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Third Quarter 2018 Earnings Conference Call
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Operator: Greetings and welcome to Cognex Third Quarter 2018 Conference Call. At this time, all participants are in a listen only mode. A brief question and answer session will follow the formal presentation. During the Q&A, please limit yourself to one question and one follow up prior to getting back in the queue.

If anyone should require operator assistance during the conference, please press *0 on your telephone keypad. As a reminder, this conference is being recorded. I would now like to turn the conference over to your host, John Curran, CFO. Thank you. Please begin.

John Curran: Thank you and good evening, everyone. I'm John Curran, Cognex' CFO, and I would like to welcome you to our third quarter earnings conference call. With me on today's call is Rob Willet, Cognex' President and CEO. Dr. Bob Shulman, Cognex' Chairman won't be

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joining us this evening. He sends his regards and he looks forward to talking with you on our next call.

Please note that our earnings release and form 10-Q are available on the Cognex website at www.cognex.com. Both 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 two 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 Rob Willett.

Rob Willet: Thanks, John and hello, everyone. Thank you for joining us today. I am pleased to report our results for the third quarter of 2018. We have a tough comparison to the exceptional record-setting results that we reported in Q3 of 2017.

Other than that comparison, this year's Q3 results were very good. We reported the second best revenue, net income, and EPS from continuing operations in the company's 37-year history. Revenue in Q3 was \$232 million, down 13 percent from last year's record-setting performance and up 10 percent on a sequential basis. It was also slightly above our guidance for the quarter.

Gross margin in Q3 was slightly higher both year on year and sequentially, mainly attributable to a favorable mix towards higher margin products. We continue to invest in sales and engineering for our long-term growth. Although the rate of increase has slowed in recent quarters, we are committed to delivering industry-leading vision and ID products to our growing customer base. We believe that we invest more in industrial machine vision and barcode reading technology than any company in the world and it is that investment that will continue to drive our growth and profitability over the long-term.

In Q3, operating margin expanded on a sequential basis to 34 percent, demonstrating the substantial leverage that incremental revenue has on our business model. During the quarter, Cognex performed well in many and markets. Of course, one significant exception was consumer electronics, which is our largest market. As expected, revenue in Q3 from consumer electronics was substantially below the extraordinary level reported a year ago.

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Excluding consumer-electronics revenue grew in mid single digits year on year. Looking at our performance in our second and third largest markets, revenue from automotive was flat year on year in Q3 after growing much faster than expected in many quarters. Demands softened in our major regions during the summer months. Since then, we have seen a sequential improvement in the Americas and Europe.

In logistics, our Q3 comparisons do not reflect the strength we see for Cognex products. Better viewed on an annual basis, revenue from logistics has grown more than 50 percent in the first 9 months of this year.

At this point in the year, I spend a lot of time in the field with our sales force visiting large customers and prospects to understand their requirements and their plans for automation in 2019 and 2020. This year, I came back more excited than ever about how Cognex machine vision and ID will improve quality and delivery and drive down costs. Many large retailers are now planning to follow the example of the world's largest E retailers in automating their distribution centers. That should mean a lot more business for Cognex in the years to come.

Interest is particularly high for our AI based deep learning vision. Cognex' deep learning vision technology allows manufacturers to perform inspection tasks that were previously very difficult or impossible for rule-based machine vision. Many of our AI customers and are now moving

from trials, where they train our deep learning tools, to factory floor deployment in industries such as medical devices, automotives, and consumer electronics.

The development of our sales force continues to be a critical part of our effort to broaden and grow our business. In the third quarter, we recruited, trained, and equipped many sales noids that will build the capacity we need to drive future growth. We've made good progress increasing the reach of our sales channels to access new and growing markets for machine vision and develop closer ties with customers. I will now turn the call over to John for financial details from the third quarter.

John Curran: Thank you, Rob. As we go through the financials, please note that our results reflect the retroactive written adoption of the new revenue standard that took effect on January first of this year. 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 has decreased from historical rates by one to two percentage points.

Now, for our Q3 highlights. As Rob noted, Q3 revenue was \$232 million, a decrease of 13 percent year on year. This decline is primarily attributable to the exceptional growth we achieved in Q3 of last year across our business, led by consumer electronics.

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Gross margin of 75 percent was up slightly year on year and within our long-term target range.

