ineffective<br>Portion) |
| Foreign exchange contracts - forwards and options   | \$ 462   | Net sales  | \$ 476   | Net foreign exchange gain (loss)   | \$ -   |
| Foreign exchange contracts - forwards and options   | 2,248  | Cost of sales  | (8 )   | Net foreign exchange gain (loss)   | -  |
| Foreign exchange contracts - forwards and options   | 1,175  | Operating expenses   | 55   | Net foreign exchange gain (loss)   | -  |
| Total   | \$ 3,885   |  | \$ 523   |  | \$ -   |

| March 31, 2011<br>(In thousands)<br>(Unaudited)     |  |  |  |  |  |
|---|--|--|--|--|--|
| Derivatives in Cash<br>Flow Hedging<br>Relationship | Gain or<br>(Loss)<br>Recognized<br>in OCI on<br>Derivative<br>(Effective<br>Portion) | Location of Gain or<br>(Loss) Reclassified from<br>Accumulated OCI into<br>Income (Effective<br>Portion) | Gain or<br>(Loss)<br>Reclassified<br>from<br>Accumulated<br>OCI into<br>Income<br>(Effective<br>Portion) | Location of Gain or<br>(Loss) Recognized in<br>Income on Derivative<br>(Ineffective Portion) | Gain or<br>(Loss)<br>Recognized<br>in Income<br>on<br>Derivative<br>(Ineffective<br>Portion) |
| Foreign exchange contracts - forwards and options   | \$ (396 )  | Net sales  | \$ (757 )  | Net foreign exchange gain (loss)   | \$ -   |
| Foreign exchange contracts - forwards and options   | 2,154  | Cost of sales  | 344  | Net foreign exchange gain (loss)   | -  |

|   |          |                    |           |                                  |     |
|---|----------|--------------------|-----------|----------------------------------|-----|
| Foreign exchange contracts - forwards and options | 1,088    | Operating expenses | 145       | Net foreign exchange gain (loss) | -   |
| Total   | \$ 2,846 |                    | \$ (268 ) |                                  | \$- |

| Derivatives not Designated as Hedging Instruments | Location of Gain (Loss) Recognized in Income | Amount of Gain (Loss) Recognized in Income March 31, 2012 (Unaudited) | Amount of Gain (Loss) Recognized in Income March 31, 2011 (Unaudited) |
|---|--|---|---|
| Foreign exchange contracts - forwards             | Net foreign exchange gain/(loss)             | \$ (1,030 )   | \$ (993 )   |
| Total   |  | \$ (1,030 )   | \$ (993 )   |

#### Note 6 – Inventories

Inventories, net consist of the following:

| (In thousands)  | March 31, 2012 (Unaudited) | December 31, 2011 |
|-----------------|----------------------------|-------------------|
| Raw materials   | \$ 63,113                  | \$ 56,139         |
| Work-in-process | 4,860                      | 5,708             |
| Finished goods  | 72,435                     | 70,148            |
|                 | \$ 140,408                 | \$ 131,995        |

#### Note 7 – Intangibles

Intangibles at March 31, 2012 and December 31, 2011 are as follows:

| (In thousands)                         | March 31, 2012 (Unaudited) |                          |                     | December 31, 2011     |                          |                     |
|--|----------------------------|--------------------------|---------------------|-----------------------|--------------------------|---------------------|
|  | Gross Carrying Amount      | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Capitalized software development costs | \$ 57,004                  | \$ (33,176 )             | \$ 23,828           | \$ 53,086             | \$ (29,606 )             | \$ 23,480           |
| Acquired technology                    | 67,989                     | (34,633 )                | 33,356              | 67,918                | (32,210 )                | 35,708              |
| Patents                                | 22,602                     | (8,351 )                 | 14,251              | 21,875                | (7,992 )                 | 13,883              |
| Other                                  | 23,886                     | (14,279 )                | 9,607               | 24,614                | (13,819 )                | 10,795              |
|  | \$ 171,481                 | \$ (90,439 )             | \$ 81,042           | \$ 167,493            | \$ (83,627 )             | \$ 83,866           |

Software development costs capitalized for the three month periods ended March 31, 2012 and 2011 were \$3.9 million for both periods, and related amortization expense was \$3.6 million and \$3.2 million, respectively. Capitalized software development costs for the three month periods ended March 31, 2012 and 2011 included costs related to stock based compensation of \$178,000 and \$149,000, respectively.

Amortization of capitalized software development costs is computed on an individual product basis for those products available for market and is recognized based on the product's estimated economic life, generally three years. Acquired core technology and intangible assets are amortized over their useful lives, which range from three to eight years. Patents are amortized using the straight-line method over their estimated period of benefit, generally 10 to 17 years. Total intangible assets amortization expenses were \$7.5 million and \$5.2 million for the three months ended March 31, 2012 and March 31, 2011, respectively.

#### Note 8 – Goodwill

The carrying amount of goodwill as of March 31, 2012, is as follows:

|  | Amount<br>(In<br>thousands) |
|--|-----------------------------|
| Balance as of December 31, 2011          | \$ 130,747                  |
| Acquisitions                             | -                           |
| Divestitures                             | -                           |
| Foreign currency translation impact      | 228                         |
| Balance as of March 31, 2012 (unaudited) | \$ 130,975                  |

The excess purchase price over the fair value of assets acquired is recorded as goodwill. As we have one operating segment, we allocate goodwill to one reporting unit for goodwill impairment testing. Goodwill is tested for impairment on an annual basis, and between annual tests if indicators of potential impairment exist, using a fair-value-based approach based on the market capitalization of the reporting unit. Our annual impairment test was performed as of February 29, 2012. No impairment of goodwill was identified during 2012 and 2011. Goodwill is deductible for tax purposes in certain jurisdictions.

#### Note 9 – Income taxes

We account for income taxes under the asset and liability method. Deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts. Valuation allowances are established when necessary to reduce deferred tax assets to amounts which are more likely than not to be realized.

We account for uncertainty in income taxes recognized in our financial statements using prescribed recognition thresholds and measurement attributes for financial statement disclosure of tax positions taken or expected to be taken on our tax returns. We had \$20.3 million and \$19.5 million of unrecognized tax benefits at March 31, 2012 and December 31, 2011, respectively, all of which would affect our effective income tax rate if recognized. We recorded a gross increase in unrecognized tax benefits of \$1.1 million for the three month period ended March 31, 2012, as a result of tax positions taken during the period. We recorded a gross decrease in unrecognized tax benefits of \$285,000 for the three month period ended March 31, 2012 related to settlements with taxing authorities. As of March 31, 2012, it is deemed reasonable that we will recognize tax benefits in the amount of \$2.2 million in the next twelve months due to the closing of open tax years. The nature of the uncertainty with regard to the amount of the benefit we may recognize is related to deductions taken on returns that have not been examined by the applicable tax authority. Our continuing policy is to recognize interest and penalties related to income tax matters in income tax expense. As of March 31, 2012, we have approximately \$874,000 accrued for interest related to uncertain tax positions. The tax years 2005 through 2011 remain open to examination by the major taxing jurisdictions to which we are subject.

Our provision for income taxes reflected an effective tax rate of 22% and 18% for the three month periods ended March 31, 2012 and 2011, respectively. For the three month period ended March 31, 2012, our effective tax rate was lower than the U.S. federal statutory rate of 35% as a result of an enhanced deduction for certain research and

development expenses and profits in foreign jurisdictions with reduced income tax rates. For the three month period ended March 31, 2011, our effective tax rate was lower than the U.S. federal statutory rate of 35% as a result of a tax benefit from equity awards that do not ordinarily result in a tax benefit, an enhanced deduction for certain research and development expenses, profits in foreign jurisdictions with reduced income tax rates and the U.S. federal research and development credit.

Our earnings in Hungary are subject to a statutory tax rate of 19%. The difference between this rate and the statutory U.S. rate of 35% resulted in income tax benefits of \$2.1 million and \$3.4 million for the three month periods ended March 31, 2012 and 2011, respectively. No countries other than Hungary had a significant impact on our effective tax rate. We have not entered into any advanced pricing or other agreements with the Internal Revenue Service with regard to any foreign jurisdictions.

The tax position of our Hungarian operation continues to benefit from assets created by the restructuring of our operations in Hungary. In addition, our research and development activities in Hungary continue to benefit from a tax law in Hungary that provides for an enhanced deduction for qualified research and development expenses. Partial release of the valuation allowance on assets from the restructuring and the enhanced tax deduction for research expenses resulted in income tax benefits of \$3.1 million and \$4.8 million for the three month periods ended March 31, 2012 and 2011, respectively.

#### Note 10 – Comprehensive income

Our comprehensive income is comprised of net income, foreign currency translation, unrealized gains and losses on forward and option contracts and securities classified as available for sale. The accumulated other comprehensive income, net of tax, for the three month periods ended March 31, 2012 and 2011, consists of the following:

| (In thousands)                            | Other Comprehensive Income<br>(Unaudited) |  |                           |   |
|---|---|--|---------------------------|---|
|   | Currency<br>translation<br>adjustment     | Unrealized<br>gain/(loss)<br>on<br>investments | Derivative<br>instruments | Accumulated<br>other<br>comprehensive<br>income |
| Balance as of December 31, 2011           | \$(1,543 )                                | \$(664 )                                       | \$(1,293 )                | \$(3,500 )                                      |
| Current-period other comprehensive income | 3,382                                     | 1,013  | 3,073                     | 7,468   |
| Balance as of March 31, 2012              | \$1,839                                   | \$349  | \$1,780                   | \$3,968   |

| (In thousands)                            | Other Comprehensive Income<br>(Unaudited) |  |                           |   |
|---|---|--|---------------------------|---|
|   | Currency<br>translation<br>adjustment     | Unrealized<br>gain/(loss)<br>on<br>investments | Derivative<br>instruments | Accumulated<br>other<br>comprehensive<br>income |
| Balance as of December 31, 2010           | \$(496 )                                  | \$196  | \$(410 )                  | \$(710 )  |
| Current-period other comprehensive income | 5,275                                     | (424 )   | 2,369                     | 7,220   |
| Balance as of March 31, 2011              | \$4,779                                   | \$(228 )                                       | \$1,959                   | \$6,510   |

#### Note 11 – Stock-based compensation plans

##### Stock option plans

Our stockholders approved the 1994 Incentive Stock Option Plan (the “1994 Plan”) on May 9, 1994. At the time of approval, 13,668,750 shares of our common stock were reserved for issuance under this plan. In 1997, an additional 10,631,250 shares of our common stock were reserved for issuance under this plan, and an additional 1,125,000 shares were reserved for issuance under this plan in 2004. The 1994 Plan terminated in May 2005, except with respect to outstanding awards previously granted thereunder.

Awards under the plan were either incentive stock options within the meaning of Section 422 of the Internal Revenue Code or nonqualified options. The right to purchase shares under the options vests over a five to ten-year period, beginning on the date of grant. Vesting of ten year awards may accelerate based on the Company’s previous year’s earnings and revenue growth but shares cannot accelerate to vest over a period of less than five years. Stock options must be exercised within ten years from date of grant. Stock options were issued with an exercise price which was equal to the market price of our common stock at the grant date. We estimate potential forfeitures of stock grants and adjust compensation cost recorded accordingly. The estimate of forfeitures will be adjusted over the requisite service period to the extent that actual forfeitures differ, or are expected to differ, from such estimates. Changes in estimated forfeitures will be recognized through a cumulative catch-up adjustment in the period of change and will also impact the amount of stock compensation expense to be recognized in future periods. During the three month period ended March 31, 2012, we did not make any changes in accounting principles or methods of estimates.

