ARMOR HOLDINGS INC
Form DEF 14A
May 23, 2005
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

SCHEDULE 14A
(RULE 14a-101)

INFORMATION REQUIRED IN PROXY STATEMENT
SCHEDULE 14A INFORMATION
PROXY STATEMENT PURSUANT TO SECTION 14(a) OF
THE SECURITIES EXCHANGE ACT OF 1934

Filed by the Registrant
Filed by a Party other than the Registrant

Check the appropriate box:
Preliminary Proxy Statement
Confidential, For Use of the Commission Only
(as permitted by Rule 14a-6(e)(2))
Definitive Proxy Statement
Definitive Additional Materials
Soliciting Material Pursuant to Section 240.14a-12

ARMOR HOLDINGS, INC.

(Name of Registrant as Specified in Its Charter)

(Name of Person(s) Filing Proxy Statement, if Other Than the Registrant)

Payment of filing fee (Check the appropriate box):

No fee required

Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

Fee paid previously with preliminary materials.

Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

ARMOR HOLDINGS, INC.

13386 INTERNATIONAL PARKWAY
JACKSONVILLE, FLORIDA 32218

May 23, 2005

To Our Stockholders:

On behalf of the Board of Directors of Armor Holdings, Inc., I cordially invite you to attend the Annual Meeting of Stockholders to be held on Wednesday, June 22, 2005, at 10:00 A.M., New York City time, at One Landmark Square, 22nd Floor, Stamford, Connecticut 06901.

The accompanying Notice of Meeting and Proxy Statement cover the details of the matters to be presented.

A copy of the 2004 Annual Report was previously mailed to you.

REGARDLESS OF WHETHER YOU PLAN TO ATTEND THE ANNUAL MEETING, I URGE THAT YOU PARTICIPATE BY COMPLETING AND RETURNING YOUR PROXY AS SOON AS POSSIBLE. YOUR VOTE IS IMPORTANT AND WILL BE GREATLY APPRECIATED. RETURNING YOUR PROXY CARD WILL ENSURE THAT YOUR VOTE IS COUNTED IF YOU LATER DECIDE NOT TO ATTEND THE ANNUAL MEETING.

Cordially,

ARMOR HOLDINGS, INC.

Warren B. Kanders
Chief Executive Officer

ARMOR HOLDINGS, INC.

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
TO BE HELD JUNE 22, 2005

To Our Stockholders:

You are cordially invited to attend the Annual Meeting of the Stockholders, and any adjournments or postponements thereof, of Armor Holdings, Inc., which will be held on Wednesday, June 22, 2005, at 10:00 A.M., New York City time, at One Landmark Square, 22nd Floor, Stamford, Connecticut 06901, for the following purposes:

1. To elect seven members to serve on the Board of Directors until the next annual meeting of stockholders and until their successors are duly elected and qualified (Proposal 1);
2. To ratify the appointment of PricewaterhouseCoopers LLP as Armor Holdings, Inc.'s independent auditors for the fiscal year ending December 31, 2005 (Proposal 2);
3. To consider and vote upon a proposal to adopt a new long-term stock incentive plan pursuant to which an aggregate of 2,500,000 shares of Armor Holdings, Inc.'s common stock will be reserved for issuance and available under such plan (Proposal 3);
4. To consider and vote upon a proposal to adopt a new annual incentive plan designed to allow for the award of "performance based compensation" under Section 162(m) of the Internal Revenue Code (Proposal 4); and
5. To transact such other business as may properly be brought before the meeting, including proposals to adjourn or postpone the meeting.

Stockholders of record at the close of business on April 28, 2005 are entitled to notice of and to vote at the meeting.

YOUR VOTE IS IMPORTANT. PLEASE SIGN AND DATE THE ENCLOSED PROXY CARD AND RETURN IT PROMPTLY IN THE ENCLOSED RETURN ENVELOPE, WHETHER OR NOT YOU EXPECT TO ATTEND THE ANNUAL MEETING. RETURNING YOUR PROXY CARD WILL ENSURE THAT YOUR VOTE IS COUNTED IF YOU LATER DECIDE NOT TO ATTEND THE ANNUAL MEETING.

By order of the Board of Directors

Philip A. Baratelli
Secretary

May 23, 2005

ARMOR HOLDINGS, INC.
13386 INTERNATIONAL PARKWAY
JACKSONVILLE, FLORIDA 32218

PROXY STATEMENT

ANNUAL MEETING OF STOCKHOLDERS

TO BE HELD ON

JUNE 22, 2005

INTRODUCTION

Proxy Solicitation and General Information

This Proxy Statement and the enclosed Proxy Card are being furnished to the holders of common stock, par value $.01 per share, of Armor Holdings, Inc., a Delaware corporation (which is sometimes referred to in this Proxy Statement as "Armor Holdings," "Company," "we," or "us"), in connection with the solicitation of proxies by our Board of Directors for use at the Annual Meeting of Stockholders to be held on Wednesday, June 22, 2005 at One Landmark Square, 22nd Floor, Stamford, Connecticut 06901, at 10:00 A.M., New York City time, and at any adjournments or postponements thereof. This Proxy Statement and the Proxy Card are first being sent to stockholders on or about May 23, 2005. Our principal executive offices are located at 13386 International Parkway, Jacksonville, Florida 32218.

At the meeting, stockholders will be asked:

1. To elect seven members to serve on the Board of Directors until the next annual meeting of stockholders and until their successors are duly elected and qualified (Proposal 1);
2. To ratify the appointment of PricewaterhouseCoopers LLP as Armor Holdings' independent auditors for the fiscal year ending December 31, 2005 (Proposal 2);
3. To consider and vote upon a proposal to adopt a new long-term stock incentive plan (the "2005 Stock Incentive Plan") pursuant to which an aggregate of 2,500,000 shares of Armor Holdings' common stock will be reserved for issuance and available under such plan (Proposal 3);
4. To consider and vote upon a proposal to adopt a new annual incentive plan (the "2005 Annual Incentive Plan") designed to allow for the award of "performance based compensation" under Section 162(m) of the Internal Revenue Code (Proposal 4); and
5. To transact such other business as may properly be brought before the meeting, including proposals to adjourn or postpone the meeting.

The Board of Directors has fixed the close of business on April 28, 2005 as the record date for the determination of stockholders entitled to notice of and to vote at the meeting. Each such stockholder will be entitled to one vote for each share of common stock held on all matters to come before the meeting and may vote in person or by proxy authorized in writing.

Stockholders are requested to complete, sign, date and promptly return the enclosed Proxy Card in the enclosed envelope. Proxies which are not revoked will be voted at the meeting in accordance with instructions contained therein. If the Proxy Card is signed and returned without instructions, the shares will be voted FOR the election of each nominee for director named in this Proxy Statement (Proposal 1), FOR the ratification of the appointment of PricewaterhouseCoopers LLP as Armor Holdings' independent auditors for the fiscal year ending December 31, 2005 (Proposal 2), FOR the approval of the 2005 Stock Incentive Plan (Proposal 3), and FOR the approval of the 2005 Annual Incentive Plan (Proposal

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4). A stockholder who so desires may revoke his proxy at any time before it is voted at the meeting by: (i) delivering written notice to us (attention: Secretary); (ii) duly executing and delivering a proxy bearing a later date; or (iii) casting a ballot at the meeting. Attendance at the meeting will not in and of itself constitute a revocation of a proxy.

The Board of Directors knows of no other matters that are to be brought before the meeting other than as set forth in the Notice of Meeting. If any other matters properly come before the meeting, the persons named in the enclosed Proxy Card or their substitutes will vote in accordance with their best judgment on such matters.

Record Date; Shares Outstanding and Entitled to Vote

Only stockholders as of the close of business on April 28, 2005 (the "Record Date") are entitled to notice of and to vote at the meeting. As of the Record Date, there were 34,535,765 shares of our common stock outstanding and entitled to vote, with each share entitled to one vote. See "Security Ownership of Certain Beneficial Owners and Management" for information regarding the beneficial ownership of our common stock by our directors, executive officers and stockholders known to us to own 5% or more of our common stock.

Our common stock is traded on the New York Stock Exchange under the symbol "AH". On May 19, 2005, the last full trading date prior to the printing and mailing of this Proxy Statement, the reported closing price for the common stock on the New York Stock Exchange was $35.74. Stockholders are urged to obtain the current market quotation for the shares of our common stock.

Required Votes

The presence at the Annual Meeting, in person or by duly authorized proxy, of the holders of a majority of the outstanding shares of stock entitled to vote constitutes a quorum for the transaction of business. Each share of Armor Holdings common stock entitles the holder to one vote on each matter presented for stockholder action. The affirmative vote of a plurality of the votes cast in person or by proxy is necessary for the election of directors (Proposal 1). The affirmative vote of a majority of the votes cast in person or by proxy is necessary for the approval of (i) the ratification of the appointment of PricewaterhouseCoopers LLP as our independent auditors for the fiscal year ending December 31, 2005 (Proposal 2); (ii) the approval of the 2005 Stock Incentive Plan (Proposal 3); and (iii) the approval of the 2005 Annual Incentive Plan (Proposal 4).

An independent inspector of elections appointed by our transfer agent or us will tabulate votes at the meeting. Since the affirmative vote of a plurality of votes cast is required for the election of directors (Proposal 1), abstentions and "broker non-votes" will have no effect on the outcome of such election. Since the affirmative vote of a majority of the votes cast is necessary for approval of the ratification of the appointment of PricewaterhouseCoopers LLP as our independent auditors for the fiscal year ending December 31, 2005 (Proposal 2), the approval of the 2005 Stock Incentive Plan (Proposal 3), and the approval of the 2005 Annual Incentive Plan (Proposal 4), an abstention will have the same effect as a negative vote, but "broker non-votes" will have no effect on the outcome of the voting for Proposals 2, 3 and 4.

Brokers holding shares for beneficial owners must vote those shares according to the specific instructions they receive from beneficial owners. If specific instructions are not received, brokers may be precluded from exercising their discretion, depending on the type of proposal involved. Shares as to which brokers have not exercised discretionary authority or received instructions from beneficial owners are considered "broker non-votes," and will be counted for purposes of determining whether there is a quorum.

Proxy Solicitation

Armor Holdings will bear the costs of the solicitation of proxies for the Annual Meeting of Stockholders to be held on June 22, 2005. Armor Holdings has retained the proxy solicitation firm of MacKenzie Partners, Inc. to assist it in the distribution and solicitation of proxies. Armor Holdings will

pay MacKenzie Partners, Inc. a fee of $7,500, plus reasonable expenses, for these services. Our directors, officers and employees may solicit proxies from stockholders by mail, telephone, telegram, e-mail, personal interview or otherwise. Such directors, officers and employees will not receive additional compensation but may be reimbursed for out-of-pocket expenses in connection with such solicitation. Brokers, nominees, fiduciaries and other custodians have been requested to forward soliciting material to the beneficial owners of our common stock held of record by them and such parties will be reimbursed for their reasonable expenses.

It is desirable that as large a proportion as possible of the stockholders' interests be represented at the meeting. Therefore, even if you intend to be present at the meeting, please sign and return the enclosed Proxy Card to ensure that your stock will be represented. If you are present at the meeting and desire to do so, you may withdraw your proxy and vote in person by giving written notice to the Secretary of Armor Holdings. Please return your executed Proxy Card promptly.

BENEFICIAL OWNERSHIP OF COMPANY COMMON STOCK BY
DIRECTORS, OFFICERS AND PRINCIPAL SHAREHOLDERS

The following table sets forth as of April 27, 2005 the number of shares and percentage of our common stock owned by (i) each person known to us to beneficially own five percent or more of our common stock, (ii) each of our directors and nominees for director, (iii) each of our executive officers set forth in the Summary Compensation Table on page 18, and (iv) our executive officers, directors and nominees for director as a group. Unless otherwise indicated, each of the stockholders shown in the table below has sole voting and investment power with respect to the shares beneficially owned. Unless otherwise indicated, the address of each person named in the table below is c/o Armor Holdings, Inc., 13386 International Parkway, Jacksonville, Florida 32218.

