NATIONAL INSTRUMENTS CORP
Form 10-Q
October 31, 2016
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: September 30, 2016 or

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

For the transition period from ________________ to ________________

Commission file number: 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) 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

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 October 24, 2016
Common Stock - $0.01 par value	128,919,410

NATIONAL INSTRUMENTS CORPORATION

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PART I - FINANCIAL INFORMATION

ITEM 1.Financial Statements

NATIONAL INSTRUMENTS CORPORATION

CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

	September 30, 2016 (unaudited)	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	$ 300,652	$ 251,129
Short-term investments	52,277	81,789
Accounts receivable, net	206,171	216,244
Inventories, net	196,391	185,197
Prepaid expenses and other current assets	55,281	65,381
Total current assets	810,772	799,740
Property and equipment, net	261,859	257,853
Goodwill	261,372	257,718
Intangible assets, net	110,161	108,196
Other long-term assets	28,729	30,349
Total assets	$ 1,472,893	$ 1,453,856
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$ 53,192	$ 50,970
Accrued compensation	31,615	27,956
Deferred revenue - current	113,645	112,283
Accrued expenses and other liabilities	23,940	11,756
Other taxes payable	33,461	37,250
Total current liabilities	255,853	240,215
Long-term debt	25,000	37,000
Deferred income taxes	37,787	44,673
Liability for uncertain tax positions	10,037	11,974
Deferred revenue - long-term	28,148	27,708
Other long-term liabilities	8,657	10,565
Total liabilities	365,482	372,135

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; 128,920,278 shares and 127,471,604 shares issued and outstanding, respectively	1,289	1,275
Additional paid-in capital	758,411	717,705
Retained earnings	372,893	400,831
Accumulated other comprehensive loss	(25,182)	(38,090)
Total stockholders’ equity	1,107,411	1,081,721
Total liabilities and stockholders’ equity	$ 1,472,893	$ 1,453,856

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

NATIONAL INSTRUMENTS CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share data)

(unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Net sales:				
Product	$ 278,521	$ 271,683	$ 816,486	$ 807,064
Software maintenance	27,843	28,129	83,161	84,053
Total net sales	306,364	299,812	899,647	891,117
Cost of sales:				
Product	74,734	75,144	225,261	225,646
Software maintenance	1,998	2,022	5,126	4,531
Total cost of sales	76,732	77,166	230,387	230,177
Gross profit	229,632	222,646	669,260	660,940
Operating expenses:				
Sales and marketing	116,662	114,507	346,230	335,916
Research and development	59,066	52,533	178,244	168,462
General and administrative	24,537	23,255	74,308	69,391
Total operating expenses	200,265	190,295	598,782	573,769
Operating income	29,367	32,351	70,478	87,171
Other income:				
Interest income	276	396	787	1,089
Net foreign exchange gain/(loss)	(760)	286	(1,471)	(1,965)
Other income (loss), net	301	133	(2,052)	787
Income before income taxes	29,184	33,166	67,742	87,082
Provision for income taxes	4,695	9,988	14,155	23,958
Net income	$ 24,489	$ 23,178	$ 53,587	$ 63,124

Basic earnings per share	$ 0.19	$ 0.18	$ 0.42	$ 0.49
Weighted average shares outstanding - basic	128,815	127,935	128,233	128,219
Diluted earnings per share	$ 0.19	$ 0.18	$ 0.42	$ 0.49
Weighted average shares outstanding - diluted	129,047	128,229	128,738	128,856
Dividends declared per share	$ 0.20	$ 0.19	$ 0.60	$ 0.57

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

NATIONAL INSTRUMENTS CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income	$ 24,489	$ 23,178	$ 53,587	$ 63,124
Other comprehensive income, before tax and net of reclassification adjustments:				
Foreign currency translation adjustment	3,964	(3,789)	12,130	(14,273)
Unrealized (loss) gain on securities available-for-sale	(70)	(348)	479	441
Unrealized (loss) gain on derivative instruments	976	(7,642)	4,541	(14,378)
Other comprehensive (loss) gain, before tax	4,870	(11,779)	17,150	(28,210)
Tax (benefit) expense related to items of other comprehensive income	967	(3,935)	4,242	(8,238)
Other comprehensive (loss) gain, net of tax	3,903	(7,844)	12,908	(19,972)
Comprehensive income	$ 28,392	$ 15,334	$ 66,495	$ 43,152

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

NATIONAL INSTRUMENTS CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Nine Months Ended September 30,	
	2016	2015
Cash flow from operating activities:		
Net income	$ 53,587	$ 63,124
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	55,164	55,157
Stock-based compensation	19,635	19,151
Tax expense from deferred income taxes	(7,321)	(7,404)
Tax benefit from stock option plans	(439)	(944)
Changes in operating assets and liabilities:		
Accounts receivable	10,073	17,162
Inventories	(11,194)	(14,809)
Prepaid expenses and other assets	19,696	(3,370)
Accounts payable	2,222	(5,609)
Deferred revenue	1,802	(1,591)
Taxes, accrued expenses and other liabilities	9,855	(386)
Net cash provided by operating activities	153,080	120,481
Cash flow from investing activities:		
Capital expenditures	(34,408)	(28,102)
Capitalization of internally developed software	(24,048)	(22,639)
Additions to other intangibles	(1,969)	(2,240)
Acquisitions, net of cash received	(549)	(28,629)
Purchases of short-term investments	(9,054)	(29,649)
Sales and maturities of short-term investments	38,566	44,752
Net cash used in investing activities	(31,462)	(66,507)
Cash flow from financing activities:		
Proceeds from revolving line of credit	15,000	42,000
Principal payments on revolving line of credit	(27,000)	(17,000)
Proceeds from issuance of common stock	22,157	21,252
Repurchase of common stock	(5,635)	(72,559)

Dividends paid	(77,056)	(73,406)
Tax benefit from stock option plans	439	944
Net cash used in financing activities	(72,095)	(98,769)
Net change in cash and cash equivalents	49,523	(44,795)
Cash and cash equivalents at beginning of period	251,129	274,030
Cash and cash equivalents at end of period	$ 300,652	$ 229,235

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, 2015, 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 September 30, 2016 and December 31, 2015, the results of our operations and comprehensive income for the three and nine month periods ended September 30, 2016 and 2015, and the cash flows for the nine month periods ended September 30, 2016 and 2015. Our operating results for the three and nine month periods ended September 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016. 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 and nine month periods ended September 30, 2016 and 2015, are as follows:

	Three Months Ended September 30, (In thousands) (Unaudited)	Nine Months Ended September 30, (In thousands) (Unaudited)

	2016	2015	2016	2015
Weighted average shares outstanding-basic	128,815	127,935	128,233	128,219
Plus: Common share equivalents				
Stock options and RSUs	232	294	505	637
Weighted average shares outstanding-diluted	129,047	128,229	128,738	128,856

Stock awards to acquire 1,068,800 shares and 1,331,000 shares for the three months ended September 30, 2016 and 2015, respectively, and 58,000 shares 433,400 shares, for the nine months ended September 30, 2016 and 2015, respectively, were excluded in the computations of diluted EPS because the effect of including the stock awards would have been anti-dilutive.

