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Operator: Greetings and welcome to Cognex Fourth 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, please press star zero 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, 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 Fourth Quarter Earnings conference call. With me on today's call are Dr. Bob Shillman, Cognex's Chairman, and Rob Willet, Cognex's President and CEO.

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Please note that our earnings release and Form 10-K 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 SCC filings, including our most recent Form 10-K for detailed list of these risk factors. With that, I will now turn the call over to Dr. Bob.

Dr. Bob Shillman: Thank, John. Hello everyone. Thank you for joining us and I hope it's still culturally acceptable to say, "Happy Valentines day." But if that offended anyone, I will immediately take responsibility for that and issue a dramatic apology. Tonight, we reported record fourth quarter and full year results from continuing operations for revenue, for net-income and for earnings per share. And as we expected and reported to you on our last call, our growth rate did slow at the end of 2018 because of slower spending by customers, particularly in China and you'll hear more about that detail later in the call. I'll now turn the call over to my partner Rob Willet, who will provide much more detail into our 2018 results. Rob, the microphone is yours.

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Rob Willett: Thank you, Dr. Bob, and good evening, everyone. For 2018, we reported our ninth consecutive year of record revenue. This achievement follows a spectacular 2017 that included substantial investments by our customers in machine division for OLED display and smart phone manufacturing. We faced tough comparisons to 2017 when a few large customers scaled back their purchases in 2018. As a result, annual revenue grew by only 5% over 2017. However, if you exclude those customers, the increase was 18%, reflecting substantial contributions from the rest of our business. Cognex performed well in a number of end markets, notably, logistics and automotive. Our logistics business grew by more than 50% over 2017, with annual revenue surpassing \$100 million, it has become a meaningful part of our business. The growth outlook for logistic remain strong. Cognex is now widely recognized as the technology leader for machine vision in this market and we are rapidly gaining market share. In automotive, annual revenue grew by high single digits year on year. Just short of 10% long-term growth expectations for that market. Following two consecutive years of faster growth, the industry became to slow in the second half of 2018.

Despite recent softness in this market, we see the potential for growth in the medium and long-term as recent trends in the automotive industry, drives significant changes in technology and automation. In 2018, Cognex invested a record \$160 million, or 14% of revenue in engineering, marking our ninth consecutive year of RD&E growth. We believe that investing in engineering

will keep Cognex on the leading edge of vision technology. In that regard, we launched several high performing products during 2018. VisionPro ViDi integrates the power of deep learning technology we acquired in 2017 into the Cognex Vision Pro platform. It's now easier for sophisticated customers to use our deep learning techniques with our industry leading vision tools.

Deep learning is one of the most exciting advances in our market in the past 20 years, and Cognex is viewed as the leader in applying this new technology to industrial machine vision. Our deep learning-based image analysis software opens a new range of applications for Cognex where our traditional rule base vision doesn't apply. Our DataMan 470 barcode reader was the most successful product launched in Cognex history, in terms of sales generated within the first six months. This high-performance reader has been rapidly adopted in the logistics industry as well as in general manufacturing.

The MX 1502 ER broadens our vision enabled mobile terminal family to include extended range reading. The MX 1502 ER can read codes in quick succession from as near as six inches to as far as 30 feet. A capability that improves our position in the high potential mobile terminal market. In Q4, we introduced the 9,000 series of our industry leading insight smart camera, enabling ultra-high-resolution machine vision in an easy to use product.

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In 2018, we added more than 350 Cognoids world wide. Most of these new employees were hired in sales and in engineering. Also, of note, we successfully implemented our new SAP Enterprise Resource Planning system, which provides a platform to scale our operations and understand our business through greater clarity as we approach \$1 billion in annual revenue.

Turning now to key financial metrics. Gross margin was within our expected range for 2018, but our success in the logistics market has required engineering to support to help customer get up and running. This support has been slightly [unintelligible] to our overall gross margin, and it is expected to continue to be in the first half of 2019. We consider this as a worthwhile near-term cost of winning share, and introducing our leading-edge products to customers in the large fast-growing logistics market. Our strategy for developing this market is similar to the one we use successfully in the factory automation market merely 20 years ago.