Name	Amount and nature of beneficial ownership (1)	Percentage (16)
Warren B. Kanders and Kanders Florida Holdings, Inc. (2)	3,879,113	10.7%
T. Rowe Price Associates, Inc. (3)	2,813,300	8.1%
FleetBoston Financial Corporation (4)	2,065,005	6.0%
Friess Associates LLC (5)	1,768,900	5.1%
Robert R. Schiller (6)	916,705	2.6%
Stephen Croskrey (7)	249,423	*
Nicholas Sokolow (8)	188,291	*
Burtt R. Ehrlich (9)	113,880	*
Thomas W. Strauss (10)	128,591	*
David R. Haas (11)	9,375	*
Glenn J. Heiar (12)	270,692	*
Deborah A. Zoullas (13)	37,169	*
Robert F. Mecredy (14)	227,424	*
All directors, nominees for directors and executive officers as a group (11 persons) (15)	6,222,580	16.5%

* Less than 1%.

(1) As used in this table, a beneficial owner of a security includes any person who, directly or indirectly, through contract, arrangement, understanding, relationship or otherwise has or shares (a) the power to vote, or direct the voting of, such security or (b) investment power which includes the power to dispose, or to direct the disposition of, such security. In addition, a person is deemed to be the beneficial owner of a security if that person has the right to acquire beneficial ownership of such security within 60 days of April 27, 2005.

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(2) The amount of securities reported as beneficially owned includes: (i) 2,098,395 shares held by Kanders Florida Holdings, Inc., of which Mr. Kanders is the sole stockholder and sole director and (ii) 117,100 shares of restricted stock sales of which will be restricted until November 11, 2005; upon Mr. Kanders' voluntary termination of employment with the Company or his termination by the Company for cause, if the foregoing lock-up period has not yet expired, it shall be extended for an additional five year period; upon a change in control of the Company, any lock-up release period that is still in effect in respect of such shares upon the occurrence of such change in control shall terminate. The amount of securities reported as beneficially owned also includes presently exercisable stock options to purchase: (i) 328,800 shares at an exercise price of $37.90 per share; sales of common stock issued upon an exercise of any such options will be subject to the following lock-up restrictions: 50,000 shares will be restricted from sale until January 1, 2007; 100,000 shares will be restricted from sale until January 1, 2008; 128,800 shares will be restricted from sale until January 1, 2009; and 50,000 shares will be restricted from sale until January 1, 2010; in addition, upon Mr. Kanders' voluntary termination of employment with the Company or his termination by the Company for cause, if the foregoing lock-up periods have not yet expired, they shall each be extended for an additional five year period; (ii) 110,000 shares at an exercise price of $23.93 per share; (iii) 225,000 shares at an exercise price of $24.07 per share; (iv) 250,000 shares at an exercise price of $24.07 per share; sales of common stock issued upon an exercise of any such options will be restricted from sale until December 31, 2006; in addition, upon Mr. Kanders' voluntary termination of employment with the Company or his termination by the Company for cause, if the foregoing lock-up period has not yet expired, it shall be extended for an additional five year period; (v) 100,000 shares at an exercise price of $14.32 per share; (vi) 200,000 shares at an exercise price of $14.32 per share; sales of common stock issued upon an exercise of any such options are subject to the following lock-up restrictions: 100,000 shares will be restricted from sale until July 26, 2005, and 100,000 shares will be restricted from sale until July 26, 2006; in addition, upon Mr. Kanders' voluntary termination of employment with the Company or his termination by the Company for cause, any of the foregoing lock-up periods which have not yet expired shall be extended for an additional five year period; (vii) 8,125 shares at an exercise price of $14.44 per share; (viii) 83,333 shares at an exercise price of $28.90 per share; (ix) 166,667 shares at an exercise price of $28.90 per share; sales of common stock issued upon an exercise of any such options are subject to the following lock-up restrictions: 83,333 shares will be restricted from sale until January 1, 2006, and 83,334 shares will be restricted from sale until January 1, 2007; in addition, upon Mr. Kanders' voluntary termination of employment with the Company or his termination by the Company for cause, any of the foregoing lock-up periods which have not yet expired shall be extended for an additional five year period; and (x) 150,000 shares at an exercise price of $45.93 per share; sales of common stock issued upon an exercise of any such options are subject to the following lock-up restrictions: 50,000 shares will be restricted from sale until January 3, 2006; 50,000 shares will be restricted from sale until January 3, 2007; and 50,000 shares

will be restricted from sale until January 3, 2008; in addition, upon Mr. Kanders' voluntary termination of employment with the Company or his termination by the Company for cause, any of the foregoing lock-up periods which have not yet expired shall be extended for an additional five year period. The amount of securities reported as beneficially owned excludes: (i) 9,228 shares of common stock awarded to the reporting person by the issuer as a restricted stock award, of which 4,614 shares vest on each of February 9, 2006, and February 9, 2007; (ii) 11,170 shares of common stock awarded to the reporting person by the issuer as a restricted stock award, of which 3,723 shares vest on each of January 1, 2006 and 2007, and 3,724 shares vest on January 1, 2008; and (iii) 4,760 shares held for the benefit of Mr. Kanders' children.

(3) This information has been obtained from Schedule 13G/A filed by T. Rowe Price Associates, Inc. on February 15, 2005. The address of T. Rowe Price Associates, Inc. is 100 E. Pratt Street, Baltimore, MD 21202.

(4) This information has been obtained from the Schedule 13G filed by FleetBoston Financial Corporation on February 13, 2004. The address of FleetBoston Financial Corporation is 100 Federal Street, Boston, MA 02110.

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(5) This information has been obtained from Schedule 13G filed by Friess Associates LLC on February 14, 2005. The address of Friess Associates LLC is 115 E. Snow King, Jackson, WY 83001.

(6) The amount of securities reported as beneficially owned includes 95,325 shares of restricted stock sales of which will be restricted until November 11, 2005; upon Mr. Schiller's voluntary termination of employment with the Company or his termination by the Company for cause, if the foregoing lock-up period has not yet expired, it shall be extended for an additional five year period; upon a change in control of the Company, any lock-up release period that is still in effect in respect of such shares upon the occurrence of such change in control shall terminate. The amount of securities reported as beneficially owned also includes presently exercisable stock options to purchase: (i) 219,200 shares at an exercise price of $37.90 per share; sales of common stock issued upon an exercise of any such options will be subject to the following lock-up restrictions: 33,333 shares will be restricted from sale until January 1, 2007; 66,666 shares will be restricted from sale until January 1, 2008; 85,867 shares will be restricted from sale until January 1, 2009; and 33,334 shares will be restricted from sale until January 1, 2010; in addition, upon Mr. Schiller's voluntary termination of employment with the Company or his termination by the Company for cause, any of the foregoing lock-up periods which have not yet expired shall be extended for an additional five year period; (ii) 50,000 shares at an exercise price of $23.93 per share; (iii) 66,666 shares at an exercise price of $17.12 per share; (iv) 133,334 shares at an exercise price of $17.12 per share; sales of common stock issued upon an exercise of any such options are subject to the following lock-up restrictions: 66,667 shares will be restricted from sale until October 8, 2005, and 66,667 shares will be restricted from sale until October 8, 2006; in addition, upon Mr. Schiller's voluntary termination of employment with the Company or his termination by the Company for cause, any of the foregoing lock-up periods which have not yet expired shall be extended for an additional five year period; (v) 100,694 shares at an exercise price of $15.05 per share; (vi) 50,000 shares at an exercise price of $15.05 per share; sales of common stock issued upon an exercise of any such options will be restricted from sale until December 31, 2005; in addition, upon Mr. Schiller's voluntary termination of employment with the Company or his termination by the Company for cause, if the foregoing lock-up period has not yet expired, it shall be extended for an additional five year period; and (vii) 100,000 shares at an exercise price of $45.93 per share; sales of common

stock issued upon an exercise of any such options are subject to the following lock-up restrictions: 33,333 shares will be restricted from sale until January 3, 2006; 33,333 shares will be restricted from sale until January 3, 2007; and 33,334 shares will be restricted from sale until January 3, 2008; in addition, upon Mr. Schiller's voluntary termination of employment with the Company or his termination by the Company for cause, any of the foregoing lock-up periods which have not yet expired shall be extended for an additional five year period. The amount of securities reported as beneficially owned excludes: (i) 11,170 shares of restricted stock 3,723 shares of which will vest on each of January 1, 2006 and 2007, and 3,724 shares of which will vest on January 1, 2008; and (ii) 6,921 shares of restricted stock which vests on February 9, 2007.

(7) Mr. Croskrey, our former President and CEO, Products Division, terminated his employment with the Company effective March 7, 2005, and the information contained in this table is as of that date. The amount of securities reported as beneficially owned also includes presently exercisable stock options to purchase 10,000 share at an exercise price of $44.76 per share. The amount of securities reported as beneficially owned excludes: (i) 2,851 shares of restricted stock which will vest on December 31, 2006 and (ii) 1,954 shares of restricted stock which will vest on March 7, 2008.

(8) The amount of securities reported as beneficially owned also includes presently exercisable stock options to purchase: (i) 9,000 shares at an exercise price of $3.75 per share; (ii) 10,000 shares at an exercise price of $9.6875 per share, (iii) 10,000 shares at an exercise price of $13.1875 per share, (iv) 12,500 shares at an exercise price of $14.44 per share, (v) 12,500 shares at an exercise price of $24.07 per share, (vi) 15,000 shares at an exercise price of $14.32 per share, and (vii) 9,375 shares at an exercise price of $35.40 per share. Also includes 60,000 shares owned by S.T. Investors Fund, LLC,

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a limited liability company of which Mr. Sokolow is a member, 10,000 shares owned by Mr. Sokolow's profit sharing plan and 11,200 shares held for the benefit of Mr. Sokolow's children and of which Mr. Sokolow disclaims beneficial ownership. The amount of securities reported as beneficially owned excludes stock options to purchase 3,125 shares at an exercise price of $35.40 which vests on June 30, 2005.

(9) The amount of securities reported as beneficially owned also includes presently exercisable stock options to purchase: (i) 12,500 shares at an exercise price of $24.07 per share and (ii) 9,375 shares at an exercise price of $35.40 per share. Excludes: (i) 5,000 shares owned by Mr. Ehrlich's children; (ii) 6,500 shares in trust for the benefit of his children, of which Mr. Ehrlich's spouse is trustee; and (iii) 400 shares owned by Mr. Ehrlich's spouse's individual retirement account of which Mr. Ehrlich disclaims beneficial ownership. The amount of securities reported as beneficially owned also excludes stock options to purchase 3,125 shares at an exercise price of $35.40 per share which vest on June 30, 2005.

(10) The amount of securities reported as beneficially owned also includes presently exercisable stock options to purchase: (i) 46,591 shares at an exercise price of $7.50 per share (ii) 10,000 shares at an exercise price of $9.6875 per share, (iii) 10,000 shares at an exercise price of $13.1875 per share, (iv) 12,500 shares at an exercise price of $14.44 per share, (v) 12,500 shares at an exercise price of $24.07 per share, (vi) 12,000 shares at an exercise price of $14.32 per share, and (vii) 9,375 shares at an exercise price of $35.40 per share. The amount of securities reported as beneficially owned excludes stock options to purchase 3,125 shares at an exercise price of $35.40 which vests on June 30, 2005.

(11) The amount of securities reported as beneficially owned includes presently exercisable stock options to purchase 9,375 shares at an exercise price of $35.40. The amount of securities reported

as beneficially owned excludes stock options to purchase 3,125 shares at an exercise price of $35.40 which vests on June 30, 2005.

