NATIONAL INSTRUMENTS CORP
Form 10-Q
August 02, 2018

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

FORM 10-Q
Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended: June 30, 2018 or

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

For the transition period from ________________ to ________________

Commission file number: 0-25426

NATIONAL INSTRUMENTS CORPORATION	
(Exact name of registrant as specified in its charter)	
Delaware	74-1871327
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
11500 North MoPac Expressway	
Austin, Texas	78759
(address of principal executive offices)	(zip code)

Registrant's telephone number, including area code: (512) 683-0100
Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer”, “accelerated filer”, “smaller reporting company”, and “emerging growth company” in Rule 12b-2 of the Exchange Act. (Check one):

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

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

Class	Outstanding at July 26, 2018
Common Stock - $0.01 par value	132,208,105

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PART I - FINANCIAL INFORMATION

ITEM 1. Financial Statements
NATIONAL INSTRUMENTS CORPORATION
CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share data)

Assets	June 30, 2018 (unaudited)	December 31, 2017
Current assets:		
Cash and cash equivalents	$217,619	$290,164
Short-term investments	210,804	121,888
Accounts receivable, net	249,910	248,825
Inventories, net	193,417	184,592
Prepaid expenses and other current assets	56,740	48,621
Total current assets	928,490	894,090
Property and equipment, net	249,834	249,715
Goodwill	263,796	266,783
Intangible assets, net	121,270	123,293
Other long-term assets	30,349	32,553
Total assets	$1,593,739	$1,566,434
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable and accrued expenses	$52,769	$49,733
Accrued compensation	43,200	43,309
Deferred revenue - current	125,451	120,638
Other current liabilities	14,795	23,782
Other taxes payable	32,013	31,793
Total current liabilities	268,228	269,255
Deferred income taxes	37,381	33,609
Liability for uncertain tax positions	10,938	10,158
Income Tax Payable - Long Term	74,015	81,515
Deferred revenue - long-term	31,550	33,742
Other long-term liabilities	5,949	10,134
Total liabilities	428,061	438,413
Commitments and contingencies		
Stockholders' equity:		
Preferred stock: par value $0.01; 5,000,000 shares authorized; none issued and outstanding	—	—
Common stock: par value $0.01; 360,000,000 shares authorized; 132,208,105 shares and 130,978,947 shares issued and outstanding, respectively	1,322	1,310
Additional paid-in capital	864,314	829,979
Retained earnings	316,607	313,241
Accumulated other comprehensive loss	(16,565)	(16,509)
Total stockholders’ equity	1,165,678	1,128,021
Total liabilities and stockholders’ equity	$1,593,739	$1,566,434

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net sales:				
Product	$306,780	$289,817	$587,139	$561,328
Software maintenance	34,229	28,792	65,767	57,386
Total net sales	341,009	318,609	652,906	618,714
Cost of sales:				
Product	79,806	79,153	152,122	154,349
Software maintenance	2,353	3,307	4,560	4,635
Total cost of sales	82,159	82,460	156,682	158,984
Gross profit	258,850	236,149	496,224	459,730
Operating expenses:				
Sales and marketing	127,138	124,414	247,255	241,674
Research and development	66,908	56,913	128,751	115,175
General and administrative	27,892	26,191	55,170	51,933
Total operating expenses	221,938	207,518	431,176	408,782
Operating income	36,912	28,631	65,048	50,948
Other income:				
Interest income	1,290	509	2,305	852
Net foreign exchange (loss) gain	(2,105)	447	(1,126)	529
Other (loss) gain, net	(1,095)	(235)	(1,613)	197
Income before income taxes	35,002	29,352	64,614	52,526
Provision for income taxes	3,948	4,197	9,292	9,223
Net income	$31,054	$25,155	$55,322	$43,303
Basic earnings per share	$0.24	$0.19	$0.42	$0.33
Weighted average shares outstanding - basic	131,877	130,197	131,504	129,820
Diluted earnings per share	$0.23	$0.19	$0.42	$0.33
Weighted average shares outstanding - diluted	133,054	131,117	132,838	130,619
Dividends declared per share	$0.23	$0.21	$0.46	$0.42

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

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Net income	$31,054	$25,155	$55,322	$43,303
Other comprehensive income, before tax and net of reclassification adjustments:				
Foreign currency translation adjustment	(11,804)	11,702	(6,001)	15,664
Unrealized gain (loss) on securities available-for-sale	128	34	(557)	26
Unrealized gain (loss) on derivative instruments	12,032	(3,522)	8,262	(6,334)
Other comprehensive income, before tax	356	8,214	1,704	9,356
Tax expense (benefit) related to items of other comprehensive income	2,621	(1,186)	1,760	(2,146)
Other comprehensive (loss) income, net of tax	(2,265)	9,400	(56)	11,502
Comprehensive income	$28,789	$34,555	$55,266	$54,805

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

NATIONAL INSTRUMENTS CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Six Months Ended June 30, 2018	2017
Cash flow from operating activities:		
Net income	$ 55,322	$ 43,303
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	35,098	35,915
Stock-based compensation	17,936	13,726
Deferred income taxes	1,766	(875)
Changes in operating assets and liabilities	(11,270)	(7,284)
Net cash provided by operating activities	98,852	84,785
Cash flow from investing activities:		
Capital expenditures	(19,764)	(15,727)
Capitalization of internally developed software	(11,344)	(24,816)
Additions to other intangibles	(3,936)	(1,124)
Purchases of short-term investments	(137,275)	(52,807)
Sales and maturities of short-term investments	47,634	21,017
Net cash used in investing activities	(124,685)	(73,457)
Cash flow from financing activities:		
Proceeds from issuance of common stock	16,622	15,407
Dividends paid	(60,575)	(54,595)

Net cash used in financing activities	(43,953)	(39,188)
Effect of exchange rate changes on cash	(2,759)	5,727
Net change in cash and cash equivalents	(72,545)	(22,133)
Cash and cash equivalents at beginning of period	290,164	285,283
Cash and cash equivalents at end of period	$ 217,619	$ 263,150

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, 2017, included in our annual report on Form 10-K, filed with the Securities and Exchange Commission. In our opinion, the accompanying consolidated financial statements reflect all adjustments (consisting only of normal recurring items) considered necessary to present fairly our financial position at June 30, 2018 and December 31, 2017, the results of our operations and comprehensive income for three and six months ended June 30, 2018 and 2017, and the cash flows for the six months ended June 30, 2018 and 2017. Our operating results for the three and six months ended June 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018. These financial statements have been prepared in accordance with accounting principles generally accepted in the United States.

Earnings Per Share

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

The reconciliation of the denominators used to calculate basic EPS and diluted EPS for the three and six months ended June 30, 2018 and 2017, are as follows:

	Three Months Ended June 30, (In thousands) (Unaudited)		Six Months Ended June 30, (In thousands) (Unaudited)	
	2018	2017	2018	2017
Weighted average shares outstanding-basic	131,877	130,197	131,504	129,820
Plus: Common share equivalents				
RSUs	1,177	920	1,334	799
Weighted average shares outstanding-diluted	133,054	131,117	132,838	130,619

Stock awards to acquire 697,800 shares and 6,800 shares for the three months ended June 30, 2018 and 2017, respectively, and 350,800 shares and 13,500 shares for the six months ended June 30, 2018 and 2017, respectively, were excluded in the computations of diluted EPS because the effect of including the stock awards would have been anti-dilutive.