The downward pressure on our overall gross margin should ease as we move through the back half of this year. Moving on to operating margin, our focus on the long-term, led to investments to run a slower growth year in 2018 that reduced Cognex's overall operating margin below the exceptional levels we saw in 2017. We believe that our long-term growth will be the result of our continued technology leadership and a larger sales force. I will now turn the call over to John, for financial details from the fourth quarter.

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John Curran: Thanks, Rob. At the outset, let me remind everyone that our results reflect the retroactive adoption of the new revenue standard that took effect in 2018. Those changes did not materially impact gross margin dollars, but did lower the gross margin percentage from historical rate by 1% to 2% points, as Dr. Bob and Rob mentioned, we reported good results for fourth quarter. Revenue for the quarter was \$193 million which was slightly above the top end of our guidance.

As expected, we have new decline from Q3 due to the seasonality associated with consumer electronics. Revenue in Q4, 2018 grew by 6% over Q4 of 2017. Our results for the quarter reflect an increasing level of customer uncertainty in certain areas of our business. Looking at revenue by industry, consumer electronics declined, as expected, in Q4 due to lower revenue from large customers in OLED display and smartphone manufacturing. Excluding the impact of those large customers, revenue grew in the mid-term over Q4, 2017, led by strong performance in logistics, which nearly doubled.

Automotive revenue in Q4 2018, was roughly flat year on year, compared to high single digit growth for all of 2018. The other industries we serve continue to grow and at a combined rate that was slower than earlier in the year. Turning to gross margin, the three-point decline from Q4 2017 was due to a higher percentage of revenue coming from application specific solutions for logistics customers in Q4 2018. Operating expenses totaled \$95 million in Q4 of 9% year on

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year and flat sequentially. The increase in [unintelligible] was driven mostly by new hires in sales and in key business areas where we see higher growth potential such as logistics, deep learning and 3D. While we continue to invest for long term growth, we're mindful of the market uncertainty we have observed in recent months. We intend to focus on productivity improvements and we'll remain prudent with regard to discretionary spending in the coming months.

Operating margin in Q4 was 23%, down from 28% in Q4 of 2017. Reflecting both the shift in revenue mix and our [unintelligible] investment to support continued growth. The effect of tax rate was 14% before discrete items. Down from our forecasted rate of 16%, due to a shift of income from higher to lower tax jurisdictions. This benefitted the quarter by approximately \$4 million. Excluding all discrete tax adjustments, we reported earnings of 26 cents/share compared to 24 cents for Q4 of 2017.

Looking at revenue year on year from a geographic perspective, market conditions were as expected in Q4. The Americas delivered the largest contribution to growth both in absolute dollars and in percentage terms. That growth was led by substantially higher revenue from logistics customers. Revenue in Europe was down from Q4 2017 because of the decline in consumer electronics, but the modest growth we experienced in other areas was in line with our other expectations. In greater China, revenue was relatively flat. The softer trends we saw

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in the third quarter across our end markets in China continued to weigh on growth in Q4.

Revenue from other Asia was also flat year on year, because of the OLED smart phone head wind. The region performed well otherwise in Q4, but the rate of growth has slowed among our machine builder customers who sell into the Chinese market.

Looking at our balance sheet, with nearly \$800 million in cash and investment with no debt.

And lastly, inventory decreased \$11 million from Q3, 2018 as we expected. I will now turn the call back to Rob.

Rob Willett: Thanks, John. Turning to guidance, revenue for the first quarter is expected to be between \$165 million and \$175 million, which at the mid point is flat, year on year. We expect gross margin for Q1 to be in the mid 70% range, similar to the gross margin we reported for Q4. Operating expense is expected to be up slightly on a sequential basis. Also, we expect the effective tax rate to be 15% excluding discreet tax items. To summarize, Cognex is performing well given current market conditions. The outlook remains uneven across N-markets and geographic regions. Logistics, deep learning, and 3D all represent near term growth drivers for us. We also continue to broaden our reach to new customers and bring new products to market.

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Demand from China is soft after many quarters of our performance. And that softness is affecting electronics OEM's and other Cognex customers who rely on export to China. In addition, we're seeing delayed spending and project push-out by our customers in the American automotive market. As for consumer electronics, we should be prepared to discuss the large order potential for 2019 in our Q1 call.

With that, we will now open the call to questions. Operator, please go ahead.