(12) The amount of securities reported as beneficially owned also includes presently exercisable stock options to purchase: (i) 75,000 shares at an exercise price of $37.90 per share; sales of common stock issued upon an exercise of any such options will be subject to the following lock-up restrictions: 6,250 shares will be restricted from sale until January 1, 2008; 12,500 shares will be restricted from sale until January 1, 2009; 18,750 shares will be restricted from sale until January 1, 2010; 18,750 shares will be restricted from sale until January 1, 2011; 12,500 shares will be restricted from sale until January 1, 2012; and 6,250 shares will be restricted from sale until January 1, 2013; in addition, upon Mr. Heiar's voluntary termination of employment with the Company or his termination by the Company for cause, any of the foregoing lock-up periods which have not yet expired shall be extended for an additional five year period; (ii) 20,000 shares at an exercise price of $28.46; (iii) 80,000 shares at an exercise price of $28.46; sales of common stock issued upon an exercise of any such options are subject to the following lock-up restrictions: 20,000 shares will be restricted from sale until March 11, 2006; 20,000 shares will be restricted from sale until March 11, 2007; 20,000 shares will be restricted from sale until March 11, 2008; and 20,000 shares will be restricted from sale until March 11, 2009; in addition, upon Mr. Heiar's voluntary termination of employment with the Company or his termination by the Company for cause, any of the foregoing lock-up periods which have not yet expired shall be extended for an additional five year period; (iv) 54,391 shares at an exercise price of $21.75; and (v) 25,000 shares at an exercise price of $44.76; sales of common stock issued upon an exercise of any such options will be subject to the following lock-up restrictions: all of the shares will be restricted from sale for two years from February 10, 2005 (the "Vesting Date"), 75% of the shares will be restricted from sale for three years from the Vesting Date, 50% of the shares will be restricted from sale for four years from the Vesting Date, and 25% of the shares will be restricted from sale for five years from the Vesting Date. The amount of securities reported as beneficially owned excludes: (i) 1,954 shares of restricted stock of which 651 will vest on each of January 1, 2006 and 2007, and 652 shares of which will vest on January 1, 2008; (ii) 25,000 shares of restricted stock which will vest upon a change of control of the Company; (iii) 2,000 shares of restricted stock which vests on December 31, 2005; and (iv) 1,520 shares of restricted stock which vests on December 31, 2006.

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(13) The amount of securities reported as beneficially owned also includes presently exercisable stock options to purchase: (i) 15,794 shares at an exercise price of $13.98; (ii) 12,000 shares at an exercise price of $14.32 per share, and (iii) 9,375 shares at an exercise price of $35.40 per share. The amount of securities reported as beneficially owned excludes stock options to purchase 3,125 shares at an exercise price of $35.40 per share which vest on June 30, 2005.

(14) Includes stock options to purchase: (i) 8,333 shares at an exercise price of $23.09 which are presently exercisable; (ii) 66,667 shares at an exercise price of $17.12 which are presently exercisable; sales of common stock issued upon an exercise of any such options are subject to the following lockup restrictions: 33,333 shares will be restricted from sale until October 8, 2005, and 33,334 shares will be restricted from sale until October 8, 2006; in addition, upon Mr. Mecredy's voluntary termination of employment with the Company or his termination by the Company for cause, any of the foregoing lockup periods which have not yet expired shall be extended for an additional five year period; (iii) 75,000 shares at an exercise price of $44.76 which are presently exercisable; sales of common stock issued upon an exercise of any such options will be subject to the following lockup restrictions: all of the shares will be restricted from sale for two years from

February 10, 2005 (the "Vesting Date"), 75% of the shares will be restricted from sale for three years from the Vesting Date, 50% of the shares will be restricted from sale for four years from the Vesting Date, and 25% of the shares will be restricted from sale for five years from the Vesting Date; and (iv) 75,000 shares at an exercise price of $37.90 which are presently exercisable; sales of common stock issued upon an exercise of any such options will be subject to the following lockup restrictions: 6,250 shares will be restricted from sale until January 1, 2008; 12,500 shares will be restricted from sale until January 1, 2009; 18,750 shares will be restricted from sale until January 1, 2010; 18,750 shares will be restricted from sale until January 1, 2011; 12,500 shares will be restricted from sale until January 1, 2012; and 6,250 shares will be restricted from sale until January 1, 2013; in addition, upon the Mr. Mecredy's voluntary termination of employment with the Company or his termination by the Company for cause, any of the foregoing lockup periods which have not yet expired shall be extended for an additional five year period. Excluded are the following unvested grants of restricted stock: (i) 3,351 shares of which 1,117 shares will vest on each of January 1, 2006, January 1, 2007, and January 1, 2008; (ii) 25,000 shares which will vest upon a change of control of the Company; (iii) 2,400 shares which will vest on December 31, 2005; and (iv) 1,900 shares which will vest on December 31, 2006.

(15) See footnotes (2) and (6) through (14).

(16) Percent is based on 34,535,765 shares of common stock outstanding as of April 27, 2005.

We are not aware of any material proceedings to which any of our directors, nominees for director, executive officers, affiliates of the foregoing persons or any security holder, including any owner of record or beneficial owner of more than 5% of any class of our voting securities, is a party adverse to us or has a material interest adverse to us.

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SECURITIES AUTHORIZED FOR ISSUANCE
UNDER EQUITY COMPENSATION PLANS

The table below shows the number of options and range of exercise prices we granted to various employees and directors during our fiscal year ended December 31, 2004 under our 1999 Stock Incentive Plan and Amended and Restated 2002 Stock Incentive Plan (the "2002 Stock Incentive Plan").

Plan Name	Number of Grants	Grant Price Ranges
1999 Stock Incentive Plan	28,000	$ 33.04 - $33.92
2002 Stock Incentive Plan	951,000	$ 28.46 - $41.85

The following table sets forth certain information regarding our equity plans at December 31, 2004.

egory	(A) Number of securities to be issued upon exercise of outstanding	(B) Weighted-average exercise price of outstanding options, warrants	(C) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (A))

	options, warrants and rights		and rights	
ompensation plans approved ty holders	2,898,516	$	23.08	1,648,012

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NOTES TO CONSOLIDAT
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	October 3, 2010	De
Cash	**$ 38,213**	$
Cash equivalents	**-**	
Cash and cash equivalents	**$ 38,213**	$
Municipal bonds	**60,046**	
Corporate bonds	**29,445**	
Sovereign debt	**13,637**	
Agency bonds	**10,388**	
Short-term investments	**$ 113,516**	$
Municipal bonds	**27,688**	
Corporate bonds	**35,192**	
Agency bonds	**19,535**	
Limited partnership interest (accounted for using cost method)	**6,175**	
Long-term investments	**$ 88,590**	$
	$ 240,319	$

In the second quarter of 20
Company invested a significant ar
cash held by its international enti
variety of investment vehicles. W
Company s domestic portfolio
consists of municipal bon
international portfolio contains c

bonds, sovereign debt, and agenc
Corporate bonds consist of debt s
issued by both international and d
companies, sovereign debt con
direct debt issued by intern
governments, and agency bonds c
international debt securities issu
third party. It is the Company s
invest in debt securities with e
maturities that do not exceed five y
The following table summari
Company s available-for-sale in
as of October 3, 2010 (in thousands

	Amortized Cost	Gross Unrealized Gains
Short-term:		
Municipal bonds	$ 59,973	$ 77
Corporate bonds	29,518	
Sovereign debt	13,654	
Agency bonds	10,383	21
Long-term:		
Municipal bonds	27,555	146
Corporate bonds	35,323	14
Agency bonds	19,582	2
	$ 195,988	$ 260

The Company uses specific ident
to quantify total realized gains o
transferred out of other compre
income. This amount was not ma
any period presented.
The following table presents the e
maturity dates of the Com
available-for-sale investmen
October 3, 2010 (in thousands):

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COGNEX CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

	<1 Year	1 Year	2 Years	3 Years	4 Years	Total
Municipal bonds	$ 60,046	$ 2,002	$ 20,113	$ 4,858	$ 715	$ 87,734
Corporate bonds	29,445	1,382	13,048	17,898	2,864	64,637
Sovereign debt	13,637	-	-	-	-	13,637
Agency bonds	10,388	9,091	8,120	2,324	-	29,923
	$ 113,516	**$ 12,475**	**$ 41,281**	**$ 25,080**	**$ 3,579**	**$ 195,931**

The Company received distributions from the limited partnership of $1,224,000 during the second quarter of 2010 and $467,000 during the third quarter of 2010 that were accounted for as a return of capital.

NOTE 5: Inventories

Inventories consisted of the following (in thousands):

	October 3, 2010	December 31, 2009
Raw materials	**$ 14,770**	$ 10,405
Work-in-process	**1,991**	652
Finished goods	**7,106**	5,775
	$ **23,867**	$ 16,832

NOTE 6: Intangible Assets and Goodwill

In March 2003, the Company acquired the wafer identification business of Siemens Dematic AG, a subsidiary of Siemens AG and leading supplier of wafer identification systems to semiconductor manufacturers in Europe. A portion of the purchase price was allocated to an intangible asset for relationships with a group of customers (Siemens Customer Relationships) reported under the MVSD segment. In the first quarter of 2009, the Company s wafer identification business decreased dramatically from the levels experienced in 2008 and it became apparent that a recovery was unlikely to happen before the end of the year. The Company determined that this significant decrease in business was a triggering event that required the Company to perform an impairment test of the Siemens Customer Relationships. The Company estimated the fair value of the Siemens Customer Relationships using the income approach on a discounted cash flow basis. The fair value test indicated the Siemens Customer Relationships had a fair value of $300,000 as of April 5, 2009, compared to a carrying value of $1,300,000, resulting in an impairment charge of $1,000,000 recorded in the first quarter of 2009, which is included in Selling, general, and administrative expenses on the Consolidated Statements of Operations. The Company is amortizing the remaining $300,000 asset over its estimated remaining life of two years on a straight-line basis.

The change in the carrying value of goodwill during the period ($291,000) is wholly attributable to fluctuations in foreign currency exchange rates, as a portion of this asset is recorded on the books of the Company s Irish subsidiary.

The Company evaluates the possible impairment of goodwill and other intangible assets whenever events or circumstances indicate that the carrying value of these assets may not be recoverable. No triggering event occurred in the nine-month period ended October 3, 2010 that would indicate a potential impairment of goodwill or other intangible assets. However, the Company continues to monitor market conditions, and changes in market conditions could result in an impairment of goodwill or other intangible assets in a future period.

NOTE 7: Warranty Obligations

The Company warrants its hardware products to be free from defects in material and workmanship for periods primarily ranging from six months to two years from the time of sale based upon the product being purchased and the terms of the customer arrangement. Warranty obligations are evaluated and recorded at the time of sale since it is probable that customers will make claims under warranties related to products that have been sold and the amount of these claims can be reasonably estimated based upon historical costs to fulfill claims. Obligations may also be recorded subsequent to the time of sale whenever specific events or circumstances impacting product quality become known that would not have been taken into account using historical data. Warranty obligations are included in Accrued expenses on the Consolidated Balance Sheets.

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COGNEX CORPORATION
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The changes in the warranty obligation were as follows (in thousands):

Balance as of December 31, 2009	$ 1,377
Provisions for warranties issued during the period	1,798
Fulfillment of warranty obligations	(1,175)
Foreign exchange rate changes	5
Balance as of October 3, 2010	**$ 2,005**

NOTE 8: Contingencies

In May 2008, Microscan Systems, Inc. filed a complaint against the Company in the United States District Court for the Western District of Washington alleging infringement of U.S. Patent No. 6.105.869 owned by Microscan Systems, Inc. The complaint alleges that certain of the Company s DataMan 100 and 700 series products infringe the patent in question. In November 2008, the Company filed an answer and counterclaim alleging that the Microscan patent was invalid and not infringed, and asserting a claim for infringement of U.S. Patent No. 6.636.298. Following a court-ordered mediation on September 28, 2010, the parties agreed to a confidential settlement of this matter prior to trial. This settlement was not material to the Company s financial results and the matter is now closed.