Operating expenses totaled \$95.5 million for the third quarter, an increase of 10 percent year on year. Our spending was slightly above guidance, mainly due to the higher-than-expected revenue in the quarter. While we continue to be prudent in terms of discretionary spending, investing for the future remains key to our success. This includes maintaining our strong commitment to engineering and the continued expansion and development of our sales team.

Turning to our new ERP system, we successfully implemented SAP in Q3 and used it to close the quarter. There's still more work to be done to fully implement the new system, but we believe it provides an excellent foundation for future growth.

Operating margin in Q3 was 34 percent, an increase of 4 percentage points compared with Q2 of 2018 and driven primarily by the higher revenue level. The eight point decrease in operating margin from a year ago mainly reflects last year's record-breaking revenue in our previously mentioned investments in engineering and sales.

Moving next to taxes, if we exclude discrete items, our tax rate was 16 percent, as expected.

Our discrete items in the quarter fell into three categories with the largest related to the Tax Cut and Jobs Act of 2017. And finalizing, our 2017 tax returns, we recorded a net benefit of \$7.7 million, based on new regulatory guidance for the 2017 Tax Act. We also recorded 2.8

million in benefits associated with the exercise of employee stock option and 1.7 million in benefits primarily related to release of tax reserves.

On a GAAP basis, we reported earnings of \$0.45 per share for Q3 of 2018. This compares with \$0.57 per share in Q3 of last year. Looking at revenue year on year from a geographic perspective, in the Americas, revenue increased over Q3 of 2017 due to growth in several end markets including logistics, automotive, and life sciences. Internationally, revenue declined because of this quarter's substantially lower contribution from consumer electronics.

Lower spending by large customers in OLED display and smartphone manufacturing was most noticeable in Europe and, to a lesser extent, in our other Asia regions. It was partially offset by growth in automotive in other industries. Also impacted by lower OLED smart phone related revenue was our greater China region.

Moving on from the income statement, our balance sheet remains very strong. We exited the quarter with 809 million in cash and investments and no debt. We continue to have sufficient capital to support our organic growth objective, our M&A plans, and for sharing our ongoing success with our shareholders through stock buybacks and dividends. In that regard, we repurchased nearly 400,000 shares of Cognex stock in Q3 and we plan to continue to buy back stock in Q4, subject to market conditions in and other factors.

As announced tonight, the board is authorized a new \$200 million stock repurchase program, which will begin once our current \$150 million plan is completed. About 53 million remains available under the existing plan. Also, our Board of Directors has increased the quarterly tax cash dividend two but \$0.05 per share. This is payable on November 30 to all shareholders of record on November 16. With that, I will turn the call back to Rob.

Rob Willet: Thank you, John. In terms of guidance, we expect that fourth-quarter revenue will be between 180 million and \$190 million. At the midpoint, that range represents a slight increase year on year. We expect a \$15 million headwind from last year's high level of investment and OLED display and smartphone manufacturing. We will be glad to have those tough comparisons behind us as we move into next year.

Excluding this OLED smartphone reduction, we expect year on year growth in Q4 of approximately 10 percent. That's slower than we'd like due to softness we are seeing in China where customers are becoming more cautious and slowing their spending plans. Gross margin for Q4 is expected to continue to be in the mid 70 percent range and lower than we reported tonight of Q3. Operating expenses are expected to be roughly flat on a sequential basis.

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Lastly, we expect the effective tax rate will be 16 percent, excluding discrete tax items. We will now open the call to questions. Operator, please go ahead.

Operator: Thank you. We will now be conducting a question and answer session. We ask that you please limit yourself to one question and one follow-up prior to returning to the queue. If you would like to ask a question, please press *1 on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press *2 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 but for pressing the * keys. One moment please while we poll for questions.

And thank you. Our first question comes from the line of Jim Ricchiuti with Needham and Company. Please proceed.

Jim Ricchiuti: Hi, good afternoon. I wonder if you could talk a little bit, Rob, about the business X consumer electronics, which is clearly going to be more volatile. But just, I wonder if you could talk about what you're saying in the market just in light of some of the concerns, the concerns being some slowing in the automotive market and, you know, it looks like that cuts

across geographic regions, as well as, you know, potential implications from the trade tariff issues in China as it may relate to demand in some of your other regions.

Rob Willet: Yeah, hi Jim. You're asking a pretty broad, a broad question there.

Jim Ricchiuti: I know.