Operator: Thank you. At this time, we'll be conducting a question-and-answer session. 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. During the Q&A session, please limit yourself to one question and one follow up prior to getting back in the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment please while we pull for questions.

Our first question comes from the line of Josh Polkowski with Morgan Stanley. Please proceed with your question.

Josh Polkowski, please proceed with your question.

Josh Polkowski: Hey, can you guys hear me?

John Curran: Yes, we can. Hi, Josh.

Josh Polkowski: Hi, sorry about that. Yeah, just, first I guess on the logistics, you know, clearly, you've had some pretty awesome growth there in the last several years, and I wanted to get, you know, an update in the state of play. Any new things you've seen out of competition, you know, good, bad, indifferent, you know, kind of new customer growth, versus growth within the existing customer base. And then anything, you know, new or different that we should be aware of geographically?

Rob Willet: OK, so yeah, your question is sort of about how the logistics market is developing and for Cognex. So, I would say, we've seen, you know, a very rapid gross rate in our logistics business in the last few years, and, you know, revenue from logistics was more than a hundred million dollars, grew more than 50%. Our business has really started out very much in eCommerce. You know, companies that, I think are very, you know, are re-inventing the supply chain and differentiate themselves by quick supply and, you know, major investments in automation to do that. And it's grown more broadly and we're seeing, you know, certainly more regular retail companies, I think, under pressure from what's happening with eCommerce, but

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more generally seeing the benefits of automation start to adopt more sophisticated automation and very much adopt Cognex vision and the technology and advantages we can bring them. So, we're certainly seeing our reputation build.

Our largest market is America but, you know, we're seeing rapid growth spread into Europe, also, and some good business picking up in Asia as well, as that develops. Other things, certainly, we do serve the parcel market, you know, the Korea Parcel and Package business, and postal as well are accounts for us, but those markets sometimes have, you know, bigger, more systems integrated type solutions that we're not really best position to serve them yet, but we do see some business in that space and we expect more to come in future.

Other things I would say in longer term potential, to broaden our business which primarily is in barcode reading today, but to broaden more into more and more vision applications where we're doing things with 2D vision, such as looking at things like hazardous labels, or damaged boxes, and into 3D visions where we'll be doing things like dimensioning and providing more information to customers and packages. And then even broader, I would say, you know, a longer-term trend that I think has a lot of legs and is beginning, and where Cognex, I think, already has a very good reputation is in more how we connect up and provide information from the readers, you know, an area variously referred to as 'industrial IOT or Industry 4.0'.

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Josh Polkowski: Got it. That's very helpful, Caller. And then just one and I'll let, you know, some of my other peers on the call go through consumer electronics in more detail, but just one on that from me. You know, I understand the business is down and, you know, it's kind of a gross year business overtime, you know, I wouldn't expect a lot of in-markets for you to decline multiple years in a row. But we have seen in that broader industry, CapEx budgets come in and often times sighted as getting leverage on existing tooling. I don't think of Cognex as necessarily being the 'be all end all' of that definition of tooling, but, you know, how do you think about, you know, tough versus easy comp still in the consumer electronic space at large?

Rob Willet: Yes. So, Josh I think we'll be in a better position to give you a sense of how the year is shaping up in that industry in Q1. I mean, if you look back over the years that we've, you know, had major business in that space, there's a lot of things being analyzed and considered for implementation at this time of year. And in general, they would have to do with new features or new technologies being adopted within smartphones, of course OLED was a big one, but we see in many different ways. In general, there's always new technology, you know, under consideration for adoption and we get more clarity in the next couple of months on what actually is going to be going.

So, certainly that's the case. And of course, there's a need to improve productivity, you know, to what degree customers have ambitions to remove what is still, you know, huge amounts of

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labor from that process as they look to automate. So, you know, I think there's a long way for what machine vision and automation can do in that space to run. I think your question probably gets at something we're not ready to give you a good insight in right now. This is how does it look for this year.

Josh Polkowski: Understood. Thanks, Robert. We'll leave it there.

Operator: Our next question comes from the line of Richard Eastmont with Robert W. Bair & Company. Please proceed with your question.