In May 2008, the Company filed a complaint against MvTec Software GmbH, MvTec LLC, and Fuji America Corporation in the United States District Court for the District of Massachusetts alleging infringement of certain patents owned by the Company. In April 2009 and again in June 2009, Defendant MvTec Software GmbH filed re-examination requests of the patents-at-issue with the United States Patent and Trademark Office. This matter is ongoing.

In May 2009, the Company pre-filed a complaint with the United States International Trade Commission (ITC) pursuant to Section 337 of the Tariff Act of 1930, as amended, 19 U.S.C. §1337, against MvTec Software GmbH, MvTec LLC, Fuji America, and several other respondents alleging unfair methods of competition and unfair acts in the unlawful importation into the United States, sale for importation, or sale within the United States after importation. By this filing, the Company requested the ITC to investigate the Company s contention that certain machine vision software, machine vision systems, and products containing the same infringe, and respondents directly infringe and/or actively induce and/or contribute to the infringement in the United States, of one or more of the Company s U.S. patents. In July 2009, the ITC issued an order that it would institute an investigation based upon the Company s assertions. In September 2009, the Company reached a settlement with two of the respondents, and in December 2009, the Company reached a settlement with five additional respondents. In March 2010, the Company reached a settlement with respondent Fuji Machine Manufacturing Co., Ltd. and its subsidiary Fuji America Corporation. These settlements did not have a material impact on the Company s financial results. An ITC hearing was held in May 2010. In July 2010, the Administrative Law Judge issued an initial determination finding two of the Company s patents invalid and that respondents did not infringe the patents-at-issue. In September 2010, the Commission issued a notice that it would review the initial determination of the Administrative Law Judge. The Final Determination of the Commission is scheduled for November 16, 2010. The Company intends to challenge any adverse decision by the ITC in an appeal before the Federal Circuit.

The Company cannot predict the outcome of the above-referenced pending matters and an adverse resolution of these lawsuits could have a material adverse effect on the Company s financial position, liquidity, results of operations, and/or indemnification obligations. In addition, various other claims and legal proceedings generally incidental to the normal course of business are pending or threatened on behalf of or against the Company. While we cannot predict the outcome of these incidental matters, we believe that any liability arising from them will not have a material adverse effect on our financial position, liquidity, or results of operations.

NOTE 9: Indemnification Provisions

Except as limited by Massachusetts law, the by-laws of the Company require it to indemnify certain current

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COGNEX CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

or former directors, officers, and employees of the Company against expenses incurred by them in connection with each proceeding in which he or she is involved as a result of serving or having served in certain capacities. Indemnification is not available with respect to a proceeding as to which it has been adjudicated that the person did not act in good faith in the reasonable belief that the action was in the best interests of the Company. The maximum potential amount of future payments the Company could be required to make under these provisions is unlimited. The Company has never incurred significant costs related to these indemnification provisions. As a result, the Company believes the estimated fair value of these provisions is minimal.

In the ordinary course of business, the Company may accept standard limited indemnification provisions in connection with the sale of its products, whereby it indemnifies its customers for certain direct damages incurred in connection with third-party patent or other intellectual property infringement claims with respect to the use of the Company s products. The term of these indemnification provisions generally coincides with the customer s use of the Company s products. The maximum potential amount of future payments the Company could be required to make under these provisions is generally subject to fixed monetary limits. The Company has never incurred significant costs to defend lawsuits or settle claims related to these indemnification provisions. As a result, the Company believes the estimated fair value of these provisions is minimal.

In the ordinary course of business, the Company also accepts limited indemnification provisions from time to time, whereby it indemnifies customers for certain direct damages incurred in connection with bodily injury and property damage arising from the installation of the Company s products. The term of these indemnification provisions generally coincides with the period of installation. The maximum potential amount of future payments the Company could be required to make under these provisions is generally limited and is likely recoverable under the Company s insurance policies. As a result of this coverage, and the fact that the Company has never incurred significant costs to defend lawsuits or settle claims related to these indemnification provisions, the Company believes the estimated fair value of these provisions is minimal.

NOTE 10: Derivative Instruments

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

The Company faces exposure to exchange rate fluctuations, as a significant portion of its revenues, expenses, assets, and liabilities are denominated in currencies other than the functional currencies of the Company s subsidiaries or the reporting currency of the Company, which is the U.S. Dollar. The Company faces two types of foreign currency exchange rate exposure:

- transactional currency/functional currency exchange rate exposure from transactions that are denominated in currencies other than the functional currency of the subsidiary (for example, a Japanese Yen receivable on the Company s Irish subsidiary s books for which the functional currency is the Euro), and

- functional currency/reporting currency exchange rate exposure from transactions that are denominated in currencies other than the U.S. Dollar, which is the reporting currency of the Company.

The Company currently uses derivative instruments to provide an economic hedge against its transactional currency/functional currency exchange rate exposure. Forward contracts on currencies are entered into to manage the transactional currency/functional currency exposure of the Company s Irish subsidiary s accounts receivable denominated in U.S. dollars and Japanese Yen. In prior periods, these contracts also related to the Irish subsidiary s tax prepayment denominated in Japanese Yen. These forward contracts are used to minimize foreign currency gains or losses, as the gains or losses on these contracts are intended to offset the losses or gains on the underlying exposure.

COGNEX CORPORATION
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These forward contracts do not qualify for hedge accounting. Both the underlying exposure and the forward contracts are recorded at fair value on the Consolidated Balance Sheets and changes in fair value are reported as Foreign currency gain (loss) on the Consolidated Statements of Operations. The Company recorded net foreign currency gains of $102,000 and $1,000 in the three-month periods ended October 3, 2010 and October 4, 2009, respectively. The Company recorded net foreign currency losses of $71,000 and $813,000 in the nine-month periods ended October 3, 2010 and October 4, 2009, respectively.

As of October 3, 2010, the Company had the following outstanding forward contracts that were entered into to mitigate foreign currency exchange rate risk:

Currency	Amount
Japanese Yen/Euro	86,250,000 Japanese Yen
U.S. Dollar/Euro	8,880,000 U.S. Dollars

Information regarding the fair value of the forward contracts outstanding as of October 3, 2010 and December 31, 2009 was as follows (in thousands):

	Asset Derivatives			Liability Derivatives		
		Fair Value			Fair Value	
	Balance Sheet Location	October 3, 2010	December 31, 2009	Balance Sheet Location	October 3, 2010	December 31, 2009
Currency forward contracts	Prepaid expenses and other current assets	**$ 334**	$ 111	Accrued expenses	**$ 13**	$ 301

Information regarding the effect of the forward contracts, net of the underlying exposure, on the Consolidated Statements of Operations for the three-month and nine-month periods ended October 3, 2010 and October 4, 2009 were as follows (in thousands):

	Location of Gain (Loss) Recognized in Income on Derivatives	Amount of Gain (Loss) Recognized in Income on Derivatives Three-months ended		Location of Gain (Loss) Recognized in Income on Derivatives	Amount of Gain (Loss) Recognized in Income on Derivatives Nine-months ended	
		October 3, 2010	October 4, 2009		October 3, 2010	October 4, 2009
Currency forward contracts	Foreign currency gain (loss)	**$ (88)**	$ 18	Foreign currency gain (loss)	**$ 185**	$ (254)

NOTE 11: Stock-Based Compensation Expense

The Company s share-based payments that result in compensation expense consist solely of stock option grants. As of October 3, 2010, the Company had 7,975,300 shares available for grant under two stock option plans: the 2001 General Stock Option Plan (6,290,690) and the 2007 Stock Option and Incentive Plan (1,684,610). Each of these plans

expires ten years from the date the plan was approved. Generally, stock options are granted with an exercise price equal to the market value of the Company s common stock at the grant date, vest over four years based upon continuous service, and expire ten years from the grant date.

The following table summarizes the Company s stock option activity for the nine-month period ended October 3, 2010:

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	Shares (in thousands)	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding as of December 31, 2009	4,828	$ 20.41		
Granted	1,164	18.18		
Exercised	(383)	19.86		
Forfeited or expired	(266)	20.18		
Outstanding as of October 3, 2010	**5,343**	**$ 20.02**	**6.3**	**$ 33,457**
Exercisable as of October 3, 2010	**2,781**	**$ 20.87**	**4.4**	**$ 15,178**

The fair values of stock options granted in each period presented were estimated using the following weighted-average assumptions:

	Three-months Ended		Nine-months Ended	
	October 3, 2010	October 4, 2009	**October 3, 2010**	October 4, 2009
Risk-free rate	**3.2%**	3.2%	**3.4%**	3.2%
Expected dividend yield	**1.4%**	1.5%	**1.3%**	1.5%
Expected volatility	**44%**	43%	**44%**	43%
Expected term (in years)	**5.3**	5.4	**5.3**	4.6

Risk-free rate
The risk-free rate was based upon a treasury instrument whose term was consistent with the contractual term of the option.

Expected dividend yield
The current dividend yield was calculated by annualizing the cash dividend declared by the Company s Board of Directors for the current quarter and dividing that result by the closing stock price on the grant date. The current dividend yield was then adjusted to reflect the Company s expectations relative to future dividend declarations.

Expected volatility
The expected volatility was based upon a combination of historical volatility of the Company s common stock over the contractual term of the option and implied volatility for traded options of the Company s stock.

Expected term
The expected term was derived from the binomial lattice model from the impact of events that trigger exercises over time.

The weighted-average grant-date fair values of stock options granted during the three-month periods ended October 3, 2010 and October 4, 2009 were $6.89 and $5.62, respectively. The weighted-average grant-date fair values of stock options granted during the nine-month periods ended October 3, 2010 and October 4, 2009 were $7.10 and $4.81, respectively.

The Company recognizes compensation expense using the graded attribution method, in which expense is recognized on a straight-line basis over the service period for each separately vesting portion of the stock option as if the option

was, in substance, multiple awards. The amount of compensation expense recognized at the end of the vesting period is based upon the number of stock options for which the requisite service has been completed. No compensation expense is recognized for options that are forfeited for which the employee does not render the requisite service. The Company applies estimated forfeiture rates to its unvested options to arrive at the amount of compensation expense that should be recognized over the requisite service period. At the end of each separately vesting portion of an option, the expense that was recognized by applying the estimated forfeiture rate is compared to the expense that should be recognized based upon the employee s service, and a credit to expense is recorded related to those employees that have not rendered the requisite service. The Company revised its estimated forfeiture rates in the second quarter of 2010, and the cumulative effect of this change resulted in a reduction in compensation expense of approximately $600,000. The Company stratifies its employee population into two groups: one consisting of senior management and another consisting of all other employees. The Company currently expects that approximately 70% of its stock options granted to senior management and 65% of its options granted to all other employees will

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COGNEX CORPORATION
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actually vest. Therefore, the Company currently applies an estimated forfeiture rate of 12% to all unvested options for senior management and a rate of 15% for all other employees.

The total stock-based compensation expense and the related income tax benefit recognized for the three-month period ended October 3, 2010 were $1,278,000 and $421,000, respectively, and for the three-month period ended October 4, 2009 were $1,444,000 and $474,000, respectively. The total stock-based compensation expense and the related income tax benefit recognized for the nine-month period ended October 3, 2010 were $1,672,000 and $552,000, respectively, and for the nine-month period ended October 4, 2009 were $5,088,000 and $1,679,000, respectively. No compensation expense was capitalized as of October 3, 2010 or December 31, 2009.