Rob Willet: But I'll start answering it and perhaps in your follow-up you can go to specific areas. Okay, so I'd say, you know, in Q3 we performed well in most end markets against some tough comparisons. We had some, you know, good growth in America from logistics. Automotive grew, but not as quickly as it has been from life sciences. And in Europe, I think we saw, you know, some slowing down in automotive. Greater China we saw a broad slowing down and-- but I think really Europe, China, and Asia in Q3 were down year on year a lot due to the declining consumer electronics.

So I think when one strips that out, we saw, you know, general growth across all of our major regions with the exception of China. So that's kind of a bit about the industries overall.

You asked a little bit, Jim, about automotive, so let me kind of speak a little to automotive. So automotive is slower than normal in the Americas and Europe and it's always slower in summer

in Europe, but it was slower this year. But what we've seen in both Americas and Europe is it has improved in recent weeks. I think Europe may have been slower in automotive through the summer partly to do with some of the new emissions regulations that I think was causing a bit of a bottleneck in automotive production and probably spending and working automation. So we saw that happening.

We've seen a lot of growth in automotive over the years, over the last few quarters, I should say. In the long run we expect it to grow at 10 percent and it's been growing faster than that, but in the last quarter it grew more slowly than that. So I would say in the long run though, you know, automotive isn't showing any signs of saturation. I think it's just more of tentativeness among customers.

So then, Jim, if I turn to sort of Q4 outlook and we think about markets, we still have, obviously as I've talked about lingering headwind from some OLED smart phone and you were asking specifically not about that, I think--I think other than China, we expect a, you know, a decent but not exceptional growth among many of our end user markets. And I think, as we said, excluding that smart phone OLED business, we would expect about 10 percent business growth for the rest of the business. And I think we're going to see slowing in China so you can think better than that across the other regions in general. So I don't know if that answers your question but--.

Jim Ricchiuti: --No, that's hopeful, Rob. I have one follow-up because it suggested I think the logistics portion of the business, you might have experienced somewhat slower growth than normal in Q3 and yet, if I heard you correctly, you're expecting that to pick up again and I'm just wondering what--what occurred in Q3 that was somewhat unusual relative to recent quarters?

Rob Willet: Yes, and I don't, I want to be clear that our logistics business has grown really quickly and--and we just happen to have a lower revenue quarter in Q3. Really, it was a matter of timing. It's not to do with the overall growth. The business and logistics is growing very, very quickly. It has grown more than 50 percent in the first 3 months, I'm sorry, 3 quarters of this year and we expected to grow on very, go on growing very rapidly.

Jim Ricchiuti: Okay, thank you.

Operator: Thank you. Our next question comes from the line of Josh (unintelligible) with Morgan Stanley. Please proceed.

Josh: Hi, good evening guys. Just need to follow up on that question. I think, you know, probably lower visibility in--on auto and consumer electronics more broadly than when we entered the quarter, you know, you mentioned some tough comps in auto, but I think, you

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know, the industry dynamics there have maybe change a little bit more recently in terms of willingness to spend some production misses. Maybe the same thing on the consumer-electronics side, we've seen, you know, a bit more weakness there than just the tough comps. When you guys look out into, I guess, beyond 4Q and kind of the next year at large, would you say your visibility is, you know, at a--at a normal place or maybe a little tighter than usual because I'm just trying to understand how much of, you know, the blip we're seeing here is tough comps verses, you know, a bit more of a macro deceleration?

Rob Willet: Sure, Josh. And you're, and you'd like me to talk about both auto and consumer electronics in that regard?

Josh: I think that's probably where we've seen the most, you know, the most demand interruptions so, and are clearly important markets for you guys, so you know, those would be helpful, Rob.

Rob Willet: Yeah, so I think our automotive market, we have a long, we have lots of tight customer relationships with major brand owners and tier one automotive part surprise and automotive so we have a pretty good view out three years. What we tend not to be able to call so well are shorter-term interruptions, whether it's around regulatory things or, you know, some of the dislocation we've seen around admissions standards, diesel problems, even supply-

chain parts, shortages and interruptions that have been going on in that market. So that's why I think our business can, you know, perform more or less well in a given quarter.

I think of the long run, you know, assuming kind of a--a reasonably stable trading environment, we expect that business to grow 10 percent and I think, you know, your question was more about next year and beyond, I mean, that's how we overall think about that market in general, right? I think if we then turn more to consumer electronics, it's almost like everything I've said but kind of more extreme and more volatile, right?