#### Restricted stock plan

Our stockholders approved our 2005 Incentive Plan (the “2005 Plan”) on May 10, 2005. At the time of approval, 4,050,000 shares of our common stock were reserved for issuance under this plan, as well as the number of shares which had been reserved but not issued under the 1994 Plan (our incentive stock option plan which terminated in May 2005), and any shares that returned to the 1994 Plan as a result of termination of options or repurchase of shares issued under such plan. The 2005 Plan, administered by the Compensation Committee of the Board of Directors, provided for granting of incentive awards in the form of restricted stock and RSUs to directors, executive officers and employees of the Company and its subsidiaries. Awards vest over a three, five or ten-year period, beginning on the date of grant. Vesting of ten year awards may accelerate based on the Company’s previous year’s earnings and growth but ten year awards cannot accelerate to vest over a period of less than five years. The 2005 Plan terminated on May 11, 2010, except with respect to outstanding awards previously granted thereunder. There were 3,362,304 shares of common stock that were reserved but not issued under the 1994 Plan and the 2005 Plan as of May 11, 2010.

Our stockholders approved our 2010 Incentive Plan (the “2010 Plan”) on May 11, 2010. At the time of approval, 3,000,000 shares of our common stock were reserved for issuance under this plan, as well as the 3,362,304 shares of common stock that were reserved but not issued under the 1994 Plan and the 2005 Plan as of May 11, 2010, and any shares that are returned to the 1994 Plan and the 2005 Plan as a result of forfeiture or termination of options or RSUs or repurchase of shares issued under these plans. The 2010 Plan, administered by the Compensation Committee of the Board of Directors, provides for granting of incentive awards in the form of restricted stock and RSUs to employees, directors and consultants of the Company and employees and consultants of any parent or subsidiary of the Company. Awards vest over a three, five or ten-year period, beginning on the date of grant. Vesting of ten year awards may accelerate based on the Company’s previous year’s earnings and growth but ten year awards cannot accelerate to vest over a period of less than five years. There were 5,076,349 shares available for grant under the 2010 Plan at March 31, 2012.

We estimate potential forfeitures of RSUs and adjust compensation cost recorded accordingly. The estimate of forfeitures will be adjusted over the requisite service period to the extent that actual forfeitures differ, or are expected to differ, from such estimates. Changes in estimated forfeitures will be recognized through a cumulative catch-up adjustment in the period of change and will also impact the amount of stock compensation expense to be recognized in future periods. During the three month period ended March 31, 2012, we did not make any changes in accounting principles or methods of estimates related to the 2010 Plan.

### Employee stock purchase plan

Our employee stock purchase plan permits substantially all domestic employees and employees of designated subsidiaries to acquire our common stock at a purchase price of 85% of the lower of the market price at the beginning or the end of the purchase period. The plan has quarterly purchase periods generally beginning on February 1, May 1, August 1 and November 1 of each year. Employees may designate up to 15% of their compensation for the purchase of common stock under this plan. On May 10, 2011, our stockholders approved an additional 3,000,000 shares for issuance under our employee stock purchase plan, and at March 31, 2012, we had 3,417,316 shares of common stock reserved for future issuance under this plan. We issued 262,822 shares under this plan in the three month period ended March 31, 2012. The weighted average fair value of the employees' purchase rights was \$22.70 per share and was estimated using the Black-Scholes model. During the three months ended March 31, 2012, we did not make any changes in accounting principles or methods of estimates with respect to such plan.

### Authorized Preferred Stock and Preferred Stock Purchase Rights Plan

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

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

There were not any shares of preferred stock issued and outstanding at March 31, 2012.

### Note 12 – Segment information

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

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

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



| (In thousands) | Three Months Ended<br>March 31,<br>(Unaudited) |           |
|----------------|--|-----------|
|                | 2012   | 2011      |
| Net sales:     |  |           |
| Americas:      | \$107,292                                      | \$97,364  |
| Europe:        | 75,707   | 71,056    |
| Asia Pacific:  | 78,134   | 69,430    |
|                | \$261,133                                      | \$237,850 |

| (In thousands)                    | Three Months Ended<br>March 31,<br>(Unaudited) |           |
|-----------------------------------|--|-----------|
|                                   | 2012   | 2011      |
| Operating income:                 |  |           |
| Americas                          | \$12,942                                       | \$18,587  |
| Europe                            | 34,637   | 34,876    |
| Asia Pacific                      | 30,780   | 25,917    |
| Unallocated:                      |  |           |
| Research and development expenses | (54,015 )                                      | (42,868 ) |
|                                   | \$24,344                                       | \$36,512  |

| (In thousands)   | Three Months Ended<br>March 31,<br>(Unaudited) |       |
|------------------|--|-------|
|                  | 2012   | 2011  |
| Interest income: |  |       |
| Americas         | \$91   | \$149 |
| Europe           | 94   | 158   |
| Asia Pacific     | 45   | 34    |
|                  | \$230  | \$341 |

| (In thousands)     | March 31,   | December  |
|--------------------|-------------|-----------|
|                    | 2012        | 31,       |
|                    | (Unaudited) |           |
| 2011               |             |           |
| Long-lived assets: |             |           |
| Americas           | \$111,132   | \$110,153 |
| Europe             | 47,050      | 47,000    |
| Asia Pacific       | 34,762      | 32,995    |
|                    | \$192,944   | \$190,148 |

Total sales outside the U.S. for the three month periods ended March 31, 2012 and 2011 were \$163.4 million and \$148.9 million, respectively.

Note 13 – Commitments and Contingencies

We offer a one-year limited warranty on most hardware products, with a two or three-year warranty on a subset of our hardware products, which is included in the sales price of many of our products. Provision is made for estimated future warranty costs at the time of the sale for the estimated costs that may be incurred under the basic limited warranty. Our estimate is based on historical experience and product sales during the period.

The warranty reserve for the three month periods ended March 31, 2012 and 2011, respectively, was as follows:

|   | Three months ended<br>March 31,<br>(In thousands)<br>(Unaudited) |        |
|---|--|--------|
|   | 2012   | 2011   |
| Balance at the beginning of the period                  | \$1,271  | \$921  |
| Accruals for warranties issued during the period        | 570  | 818    |
| Settlements made (in cash or in kind) during the period | (543 )   | (818 ) |
| Balance at the end of the period                        | \$1,298  | \$921  |

As of March 31, 2012, we have non-cancelable purchase commitments with various suppliers of customized inventory and inventory components totaling approximately \$10 million over the next twelve months.

As of March 31, 2012, we have outstanding guarantees for payment of customs and foreign grants totaling approximately \$5 million, which are generally payable over the next twelve months.

From November 1999 to May 2011, we sold products to the U.S. government under a contract with the General Services Administration ("GSA"). During such time, our sales under the contract were approximately 2% of our total sales. Our previous contract with GSA contained a price reduction or "most favored customer" pricing provision. For the past few quarters, we have been in discussions with GSA regarding our compliance with this pricing provision and have provided GSA with information regarding our pricing practices. In 2011, GSA conducted an on-site review of our GSA pricing practices and orally informed us that GSA did not agree with our previous determination of the potential non-compliance amount. GSA subsequently requested that we conduct a further analysis of the non-compliance amount based upon a methodology that GSA proposed. This analysis resulted in calculated overpayments (including added interest) by GSA to us of approximately \$13.1 million. GSA is reviewing the analysis and has not yet officially responded, and has not made any formal demand for pricing adjustments related to our previous GSA contract. However, GSA may make such a demand in the future, and there can be no assurance that the amount of any such demand, if we were required to pay it, would not have a material adverse impact on our results of operations. If GSA believes that our pricing practices did not comply with the contract, GSA could conduct a formal investigation of such matter or could refer such matter to the U.S. Department of Justice for investigation, including an investigation regarding potential violations of the False Claims Act, which could result in litigation and the possible imposition of a damage remedy that includes treble damages plus civil penalties, and could also result in us being suspended or debarred from future government contracting. As a result of the foregoing, during the quarter ended September 30, 2011, we established an accrual of \$13.1 million which represents the amount of the loss contingency that is reasonably estimable at this time. There can be no assurance that our actual losses will not exceed such reserve amount. Due to the complexities of conducting business with GSA, the relatively small amount of revenue we realized from our previous GSA contract, and our belief that we can continue to sell our products to U.S. government agencies through other contracting methods, we cancelled our contract with GSA in April 2011, effective May 2011. To date, we have not experienced any material adverse impact on our results of operations as a result of the cancellation of our previous GSA contract.

Note 14 – Recently issued accounting pronouncements

In January 2010, the FASB updated FASB ASC 820, Fair Value Measurements and Disclosures (FASB ASC 820) that requires additional disclosures and clarifies existing disclosures regarding fair value measurements. The additional disclosures include (i) transfers in and out of Levels 1 and 2 and (ii) activity in Level 3 fair value measurements. The update provides amendments that clarify existing disclosures on level of disaggregation and disclosures about inputs and valuation techniques. This update is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements which were effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. We adopted the update on January 1, 2010 as required and subsequently adopted on January 1, 2011, the update surrounding disclosures on Level 3 fair value measurements and concluded it did not have a material impact on our consolidated financial position or results of operations. In May 2011, the FASB updated FASB ASC 820 that resulted in common fair value measurement and disclosure requirements in U.S. GAAP and International Financial Reporting Standards (IFRSs). Some of the amendments clarify the FASB's intent about the application of existing fair value measurement requirements. Other amendments change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. The amendments are to be applied prospectively and are effective during interim and annual periods beginning after December 15, 2011. We adopted the update as required as of March 31, 2012 and concluded it did not have a material impact on our consolidated financial position or results of operations.

In June 2011, the FASB updated FASB ASC 220, Comprehensive Income (FASB ASC 220) that gives an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. The update does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The update does not change the option for an entity to present components of other comprehensive income either net of related tax effects or before related tax effects, with one amount shown for the aggregate income tax expense or benefit related to the total of other comprehensive income items. The update does not affect how earnings per share is calculated or presented. The update should be applied retrospectively and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. In December 2011, the FASB deferred the effective date for the amendment issued in June 2011 regarding the presentation of reclassifications of items out of accumulated other comprehensive income. This update deferred the implementation requirement to present on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income. The amended guidance specifies that entities should continue to report reclassifications out of accumulated other comprehensive income consistent with presentation requirements in effect before the update in June 2011. We adopted the update as required as of March 31, 2012, and concluded that the adoption did not have a material impact on our financial position or results of operations; however, the adoption resulted in an additional statement of other comprehensive income for the period ended March 31, 2012.

In September 2011, the FASB updated FASB ASC 350, Goodwill and Other (FASB ASC 350) that gives an entity the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. The amendments are effective for annual and interim goodwill impairment test performed for fiscal years beginning after December 15, 2011. We adopted the update as required as of the period ended March 31, 2012 and concluded it did not have a material impact on our consolidated financial position or results of operations.

