

**Cognex Second Quarter 2018 Earnings Conference Call**  
**July-30-2018**  
**Confirmation #13680912**

Operator: Greetings and welcome to Cognex Second Quarter 2018 Earnings Conference Call. At this time, all participants are in a listen-only mode. A question and answer session will follow the formal presentation. If anyone should require operator assistance during the conference, press star-zero on your telephone keypad. As a reminder, this conference is being recorded.

I would now like to turn the conference over your host, John Curran, Senior Vice President and Chief Financial Officer. Please go ahead.

John Curran: Thank you, and good evening, everyone. I'm John Curran, Cognex's CFO, and I would like to welcome you to our second quarter earnings conference call. With me on today's call are Dr. Bob Shillman, Cognex's Chairman, and Rob Willett, Cognex's President and CEO.

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Please note that our earnings release and Form 10-Q are available on the Cognex website at [www.cognex.com](http://www.cognex.com). Both documents contain detailed information about our financial results.

During the call, we may use a non-GAAP financial measure if we believe it is useful to investors or if we believe it will help investors better understand our results or business trends. You can see a reconciliation of certain items from GAAP to non-GAAP in Exhibit 2 of the earnings release.

Any forward-looking statements we made in the earnings release or any that we may make during this call are based upon information that we believe to be true as of today. Things can change, however, and actual results may differ materially from those projected or anticipated. You should refer to our SEC filings, including our most recent Form 10-K, for a detailed list of these risk factors.

With that, I will now turn the call over to Dr. Bob.

Bob Shillman: Thanks, John. And hello everyone, and thank all of you for joining us today. Cognex reported rather good results for the second quarter of 2018. In fact, our revenue for this Q2 was the second highest of any quarter in our company's 37 year history. And operating margin was 30%, which is in line with our long term target.

The underlying business trends in the broad factory automation market continue to be strong. Excluding consumer electronics, revenue in Q2 grew at a rate that was well above our long term target of 20%.

I'm now going to turn the call over to my partner, Rob Willett, who will provide more details. And I'll be available at the end of the call for any questions that you may have for me. Rob, the microphone is yours.

Rob Willett: Thank you, Dr. Bob, and good evening, everyone. Revenue in Q2 was \$211 million, representing year-on-year growth of 19% and landing slightly over the top end of our guidance. We performed well across most end markets, led by logistics and automotive. Our investments in new product development and sales force expansion continue to deliver share gains for Cognex across most of our served markets.

Strength in our broader factory automation market is obscured this year by lower spending on vision by major OLED display and smartphone manufacturers following substantial investments last year. Despite this, our very positive view of Cognex's long term growth prospects remains unchanged. Positive drivers, including rising labor costs around the world, the need for increased productivity and improvements in product quality, and of course the manufacture of

products too small for to assemble by human hand are all increasingly investments in machine vision.

We see the fastest growth rates among our smaller, newer markets such as consumer products and food, which are increasingly adding Cognex Vision and ID to improve product quality and increase productivity. We are able to satisfy these needs both by increasing the ease of use and integration of our products, as well as by adding sales Noids to reach an ever-broader set of machine vision customers.

Regarding new products, we're pleased to report good progress in integrating technology from our recent acquisitions into Cognex's standard products. Deep learning-based image analysis software from ViDi Systems is now accessible through our Vision Pro platform. This enables sophisticated customers to more easily leverage deep learning technology together with our industry-leading vision tools. We are pleased to report that we have just received our first million dollar purchase order for our deep learning vision software, and we are working on its application at many other leading manufacturers.

The barcode verification capabilities we acquired from Webscan are now available on our DataMan ID platform. We are seeing broad-based demand for code verifiers. Grading and

verification is becoming increasingly important as manufacturers seek to implement a consistent quality of ID codes across their widely distributed supply chains.

In other news, we received our first large purchase order for mobile terminals of approximately \$1 million from a Fortune 100 company. While we are still at the beginning of our journey into the mobile terminal market, this year's addition of our long range MX-1502 ER product has noticeably strengthened our position.

I'll now turn the call over to John for some financial details from the second quarter.