Summary of Significant Accounting Policies

We adopted ASU 2014-09, Revenue from Contracts with Customers and all the related amendments ("new revenue standard") as of January 1, 2018. The impact of this new guidance on our accounting policies and operating results is also described below. There were no other significant changes in our accounting policies during the six months ended June 30, 2018 compared to the significant accounting policies described in our Annual Report on Form 10-K for the year ended December 31, 2017.

Accounts Receivable, net

Accounts receivable are recorded net of allowances for doubtful accounts. Our allowance for doubtful accounts is based on historical experience. We analyze historical bad debts, customer concentrations, customer creditworthiness and current economic trends when evaluating the adequacy of our allowance for doubtful accounts. Unbilled receivables represent amounts for which revenue has been recognized but which have not yet been invoiced to the customer. The current portion of unbilled receivables is included in accounts receivable, net on the consolidated balance sheet and is not material.

Sales Tax

Taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue-producing transaction, that are collected from our customers, are excluded from revenue.

Shipping and Handling Costs

Shipping and handling costs associated with outbound freight after control over a product has transferred to a customer are accounted for as a fulfillment cost and are in included in cost of sales.

Recently Adopted Accounting Pronouncements

Revenue from Contracts with Customers

On January 1, 2018, we adopted the new revenue standard using the modified retrospective transition method. Under this method, we evaluated all contracts that were in effect at the beginning of 2018 as if those contracts had been accounted for under the new revenue standard. We did not evaluate individual modifications for those periods prior to the adoption date, but the aggregate effect of all modifications as of the adoption date and such effects are provided below. Under the modified retrospective transition approach, periods prior to the adoption date were not adjusted and continue to be reported in accordance with historical GAAP. A cumulative catch-up adjustment was recorded to beginning retained earnings to reflect the impact of all existing arrangements under the new revenue standard.

We do not expect the impact of the adoption of the new revenue standard to be material to our annual net income on an ongoing basis. A majority of our sales revenue continues to be recognized when products are shipped from our manufacturing facilities. Historically, we have had to defer revenue for certain types of licenses arrangements and recognize revenue for such licenses ratably over the license term. Under the new revenue standard, we are no longer required to establish vendor-specific objective evidence ("VSOE") to recognize software license revenue separately from the other elements, and we are able to recognize all software license revenue once the customer obtains control of the license, which will generally occur at the start of each license term.

The cumulative effects of the changes made to our consolidated January 1, 2018 balance sheet for the adoption of ASU 2014-09, Revenue - Revenue from Contracts with Customers were as follows (in thousands):

(in thousands)	Balance at December 31, 2017	Adjustments Due to ASU 2014-09	Balance at January 1, 2018
Balance Sheet			
Assets			
Accounts receivable, net	$ 248,825	2,399	$ 251,224
Other long-term assets	32,553	(106)	32,447
Liabilities and Stockholders' Equity			
Deferred revenue - current	120,638	(9,067)	111,571
Deferred revenue - long-term	33,742	(997)	32,745
Other current liabilities	23,782	2,100	25,882
Deferred income taxes	33,609	1,638	35,247
Retained earnings	$ 313,241	8,619	$ 321,860

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The following tables present the amounts by which financial statement line items were affected in the current period due to the adoption of ASU 2014-09. Our historical net cash flows are not impacted by this accounting change.

(In thousands, except per share data)	For the three month period ended June 30, 2018	For the six month period ended June 30, 2018
	Increase / (Decrease)	Increase / (Decrease)
Consolidated Statements of Income		
Net Sales		
Products	$ 1,042	$ 7,454
Software Maintenance	—	—
Total net sales	1,042	7,454
Operating Expenses	(183)	(206)
Operating Income	1,225	7,660
Provision for income taxes	124	1,282
Net income	$ 1,101	$ 6,378
Basic earnings per share	0.01	0.05
Diluted earnings per share	0.01	0.05

* Excludes line items that were not materially affected by our adoption of ASU 2014-09.

(in thousands)	June 30, 2018
	Increase / (Decrease)
Consolidated Balance Sheet*	
Assets	
Accounts receivable, net	$ 2,093
Other long-term assets	100
Liabilities and Stockholder's Equity	
Deferred revenue - current	(14,276)
Deferred revenue - non-current	(3,491)
Other current liabilities	3,382
Deferred income taxes	1,638
Retained earnings	$ 14,940

* Excludes line items that were not materially affected by our adoption of ASU 2014-09. Balance sheet line item amounts include the cumulative-effect adjustment recorded on January 1, 2018.

Recently Issued Accounting Pronouncements

In January 2018, the FASB issued ASU 2018-02, Income Statement — Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, which gives entities the option to reclassify to retained earnings tax effects resulting from the Tax Cuts and Jobs Act (the "Act") related to items that the FASB refers to as having been stranded in accumulated other comprehensive income ("AOCI"). The new guidance may be applied retrospectively to each period in which the effect of the Act is recognized or in the period of adoption. We must adopt this guidance for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. Early adoption is permitted for periods for which financial statements have not yet been issued or made available for issuance, including the period the Act was enacted. The guidance, when adopted, will require new disclosures regarding a company's accounting policy for releasing the tax effects in AOCI and permit the company the option to reclassify to retained earnings the tax effects resulting from the Act that are stranded in AOCI. We are currently evaluating how to apply the new guidance and have not determined whether we will elect to reclassify stranded amounts. The adoption of ASU 2018-02 is not expected to have a material effect on our consolidated financial statements.

In August 2017, the FASB issued ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. The ASU simplifies certain aspects of hedge accounting and improves disclosures of hedging arrangements through the elimination of the requirement to separately measure and report hedge ineffectiveness. The ASU generally requires the entire change in the fair value of a hedging instrument to be presented in the same income statement line as the hedged item in order to align financial reporting of hedge relationships with the associated economic results. Entities must apply the amendments to cash flow and net investment hedge relationships that exist on the date of adoption using a modified retrospective approach. The presentation and disclosure requirements must be applied prospectively. Our effective date for adoption of this guidance is our fiscal year beginning January 1, 2019. We are currently evaluating the effect that this guidance will have on our consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which supersedes ASC 840, Leases. The guidance requires lessees to recognize most lease liabilities on their balance sheets but recognize the expenses on their income statements in a manner similar to current practice. The update states that a lessee would recognize a lease liability for the obligation to make lease payments and a right-to-use asset for the right to use the underlying asset for the lease term. The update is effective for interim and annual periods beginning after December 15, 2018, and early adoption is permitted. We are currently evaluating the effect that the updated standard will have on our consolidated financial statements and related disclosures. Based on our initial assessment, we expect that the adoption of this standard will have a material impact on our balance sheet but that it will not have a material impact on our ongoing results of operations. We do not expect to adopt the new standard prior to the required effective date. As permitted by ASU 2018-11, Leases (Topic 842): Targeted Improvements, we do not expect to adjust comparative-period financial statements.

Note 2 - Revenue

Revenue Recognition

Revenue is recognized upon transfer of control of the promised products or services to customers in an amount that reflects the consideration we expect to receive in exchange for those products or services. We enter into contracts that can include various combinations of our products or services, which are generally capable of being distinct and accounted for as separate performance obligations. Revenue is recognized net of allowances for returns and any taxes collected from customers, which are subsequently remitted to governmental authorities.

Nature of Goods and Services

We derive revenues from two primary sources: products and software maintenance.