Note 15 – Litigation

We are not currently a party to any material litigation. However, in the ordinary course of our business, we are involved in a limited number of legal actions, both as plaintiff and defendant, and could incur uninsured liability in any one or more of them. See Note 14 – Commitments and Contingencies in the Notes to our Consolidated Financial Statements, for discussion of the accrual we have recorded in connection with our previous GSA contract. No assurances can be given with respect to the extent or outcome of any future litigation or dispute.

#### Note 16 – Acquisitions

##### AWR Corporation

On June 30, 2011, we acquired all of the outstanding shares of AWR Corporation (AWR), a privately held company that is a leading supplier of electronic design automation software for designing radio frequency and high-frequency components and systems for the semiconductor, aerospace and defense, communications and test equipment industries. The acquisition is expected to improve customer productivity through increased interoperability between upfront design and validation and production test functions. The purchase price of the acquisition was \$66 million consisting of \$54 million in cash and a three-year earn-out arrangement. We funded the purchase price from existing cash balances. The range of potential undiscounted payments that we could be required to make under the earn-out arrangement is between \$0 and \$29 million and are payable if AWR achieves certain revenue and operating income targets. The fair value of the earn-out arrangement was estimated at \$12 million using the income approach, the key assumptions of which included probability-weighted revenue and operating expense growth projections.

The allocation of the purchase price was determined using the fair value of assets and liabilities acquired as of June 30, 2011. The primary area which is not finalized is deferred taxes. Our consolidated financial statements include the operating results from the date of acquisition. Pro-forma results of operations have not been presented because the effects of those operations were not material. The following table summarizes the allocation of the purchase price of AWR:

|                               | Amount<br>(in<br>thousands) |
|-------------------------------|-----------------------------|
| Net tangible assets acquired  | \$ 10,718                   |
| Amortizable intangible assets | 31,685                      |
| Deferred tax liability        | (10,011 )                   |
| Goodwill                      | 34,003                      |
| Total                         | \$66,395                    |

Goodwill is not deductible for tax purposes. Amortizable intangible assets have useful lives of 5 years from the date of acquisition.

##### Phase Matrix Inc.

On May 20, 2011, we acquired all of the outstanding shares of Phase Matrix, Inc. (PMI), a privately held company that designs and manufactures radio frequency and microwave test and measurement instruments, subsystems and components. The acquisition is expected to speed our deployment of high-performance RF and wireless technologies to our production test and R&D customers. The purchase price of the acquisition was \$40.7 million consisting of \$38.9 million in cash and \$1.8 million in shares of our common stock. We funded the cash portion of the purchase price from existing cash balances.

The allocation of the purchase price was determined using the fair value of assets and liabilities acquired as of May 20, 2011. Our consolidated financial statements include the operating results from the date of acquisition. Pro-forma results of operations have not been presented because the effects of those operations were not material. The following

table summarizes the allocation of the purchase price of Phase Matrix, Inc.:

|                               | Amount<br>(in<br>thousands) |
|-------------------------------|-----------------------------|
| Net tangible assets acquired  | \$5,624                     |
| Amortizable intangible assets | 8,331                       |
| Goodwill                      | 26,725                      |
| Total                         | \$40,680                    |

Goodwill is deductible for tax purposes. Amortizable intangible assets have useful lives which range from 9 months to 8 years from the date of acquisition. These assets are also deductible for tax purposes.

Note 17 – Subsequent events

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

On April 19, 2012, our Board of Directors declared a quarterly cash dividend of \$0.14 per common share, payable May 25, 2012, to shareholders of record on May 7, 2012.

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

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Any statements contained herein regarding our future financial performance or operations (including, without limitation, statements to the effect that we "believe," "expect," "plan," "may," "will," "project," "continue," or "estimate" or other variations thereof or comparable terminology or the negative thereof) should be considered forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements as a result of a number of important factors, including those set forth under the heading "Risk Factors" beginning on page 33, and the discussion below. Readers are also encouraged to refer to the documents regularly filed by us with the Securities and Exchange Commission, including our Annual Report on Form 10-K for further discussion of our business and the risks attendant thereto.

Overview

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

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

Expanding our broad customer base

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

Maintaining a high level of customer satisfaction

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

Leveraging external and internal technology

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

We sell into test and measurement ("T&M") and industrial/embedded applications in a broad range of industries and as such are subject to the economic and industry forces which drive those markets. It has been our experience that the performance of these industries and our performance is impacted by general trends in industrial production for the global economy and by the specific performance of certain vertical markets that are intensive consumers of

measurement technologies. Examples of these markets are semiconductor capital equipment, telecom, defense, aerospace and automotive.

In assessing our business, we consider the trends in the Global Purchasing Managers Index (“PMI”) published by JP Morgan, global industrial production as well as industry reports on the specific vertical industries that we target. A PMI reading above 50 is indicative of expansion in the global industrial economy. Our business is sensitive to fluctuations in general economic conditions, both in the U.S. and globally. Historically, our business cycles have generally followed the expansion and contraction cycles in the global industrial economy as measured by the PMI. The most recent reading for March 2012, showed the PMI had increased to 51.1 up from a reading of 50.8 for December 2011, but the PMI continues to indicate overall weakness in the global industrial economy. We are unable to predict whether the industrial economy, as measured by the PMI, will strengthen or contract during the remainder of 2012. If the industrial economy, as measured by the PMI, contracts or remains at a neutral reading at or around 50, indicating general weakness, it could have an adverse effect on the spending patterns of businesses, including our current and potential customers, which could adversely affect our revenues and result of operations.

We distribute our software and hardware products primarily through a direct sales organization. We also use independent distributors, OEMs, VARs, system integrators and consultants to market our products. We have sales offices in the U.S. and sales offices and distributors in key international markets. Sales outside of the Americas accounted for approximately 59% of our revenues during each of the three month periods ended March 31, 2012 and March 31, 2011. The vast majority of our foreign sales are denominated in the customers’ local currency, which exposes us to the effects of changes in foreign currency exchange rates. We expect that a significant portion of our total revenues will continue to be derived from international sales. (See Note 12 - Segment information of Notes to Consolidated Financial Statements for details concerning the geographic breakdown of our net sales, operating income, interest income and long-lived assets).

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

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

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

Current business outlook

Many of the industries we serve have historically been cyclical and have experienced periodic downturns. In assessing our business, we consider the trends in the PMI, global industrial production as well as industry reports on the specific vertical industries that we target. We remain concerned by the fact that the global industrial economy continues to show weakness. We are unable to predict whether the industrial economy, as measured by the PMI, will strengthen or contract during the remainder of 2012. If the industrial economy, as measured by the PMI, contracts or remains at a neutral reading at or around 50, indicating general weakness, it could have an adverse effect on the spending patterns of businesses, including our current and potential customers, which could adversely affect our revenues and result of operations. Our key strategies are to maintain a stable gross margin and to optimize our operating cost structure while maintaining strong employee productivity.

## Results of Operations

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

|                                  | Three Months Ended       |   |      |   |
|----------------------------------|--------------------------|---|------|---|
|                                  | March 31,<br>(Unaudited) |   |      |   |
|                                  | 2012                     |   | 2011 |   |
| Net sales:                       |                          |   |      |   |
| Americas                         | 41.1                     | % | 40.9 | % |
| Europe                           | 29.0                     |   | 29.9 |   |
| Asia Pacific                     | 29.9                     |   | 29.2 |   |
| Consolidated net sales           | 100                      |   | 100  |   |
| Cost of sales                    | 23.5                     |   | 22.1 |   |
| Gross profit                     | 76.5                     |   | 77.9 |   |
| Operating expenses:              |                          |   |      |   |
| Sales and marketing              | 38.3                     |   | 36.7 |   |
| Research and development         | 20.7                     |   | 18.0 |   |
| General and administrative       | 8.2                      |   | 7.9  |   |
| Total operating expenses         | 67.2                     |   | 62.6 |   |
| Operating income                 | 9.3                      |   | 15.3 |   |
| Other income (expense):          |                          |   |      |   |
| Interest income                  | 0.1                      |   | 0.2  |   |
| Net foreign exchange gain (loss) | (0.3                     | ) | (0.1 | ) |
| Other income, net                | 0.0                      |   | 0.2  |   |
| Income before income taxes       | 9.1                      |   | 15.6 |   |
| Provision for income taxes       | 2.0                      |   | 2.8  |   |
| Net income                       | 7.1                      | % | 12.8 | % |

## Results of Operations for the Three Month Periods ended March 31, 2012 and 2011

We are encouraged that 2012 began with record revenue for us for a first quarter despite a challenging global economy. We saw further evidence of market acceptance of software defined modular instrumentation through strong growth in our PXI and CompactRio products. We believe our continued investment in innovation and product development are key to our long-term growth.

**Net Sales.** Our consolidated net sales were \$261 million and \$238 million for the three month periods ended March 31, 2012 and 2011, respectively, an increase of 10%. For the same periods, product sales were \$239 million and \$219 million, an increase of 9%, and software maintenance sales were \$22 million and \$19 million, an increase of 13%. Products in the areas of virtual instrumentation and graphical system design, which comprised approximately 95% of



our revenue in the three months ended March 31, 2012, saw a year-over-year revenue increase of 12%. Instrument control products, which comprised approximately 5% of our revenues in the three months ended March 31, 2012, saw a year-over-year revenue decrease of 24%. Products in the areas of virtual instrumentation and graphical system design comprised approximately 93% of our revenue in the three months ended March 31, 2011 and instrument control products comprised approximately 7% of our revenues in the three months ended March 31, 2011. Revenues from our instrument control products are the most sensitive to the cycles of the global industrial economy. The increase in net sales in the 2012 period is attributed to increases in sales volume across all geographic regions of our business. We did not take any significant action with regard to pricing during the three month periods ended March 31, 2012 and 2011.

Large orders, defined as orders with a value greater than \$20,000, grew by 25%, during the three month period ended March 31, 2012 following growth of 29% during 2011. During the three month periods ended March 31, 2012 and 2011, these large orders were 47% and 41%, respectively, of our total sales. Larger orders may be more sensitive to changes in the global industrial economy, may be subject to greater discount variability and may contract at a faster pace during an economic downturn.

For the three month periods ended March 31, 2012 and 2011, net sales in the Americas were \$107 million and \$97 million, respectively, an increase of 10%. Sales in the Americas, as a percentage of consolidated sales were 41% and in each of the 2012 and 2011 periods. In Europe, net sales were \$76 million and \$71 million in the 2012 and 2011 periods, respectively, an increase of 7%. Sales in Europe, as a percentage of consolidated sales were 29% and 30% in the 2012 and 2011 periods, respectively. In Asia, net sales were \$78 million and \$69 million in the 2012 and 2011 periods, respectively, an increase of 13%. Sales in Asia, as a percentage of consolidated sales were 30% and 29% in the 2012 and 2011 periods, respectively. We anticipate that sales growth in Asia will continue to outpace growth in the Americas and Europe and continue to grow as a percent of our total net sales. For the three month periods ended March 31, 2012 and 2011, sales from our acquisitions were \$15 million and \$7 million, respectively.