John Curran: Thank you, Rob. As noted last quarter, our Q2 earnings release and all discussions reflect the retroactive adoption of the new revenue standard that took effect on January 1st. As a reminder, the sale of certain accessories that we historically reported on a net basis are now reported on a gross basis. This does not change our gross margin dollars, but our gross margin percentage is decreased from historical rates by 100 to 200 basis points.

Now for our Q2 highlights. As mentioned, Q2 revenue was \$211 million, an increase of 19% year-on-year. Gross margin was 74% compared to 76% in the year ago period. This decrease is primarily due to an increase in revenue related to application specific customer solutions.

These solutions typically have lower gross margins due to the engineering effort required to develop the solution as well as services associated with the installation and support.

Operating expenses totaled \$94 million for the second quarter, an increase of 23% year-on-year. It's worth noting that the rate of expense growth is slowing, but we expect to continue to invest in critical areas to support the long term growth opportunities we see for our business.

Incremental spending in Q2 came from new hires and increased activity in sales and engineering. In terms of headcount, we now have nearly 2,000 Cognoids worldwide, an increase of 26% over a year ago.

Operating margin in Q2 was 30%, an increase of 10 percentage points compared to Q1 of 2018, but a decrease of 4 percentage points when compared to Q2 of 2017. The year-over-year change is mainly a reflection of our record-breaking performance last year along with our continued investments in engineering and sales.

Our tax rate, excluding discrete items, was 17% for the quarter compared to 15% in Q1 of 2018 and 18% in Q2 of 2017. We have increased our tax rate for 2018 to 16%, reflecting our expectation that more of the company's profits will be earned and taxed in a higher tax

jurisdiction than previously expected. Excluding discrete tax adjustments, we reported earnings of \$0.31 per share for Q2 of 2018 compared to \$0.28 in Q2 of last year.

Looking at revenue year-on-year from a geographic perspective, overall market conditions were strong. Greater China led the way in percentage growth as revenue grew more than 50% year-on-year. Demand was strong in automotive and in the broad electronics supply chain.

Revenue from the Americas grew by more than 20% over Q2 of '17. Similar to Q1, growth was particularly strong in the logistics market as well as other industry verticals including automotive, food, and consumer products.

Europe increased mid single digits in constant currency. Strength in the broad factory automation market led by logistics, automotive, and consumer products was partially offset by lower large order revenue from consumer electronics.

Revenue from other Asia region decreased mid single digits on a percentage basis from Q2 of 2017, reflecting lower spending by customers in OLED display manufacturing.

Our balance sheet remains in great shape, as we exited the quarter with \$755 million in cash and investments and no debt. We have sufficient capital to support our organic growth

objectives, M&A plans, and for returning capital to our investors through stock buybacks and dividends.

In Q2, we bought back 1.1 million shares. We plan to continue to buy back stock in Q3 subject to market conditions and other factors. As announced tonight, our Board of Directors declared a cash dividend of \$0.045 per share payable on August 31st to all shareholders of record as of August 17th.

With that, I will now turn the call back to Rob.

Rob Willett: Thanks, John. Turning to guidance for the third quarter, we expect revenue of between \$220 million and \$230 million, which at the midpoint represents growth of 7% from Q2. However, if we look year-on-year, this range reflects a substantial decline from an exceptional quarter a year ago when large projects in OLED display and smartphone manufacturing drove revenue to a record level.

Gross margin for Q3 is expect to continue to be in the mid 70% range. Quarterly operating expense growth is expected to continue to moderate year-on-year as we move through the second half of 2018. On a sequential basis, operating expenses are expected to be

approximately flat with Q2. The effective tax rate is expected to be 16% excluding discrete tax items.

In summary, Q2 proved to be the quarter we expected, and we remain confident about our longer term growth opportunities. As such, we will continue to make investments in Cognoids and technology to strengthen our leadership in the global machine vision market.

We'll now open the call to questions. Operator, please go ahead.

Operator: As this time, we will be conducting a question and answer session. During the question and answer session, please limit yourself to one question and one follow up prior to getting back into the queue.

If you would like to ask a question, please press star-one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star-two if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star key. One moment, please, while we poll for questions.

Our first question comes from the line of Joe Giordano with Cowen. Please proceed with your question.

Joe Giordano: Hey, guys, good afternoon.

Rob Willett: Hi, Joe.

John Curran: Hey, Joe.