So there, you know, we tend to see companies implementing and executing railroad maps on a much shorter-term basis, you know, more in a six to nine months kind of window, you know, they may be planning rollouts of new products now that we'll be seeing in the market, you know, next spring and summer or fall and--and we expect their investment in automation and in machine vision to be growing much more quickly than automotive. There we think 20 percent, you know, long-term growth or above is what we expect in that industry. But the volatility and those markets can come from the readiness and the adoption of new technologies.

So obviously, we've all spoken a great deal of the last few quarters about OLED technology. There was massive investment and that in capacity in 2017 really for vision, anyway, and we're

seeing a much slower year this year. It's a difficult call to say when the next round of capacity expansion and major investment would go one, but there's still a great deal of investment going on in yield, you know, to improve the yield of screen production, whether it still many people involved visually inspecting. So there's ongoing business in that area, but in terms of the volatility and the timing of investment, that's what can drive some to spend.

And then obviously, in the smartphone market, where we sort of all--all the major players and of course the big ones, a lot can have to do with the timing and the number of new products introduced in that space and the number of features, new technologically complex and difficult to manufacture features that go into those products. So again, that can drive what's going on in that space. And you know, obviously we don't comment on specific customers and their plans, but, you know, more features, more models, more changes to form factors or technology will drive higher growth for us and we remain very confident about our growth potential in that market over the next few years.

Josh: Got it. And then just as my follow-up, you know, Rob, you--you've added a lot of new sales talent and the last, you know, call it four quarters, how do you view, you know, kind of the ramped time on those folks getting out there in the field and do you--are you starting to go a lot more direct, you know, maybe, you know, to mirror your big competitor a bit more in terms of the path to market?

Rob Willet: We have--we have been adding a lot of sales noids as we call them over the last few years and they allow us to reach more customers and particularly service larger, more sophisticated customers, better understand their needs. We see about 60 percent of our business going direct, although it may vary quarter by quarter, and about 40 percent through partners.

Partners are very important to Cognex' go to market strategy. They allow us to, some of them are system integrators who have very sophisticated technology and application skills for our vision and they do business that we as a company don't wish to undertake directly ourselves, particularly for small or medium-size customers. And in other cases, they serve regions or industries that they can serve better than we can.

And thirdly, I would say, you know, we are a vision specific company but we sell products into a broader factory automation ecosystem. So very often, our products are sold with motion control robots, PLCs, and we have no intention of selling those products. So we may be selling only one vision system or sensor with a number of those other products and those partners have the economies of scale and they have the customer relationships to sell those into smaller accounts. So that works well. But, you know, our market is growing quickly and we continue to invest in Cognex salespeople as we--as we harvest all the great R&D product development that

we're bringing into market and they're allowing us to do that better and faster than we were able to before.

Josh: Got it, that's helpful. And because I know it's a big deal around there, happy Halloween.

Rob Willet: Thank you.

Operator: Thank you. Our next question comes from the line of Richard Eastman with Robert W Baird. Please proceed.

Richard Eastman: Yes, good afternoon. Rob, you had mentioned earlier when you were kind of speaking to the sort of fourth-quarter revenue guide and kind of suggesting, you know, at the midpoint of that guide, call at 185 million, without the smartphone and OLED, the business would be up, you know, maybe 10 percent at the midpoint. And I'm curious so, you know again, we tend to target 20 percent and, you know, we talked a little bit about automotive, but just, so the general slowdown, you know, if we were talking about 10 percent without the troublesome areas, the smart phone OLED, is the thought is that--that automotive is still against have comps or there are still tough comps in the underlying revenue number or are we just expecting, you know, somewhat of a drag on the macro industrial spend into Q4?

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Rob Willet: Hi, Rick. The slow down, as we kind of size it out, there's a \$15 million headwind around OLED and smart phone, right? And then, we're going to get to, you know, at the midpoint, as you say, about, we would see about a 10 percent growth rate net of that slowdown.

Why is that not 20? The biggest single reason would be China. You know, we're seeing slowdown in the business in China really across all industries in that space. It's not, like, it's not we can point to electronics or automotive as the main part. It's a broad slowing down in that market and I would point out, you know, as you--as you look at Cognex and you look at other companies that we really have, we really sell and have close relationships on a direct basis with our end-users even if we sell through partners. So, you know, generally we know where well north of 90 percent of all of the business we sell goes and so we have a pretty good sense of the funnel playing out.

And I think other companies that may be reporting are more insulated from that end-user position as a--as a factor of distributors buying and holding inventory. So slightly, my take on it there as we may have a better view about what's going on in China than some of the other automation players reporting who rely on partners and don't see end-user business. So I think--so I think, going back to your question, the \$15 million OLED headwind, there's--and then there's the China situation driving a lot of our slowdown.