We expect sales outside of the Americas to continue to represent a significant portion of our revenue. We intend to continue to expand our international operations by increasing our presence in existing markets, adding a presence in some new geographical markets and continuing the use of distributors to sell our products in some countries.

Almost all of the sales made by our direct sales offices in the Americas, outside of the U.S., in Europe and in Asia Pacific are denominated in local currencies, and accordingly, the U.S. dollar equivalent of these sales is affected by changes in foreign currency exchange rates. For the three month period ended March 31, 2012, in local currency terms, our consolidated net sales increased by \$22 million or 9%, Americas sales increased by \$11 million or 11%, European sales increased by \$5 million or 7%, and sales in Asia Pacific increased by \$7 million or 10%, compared to the three month period ended March 31, 2011. During this same period, the change in exchange rates had the effect of increasing our consolidated sales by \$365,000 or 0.2%, decreasing Americas sales by \$594,000 or 1%, decreasing European sales by \$726,000 or 1%, and increasing sales in Asia Pacific by \$1.7 million or 2%.

For the three month period ended March 31, 2011, in local currency terms, our consolidated sales increased by \$49 million or 26%, Americas sales increased by \$18 million or 23%, European sales increased by \$15 million or 26%, and sales in Asia Pacific increased by \$16 million or 29%. During this same period, the change in exchange rates had the effect of decreasing our consolidated sales by \$1.0 million or 0.5%, decreasing Americas sales by \$3,000 or 0.0%, decreasing European sales by \$1.1 million or 2%, and increasing sales in Asia Pacific by \$14,000 or 0.0%.

To help protect against a reduction in value caused by a fluctuation in foreign currency exchange rates of forecasted foreign currency cash flows resulting from international sales, we have instituted a foreign currency cash flow hedging program. We hedge portions of our forecasted revenue denominated in foreign currencies with forward and purchased option contracts. During the three month periods ended March 31, 2012 and 2011, these hedges had the effect of increasing our consolidated sales by \$476,000 and decreasing our consolidated sales by \$757,000, respectively. (See Note 5 - Derivative instruments and hedging activities of Notes to Consolidated Financial Statements for further

discussion regarding our cash flow hedging program and its related impacted on our consolidated sales for the three month periods ended March 31, 2012 and 2011).

**Gross Profit.** For the three month periods ended March 31, 2012 and 2011, gross profit was \$200 million and \$185 million, respectively. As a percentage of sales, gross profit was 77% and 78% for the three month periods ended March 31, 2012 and 2011, respectively. We continued to focus on cost control and cost reduction measures throughout our manufacturing cycle and continued to see the benefits of those efforts. These cost control and cost reduction measures along with sales growth have allowed us to maintain stability in our gross margin percentage.

For three month periods ended March 31, 2012 and 2011, the change in exchange rates had the effect of decreasing our cost of sales by \$42,000 or 0.1% and increasing our cost of sales by \$1.2 million or 3%, respectively. To help protect against changes in our cost of sales caused by a fluctuation in foreign currency exchange rates of forecasted foreign currency cash flows, we have a foreign currency cash flow hedging program. We hedge portions of our forecasted costs of sales denominated in foreign currencies with forward contracts. During the three month periods ended March 31, 2012 and 2011, these hedges had the effect of increasing our cost of sales by \$8,000 and decreasing our cost of sales by \$344,000, respectively. (See Note 5 - Derivative instruments and hedging activities of Notes to Consolidated Financial Statements for further discussion regarding our cash flow hedging program and its related impacted on our consolidated sales for the three month periods ended March 31, 2012 and 2011).

**Operating Expenses.** For the three month periods ended March 31, 2012 and 2011, operating expenses were \$175 million and \$149 million, respectively, an increase of 18%. This increase in our operating expenses was due to higher personnel related expenses of \$17 million which included commissions, variable compensation and benefits. The increase in personnel expenses is related to a net increase in our overall headcount of 854 employees, including 150 related to our most recent acquisitions. The majority of these personnel additions occurred during the second and third quarters of 2011 resulting in a more significant impact on our March 31, 2012 year over year comparison. In addition, this increase is attributed to higher expenses for building and equipment of \$3.7 million, higher expenses related to marketing and outside services of \$2.6 million, higher travel related expenses of \$1.3 million and higher charges related to stock based compensation of \$1.6 million. Over the same period, the net impact of changes in foreign currency exchange rates increased our operating expense by \$415,000.

As a percentage of net sales, operating expenses in the three month periods ended March 31, 2012 and 2011 were 67% and 63%, respectively. The year over year increase in our operating expenses as a percent of sales is attributed to the fact that we grew our overall operating expenses by 18% as a result of the factors detailed above while our net sales grew by 10%.

We believe that our long-term growth and success depends on developing high quality software and hardware products on a timely basis. To that end, we made investments in research and development and our field sales force a priority in 2011. For the three month periods ended March 31, 2012 and 2011, our research and development expenses were \$54 million and \$43 million, respectively. This increase was due to an increase in our research and development headcount to 1,884 at March 31, 2012 from 1,600 at March 31, 2011.

**Operating Income.** For the three month periods ended March 31, 2012 and 2011, operating income was \$24 million and \$37 million, respectively, a decrease of 33%. As a percentage of net sales, operating income was 9% and 15%, respectively in these same periods. The decrease in our operating income as a percent of sales during this period can be attributed to our overall increase in net sales of 10% while our operating expenses increased by 18% as a result of the factors detailed above. As a result of the timing of our personnel hires in 2011, we expect the year over year growth rate in our operating expenses to moderate through the third quarter of 2012.

**Interest Income.** For the three month periods ended March 31, 2012 and 2011, interest income was \$230,000 and \$341,000, respectively. We continue to see low yields for high quality investment alternatives that comply with our corporate investment policy. We do not expect yields in these types of investments to increase during the remainder of

2012.

Net Foreign Exchange (Loss). For the three month periods ended March 31, 2012 and 2011, net foreign exchange (loss) was \$(888,000) and \$(223,000), respectively. These results are attributable to movements in the foreign currency exchange rates between the U.S. dollar and foreign currencies in subsidiaries for which our functional currency is not the U.S. dollar. During the three month period ended March 31, 2012, we noted mixed volatility in the exchange rates between the U.S. dollar and most of the major currencies in the markets in which we do business. We cannot predict the direction or degree of future volatility in these exchange rates. In the past, we have noted that significant volatility in foreign currency exchange rates in the markets in which we do business has had a significant impact on the revaluation of our foreign currency denominated firm commitments, on our ability to forecast our U.S. dollar equivalent revenues and expenses and on the effectiveness of our hedging programs. In the past, these dynamics have also adversely affected our revenue growth in international markets and may pose similar challenges in the future. We recognize the local currency as the functional currency in virtually all of our international subsidiaries.

We utilize foreign currency forward contracts to hedge our foreign denominated net foreign currency balance sheet positions to help protect against the change in value caused by a fluctuation in foreign currency exchange rates. We typically hedge up to 90% of our outstanding foreign denominated net receivable or payable positions and typically limit the duration of these foreign currency forward contracts to approximately 90 days. The gain or loss on these derivatives as well as the offsetting gain or loss on the hedged item attributable to the hedged risk is recognized in current earnings under the line item "Net foreign exchange gain (loss)". Our hedging strategy reduced our foreign exchange gains by \$1.0 million in the three month period ended March 31, 2012 and reduced our foreign exchange gains by \$993,000 in the three month period ended March 31, 2011.

Provision for Income Taxes. For the three month periods ended March 31, 2012 and 2011, our provision for income taxes reflected an effective tax rate of 22% and 18%, respectively. The factors that caused our effective tax rate to change year-over-year are detailed in the table below:

|   | Three<br>Months<br>Ended<br>March 31,<br>2012<br>(Unaudited) |   |
|---|--|---|
| Effective tax rate at March 31, 2011  | 18   | % |
| Change in unrecognized tax benefits for uncertain tax positions             | 1  |   |
| Change in enhanced deduction for certain research and development expenses  | (3   | ) |
| Decrease in the partial release of a deferred tax asset valuation allowance | 2  |   |
| Decrease in tax benefit from equity awards                                  | 2  |   |
| Change in research and development tax credit                               | 2  |   |
| Effective tax rate at March 31, 2012  | 22   | % |

(See [Note 9 – Income taxes](#) of Notes to Consolidated Financial Statements for further discussion regarding changes in our effective tax rate and a reconciliation of income taxes at the U.S. federal statutory income tax rate of 35% to our effective tax rate).

#### Other operational metrics

We believe that the following additional unaudited operational metrics assist investors in assessing our operational performance relative to our peers and to our historical results.

Acquisition related deferred revenue excluded from revenue. For the three month periods ended March 31, 2012 and 2011, the excluded acquisition related deferred revenue was as follows:

|                                      | Three Months Ended<br>March 31,<br>(Unaudited)<br>(In thousands) |      |
|--------------------------------------|--|------|
|                                      | 2012   | 2011 |
| Revenue                              |  |      |
| Acquisition related deferred revenue | \$1,269  | \$-  |
| Provision for income taxes           | (444 )   | -    |
| Total                                | \$825  | \$-  |

Charges related to stock-based compensation, amortization of acquired intangibles and acquisition related transaction costs. For the three month periods ended March 31, 2012 and 2011, the gross charges related to stock-based compensation as a component of cost of sales, sales and marketing, research and development, and general and administrative expenses and the total charges were as follows:

|                            | Three Months Ended<br>March 31,<br>(Unaudited)<br>(In thousands) |          |
|----------------------------|--|----------|
|                            | 2012   | 2011     |
| Stock-based compensation   |  |          |
| Cost of sales              | \$415  | \$317    |
| Sales and marketing        | 2,640  | 1,922    |
| Research and development   | 2,449  | 1,686    |
| General and administrative | 799  | 665      |
| Provision for income taxes | (1,507 )   | (1,840 ) |
| Total                      | \$4,796  | \$2,750  |

For the three month periods ended March 31, 2012 and 2011, the gross charges related to the amortization of acquisition related intangibles as a component of cost of sales, sales and marketing and other income (expense), net and the total charges were as follows:

|                                      | Three Months Ended<br>March 31,<br>(Unaudited)<br>(In thousands) |         |
|--------------------------------------|--|---------|
|                                      | 2012   | 2011    |
| Amortization of acquired intangibles |  |         |
| Cost of sales                        | \$2,410  | \$1,004 |
| Sales and marketing                  | 447  | 77      |
| Other income, net                    | 189  | -       |
| Provision for income taxes           | (972 )   | (350 )  |
| Total                                | \$2,074  | \$731   |

For the three month periods ended March 31, 2012 and 2011, the gross charges related to acquisition related transaction costs as a component of cost of sales, sales and marketing, research and development and general and administrative expenses and the total charges were as follows:

|                                       | Three Months Ended<br>March 31,<br>(Unaudited)<br>(In thousands) |      |
|---------------------------------------|--|------|
|                                       | 2012   | 2011 |
| Acquisition related transaction costs |  |      |
| Cost of sales                         | \$32   | \$-  |
| Sales and marketing                   | 220  | -    |
| Research and development              | 106  | -    |
| General and administrative            | 47   | -    |
| Provision for income taxes            | (142)  | -    |
| Total                                 | \$263  | \$-  |

### Liquidity and Capital Resources

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

| (In thousands)  | March 31,<br>2012<br>(unaudited) | December<br>31,<br>2011 | Increase/<br>(Decrease) |
|---|----------------------------------|-------------------------|-------------------------|
| Working capital   | \$517,479                        | \$496,629               | \$20,850                |
| Cash and cash equivalents (1)                           | 238,510                          | 142,608                 | 95,902                  |
| Short-term investments (1)                              | 138,896                          | 223,504                 | (84,608)                |
| Total cash, cash equivalents and short-term investments | \$377,406                        | \$366,112               | \$11,294                |

(1) Included in working capital

During the three month period ended March 31, 2012, our working capital increased by \$21 million due to the increase in our cash, cash equivalents and short-term investments of \$11 million, an increase in inventory of \$8 million, offset by a decrease in accounts receivable of \$2 million and a decrease in prepaid expenses and other current assets of \$4 million. These increases can be attributed to our overall business growth during the three month period ended March 31, 2012.