Product revenues are primarily generated from the sale of off-the-shelf modular test and measurement hardware components and related drivers, and application software licenses. Sales of most hardware components may also include optional extended hardware warranties, which typically provide additional service-type coverage for three years from the purchase date. Our software licenses typically provide for a perpetual right to use our software. We also offer some term-based software licenses that expire, which are referred to as subscription arrangements. We do not customize software for customers and installation services are not required. The software is delivered before related services are provided and is functional without professional services, updates and technical support. We sell our customer support contracts as a percentage of net software purchases the support is related to. Revenues from offerings related to our hardware and software products such as extended hardware warranties, training, consulting and installation services are not significant and presented within product revenues, as further discussed below.

Software maintenance revenues consists of post contract customer support that provides the customer with unspecified upgrades and technical support. For these contracts, we account for individual performance obligations separately if they are distinct. The transaction price is allocated to the separate performance obligations on a relative standalone selling price basis. Standalone selling prices of software licenses are estimated based on our established pricing practices and maximize the use of observable inputs. Standalone selling prices of hardware products are typically estimated based on observable transactions when these services are sold on a standalone basis. Our typical performance obligations include the following:

Performance Obligation	When performance obligation is typically satisfied	When payment is typically due	How standalone selling price is typically estimated
Product revenue			
Modular hardware	When customer obtains control of the product (point in time)	Within 30-90 days of shipment	Observable in transactions without multiple performance obligations
Software licenses	When software media is delivered to customer or made available for download electronically, and the applicable license period has begun (point-in-time)	Within 30-90 days of the beginning of license period	Established pricing practices for software licenses bundled with maintenance, which are separately observable in renewal transactions
Extended hardware warranty	Ratably over the course of the support contract (over time)	At the beginning of the contract period	Observable in renewal transactions
Other related support offerings	As work is performed (over time) or course is delivered (point in time)	Within 30-90 days of delivery	Observable in transactions without multiple performance obligations

Software maintenance revenue

Software maintenance	Ratably over the course of the support contract (over time)	At the beginning of the contract period	Observable in renewal transactions

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Significant Judgments

Judgment is required to determine the standalone selling price ("SSP") for each distinct performance obligation. We use a single amount to estimate SSP for items that are not sold separately, including perpetual and term licenses sold with software maintenance. We use a range of amounts to estimate SSP when we sell each of the products and services separately and need to determine whether there is a discount that needs to be allocated based on the relative SSP of the various products and services.

Due to the various benefits from and the nature of our enterprise agreement program, judgment is required to assess the pattern of delivery, including the exercise pattern of certain benefits across our portfolio of customers. Additionally, whether a renewal option represents a distinct performance obligation could significantly impact the timing of revenue recognized.

Our products are generally sold with a right of return which are accounted for as variable consideration when estimating the amount of revenue to recognize. Returns and credits are estimated at contract inception and updated at the end of each reporting period as additional information becomes available and only to the extent that it is probable that a significant reversal of any incremental revenue will not occur. During the first quarter of 2018, we began to reclassify our allowance for sales returns to
"other current liabilities" from "accounts receivable, net" due to the adoption of the new revenue standard.

Disaggregation of Revenues

We disaggregate revenue from contracts with customers based on the timing of transfer of goods or services to customers (point-in-time or over time) and geographic region based on the billing location of the customer. The geographic regions that are tracked are the Americas (United States, Canada and Latin America), EMEIA (Europe, Middle East, India and Africa) and APAC (Australia, New Zealand, Southeast Asia and China). Total net sales based on the disaggregation criteria described above are as follows:

(In thousands)	Three Months Ended June 30, (Unaudited)					
	2018			2017 (1)		
Net sales:	Point-in-Time	Over Time	Total	Point-in-Time	Over Time	Total
Americas	$105,670	24,121	$129,791	$102,034	19,614	$121,648
EMEIA	90,487	19,554	110,041	77,485	23,064	100,549
APAC	93,251	7,926	101,177	87,330	9,082	96,412
Total net sales (2)	$289,408	51,601	$341,009	$266,849	51,760	$318,609

(1): As discussed in Note 1, prior periods have not been adjusted for adoption of ASU 2014-09

(2): Net sales contains hedging gain and losses, which do not represent revenues recognized from customers. See Note - 5 Derivatives for more information on the impact of our hedging activities on our results of operations

(In thousands)	Six Months Ended June 30, (Unaudited)			
	2018		2017 (1)	
Net sales:	Point-in-Time	Total	Point-in-Time	Total

		Over Time			Over Time	
Americas	$202,211	47,301	$249,512	$200,338	39,749	$240,087
EMEIA	177,394	38,059	215,453	149,528	45,760	195,288
APAC	171,937	16,004	187,941	166,947	16,392	183,339
Total net sales (2)	$551,542	101,364	$652,906	$516,813	101,901	$618,714

(1): As discussed in Note 1, prior periods have not been adjusted for adoption of ASU 2014-09

(2): Net sales contains hedging gain and losses, which do not represent revenues recognized from customers. See Note - 5 Derivatives for more information on the impact of our hedging activities on our results of operations

Information about Contract Balances

Amounts collected in advance of services being provided are accounted for as deferred revenue. Nearly all of our deferred revenue balance is related to extended hardware and software maintenance contracts. Payment terms and conditions vary by contract type, although payment is typically due within 30 to 90 days of contract inception. In instances where the timing of revenue recognition differs from the timing of invoicing, we have determined our contracts generally do not include a significant financing component. The primary purpose of our invoicing terms is to provide customers with simplified and predictable ways of purchasing our products and services, not to receive financing from our customers, such as invoicing at the beginning of a subscription term with a portion of the revenue recognized ratably over the contract period, or to provide customers with financing, such as multi-year on-premises licenses that are invoiced annually with revenue recognized upfront.

Changes in deferred revenue, current and non-current, during the six months ended June 30, 2018 were as follows:

	Amount (In thousands)
Deferred Revenue at December 31, 2017	$ 154,380
Impact of adopting new revenue standard	(10,064)
Deferred Revenue at January 1, 2018	$ 144,316
Deferral of revenue billed in current period, net of recognition	91,732
Recognition of revenue deferred in prior periods	(76,519)
Foreign currency translation impact	(2,528)
Balance as of June 30, 2018 (unaudited)	$ 157,001

For the six months ended June 30, 2018, revenue recognized from performance obligations related to prior periods (for example, due to changes in transaction price) was not material. Amounts recognized as revenue in excess of amounts billed are recorded as unbilled receivables. Unbilled receivables which are anticipated to be invoiced in the next twelve months are included in "accounts receivable, net" on the consolidated balance sheet. Based on the nature of our contracts with customers, we do not typically recognize unbilled receivables related to revenues recognized in excess of amounts billed. For the six months ended June 30, 2018 amounts recognized related to unbilled receivables were not material.

Unsatisfied Performance Obligations

Revenue expected to be recognized in any future period related to remaining performance obligations, excluding revenue pertaining to contracts that have an original expected duration of one year or less, and excluding contracts where revenue is recognized as invoiced, was approximately $54.5 million as of June 30, 2018. Since we typically invoice customers at contract inception, this amount is included in our current and non-current deferred revenue balances. As of June 30, 2018, we expect to recognize approximately 25% of the revenue related to these unsatisfied performance obligations during the remainder of 2018, 40% during 2019, and 35% thereafter.