Richard Eastman: Do you--do you think that the China situation, was there any, you know, pull forward of business, you know, relative to any concerns over terrorist kicking in kind of in the fall? You know, speaking to China in particular, because we had, you know, second-quarter 50, if my memory serves me right, 55 percent growth in auto in China, and so is it your sense, I mean we all saw the PMI slowdown in September in China, I mean it's been slowing but it, you know, it hit the 50 mark, but I'm curious if you, is there any way to tease out is that tariff benefit and did you benefit from any kind of pull forward from sales relative to, you know, tariff concerns in China?

Rob Willet: I think, you know, as I--as I said, you know, we don't have a situation where customers and particularly partners pull forward, pull forward, you know, and hold inventory. You know that sort of, we don't sort of stock up and destock. It would be hard though however to know whether our customers were buying ahead of tariffs issues.

It is possible that they may have been. You know, I was with the China sales force. We did kind of drill into and discuss those types of issues. So I think the answer is possibly, but not something I can say definitively to you.

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Richard Eastman: Yep, I understand. And just--just, lastly just to finish off that--that thought, train of thought, but if, again, some of these--some of these concerns whether they are auto, whether they're CE, whether they're OLED, if trends continue through the fourth quarter and you're looking at 19 where perhaps, you know, maybe we get off to a mid to high single digit type of revenue growth rate, are you prepared at this point to just, you know, to slow investment in the business just to accommodate, you know, if that pauses short-term, midterm, or longer-term?

Rob Willet: Well your question, Rick, relates to 2019 outlook and I think it's a little early to kind of call that one. But we're going to meet as a leadership team for a bottoms-up detailed review of our product line and geographic plans for next year. And you know, we're--there's opportunity for us to prioritize investments into faster growing areas certainly and- to, you know, taper investments into, from slower growing areas. You know, at the moment, that's kind of how it looks to me as sort of a steady state, but, you know, we'll be watching very closely to see how the outlook is and what goes on in the meantime.

So we, you know, we successfully managed through turbulent times in the past and I've had a lot of experience of that both, you know, at Cognex and before, but our revenue at Cognex has grown organically in 9 of the last 10 years. So you know, were certainly not, you know heading for the bunkers at this point. But you can see as you look at our sequential spending patterns

over the last few quarters that we have been slowing down and matching more closely expense rate growth to revenue growth.

That said, you know, Cognex is a technology and growth company. We're bringing a lot of really exciting technologies and products to market over the next year, year and a half, so we don't want to inhibit the growth and adoption of those technologies based on hitting some sort of shorter term expense growth, you know, constraints. So we're bearing all that in mind I guess is what I would say. And you can bet we're going to think very carefully and act on it.

Richard Eastman: Gotcha. Okay, great. Thank you for answering the questions.

Operator: Thank you. Our next question comes from the line of Matt Summerville with DA Davidson. Please proceed.

Matt Summerville: Thanks. A couple of questions. First, can you comment on your inventory levels coming out of Q3? You'd mentioned just some of that was the result of perhaps some safety stock in advance of this standing up of the SAP ERP system and talk about kind of what you think about potential timing of drawdown. And then I have a follow-up as well.

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Rob Willett: Sure. Thanks, Matt. So our, you know, our inventory balance at the end of Q3 included some strategic purchases we made for our ERP implementation that were really not needed in the end, you know, because it went smoother I think than we were expecting in that regard. And then we also have some, a fair amount of inventory related to new product in the introduction that we'll be seeing this quarter and next quarter, so where we're building up product in-house, rather than through a subcontract manufacturer.

So we're building that. That's really, that's why went up and we do expect to see inventory balance come down in the fourth quarter. So we do expect a report lower inventory balance year-end then you saw at the end of Q3.

Matt Summerville: And then just a follow-up on China, can you maybe talk about when during the third quarter you started to see your business there outside of consumer electronics? So when you started to see your business tail off and do you feel that it's now stabilized at a lower level or is it still in the process of rolling over?

Rob Willet: I think we really began to see the slowdown as we came out of August and we moved into September and we saw that continue into October. And the answer is no, we don't--we don't know what's going to happen now. We're watching it very closely and, you know, I think we're trying to tailor our internal forecast to what we're seeing in our sales funnel

and spending patterns. But it's not, I wouldn't say that necessarily it settled and I think it could go up or down relatively rapidly from on a week to week or month to month basis. I just want to revisit a point that--.