Joe Giordano: I was wondering, is there a way you can frame the OLED impact on your business this year, or somehow frame the base as we go into next year just so, you know, we'll come--we could figure out what we're--what our expectations are for the end market. But just how much of that is left in your business this year, since it seems like that--you know, that's obviously a different part of your business that's less kind of recurring?

Rob Willett: Yeah. Hi, Joe. It's Rob. I'll--yeah, I'll make a few comments to try to help you with that. So, while investment in OLED manufacturing capacity has slowed this year, we continue to be positive about the long term prospects for OLED and the contribution that machine vision and Cognex will play in OLED manufacturing.

The largest manufacturers with whom we work in our other Asia region have paused their investment in machine vision with respect to OLED displays for smartphones after record levels in 2017. And you can really see that if you look at the regional breakdown in the 10-Q, where, you know, what has been our fastest growing region actually shrank in the second quarter, so you can see a pretty substantial impact there localized to that region.

I think we all know that investments in new technologies like OLED displays tend to come in phases. It appears that investments in capacity obviously addition to lower this year, and we think they'll be up over the three years. It's very hard to make a call, though, about next year at this point. And obviously we don't give guidance out beyond a quarter, so your question about, you know, what would it be next year is difficult.

We think we have clear technical advantages in OLED manufacturing. We're very well positioned to see pickup in the business when capital investment returns into that sector. And then I would say this. I think OLED drove more than \$20 million of growth for Cognex in 2017. And if you include its influence over the other areas of electronics, obviously it was multiples of that. But if you really talk about OLED material, that would be the case. And the negative impact to this year was mostly on our other Asia region and in the first half.

Joe Giordano: Okay, that's very helpful.

Then when I look at--you know, I'm not asking to--again, for guidance into next year, but when I think about the spending patterns you've had, if we just assume that 2019 is like a normalized growth year for Cognex according to your longer term growth rates that you expect, do you feel that you've spent ahead of that, or would we require kind of like another move higher in OpEx to kind of support that level of growth?

Rob Willett: Yeah, I think we're managing the company for the long term, right? So, I'd say we were kind of behind, you know, in investments we needed for the long term growth of the business, you know, so we found ourselves spending to catch up with that.

I think in the long term, though, you know, we expect, you know, expenses to grow at a lower rate than revenue. And then we'll kind of adjust expense growth based on how much growth or lack of growth we see in certain areas in the shorter term.

Joe Giordano: Okay, I'll leave it there and I'll jump back in queue. Thanks.

Rob Willett: Thank you, Joe.

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Operator: Our next question comes from the line of Joe Ritchie with Goldman Sachs. Please proceed with your question.

Joe Ritchie: Thank you. Good afternoon, everyone.

Rob Willett: Hi, Joe.

Joe Ritchie: Hey, Rob, maybe you can touch on this whole concept of, you know, application specific customer solutions, the impact that that's having to your gross margins. And if you could provide any color on the--you know, maybe some examples, specific end markets where this is occurring, that would be helpful.

Rob Willett: Yes, I think I can help with that. So, at Cognex we provide a higher level of support to those companies that offer large potential and require extra help deploying machine vision as part of their current automation plans. And we have an advanced engineering team, or we have many advanced engineers, who work closely with influential customers helping them install and apply our capabilities to improve the performance of their processes.

This is not something we do for most customers. This is something we do for a select group of very sophisticated high potential customers, and they tend to be in our major industries. We

do it significantly in consumer electronics. We do it in automotive and, increasingly, in logistics as that business grows and these capabilities help us unlock the potential that we see.

Now, our high level of support can influence gross margin in the near term, and we see it as an investment at the future. We don't think in the long term, you know, it's a factor that affects the overall gross margin profile of the company.

Joe Ritchie: That's helpful, Rob.

And maybe as my follow-on question, you know, obviously China, you know, growing a lot this quarter. I think you--I think I heard earlier up 65%. I--you know, how are you guys thinking about, you know, all of what's happening in the background from a trade war perspective and how that potentially impacts your business?

Rob Willett: Right. So, I mean, you're right that Greater China continues to be the region where revenue for us is growing fastest. And our business in China is really quite diverse in terms of end user markets. Of course, consumer electronics is large, but--you know, but automotive is substantial and consumer products are also substantial. You know, just in the last quarter, automotive in Greater China increased at the fastest rate of our major geographic regions.

