NATIONAL INSTRUMENTS CORP /DE/
Form 10-Q
May 05, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended: March 31, 2008 or

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

For the transition period from ________________ to ________________

Commission file number: 0-25426

NATIONAL INSTRUMENTS CORPORATION

(Exact name of registrant as specified in its charter)

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

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

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

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

Large accelerated filer [X] Accelerated filer [ ] Non-accelerated filer [ ] Smaller reporting company [ ]

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

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

Class	**Outstanding at May 2, 2008**
Common Stock - $0.01 par value	78,354,810

NATIONAL INSTRUMENTS CORPORATION

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PART I - FINANCIAL INFORMATION

ITEM 1. ***Financial Statements***

NATIONAL INSTRUMENTS CORPORATION

CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

	March 31,	**December 31,**
	2008	**2007**
Assets	(unaudited)	
Current assets:		
Cash and cash equivalents	$ 205,865	$ 194,839
Short-term investments	31,791	93,838
Accounts receivable, net	128,595	131,282
Inventories, net	89,879	82,675
Prepaid expenses and other current assets	29,846	23,312
Deferred income taxes, net	20,780	19,264
Total current assets	506,756	545,210
Long-term investments	8,477	—
Property and equipment, net	152,694	151,462
Goodwill, net	65,375	54,111
Intangible assets, net	44,415	40,357
Other long-term assets	28,578	27,672
Total assets	$ 806,295	$ 818,812
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 41,765	$ 36,187
Accrued compensation	23,633	25,778
Deferred revenue	39,665	36,091
Accrued expenses and other liabilities	13,942	10,437
Other taxes payable	13,908	16,843
Total current liabilities	132,913	125,336
Deferred income taxes	22,273	21,221
Other long-term liabilities	11,471	11,169
Total liabilities	166,657	157,726
Commitments and contingencies		
Stockholders' equity:		
Preferred stock: par value $0.01; 5,000,000 shares authorized; none issued and outstanding		

	—		—
Common stock: par value $0.01; 180,000,000 shares authorized; 78,163,288 and 79,405,359 shares issued and outstanding, respectively	781		794
Additional paid-in capital	56,234		89,809
Retained earnings	572,317		563,418
Accumulated other comprehensive income (loss)	10,306	7,065	
Total stockholders' equity	639,638		661,086
Total liabilities and stockholders’ equity	$ 806,295		$ 818,812

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

NATIONAL INSTRUMENTS CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share data)

(unaudited)

	Three Months Ended March 31,	
	2008	**2007**
Net sales	$ 192,918	$ 171,641
Cost of sales	48,247	42,148
Gross profit	144,671	129,493
Operating expenses:		
Sales and marketing	74,339	63,580
Research and development	35,604	29,236
General and administrative	16,663	14,575
Total operating expenses	126,606	107,391
Operating income	18,065	22,102
Other income (expense):		
Interest income	2,137	2,236
Net foreign exchange gain (loss)	1,548	189
Other income (expense), net	61	(106)
Income before income taxes	21,811	24,421
Provision for income taxes	4,195	5,372
Net income	$ 17,616	$ 19,049
Basic earnings per share	$ 0.22	$ 0.24
Weighted average shares outstanding – basic	78,840	79,842
Diluted earnings per share	$ 0.22	$ 0.23
Weighted average shares outstanding – diluted	79,825	81,232
Dividends declared per share	$ 0.11	$ 0.07

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

NATIONAL INSTRUMENTS CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Three Months Ended March 31, 2008	2007
Cash flow from operating activities:		
Net income	$ 17,616	$ 19,049
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	10,675	9,371
Stock-based compensation	4,739	3,732
Benefit from deferred income taxes	(2,711)	(741)
Tax benefit from stock option plans	(161)	(1,395)
Changes in operating assets and liabilities:		
Accounts receivable	5,112	6,837
Inventories	(7,099)	76
Prepaid expenses and other assets	(5,677)	(6,793)
Accounts payable	5,241	820
Deferred revenue	3,574	2,150
Taxes and other liabilities	(867)	(2,613)
Net cash provided by operating activities	30,442	30,493
Cash flow from investing activities:		
Capital expenditures	(5,051)	(6,216)
Capitalization of internally developed software	(1,528)	(2,452)
Additions to other intangibles	(431)	(3,602)
Acquisition, net of cash received	(17,055)	—
Purchases of short-term and long-term investments	(12,638)	(23,408)
Sales and maturities of short-term and long-term investments	66,208	65,829
Purchases of foreign currency option contracts	(1,481)	—
Net cash provided by investing activities	28,024	30,151
Cash flow from financing activities:		
Proceeds from issuance of common stock	10,197	9,824
Repurchase of common stock	(49,081)	(29,242)
Dividends paid	(8,717)	(5,592)
Tax benefit from stock option plans	161	1,395
Net cash (used in) financing activities	(47,440)	(23,615)
Net change in cash and cash equivalents	11,026	37,029
Cash and cash equivalents at beginning of period	194,839	100,287