The following table details the stock-based compensation expense by caption for each period presented on the Consolidated Statements of Operations (in thousands):

	Three-months Ended		**Nine-months Ended**	
	October 3, 2010	October 4, 2009	**October 3, 2010**	October 4, 2009
Product cost of revenue	**$ 63**	$ 67	**$ 135**	$ 346
Service cost of revenue	**32**	41	**44**	155
Research, development, and engineering	**346**	387	**680**	1,354
Selling, general, and administrative	**837**	949	**813**	3,233
	$ 1,278	$ 1,444	**$ 1,672**	$ 5,088

The total intrinsic values of stock options exercised for the three-month periods ended October 3, 2010 and October 4, 2009 were $2,004,000 and $0, respectively. The total intrinsic values of stock options exercised for the nine-month periods ended October 3, 2010 and October 4, 2009 were $2,055,000 and $3,000, respectively.

The total fair values of stock options vested for the three-month periods ended October 3, 2010 and October 4, 2009 were $557,000 and $578,000, respectively. The total fair values of stock options vested for the nine-month periods ended October 3, 2010 and October 4, 2009 were $12,790,000 and $13,780,000, respectively.

As of October 3, 2010, total unrecognized compensation expense related to non-vested stock options was $6,869,000, which is expected to be recognized over a weighted-average period of 1.7 years.

In the third quarter of 2010, the Company recorded a receivable in the amount of $3,300,000 representing funds that were received during the fourth quarter of 2010 from the Company s brokerage agent as a result of stock option exercises in the final days of the quarter. This amount has been included in Prepaid expenses and other current assets on the Consolidated Balance Sheets as of October 3, 2010.

NOTE 12: Stock Repurchase Program

In April 2008, the Company s Board of Directors authorized the repurchase of up to $50,000,000 of the Company s common stock. As of October 3, 2010, the Company had repurchased a total of 1,038,797 shares at a cost of $20,000,000 under this program. The Company did not purchase any shares under this program during the nine-month period ended October 3, 2010. The Company may repurchase shares under this program in future periods depending upon a variety of factors, including, among other things, stock price levels, share availability, and cash reserve requirements.

NOTE 13: Taxes

A reconciliation of the United States federal statutory corporate tax rate to the Company s effective tax rate was as follows:

Three-months Ended	**Nine-months Ended**

	October 3, 2010	October 4, 2009	**October 3, 2010**	October 4, 2009
Income tax (benefit) at federal statutory rate	**35%**	35%	**35%**	(35%)
State income taxes, net of federal benefit	**1**	1	**1**	(1)
Foreign tax rate differential	**(13)**	(20)	**(13)**	21
Tax-exempt investment income	**-**	3	**-**	(3)
Cumulative effect of rate change	**-**	(19)	**-**	(2)
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	Three-months Ended		Nine-months Ended	
	October 3, 2010	October 4, 2009	**October 3, 2010**	October 4, 2009
Discrete tax events	**(3)**	(293)	**(1)**	(31)
Other	**-**	(1)	**-**	-
Income tax provision (benefit)	**20%**	(294%)	**22%**	(51%)

The Company s effective tax rate was a provision of 20% and a provision of 22% for the three-month and nine-month periods ended October 3, 2010, respectively, compared to a benefit of 294% and a benefit of 51% for the same periods in 2009.

The Company s effective tax rate for the third quarter of 2010 included a decrease in tax expense of $462,000 due to the settlement of the Competent Authority tax case with Japan, a decrease in tax expense of $151,000 for the final true-up of the prior year s tax accrual upon filing the actual tax returns, and a decrease in tax expense of $105,000 upon the expiration of the statutes of limitations for certain reserves for income tax uncertainties. These discrete tax events decreased the effective tax rate from a provision of 23% to a provision of 20% for the three-month period in 2010 and decreased the effective tax rate from a provision of 23% to a provision of 22% for the nine-month period in 2010.

The Company s effective tax rate for the third quarter of 2009 included a decrease in tax expense of $3,150,000 upon the expiration of the statutes of limitations for certain reserves for income tax uncertainties and a decrease in tax expense of $197,000 for the final true-up of the prior year s tax accrual upon filing the actual tax returns. These discrete tax events decreased the effective tax rate from a benefit of 1% to a benefit of 294% for the three-month period in 2009 and decreased the effective tax rate from a benefit of 20% to a benefit of 51% for the nine-month period in 2009. The effective tax rate excluding discrete events for the third quarter of 2009 also reflects a true-up of the 2009 tax rate from an 18% benefit to a 20% benefit.

Excluding these discrete tax events and the final rate true-up, the Company s effective tax rate increased from a benefit of 20% of the Company s pretax loss in 2009 to a provision of 23% of the Company s pretax income in 2010 due to more of the Company s profits being earned in higher tax jurisdictions.

During the nine-month period ended October 3, 2010, the Company recorded a $650,000 increase in liabilities, net of deferred tax benefit, for uncertain tax positions that were recorded as income tax expense, of which $487,000 was recorded in the three-month period ended October 3, 2010. Estimated interest and penalties included in these amounts totaled $223,000 for the nine-month period ended October 3, 2010, of which $186,000 was recorded in the three-month period ended October 3, 2010.

The Company s reserve for income taxes, including gross interest and penalties of $1,156,000, was $4,954,000 as of October 3, 2010. All of the Company s liabilities for uncertain tax positions are classified as non-current as of October 3, 2010. If the Company s tax positions were sustained or the statutes of limitations related to certain positions expired, these reserves would be released and income tax expense would be reduced in a future period.

The Company has defined its major tax jurisdictions as the United States, Ireland, and Japan, and within the United States, Massachusetts and California. The tax years 2006 through 2009 remain open to examination by various taxing authorities in the jurisdictions in which the Company operates.

During the third quarter of 2010, the Company concluded its Competent Authority tax case with Japan. A settlement was finalized between Japan and Ireland as a transfer price adjustment and no finding of a permanent establishment against the Company in Japan was noted. The Company s deposit of 766,257,300 Yen placed with Japan in 2007 was returned, plus interest. This deposit had been included in Other assets on the Consolidated Balance Sheets in prior

periods. This Competent Authority agreement closed the Company s tax years 2002 through 2005 to future examination in Japan. The Company is currently negotiating an Advanced Pricing Agreement (APA) with Japan that will cover tax years 2006 through 2012. The Company believes it is adequately reserved for these open years.

The Company recorded $2,003,000 of other income in the first quarter of 2009 upon the expiration of the applicable statute of limitations relating to a tax holiday, during which time the Company collected value-added taxes from customers that were not required to be remitted to the government authority. This amount has been included in Other income on the Consolidated Statements of Operations.

NOTE 14: Restructuring Charges

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November 2008

In November 2008, the Company announced the closure of its MVSD facility in Duluth, Georgia. The $12,000 balance in this restructuring accrual as of December 31, 2009 was paid in the first quarter of 2010, thereby concluding this restructuring program.

April 2009

In April 2009, the Company implemented a variety of cost-cutting measures at MVSD intended to more closely align the Company s cost structure with the lower levels of business at that time. Of the $16,000 balance in this restructuring accrual as of December 31, 2009, $4,000 was reversed in the first quarter of 2010, $8,000 was paid in the first quarter of 2010, and $4,000 was paid in the second quarter of 2010, thereby concluding this restructuring program.

September 2009

On October 1, 2009, which was part of the Company s fiscal September, the Company announced the closure of its facility in Kuopio, Finland, which is expected to result in long-term cost savings and production efficiencies. This SISD facility included a system assembly and integration team, a spare parts depot, and an engineering group dedicated to supporting the Company s SISD products, as well as finance and support staff.

The restructuring charge from these actions was $584,000, all of which has been recorded to date and included in Restructuring charges on the Consolidated Statements of Operations in the SISD reporting segment. The following table summarizes this restructuring plan (in thousands):

	Total Amount Incurred	Incurred in the Three-Month Period Ended October 3, 2010	Incurred in the Nine-Month Period Ended October 3, 2010
One-time termination benefits	$ 365	$ -	$ 63
Contract termination costs	153	(13)	(13)
Other associated costs	66	-	29
	$ 584	**$ (13)**	**$ 79**

One-time termination benefits include salary, which the Company was obligated to pay over the legal notification period, and severance for eight employees who were terminated. A liability for the termination benefits of those employees who were not retained to render service beyond the legal notification period was measured and recognized at the communication date. A liability for the termination benefits of those employees who were retained to render service beyond the legal notification period was measured initially at the communication date but was recognized over the future service period. Contract termination costs include rental payments for the Kuopio, Finland facility during the periods for which the Company did not receive an economic benefit, as well as lease cancellation costs. The costs related to rental payments were recognized in the fourth quarter of 2009 when the Company ceased using the facility. Lease cancellation costs had been recorded based upon management s estimates of those costs; however, a final settlement was recognized in the third quarter of 2010 when negotiations with the landlord concluded. Other associated costs include legal costs related to the employee termination actions and lease negotiations, as well as travel and transportation expenses between Kuopio and other Cognex locations related to the closure of the facility. These costs were recognized when the services were performed.

The following table summarizes the activity in the Company s restructuring reserve related to the closure of the Finland facility, which is included in Accrued expenses on the Consolidated Balance Sheets (in thousands):

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COGNEX CORPORATION
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	One-time Termination Benefits	Contract Termination Costs	Other Associated Costs	Total
Balance as of December 31, 2009	$ 113	$ 153	$ -	$ 266
Restructuring charges	63	-	29	92
Cash payments	(176)	(140)	(29)	(345)
Restructuring adjustments	-	(13)	-	(13)
Balance as of October 3, 2010	**$ 0**	**$ 0**	**$ 0**	**$ 0**

NOTE 15: Weighted-Average Shares

Weighted-average shares were calculated as follows (in thousands):

	Three-months Ended		Nine-months Ended	
	October 3, 2010	October 4, 2009	**October 3, 2010**	October 4, 2009
Basic weighted-average common shares outstanding	**39,729**	39,662	**39,693**	39,658
Effect of dilutive stock options	**188**	4	**99**	-
Weighted-average common and common-equivalent shares outstanding	**39,917**	39,666	**39,792**	39,658

Stock options to purchase 3,665,742 and 3,441,414 shares of common stock, on a weighted-average basis, were outstanding during the three-month and nine-month periods ended October 3, 2010, respectively, and 10,174,797 and 10,691,649 for the same periods in 2009, but were not included in the calculation of dilutive net income (loss) per share because they were anti-dilutive. Additionally, because the Company recorded a net loss during the nine-month period ended October 4, 2009, potential common stock equivalents of 830 were not included in the calculation of diluted net loss per share for these periods.

NOTE 16: Segment Information

The Company has two reportable segments: the Modular Vision Systems Division (MVSD) and the Surface Inspection Systems Division (SISD). MVSD develops, manufactures, and markets modular vision systems that are used to control the manufacturing of discrete items by locating, identifying, inspecting, and measuring them during the manufacturing process. SISD develops, manufactures, and markets surface inspection vision systems that are used to inspect surfaces of materials processed in a continuous fashion, such as metals, papers, non-wovens, plastics, and glass, to ensure there are no flaws or defects on the surfaces. Segments are determined based upon the way that management organizes its business for making operating decisions and assessing performance. The Company evaluates segment performance based upon income or loss from operations, excluding stock-based compensation expense.

The following table summarizes information about the Company s segments (in thousands):

Three-months Ended October 3, 2010	MVSD	SISD	Reconciling Items	Consolidated
Product revenue	$ 61,454	$ 7,834	$ -	$ 69,288
Service revenue	1,618	4,087	-	5,705
Operating income	24,651	2,290	(4,666)	22,275

Nine-months Ended October 3, 2010	MVSD	SISD	Reconciling Items	Consolidated
Product revenue	$ 170,459	$ 20,509	$ -	$ 190,968
Service revenue	4,768	10,035	-	14,803
Operating income	63,035	3,292	(13,559)	52,768

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Three-months Ended October 4, 2009	MVSD	SISD	Reconciling Items	Consolidated
Product revenue	$ 31,575	$ 5,854	$ -	$ 37,429
Service revenue	1,229	2,520	-	3,749
Operating income	4,250	789	(4,159)	880

Nine-months Ended October 4, 2009	MVSD	SISD	Reconciling Items	Consolidated
Product revenue	$ 95,195	$ 16,990	$ -	$ 112,185
Service revenue	4,036	8,212	-	12,248
Operating income (loss)	(2,125)	1,397	(12,696)	(13,424)

Reconciling items consist of stock-based compensation expense and unallocated corporate expenses, which primarily include corporate headquarters costs, professional fees, and patent infringement litigation. Additional asset information by segment is not produced internally for use by the chief operating decision maker, and therefore, is not presented. Additional asset information is not provided because cash and investments are commingled and the divisions share assets and resources in a number of locations around the world.