So, yeah, I think we remain very positive about the long term growth prospects for machine vision in the China market based on all the kind of mega issues that are going on there in terms of labor costs rising fast, productivity not keeping pace with cost, the population being squeezed in terms of people going into the workforce versus those leaving. So, I think in the long term we remain positive.

Now, you asked about kind of the noise that we hear in--you know, from, you know, governments and trade wars. You know, we're watching that situation very carefully, but currently we don't see much or any impact on our business than what we currently see. And, you know, certainly our product that we sell in China is manufactured outside of the U.S., so it's not as if, you know, that's necessarily on the first kind of line of fire for any trade stuff that would be going on.

But, of course, I think the second order effects as it relates to customers and changes in markets are things that we're watching carefully. But in some cases, you know, in terms of automotive production, it may mean fewer cars coming into the country, which may benefit our--the investments in our technology inside the country.

So, all that to say we're positive about China. We're very positive about the long term effects. Our business is doing well there. We don't see short--any short term impact based on what we're reading in the news. We're watching very carefully.

Joe Ritchie: Helpful; thank you.

Operator: Our next question comes from the line of Jairam Nathan with Daiwa Securities. Please proceed with your question.

Jairam Nathan: Hi. Thanks for taking my question. I--just with regard to the mobile terminal order, can you give us an idea of what end market did that--did you get the order from?

Rob Willett: Yes, hi. So, our progress in the mobile terminal market is kind of similar to other markets like logistics, 3D, life sciences. So, we're very--we're still very early on.

We have what we think and what our customers seem to think is a highly technically advantaged product, and we continue to be enthusiastic. Most of our business today is sort of small orders with customers that are starting to explore our technology. And we think if--we're encouraged by that activity.

Your question was specifically about the large order we received, so it was a--from a Fortune 100 company, and it's going to use our mobile terminals to track its product through the production process, the supply chain, and ultimately in its delivery to retail locations. Now, that's about as much as I can say. And I don't want to be--say more for--mostly for competitive reasons, but also we don't talk specifically about customers. But I would say, you know, we're encouraged, but it's still early stages in that market.

Jairam Nathan: Okay.

And just as a follow up, with regard to R&D, we did see an increase in the first quarter and then a decline now. Certainly you talked about some large projects. So, should we kind of--should we think of the--like, the base kind of to be at these levels on the RD&E side?

Rob Willett: Well, I think, you know, R&D expense, you know, can be a little bit lumpy. Sometimes it's all--also can dispend--can depend on some of the application specific work we're doing in support of growth. I think we saw probably more of that hitting the expense line in Q2--in Q1, I'm sorry, and more of it hitting the gross margin line in Q2.

I think I would say that our R&D plans are long term in nature, you know, and we're targeting, you know, between 10 and 15%, last year roughly 13% or \$100 million. And we're confident about where we're going, and we continue to spend on a--on R&D and our technology.

So, I think, you know, beyond that, I wouldn't say there's a change in our overall spending, a little bit of a pattern between Q1 where more is going in expenses and Q2 where more was going against gross margin. And I would imagine in Q3 we'd probably see more going against gross margin.

Jairam Nathan: Okay.

And just quickly on R&D, do you get reimbursed from the customer sometimes, like in the autos? Some of the auto companies reimburse R&D.

Rob Willett: Yeah, as a rule, no. I mean, it has happened on occasion with Cognex, but we prefer not to do that.

Jairam Nathan: Okay. Thank you. Thanks a lot.

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Operator: Again, if you would like to ask a question, please press star-one on your telephone keypad. Again, if you would like to ask a question, please press star-one on your telephone keypad.

Our next question comes from the line of Rob Mason with Robert W. Baird. Please proceed with your question.

Rob Mason: Yes, good afternoon.

Rob Willett: Hi, Rob.

Rob Mason: Rob, could you just address the product ID business? I know we've had a long stated kind of 30% growth target on that business over and above, you know, your 20% larger target. It sounds from the commentary that it's reasonable to assume logistics continues to grow at its 50% clip. So, maybe that's question one.

And then just for the balance of that ID business, could you speak to the growth rate there with respect to the 30% target and perhaps what is driving it beyond logistics?