Assets Recognized from the Costs to Obtain a Contract with a Customer

We recognize an asset for the incremental costs of obtaining a contract with a customer if we expect the benefit of those costs to be longer than one year. We have determined that certain sales incentive programs meet the requirements to be capitalized. Capitalized incremental costs related to initial contracts and renewals are amortized over the same period because the commissions paid on both the initial contract and renewals are commensurate with one another. Total capitalized costs to obtain a contract were immaterial during the periods presented and are included in other long-term assets on our consolidated balance sheets.

Practical Expedients

As discussed elsewhere within "Note 1 - Basis of presentation" and "Note 2 - Revenue," we have elected the following practical expedients in accordance with ASC 606:

- We generally expense sales commissions when incurred because the amortization period would have been one year or less. These costs are recorded within sales and marketing expenses.
- We do not disclose the value of unsatisfied performance obligations for (i) contracts with an original expected length of one year or less and (ii) contracts for which we recognize revenue at the amount to which we have the right to invoice for services performed.
- We do not consider the time value of money for contracts with original durations of one year or less.

Note 3 – Short-term investments

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

(In thousands)	As of June 30, 2018 (Unaudited)			
	Adjusted Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
Corporate bonds	$170,921	$ 177	$ (948)	$170,150
U.S. treasuries and agencies	39,353	1	—	39,354
Time deposits	1,300	—	—	1,300
Total Short-term investments	$211,574	$ 178	$ (948)	$210,804

(In thousands)	As of December 31, 2017			
	Adjusted Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
Corporate bonds	$120,341	$ 182	$ (395)	$120,128
Time deposits	1,760	—	—	1,760
Total Short-term investments	$122,101	$ 182	$ (395)	$121,888

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

(In thousands)	As of June 30, 2018 (Unaudited)	
	Adjusted Cost	Fair Value
Due in less than 1 year	$112,533	$112,405
Due in 1 to 5 years	99,041	98,399
Total available-for-sale debt securities	$211,574	$210,804

Due in less than 1 year	Adjusted Cost	Fair Value
Corporate bonds	$71,880	$71,751
U.S. treasuries and agencies	39,353	39,354
Time deposits	1,300	1,300
Total available-for-sale debt securities	$112,533	$112,405

Due in 1 to 5 years	Adjusted Cost	Fair Value
Corporate bonds	$99,041	$98,399
Total available-for-sale debt securities	$99,041	$98,399

Note 4 – Fair value measurements

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

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

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

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

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

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

(In thousands)	Fair Value Measurements at Reporting Date Using (Unaudited)			
Description	June 30, 2018	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Cash and cash equivalents available for sale:				
Money Market Funds	$46,170	$46,170	$—	$ —
Short-term investments available for sale:				
Corporate bonds	170,150	—	170,150	—
U.S. treasuries and agencies	39,354	—	39,354	—
Time deposits	1,300	1,300	—	—
Derivatives	7,799	—	7,799	—
Total Assets	$264,773	$47,470	$217,303	$ —
Liabilities				
Derivatives	$(3,232)	$—	$(3,232)	$ —
Total Liabilities	$(3,232)	$—	$(3,232)	$ —

(In thousands)	Fair Value Measurements at Reporting Date Using			
Description	December 31, 2017	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Cash and cash equivalents available for sale:				
Money Market Funds	$61,423	$61,423	$—	$ —
U.S. treasuries and agencies	39,461	—	39,461	—
Short-term investments available for sale:				
Corporate bonds	120,128	—	120,128	—
Time deposits	1,760	1,760	—	—
Derivatives	7,232	—	7,232	—
Total Assets	$230,004	$63,183	$166,821	$ —
Liabilities				
Derivatives	$(12,743)	$—	$(12,743)	$ —
Total Liabilities	$(12,743)	$—	$(12,743)	$ —

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

Derivatives include foreign currency forward 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. We consider counterparty credit risk in the valuation of our derivatives. However, counterparty credit risk did not impact the valuation of our derivatives during the six months ended June 30, 2018. There were no transfers in or out of Level 1 or Level 2 during the six months ended June 30, 2018.

As of June 30, 2018, our short-term investments did not include sovereign debt from any country other than the United States.

We did not have any items that were measured at fair value on a nonrecurring basis at June 30, 2018 and December 31, 2017. The carrying value of net accounts receivable, accounts payable, and long-term debt contained in the consolidated balance sheets approximates fair value.

Note 5 – Derivative instruments and hedging activities

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

We have operations in over 50 countries. Sales outside of the Americas accounted for approximately 62% of our net sales during each of the three months ended June 30, 2018 and 2017, and approximately 62% and 61% of our net sales during the six months ended June 30, 2018 and 2017, respectively. Our activities expose us to a variety of market risks, including the effects of changes in foreign currency exchange rates. These financial risks are monitored and managed by us as an integral part of our overall risk management program.

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

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

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

Cash flow hedges

To help protect against the reduction in value caused by a fluctuation in foreign currency exchange rates of forecasted foreign currency cash flows resulting from international sales over the next one to three years, we have instituted a foreign currency cash flow hedging program. We hedge portions of our forecasted net sales and forecasted expenses denominated in foreign currencies with forward 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. We purchase foreign currency forward contracts for up to 100% of our forecasted exposures in selected currencies (primarily in Euro, Japanese yen, Hungarian forint, British pound, Malaysian ringgit, Korean won and Chinese yuan) and limit the duration of these contracts to 36 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 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 designated as cash flow hedges with the following notional amounts:

(In thousands)	US Dollar Equivalent	
	As of June 30, 2018 (Unaudited)	As of December 31, 2017
Chinese yuan	$80,203	$39,197
Euro	153,178	177,406
Japanese yen	15,657	22,857
Hungarian forint	30,364	41,296
British pound	6,463	9,931
Malaysian ringgit	20,694	28,287
Korean won	13,359	—
Total forward contracts notional amount	$319,918	$318,974

The contracts in the foregoing table had contractual maturities of 18 months or less and 24 months or less at June 30, 2018 and December 31, 2017, respectively.

At June 30, 2018, we expect to reclassify $2.2 million of gains on derivative instruments from accumulated OCI to net sales during the next twelve months when the hedged international sales occur, $0.2 million of gains on derivative instruments from accumulated OCI to cost of sales during the next twelve months when the cost of sales are incurred and $0.3 million of 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 June 30, 2018. Actual results may vary materially as a result of changes in the corresponding exchange rates subsequent to this date.

The gains and losses recognized in earnings due to hedge ineffectiveness were not material for each of the six months ended June 30, 2018 and 2017 and are included as a component of net income under the line item "net foreign exchange gain (loss)."

Other Derivatives

Other derivatives not designated as hedging instruments consist primarily of foreign currency forward contracts that we use to hedge our foreign denominated net receivable or net payable positions to help protect against the change in value caused by a fluctuation in foreign currency exchange rates. We typically attempt to hedge up to 90% of our outstanding foreign denominated net receivables or net payables and typically limit the duration of these foreign currency forward contracts to approximately 90 days or less. The gain or loss on the derivatives as well as the offsetting gain or loss on the hedge item attributable to the hedged risk is recognized in current earnings under the line item "net foreign exchange gain (loss)." As of June 30, 2018 and December 31, 2017, we held foreign currency forward contracts that were not designated as hedging instruments with a notional amount of $34 million and $63 million, respectively.

The following tables present the fair value of derivative instruments on our Consolidated Balance Sheets at June 30, 2018 and December 31, 2017, respectively.