NOTE 17: Acquisition of Web Monitoring Business

On September 30, 2009, the Company acquired the web monitoring business of Monitoring Technology Corporation (MTC), a manufacturer of products for monitoring industrial equipment and processes. The acquired SmartAdvisor Web Monitoring System (WMS) is complementary to Cognex s SmartView Web Inspection System (WIS), which is sold by the Company s Surface Inspection Systems Division (SISD). When used together, the WIS will automatically identify and classify defects and the WMS will then provide the customer with the ability to determine the root causes of each of those defects so that they can be quickly eliminated. The combination of WMS and WIS will allow SISD to provide a fully-integrated system to paper manufacturers. SISD will serve SmartAdvisor s established customer base, primarily in North America, and plans to expand the sales of SmartAdvisor globally through its existing worldwide sales and service organization. The Company recorded goodwill of $1,692,000 related to the synergies resulting from this acquisition.

The Company paid $5,000,000 in cash, with $4,500,000 paid upon closing and $500,000 paid into an escrow account during the fourth quarter of 2009. There are no contingent payments. The purchase price was subject to a working capital adjustment of $59,000, which was paid to Cognex during the fourth quarter of 2009, thereby reducing the purchase price to $4,941,000. Transaction costs, which were expensed as incurred during the third quarter of 2009, totaled $40,000.

The purchase price was allocated as follows (in thousands):

	Estimated Fair Value	Weighted-Average Amortization Period (in years)

Inventories	$ 259	
Intangible assets		
Completed technology	670	7
Customer relationships	1,950	9
Trademark	140	8
Non-compete agreements	230	5
Goodwill	1,692	
Total assets acquired	4,941	
Total liabilities assumed	0	
Total purchase price	**$ 4,941**	

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The acquired goodwill has been assigned to the SISD segment. The acquired intangible assets, including goodwill, are deductible for tax purposes.

NOTE 18: Dividends

On July 29, 2010, the Company s Board of Directors declared a cash dividend of $0.06 per share. The dividend is payable on September 17, 2010 to all shareholders of record at the close of business on September 3, 2010.

On November 1, 2010, the Company s Board of Directors declared a cash dividend of $0.08 per share. The dividend is payable on December 17, 2010 to all shareholders of record at the close of business on December 3, 2010.

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ITEM 2: MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

Certain statements made in this report, as well as oral statements made by the Company from time to time, constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Readers can identify these forward-looking statements by our use of the words expects, anticipates, estimates, believes, projects, intends, plans, wi could, should, and similar words and other statements of a similar sense. These statements are based upon our current estimates and expectations as to prospective events and circumstances, which may or may not be in our control and as to which there can be no firm assurances given. These forward-looking statements, which include statements regarding business, economic, and market trends, future financial performance, customer order rates, strategic plans, and the impact of the Company s cost-cutting measures, involve known and unknown risks and uncertainties that could cause actual results to differ materially from those projected. Such risks and uncertainties include: (1) current and future conditions in the global economy; (2) potential disruption to the Company s business from its restructuring programs; (3) the cyclicality of the semiconductor and electronics industries; (4) the inability to achieve significant international revenue; (5) fluctuations in foreign currency exchange rates; (6) the loss of a large customer; (7) the inability to attract and retain skilled employees; (8) the reliance upon key suppliers to manufacture and deliver critical components for our products; (9) the failure to effectively manage product transitions or accurately forecast customer demand; (10) the inability to design and manufacture high-quality products; (11) the technological obsolescence of current products and the inability to develop new products; (12) the failure to properly manage the distribution of products and services; (13) the inability to protect our proprietary technology and intellectual property; (14) our involvement in time-consuming and costly litigation; (15) the impact of competitive pressures; (16) the challenges in integrating and achieving expected results from acquired businesses; (17) potential impairment charges with respect to our investments or for acquired intangible assets or goodwill; and (18) exposure to additional tax liabilities. The foregoing list should not be construed as exhaustive and we encourage readers to refer to the detailed discussion of risk factors included in Part I - Item 1A of the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2009. The Company cautions readers not to place undue reliance upon any such forward-looking statements, which speak only as of the date made. The Company disclaims any obligation to subsequently revise forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date such statements are made.

Executive Overview

Cognex Corporation is a leading worldwide provider of machine vision products that capture and analyze visual information in order to automate tasks, primarily in manufacturing processes, where vision is required. Our Modular Vision Systems Division (MVSD) specializes in machine vision systems that are used to automate the manufacturing of discrete items, while our Surface Inspection Systems Division (SISD) specializes in machine vision systems that are used to inspect the surfaces of materials processed in a continuous fashion.

In addition to product revenue derived from the sale of machine vision systems, the Company also generates revenue by providing maintenance and support, training, consulting, and installation services to its customers. Our customers can be classified into three primary markets: discrete factory automation, semiconductor and electronics capital equipment, and surface inspection.

Discrete factory automation customers purchase Cognex vision products and incorporate them into their manufacturing processes. Virtually every manufacturer can achieve better quality and manufacturing efficiency by using machine vision, and therefore, this segment includes a broad base of customers across a variety of industries, including automotive, consumer electronics, food and beverage, health and beauty, medical devices, packaging, and pharmaceutical. Sales to discrete factory automation customers represented approximately 65% of total revenue in the third quarter of 2010.

Semiconductor and electronics capital equipment manufacturers purchase Cognex vision products and integrate them into the automation equipment that they manufacture and then sell to their customers to either make

semiconductor chips or assemble printed circuit boards. Demand from

these capital equipment manufacturers has historically been highly cyclical, with periods of investment followed by downturn. Sales to semiconductor and electronics capital equipment manufacturers represented approximately 19% of total revenue in the third quarter of 2010.

Surface inspection customers are manufacturers of materials processed in a continuous fashion, such as metals, paper, non-wovens, plastics, and glass. These customers need sophisticated machine vision to detect and classify defects on the surfaces of those materials as they are being processed at high speeds. Surface inspection sales represented approximately 16% of total revenue in the third quarter of 2010.

Revenue for the third quarter of 2010 totaled $74,993,000, representing an increase of $33,815,000 over the third quarter of 2009 when the Company s business was adversely impacted by the worldwide economic slowdown. During the slowdown, the Company continued to invest in strategic areas intended to grow factory automation revenue, and demand for the Company s factory automation products was at a record level during the third quarter of 2010. The higher revenue contributed to a gross margin of 75% of revenue in the third quarter of 2010, compared to 71% of revenue in the same period in 2009. Operating expenses increased by $5,545,000 over the prior year s third quarter due primarily to expenses associated with the revenue growth, such as higher sales commissions, company bonus accruals, and marketing and promotional expenses. As a result, the Company was able to generate an operating profit of $22,275,000, or 30% of revenue, in the third quarter of 2010, compared to an operating profit of $880,000, or 2% of revenue, in the third quarter of 2009.

Results of Operations

Revenue

Revenue increased by $33,815,000, or 82%, for the three-month period and increased by $81,338,000, or 65%, for the nine-month period due to higher sales in all three of the Company s primary markets.

Discrete Factory Automation

Sales to manufacturing customers in the discrete factory automation area, which are included in the Company s MVSD segment, represented 65% and 68% of total revenue for the three-month and nine-month periods in 2010, respectively, compared to 70% and 73% for the same periods in 2009. Sales to these customers increased by $19,589,000, or 68%, for the three-month period and increased by $49,395,000, or 55%, for the nine-month period. Revenue for the nine-month period in 2009 included $4,400,000 related to an arrangement with a single customer for which product was shipped over the prior two years, but revenue was deferred until the final unit was delivered in the first quarter of 2009. Revenue for the three-month and nine-month periods in 2010 included $1,130,000 and $2,601,000, respectively, related to the adoption of new revenue recognition rules (refer to Note 2 to the Consolidated Financial Statements) that would have been deferred under the previous guidance. Excluding the recognition of the revenue noted above, sales to these customers increased by $18,459,000, or 64%, for the three-month period and increased by $51,194,000, or 57%, for the nine-month period. Management believes that excluding this revenue from the growth in factory automation sales allows investors to more accurately assess business trends. Revenue levels in 2009 were adversely impacted by the worldwide economic slowdown that first began to affect the Company s business in the third quarter of 2008. During the slowdown, the Company continued to invest in developing and marketing new factory automation products and expanding its global factory automation sales force and partner network. Demand for the Company s factory automation products was at a record level during the third quarter of 2010 and factory automation revenue increased from 2009 in all of the Company s geographic regions and product lines.

Semiconductor and Electronics Capital Equipment

Sales to customers who make automation equipment for the semiconductor and electronics industries, which are included in the Company s MVSD segment, represented 19% and 17% of total revenue for the three-month and nine-month periods in 2010, respectively, compared to 10% and 7% for the same periods in 2009. Sales to these customers increased by $10,679,000, or 268%, for the three-month period and increased by $26,601,000, or 297%, for the nine-month period. Revenue for the three-month period in 2010 would have been higher by $439,000 due to the recognition of specific customer orders that would have been deferred in a prior period and recognized in the current period under the previous guidance. Revenue

for the nine-month period in 2010 included $458,000 related to the adoption of new revenue recognition rules (refer to Note 2 to the Consolidated Financial Statements) that would have been deferred in this period under the previous guidance. Including the recognition of the $439,000 of revenue for the three-month period and excluding the recognition of the $458,000 of revenue for the nine-month period, sales to these customers increased by $11,118,000, or 279%, for the three-month period and increased by $26,143,000, or 292%, for the nine-month period. Management believes that including or excluding this revenue, as the case may be, from the growth in semiconductor and electronics capital equipment sales allows investors to more accurately assess business trends. Although revenue levels were significantly higher than the prior year, business in 2009 was adversely impacted by the worldwide economic slowdown. Furthermore, demand in this market during the third quarter of 2010 declined from the second quarter of 2010. The semiconductor and electronics capital equipment market has historically been highly cyclical and management has limited visibility regarding future order levels from these customers.

Surface Inspection

Sales to surface inspection customers, which comprise the Company s SISD segment, represented 16% and 15% of total revenue for the three-month and nine-month periods in 2010, respectively, compared to 20% for both periods in 2009. Revenue from these customers increased by $3,547,000, or 42%, for the three-month period and increased by $5,342,000, or 21%, for the nine-month period due to higher demand for web inspection systems in the global metals and paper markets. Revenue for the three-month and nine-month periods in 2010 included $235,000 and $225,000, respectively, related to the adoption of new revenue recognition rules (refer to Note 2 to the Consolidated Financial Statements) that would have been deferred under the previous guidance. Excluding the recognition of this revenue, sales to these customers increased by $3,312,000, or 40%, for the three-month period and increased by $5,117,000, or 20%, for the nine-month period. Management believes that excluding this revenue from the growth in factory automation sales allows investors to more accurately assess business trends. Due to the relatively large average order values at SISD, the revenue reported each quarter can vary depending upon the timing of customer orders, system deliveries, and installations, as well as the impact of revenue deferrals.

Product Revenue

Product revenue increased by $31,859,000, or 85%, for the three-month period and increased by $78,783,000, or 70%, for the nine-month period due primarily to a higher volume of vision systems sold to customers in discrete factory automation and the semiconductor and electronics capital equipment markets. The impact of the higher volume was partially offset by lower average selling prices, as the Company introduced new products at lower price points.