Matt Summerville: --Thanks, Rob--.

Rob Willett: --I just want to revisit a question that Rick mentioned as well about concerning Q4 demand and our thoughts about Q4 demand, I think it's fair to say at the end of every year in industrial companies that's what's referred to as the budget flush, you know, we have particularly in strong years there's the kind of a move to spend capital at the end of the quarter, at the end of the year. And I would say in that regard, you know, we're taking a relatively prudent view about what's going to happen at the end of this year and certainly at the end of last year, you know, we saw a pretty significant budget flush and you know, had a lot of our sales noise maxing out their quotas and booking a lot of business with customers who wanted to spend budgets. So we don't expect that kind of, you know, a wave of strength at the end of the year this year based on what were seeing in the marketplace.

Matt Summerville: Thank you.

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Operator: Thank you. Our next question comes from the line of Jairam Nathan (sp) with Daiwa Asset Management. Please proceed.

Jairam Nathan: Hi, thanks for taking my question. It's the Daiwa Capital Markets, actually. So, you guys mentioned consumer electronics being, you know, you have a long-term view of increasing the 20 percent range. I just wanted to understand what is more the drivers behind that, you're seeing, apart from sales kind of, you know, not growing too high, too much, the features, are there any--the feature set is probably, you know, you're not seeing a lot of innovation that's coming from the smartphone manufacturers and the features set, so I just wanted--wanted to try to understand what gives you the confidence. And I had a follow up.

Rob Willett: Sure. Yeah, thanks for your question. So I think we all see that handset unit production rates and, you know, the--and the increases in average sales price, you know, at the high end of the market, so we sort of see those dynamics going on. So I think we all have foresight into those. What really is going to drive, you know, Cognex' vision sales, though, in the market, well one, in the long term is there is a lot of labor, you know, still in the production of smart phones that the large manufacturer is going to take out. So you know, in many cases the products are becoming too small for human hands to manufacture and the yield and quality that can be achieved with humans versus automation and particularly vision makes, you know,

vision a, you know, a long-term focus of investment for the engineering teams. So that's certainly part of it.

The other part of it is, and that's where I take issue with what you said is I think there are still many features, advanced technology features that are being planned for introduction in the smartphone market. So you know, as we look across and we really do deal with many of the large players in that market, many of the players overall, certainly there are technology features that are, you know, that are in their roadmaps that make the adoption, which make the use of vision and implementing them very important and give us the sense that we could see, you know, strong future growth from that market.

And then we spoke also about the OLED screens and the investment in screens, which are, you know, very important to long-term roadmaps in that industry and very difficult and investment intensive to manufacture. So all of those give us the sense, you know, underwrite our sense of why we expect long-term investment and growth in machine vision in that market.

Jairam Nathan: Thanks. And just finally on with regard to--with regard to competition, as the, you know, as you're seeing the environment kind of getting a little more sensitive here, do you, are you seeing customers, you know, being a little, asking for more being a lot more price

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competitive or are you seeing, kind of, does that open up, you know, an opportunity for competitors, lower-cost competitors?

Rob Willet: The answer to that is no. I mean, machine vision is very difficult to do and the competitive advantage of advanced products from us and a few of our competitors is very substantial. So in general, you know, the--this is not a market driven by price, it's a market still driven by technology. You know, of course, we could, you know, draw price to try to win share, but that's never been something that, you know, we've wanted to do. It's not what we're about as a company, nor I believe is it really what about our major competitors are about.

Jairam Nathan: Okay, thank you.

Operator: Thank you. Our next question comes from the line of Paul Koster with J.P. Morgan.

Paul Koster: Yes, thanks for taking my questions. I just want to follow-up on Jim Ricchiuti's question from earlier on regarding logistics. There was--although I take your point that year to date has been very strong, there was something in your prepared remarks, Rob, that just (unintelligible) recent change. What was the point of the intro remark on logistics?

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Rob Willett: Yeah, Paul, I mean the point--the point was really there was no point. It was just we had, it was just, it was just wheat had a timing of revenue for logistics and Americas in the quarter was, you know, slower than we'd seen and it really had just to do with the timing and a few customers where bookings turned and revenue, simple as that. The market is great and growing strongly and, you know, we'll--we have reported a growth year to date in the first 9 months of over 50 percent and we see no change in that profile going forward.

