NATIONAL INSTRUMENTS CORP
Form 10-Q
October 31, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

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

For the quarterly period ended: September 30, 2017 or

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

For the transition period from ________________ to ________________

Commission file number: 0-25426

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

Delaware	74-1871327
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
11500 North MoPac Expressway	
Austin, Texas	78759
(address of principal executive offices)	(zip code)

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer”, “accelerated filer”, “smaller reporting company”, and “emerging growth company” in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company Emerging growth company
If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at October 24, 2017

Common Stock - $0.01 par value	130,745,022

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NATIONAL INSTRUMENTS CORPORATION

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PART I - FINANCIAL INFORMATION

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

	September 30, 2017 (unaudited)	December 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	$294,194	$285,283
Short-term investments	91,223	73,117
Accounts receivable, net	235,177	228,686
Inventories, net	184,641	193,608
Prepaid expenses and other current assets	50,325	53,953
Total current assets	855,560	834,647
Property and equipment, net	254,918	260,456
Goodwill	265,091	253,197
Intangible assets, net	122,681	108,663
Other long-term assets	32,878	39,601
Total assets	$1,531,128	$1,496,564
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable and accrued liabilities	$51,274	$48,800
Accrued compensation	45,231	27,743
Deferred revenue - current	120,271	115,577
Other current liabilities	17,802	32,997
Other taxes payable	30,832	34,958
Total current liabilities	265,410	260,075
Long-term debt	15,000	25,000
Deferred income taxes	37,074	45,386
Liability for uncertain tax positions	9,284	11,719
Deferred revenue - long-term	31,405	29,752
Other long-term liabilities	9,156	10,413
Total liabilities	367,329	382,345
Commitments and contingencies		
Stockholders' equity:		
Preferred stock: par value $0.01; 5,000,000 shares authorized; none issued and outstanding	—	—
Common stock: par value $0.01; 360,000,000 shares authorized; 130,745,022 shares and 129,202,979 shares issued and outstanding, respectively	1,307	1,292
Additional paid-in capital	816,152	771,346
Retained earnings	365,021	376,202
Accumulated other comprehensive loss	(18,681)	(34,621)
Total stockholders’ equity	1,163,799	1,114,219
Total liabilities and stockholders’ equity	$1,531,128	$1,496,564

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Net sales:				
Product	$291,891	$278,521	$853,219	$816,486
Software maintenance	29,030	27,843	86,416	83,161
Total net sales	320,921	306,364	939,635	899,647
Cost of sales:				
Product	81,641	74,734	235,989	225,261
Software maintenance	2,110	1,998	6,744	5,126
Total cost of sales	83,751	76,732	242,733	230,387
Gross profit	237,170	229,632	696,902	669,260
Operating expenses:				
Sales and marketing	116,661	116,662	358,335	346,230
Research and development	56,526	59,066	171,701	178,244
General and administrative	26,468	24,537	78,400	74,308
Total operating expenses	199,655	200,265	608,436	598,782
Operating income	37,515	29,367	88,466	70,478
Other income:				
Interest income	657	276	1,509	787
Net foreign exchange gain (loss)	1,096	(760)	1,624	(1,471)
Other (loss) gain, net	(1,153)	301	(957)	(2,052)
Income before income taxes	38,115	29,184	90,642	67,742
Provision for income taxes	4,726	4,695	13,949	14,155
Net income	$33,389	$24,489	$76,693	$53,587
Basic earnings per share	$0.26	0.19	0.59	0.42
Weighted average shares outstanding - basic	130,660	128,815	130,103	128,233
Diluted earnings per share	$0.25	$0.19	$0.59	0.42
Weighted average shares outstanding - diluted	131,617	129,047	131,050	128,738
Dividends declared per share	$0.21	$0.20	$0.63	$0.60

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Net income	$33,389	$24,489	$76,693	$53,587
Other comprehensive income, before tax and net of reclassification adjustments:				
Foreign currency translation adjustment	6,226	3,964	21,890	12,130
Unrealized gain (loss) on securities available-for-sale	162	(70)	187	479
Unrealized (loss) gain on derivative instruments	(3,136)	976	(9,470)	4,541
Other comprehensive gain, before tax	3,252	4,870	12,607	17,150
Tax (benefit) expense related to items of other comprehensive income	(1,186)	967	(3,333)	4,242
Other comprehensive gain, net of tax	4,438	3,903	15,940	12,908
Comprehensive income	$37,827	$28,392	$92,633	$66,495