Service Revenue

Service revenue, which is derived from the sale of maintenance and support, education, consulting, and installation services increased by $1,956,000, or 52%, for the three-month period and increased by $2,555,000, or 21%, for the nine-month period due primarily to higher revenue from maintenance and support arising from a higher level of spare part sales and repair services, as well as higher revenue from installation services. The growth in product revenue has outpaced the growth in service revenue resulting in a decline in service revenue as a percentage of total revenue. Service revenue decreased as a percentage of total revenue to 8% and 7% for the three-month and nine-month periods in 2010, respectively, from 9% and 10% for the same periods in 2009.

Gross Margin

Gross margin as a percentage of revenue was 75% and 74% for the three-month and nine-month periods in 2010, respectively, compared to 71% and 67% for the same periods in 2009. This increase was primarily due to higher MVSD product margins and a higher percentage of total revenue from the sale of modular vision systems, which have higher margins than the sale of surface inspection systems.

MVSD Margin

MVSD gross margin as a percentage of revenue was 80% and 79% for the three-month and nine-month periods in 2010, respectively, compared to 76% and 73% for the same periods in 2009. The increase in MVSD margin was primarily due to higher product margins resulting from improved absorption of

manufacturing overhead costs, relatively flat new product introduction costs spread over a higher revenue base, and lower provisions for excess and obsolete inventory.

SISD Margin

SISD gross margin as a percentage of revenue was 46% and 44% for the three-month and nine-month periods in 2010, respectively, compared to 50% and 45% for the same periods in 2009. The decrease in SISD margin was primarily due to lower product margins resulting from higher discounting of products in response to competitive market pressures, partially offset by improved margins on installation services.

Product Margin

Product gross margin as a percentage of revenue was 78% for the three-month period and 77% for the nine-month period in 2010, respectively, compared to 74% and 72% for the same periods in 2009. This increase was primarily due to higher MVSD product margins as described above, as well as a higher percentage of total revenue from the sale of modular vision systems, which have higher margins than the sale of surface inspection systems.

Service Margin

Service gross margin as a percentage of revenue was 41% and 38% for the three-month and nine-month periods in 2010, respectively, compared to 35% and 30% for the same periods in 2009. This increase was primarily due to improved margins on installation services, as well as improvements in product ease of use that resulted in lower technical support costs.

Operating Expenses

Research, Development, and Engineering Expenses

Research, development, and engineering (RD&E) expenses increased by $1,205,000, or 18%, for the three-month period and increased by $845,000, or 4%, for the nine-month period. MVSD RD&E expenses increased by $1,209,000, or 20%, for the three-month period and increased by $723,000, or 3%, for the nine-month period, while SISD RD&E expenses decreased by $4,000, or 1%, for the three-month period and increased by $122,000, or 5%, for the nine-month period.

The table below details the $1,209,000 net increase in MVSD RD&E for the three-month period and the $723,000 net increase in MVSD RD&E for the nine-month period:

	Three-Month Period	**Nine-Month Period**
MVSD RD&E expenses in 2009	$ 6,007	$ 20,887
Personnel-related costs	219	(774)
Stock-based compensation expense	(39)	(632)
Company bonus accruals	488	1,431
Vacation	299	568
Materials and supplies	200	413
Other	42	(283)
MVSD RD&E expenses in 2010	**$ 7,216**	**$ 21,610**

The savings in personnel-related costs for the nine-month period resulted from a work force reduction in the second quarter of 2009, primarily in the United States. Although these savings in 2010 were significant compared to the nine-month period in 2009, management does not expect this trend to continue. Due to the improved business climate in 2010, the Company has increased its RD&E headcount in strategic areas, which began to impact year-over-year comparisons in the third quarter of 2010. The lower stock-based compensation expense was due to the declining trend in the number of options granted, the accelerated expense taken in the fourth quarter of 2009 related to unvested options tendered by employees, and higher estimated forfeiture rates in 2010. These savings were offset in the three-month period by the impact of stock options that were granted late in the second quarter of 2010 as part of the Company s annual program. Expenses increased as a result of company bonus accruals recorded during 2010 as the Company returned

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to profitability, higher vacation expense in 2010 as the Company did not continue the mandatory shutdown programs employed in 2009, and higher materials and supplies costs to support new product development.

There were no significant changes to SISD RD&E expenses in the three-month period. The increase in SISD RD&E expenses for the nine-month period was due primarily to company bonus accruals recorded during 2010.

RD&E expenses as a percentage of revenue were 11% and 12% for the three-month and nine-month periods in 2010 compared to 16% and 19% for the same periods in 2009. We believe that a continued commitment to RD&E activities is essential in order to maintain or achieve product leadership with our existing products and to provide innovative new product offerings, and therefore, we expect to continue to make RD&E investments in the future in strategic areas, such as the ID products business and the development of a Vision System on a Chip. In addition, we consider our ability to accelerate time to market for new products to be critical to our revenue growth. Although we target our RD&E spending to be between 10% and 15% of revenue, this percentage is impacted by revenue levels.

Selling, General, and Administrative Expenses

Selling, general, and administrative (SG&A) expenses increased by $4,576,000, or 22%, for the three-month period and increased by $5,391,000, or 8%, for the nine-month period. MVSD SG&A expenses increased by $3,755,000, or 24%, for the three-month period and increased by $1,001,000, or 2%, for the nine-month period, while SISD SG&A expenses decreased by $30,000, or 1%, for the three-month period and decreased by $66,000, or 1% for the nine-month period. Corporate expenses that are not allocated to either division increased by $851,000, or 29%, for the three-month period and increased by $4,456,000, or 54%, for the nine-month period.

The table below details the $3,755,000 net increase in MVSD SG&A for the three-month period and the $1,001,000 net increase in MVSD SG&A for the nine-month period:

	Three-Month Period	Nine-Month Period
MVSD SG&A expenses in 2009	$ 15,741	$ 53,696
Stock-based compensation expense	(272)	(2,412)
Personnel-related costs	973	(1,499)
Intangible asset impairment and amortization	-	(1,222)
Sales commissions	1,681	3,628
Marketing and promotional expenses	622	1,461
Company bonus accruals	435	1,403
Other	316	(358)
MVSD SG&A expenses in 2010	**$ 19,496**	**$ 54,697**

The lower stock-based compensation expense was due to the declining trend in the number of options granted, the accelerated expense taken in the fourth quarter of 2009 related to unvested options tendered by employees, higher estimated forfeiture rates in 2010, and higher credits related to forfeited options in 2010. These savings were offset for the three-month period by the impact of stock options that were granted late in the second quarter of 2010 as part of the Company s annual program, resulting in third-quarter expense. The savings in personnel-related costs for the nine-month period resulted from a work force reduction in the second quarter of 2009. Although these savings in 2010 were significant compared to the nine-month period in 2009, management does not expect this trend to continue. Due to the improved business climate in 2010, the Company has increased its SG&A headcount in strategic areas, such as China, which began to impact year-over-year comparisons in the third quarter of 2010. A $1,000,000 intangible asset impairment charge in the first quarter of 2009 (refer to Note 6 to the Consolidated Financial Statements) and lower amortization expense also contributed to the decrease in SG&A expenses. Offsetting these savings were higher sales commissions related to the increase in revenues over the prior year, higher spending on marketing and promotional expenses intended to grow factory automation revenue, and company bonus accruals recorded during 2010 as the Company returned to profitability.

There were no significant changes to SISD SG&A expenses in the three-month and nine-month periods.

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In the three-month period, the increase in corporate expenses was due to higher tax service fees related to the settlement of the Competent Authority tax case with Japan ($187,000 refer to Note 13 to the Consolidated Financial Statements), higher stock option expense related to the 2010 stock option grants ($180,000), and company bonus accruals recorded during 2010 as the Company returned to profitability ($359,000). In the nine-month period, the increase in corporate expenses was due to higher costs related to patent-infringement actions ($2,341,000 refer to Note 8 to the Consolidated Financial Statements), company bonus accruals ($1,159,000), and higher stock option expense ($178,000). In addition, expenses for the Company s President were transferred into the corporate group upon his promotion in January 2010, as he is now responsible for both divisions.

Restructuring Charges

November 2008

In November 2008, the Company announced the closure of its MVSD facility in Duluth, Georgia. The $12,000 balance in this restructuring accrual as of December 31, 2009 was paid in the first quarter of 2010, thereby concluding this restructuring program.

April 2009

In April 2009, the Company implemented a variety of cost-cutting measures at MVSD intended to more closely align the Company s cost structure with the lower levels of business at that time. Of the $16,000 balance in this restructuring accrual as of December 31, 2009, $4,000 was reversed in the first quarter of 2010, $8,000 was paid in the first quarter of 2010, and $4,000 was paid in the second quarter of 2010, thereby concluding this restructuring program.

September 2009

On October 1, 2009, which was part of the Company s fiscal September, the Company announced the closure of its facility in Kuopio, Finland, which is expected to result in long-term cost savings and production efficiencies. This SISD facility included a system assembly and integration team, a spare parts depot, and an engineering group dedicated to supporting the Company s SISD products, as well as finance and support staff. The expense savings were offset by the restructuring costs in 2009; however, the Company expects to achieve cost savings of approximately $650,000 in 2010. These savings will be realized in Cost of revenue, Research, development, and engineering expenses, and Selling, general, and administrative expenses on the Consolidated Statements of Operations.

The restructuring charge from these actions was $584,000, all of which has been recorded to date and included in Restructuring charges on the Consolidated Statements of Operations in the SISD reporting segment. The following table summarizes this restructuring plan (in thousands):

	Total Amount Incurred	Incurred in the Three-Month Period Ended October 3, 2010	Incurred in the Nine-Month Period Ended October 3, 2010
One-time termination benefits	$ 365	$ -	$ 63
Contract termination costs	153	(13)	(13)
Other associated costs	66	-	29
	$ 584	**$ (13)**	**$ 79**

One-time termination benefits include salary, which the Company was obligated to pay over the legal notification period, and severance for eight employees who were terminated. A liability for the termination benefits of those employees who were not retained to render service beyond the legal notification period was measured and recognized at the communication date. A liability for the termination benefits of those employees who were retained to render service beyond the legal notification period was measured initially at the communication date but was recognized over

the future service period. Contract termination costs include rental payments for the Kuopio, Finland facility during the periods for which the Company did not receive an economic benefit, as well as lease cancellation costs. The costs related to rental payments were recognized in the fourth quarter of 2009 when the Company ceased using the facility. Lease cancellation costs had been recorded based upon management s estimates of those costs; however, a final settlement was recognized in the third quarter of 2010 when negotiations with the landlord concluded. Other associated costs include legal costs related to the employee termination actions and lease negotiations, as well as travel

and transportation expenses between Kuopio and other Cognex locations related to the closure of the facility. These costs were recognized when the services were performed.

The following table summarizes the activity in the Company s restructuring reserve related to the closure of the Finland facility, which is included in Accrued expenses on the Consolidated Balance Sheets (in thousands):

	One-time Termination Benefits	Contract Termination Costs	Other Associated Costs	Total
Balance as of December 31, 2009	$ 113	$ 153	$ -	$ 266
Restructuring charges	63	-	29	92
Cash payments	(176)	(140)	(29)	(345)
Restructuring adjustments	-	(13)	-	(13)
Balance as of October 3, 2010	**$ 0**	**$ 0**	**$ 0**	**$ 0**

Nonoperating Income (Expense)

The Company recorded a foreign currency gain of $102,000 for the three-month period in 2010 and a foreign currency loss of $71,000 for the nine-month period in 2010, compared to a gain of $1,000 and a loss of $813,000 for the same periods in 2009. The foreign currency fluctuations in each period resulted primarily from the revaluation and settlement of accounts receivable and intercompany balances that are reported in one currency and collected in another. Although the foreign currency exposure of accounts receivable is largely mitigated through the use of forward contracts, this program depends upon forecasts of sales and collections, and therefore, gains or losses on the underlying receivables may not perfectly offset losses or gains on the contracts.