Cash and cash equivalents at end of period	$ 205,865	$ 137,316

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

NATIONAL INSTRUMENTS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – Basis of Presentation

The accompanying unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2007 included in our annual report on Form 10-K, filed with the Securities and Exchange Commission. In our opinion, the accompanying consolidated financial statements reflect all adjustments (consisting only of normal recurring items) considered necessary to present fairly our financial position at March 31, 2008 and December 31, 2007, and the results of our operations and cash flows for the three-month periods ended March 31, 2008 and March 31, 2007. Operating results for the three-month period ended March 31, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008.

NOTE 2 – Earnings Per Share

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

The reconciliation of the denominators used to calculate basic EPS and diluted EPS for the three-month periods ended March 31, 2008 and 2007, respectively, are as follows (in thousands):

	March 31, (unaudited)	
	2008	**2007**
Weighted average shares outstanding-basic	78,840	79,842
Plus: Common share equivalents		
Stock options, restricted stock units	985	1,390
Weighted average shares outstanding-diluted	79,825	81,232

Stock options to acquire 2,877,000 and 3,314,000 shares for the three months ended March 31, 2008 and 2007, respectively, were excluded in the computations of diluted EPS because the effect of including the stock options would have been anti-dilutive.

NOTE 3 – Fair Value Measurements

Effective January 1, 2008, we adopted SFAS 157, Fair Value Measurements (SFAS 157). SFAS 157 clarifies the definition of fair value, prescribes methods for measuring fair value, establishes a fair value hierarchy based on the inputs used to measure fair value and expands disclosures about the use of fair value measurements. In accordance with Financial Accounting Standards Board Staff Position FAS 157-2, Effective Date of FASB Statement No. 157 (FSP 157-2), we will defer the adoption of SFAS No. 157 for our nonfinancial assets and nonfinancial liabilities, except those items recognized or disclosed at fair value on an annual or more frequently recurring basis, until January 1, 2009. The adoption of SFAS No. 157 did not have a material impact on our fair value measurements.

The following tables present our assets and liabilities that are measured at fair value on a recurring basis and are categorized using the fair value hierarchy. The fair value hierarchy has three levels based on the reliability of the inputs used to determine fair value.

Description	March 31, 2008	Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Money Market Funds	$ 118,589	$ 118,589	$ —	$ —
Short-term investments available for sale	31,791	31,791	—	—
Long-term investments available for sale	8,477	—	—	8,477
Derivatives	2,623	—	2,623	—
Total Assets	$ 161,479	$ 150,380	$ 2,623	$ 8,477
Liabilities				
Derivatives	$ (3,825)	$ —	$ (3,825)	$ —
Total Liabilities	$ (3,825)	$ —	$ (3,825)	$ —

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Long-term investments available for sale
Beginning Balance	$ —
Total gains or (losses) (realized/unrealized)	
Included in earnings	—
Included in other comprehensive income	(123)
Purchases, issuances and settlements	—
Transfer in and/or out of Level 3	8,600
Ending Balance	$ 8,477
The amount of total gains or (losses) for the period included in earnings (or changes in net assets) attributable to the change in unrealized gains or losses relating to assets still held at the reporting date	$ —

Short-term investments available for sale are valued using a market approach based on the quoted market prices of identical instruments when available or other observable inputs such as trading prices of identical instruments in inactive markets.

Derivatives include foreign currency forward and option contracts. Our foreign currency forward contracts are valued using an income approach based on the spot rate less the contract rate multiplied by the notional amount. Our foreign currency option contracts are valued using a market approach based on the quoted market prices which are derived from observable inputs including current and future spot rates, interest rate spreads as well as quoted market prices of identical instruments.

Marketable securities reported using significant unobservable inputs (Level 3) are comprised of auction rate securities and are valued using discounted cash flow models which take into account market indexes for risk free rates of return, market rates of return for like securities as well as management judgment regarding the temporary illiquidity of the auction rate security market, the credit rating of the underlying securities, government guarantees where applicable and call features where applicable.