Our cash and cash equivalent balances are held in numerous financial institutions throughout the world, including substantial amounts held outside of the U.S., however, the majority of our cash and investments that are located outside of the U.S. are denominated in the U.S. dollar with the exception of \$33 million U.S. dollar equivalent of German government sovereign debt that is denominated in Euro. At March 31, 2012, we had \$377 million in cash, cash equivalents and short-term investments. Approximately \$52 million or 14% of these amounts were held in domestic accounts with various financial institutions and \$325 million or 86% was held in accounts outside of the U.S. with various financial institutions. Of our short-term investments, \$14 million or 10% is held in our investment accounts in the U.S. and \$125 million or 90% is held in investment accounts of our foreign subsidiaries. Most of the amounts held outside of the U.S. could be repatriated to the U.S., but under current law, would be subject to U.S. federal income taxes, less applicable foreign tax credits. We have provided for the U.S. federal tax liability on these amounts for financial statement purposes, except for foreign earnings that are considered indefinitely reinvested outside of the U.S. Repatriation could result in additional U.S. federal income tax payments in future years. We utilize a variety of tax planning and financing strategies with the objective of having our worldwide cash available in the locations in which it is needed.

Cash Provided and (Used) in the Three Month Periods ended March 31, 2012 and 2011. Cash and cash equivalents increased to \$239 million at March 31, 2012 from \$143 million at December 31, 2011. The following table summarizes the proceeds and (uses) of cash:

|  | Three Months Ended<br>March 31,<br>(unaudited)<br>(in thousands) |           |
|--|--|-----------|
|  | 2012   | 2011      |
| Cash provided by operating activities          | \$33,504   | \$41,630  |
| Cash provided/(used) by investing activities   | 71,481   | (12,992 ) |
| Cash (used)/provided by financing activities   | (9,083 )   | 6,509     |
| Net increase in cash equivalents               | 95,902   | 35,147    |
| Cash and cash equivalents at beginning of year | 142,608  | 219,447   |
| Cash and cash equivalents at end of period     | \$238,510  | \$254,594 |

For each of the three month periods ended March 31, 2012 and 2011, cash provided by operating activities was \$34 million. Year over year, we saw a decrease in net income of \$12 million offset by an increase in cash provided by operating assets and liabilities of \$3.7 million.

Accounts receivable decreased to \$155 million at March 31, 2012 compared to \$157 million at December 31, 2011. Days sales outstanding was 54 days at March 31, 2012, compared to 51 days at December 31, 2011. We typically bill customers on an open account basis subject to our standard net 30 day payment terms. If, in the longer term, our revenue increases, it is likely that our accounts receivable balance will also increase. Our accounts receivable could also increase if customers delay their payments or if we grant extended payment terms to customers, both of which are more likely to occur during challenging economic times when our customers may face issues gaining access to sufficient funding or credit.

Consolidated inventory balances increased to \$140 million at March 31, 2012 from \$132 million at December 31, 2011. Inventory turns were 1.8 at March 31, 2012, compared to 1.9 at December 31, 2011. Inventory increased by \$8 million during the three month period ended March 31, 2012, as we took actions to support the growth in our overall business. Our inventory levels will continue to be determined based upon our anticipated demand for products and our need to keep sufficient inventory on hand to meet our customers' demands. Such considerations are balanced against the risk of obsolescence or potentially excess inventory levels. Rapid changes in customer demand could have a significant impact on our inventory balances in future periods.

Investing activities provided cash of \$71 million during the three months ended March 31, 2012, as the result of the maturities of \$85 million of short-term investments offset by the purchase of property and equipment of \$9 million and capitalization of internally developed software of \$3.7 million. Investing activities used cash of \$13 million during the three months ended March 31, 2011, which was the result of the purchase of property and equipment of \$10 million and capitalization of internally developed software of \$4 million.

Financing activities used cash of \$9 million during the three months ended March 31, 2012, which was the result of \$8 million received from the issuance of our common stock from the exercise of stock options and our employee stock purchase plan, offset by \$17 million used to pay dividends to our stockholders. Financing activities provided cash of \$7 million during the three months ended March 31, 2011, as the result of \$17 million received from the issuance of our common stock from the exercise of stock options and our employee stock purchase plan, offset by \$12 million used to pay dividends to our stockholders.

From time to time, our Board of Directors has authorized various programs to repurchase shares of our common stock depending on market conditions and other factors. On April 21, 2010, our Board of Directors approved a share

repurchase program that increased the aggregate number of shares of common stock that we are authorized to repurchase from 1,011,147 to 4.5 million. We did not make any purchases under this plan during the three month period ended March 31, 2012. At March 31, 2012, there were 3,932,245 shares remaining available for repurchase under this plan. This repurchase plan does not have an expiration date.

During the three month period ended March 31, 2012, we received less proceeds from the exercise of stock options compared to the three months ended March 31, 2011. The timing and number of stock option exercises and the amount of cash proceeds we receive through those exercises are not within our control and in the future, we may not generate as much cash from the exercise of stock options as we have in the past. Moreover, since 2005, it has been our practice to issue restricted stock units and not stock options to eligible employees which will reduce the number of stock options available for exercise in the future. Unlike the exercise of stock options, the issuance of shares upon vesting of restricted stock units does not result in any cash proceeds to us.

**Contractual Cash Obligations.** Purchase obligations primarily represent purchase commitments for customized inventory and inventory components. At March 31, 2012, we had non-cancelable purchase commitments with various suppliers of customized inventory and inventory components totaling approximately \$10 million. At December 31, 2011, we had non-cancelable purchase commitments with various suppliers of customized inventory and inventory components totaling approximately \$14 million.

Guarantees are related to payments of customs and foreign grants. At March 31, 2012, we had outstanding guarantees for payment of customs and foreign grants totaling approximately \$5 million. At December 31, 2011, we had outstanding guarantees for payment of customs, foreign grants and potential customer disputes totaling approximately \$5 million.

**Off-Balance Sheet Arrangements.** We do not have any debt or off-balance sheet debt. At March 31, 2012, we did not have any relationships with any unconsolidated entities or financial partnerships, such as entities often referred to as structured finance entities, which would have been established for the purpose of facilitating off-balance sheet arrangements. As such, we are not exposed to any financing, liquidity, market or credit risk that could arise if we were engaged in such relationships.

**Prospective Capital Needs.** We believe that our existing cash, cash equivalents and short-term investments, together with cash generated from operations as well as from the exercise of employee stock options and the purchase of common stock through our employee stock purchase plan, will be sufficient to cover our working capital needs, capital expenditures, investment requirements, commitments, payment of dividends to our stockholders and repurchases of our common stock for at least the next 12 months. We also believe these sources of cash will be sufficient to fund the construction of our manufacturing, logistics and research and development facility in Penang, Malaysia, which began in the third quarter of 2011. However, we may choose or be required to raise additional funds by selling equity or debt securities to the public or to selected investors, or by borrowing money from financial institutions. Historically, we have not had to rely on debt, public or private, to fund our operating, financing or investing activities. We could also choose or be required to reduce certain expenditures, such as payments of dividends or repurchases of our common stock. In addition, even though we may not need additional funds, we may still elect to sell additional equity or debt securities or obtain credit facilities for other reasons. If we elect to raise additional funds, we may not be able to obtain such funds on a timely basis on acceptable terms, if at all. If we raise additional funds by issuing additional equity or convertible debt securities, the ownership percentages of our existing stockholders would be reduced. In addition, the equity or debt securities that we issue may have rights, preferences or privileges senior to those of our common stock.

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

- costs associated with the planned expansion of our manufacturing facilities in Malaysia;
  - difficulties and the high tax costs associated with the repatriation of earnings;
    - payment of dividends to our stockholders;
- general economic and political conditions and specific conditions in the markets we address, including any volatility in the industrial economy in the various geographic regions in which we do business;
- the inability of certain of our customers who depend on credit to have access to their traditional sources of credit to finance the purchase of products from us, which may lead them to reduce their level of purchases or to seek credit or other accommodations from us;
- the timing, cost or outcome of any future intellectual property litigation or commercial disputes including under our previous GSA contract;
  - required levels of research and development and other operating costs;
    - capital improvements for new and existing facilities;
  - the overall levels of sales of our products and gross profit margins;
    - acquisitions of other businesses, assets, products or technologies;
- our business, product, capital expenditure and research and development plans, and product and technology roadmaps;
  - the levels of inventory and accounts receivable that we maintain;
    - repurchases of our common stock;
    - our relationships with suppliers and customers; and
- the level of exercises of stock options and stock purchases under our employee stock purchase plan.

#### Recently Issued Accounting Pronouncements

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

#### Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

#### Financial Risk Management

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

The vast majority of our sales outside of North America are denominated in local currencies, and accordingly, the U.S. dollar equivalent of these sales is affected by changes in the foreign currency exchange rates. The change in exchange rates had the effect increasing our consolidated sales by \$365,000 or 0.2% in the three month period ended March 31, 2012, and decreasing our consolidated sales by \$1.0 million or 0.5% in the three month period ended March 31, 2011. Since most of our international operating expenses are also incurred in local currencies, the change in exchange rates had the effect of increasing our consolidated operating expenses by \$415,000 or 0.3% in the three month period ended March 31, 2012, and increasing our consolidated operating expenses by \$1.1 million or 1% in the three month period ended March 31, 2011.