Paul Koster: Okay, got it. Right. And then you also mentioned that there's a new product cycle coming. Is that across the entire range of products and is it a new feature set at the same price points or is it, you know, product extension or are you reducing prices here? Just give us some sense of what you're doing here and what are you doing to mitigate the risk that, A, customers wait until the new products are available now and/or that you have, you know, some execution challenges in breaking a product to market.

Rob Willet: Yeah, so we really don't talk about, you know, specific new product introductions that are coming up. But in general, what I can say, you know, as we continue to invest significantly in R&D and we have products being launched pretty regularly in most quarters, so you can expect to see new products from us this quarter, next quarter, second quarter of next year our coming to market, we don't telegraph specifically what those are going to be, but

when we do launch them, then we end of life other products. And you know, that can--that can lead to increase pricing and demand opportunities as well.

Paul Koster: Okay, got it. Thank you.

Operator: Thank you. Our next question comes from the line of Joe Giordano with COWEN and Company. Please proceed.

Joe Giordano: Hey, guys.

Rob Willet: Hi, Joe.

Joe Giordano: Just a quick clarification. The 15 million headwind, is that--that's OLED, is it--but is it also, like the large customers spillover from 3Q into 4Q last year? Is that--are those--both of those numbers included in that 15?

John Curran: Yeah, so the 15 is smartphone and OLED, so predominantly on the smartphone front.

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Joe Giordano: Okay. And then on the fourth quarter guide, I'm just curious, as you look at what the trends that are happening and particularly in China, how, like, haircut is that fourth quarter? Like, are you holding conditions as of today flat or are you anticipating like a continuation of a downward trend into that guide? What--you know, I just want to understand the baseline an expectation in there.

Rob Willet: Well, you know, generally, we've never forecast specific regions and specific quarters in terms of growth. I think our message to you is we've seen a decline in that market, you know, we look at our sales funnel and, you know, we don't expect the kind of growth, in fact, we don't expect growth in that market year on year in Q4 and we bake that into our guidance. But other than second to the smartphone OLED piece, that's the second piece that is giving us headwind, meaning we won't be reporting 20 percent growth, we'll be reporting more like 10 percent growth net of the OLED smartphone piece.

Joe Giordano: And then I guess that kind of gets me to the follow-up. On the 20 percent longer-term view, what's, like, the baseline level of activity that you need to be able to drive that kind of growth? You know, how do you, how do we frame your ability to outgrow markets when you think about your most important regions? Like, do we need some sort of certain level of whether it's GDP or PMI in a region like China? Like, how do you think about that?

Rob Willet: Well, we'd see vision as technology that's expected to grow at about a 10 percent, you know, growth. The markets, the main vision markets that we serve, we expect them to grow at a 10 percent rate. And then we are, you know, the market leader investing, you know, and bringing to market the best technology and we have the best brand. And then we have some specific market segments that we're, you know, in, logistics being in a good example, 3D, life-sciences, some of the new markets that we've entered, mobile terminals, that can bring our growth rate well above that rate, right?

So you know, and obviously historically looking back, our ID business has put up some awesome growth rates well north of that 20 percent goal over our life, you know, over the most recent years and we would expect it to go on doing so. You know, that's kind of one piece. The other piece is if you look back over a three-year period or a five-year period, you see, you know compound annual growth rates of in excess of 20 percent. So we've been doing that and we are also investing in our sales force to the point where we can reach more and more customers and grow with the--with the business.

So what we've always said is, you know, we're not going to do 20 percent every quarter or every year, right? We're going to, you know some years as you look back on a history, we tended to have enormous years like we had last year and some years slower growth, although we have grown in nine of the last 10 years. So that's, that's how we think of it.

Joe Giordano: Thanks, guys.

Operator: Thank you. Again, if you'd like to ask a question, please press *1 on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press start to if you would like to remove your question from the Q. And for participants using speaker equipment, it may be necessary to pick up your handset prior to picking pressing the *keys. And thank you, our next question comes from the line of Bobby Eubanks with Chevy Chase Trust. Please proceed.

Bobby Eubanks: Good evening, guys.

Rob Willet: Hi, Bobby.

Bobby Eubanks: Could you update on ViDi? I know you mentioned a strength of their in customers moving from training their models to deployment, are we over the 10 million revenue mark or expectations for that in 2019? And then if you could update on your acquisition pipeline, I know you guys haven't done any acquisitions this year, but, you know, is there any talent out there that you can find a more valuable reasonable evaluation or think could be complementary to your product set? Thanks.