(In thousands)	Asset Derivatives June 30, 2018 (Unaudited)		December 31, 2017	
	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	$4,980	Prepaid expenses and other current assets	$4,707
Foreign exchange contracts - LT forwards	Other long-term assets	2,027	Other long-term assets	2,339
Total derivatives designated as hedging instruments		$7,007		$7,046
Derivatives not designated as hedging instruments				
Foreign exchange contracts - ST forwards	Prepaid expenses and other current assets	$792	Prepaid expenses and other current assets	$187
Total derivatives not designated as hedging instruments		$792		$187
Total derivatives		$7,799		$7,233

(In thousands)	Liability Derivatives June 30, 2018 (Unaudited)		December 31, 2017	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments				
Foreign exchange contracts - ST forwards	Other current liabilities	$(2,286)	Other current liabilities	$(7,487)
Foreign exchange contracts - LT forwards	Other long-term liabilities	(899)	Other long-term liabilities	(3,959)
Total derivatives designated as hedging instruments		$(3,185)		$(11,446)
Derivatives not designated as hedging instruments				
Foreign exchange contracts - ST forwards	Other current liabilities	$(47)	Other current liabilities	$(1,297)
Total derivatives not designated as hedging instruments		$(47)		$(1,297)
Total derivatives		$(3,232)		$(12,743)

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The following tables present the effect of derivative instruments on our Consolidated Statements of Income for three months ended June 30, 2018 and 2017, respectively:

June 30, 2018
(In thousands)
(Unaudited)

Derivatives in Cash Flow Hedging Relationship	Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion)	Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion)
Foreign exchange contracts - forwards	$ 17,632	Net sales	$ (1,295)	Net foreign exchange gain/(loss)	$ —
Foreign exchange contracts - forwards	(3,052)	Cost of sales	302	Net foreign exchange gain/(loss)	—
Foreign exchange contracts - forwards	(2,548)	Operating expenses	321	Net foreign exchange gain/(loss)	—
Total	$ 12,032		$ (672)		$ —

June 30, 2017
(In thousands)
(Unaudited)

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

(In thousands)

Derivatives not Designated as Hedging Instruments	Location of Gain (Loss) Recognized in Income	Amount of Gain (Loss) Recognized in Income	Amount of Gain (Loss) Recognized in Income
		June 30, 2018	June 30, 2017

		(Unaudited)		(Unaudited)		
Foreign exchange contracts - forwards	Net foreign exchange gain/(loss)	$	1,573	(632		)
Total		$	1,573	$	(632	)

The following tables present the effect of derivative instruments on our Consolidated Statements of Income for the six months ended June 30, 2018 and 2017, respectively:

June 30, 2018
(In thousands)
(Unaudited)

Derivatives in Cash Flow Hedging Relationship	Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion)	Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion)
Foreign exchange contracts - forwards	$ 12,560	Net sales	$ (3,915)	Net foreign exchange gain/(loss)	$ —
Foreign exchange contracts - forwards	(2,326)	Cost of sales	643	Net foreign exchange gain/(loss)	—
Foreign exchange contracts - forwards	(1,972)	Operating expenses	777	Net foreign exchange gain/(loss)	—
Total	8,262		$ (2,495)		$ —

June 30, 2017
(In thousands)
(Unaudited)

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

(In thousands)

Derivatives not Designated as Hedging Instruments	Location of Gain (Loss) Recognized in Income	Amount of Gain (Loss) Recognized in Income	Amount of Gain (Loss) Recognized in Income

		June 30, 2018 (Unaudited)	June 30, 2017 (Unaudited)
Foreign exchange contracts - forwards	Net foreign exchange gain/(loss)	$ (188)	(3,178)
Total		$ (188)	$ (3,178)

Note 6 – Inventories, net

Inventories, net consist of the following:

(In thousands)	June 30, 2018 (Unaudited)	December 31, 2017
Raw materials	$ 98,499	$ 91,513
Work-in-process	10,059	8,938
Finished goods	84,859	84,141
	$ 193,417	$ 184,592

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Note 7 – Intangible assets, net

Intangible assets at June 30, 2018 and December 31, 2017 are as follows:

(In thousands)	June 30, 2018 (Unaudited)			December 31, 2017		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Capitalized software development costs	$121,954	$ (36,684)	$85,270	$116,691	$ (30,345)	$86,346
Acquired technology	95,776	(88,842)	6,934	96,198	(87,341)	8,857
Patents	33,733	(20,865)	12,868	33,163	(19,931)	13,232
Other	49,753	(33,555)	16,198	45,565	(30,707)	14,858
	$301,216	$ (179,946)	$121,270	$291,617	$ (168,324)	$123,293

Software development costs capitalized for the three months ended June 30, 2018 and 2017 were $3.9 million and $13.7 million, respectively, and related amortization expense was $6.8 million and $5.5 million, respectively. For the six months ended June 30, 2018 and 2017, capitalized software development costs were $11.9 million and $26.0 million, respectively, and related amortization expense was $12.9 million and $10.8 million, respectively. Capitalized software development costs for the three months ended June 30, 2018 and 2017 included costs related to stock based compensation of $0.2 million and $0.5 million, respectively. For the six months ended June 30, 2018 and 2017, capitalized software development costs included costs related to stock based compensation of $0.5 million and $1.0 million, respectively. The related amounts in the table above are net of fully amortized assets.

Amortization of capitalized software development costs is computed on an individual product basis for those products available for market and is recognized based on the product's estimated economic life, generally three to six years. Acquired technology and other intangible assets are amortized over their useful lives, which range from three to eight years. Patents are amortized using the straight-line method over their estimated period of benefit, generally 10 to 17 years. Total intangible assets amortization expenses were $9.0 million and $8.6 million for the three months ended June 30, 2018 and 2017, respectively, and $17.4 million and $17.0 million for the six months ended June 30, 2018 and 2017, respectively.

Note 8 – Goodwill

The carrying amount of goodwill as of June 30, 2018, was as follows:

	Amount (In thousands)
Balance as of December 31, 2017	$ 266,783
Foreign currency translation impact	(2,987)
Balance as of June 30, 2018 (unaudited)	$ 263,796

The excess purchase price over the fair value of assets acquired is recorded as goodwill. As we have one operating segment comprised of components with similar economic characteristics, we allocate goodwill to one reporting unit for goodwill impairment testing. Goodwill is tested for impairment on an annual basis, and between annual tests if indicators of potential impairment exist, using a fair-value-based approach based on the market capitalization of the reporting unit. Effective for the annual goodwill impairment test for 2018 and for future testing, we will perform the required annual testing as of November 30 of each year rather than on February 28. In anticipation of this change, we reperformed our annual goodwill impairment test as of November 30, 2017 and determined that it was more likely than not that the estimated fair value for the reporting unit exceeded the carrying amount and that no impairment existed as of the assessment date. We do not believe that the change in the date of the annual goodwill impairment test is a material change in the method of applying an accounting principle nor do we expect that it will result in any delay, acceleration or impact to the results of the impairment testing. We believe this date is preferable because it aligns with the timing of our annual planning process which largely occurs during the fourth quarter. Retrospective application to prior periods is impracticable as we are unable to objectively determine, without the use of hindsight, the assumptions that would be used in those earlier periods.

No impairment of goodwill was identified during the six months ended June 30, 2018 or the twelve months ended December 31, 2017.