During the three month period ended March 31, 2012, we noted mixed volatility in the exchange rates between the U.S. dollar and most of the major currencies in the markets in which we do business. We cannot predict the direction or degree of future volatility in these exchange rates. In the past, we have noted that significant volatility in foreign currency exchange rates in the markets in which we do business has had a significant impact on the revaluation of our



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

If the local currencies in which we sell our products strengthen against the U.S. dollar, we may need to lower our prices in the local currency to remain competitive in our international markets which could have a material adverse effect on our gross and net profit margins. If the local currencies in which we sell our products weaken against the U.S. dollar and if the local sales prices cannot be raised due to competitive pressures, we will experience a deterioration of our gross and net profit margins. To help protect against the change in the value caused by a fluctuation in foreign currency exchange rates of forecasted foreign currency cash flows resulting from international sales and expenses over the next one to two years, we have a foreign currency cash flow hedging program. We hedge portions of our forecasted revenue, cost of sales and operating expenses denominated in foreign currencies with foreign currency forward contracts. For forward contracts, when the dollar strengthens significantly against the foreign currencies, the change in the present value of future foreign currency cash flows may be offset by the change in the fair value of the forward contracts designated as hedges. For purchased option contracts, when the dollar strengthens significantly against the foreign currencies, the change in the present value of future foreign currency cash flows may be offset by the change in the fair value of the option contracts designated as hedges, net of the premium paid. Our foreign currency purchased option contracts are purchased “at-the-money” or “out-of-the-money.” We purchase foreign currency forward and option contracts for up to 100% of our forecasted exposures in selected currencies (primarily in Euro, Japanese yen, British pound sterling, Korean won and Hungarian forint) and limit the duration of these contracts to 40 months or less. As a result, our hedging activities only partially address our risks from foreign currency transactions, and there can be no assurance that this strategy will be successful. We do not invest in contracts for speculative purposes.

During the three month period ended March 31, 2012, these hedges had the effect of increasing our consolidated sales by \$476,000, increasing our cost of sales by \$8,000, and decreasing our operating expenses by \$55,000. During the three month period ended March 31, 2011, these hedges had the effect of decreasing our consolidated sales by \$757,000, decreasing our cost of sales by \$344,000, and decreasing our operating expenses by \$145,000. (See Note 5 - Derivative instruments and hedging activities of Notes to Consolidated Financial Statements for further discussion regarding our cash flow hedging program and its related impacted on our consolidated sales, cost of sales and operating expenses for the three month periods ended March 31, 2012 and 2011).

#### Inventory Management

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

#### Market Risk

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

#### Cash, Cash Equivalents and Short-Term Investments

At March 31, 2012, we had \$377 million in cash, cash equivalents and short-term investments. We maintain cash and cash equivalents and short-term investments with various financial institutions located in many countries throughout the world. Approximately \$52 million or 14% of these amounts were held in domestic accounts with various financial institutions and \$325 million or 86% was held in accounts outside of the U.S. with various financial institutions. At March 31, 2012, \$99 million or 42% of our cash and cash equivalents was held in cash in various operating accounts throughout the world, \$130 million or 54% was held in money market accounts, and \$10 million or 4% was held in U.S. Treasuries. The most significant of our operating accounts was our domestic operating account which held approximately \$12 million or 5% of our total cash and cash equivalents at a bank that carried A+/A2/AA- ratings at March 31, 2012. Our short-term investment balance is comprised of \$14 million or 10% which is held in our investment accounts in the U.S. and \$125 million or 90% which is held in investment accounts of our foreign subsidiaries. We have \$33 million U.S. dollar equivalent of German government sovereign debt that is denominated in Euro. Our German government sovereign debt holdings have a maximum maturity of 18 months and carry Aaa/AAA ratings.

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

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

We account for our investments in debt and equity instruments under FASB ASC 320 Investments – Debt and Equity Securities (FASB ASC 320). Our investments are classified as available-for-sale and accordingly are reported at fair value, with unrealized gains and losses reported as other comprehensive income, a component of shareholders’ equity. Unrealized losses are charged against income when a decline in fair value is determined to be other than temporary. Investments with maturities beyond one year are classified as short-term based on their highly liquid nature and because such marketable securities represent the investment of cash that is available for current operations. The fair value of our short-term investments at March 31, 2012 and December 31, 2011 was \$139 million and \$224 million, respectively. The decrease was due to the maturities of \$85 million of short-term investments which funds were reinvested in debt instruments with original maturities of less than 90 days and are therefore classified as cash equivalents at March 31, 2012.

We follow the guidance provided by FASB ASC 320 to assess whether our investments with unrealized loss positions are other than temporarily impaired. Realized gains and losses and declines in value judged to be other than temporary

are determined based on the specific identification method and are reported in other income (expense), net, in our Consolidated Statements of Income. There were not any other than temporary impairments recognized in other expense during the three month period ended March 31, 2012.

#### Interest Rate Risk

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

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

In order to assess the interest rate risk associated with our investment portfolio, we performed a sensitivity analysis to determine the impact a change in interest rates would have on the value of our investment portfolio assuming a 100 basis point parallel shift in the yield curve. Based on our investment positions as of March 31, 2012, a 100 basis point increase or decrease in interest rates across all maturities would result in a \$1.2 million increase or decrease in the fair market value of our portfolio. As of December 31, 2011, a similar 100 basis point increase or decrease in interest rates across all maturities would result in a \$1.9 million increase or decrease in the fair market value of our portfolio. Such losses would only be realized if we sold the investments prior to maturity or if there is an other than temporary impairment.

Actual future gains and losses associated with our investments may differ from the sensitivity analyses performed as of March 31, 2012, due to the inherent limitations associated with predicting the changes in the timing and level of interest rates and our actual exposures and positions.

We continue to monitor the stability of the financial markets, particularly those in the European region and have taken steps to limit our direct and indirect exposure to these markets; however, we can give no assurance that we will not be negatively impacted by any adverse outcomes in those markets. We also continue to weigh the benefit of the higher yields associated with longer maturities against the interest rate risk and credit rating risk, also associated with these longer maturities when making these decisions. We cannot predict when or if interest rates and investment yields will rise. If yields continue to stay at these low levels, our investment income will continue to be negatively impacted.

#### Exchange Rate Risk

Our objective in managing our exposure to foreign currency exchange rate fluctuations is to reduce the impact of adverse fluctuations in such exchange rates on our earnings and cash flow. Accordingly, we utilize purchased foreign currency option and forward contracts to hedge our exposure on anticipated transactions and firm commitments. The principal currencies hedged are the Euro, British pound, Japanese yen and Hungarian forint. We monitor our foreign exchange exposures regularly to help ensure the overall effectiveness of our foreign currency hedge positions. There can be no assurance that our foreign currency hedging activities will substantially offset the impact of fluctuations in currency exchanges rates on our results of operations and financial position. Based on the foreign exchange instruments outstanding at March 31, 2012 and December 31, 2011, an adverse change (defined as 20% in the Asian

currencies and 10% in all other currencies) in exchange rates would result in a decline in the aggregate settlement value of all of our instruments outstanding of approximately \$18 million and \$23 million, respectively. However, as we utilize foreign currency instruments for hedging anticipated and firmly committed transactions, we believe that a loss in settlement value for those instruments will be substantially offset by increases in the value of the underlying exposure. (See Note 5 - Derivative instruments and hedging activities of Notes to Consolidated Financial Statements for a further description of our derivative instruments and hedging activities).

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this Quarterly Report on Form 10-Q, our Chief Executive Officer, Dr. James Truchard, and our EVP, Chief Operating Officer and Chief Financial Officer, Alex Davern, based on their evaluation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended), required by paragraph (b) of Rule 13a – 15 or Rule 15d – 15, have concluded that our disclosure controls and procedures were effective at the reasonable assurance level, to ensure the timely collection, evaluation and disclosure of information relating to us that would potentially be subject to disclosure under the Securities Exchange Act of 1934, as amended, and the rules and regulations promulgated there under, and that such information is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. These disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports we file or submit is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Our disclosure controls and procedures include components of our internal control over financial reporting. Our assessment of the effectiveness of our internal control over financial reporting is expressed at the level of reasonable assurance because a control system, no matter how well designed and operated, can provide only reasonable, but not absolute assurance that the control system’s objectives will be met.

Changes in Internal Control Over Financial Reporting

We continue to enhance our internal control over financial reporting in key functional areas with the goal of monitoring our operations at the level of documentation, segregation of duties, and systems security necessary, as well as transactional control procedures required under Auditing Standard No. 5 issued by the Public Company Accounting Oversight Board. We discuss and disclose these matters to the audit committee of our board of directors and to our auditors.

During the three month period ended March 31, 2012, there were no changes in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of the Rule 13a – 15 or Rule 15d – 15 that have materially affected, or are likely to materially affect, our internal control over financial reporting.

## PART II - OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

We are not currently a party to any material litigation. However, in the ordinary course of our business, we are involved in a limited number of legal actions, both as plaintiff and defendant, and could incur uninsured liability in any one or more of them. We also periodically receive notifications from various third parties related to alleged infringement of patents or intellectual property rights, commercial disputes or other matters. See Note 13 – Commitments and Contingencies in the Notes to our Consolidated Financial Statements, for discussion of the accrual we have recorded in connection with our previous GSA contract. No assurances can be given with respect to the extent or outcome of any future litigation or dispute.

### ITEM 1A. RISK FACTORS

**Uncertain Economic Conditions Could Materially Adversely Affect Our Business and Results of Operations.** Our business is sensitive to fluctuations in general economic conditions, both in the U.S. and globally. Uncertainty associated with financial markets, negative financial news, foreign currency markets, natural disasters, energy costs, budget and tax policies throughout the world's developed economies, employment levels, labor costs, healthcare costs, declining income or asset values and credit availability, could negatively impact the global industrial economy. Historically, our business cycles have generally followed the expansion and contraction cycles in the global industrial economy as measured by the PMI. The most recent reading for March 2012, showed the PMI had increased to 51.1 up from a reading of 50.8 for December 2011, but the PMI continues to indicate overall weakness in the global industrial economy. A PMI reading above 50 indicates an expanding industrial economy while a reading below 50 indicates a contracting industrial economy. We are unable to predict whether the industrial economy, as measured by the PMI will strengthen or contract during the remainder of 2012. If the industrial economy, as measured by the PMI, contracts or remains at a neutral reading at or around 50, indicating general weakness, it could have an adverse effect on the spending patterns of businesses including our current and potential customers which could adversely affect our revenues and result of operations.

**Changes in the Amount of Revenue Derived from Large Orders Could Adversely Affect our Gross Margin and Could Lead to Greater Variability in our Quarterly Results.** Our large order business, defined as orders with a value greater than \$20,000, continues to grow as a percent of our overall business. As a percent of our overall business, larger orders reached a new high during the three month period ended March 31, 2012 and represented 47% and 41% of our total sales during the three month periods ended March 31, 2012 and 2011, respectively. Larger orders may be more sensitive to changes in the global industrial economy, may be subject to greater discount variability and may contract at a faster pace during an economic downturn. Historically, our gross margins have been stable from period to period. To the extent that the amount of our revenue derived from larger orders increases in future periods, both in absolute dollars and as a percent of our overall business, our gross margins could experience greater volatility and we could see a greater negative impact on our business from future downturns in the global industrial economy. This dynamic may also have an adverse effect on the historical seasonal pattern of our revenues and our results of operations.

**We Operate in Intensely Competitive Markets.** The markets in which we operate are characterized by intense competition from numerous competitors, some of which are divisions of large corporations having far greater resources than we have, and we may face further competition from new market entrants in the future. A key competitor is Agilent Technologies Inc. ("Agilent"). Agilent offers hardware and software products that provide solutions that directly compete with our virtual instrumentation products and Agilent has released its own line of PXI based hardware. Agilent is aggressively advertising and marketing products that are competitive with our products.

Because of Agilent's strong position in the instrumentation business, changes in its marketing strategy or product offerings could have a material adverse effect on our operating results.