Richard Eastmont: Yes, thank you. Good afternoon. Rob, could you--could you perhaps just kind of walk us through a little bit of the automotive business. Was it--did it stay soft or soften in all three regions in the quarter? And would it be best to assume with a first half where you really have some big comparisons in auto. Do you think the auto business can grow for you in 2019, you should have a little bit better visibility there, I would think?

Rob Willett: Yeah, thanks. Thanks, Rick. Well, I'd say if there's a, you know, a word that would describe, you know, what we're seeing at the moment it's 'uncertainty'. So, I think, it's a--there's uncertainty around many of our industry, but certainly automotive. So, of our [unintelligible] regions, you know, we see broad softness in China, you know, capital

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expenditure being delayed across the region. Europe, in contrast we see performing relatively well at the moment, it's not buoyant, but it's growing. And I think in Europe, what we saw is they had some kind of challenges in that market in the middle of last year, and now customers appear to have worked through those issues around, diesel engines and emission standards that caused the delay. And we're starting to see, in a more concerted and more planful investments around the future of automotive, particularly around electric vehicles and new technology, that require, you know, significant and in some cases quite complex automation.

What we're seeing in the America's is that the market seems to be scaling back and delaying large automation projects at the moment, and that's something, you know, we saw more recently, you know, in December and January and the first part of February. So, it seems to be, I guess, uncertainty, again, in that space, and particularly among larger capital projects, that's where we're seeing. We would expect to have seen in a normal year, many more of those breaking loose at the moment. So, there seems to be tentativeness about that.

So, we--I think we have--we have positive views about the long-term plans for our automotive customers and, you know, good visibility into those longer-term plans, but we're certainly seeing some shorter-term anxiety mostly in China and America. And then it's hard to give you a view on that given, you know, it's not clear how long that uncertainty, particularly I would say in the Chinese market, is going to continue and how much it's related to trade talks and other

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things that are going on. So, we're--you know, it's hard to give you a better sense of 2019, but we can certainly discuss it more as we move through the year.

Richard Eastmont: OK. And then I noticed in the K, your largest customer was about 15% of your revenue in 2018, which was, you know, works to a bigger number than we might have thought. Did you suggest that in the fourth quarter, year over year, was that--was that one your largest customer? Was revenue up or was it down for that particular customer? In the fourth quarter.

Rob Willett: Yeah, yeah. Well, I think unfortunately, we don't talk about specifics related really to any customers revenue in the quarter and certainly not that one. But I think maybe if I just--I wonder if we can help you by talking more broadly about consumer electronics and perhaps our--you know, I think we mentioned a few, you know, I would say a very few large customers in smartphone and OLED, so perhaps we can help frame your question in that context, John?

John Curran: Yeah, I think we did kind of discuss across the number of large customers, roughly \$15 million headwind in the quarter. Is that what you were referring to, Rick?

Richard Eastmont: So--well, there's a \$15 million headwind, you're suggesting in the fourth quarter of 2017?

[Crosstalk]

John Curran: Compared to fourth quarter of 2017 to fourth quarter of 2018.

Richard Eastmont: OK. All right, I'm not sure how to interpret that, but I will do my best.

John Curran: Well let's--let's try--let's try again, let's see if we can clarify. I think--I think what we're saying is we refer to a few customers in that large--in that area of OLED and smartphone, and we saw a \$15 million headwind in Q4 of 2018 compared to Q4 of 2017.

Richard Eastmont: OK. It--just one last question about the VisionPro ViDi that you spoken to, I think that is in market, and was there--is this kind of the first deep learning tool that you have? And I'm curious, where there some pre-orders for that, or any, you know, early adopters, what market is that targeted at, that product?

Rob Willett: Yes, so, you know, our ViDi technology addresses broad markets that we address overall, so quite similar to our overall mix, so certainly, we have significant costumers and early adopters in electronics and in automotive, but we see them in all kinds of markets, actually two.

Richard Eastmont: OK. All right. Thank you very much.

Rob Willett: Thank you.

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

Joe Richie: Thanks. Good afternoon, everyone, and Happy Valentines Day, Dr. Bob. So, maybe just starting on, on auto for a second. Rob, can you just remind us in North America, what percentage--what percentage of your businesses is North America auto?

Rob Willett: Yeah, I'm not sure that's something we disclose, but I would say, you know, a little less than half, roughly half.