Investment income decreased by $35,000, or 8%, and $926,000, or 49%, for the three-month and nine-month periods, respectively. The decrease was primarily due to declining yields on the Company s portfolio of debt securities. However, beginning in the second quarter of 2010, this impact was partially offset by the investment of excess cash accumulated in the Company s international entities, which is expected to contribute to higher investment income in future periods.

The Company recorded other expense of $129,000 and $531,000 for the three-month and nine-month periods in 2010, respectively, compared to expense of $158,000 in the three-month period in 2009 and income of $1,517,000 in the nine-month period in 2009. The Company recorded $2,003,000 of other income in the first quarter of 2009 upon the expiration of the applicable statute of limitations relating to a tax holiday, during which time the Company collected value-added taxes from customers that were not required to be remitted to the government authority. Other income (expense) also includes rental income, net of associated expenses, from leasing buildings adjacent to the Company s corporate headquarters.

Income Tax Expense (Benefit)

The Company s effective tax rate was a provision of 20% and a provision of 22% for the three-month and nine-month periods ended October 3, 2010, respectively, compared to a benefit of 294% and a benefit of 51% for the same periods in 2009.

The Company s effective tax rate for the third quarter of 2010 included a decrease in tax expense of $462,000 due to the settlement of the Competent Authority tax case with Japan, a decrease in tax expense of $151,000 for the final true-up of the prior year s tax accrual upon filing the actual tax returns, and a decrease in tax expense of $105,000 upon the expiration of the statutes of limitations for certain reserves for income tax uncertainties. These discrete tax events decreased the effective tax rate from a provision of 23% to a provision of 20% for the three-month period in 2010 and decreased the effective tax rate from a provision of 23% to a provision of 22% for the nine-month period in 2010.

The Company s effective tax rate for the third quarter of 2009 included a decrease in tax expense of $3,150,000 upon the expiration of the statutes of limitations for certain reserves for income tax uncertainties and a decrease in tax expense of $197,000 for the final true-up of the prior year s tax accrual upon filing the actual tax returns. These discrete tax events decreased the effective tax rate from a benefit of 1% to a benefit of 294% for the three-month period in 2009 and decreased the effective tax rate from a benefit of 20% to a benefit of 51% for the nine-month period in 2009. The effective tax rate excluding discrete events for the third quarter of 2009 also reflects a true-up of the 2009 tax rate from an 18% benefit to a 20% benefit.

Excluding these discrete tax events and the final rate true-up, the Company s effective tax rate increased from a benefit of 20% of the Company s pretax loss in 2009 to a provision of 23% of the Company s pretax income in 2010 due to more of the Company s profits being earned in higher tax jurisdictions.

Liquidity and Capital Resources

The Company has historically been able to generate positive cash flow from operations, which has funded its operating activities and other cash requirements and has resulted in an accumulated cash, cash equivalent, and investment balance of $240,319,000 as of October 3, 2010. The Company has established guidelines relative to credit ratings, diversification, and maturities of its investments that maintain liquidity.

The Company s cash requirements during the nine-month period in 2010 were met with its existing cash balances, cash from investment maturities, and positive cash flows from operations. Cash requirements primarily consisted of operating activities, capital expenditures, and the payment of dividends. Capital expenditures for the nine-month period in 2010 totaled $3,307,000 and consisted primarily of expenditures for computer hardware, computer software, and manufacturing test equipment for new product introductions.

Late in 2008 and again during 2009, the Company implemented a number of cost-cutting measures intended to reduce expenses in response to lower revenue expectations. Restructuring charges for these actions totaled $4,859,000, all of which has been paid to date.

In November 2009, the Company commenced a cash tender offer for certain underwater stock options held by employees, officers, and directors. In December 2009, options to purchase a total of 4,900,694 shares of the Company s common stock were tendered under the program for an aggregate cash payment of $9,158,000, of which $9,075,000 was paid out in December 2009 and $83,000 was paid out in January 2010. This is the first time the Company has offered to purchase outstanding stock options in exchange for cash, and there is no intent to make another such offer.

In June 2000, the Company became a Limited Partner in Venrock Associates III, L.P. (Venrock), a venture capital fund. The Company has committed to a total investment in the limited partnership of up to $20,500,000, with the commitment period expiring on December 31, 2010. The Company does not have the right to withdraw from the partnership prior to December 31, 2010. As of October 3, 2010, the Company had contributed $19,886,000 to the partnership. No contributions were made during the nine-month period in 2010; however, the Company received distributions of $1,224,000 during the second quarter of 2010 and $467,000 during the third quarter of 2010, which were accounted for as a return of capital. The remaining commitment of $614,000 can be called by Venrock in any period through December 31, 2010.

In April 2008, the Company s Board of Directors authorized the repurchase of up to $50,000,000 of the Company s common stock. As of October 3, 2010, the Company had repurchased 1,038,797 shares at a cost of $20,000,000 under this program. The Company did not purchase any shares under this program during the nine-month period in 2010. The Company may repurchase shares under this program in future periods depending upon a variety of factors, including, among other things, stock price levels, share availability, and cash reserve requirements.

Beginning in the third quarter of 2003, the Company s Board of Directors has declared and paid a cash dividend in each quarter, including dividends of $0.05 per share in the first quarter of 2010 and $0.06 per share in both the second and third quarters of 2010 that amounted to $6,747,000 for the nine-month period in 2010. On November 1, 2010, the Company s Board of Directors declared a cash dividend of $0.08 per share payable in the fourth quarter of 2010. Future dividends will be declared at the discretion of the Company s Board of Directors and will depend upon such factors as the Board deems relevant including, among other things, the Company s ability to generate positive cash flows from operations.

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The Company believes that its existing cash, cash equivalents, and investments balances, together with cash flow from operations, will be sufficient to meet its operating, investing, and financing activities for the next twelve months. As of October 3, 2010, the Company had approximately $234,144,000 in either cash or investments that could be converted into cash. In addition, Cognex has no long-term debt and does not anticipate needing debt financing in the near future. We believe that our strong cash position has put us in a relatively good position with respect to our longer-term liquidity needs.

Critical Accounting Policies and Estimates

Reference should be made to the Company s Annual Report on Form 10-K for the year ended December 31, 2009 where management outlines the Company s Critical Accounting Policies and Estimates. Updates to these policies are discussed below.

Revenue Recognition

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

ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes to the Company s exposures to market risk since December 31, 2009.

ITEM 4: CONTROLS AND PROCEDURES

As required by Rules 13a-15 and 15d-15 of the Securities Exchange Act of 1934, the Company has evaluated, with the participation of management, including the Chief Executive Officer and the Chief Financial Officer, the effectiveness of its disclosure controls and procedures (as defined in such rules) as of the end of the period covered by this report. Based on such evaluation, the Chief Executive Officer and Chief Financial Officer concluded that such disclosure controls and procedures were effective as of that date. From time to time, the Company reviews its disclosure controls and procedures, and may from time to time make changes aimed at enhancing their effectiveness and to ensure that the Company s systems evolve with its business. There was no change in the Company s internal control over financial reporting that occurred during the three-month period ended October 3, 2010 that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II: OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In May 2008, Microscan Systems, Inc. filed a complaint against the Company in the United States District Court for the Western District of Washington alleging infringement of U.S. Patent No. 6.105.869 owned by Microscan Systems, Inc. The complaint alleges that certain of the Company s DataMan 100 and 700 series products infringe the patent in question. In November 2008, the Company filed an answer and counterclaim alleging that the Microscan patent was invalid and not infringed, and asserting a claim for infringement of U.S. Patent No. 6.636.298. Following a court-ordered mediation on September 28, 2010, the parties agreed to a confidential settlement of this matter prior to trial. This settlement was not material to the Company s financial results and the matter is now closed.

In May 2008, the Company filed a complaint against MvTec Software GmbH, MvTec LLC, and Fuji America Corporation in the United States District Court for the District of Massachusetts alleging infringement of certain patents owned by the Company. In April 2009 and again in June 2009, Defendant MvTec Software GmbH filed re-examination requests of the patents-at-issue with the United States Patent and Trademark Office. This matter is ongoing.

In May 2009, the Company pre-filed a complaint with the United States International Trade Commission (ITC) pursuant to Section 337 of the Tariff Act of 1930, as amended, 19 U.S.C. §1337, against MvTec Software GmbH, MvTec LLC, Fuji America, and several other respondents alleging unfair methods of competition and unfair acts in the unlawful importation into the United States, sale for importation, or sale within the United States after importation. By this filing, the Company requested the ITC to investigate the Company s contention that certain machine vision software, machine vision systems, and products containing the same infringe, and respondents directly infringe and/or actively induce and/or contribute to the infringement in the United States, of one or more of the Company s U.S. patents. In July 2009, the ITC issued an order that it would institute an investigation based upon the Company s assertions. In September 2009, the Company reached a settlement with two of the respondents, and in December 2009, the Company reached a settlement with five additional respondents. In March 2010, the Company reached a settlement with respondent Fuji Machine Manufacturing Co., Ltd. and its subsidiary Fuji America Corporation. These settlements did not have a material impact on the Company s financial results. An ITC hearing was held in May 2010. In July 2010, the Administrative Law Judge issued an initial determination finding two of the Company s patents invalid and that respondents did not infringe the patents-at-issue. In September 2010, the Commission issued a notice that it would review the initial determination of the Administrative Law Judge. The Final Determination of the Commission is scheduled for November 16, 2010. The Company intends to challenge any adverse decision by the ITC in an appeal before the Federal Circuit.

The Company cannot predict the outcome of the above-referenced pending matters and an adverse resolution of these lawsuits could have a material adverse effect on the Company s financial position, liquidity, results of operations, and/or indemnification obligations. In addition, various other claims and legal proceedings generally incidental to the normal course of business are pending or threatened on behalf of or against the Company. While we cannot predict the outcome of these incidental matters, we believe that any liability arising from them will not have a material adverse effect on our financial position, liquidity, or results of operations.

ITEM 1A. RISK FACTORS

For a complete list of factors that could affect the Company s business, results of operations, and financial condition, see the risk factors discussion provided in Part I Item 1A of the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2009.

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

The following table sets forth information with respect to purchases by the Company of shares of its Common Stock during the periods indicated.

	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
July 5 August 1, 2010	-	-	-	$ 30,000,000
August 2 August 29, 2010	-	-	-	$ 30,000,000
August 30 October 3, 2010	-	-	-	$ 30,000,000
Total	-	-	-	$ 30,000,000

(1) In April 2008, the Company s Board of Directors authorized the repurchase of up to $50,000,000 of the Company s common stock.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. REMOVED AND RESERVED

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934*

31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934*

32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

101 xBRL (Extensive Business Reporting Language)

The following materials from Cognex Corporation s Quarterly Report on Form 10-Q for the period ended October 3, 2010, formatted in xBRL: (i) Consolidated Statements of Operations for the three-month and nine-month periods ended October 3, 2010 and October 4, 2009; (ii) Consolidated Balance Sheets as of October 3, 2010 and December 31, 2009; (iii) Consolidated Statement of Shareholders Equity and Comprehensive Income for the nine-month period ended October 3, 2010; (iv) Consolidated Condensed Statements of Cash Flows for the nine-month

periods ended October 3, 2010 and October 4, 2009; and (v) Notes to Consolidated Financial Statements.

* Filed herewith

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** Furnished herewith
*** Pursuant to Rule 406T of Regulation S-T, the xBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

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SIGNATURES

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

Date: November 1, 2010 COGNEX CORPORATION

By: /s/ Robert J. Shillman

Robert J. Shillman
Chief Executive Officer and Chairman
of the Board of Directors
(duly authorized officer, principal executive officer)

By: /s/ Richard A. Morin

Richard A. Morin
Executive Vice President of Finance, Chief Financial Officer,
and Treasurer
(duly authorized officer, principal financial and accounting officer)

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