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

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

(In thousands)	As of September 30, 2016 (Unaudited)				
	Adjusted Cost	Gross Unrealized Gain	Gross Unrealized Loss	Cumulative Translation Adjustment	Fair Value
Cash	$ 254,227	-	-	(1,173)	253,054
Money Market Accounts	47,598	-	-	-	47,598
Corporate bonds	51,979	110	(36)	(1,536)	50,517
Time deposits	1,760	-	-	-	1,760
Cash, cash equivalents, and short-term investments	$ 355,564	$ 110	$ (36)	$ (2,709)	$ 352,929

(In thousands)	December 31, 2015				
	Adjusted Cost	Gross Unrealized Gain	Gross Unrealized Loss	Cumulative Translation Adjustment	Fair Value
Cash	$ 165,251	$ -	$ -	$ (1,551)	$ 163,700
Money Market Accounts	87,429	-	-	-	87,429
Corporate bonds	69,442	2	(281)	(1,119)	68,044
U.S. treasuries and agencies	4,419	-	(2)	-	4,417
Time deposits	9,326	2	-	-	9,328
Cash, cash equivalents, and short-term investments	$ 335,867	$ 4	$ (283)	$ (2,670)	$ 332,918

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

(In thousands)	As of September 30, 2016 (Unaudited)	
	Adjusted Cost	Fair Value
Due in less than 1 year	$ 37,442	$ 37,439
Due in 1 to 5 years	16,297	14,838
Total available-for-sale debt securities	$ 53,739	$ 52,277

Due in less than 1 year	Adjusted Cost	Fair Value
Corporate bonds	$ 35,682	$ 35,679
Time deposits	1,760	1,760
Total available-for-sale debt securities	$ 37,442	$ 37,439

Due in 1 to 5 years	Adjusted Cost	Fair Value
Corporate bonds	$ 16,297	$ 14,838
Total available-for-sale debt securities	$ 16,297	$ 14,838

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	September 30, 2016	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Cash and cash equivalents available for sale:				
Money Market Funds	$ 47,598	47,598	-	-
Short-term investments available for sale:				
Corporate bonds	50,517	-	50,517	-
Time deposits	1,760	1,760	-	-
Derivatives	2,698	-	2,698	-
Total Assets	$ 102,573	$ 49,358	$ 53,215	$ -
Liabilities				
Derivatives	$ (6,188)		(6,188)	
Total Liabilities	$ (6,188)	$ -	$ (6,188)	$ -

(In thousands)	Fair Value Measurements at Reporting Date Using			
Description	December 31, 2015	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	$ 87,429	$ 87,429	$ -	$ -
Short-term investments available for sale:				
Corporate bonds	68,044	-	68,044	-
U.S. treasuries and agencies	4,417	-	4,417	-
Time deposits	9,328	9,328	-	-
Derivatives	1,231	-	1,231	-
Total Assets	$ 170,449	$ 96,757	$ 73,692	$ -
Liabilities				
Derivatives	$ (8,746)	$ -	$ (8,746)	$ -
Total Liabilities	$ (8,746)	$ -	$ (8,746)	$ -

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 short-term investments available-for-sale have contractual maturities of less than 60 months.

Derivatives include foreign currency forward and option contracts. Our foreign currency forward contracts are valued using an income approach (Level 2) based on the spot rate less the contract rate multiplied by the notional amount. Our foreign currency option contracts are valued using a market approach based on the quoted market prices which are derived from observable inputs including current and future spot rates, interest rate spreads as well as quoted market prices of similar instruments. We consider counterparty credit risk in the valuation of our derivatives. However, counterparty credit risk did not impact the valuation of our derivatives during the nine month period ended September 30, 2016. There were no transfers in or out of Level 1 or Level 2 during the nine month period ended September 30, 2016.

As of September 30, 2016, 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 September 30, 2016 and December 31, 2015. 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 58% of our net sales during each of the three month periods ended September 30, 2016 and 2015, and approximately 61% and 58% of our net sales during the nine month periods ended September 30, 2016 and 2015, respectively. Our activities expose us to a variety of market risks, including the effects of changes in foreign currency exchange rates. These financial risks are monitored and managed by us as an integral part of our overall risk management program.

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

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

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

Cash flow hedges

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

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

We held forward contracts with the following notional amounts:

(In thousands)	US Dollar Equivalent	
	As of September 30, 2016 (Unaudited)	As of December 31, 2015
Euro	$ 87,972	$ 30,867
Japanese yen	38,217	4,119
Hungarian forint	63,587	38,836
British pound	2,826	4,342
Malaysian ringgit	46,692	40,249
Chinese yuan	34,390	26,548
Total forward contracts notional amount	$ 273,684	$ 144,961

The contracts in the foregoing table had contractual maturities of 40 months or less at September 30, 2016 and December 31, 2015.

At September 30, 2016, we expect to reclassify $1.0 million of losses on derivative instruments from accumulated OCI to net sales during the next twelve months when the hedged international sales occur, $1.1 million of losses on derivative instruments from accumulated OCI to cost of sales during the next twelve months when the cost of sales are incurred and $1.3 million of losses on derivative instruments from accumulated OCI to operating expenses during the next twelve months when the hedged operating expenses occur. Expected amounts are based on derivative valuations at September 30, 2016. Actual results may vary materially as a result of changes in the corresponding exchange rates subsequent to this date.

We did not record any ineffectiveness from our hedges during the three and nine month periods ended September 30, 2016 and 2015.

Other Derivatives

Other derivatives not designated as hedging instruments consist primarily of foreign currency forward contracts that we use to hedge our foreign denominated net receivable or net payable positions to help protect against the change in value caused by a fluctuation in foreign currency exchange rates. We typically attempt to hedge up to 90% of our outstanding foreign denominated net receivables or net payables and typically limit the duration of these foreign currency forward contracts to approximately 120 days or less. The gain or loss on the derivatives as well as the offsetting gain or loss on the hedge item attributable to the hedged risk is recognized in current earnings under the line item “net foreign exchange gain (loss).” As of September 30, 2016 and December 31, 2015, we held foreign currency forward contracts with a notional amount of $66 million and $97 million, respectively.

The following tables present the fair value of derivative instruments on our Consolidated Balance Sheets at September 30, 2016 and December 31, 2015, respectively.

(In thousands)	Asset Derivatives September 30, 2016 (Unaudited)		December 31, 2015	
	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	$ 1,030		$ 391
Foreign exchange contracts - LT forwards	Other long-term assets	950		-
Total derivatives designated as hedging instruments		$ 1,980		$ 391
Derivatives not designated as hedging instruments				
Foreign exchange contracts - ST forwards	Prepaid expenses and other current assets	$ 718		$ 840
Total derivatives not designated as hedging instruments		$ 718		$ 840
Total derivatives		$ 2,698		$ 1,231

(In thousands)	Liability Derivatives September 30, 2016 (Unaudited)		December 31, 2015	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments				
Foreign exchange contracts - ST forwards	Accrued expenses and other liabilities	$ (4,116)		$ (4,653)
Foreign exchange contracts - LT forwards	Other long-term liabilities	(1,349)		(3,613)
Total derivatives designated as hedging instruments		$ (5,465)		$ (8,266)

Derivatives not designated as hedging instruments			
Foreign exchange contracts - ST forwards	Accrued expenses and other liabilities	$ (723)	$ (480)
Total derivatives not designated as hedging instruments		$ (723)	$ (480)
Total derivatives		$ (6,188)	$ (8,746)

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The following tables present the effect of derivative instruments on our Consolidated Statements of Income for three month periods ended September 30, 2016 and 2015, respectively:

September 30, 2016
(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 and options	$	(1,156)	Net sales	$	(160)	Net foreign exchange gain/(loss)	$	-
Foreign exchange contracts - forwards and options		1,412	Cost of sales		(414)	Net foreign exchange gain/(loss)		-
Foreign exchange contracts - forwards and options		720	Operating expenses		(389)	Net foreign exchange gain/(loss)		-
Total	$	976		$	(963)		$	-

September 30, 2015
(In thousands)
(Unaudited)

Derivatives in Cash Flow Hedging Relationship	Gain or (Loss) Recognized in OCI on Derivative (Effective	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	Gain or (Loss) Recognized in Income on Derivative (Ineffective

	Portion)			(Ineffective Portion)	Portion)
Foreign exchange contracts - forwards and options	$ (4,706)	Net sales	$ 5,405	Net foreign exchange gain/(loss)	$ -
Foreign exchange contracts - forwards and options	(649)	Cost of sales	(698)	Net foreign exchange gain/(loss)	-
Foreign exchange contracts - forwards and options	(2,287)	Operating expenses	(573)	Net foreign exchange gain/(loss)	-
Total	$ (7,642)		$ 4,134		$ -

(In thousands)

Derivatives not Designated as Hedging Instruments	Location of Gain (Loss) Recognized in Income	Amount of Gain (Loss) Recognized in Income September 30, 2016 (Unaudited)	Amount of Gain (Loss) Recognized in Income September 30, 2015 (Unaudited)
Foreign exchange contracts - forwards		$ (814)	$ 2,967
Total		$ (814)	$ 2,967

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The following tables present the effect of derivative instruments on our Consolidated Statements of Income for the nine month periods ended September 30, 2016 and 2015, respectively:

September 30, 2016
(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 and options	$ $(1,432)	Net sales	$ $(1,301)	Net foreign exchange gain/(loss)	$ -
Foreign exchange contracts - forwards and options	$3,009	Cost of sales	$(1,367)	Net foreign exchange gain/(loss)	-
Foreign exchange contracts - forwards and options	$2,964	Operating expenses	$(1,278)	Net foreign exchange gain/(loss)	-
Total	$ 4,541		$ (3,946)		$ -

September 30, 2015
(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 and options	$ (7,599)	Net sales	$ 15,687	Net foreign exchange gain/(loss)	$ -
Foreign exchange contracts - forwards and options	(2,608)	Cost of sales	(1,540)	Net foreign exchange gain/(loss)	-
Foreign exchange contracts - forwards and options	(4,171)	Operating expenses	(1,315)	Net foreign exchange gain/(loss)	-
Total	$ (14,378)		$ 12,832		$ -

(In thousands)

Derivatives not Designated as Hedging Instruments	Location of Gain (Loss) Recognized in Income	Amount of Gain (Loss) Recognized in Income September 30, 2016 (Unaudited)	Amount of Gain (Loss) Recognized in Income September 30, 2015 (Unaudited)
Foreign exchange contracts - forwards	Net foreign exchange gain/(loss)	$ (1,005)	$ 3,606
Total		$ (1,005)	$ 3,606

Note 6 – Inventories, net

Inventories, net consist of the following:

(In thousands)		September 30, 2016 (Unaudited)		December 31, 2015
Raw materials	$	97,174	$	94,816
Work-in-process		9,059		10,819
Finished goods		90,158		79,562
	$	196,391	$	185,197

Note 7 – Intangible assets, net

Intangible assets at September 30, 2016 and December 31, 2015 are as follows:

(In thousands)		September 30, 2016 (Unaudited)						December 31, 2015				
		Gross Carrying Amount		Accumulated Amortization		Net Carrying Amount		Gross Carrying Amount		Accumulated Amortization		Net Carrying Amount
Capitalized software development costs	$	90,878	$	(29,112)	$	61,766	$	80,682	$	(30,434)	$	50,248
Acquired technology		95,148		(78,078)		17,070		93,976		(69,908)		24,068
Patents		31,216		(16,905)		14,311		30,221		(14,941)		15,280
Other		44,697		(27,683)		17,014		43,201		(24,601)		18,600
	$	261,939	$	(151,778)	$	110,161	$	248,080	$	(139,884)	$	108,196

Software development costs capitalized for the three month periods ended September 30, 2016 and 2015 were $9.1 million and $11.7 million, respectively, and related amortization expense was $4.9 million and $4.4 million, respectively. For the nine month periods ended September 30, 2016 and 2015, capitalized software development costs were $25 million and $24 million, respectively, and related amortization expense was $14 million for each period. Capitalized software development costs for the three month periods ended September 30, 2016 and 2015 included costs related to stock based compensation of $445,000 and $480,000, respectively. For the nine month periods ended

September 30, 2016 and 2015, capitalized software development costs included costs related to stock based compensation of $970,000 and $950,000 respectively. The related amounts in the table above are net of fully amortized assets.

Amortization of capitalized software development costs is computed on an individual product basis for those products available for market and is recognized based on the product's estimated economic life, generally three to six years. Acquired technology and other intangible assets are amortized over their useful lives, which range from three to eight years. Patents are amortized using the straight-line method over their estimated period of benefit, generally 10 to 17 years. Total intangible assets amortization expenses were $8 million and $9 million for the three months ended September 30, 2016 and 2015, respectively, and $27 million and $26 million for the nine month periods ended September 30, 2016 and 2015.

Note 8 – Goodwill

The carrying amount of goodwill as of September 30, 2016, was as follows:

		Amount (In thousands)
Balance as of December 31, 2015	$	257,718
Acquisitions		419
Foreign currency translation impact		3,235
Balance as of September 30, 2016 (unaudited)	$	261,372

The excess purchase price over the fair value of assets acquired is recorded as goodwill. As we have one operating segment comprised of components with similar economic characteristics, we allocate goodwill to one reporting unit for goodwill impairment testing. Goodwill is tested for impairment on an annual basis, and between annual tests if indicators of potential impairment exist, using a fair-value-based approach based on the market capitalization of the reporting unit. Our annual impairment test was performed as of February 28, 2016. No impairment of goodwill was identified during 2016 or 2015. (See “Note 17 – Acquisitions” of Notes to Consolidated Financial Statements for additional discussion related to our recent acquisitions).

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 $10.6 million and $12.5 million unrecognized tax benefits at September 30, 2016 and December 31, 2015, respectively, all of which would affect our effective income tax rate if recognized. We recorded a gross increase in unrecognized tax benefits of $606,400 and $1.2 million for the three and nine month periods ended September 30, 2016, respectively, as a result of the tax positions taken during these periods. We recorded a gross decrease in unrecognized tax benefits of $3.5 million for each of the three and nine month periods ended September 30, 2016 as a result of closing open tax years. As of September 30, 2016, it is reasonably possible that we will recognize tax benefits in the amount of $3.6 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 September 30, 2016, we had approximately $1.0 million accrued for interest related to uncertain tax positions. The tax years 2008 through 2016 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 16% and 30% for the three month periods ended September 30, 2016 and 2015, respectively, and 21% and 28% for the nine month periods ended September 30, 2016 and 2015, respectively. For the three and nine month periods ended September 30, 2016, our effective tax rate was lower than the U.S. federal statutory rate of 35% as a result of an enhanced deduction for certain research and development expenses, profits in foreign jurisdictions with reduced income tax rates, the research and development tax credit, and a tax benefit from disqualifying dispositions of equity awards that do not ordinarily result in a tax benefit. For the three and nine month periods ended September 30, 2015, 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, and a tax benefit from disqualifying dispositions of equity awards that do not ordinarily result in a tax benefit.