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

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

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

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

**Our Revenues are Subject to Seasonal Variations.** In previous years, our revenues have been characterized by seasonality, with revenues typically growing from the first quarter to the second quarter, being relatively constant from the second quarter to the third quarter, growing in the fourth quarter compared to the third quarter and declining in the first quarter of the following year from the fourth quarter of the preceding year. This historical trend has been affected and may continue to be affected in the future by broad fluctuations in the global industrial economy, the economic impact of larger orders as well as the timing of new product introductions or acquisitions, if any. The ongoing economic contraction in the Euro zone could persist or worsen in the remainder of 2012. If this instability in the Euro zone continues, worsens or negatively affects other economic regions in the remainder of 2012, it may have a material adverse effect on the seasonal patterns described above as well as on our overall results of operations and profitability. Our total operating expenses have in the past tended to increase in each successive quarter and have

fluctuated as a percentage of revenue based on the seasonality of our revenue.

Concentrations of Credit Risk and Uncertain Conditions in the Global Financial Markets May Adversely Affect Our Business and Result of Operations. By virtue of our holdings of cash, investment securities and foreign currency derivatives, we have exposure to many different counterparties, and routinely execute transactions with counterparties in the financial services industry, including commercial banks and investment banks. Many of these transactions expose us to credit risk in the event of a default of our counterparties. We continue to monitor the stability of the financial markets, particularly those in the European region and have taken steps to limit our direct and indirect exposure to these markets; however, we can give no assurance that we will not be negatively impacted by any adverse outcomes in those markets. There can be no assurance that any losses or impairments to the carrying value of our financial assets as a result of defaults by our counterparties, would not materially and adversely affect our business, financial position and results of operations.

Risks or Claims Associated With the Compliance With Our Pricing Provisions of Our Previous GSA Contract Could Have a Material Adverse Impact on Our Results of Operations. From November 1999 to May 2011, we sold products to the U.S. government under a contract with the General Services Administration ("GSA"). During such time, our sales under the contract were approximately 2% of our total sales. Our previous contract with GSA contained a price reduction or "most favored customer" pricing provision. For the past few quarters, we have been in discussions with GSA regarding our compliance with this pricing provision and have provided GSA with information regarding our pricing practices. In 2011, GSA conducted an on-site review of our GSA pricing practices and orally informed us that GSA did not agree with our previous determination of the potential non-compliance amount. GSA subsequently requested that we conduct a further analysis of the non-compliance amount based upon a methodology that GSA proposed. This analysis resulted in calculated overpayments (including added interest) by GSA to us of approximately \$13.1 million. GSA is reviewing the analysis and has not yet officially responded, and has not made any formal demand for pricing adjustments related to our previous GSA contract. However, GSA may make such a demand in the future, and there can be no assurance that the amount of any such demand, if we were required to pay it, would not have a material adverse impact on our results of operations. If GSA believes that our pricing practices did not comply with the contract, GSA could conduct a formal investigation of such matter or could refer such matter to the U.S. Department of Justice for investigation, including an investigation regarding potential violations of the False Claims Act, which could result in litigation and the possible imposition of a damage remedy that includes treble damages plus civil penalties, and could also result in us being suspended or debarred from future government contracting. As a result of the foregoing, during the quarter ended September 30, 2011, we established an accrual of \$13.1 million which represents the amount of the loss contingency that is reasonably estimable at this time. There can be no assurance that our actual losses will not exceed such reserve amount. Due to the complexities of conducting business with GSA, the relatively small amount of revenue we realized from our previous GSA contract, and our belief that we can continue to sell our products to U.S. government agencies through other contracting methods, we cancelled our contract with GSA in April 2011, effective May 2011. To date, we have not experienced any material adverse impact on our results of operations as a result of the cancellation of our previous GSA contract.

Our Acquisitions are Subject to a Number of Related Costs and Challenges that Could Have a Material Adverse Effect on Our Business and Results of Operations. During the second quarter of 2011, we completed the acquisitions of AWR Corporation (AWR) and Phase Matrix Inc. (PMI). We may in the future acquire additional complementary businesses, products or technologies. Achieving the anticipated benefits of an acquisition depends upon whether the integration of the acquired business, products or technology is accomplished efficiently and effectively. In addition, successful acquisitions generally require, among other things, integration of product offerings, manufacturing operations and coordination of sales and marketing and R&D efforts. These difficulties can become more challenging due to the need to coordinate geographically separated organizations, the complexities of the technologies being integrated, and the necessities of integrating personnel with disparate business backgrounds and combining different corporate cultures. The integration of operations following an acquisition also requires the dedication of management resources, which may distract attention from our day-to-day business and may disrupt key R&D, marketing or sales efforts. Our inability to successfully integrate AWR and PMI or any future acquisition could harm our business. The

existing products previously sold by entities we have acquired may be of a lesser quality than our products and/or could contain errors that produce incorrect results on which users rely or cause failure or interruption of systems or processes that could subject us to liability claims that could have a material adverse effect on our operating results or financial position. Furthermore, products acquired in connection with acquisitions may not gain acceptance in our markets, and we may not achieve the anticipated or desired benefits of such transactions.

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

- changes in the global economy or global credit markets, particularly in the Euro zone;
  - adjustments to acquisition earn-out accruals;
- changes in the amount of revenue derived from large orders;
  - fluctuations in foreign currency exchange rates;
- the timing, cost or outcome of any future intellectual property litigation or commercial disputes including under our previous GSA contract;
  - changes in the mix of products sold;
- the availability and pricing of components from third parties (especially limited sources);
- the difficulty in maintaining margins, including the higher margins traditionally achieved in international sales;
  - changes in pricing policies by us, our competitors or suppliers;
  - delays in product shipments caused by human error or other factors; and,
  - disruptions in transportation channels.

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

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

A Substantial Majority of Our Manufacturing Capacity is Located in Hungary. Our Hungarian manufacturing and warehouse facility sources a substantial majority of our sales. In order to enable timely shipment of products to our customers we also maintain the vast majority of our inventory at our Hungary warehouse facility. In addition to being subject to the risks of maintaining such a concentration of manufacturing capacity and global inventory, this facility and its operation are also subject to risks associated with doing business internationally, including:

- a changing and unstable political environment;
- significant and frequent changes in the corporate tax law;
- the volatility of the Hungarian forint relative to the U.S. dollar;
- difficulty in managing manufacturing operations in a foreign country;
  - challenges in expanding capacity to meet increased demand;
  - difficulty in achieving or maintaining product quality;



- interruption to transportation flows for delivery of components to us and finished goods to our customers;
  - a restrictive labor code; and,
  - increasing labor costs.

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

Our long term manufacturing and warehousing capacity planning contemplates a third manufacturing and warehousing facility in Penang, Malaysia. We began warehousing and distribution operations out of Penang, Malaysia via a third party logistics provider in October 2010. We began construction of a manufacturing, logistics and research and development facility in Malaysia in the third quarter of 2011. We can give no assurance that we will be successful in deploying our new facility in Malaysia on schedule or that we will not exceed our cost estimates. Our failure to successfully deploy our new facility in Malaysia or our failure to deploy this facility without exceeding our cost estimates could have a material adverse effect on our ability to meet customer demands, our ability to grow our business as well as our liquidity, capital resources and results of operations. If we succeed in deploying our Malaysian manufacturing facility on schedule and the demand for our products does not grow as expected, we will have excess manufacturing capacity which will cause an increase in overhead that will negatively impact our gross margins and results of operations.

We Have Established a Budget and Variations From Our Budget Will Affect Our Financial Results. We established an operating budget for 2012 in 2011. Our budget was established based on the estimated revenue from sales of our products which are based on economic conditions in the markets in which we do business as well as the timing and volume of our new products and the expected penetration of both new and existing products in the marketplace. In 2011, we increased our overall headcount by 955. During 2012, we will see the full year impact of these headcount additions on our operating expenses. If demand for our products in 2012 is less than the demand we anticipated in setting our 2012 budget, our operating results could be negatively impacted. If we exceed the level of expenses established in our 2012 operating budget or if we cannot reduce budgeted expenditures in response to a decrease in revenue, our operating results could be adversely affected. Our spending could exceed our budget due to a number of factors, including:

- increased costs from hiring more product development engineers or other personnel;
  - increased costs from hiring more field sales personnel;
- the timing cost or outcome of any future intellectual property litigation or commercial disputes including under our previous GSA contract;
  - increased manufacturing costs resulting from component supply shortages or component price fluctuations;
    - additional marketing costs for new product introductions or for conferences and tradeshows;
- increased component costs resulting from vendors increasing prices in response to increased economic activity; or
  - additional costs related to acquisitions, if any.

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

Our Income Tax Rate is Affected by our Tax Benefits in Hungary. The profit from our Hungarian operation benefits from the fact that it is subject to an effective income tax rate that is lower than the U.S. federal statutory tax rate of

35%. Our earnings in Hungary are subject to a statutory tax rate of 19%. The difference between this rate and the statutory U.S. rate of 35% resulted in income tax benefits of \$2.1 million and \$3.4 million for the three month periods ended March 31, 2012 and 2011, respectively. In addition, effective January 1, 2010, certain qualified research and development expenses became eligible for an enhanced tax deduction. The enhanced tax deduction for research and development expenses resulted in income tax benefits of \$3.1 million and \$4.8 million for the three month periods ended March 31, 2012 and 2011, respectively. This tax benefit may not be available in future years due to changes in political conditions in Hungary or changes in tax laws in Hungary and in the U.S. The reduction or elimination of these benefits in Hungary or future changes in U.S. law pertaining to the taxation of foreign earnings could result in an increase in our future effective income tax rate which could have a material adverse effect on our operating results. No countries other than Hungary had a significant impact on our effective tax rate. We have not entered into any advanced pricing or other agreements with the Internal Revenue Service with regard to any foreign jurisdictions.

We are Subject to Risks Associated with Our Centralization of Inventory and Distribution. Currently, shipments to our customers worldwide are primarily sourced from our warehouse facility in Debrecen, Hungary. Shipments to some of our customers in Asia are currently made either out of local inventory managed by our branch operations in various Asian countries or from a centralized distribution point in Penang, Malaysia. We plan to continue to devote resources to centralizing our distribution to a limited number of shipping points. Our centralization of inventory and distribution from a limited number of shipping points is subject to inherent risks, including:

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

Any difficulties with the centralization of our distribution or delays in the implementation of the systems or processes to support this centralized distribution could result in an interruption of our normal operations, including our ability to process orders and ship products to our customers. Any failure or delay in distribution from our facilities in Hungary and Malaysia could have a material adverse effect on our operating results.

We Rely on Management Information Systems and Interruptions in our Information Technology Systems Could Adversely Affect our Business. We rely on the efficient and uninterrupted operation of complex information technology systems and networks to operate our business. We rely on a primary global center for our management information systems and on multiple systems in branches not covered by our global center. As with any information system, unforeseen issues may arise that could affect our ability to receive adequate, accurate and timely financial information, which in turn could inhibit effective and timely decisions. Furthermore, it is possible that our global center for information systems or our branch operations could experience a complete or partial shutdown. Significant system or network disruption could be the result of new system implementations, computer viruses, security breaches, facility issues or energy blackouts. If such a shutdown or disruption occurred, it would impact our product shipments and revenues, as order processing and product distribution are heavily dependent on our management information systems. Such an interruption could also result in a loss of our intellectual property or the release of sensitive competitive information or partner, customer or employee personal data. Any loss of such information could harm our competitive position, result in a loss of customer confidence, and cause us to incur significant costs to remedy the damages caused by the disruptions or security breaches. Accordingly, our operating results in such periods would be adversely impacted.