The securities transferred into Level 3 during the three months ended March 31, 2008, were transferred in at their fair market value at the beginning of the period. We have historically reported the fair market value of these securities at par as any differences between par value and the purchase price or settlement value have historically been comprised of accrued interest. At March 31, 2008 we have recorded the unrealized loss related to these securities as a component of other comprehensive income as we have determined that the impairment is primarily driven by the temporary illiquidity of the Auction Rate Securities market, the fact that these securities have redemption features which call for redemption at 100% of par value, the fact that the underlying debt continues to carry Aaa/AAA/AA and the fact that we have the ability and intent to hold these securities to maturity. Due to the temporary illiquidity of the Auction Rate Securities market, we have also reclassified these securities from short-term to long-term as of March 31, 2008.

NOTE 4 – Inventories

Inventories, net consist of the following (in thousands):

	March 31, (unaudited) 2008	**December 31, 2007**
Raw materials	$ 39,016	$ 40,521
Work-in-process	3,996	3,511
Finished goods	46,867	38,643
	$ 89,879	$ 82,675

NOTE 5 – Intangibles

Intangibles at March 31, 2008 and December 31, 2007 are as follows:

	March 31, 2008 (unaudited)			December 31, 2007		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Capitalized software development costs	$ 67,362	$ (53,206)	$ 14,156	$ 65,834	$ (50,722)	$ 15,112
Acquired technology	26,656	(14,133)	12,523	21,228	(12,976)	8,252
Patents	15,008	(3,969)	11,039	14,598	(3,789)	10,809
Leasehold equipment and other	11,801	(5,104)	6,697	10,919	(4,735)	6,184
	$ 120,827	$ (76,412)	$ 44,415	$ 112,579	$ (72,222)	$ 40,357

During the three months ended March 31, 2008, we acquired all of the outstanding shares of microLEX which included $5.2 million of acquired core technology. (See Note 12 of Notes to Consolidated Financial Statements).

Software development costs capitalized for the three months ended March 31, 2008 and March 31, 2007 were $1.5 million and $2.5 million, respectively. Capitalized software amortization expense was $2.5 million and $2.1 million for the three months ended March 31, 2008 and March 31, 2007, respectively. Amortization of capitalized software development costs is computed on an individual product basis for those products available for market and is recognized based on the product's estimated economic life, generally three years. Patents are amortized using the straight-line method over their estimated period of benefit, generally ten to seventeen years. Total intangible assets amortization expenses were $3.9 million and $3.4 million for the three months ended March 31, 2008 and March 31, 2007, respectively.

Acquired core technology and intangible assets are amortized over their useful lives, which range from three to eight years. Amortization expense for intangible assets acquired was approximately $1.0 million and $797,000 for the three months ended March 31, 2008 and March 31, 2007, respectively, of which approximately $850,000 and $677,000 was recorded in cost of sales for the three months ended March 31, 2008 and March 31, 2007, respectively, and approximately $150,000 and $120,000 was recorded in operating expenses for the three months ended March 31, 2008 and March 31, 2007, respectively. The estimated amortization expense of intangible assets acquired for the current fiscal year and in future years will be recorded in the consolidated statements of income as follows (in thousands):

Fiscal Year	Cost of Sales	Acquisition related costs and amortization, net	Total
2008	$ 3,485	$ 562	$ 4,047
2009	3,300	502	3,802
2010	2,765	341	3,106
2011	2,121	214	2,335
Thereafter	1,212	206	1,418

Total	$ 12,883	$ 1,825	$ 14,708

NOTE 6 – Goodwill

The carrying amount of goodwill for 2008 is as follows:

	Amount (in thousands)
Balance as of December 31, 2007	$ 54,111
Acquisitions	10,563
Divestitures	--
Foreign currency translation impact	701
Balance as of March 31, 2008	$ 65,375

During the three months ended March 31, 2008, we acquired all of the outstanding shares of microLEX which included $10.6 million of goodwill. (See Note 12 of Notes to Consolidated Financial Statements).

The excess purchase price over the fair value of assets acquired is recorded as goodwill. In accordance with SFAS 142, *Goodwill and Other Intangible Assets*, goodwill is tested for impairment on an annual basis, and between annual tests if indicators of potential impairment exist, using a fair-value-based approach. Our annual impairment test was performed as of February 28, 2008. No impairment of goodwill has been identified during the period presented. Goodwill is deductible for tax purposes in certain jurisdictions.