Our earnings in Hungary are subject to a statutory tax rate of 19%. The difference between this rate and the statutory U.S. rate of 35% resulted in income tax benefits of $1.8 million and $500,000, for the three month periods ended September 30, 2016 and 2015, respectively, and $3.8 million and $2.2 million for the nine month periods ended September 30, 2016 and 2015, respectively.

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 $2.7 million and $1.9 million for the three month periods ended September 30, 2016 and 2015, respectively, and $6.5 million and $6.0 million for the nine month periods ended September 30, 2016 and 2015, 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 tax holiday resulted in income tax benefits of $771,000 and $460,000 for the three month periods ended September 30, 2016 and 2015, respectively, and $1.9 million and $2.2 million for the nine month periods ended September 30, 2016 and 2015, respectively.

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

Note 10 – Comprehensive income

Our comprehensive income is comprised of net income, foreign currency translation, unrealized gains and losses on forward and option contracts and securities classified as available-for-sale. The accumulated OCI, net of tax, for the nine month periods ended September 30, 2016 and 2015, consisted of the following:

	September 30, 2016 (Unaudited)			
(In thousands)	Currency translation adjustment	Investments	Derivative instruments	Accumulated other comprehensive income/(loss)
Balance as of December 31, 2015	$ (31,871)	$ (857)	(5,362)	$ (38,090)
Current-period other comprehensive income	12,130	479	595	13,204
Reclassified from accumulated OCI into income	-	-	3,946	3,946
Income tax expense	2,582	123	1,537	4,242
Balance as of September 30, 2016	$ (22,323)	$ (501)	$ (2,358)	$ (25,182)

	September 30, 2015 (Unaudited)			
(In thousands)	Currency translation adjustment	Investments	Derivative instruments	Accumulated other comprehensive income/(loss)
Balance as of December 31, 2014	$ (17,304)	$ (1,399)	$ 7,039	$ (11,664)
Current-period other comprehensive (loss) income	(14,273)	441	(1,547)	(15,379)
Reclassified from accumulated OCI into income	-	-	(12,832)	(12,832)
Income tax (benefit) expense	(3,318)	88	(5,008)	(8,238)
	$ (28,259)	$ (1,046)	$ (2,332)	$ (31,637)

Balance as of September 30, 2015

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

Authorized shares of common and preferred stock

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

Stock option plans

Our stockholders approved the 1994 Incentive Stock Option Plan (the "1994 Plan") in May 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 1994 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 vested over a five to ten-year period, beginning on the date of grant. Vesting of ten year awards may have accelerated based on the Company's previous year's earnings and revenue growth but shares could not accelerate to vest over a period of less than five years. Stock options were required to 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 estimated the potential forfeitures of stock grants and adjusted the compensation cost recorded accordingly. During nine month period ended September 30, 2016, we did not make any changes in accounting principles or methods of estimates related to the 1994 Plan.

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 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 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, 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 4,849,044 shares available for grant under the 2015 Plan at September 30, 2016.

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 nine month period ended September 30, 2016, 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 13, 2014, our stockholders approved an additional 3,000,000 shares for issuance under our employee stock purchase plan. At September 30, 2016, we had 1,215,752 shares of common stock reserved for future issuance under this plan. We issued 935,128 shares under this plan in the nine month period ended September 30, 2016. The weighted average purchase price of the employees' purchase rights was $23.69 per share. During the nine month period ended September 30, 2016, 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. There were no shares of preferred stock issued and outstanding at September 30, 2016.

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 three month period ended September 30, 2016. We repurchased a total of 2,212,301 shares of our common stock at a weighted average price per share of $28.94 during the three month period ended September 30, 2015. We repurchased a total of 206,780 shares and 2,500,305 shares of our common stock at a weighted average price per share of $27.25 and $29.02 during the nine month periods ended September 30, 2016 and 2015, respectively. At September 30, 2016, there were 1,134,247 shares remaining available for repurchase under this program. This repurchase program does not have an expiration date.

During the nine month period ended September 30, 2016, we did not receive any proceeds from the exercise of stock options as all remaining options outstanding under our 1994 Plan were exercised or expired in 2015.

Note 12 – Segment and geographic information

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

We sell our product in three geographic regions which consist of Americas; Europe, Middle East, India, and Africa (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.

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

(In thousands)	Three Months Ended September 30, (Unaudited)		Nine Months Ended September 30, (Unaudited)	
	2016	2015	2016	2015
Net sales:				
Americas	$ 129,710	$ 126,477	$ 354,806	$ 371,479
EMEIA	92,232	97,899	278,616	289,130
APAC	84,422	75,436	266,225	230,508
	$ 306,364	$ 299,812	$ 899,647	$ 891,117

Based on the billing location of the customer, total sales outside the U.S. for the three month periods ended September 30, 2016 and 2015 were $184 million and $180 million, respectively, and $564 million and $544 million for the nine month periods ended September 30, 2016 and 2015, respectively.

Total property and equipment, net, outside the U.S. was $136 million and $138 million as of September 30, 2016 and December 31, 2015, respectively.

Note 13 - Debt

On May 9, 2013, we entered into a Loan Agreement (the "Loan Agreement") with Wells Fargo Bank (the "Lender"). The Loan Agreement provided for a $50 million unsecured revolving line of credit with a scheduled maturity date of May 9, 2018 (the "Maturity Date"). On October 29, 2015, we entered into a First Amendment to Loan Agreement (the "Amendment") with the Lender, which amended our Loan Agreement to among other things, (i) increase the unsecured revolving line of credit from $50.0 million to $125.0 million, (ii) extend the Maturity Date of the line of credit from May 9, 2018 to October 29, 2020, and (iii) provide us with an option to request increases to the line of credit of up to an additional $25.0 million in the aggregate, subject to consent of the Lender and terms and conditions to be mutually agreed between us and the Lender.

The loans bear interest, at our option, at a base rate determined in accordance with the Loan Agreement, plus a spread of 0.0% to 0.5%, or a LIBOR rate plus a spread of 1.125% to 2.0%, in each case with such spread determined based on a ratio of consolidated indebtedness to EBITDA, determined in accordance with the Loan Agreement. Principal, together with all accrued and unpaid interest, is due and payable on the Maturity Date. We are also obligated to pay a quarterly commitment fee, payable in arrears, based on the available commitments at a rate of 0.175% to 0.300%, with such rate determined based on the ratio described above. The Loan Agreement contains customary affirmative and negative covenants. The affirmative covenants include, among other things, delivery of financial statements, compliance certificates and notices; payment of taxes and other obligations; maintenance of existence; maintenance of properties and insurance; and compliance with applicable laws and regulations. The negative covenants include, among other things, limitations on indebtedness, liens, mergers, consolidations, acquisitions and sales of assets, investments, changes in the nature of the business, affiliate transactions and certain restricted payments. The Loan Agreement also requires us to maintain a ratio of consolidated indebtedness to EBITDA equal to or less than 3.25 to 1.00, and a ratio of consolidated EBITDA to interest expense greater than or equal to 3.00 to 1.00, in each case determined in accordance with the Loan Agreement. As of September 30, 2016, we were in compliance with all covenants in the Loan Agreement.