We are continually working to maintain reliable systems to control costs and improve our ability to deliver our products in our markets worldwide. Our efforts include, but are not limited to following: firewalls, antivirus, patches, log monitors, routine backups with offsite retention of storage media, system audits, data partitioning and routine password modifications. No assurance can be given that our efforts will be successful.

During 2010, we devoted significant resources to completing the upgrade of our Americas business application suite to Oracle's version R12. During 2011, we devoted significant resources to completing the upgrade of our business

application suite used primarily by our European, Japanese, and global manufacturing operations to Oracle's version R12 and completing an upgrade to the underlying infrastructure of our website, ni.com. We continue to devote resources to the development of our web offerings. There can be no assurance that we will not experience difficulties with these new systems. Difficulties with these new systems may interrupt normal operations, including the ability to provide quotes, process orders, ship products, provide services and support to our customers, bill and track our customers, fulfill contractual obligations and otherwise run our business. Any disruptions of the systems may have a material adverse effect on our results of operations.

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

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

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

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

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

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

In many foreign countries, particularly in those with developing economies, it is common to engage in business practices that are prohibited by U.S. regulations applicable to us such as the Foreign Corrupt Practices Act. Although we have policies and procedures designed to ensure compliance with these laws, there can be no assurance that all of our employees, contractors and agents, including those based in or from countries where practices which violate such U.S. laws may be customary, will not take actions in violation of our policies. Any violation of foreign or U.S. laws by our employees, contractors or agents, even if such violation is prohibited by our policies, could have a material adverse effect on our business. We must also comply with various import and export regulations. The application of these various regulations depends on the classification of our products which can change over time as such regulations are modified or interpreted. As a result, even if we are currently in compliance with applicable regulations, there can be no assurance that we will not have to incur additional costs or take additional compliance actions in the future. Failure to comply with these regulations could result in fines or termination of import and export privileges, which could have a material adverse effect on our operating results. Additionally, the regulatory environment in some countries is very restrictive as their governments try to protect their local economy and value of their local currency against the U.S. dollar.

The vast majority of our sales outside of North America are denominated in local currencies, and accordingly, the U.S. dollar equivalent of these sales is affected by changes in the foreign currency exchange rates. The change in exchange rates had the effect of increasing our consolidated sales by \$365,000 or 0.2% in the three month period ended March 31, 2012, and decreasing our consolidated sales by \$1.0 million or 0.5% in the same period in 2011. Since most of our international operating expenses are also incurred in local currencies, the change in exchange rates had the effect of increasing our consolidated operating expenses by \$415,000 or 0.3% in the three month period ended March 31, 2012, and increasing our consolidated operating expenses by \$1.0 million or 0.9% in the three month period ended March 31, 2011.

During the three month period ended March 31, 2012, we noted mixed volatility in the exchange rates between the U.S. dollar and most of the major currencies in the markets in which we do business. We cannot predict the direction or degree of future volatility in these exchange rates. We cannot predict to what degree or how long this recent volatility in the foreign currency exchange markets will continue. In the past, we have noted that significant volatility in foreign currency exchange rates in the markets in which we do business has had a significant impact on the revaluation of our foreign currency denominated firm commitments, on our ability to forecast our U.S. dollar equivalent revenues and expenses and on the effectiveness of our hedging programs. In the past, these dynamics have also adversely affected our revenue growth in international markets and may pose similar challenges in the future. We recognize the local currency as the functional currency in virtually all of our international subsidiaries.

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

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

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

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

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

Provisions in Our Charter Documents and Delaware Law and Our Stockholder Rights Plan May Delay or Prevent an Acquisition of Us. Our certificate of incorporation and bylaws and Delaware law contain provisions that could make it more difficult for a third party to acquire us without the consent of our Board of Directors. These provisions include a classified Board of Directors, prohibition of stockholder action by written consent, prohibition of stockholders to call special meetings and the requirement that the holders of at least 80% of our shares approve any business combination not otherwise approved by two-thirds of the Board of Directors. Delaware law also imposes some restrictions on mergers and other business combinations between us and any holder of 15% or more of our outstanding common stock. In addition, our Board of Directors has the right to issue preferred stock without stockholder approval, which could be used to dilute the stock ownership of a potential hostile acquirer. Our Board of Directors adopted a stockholders rights plan on January 21, 2004, pursuant to which we declared a dividend of one right for each share of our common stock outstanding as of May 10, 2004. This rights plan replaced a similar rights plan that had been in

effect since our initial public offering in 1995. Unless redeemed by us prior to the time the rights are exercised, upon the occurrence of certain events, the rights will entitle the holders to receive upon exercise thereof shares of our preferred stock, or shares of an acquiring entity, having a value equal to twice the then-current exercise price of the right. The issuance of the rights could have the effect of delaying or preventing a change of control of us.

Compliance With Sections 302 and 404 of the Sarbanes-Oxley Act of 2002 is Costly and Challenging. As required by Section 302 of the Sarbanes-Oxley Act of 2002, this Form 10-Q contains our management's certification of adequate disclosure controls and procedures as of March 31, 2012. Our most recent annual report on Form 10-K also contains a report by our management on our internal control over financial reporting including an assessment of the effectiveness of our internal control over financial reporting as of December 31, 2011. Our most recent annual report on Form 10-K also contains an attestation and report by our external auditors with respect to the effectiveness of our internal control over financial reporting under Section 404. While these assessments and reports did not reveal any material weaknesses in our internal control over financial reporting, compliance with Sections 302 and 404 is required for each future fiscal year end. We expect that the ongoing compliance with Sections 302 and 404 will continue to be both very costly and very challenging and there can be no assurance that material weaknesses will not be identified in future periods. Any adverse results from such ongoing compliance efforts could result in a loss of investor confidence in our financial reports and have an adverse effect on our stock price.

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

The following table provides information as of March 31, 2012 with respect to the shares of common stock that we repurchased during the first quarter of 2012.

| Period                                | Total number of shares purchased | Average price paid per share | Total number of shares purchased as part of publicly announced plans or programs | Maximum number of shares that may yet be purchased under the plans or programs (1) |
|---------------------------------------|----------------------------------|------------------------------|--|--|
| January 1, 2012 to January 31, 2012   | -                                | -                            | -  | 3,932,245  |
| February 1, 2012 to February 29, 2012 | -                                | -                            | -  | 3,932,245  |
| March 1, 2012 to March 31, 2012       | -                                | -                            | -  | 3,932,245  |
| Total                                 | -                                | -                            | -  |  |

(1) For the past several years, we have maintained various stock repurchase programs. At March 31, 2012, there were 3,932,245 shares available for repurchase under the plan approved on April 21, 2010. This repurchase plan does not have an expiration date.

## ITEM 5. OTHER INFORMATION

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



ITEM 6. EXHIBITS

- 3.1(1) Certificate of Incorporation, as amended, of the Company.
- 3.2(2) Amended and Restated Bylaws of the Company.
- 3.3(3) Certificate of Designation of Rights, Preferences and Privileges of Series A Participating Preferred Stock of the Company.
- 4.1(4) Specimen of Common Stock certificate of the Company.
- 4.2(5) Rights Agreement dated as of January 21, 2004, between the Company and EquiServe Trust Company, N.A.
- 10.1(4) Form of Indemnification Agreement.
- 10.2(6) 1994 Incentive Plan, as amended.\*
- 10.3(7) 1994 Employee Stock Purchase Plan.\*
- 10.5(8) National Instruments Corporation Annual Incentive Program, as amended.\*
- 10.6(9) 2005 Incentive Plan.\*
- 10.7(10) 2005 Form of Restricted Stock Unit Award Agreement (Non-Employee Director).\*
- 10.8(10) 2005 Form of Restricted Stock Unit Award Agreement (Performance Vesting).\*
- 10.9(10) 2005 Form of Restricted Stock Unit Award Agreement (Current Employee).\*
- 10.10(10) 2005 Form of Restricted Stock Unit Award Agreement (Newly Hired Employee).\*
- 10.11(11) 2010 Incentive Plan.\*
- 10.12(12) 2010 Form of Restricted Stock Unit Award Agreement (Non-Employee Director).\*
- 10.13(13) 2010 Form of Restricted Stock Unit Award Agreement (Performance Vesting).\*
- 10.14(14) 2010 Form of Restricted Stock Unit Award Agreement (Current Employee).\*
- 10.15(15) 2010 Form of Restricted Stock Unit Award Agreement (Newly Hired Employee).\*
- 31.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS XBRL Instance Document \*\*
- 101.SCH XBRL Taxonomy Extension Schema Document \*\*
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document \*\*
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document \*\*
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document \*\*
  
- (1) Incorporated by reference to the same-numbered exhibit filed with the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2003.
- (2) Incorporated by reference to the same-numbered exhibit filed with the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2007.
- (3) Incorporated by reference to the same-numbered exhibit filed with the Company's Registration Statement on Form 8-A on April 27, 2004.
- (4) Incorporated by reference to the Company's Registration Statement on Form S-1 (Reg. No. 33-88386) declared effective March 13, 1995.
- (5) Incorporated by reference to exhibit 4.1 filed with the Company's Current Report on Form 8-K filed on January 28, 2004.
- (6) Incorporated by reference to the same-numbered exhibit filed with the Company's Form 10-Q on August 5, 2004.
- (7)



- Incorporated by reference to exhibit 10.3 filed with the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2006.
- (8) Incorporated by reference to exhibit 99.1 filed with the Company's Current Report on Form 8-K filed on February 24, 2012.
- (9) Incorporated by reference to exhibit A of the Company's Proxy Statement dated and filed on April 4, 2005.
- (10) Incorporated by reference to the same-numbered exhibit filed with the Company's Form 10-Q on August 2, 2006.
- (11) Incorporated by reference to exhibit 10.1 filed with the Company's Current Report on Form 8-K filed on May 17, 2010.
- (12) Incorporated by reference to exhibit 10.2 filed with the Company's Current Report on Form 8-K filed on June 24, 2010.
- (13) Incorporated by reference to exhibit 10.3 filed with the Company's Current Report on Form 8-K filed on June 24, 2010.
- (14) Incorporated by reference to exhibit 10.4 filed with the Company's Current Report on Form 8-K filed on June 24, 2010.
- (15) Incorporated by reference to exhibit 10.5 filed with the Company's Current Report on Form 8-K filed on June 24, 2010.

\* Management Contract or Compensatory Plan or Arrangement

\*\* In accordance with Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability.

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SIGNATURE

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

NATIONAL INSTRUMENTS CORPORATION

April 30, 2012

By: /s/ Alex M. Davern  
Alex M. Davern  
EVP, Chief Operating Officer  
Chief Financial Officer and  
Treasurer  
(Principal Financial and Accounting  
Officer)