Note 9 – Income taxes

We account for income taxes under the asset and liability method. Deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts. Valuation allowances are established when necessary to reduce deferred tax assets to amounts which are more likely than not to be realized. We had a valuation allowance of $78 million at June 30, 2018 and December 31, 2017. A majority of the valuation allowance is related to the deferred tax assets of National Instruments Hungary Kft. (“NI Hungary”).

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 $10.9 million and $10.2 million of unrecognized tax benefits at June 30, 2018 and December 31, 2017, respectively, all of which would affect our effective income tax rate if recognized. We recorded a gross increase in unrecognized tax benefits of $0.3 million and $0.6 million for the three and six months ended June 30, 2018, respectively, as a result of the tax positions taken during these periods. As of June 30, 2018, it is reasonably possible that we will recognize tax benefits in the amount of $1.8 million in the next twelve months due to the closing of open tax years. The nature of the uncertainty is related to deductions taken on returns that have not been examined by the applicable tax authority. Our continuing policy is to recognize interest and penalties related to income tax matters in income tax expense. As of June 30, 2018, we had approximately $1.1 million accrued for interest related to uncertain tax positions. The tax years 2009 through 2018 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 11% and 14% for the three months ended June 30, 2018 and 2017, respectively, and 14% and 18% for the six months ended June 30, 2018 and 2017, respectively. For the three and six months ended June 30, 2018, our effective tax rate was lower than the U.S. federal statutory rate of 21% as a result of an enhanced deduction for certain research and development expenses, profits in foreign jurisdictions with reduced income tax rates, the research and development tax credit, a tax benefit from disqualifying dispositions of equity awards that do not ordinarily result in a tax benefit, excess tax benefits from share-based compensation, and the deduction for foreign-derived deduction eligible income, offset by the U.S. tax on global intangible low-taxed income.

For the three and six months ended June 30, 2017, our effective tax rate was lower than the U.S. federal statutory rate of 35% as a result of an enhanced deduction for certain research and development expenses, profits in foreign jurisdictions with reduced income tax rates, the research and development tax credit, and a tax benefit from disqualifying dispositions of equity awards that do not ordinarily result in a tax benefit, and excess tax benefits from share-based compensation.

Our earnings in Hungary are subject to a statutory tax rate of 9%. In addition, our research and development activities in Hungary benefit from a tax law in Hungary that provides for an enhanced deduction for qualified research and development expenses. The tax position of our Hungarian operations resulted in income tax benefits of $2.9 million and $4.4 million for the three months ended June 30, 2018 and 2017, respectively, and $4.6 million and $7.3 million for the six months ended June 30, 2018 and 2017, respectively.

Earnings from our operations in Malaysia are free of tax under a tax holiday effective January 1, 2013. This tax holiday expires in 2027. If we fail to satisfy the conditions of the tax holiday, this tax benefit may be terminated early. The income tax benefits of the tax holiday for the three and six months ended June 30, 2018 were approximately $0.5 million and $1.1 million, respectively. The impact of the tax holiday on a per share basis for each of the three and six months ended June 30, 2018 was a benefit of $0.01 per share. The income tax benefits of the tax holiday for the three and six months ended June 30, 2017 were approximately $0.6 million and $1.1 million, respectively. The impact of the tax holiday on a per share basis for each of the three and six months ended June 30, 2017 was a benefit of $0.01 per share.

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

The Tax Cuts and Jobs Act was enacted on December 22, 2017. The Act reduced the federal corporate tax rate from 35% to 21%, requires companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred, and creates new taxes on certain foreign earnings.

We are applying the guidance in SAB 118 when accounting for the enactment-date effects of the Act. As of June 30, 2018, we had not completed our accounting for the tax effects of enactment of the Act. However, we have made a reasonable estimate of the effects on our existing deferred tax balances and the one-time transition tax. At December 31, 2017, we recognized a provisional amount of $69.9 million, which is included as a component of income tax expense from continuing operations. We will continue to make and refine our calculations as additional analysis is completed. Our estimates may also be affected as we gain a more thorough understanding of the Act. During the six month period ended June 30, 2018, we did not recognize any adjustments to the provisional amounts recorded at December 31, 2017.

The Act subjects a U.S. shareholder to tax on global intangible low-taxed income ("GILTI") earned by certain foreign subsidiaries. The FASB staff Q&A, Topic 740, No. 5, Accounting for Global Intangible Low-Taxed Income, states that an entity can make an accounting policy election to either recognize deferred taxes for temporary basis differences expected to reverse as GILTI in future years or provide for the tax expense related to GILTI in the years the tax is incurred as a period expense only. Given the complexity of the GILTI provisions, we are still evaluating the effects of the GILTI provisions and have not yet determined our accounting policy. At June 30, 2018, because we are still evaluating the GILTI provisions and our analysis of future taxable income that is subject to GILTI we have included GILTI related to current-year operations only in our estimated annual effective tax rate and have not provided additional GILTI on deferred items.

Note 10 – Comprehensive income

Our comprehensive income is comprised of net income, foreign currency translation, unrealized gains and losses on forward contracts and securities classified as available-for-sale. The accumulated OCI, net of tax, for the six months ended June 30, 2018 and 2017, consisted of the following:

	June 30, 2018 (Unaudited)			
(In thousands)	Currency translation adjustment	Investments	Derivative instruments	Accumulated other comprehensive income/(loss)
Balance as of December 31, 2017	$(12,717)	$ (782)	(3,010)	$ (16,509)
Current-period other comprehensive (loss) income	(6,001)	(557)	5,767	(791)
Reclassified from accumulated OCI into income	—	—	2,495	2,495
Income tax expense	—	33	1,727	1,760
Balance as of June 30, 2018	$(18,718)	$ (1,372)	$ 3,525	$ (16,565)

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

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

Authorized shares of common and preferred stock

Following approval by the Company's Board of Directors and stockholders, on May 14, 2013, the Company's certificate of incorporation was amended to increase the authorized shares of common stock by 180,000,000 shares to a total of 360,000,000 shares. As a result of this amendment, the total number of shares which the Company is authorized to issue is 365,000,000 shares, consisting of (i) 5,000,000 shares of preferred stock, par value $0.01 per share, and (ii) 360,000,000 shares of common stock, par value $0.01 per share.

Restricted stock plan

Our stockholders approved our 2005 Incentive Plan (the "2005 Plan") in May 2005. At the time of approval, 4,050,000 shares of our common stock were reserved for issuance under this plan, as well as the number of shares which had been reserved but not issued under our 1994 Incentive Plan which terminated in May 2005 (the "1994 Plan"), and any shares that returned to the 1994 Plan as a result of termination of options or repurchase of shares issued under such plan. The 2005 Plan, administered by the Compensation Committee of the Board of Directors, provided for granting of incentive awards in the form of restricted stock and RSUs to directors, executive officers and employees of the

Company and its subsidiaries. Awards vest over a three, five or ten-year period, beginning on the date of grant. Vesting of ten year awards may accelerate based on the Company's previous year's earnings and growth but ten year awards cannot accelerate to vest over a period of less than five years. The 2005 Plan terminated on May 11, 2010, except with respect to outstanding awards previously granted thereunder. There were 3,362,304 shares of common stock that were reserved but not issued under the 2005 Plan as of May 11, 2010.