NOTE 7 – Income Taxes

In July 2006, the Financial Accounting Standards Board (“FASB”) issued FASB Interpretation (“FIN”) 48, *Accounting for Uncertainty in Income Taxes – an interpretation of Statement of Financial Accounting Standards (“SFAS”) 109*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity’s financial statements and prescribes a recognition threshold and measurement attribute for financial statement disclosure of tax positions taken or expected to be taken on a tax return. We had $5.1 million of unrecognized tax benefits at March 31, 2007 and $8.7 million at March 31, 2008, all of which would affect our effective income tax rate if recognized. As of March 31, 2008, it is deemed reasonable that we will recognize tax benefits in the amount of $1.2 million in the next twelve months due to the closing of open tax years. The nature of the uncertainty related to deductions taken on returns that have not been examined by the applicable tax authority. Our continuing policy is to recognize interest and penalties related to income tax matters in income tax expense. As of March 31, 2008, we have approximately $462,000 accrued for interest related to uncertain tax positions. We recognized no material adjustment to the liability for unrecognized income tax benefits. The tax years 2001 through 2007 remain open to examination by the major taxing jurisdictions to which we are subject.

Our provision for income taxes reflects an effective tax rate of 19% for the three months ended March 31, 2008 and 22% for the three months ended March 31, 2007. For the three months ended March 31, 2007, our effective tax rate was lower than the U.S. federal statutory rate of 35% primarily as a result of the research credit, tax exempt interest and reduced tax rates in certain foreign jurisdictions. For the three months ended March 31, 2008, our effective tax rate is lower than the U.S. federal statutory rate of 35% primarily as a result of tax exempt interest and reduced tax rates in certain foreign jurisdictions. The decrease in our tax rate for the three months ended March 31, 2008 is due to increased profits in foreign jurisdictions with reduced income tax rates.

NOTE 8 – Comprehensive Income

Our comprehensive income is comprised of net income, foreign currency translation and unrealized gains and losses on forward and option contracts and securities available for sale. Comprehensive income for the three-month periods ended March 31, 2008 and March 31, 2007 was as follows (in thousands):

	Three Months Ended March 31, (unaudited)	
	2008	**2007**
Comprehensive income:		
Net income	$ 17,616	$ 19,049
Foreign currency translation gains	5,703	446

Unrealized losses on derivative instruments	(2,107)	(46)
Unrealized gains (losses) on available for sale securities	(355)	(43)
Total comprehensive income	$ 20,857	$ 19,406

NOTE 9 – Stock-Based Compensation Plans

Stock option plans

Our stockholders approved the 1994 Incentive Stock Option Plan (the "1994 Plan") on May 9, 1994. At the time of approval, 9,112,500 shares of our common stock were reserved for issuance under this plan. In 1997, an additional 7,087,500 shares of our common stock were reserved for issuance under this plan, and an additional 750,000 shares were reserved for issuance under this plan, as amended, in 2004. The 1994 Plan terminated in May 2005, except with respect to outstanding awards previously granted thereunder. Awards under the plan were either incentive stock options within the meaning of Section 422 of the Internal Revenue Code or nonqualified options. The right to purchase shares vests over a five to ten-year period, beginning on the date of grant. Vesting of ten year awards may accelerate based on the Company's previous year's earnings and growth but shares cannot accelerate to vest over a period less than five years. Stock options must be exercised within ten years from date of grant. Stock options were issued at the market price at the grant date. As part of the requirements of SFAS 123R, the Company is required to estimate potential forfeitures of stock grants and adjust compensation cost recorded accordingly. The estimate of forfeitures will be adjusted over the requisite service period to the extent that actual forfeitures differ, or are expected to differ, from such estimates. Changes in estimated forfeitures will be recognized through a cumulative catch-up adjustment in the period of change and will also impact the amount of stock compensation expense to be recognized in future periods.

Transactions under all stock option plans are summarized as follows:

	Number of shares under option	**Weighted average Exercise price**
Outstanding at December 31, 2007	5,294,641	$ 24.47
Exercised	(439,134)	15.42
Canceled	(24,762)	23.78
Granted	—	—
Outstanding at March 31, 2008	4,830,745	$ 25.30

The aggregate intrinsic value of stock options at exercise, represented in the table above, was $4.9 million for the three months ended March 31, 2008. Total unrecognized stock-based compensation expense related to non-vested stock options was approximately $9.9 million as of March 31, 2008, related to approximately 742,000 shares with a per share weighted average fair value of $16.19. We anticipate this expense to be recognized over a weighted average period of approximately 3.4 years.

Outstanding and Exercisable by Price Range as of March 31, 2008

Options Outstanding **Options Exercisable**

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