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, 2017		2016	
Cash flow from operating activities:				
Net income	$ 76,693		$ 53,587	
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	54,794		55,164	
Stock-based compensation	21,272		19,635	
Tax expense from deferred income taxes	(4,290	)	(7,321	)
Changes in operating assets and liabilities	(1,013	)	28,951	
Net cash provided by operating activities	147,456		150,016	
Cash flow from investing activities:				
Capital expenditures	(24,084	)	(34,408	)
Capitalization of internally developed software	(34,406	)	(24,048	)
Additions to other intangibles	(1,379	)	(1,969	)
Acquisitions, net of cash received	—		(549	)
Purchases of short-term investments	(62,845	)	(9,054	)
Sales and maturities of short-term investments	45,582		38,566	
Net cash used in investing activities	(77,132	)	(31,462	)
Cash flow from financing activities:				
Proceeds from revolving line of	—		15,000	

credit				
Principal payments on revolving line of credit	(10,000	)	(27,000	)
Proceeds from issuance of common stock	22,870		22,157	
Repurchase of common stock	—		(5,635	)
Dividends paid	(82,051	)	(77,056	)
Net cash used in financing activities	(69,181	)	(72,534	)
Effect of exchange rate changes on cash	7,768		3,503	
Net change in cash and cash equivalents	8,911		49,523	
Cash and cash equivalents at beginning of period	285,283		251,129	
Cash and cash equivalents at end of period	$ 294,194		$ 300,652	

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

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NATIONAL INSTRUMENTS CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 – Basis of presentation

The accompanying unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2016, included in our annual report on Form 10-K, filed with the Securities and Exchange Commission. In our opinion, the accompanying consolidated financial statements reflect all adjustments (consisting only of normal recurring items) considered necessary to present fairly our financial position at September 30, 2017 and December 31, 2016, the results of our operations and comprehensive income for the three and nine months ended September 30, 2017 and 2016, and the cash flows for the nine months ended September 30, 2017 and 2016. Our operating results for the three and nine months ended September 30, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017. These financial statements have been prepared in accordance with accounting principles generally accepted in the United States.

Starting January 1, 2017, we began separately presenting the effect of exchange rate changes on cash and cash equivalents in our condensed consolidated statements of cash flows due to growing operations in foreign currency environments. Amounts in the comparable prior period have been reclassified to conform to the current period presentation. The reclassifications resulted in the disaggregation of the amount attributable to the "Effect of exchange rate changes on cash" of $3.5 million, with a corresponding decrease to "Net cash provided by operating activities" for the nine months ended September 30, 2016. We believe the reclassification is immaterial to the consolidated financial statements.

Recently Adopted Accounting Pronouncements

In October 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-16, Income Taxes – Intra-Entity Transfers of Assets Other Than Inventory. The standard is intended to address diversity in practice and complexity in financial reporting, particularly for intra-entity transfers of intellectual property. We early adopted ASU 2016-16 effective January 1, 2017. Using the modified retrospective method, the impact of the adoption of the standard was to increase deferred tax assets by $0.4 million, decrease other assets, net by $6.2 million and decrease retained earnings by $5.8 million. The adoption of the amendments had the effect of increasing our diluted earnings per share by $0.01 and $0.03 for the three and nine months ended September 30, 2017, respectively.

Recently Issued Accounting Pronouncements

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

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

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

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

ASU 2014-09, as amended, could have a material impact on our consolidated financial statements and disclosures. While we are still evaluating the matter we believe the impact of the change to the timing of revenue recognition for our limited offerings mentioned above may have a material impact on our deferred revenue balance on the adoption date under the application of the modified retrospective transition method. However, it is not expected to have a material impact to our results of operations in subsequent annual periods.

Note 2 – Earnings per share

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

The reconciliation of the denominators used to calculate basic EPS and diluted EPS for the three and nine months ended September 30, 2017 and 2016, are as follows:

	Three Months Ended September 30, (In thousands) (Unaudited)		Nine Months Ended September 30, (In thousands) (Unaudited)	
	2017	2016	2017	2016
Weighted average shares outstanding-basic	130,660	128,815	130,103	128,233
Plus: Common share equivalents				
RSUs	957	232	947	505
Weighted average shares outstanding-diluted	131,617	129,047	131,050	128,738

Stock awards to acquire 40,700 shares and 1,068,800 shares for the three months ended September 30, 2017 and 2016, respectively, and 22,300 shares and 58,000 shares for the nine months ended September 30, 2017 and 2016, respectively, were excluded in the computations of diluted EPS because the effect of including the stock awards would have been anti-dilutive.

Note 3 – Short-term investments

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

(In thousands)	As of September 30, 2017 (Unaudited)				
	Adjusted Cost	Gross Unrealized Gain	Gross Unrealized Loss	Cumulative Translation Adjustment	Fair Value
Corporate bonds	$90,817	$ 170	$ (76)	$ (1,448)	$89,463
Time deposits	1,760	—	—	—	1,760
Short-term investments	$92,577	$ 170	$ (76)	$ (1,448)	$91,223

(In thousands)	As of December 31, 2016				
	Adjusted Cost	Gross Unrealized Gain	Gross Unrealized Loss	Cumulative Translation Adjustment	Fair Value
Corporate bonds	$72,986	$ 89	$		