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

Our stockholders approved our 2015 Equity Incentive Plan (the “2015 Plan”) on May 12, 2015. At the time of approval, 3,000,000 shares of our common stock were reserved for issuance under this plan, as well as the 2,518,416 shares of common stock that were reserved but not issued under the 2010 Plan as of May 12, 2015, and any shares that were returned to the 1994, 2005, and the 2010 Plans as a result of the forfeiture or termination of options or RSUs or repurchase of shares issued under these plans. The 2015 Plan, administered by the Compensation Committee of the Board of Directors, provides for the granting of incentive awards in the form of restricted stock and RSUs to employees, directors and consultants of the Company and employees and consultants of any parent or subsidiary of the Company. Awards vest over a three, four, five or ten-year period, beginning on the date of grant. Vesting of ten year awards may accelerate based on the Company’s previous year’s earnings and growth but ten year awards cannot accelerate to vest over a period of less than five years. There were 2,971,181 shares available for grant under the 2015 Plan at June 30, 2018.

During the three months ended June 30, 2018, we did not make any changes in accounting principles or methods of estimates related to the 2005, 2010 and 2015 Plans.

Employee stock purchase plan

Our employee stock purchase plan permits substantially all domestic employees and employees of designated subsidiaries to acquire our common stock at a purchase price of 85% of the lower of the market price at the beginning or the end of the purchase period. The plan has quarterly purchase periods generally beginning on February 1, May 1, August 1 and November 1 of each year. Employees may designate up to 15% of their compensation for the purchase of common stock under this plan. On May 9, 2017, our stockholders approved an additional 3,000,000 shares for issuance under our employee stock purchase plan. At June 30, 2018, we had 2,412,255 shares of common stock reserved for future issuance under this plan. We issued 455,642 shares under this plan in the six months ended June 30, 2018 and the weighted average purchase price of the employees’ purchase rights was $36.48 per share. During the six months ended June 30, 2018, we did not make any changes in accounting principles or methods of estimates with respect to such plan.

Authorized Preferred Stock and Preferred Stock Purchase Rights Plan

We have 5,000,000 authorized shares of preferred stock. On January 21, 2004, our Board of Directors designated 750,000 of these shares as Series A Participating Preferred Stock in conjunction with the adoption of a Preferred Stock Rights Agreement which expired on May 10, 2014. There were no shares of preferred stock issued and outstanding at June 30, 2018.

Stock repurchases and retirements

From time to time, our Board of Directors has authorized various programs for our repurchase of shares of our common stock depending on market conditions and other factors. Under the current program, we did not make any share repurchases during the six months ended June 30, 2018 or the six months ended June 30, 2017. At June 30, 2018, there were 1,134,247 shares remaining available for repurchase under this program. This repurchase program does not have an expiration date.

Note 12 – Segment and geographic information

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

We sell our products in three geographic regions which consist of Americas; Europe, Middle East, India, and Africa (EMEIA); and Asia-Pacific (APAC). Our sales to these regions share similar economic characteristics, similar product mix, similar customers, and similar distribution methods. Revenue from the sale of our products, which are similar in nature, and software maintenance is reflected as total net sales in our Consolidated Statements of Income. (See "Note 2 -Revenue" of Notes to consolidated financial statements for total net sales by the major geographic areas in which we operate).

Based on the billing location of the customer, total sales outside the U.S. for the three months ended June 30, 2018 and 2017 were $222 million and $204 million, respectively, and $422 million and $393 million for the six months ended June 30, 2018 and 2017, respectively. Total property and equipment, net, outside the U.S. was $133 million as of June 30, 2018 and $132 million at December 31, 2017.

Note 13 - Debt

On May 9, 2013, we entered into a Loan Agreement (the “Loan Agreement”) with Wells Fargo Bank (the “Lender”). The Loan Agreement provided for a $50 million unsecured revolving line of credit with a scheduled maturity date of May 9, 2018 (the “Maturity Date”). On October 29, 2015, we entered into a First Amendment to Loan Agreement (the “Amendment”) with the Lender, which amended our Loan Agreement to among other things, (i) increase the unsecured revolving line of credit from $50 million to $125 million, (ii) extend the Maturity Date of the line of credit from May 9, 2018 to October 29, 2020, and (iii) provide us with an option to request increases to the line of credit of up to an additional $25 million in the aggregate, subject to consent of the Lender and terms and conditions to be mutually agreed between us and the Lender. On April 27, 2018, we entered into a Second Amendment to Loan Agreement (the "Second Amendment") which amended the Loan Agreement, as amended by the Amendment to, among other things, (i) reduce the revolving line of credit from $125.0 million to $5.0 million, (ii) reduce the letter of credit sublimit under the line of credit from $10.0 million to $5.0 million and (iii) require us and our subsidiaries to comply with certain of the affirmative and negative covenants under the Loan Agreement only if loans are outstanding under the Loan Agreement or if we have not reimbursed any drawing under a letter of credit issued under the Loan Agreement within five business days following the request of the Lender.

The loans bear interest, at our option, at a base rate determined in accordance with the Loan Agreement, plus a spread of 0.0% to 0.50%, or a LIBOR rate plus a spread of 1.13% to 2.00%, in each case with such spread determined based on a ratio of consolidated indebtedness to EBITDA, determined in accordance with the Loan Agreement. Principal, together with all accrued and unpaid interest, is due and payable on the Maturity Date. We are also obligated to pay a quarterly commitment fee, payable in arrears, based on the available commitments at a rate of 0.18% to 0.30%, with such rate determined based on the ratio described above. The Loan Agreement contains customary affirmative and negative covenants. The affirmative covenants include, among other things, delivery of financial statements, compliance certificates and notices; payment of taxes and other obligations; maintenance of existence; maintenance of properties and insurance; and compliance with applicable laws and regulations. The negative covenants include, among other things, limitations on indebtedness, liens, mergers, consolidations, acquisitions and sales of assets, investments, changes in the nature of the business, affiliate transactions and certain restricted payments. The Loan Agreement also requires us to maintain a ratio of consolidated indebtedness to EBITDA equal to or less than 3.25 to 1.00, and a ratio of consolidated EBITDA to interest expense greater than or equal to 3.00 to 1.00, in each case determined in accordance with the Loan Agreement. As of June 30, 2018, we were in compliance with all applicable covenants in the Loan Agreement.

The Loan Agreement contains customary events of default including, among other things, payment defaults, breaches of covenants or representations and warranties, cross-defaults with certain other indebtedness, bankruptcy and insolvency events, judgment defaults and change in control events, subject to grace periods in certain instances. Upon an event of default, the lender may declare all or a portion of the outstanding obligations payable by us to be immediately due and payable and exercise other rights and remedies provided for under the Loan Agreement. Under certain circumstances, a default interest rate will apply on all obligations during the existence of an event of default under the Loan Agreement at a per annum rate of interest equal to 2.00% above the otherwise applicable interest rate. Proceeds of loans made under the Loan Agreement may be used for working capital and other general corporate purposes. We may prepay the loans under the Loan Agreement in whole or in part at any time without premium or penalty. Certain of our existing and future material domestic subsidiaries are required to guaranty our obligations under the Loan Agreement.

As of June 30, 2018, we had no outstanding borrowings under this line of credit. During the three months ended June 30, 2018 and June 30, 2017, we incurred interest expense related to our outstanding borrowings of $0 and $179,000, respectively. During the six months ended June 30, 2018 and June 30, 2017, we incurred interest expense related to our outstanding borrowings of $0 and $343,000, respectively. As of June 30, 2018 and June 30, 2017, the weighted-average interest rate on the revolving line of credit was 3.2% and 2.3%, respectively. These charges are included in “Other income (loss), net” in our Consolidated Statements of Income.