Rob Willett: Right. Yes. Hi, Rob. So, you're right. We're seeing very strong growth in the logistics business, and that continues. We've said and I would reiterate that we think logistics is--you know, continues to be a great market for Cognex. And it's a business that is growing and we expect to continue to grow at 50% over the long term.

In terms of the ID business overall, you know, it's been a major contributor to Cognex's growth for many, many years now, and it continues to be. In terms of recent growth rates, I think if we strip out consumer electronics because, again, that can be a bit of a confusing factor, we continue to see growth rate in ID which is in excess of the company's overall growth rate, right, so certainly, you know, in the 20% plus range. We add logistics on top of that, we get north of the 30% target that we have long talked about.

Rob Mason: Could you just assess perhaps the seasonality, the seasonal impact of how logistics business may flow this year? I know in the past the fourth quarter can sometimes be stronger than others for logistics, but maybe how that is shaping up this year.

Rob Willett: Right. It's still a relatively kind of new market for us. And it's a market that's changing so it's a little difficult to do.

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I would expect our Q1, you know, revenue rate to be the lowest overall. And then Q4 can be a little bit difficult to call because it depends on how much automation is deployed earlier before kind of ramp up around, you know, Thanksgiving and Christmas and all of that, or how much gets recorded in Q3 versus Q4. But I would say Q1 the lowest and Q2, 3, and 4 potentially all strong quarters for logistics.

Rob Mason: Okay.

And maybe just an update then as well. You commented last quarter that you expected Q2 through 4Q revenue to be flattish versus 2017. Any update on that pattern?

Rob Willett: Well, I would say those remarks were particularly targeted to the impact of the OLED and smartphone business. But I think how I'd add to that is, you know, we took the kind of unusual step of--when we released Q1 earnings of talking about the year overall. And we're--you know, we're not going to be giving guidance to Q4 now, right?

That said, you know, I think the--our underlying business performed--seems to be performing quite strongly, and our view of the smartphone OLED challenge that we face hasn't really changed since the last quarter. We believe that, you know, revenue will increase year-on-year

in Q4, but that growth will be muted by the large orders a year ago from smartphone manufacturing.

And we're not going to be too specific about the decline in revenue from large customers, but I will say that roughly 15% of their business with us in 2017 was reported in Q4, 15% of the overall OLED smartphone large customer business. So, you can see in Q4, you know, we're expecting growth but we're still facing a bit of headwind from those very large customers we had last year. And we still think we--from what we can see at the moment, although we don't give guidance and it's hard to call the overall trading environment in Q4, we do expect growth and continued good performance from our base business.

Rob Mason: Okay, very good. That's very helpful. I'll hop back in queue. Thank you.

Operator: Our next question comes from the line of Joe Giordano with Cowen. Please proceed with your question.

Joe Giordano: Hey, guys. So, without getting into any big--any specific customers, some of the--one of the large players in the logistics side talked about slowing its investment in square footage growth based on spending patterns of the last couple years. When you think about your business and how broad it is, like, can you kind of frame the sensitivity to large big players

in that logistics market versus a conglomeration of a lot of smaller players and how--you know, what the relative impact could be to your business to certain kind of specific companies?

Rob Willett: Yes. So, your question relates to our overall kind of exposure to logistics and any, you know, speeding up or slowing down of spend in that market. You know, I would say what we hear from our customers tends to be very positive. You know, particularly in the U.S. and in Europe, we see them increasing their spending plans.

Our business is more focused in that market on e-commerce fulfillment, right? That's the bit of the market that's growing fastest. It's the market where we think there's the most innovation. And we have--you know, we have a whole range of customers from very big companies to, you know, much smaller companies in that market.

So, you know, I--and I think we see initial orders from large, very famous retailing names who are really working hard to catch up with some of the big e-commerce players, and they have deep pockets and money to spend. And then we also have, you know, significant business with some very large e-commerce players both in--market leaders in Europe and America who are investing heavily also to maintain their level.

Other things we have going on in that space is the majority of our business is in ID, so really reading barcodes. But increasingly we're seeing interest in other technologies from Cognex in that space to do more things for them.

So, we remain very positive. We don't see anything in the end user market or end user customer profile which gives us cause to think anything else is going to happen in the near term.

Joe Giordano: Okay.