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

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

As of September 30, 2016, we had outstanding $25 million in borrowings under this line of credit. During the three month periods ended September 30, 2016 and September 30, 2015, we incurred interest expense related to our outstanding borrowings of $167,000 and $53,000, respectively. During the nine month periods ended September 30, 2016 and September 30, 2015, we incurred interest expense related to our outstanding borrowings of $377,000 and $53,000, respectively. As of September 30, 2016 and September 30, 2015, the weighted-average interest rate on the revolving line of credit was 1.6% and 1.3%, respectively.

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 nine month periods ended September 30, 2016 and 2015 was as follows:

(In thousands)	Nine Months Ended September 30, (Unaudited)	
	2016	2015
Balance at the beginning of the period	$ 1,755	$ 1,885
Accruals for warranties issued during the period	1,470	3,572
Settlements made (in cash or in kind) during the period	(1,104)	(3,732)
Balance at the end of the period	$ 2,121	$ 1,725

As of September 30, 2016, we had non-cancelable purchase commitments with various suppliers of customized inventory and inventory components totaling approximately $6.3 million over the next twelve months.

As of September 30, 2016, we had outstanding guarantees for payment of customs and foreign grants totaling approximately $3.1 million, which are generally payable over the next twelve months.

Note 15 – Recently issued and adopted accounting pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued ASU 2014-09, Revenue from Contracts with Customers. The update is a comprehensive new revenue recognition model that requires a company to recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services. ASU 2014-09 also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. As currently issued and amended, ASU 2014-09 is effective for annual reporting periods, and interim periods within that period, beginning after December 15, 2017 and early adoption is permitted for annual reporting periods, and interim periods within that period, beginning after December 31, 2016. We intend to adopt this standard as of January 1, 2018 by applying the modified retrospective transition method. Consequently, the cumulative effect of applying the standard will be recognized in the first quarter of 2018. We are currently evaluating the effect that the updated standard will have on our Consolidated Financial Statements and related disclosures. The adoption of this standard will likely impact the timing of revenue recognition for some of our software licensing arrangements, particularly arrangements with customers of our enterprise licensing agreements.

In March 2016, FASB issued ASU 2016-09, Compensation - Stock Compensation, which simplifies the accounting for the taxes related to stock based compensation, including adjustments to how excess tax benefits and a company's payments for tax withholdings should be classified. The update is effective for annual and interim periods beginning after December 31, 2016 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.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which supersedes ASC840, Leases. The guidance requires lessees to recognize most lease liabilities on their balance sheets but recognize the expenses on their income statements in a manner similar to current practice. The update states that a lessee would recognize a lease liability for the obligation to make lease payments and a right-to-use asset for the right to use the underlying asset for the lease term. The update is effective for interim and annual periods beginning after December 15, 2018, and early adoption is permitted. We are currently evaluating the effect that the updated standard will have on our Consolidated Financial Statements and related disclosures.

Other Updates

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

- Update 2016-15—Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force)

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 – Acquisitions

2015 Acquisitions

Micropross

On October 23, 2015, we completed the acquisition of M2, a privately held French holding company and its wholly-owned subsidiary, Micropross, a supplier of software-based test systems for Near Field Communications (NFC), smart cards, and wireless charging test systems, pursuant to an Agreement for the Sale and Purchase of Shares (the “Purchase Agreement”). Under the terms of the Purchase Agreement, the purchase price of the transaction was approximately $99 million, which included $89 million cash consideration paid directly to existing shareholders and $10.4 million of consideration which was paid by issuing an aggregate of 367,481 shares of our common stock. We also assumed and repaid $5 million of existing Micropross borrowings, net of cash received. The results of operations of Micropross are included in our consolidated financial statements from the date of acquisition.

The allocation of the purchase price was determined using the fair value of assets and liabilities acquired as of October 23, 2015. The preliminary purchase price allocation related to the Micropross acquisition was not finalized with respect to inventory and deferred revenue as of September 30, 2016, and was based upon a preliminary valuation using information obtained during the reporting period.

Other Acquisitions

During the twelve month period ending December 31, 2015, we acquired four additional businesses, all of which were treated as business combinations. The total purchase price for these four acquisitions was approximately $36 million which consisted of $31 million cash, net of $1.5 million in cash received, $1.1 million in cash obligations incurred to former owners, $3.4 million in shares of our common stock, and $ 0.2 million of a previously-held interest in an equity-method investee. The acquired businesses included a leading designer, manufacturer, and provider of data acquisition solutions for the test and measurement marketplace, a technology innovator and leading supplier of high-performance FPGA prototyping and deployment products for advanced wireless research, wireless infrastructure and military/defense applications and a PXI modular instruments hardware product line. Our consolidated financial statements include the operating results from the dates of acquisition.

The allocation of the purchase prices for the four acquisitions was determined using the fair value of assets and liabilities acquired as of the acquisition dates.

Pro-forma Results of Operations

Pro-forma results of operations have not been presented because the effects of the acquired operations were not material individually or in the aggregate.

We allocate the fair value of the purchase consideration of the Company's acquisitions to the tangible assets, intangible assets, including in-process research and development ("IPR&D"), if any, and liabilities assumed, based on estimated fair values. The excess of the fair value of purchase consideration over the fair values of these identifiable assets and liabilities is recorded as goodwill. IPR&D is initially capitalized at fair value as an intangible asset with an indefinite life and assessed for impairment thereafter. When a project underlying reported IPR&D is completed, the corresponding amount of IPR&D is amortized over the asset's estimated useful life. Acquisition-related expenses are recognized separately from the business combination and are expensed as incurred in "Selling, General, and Administrative" in the Consolidated Statements of Operations. The following table summarizes the aggregate allocation of the purchase price of our acquisitions resulting from all adjustments as of September 30, 2016 (in thousands):

Purchase Price	
Cash consideration paid to former shareholders	$ 121,944
Issuance of common stock	13,778
Fair value of previously held interest in equity method investee	214
Future payment obligations	1,139
Non-Cash Consideration	15,131
Total Purchase Price	$ 137,075
Net Assets Acquired	
Fair value of debt assumed and cash received	$ (3,668)
Fair value of tangible net assets acquired (excluding debt assumed and cash received)	1,136
Fair value of identifiable intangible assets acquired	30,783
Goodwill	116,635
Deferred Tax Assets/(Liabilities)	(7,811)
Total Net Assets Acquired	$ 137,075

Note 18 – Subsequent events

On October 26, 2016, our Board of Directors declared a quarterly cash dividend of $0.20 per common share, payable on December 5, 2016, to stockholders of record on November 14, 2016.

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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 38, 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, 2015, for further discussion of our business and the risks attendant thereto.

Recent Events

On August 30, 2016, we announced that Alex Davern, our current Chief Operating Officer and Chief Financial Officer, will become our President and Chief Executive Officer. Mr. Davern will succeed Dr. James Truchard, who will retain his role as Chairman of our Board of Directors. These changes will be effective on January 1, 2017.

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 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 that our long-term vision and focus on technology supports the success of our customers, employees, suppliers and stockholders. We sell to a large number of customers in a wide variety of industries. We have been profitable in every year since 1990.