Note 14 – Commitments and contingencies

We offer a one-year limited warranty on most hardware products which is included in the terms of sale of such products. We also offer optional extended warranties on our hardware products for which the related revenue is recognized ratably over the warranty period. Provision is made for estimated future warranty costs at the time of the sale for the estimated costs that may be incurred under the standard warranty. Our estimate is based on historical experience and product sales during the period. The warranty reserve for the six months ended June 30, 2018 and 2017 was as follows:

(In thousands)	Six Months Ended June 30, (Unaudited)	
	2018	2017
Balance at the beginning of the period	$2,846	$2,686
Accruals for warranties issued during the period	1,456	1,288
Accruals related to pre-existing warranties	155	161
Settlements made (in cash or in kind) during the period	(1,459)	(1,330)
Balance at the end of the period	$2,998	$2,805

As of June 30, 2018, we had non-cancelable purchase commitments with various suppliers of customized inventory and inventory components totaling approximately $7.8 million over the next twelve months.

As of June 30, 2018, we had outstanding guarantees for payment of customs and foreign grants totaling approximately $2.1 million, which are generally payable over the next twelve months.

Note 15 – Restructuring

Since the first quarter of 2017, we have been taking steps to reduce our overall employee headcount in an effort to reduce job duplication or evaluate where we should shift and centralize activities, improve efficiencies, and rebalance our resources on higher return activities. The timing and scope of our headcount reductions will vary.

A summary of the charges in our consolidated statement of operations resulting from our restructuring activities is shown below:

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	(Unaudited)		(Unaudited)	
	2018	2017	2018	2017
Cost of sales	$—	574	$29	907
Research and development	830	1,042	976	1,296
Sales and marketing	3,033	4,024	4,678	6,379
General and Administration	553	419	1,165	594
Total restructuring and other related costs	$4,416	6,059	$6,848	9,176

A summary of balances and activity related to our restructuring activity is shown below:

	Restructuring Liability (in thousands)
Balance as of December 31, 2017	$ 5,408
Income statement expense	6,848
Cash payments	(8,359)
Balance as of June 30, 2018	$ 3,897

The restructuring liability of $3.9 million at June 30, 2018 relating to our restructuring activity is recorded in the “accrued compensation” line item of our consolidated balance sheet.

Note 16 – Litigation

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

Note 17 – Subsequent events

On July 25, 2018, our Board of Directors declared a quarterly cash dividend of $0.23 per common share, payable on September 4, 2018, to stockholders of record on August 13, 2018.

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

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Any statements contained herein regarding our future financial performance, operations or other matters (including, without limitation, statements to the effect that we "believe," "expect," "plan," "may," "will," "intend to," "project," "anticipate," "continue," or "estimate" or other variations thereof or comparable terminology or the negative thereof) should be considered forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements as a result of a number of important factors, including those set forth under the heading "Risk Factors" beginning on page 44, and in the discussion below. Readers are also encouraged to refer to the documents regularly filed by us with the Securities and Exchange Commission, including our Annual Report on Form 10-K for the year ended December 31, 2017, for further discussion of our business and the risks attendant thereto.

Overview

National Instruments Corporation (the "Company", "we", "us" or "our") designs, manufactures and sells systems to engineers and scientists that accelerate productivity, innovation and discovery. Our software defined platform provides integrated software and modular hardware that speeds the development of automated test and automated measurement systems. 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 and to grow our large order business by serving a large market on many computer platforms, through a global marketing and distribution network. We also seek new opportunities for our existing product portfolio through acquisitions of new technologies and expertise aligned with our strategic initiatives.

Maintaining a high level of customer satisfaction

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

Leveraging external and internal technology

Our product strategy is to provide superior products by leveraging generally available technology, supporting open architectures on multiple platforms and leveraging our core technologies across multiple products.

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

Leveraging a worldwide sales, distribution and manufacturing network

We distribute and sell our software and hardware products primarily through a direct sales organization. We also use independent distributors, OEMs, VARs, system integrators, and consultants to market and sell our products. We have sales offices in the U.S. and sales offices and distributors in key international markets. Sales outside of the Americas accounted for approximately 62% of our net sales during each of the three months ended June 30, 2018 and 2017, and approximately 62% and 61% of our net sales during the six months ended June 30, 2018 and 2017, respectively. The vast majority of our foreign sales are denominated in the customers' local currency, which exposes us to the effects of changes in foreign currency exchange rates. We expect that a significant portion of our total net sales will continue to be derived from international sales. (See "Note 2 - Revenue" of Notes to consolidated financial statements for details concerning the geographic breakdown of our net sales).

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

Delivering high quality, reliable products

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

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

Current business outlook

Many of the industries we serve have historically been cyclical and have experienced periodic downturns. In assessing our business, we consider the trends in the Global Purchasing Managers' Index ("PMI"), global industrial production as well as industry reports on the specific vertical industries that we target. Historically, our business cycles have generally followed the expansion and contraction cycles in the global industrial economy as measured by the Global PMI. For the three months ended June 30, 2018, the average of the Global PMI was 53.2 and the average of the new order element of the Global PMI was 53.4. Although these readings are indicative of expansion in the industrial sector we are unable to predict whether the industrial economy, as measured by the PMI, will remain above the neutral reading of 50, strengthen or contract during the remainder of 2018.

We are optimistic about our long-term position in the industry through the sustained differentiation we deliver to our customers through our platform-based approach. We continue to see growth in our orders above $20,000 which we believe reflects our focus on developing highly differentiated products, particularly for complex test and measurement systems. In the second quarter of 2018, we saw a 6% year over year increase from orders under $20,000 and a 16% year over year increase from orders over $20,000.

Since the first quarter of 2017, we have been taking steps to reduce our overall employee headcount in an effort to reduce job duplication, shift and centralize activities, improve efficiencies, and rebalance our resources on higher return activities. In connection with these activities, we expect to incur an additional $3 million to $5 million in severance and other restructuring-related charges, net of tax, by the end of 2018, most of which we expect to incur in the third quarter of 2018.

During the second quarter of 2018, we saw a broad appreciation in the value of the U.S. dollar against the local currency in many of the currency markets where we do business. In particular, we noted a sharp appreciation of the U.S. dollar against the Euro and against the Chinese yuan. Despite the broad appreciation of the U.S dollar, we continue to see strength in the overall industrial economy, as measured by the PMI. See “Results of Operations” below for additional discussion on the impact of foreign exchange rates on our business for the three and six months ended June 30, 2018. See “Our Revenues are Subject to Seasonal Variations” under “Risk Factors” for additional discussion of potential fluctuations in our net sales.

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

Results of Operations

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

	Three Months Ended June 30, 2018 (Unaudited)				Six Months Ended June 30, 2018 (Unaudited)			
	2018		2017		2018		2017	
Net sales:								
Americas	38.1	%	38.2	%	38.2	%	38.8	%
EMEIA	32.3		31.6		33.0		31.6	
APAC	29.7		30.2		28.8		29.6	
Total net sales	100.0		100.0		100.0		100.0	
Cost of sales	24.1		25.9		24.0		25.7	
Gross profit	75.9		74.1		76.0		74.3	
Operating expenses:								
Sales and marketing	37.3		39.0		37.9		39.1	
Research and development	19.6		17.9		19.7		18.6	
General and administrative	8.2		8.2		8.4		8.4	
Total operating expenses	65.1		65.1		66.0		66.1	
Operating income	10.8		9.0		10.0		8.2	
Other income (expense):								