And then last for me, when I look at your inventory and receivable levels, how would you categorize them relative to the pacing of business right now? I mean, just versus the last couple years it seems high, but maybe they were--maybe it was too lean in inventory in the past couple years. So, how do you kind of think about that? Do you expect that to run down, or is this a level that you're comfortable with?

John Curran: Yeah, I think--this is John. Yeah, our inventory we saw come down, certainly off of Q1, which is positive, and we would expect it to come down a bit more in the second half. And that kind of follows our--what we'd call our normal seasonal trend on inventory. So, that's the story on inventory.

Receivables, we're also seeing kind of timing impact of our large customer orders in consumer electronics impact our receivables this quarter. And again, we'd expect it to kind of come down towards the end of the year. That--but that exact timing is still unclear, but by year-end it should be down.

Joe Giordano: Okay. Thank you.

Operator: Our next question comes from the line of Paul Coster with J.P. Morgan. Please proceed with your question.

Paul Chung: Hi. This is Paul Chung on for Coster. Thanks for taking my question. So, just a follow up on the free cash flow question, just do you expect the conversion rate to be pretty similar to, you know, fiscal year '17, '16 averages?

John Curran: The percentage or dollars?

Paul Chung: Percentage, percentage.

John Curran: Yeah. Probably slightly less just given the operating margin impact, but it should be somewhat consistent.

Paul Chung: Okay.

And then just to follow up on the mobile computing front, I know you're starting from kind of a small base. But if you could talk more about the million dollar win in the quarter, did you displace an incumbent? And if so, how did you end up winning that business? Thank you.

Rob Willett: Yep. Hi. You know, I did mention that Fortune 100 company will deploy approximately a million dollars of our mobile terminals to track its product through production process, supply chain, and ultimately delivery to retail locations. You know, we can't really say much more about that from competitive reasons.

I mean, this is a large organization that's been using mobile terminals for a very long time. So, certainly they're well aware of the competitive advantage and the competitive set of mobile terminals and mobile computing. They, like most of our customers, really value the vision capability that our mobile terminal has, and they also really value the operating system and connectivity and the platform of a smartphone in that environment.

So, for those of you who are not familiar with our product, ours is a--our product uses the--all the power of Cognex Vision with an engine on the front of any iOS or Android smartphone that can be integrated into the product. And this really resonates with customers who are moving away from older IT platforms and older products that really were designed for a different age with a lot of Microsoft type operating systems.

So--and we were the only product that really had those vision advantages and capabilities together with this smartphone-based technology in a ruggedized platform. So, those benefits are resonating, and that's why we're winning business. And that certainly was true in the case of this customer.

Paul Chung: Thank you; appreciate it.

Operator: Again, if you would like to ask a question, please press star-one on your telephone keypad. Again, if you would like to ask a question, please press star-one on your telephone keypad.

Our next question comes from the line of Ben Rose with Battle Road Research. Please proceed with your question.

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Ben Rose: Yes, good afternoon. To start off with a question for John, exclusive of electronics, could you maybe speak to any trends that you're seeing in average order size among customers in the various segments that you serve?

John Curran: We haven't seen any change in trends outside of the large orders in consumer electronics.

Ben Rose: Okay.

And in the logistics--excuse me. In the logistics area, I was intrigued, Rob, by your mention of perhaps some newer customers. I sensed in the e-commerce area some, you know, perhaps smaller players, but maybe some newer players. Is it fair to assume that the business outside of the e-commerce giants is growing at a healthy clip?

John Curran: Yes, I think that's a fair assumption, Ben, yeah. You know, Cognex technology is helping to enable a lot of players, increasingly on a global basis. And yeah, we're definitely seeing that business grow quickly. But then among large customers also, we're seeing very healthy take up of our technology as it becomes more established. So, the customer base is broadening and the growth is strong across all areas.

Ben Rose: Okay.

And, sorry, a final question. I know that the food vertical has been a longstanding segment that you've served. But is--and--but I did note that you called it out as having strong performance in the U.S. this past quarter. Is there anything new there to comment on in terms of customer use, or was it perhaps just a function of some large orders for the quarter?

Rob Willett: Yeah. Hi, Ben. Yeah, it's Rob again. I think the uptake of machine vision in food has been a strongly growing and relatively consistent trend over the last few years. Why is it happening?