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

Expanding our broad customer base

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

Maintaining a high level of customer satisfaction

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

Leveraging external and internal technology

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

We sell into test and measurement and industrial/embedded applications in a broad range of industries and are subject to the economic and industry forces that drive those markets. It has been our experience that the performance of these industries and our performance are impacted by general trends in industrial production for the global economy and by the specific performance of certain vertical markets that are intensive consumers of measurement technologies. Examples of these markets are semiconductor capital equipment, telecom and mobile devices, consumer electronics, energy, defense, aerospace and automotive.

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 58% of our net sales during each of the three month periods ended September 30, 2016 and 2015, and approximately 61% and 58% of our net sales during the nine month periods ended September 30, 2016 and 2015, respectively. The vast majority of our foreign sales are denominated in the customers' local currency, which exposes us to the effects of changes in foreign currency exchange rates. We expect that a significant portion of our total net sales will continue to be derived from international sales. (See "Note 12 – Segment and geographic information" of Notes to Consolidated Financial Statements for details concerning the geographic breakdown of our net sales).

We manufacture substantially all of our product volume at our facilities in Debrecen, Hungary and Penang, Malaysia. In the remainder of 2016, our site in Malaysia is expected to produce approximately 35% of our global production and our site in Hungary is expected to produce approximately 65% of our global production. Our product manufacturing operations can be divided into four areas: electronic circuit card and module assembly; chassis and cable assembly; technical manuals and product support documentation; and software duplication. Most of our electronic circuit card assemblies, modules and chassis are manufactured in house, although subcontractors are used from time to time. The majority of our electronic cable assemblies are produced by subcontractors; however, we do manufacture some on an exception basis. Our software duplication, technical manuals and product support documentation is primarily produced by subcontractors.

Delivering high quality, reliable products

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

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

Current business outlook

Many of the industries we serve have historically been cyclical and have experienced periodic downturns. In assessing our business, we consider the trends in the Global Purchasing Managers' Index ("PMI"), global industrial production as well as industry reports on the specific vertical industries that we target. Historically, our business cycles have generally followed the expansion and contraction cycles in the global industrial economy as measured by the Global PMI. In the three month period ended September 30, 2016, the average of the Global PMI was 50.9. The average of the new order element of the Global PMI was 51.3 for the quarter ended September 30, 2016. During the quarter ended September 30, 2016, the PMI in the U.S. and the Eurozone maintained readings at or above 50. Although these readings are indicative of expansion in the industrial sector we are unable to predict whether the industrial economy, as measured by the PMI, will remain above the neutral reading of 50, strengthen or contract during the remainder of 2016.

During the third quarter of 2016, we continued to experience headwinds in our business as a result of the continued strength of the U.S. dollar and continued weakness in the energy and personal computer ("PC") markets. In the third quarter of 2016, we saw a 2.5% year over year decrease from orders under $20,000, a 1.8% year over year increase from orders between $20,000 and $100,000, and a 28% year over year increase from orders over $100,000. Excluding our largest customer, orders over $100,000 were up 34% year over year. The timing and amount of orders from our largest customer are unpredictable and therefore can cause unusual variations in the results and trends of our business. See "Results of Operations" below for additional discussion on the impact of orders from our largest customer on our business for the nine month period ended September 30, 2016.

During the third quarter of 2016, we continued to experience broad volatility in the foreign exchange markets and a strong U.S. dollar in many of the currency markets where we have exposure. As of the date of this filing, the U.S. dollar index, as tracked by the St. Louis Federal Reserve, remains near a ten year high. See "Results of Operations" below for additional discussion on the impact of foreign exchange rates on our business for the nine month period ended September 30, 2016.

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.) In the fourth quarter of 2016, we expect continued market uncertainty and volatility following the impending exit of the United Kingdom (U.K.) from the European Union (“Brexit”) and the upcoming U.S. election.

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 September 30, (Unaudited)				Nine Months Ended September 30, (Unaudited)			
	2016		2015		2016		2015	
Net sales:								
Americas	42.3	%	42.2	%	39.4	%	41.7	%
EMEIA	30.1		32.6		31.0		32.4	
APAC	27.6		25.2		29.6		25.9	
Total net sales	100.0		100.0		100.0		100.0	
Cost of sales	25.1		25.7		25.6		25.8	
Gross profit	74.9		74.3		74.4		74.2	
Operating expenses:								
Sales and marketing	38.1		38.2		38.5		37.7	
Research and development	19.3		17.5		19.8		18.9	
General and administrative	8.0		7.8		8.3		7.8	
Total operating expenses	65.4		63.5		66.6		64.4	
Operating income	9.5		10.8		7.8		9.8	
Other income (expense):								
Interest income	0.1		0.1		0.1		0.1	
Net foreign exchange loss	(0.2)		0.1		(0.2)		(0.2)	
Other income, net	0.1		0.0		(0.2)		0.1	
Income before income taxes	9.5		11.1		7.5		9.8	
Provision for income taxes	1.5		3.3		1.5		2.7	
Net income	8.0	%	7.7	%	6.0	%	7.1	%

Figures may not sum due to rounding.

Results of Operations for the three and nine month periods ended September 30, 2016 and 2015

Net Sales. The following table sets forth our net sales for the three and nine month periods ending September 30, 2016 and 2015 along with the changes between the corresponding periods.

	Three Months Ended September 30, (Unaudited)				Nine Months Ended September 30, (Unaudited)			
			Change				Change	
($ in millions)	2016	2015	Dollars	Percentage	2016	2015	Dollars	Percentage
Product sales	$ 278.5	$ 271.7	6.8	2.5%	$ 816.5	$ 807.1	9.4	1.2%
Software maintenance sales	27.9	28.1	(0.2)	(1.0%)	83.1	84.0	(0.9)	(1.1%)
Total net sales	$ 306.4	$ 299.8	6.6	2.2%	$ 899.6	$ 891.1	8.5	1.0%

The factors that most significantly impacted our net sales were the year over year change in orders from our largest customer and the year over year impact of changes in the foreign currency exchange markets, both discussed in more detail below.

Large orders, defined as orders with a value greater than $100,000, increased by 28% year over year during the three months ended September 30, 2016, compared to the year over year decrease of 7% in the three month period ended September 30, 2015. A significant factor in the continued expansion of our large orders in the three month period ended September 30, 2016, compared to the comparable period in 2015 was strong demand for our RF products. In the nine month period ended September 30, 2016, large orders increased by 10% year over year compared to the year over year decrease of 7% during the nine month period ended September 30, 2015. A significant factor in the continued expansion of our large orders in the nine month period ended September 30, 2016, compared to the comparable period in 2015 was the result of an increase in orders from our largest customer. Year over year, orders from our largest customer increased by 53% in the nine months ended September 30, 2016. Excluding the impact of our largest customer, large orders increased by 34% year over year during the three month period ended September 30, 2016, and increased by 5% year over year during the nine month period ended September 30, 2016. Orders from our largest customer are discussed in more detail below. During the three month periods ended September 30, 2016 and 2015, large orders were 24% and 20% of our total orders, respectively, and for the nine month periods ended September 30, 2016 and 2015, large orders were 23% and 22% of our total orders, respectively. Large orders are more volatile, are subject to greater discount variability and may contract at a faster pace during an economic downturn compared to our other orders.