Rob Willet: Great, Bobby. So your questions are really about deep learning and acquisitions. So we made a, you know, a very important acquisition and technology in ViDi in April of last year and we've been introducing that technology to customers and making it easier to deploy by most recently putting it inside our Vision Pro system of vision software. But this is very sophisticated technology that we continue to develop and make it easier to use and the reception has been very good for this technology and it's allowing customers to perform machine vision tasks that were either extremely difficult or impossible for them to perform in the past.

And the way I think about it is these are tasks that are more like human tasks where instead of a rule-based division where one may be measuring something precisely as an angle 90° or 90.1° or is a whole the right with the part or the distance from another whole. These are the sort of tasks today that human beings inspect and we are good at seeing like is, are these glue lines, they may not be straight exactly because, you know, glue tends to glob and move around when it's dispensed, right, but are they continuous and are they in the right kind of areas? Our solder bowls in a, in an electronics application, are they generally the right size and at the right place even though their makeup and size may look different the machine vision or even chocolates, you know, which may be being dispensed and don't have a regular form, if you think about them always particularly high end, but are generally correct or incorrect.

These are just kind of accessible examples of what deep learning technology can do. We've been starting to see a lot of what, since we began to introduce the technology, we've seen a lot of customers taking our technology and looking at their problems with it and it's an area that's getting a lot of attention and we've seen a lot of purchase of training licenses where customers are becoming familiar with the technology and now we're seeing it being deployed by many of our most sophisticated customers into their production. I'm not going to give specific growth for numbers or dollar numbers out at this time, but it's certainly beating the expectations we had for growth when we acquired the company and it is many, many millions of dollars.

Your second question had to do with acquisitions. We made a significant number of acquisitions in '16 and '17. I think six acquisitions we made and we haven't made acquisitions since then. But we continue to engage with potential targets and look for similar things that we liked in those companies we acquired, great technology, great engineers, great cultural fit, vision related, good growth potential that we could integrate. So we've certainly engaged with and in the end decided to proceed with a number of companies this year in that space.

And then, you know as you think of our cash on our balance sheet, certainly some of that we would like to deploy to acquire some larger companies and we continue to cultivate and engage

them. But we haven't certainly the last few years been successful at convincing any of those companies to sell themselves to Cognex. But we continue to ask.

Operator: Thank you. Again, if you'd like to ask a question, please press *1 on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press *2 if you would like to remove your question from the Q. And for participants using speaker equipment, it may be necessary to pick up your handset before pressing the * keys. And thank you, our next question comes from the line of Joe Giordano with COWEN and Company. Please proceed.

Joe Giordano: Hi, guys. Thanks for taking the follow-up. Just a quick one on curious about the integration of ViDi into the Insight platform and how much of that can be kind of combined and where are you now and where you see that ultimately going?

Rob Willet: I'll definitely talk about how we've combined it and where we see it now, but I'm not going to comment on where it's going, only in general terms maybe. Okay, so when we acquired ViDi, they had, you know, we thought and still think they had the best deep learning technology for industrial applications that we'd ever seen and we were, you know, really impressed with what they could do. They also had a number of rule-based vision tools that allowed them to do such things as, you know, find the object that they wanted to work on

quickly. And these are things that we do exceptionally well at Cognex through technology known as PatMax and PatMax redline.

So when we bought those two technologies together and brought them up inside Vision Pro, some of our Vision tools helped the ViDi technology operate better. It was complementary. The other thing is at Cognex we have excellent user environments. We hear regularly from customers that they standardize and they really like our Insight and our Vision Pro user interfaces and environment. So bringing ViDi into that environment also makes it more accessible to all the thousands of customers today who were standardized and used those user interfaces. So that's been the sort of quick and easy win for us.

In the longer term, you know, we think this technology has a long way to run as we make it easier to use and more accessible to more and more of our customers. And of course, the actual technology profile underneath that processor development and programming techniques around deep learning and plus our own experiences seeing more and more examples to train on mean that our technology and that area is developing very, very quickly. So it's an exciting area, perhaps one we'll give you more of a preview next year when you come for analyst day.

Joe Giordano: Sounds good. Thanks.

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Operator: Thank you. We have reached the end of the call. I will now turn it back over to Mr. Willet for closing comments.

Rob Willet: Okay, thank you for joining us this evening. We look forward to speaking with you next quarter. Good night from Boston, home of the world champion Red Sox and happy Halloween. Good night.

Operator: Thank you. This does conclude tonight's teleconference. You may disconnect your lines at this time and thank you for your participation.