Well, one is I think food is increasingly coming under scrutiny from regulation about safety. You know, there have been some--I can't remember the name of the act as I'm sitting here, but, you know, a food regulation act in the U.S. that really required much more tracking and tracing of food and products more similar to what we saw in pharmaceuticals over the last, you know, 10 or 15 years. So, that'd definitely be--definitely has been driving the adoption of machine vision. I think it was the North American Food Safety Act a couple of--a couple years back. And we're seeing it regularly being adopted now, so that's driving part of it.

I think the second thing going on is machine vision is just becoming easier to integrate and less expensive. So, we have, you know, now machine vision and ID products that can be relatively easily implemented and demonstrate a quick payback. And that's really taking it away--or beyond the realm of very sophisticated, high performance manufacturing companies in consumer electronics, automotive, and other industries towards, you know, less engineering heavy organizations. But what it is doing is it's really catching on in those markets, and that's happening.

And then the other thing I would point to is we at Cognex have been adding a lot of sales Noids, as we call them. And these are our guys, you know, engineers mostly, we recruit and train and develop. And they're out on the street making many more sales calls per day than we've made in the past because our technology is easier, and they're able to reach other industries.

And that's driving a lot of growth in what have--traditionally have been small industries but are growing now at a faster than fleet average rate. And that would apply certainly to food, but would also apply to other markets like beverages, medical devices, pharmaceuticals, or a lot of other industries.

Ben Rose: Okay, thank you very much. That's very helpful.

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Operator: Our next question comes from the line of Rob Mason with Robert W. Baird. Please proceed with your question.

Rob Mason: Yes, thanks for taking the follow up. Just real quickly, I wanted to circle back to automotive. Rob, I know we came--you came into the year thinking that that sector of your business might grow below the long term average just given the strength that it had last year. And it seems to have surprised you positively, at least through the first half. And frankly, some other discrete automation players had strong years last year in automotive too, and they have seen that business, you know, slow against tougher compares, whereas you have not.

So, I'm just curious what you would attribute the strength to. You seemed to call automotive out in almost all of your regional commentary as well, whether it's the new sales hires or if it's new applications, you know, electric vehicles ramping. There's just--maybe what would be the stronger contributors to that outperformance versus how you came into the year?

Rob Willett: Yes. Hi, Rob. Yeah, I think--so, you're right. We at Cognex expect automotive--which is our second largest industry and accounts for about a quarter of our business overall, we expect that vertical market to grow more slowly than our overall business. And we've kind of said around 10% is what we expect that to do.

And you're right. It's been overachieving that by a good amount this year. Why is that happening? I would say it has to be a very broad number of reasons, as you kind of hinted at. We've--our products are becoming more powerful and easier to use and more competitive. I think--and I think we're being much more recognized by global automotive companies and tier one companies. So, I think that's helping. We've added a lot of salespeople who are more able to penetrate particularly tier one automotive suppliers overall.

And then, you know, there are ongoing trends which probably have more life in them than we perhaps thought, for instance vehicle model changes, you know, phasing out of sedans and increasing of SUVs, the adoption of electric, but I would also say hybrid engines particularly seems like it's got a lot further to run than perhaps we thought. Although we read so much about, all of us, you know, autonomous vehicles and electric vehicles, certainly the major investments still seem to be more in hybrid engines and more energy efficiency engines at the moment.

And then--you know, and then another factor is China. You know, China increased at the fastest rate for automotive of our major geographies. And, you know, it continues to perform very well for us. So, it really is a broad range of issues, Rob, but the trend continues to be good.

Rob Mason: Thank you. That was very helpful.

Operator: Again, if you would like to ask a question, please press star-one on your telephone keypad. Again, if you would like to ask a question, please press star-one on your telephone keypad.

As there are no further questions, I would like to turn the call back over to Dr. Shillman for closing remarks.

Bob Shillman: Thank you very much, Devon; good job, by the way. And I want to thank all of you who have taken your time to call into the call and ask questions. I hope they've been answered appropriately for you.

We look forward to speaking with you next quarter. And until then, the entire team of Cognoids are going to continue to work hard because we believe in work hard, play hard, and moving fast. Good night.

Operator: Ladies and gentlemen, this concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.