During the three month periods ended September 30, 2016 and 2015, we received $4.8 million and $6.2 million, respectively, in orders from our largest customer. During the nine month periods ended September 30, 2016 and 2015, we received $29 million and $19 million, respectively, in orders from our largest customer. In the three month periods ended September 30, 2016 and 2015, we recognized net sales of $7.9 million and $5.9 million, respectively, from orders from our largest customer, and in the nine month periods ended September 30, 2016 and 2015, we recognized net sales of $31 million and $19 million, respectively, from these orders.

The following table sets forth our net sales by geographic region for the three and nine month periods ending September 30, 2016 and 2015 along with the changes between the corresponding periods and the region's percentage of total net sales.

	Three Months Ended September 30, (Unaudited)				Nine Months Ended September 30, (Unaudited)			
			Change				Change	
($ in millions)	2016	2015	Dollars	Percentage	2016	2015	Dollars	Percentage
Americas	$ 129.7	$ 126.5	3.2	2.6%	$ 354.8	$ 371.5	(16.7)	(4.5%)
Percentage of total net sales	42.3%	42.2%			39.4%	41.7%		
EMEIA	$ 92.2	$ 97.9	(5.7)	(5.8%)	$ 278.6	$ 289.1	(10.5)	(3.6%)
Percentage of total net sales	30.1%	32.6%			31.0%	32.4%		
APAC	$ 84.4	$ 75.4	9.0	11.9%	$ 266.2	$ 230.5	35.7	15.5%
Percentage of total net sales	27.6%	25.2%			29.6%	25.9%		

We expect sales outside of the Americas to continue to represent a significant portion of our net sales. We intend to continue to expand our international operations by increasing our presence in existing markets, adding a presence in some new geographical markets and continuing the use of distributors to sell our products in some countries. Almost all of the sales made by our direct sales offices in the Americas (excluding the U.S.), EMEIA, and APAC are denominated in local currencies, and accordingly, the U.S. dollar equivalent of these sales is affected by changes in foreign currency exchange rates. In order to provide a framework for assessing how our underlying business performed excluding the effects of foreign currency fluctuations between periods, we compare the percentage change in our results from period to period using constant currency disclosure. To calculate the change in constant currency, current and comparative prior period results for entities reporting in currencies other than U.S. Dollars are converted into U.S. Dollars at constant exchange rates (i.e. the average rates in effect during the three and nine month periods ended September 30, 2015). The following tables present this information, along with the impact of changes in foreign currency exchange rates on sales denominated in local currencies, for the three and nine month periods ended September 30, 2016.

($ in millions)	Three Months ended September 30, 2015 GAAP Net Sales	Change in Constant Dollars Dollars	Change in Constant Dollars Percentage	Impact of changes in foreign currency exchange rates on net sales Dollars	Impact of changes in foreign currency exchange rates on net sales Percentage	Three Months ended September 30, 2016 GAAP Net Sales
Americas	$ 126.5	3.7	2.9%	(0.4)	(0.3%)	129.7
EMEIA	$ 97.9	1.1	1.1%	(6.7)	(6.9%)	92.2
APAC	$ 75.4	9.4	12.5%	(0.4)	(0.6%)	84.4
Total net sales	$ 299.8	14.1	4.7%	(7.6)	(2.5%)	306.4

Figures may not sum due to rounding.

($ in millions)	Nine Months ended September 30, 2015 GAAP Net Sales	Change in Constant Dollars Dollars	Change in Constant Dollars Percentage	Impact of changes in foreign currency exchange rates on net sales Dollars	Impact of changes in foreign currency exchange rates on net sales Percentage	Nine Months ended September 30, 2016 GAAP Net Sales
Americas	$ 371.5	(13.3)	(3.6%)	(3.4)	(0.9%)	354.8
EMEIA	$ 289.1	10.8	3.7%	(21.3)	(7.4%)	278.6
APAC	$ 230.5	43.9	19.0%	(8.2)	(3.5%)	266.2
Total net sales	$ 891.1	41.4	4.6%	(32.9)	(3.7%)	899.6

Figures may not sum due to rounding.

To help protect against changes in U.S. dollar equivalent value caused by fluctuations in foreign currency exchange rates of forecasted foreign currency cash flows resulting from international sales, we have instituted a foreign currency cash flow hedging program. We hedge portions of our forecasted net sales denominated in foreign currencies with average rate forward contracts. During the three month periods ended September 30, 2016 and 2015, these hedges had the effect of decreasing our net sales by $0.2 million and increasing our net sales by $5.4 million, respectively. During the nine month periods ended September 30, 2016 and 2015, these hedges had the effect of decreasing our net sales by $1.3 million and increasing our net sales by $15.7 million, respectively. (See “Note 5 - Derivative instruments and hedging activities" of Notes to Consolidated Financial Statements for further discussion regarding our cash flow hedging program and its related impact on our net sales for 2016 and 2015).

Gross Profit. Our gross profit as a percentage of sales is impacted by many factors including changes in the amount of revenues from our largest customer and changes in the foreign currency exchange markets. We continue to focus on cost control and cost reduction measures throughout our manufacturing cycle. The following table sets forth our gross profit and gross profit as a percentage of net sales for the three and nine month periods ending September 30, 2016 and 2015 along with the percentage changes in gross profit for the corresponding periods.

	Three Months Ended September 30, (Unaudited)		Nine Months Ended September 30, (Unaudited)	
($ in millions)	2016	2015	2016	2015
Gross Profit	$ 229.6	$ 222.6	$ 669.3	$ 660.9
% change compared with prior period	3.1%		1.3%	
Gross Profit as a percentage of net sales	75.0%	74.3%	74.4%	74.2%

For the three month periods ended September 30, 2016 and 2015, the change in exchange rates had the effect of decreasing our cost of sales by $0.5 and $3.0 million, respectively. For the nine month periods ended September 30, 2016 and 2015, the change in exchange rates had the effect of decreasing our cost of sales by $3.2 million and $7.3 million, respectively. To help protect against changes in our cost of sales caused by a fluctuation in foreign currency exchange rates of forecasted foreign currency cash flows, we have a foreign currency cash flow hedging program. We hedge portions of our forecasted costs of sales denominated in foreign currencies with average rate forward contracts. During the three month periods ended September 30, 2016 and 2015, these hedges had the effect of increasing our cost of sales by $414,000 and $698,000, respectively. During the nine month periods ended September 30, 2016 and 2015, these hedges had the effect of increasing our cost of sales by $1.4 million and $1.5 million, respectively. (See "Note 5 - Derivative instruments and hedging activities" of Notes to Consolidated Financial Statements for further discussion regarding our cash flow hedging program and its related impact on our cost of sales for 2016 and 2015).

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

Operating Expenses. The following table sets forth our operating expenses for the three and nine month periods ending September 30, 2016 and 2015 along with the percentage changes between the corresponding periods and the line item as a percentage of total net sales.

	Three Months Ended September 30, (Unaudited)			Nine Months Ended September 30, (Unaudited)		
($ in thousands)	2016	2015	Change	2016	2015	Change
Sales and marketing	$ 116,662	$ 114,507	2%	$ 346,230	$ 335,916	3%
Percentage of total net sales	38%	38%		38%	38%	
Research and development	$ 59,066	$ 52,533	12%	$ 178,244	$ 168,462	6%
Percentage of total net sales	19%	18%		20%	19%	
General and Administrative	$ 24,537	$ 23,255	6%	$ 74,308	$ 69,391	7%
Percentage of total net sales	8%	8%		8%	8%	
Total operating expenses	$ 200,265	$ 190,295	5%	$ 598,782	$ 573,769	4%
Percentage of total net sales	65%	63%		67%	64%	

During the three month period ending September 30, 2016, the year over year increase in operating expenses was primarily the result of an increase in personnel related expenses of $8.5 million due to increased headcount and increased variable compensation in regions with strong local currency growth. In addition, marketing and outside services costs increased by $1.0 million, building and equipment costs increased by $1.0 million, and software development costs increased by $2.6 million due to a decrease in capitalization of software development costs compared to the three month period ended September 30, 2015. The year over year change in exchange rates had the effect of decreasing our operating expenses by $1.2 million.

During the nine month period ending September 30, 2016, the year over year increase in operating expenses was primarily the result of an increase in personnel related expenses of $30 million due to an increase in head count of 138 employees and increased variable compensation in regions with strong local currency growth. In addition, building and equipment costs increased by $3.8 million, marketing and outside services costs increased by $3 million, offset by a decrease in software development costs of $1.4 million due to an increase in capitalization of software development costs compared to the nine month period ending September 30, 2015. During the nine month period ending September 30, 2016, the year over year change in exchange rates had the effect of decreasing our operating expenses by $8.6 million.

We believe that our long-term growth and success depends on developing high quality software and hardware products on a timely basis. We are focused on leveraging recent investments in research and development and in our field sales force and taking actions to help ensure that those resources are concentrated in areas and on initiatives that will contribute to future growth in our business. The increase in our research and development expenses for the three and nine month periods ended September 30, 2016, compared to the three and nine month periods ended September 30, 2015 was primarily driven by the increase in research and development headcount of 49 employees. The increase in our sales and marketing expenses for the nine month period ended September 30, 2016, compared to the nine month period ended September 30, 2015, was primarily driven by the increase in sales and marketing headcount of 39 employees and increased variable compensation in regions with strong local currency growth.

Operating Income. For the three month periods ended September 30, 2016 and 2015, operating income was $29 million and $32 million, respectively, a decrease of 9%. As a percentage of net sales, operating income was 10% and 11% for three month periods ended September 30, 2016 and 2015, respectively. For the nine month periods ended September 30, 2016 and 2015, operating income was $70 million and $87 million, respectively, a decrease of 19%. As a percentage of net sales, operating income was 8% and 10% for the nine month periods ended September 30, 2016 and 2015, respectively. The decreases in operating income in absolute dollars for the three month period ended September 30, 2016, compared to the three month period ended September 30, 2015, and for the nine month period ended September 30, 2016, compared to the nine month period ended September 30, 2015, are attributable to the factors discussed in Net Sales, Gross Profit and Operating Expenses above.

Interest Income. For the three month periods ended September 30, 2016 and 2015, interest income was $276,000 and $396,000, respectively. For the nine month periods ended September 30, 2016 and 2015, interest income was $787,000 and $1.1 million, 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 significantly during the remainder of 2016.

Net Foreign Exchange Gain/(Loss). For the three month periods ended September 30, 2016 and 2015, net foreign exchange loss was $(760,000) and net foreign exchange gain was $286,000, respectively. During the nine month periods ended September 30, 2016 and 2015, net foreign exchange loss was $(1.5) million and $(2.0) million, respectively. These results are attributable to movements in the foreign currency exchange rates between the U.S. dollar and foreign currencies in subsidiaries for which our functional currency is not the U.S. dollar. During the third quarter of 2016, we continued to see broad volatility in the foreign currency exchange markets and a strong U.S. dollar in many of the currency markets where we have exposure, with the trade-weighted U.S. dollar index, as tracked by the St. Louis Federal Reserve, near a ten year high. In addition, the announcement of Brexit caused significant short-term volatility in the foreign currency markets and an approximately 15% devaluation of the GBP against the U.S. dollar. The ongoing uncertainty surrounding the implementation of Brexit, including the conditions and timing of the exit negotiation period, and uncertainty in relation to the relationship of the U.K. with the remaining members of the E.U. (including in relation to trade) has caused and is likely to continue to cause continued volatility in the foreign currency markets. We cannot predict the direction or degree of future volatility in the foreign exchange markets or the impact the impending Brexit U.K. referendum will have in future periods. In the past, we have noted that significant volatility in the foreign currency exchange markets in which we do business has had a significant impact on the revaluation of our foreign currency denominated firm commitments, on our ability to forecast our U.S. dollar equivalent net sales and expenses and on the effectiveness of our hedging programs. In the past, these dynamics have also adversely affected our net sales growth in international markets and may pose similar challenges in the future. We recognize the local currency as the functional currency in virtually all of our international subsidiaries.

We utilize foreign currency forward contracts to hedge our foreign denominated net foreign currency balance sheet positions to help protect against the change in value caused by a fluctuation in foreign currency exchange rates. We typically hedge up to 90% of our outstanding foreign denominated net receivable or payable positions and typically limit the duration of these foreign currency forward contracts to approximately 90 days. The gain or loss on these derivatives as well as the offsetting gain or loss on the hedged item attributable to the hedged risk is recognized in current earnings under the line item "Net foreign exchange gain (loss)." Our hedging strategy decreased our foreign exchange gains by $814,000 and decreased our foreign exchange losses by $3.0 million in the three month period ended September 30, 2016 and September 30, 2015, respectively. Our hedging strategy increased our foreign exchange losses by $1.0 million and decreased our foreign exchange losses by $3.6 million in the nine month periods ended September 30, 2016 and 2015, respectively. (See “Note 5 - Derivative instruments and hedging activities” of Notes to Consolidated Financial Statements for a further description of our derivative instruments and hedging activities).

Provision for Income Taxes. For the three month periods ended September 30, 2016 and September 30, 2015, our provision for income taxes reflected an effective tax rate of 16% and 30%, respectively. For the nine month periods ended September 30, 2016 and 2015, our provision for income taxes reflected an effective tax rate of 21% and 28%, respectively. The factors that caused our effective tax rate to change year over year are detailed in the table below:

	Three Months Ended September 30, 2016 (Unaudited)		Nine Months Ended September 30, 2016 (Unaudited)	
Effective tax rate at September 30, 2015	30	%	28	%
Change in research and development credit	(2)		(2)	
Change in profit in foreign jurisdictions with reduced tax rates	(5)		(3)	
Change in enhanced deduction for certain research and development expenses	(3)		(3)	
Change in intercompany profit	2		2	
Change in unrecognized tax benefits	(10)		(3)	
Change in valuation allowance related to deferred tax assets	3		1	
Other	1		1	
Effective tax rate at September 30, 2016	16	%	21	%

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

Other operational metrics

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

Charges related to stock-based compensation, amortization of acquired intangibles, acquisition related transaction costs, restructuring charges, foreign exchange loss on acquisitions and taxes levied on the transfer of acquired intellectual property.

For the three and nine month periods ended September 30, 2016 and 2015, the gross charges related to stock-based compensation were recorded in the following line items in the amounts shown:

(In thousands)	Three Months Ended September 30, (Unaudited)		Nine Months Ended September 30, (Unaudited)	
	2016	2015	2016	2015
Stock-based compensation				
Cost of sales	$ 556	$ 499	$ 1,643	$ 1,427
Sales and marketing	2,635	2,854	8,422	8,303
Research and development	2,027	2,132	6,745	6,764
General and administrative	921	921	2,764	2,656
Provision for income taxes	(2,092)	(1,933)	(6,202)	