[Crosstalk]

The America's business. Exactly. I think we've said, you know, we've said it over the years, we've told you that automotive is about a quarter of our business overall on a global basis.

Joe Richie: Yeah. OK. That makes sense. And then--and then maybe just kind of following up on that last line of questioning about, you know, you guys called out that \$15 million headwind in 4Q, when you did kind of like your revenue forecast for the first quarter, are there any specific headwinds either related to OLED or anything else that you'd like to call out?

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John Curran: No, there's no--in the first quarter, there's no material effect in the first quarter of consumer electronics.

Joe Richie: OK, all right. Fair enough. And then I guess, you know, I guess as we progress through the year, you talked a little bit about the gross profit rate improving as the year progressed, partly due to some investments that are occurring in the first half, can you maybe just talk a little bit more about those investment and then the follow on to that is, you know, given logistics is growing at such a fast pace, is it fair to assume that from a mixed perspective, you're going to--you're probably going to have this headwinds for sometime, just given--just given how quickly that market is growing?

Rob Willett: Joe, there are a number of factors at play here. One is, as we would move through the year, we normally would expect a different mix in revenue with much more consumer electronics, you know, and other business kind of flowing through the P&L, so that's, I think, one thing to keep in mind. But to address this issue of what's going on in logistics, we have new customers, some of them, you know, significant in size, beginning to adopt Cognex machine vision, and they're not necessarily the most sophisticated or experienced users of machine vision. So, we're doing more work for them in applications engineering to help them adopt and use the technology. It's something we only do, you know, for large and important customers, in general.

Another factor is the logistics market, you know, it's been around a long time, and there's been a lot of laser-based systems sold into that market, very hard to configure, long setup laser-based barcode readers.

And so, the industry has become used to suppliers, and, you know, companies coming in and actually doing that installation themselves because our technology is much easier to configure. And often, you know, we think it takes less than 25% of the time to set up a Cognex barcode reading tunnel in a logistics distribution center as it would to set up a line scan vision system or a laser-based system that the share leader in that--in this market sells, right?

So--but in order to kind of make sure that we get that business and get customers going, we're doing a little more applications engineering. Now we expect to introduce products, to help customers and to lessen the percentage of that type of business that we see in our logistics P&L. And we expect to see some benefits of that or some improvements start to come in later in the year. That's kind of our overall view on that.

Dr. Bob Shillman: That's helpful, Rob. If I could just sneak in one more. You mentioned giving us an update on electronics and the outlook for the year in the first quarter. Are you guys planning

to give a full year of guidance like you did last year or how are you thinking about the guidance for the year?

Rob Willett: In general, it's not our practice to give full--year guidance, but--at all for anything. But in that case, it was obviously so material and we'd understood the headwind that we were facing. And so, we were able to share it with you. I'm not willing to commit at this point on whether we'll give you a longer--term view of consumer electronics for the year. But we'll be better positioned to sort of address that in 13 weeks from now.

Dr. Bob Shillman: OK, great. Thank you.

Operator: Our next question comes from the line of Joe Racici [sp] with Needham & Co. Please proceed with your question.

Joe Racici: I think it's Jim, but--

Rob Willett: --Oh hi, Jim. Your brother [unintelligible]

Joe Racici: Yeah, the twin brother. Afternoon, so the question I have is just with respect to the decline in revenues that you saw last year from your large customer. Was the--was that

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consistent, Rob with the decline you saw overall with other consumer electronics related business or was that decline worse? Sounds like it was worse, you know, more broadly in the consumer electronics market.

Rob Willett: Yeah, but we're sort of thinking. I would probably say it was similar. But John's looking at some data here. I think, you know, an obvious takeaway is that, you know, that we have a few customers--a select few in that OLED smartphone space. And we saw, you know, more than one have a material impact on, you know, in terms of decline. Now your question is, is that similar to what we saw in the overall consumer electronics industry?

John Curran: Yeah. So, if we break it down, Jim, what we saw, we had declines from a few large customers while the remainder of the business actually grew during the year. So, net we saw an overall decline in our consumer electronics with the overall business. But that mix was quite different when you look at a couple of large customers versus the remainder of that industry group.

Joe Racici: Got it. And with respect to the logistics business, sounds like you're suggesting that some of the headwind that you've seen on gross margins resulting from working closely with some customers in logistics, that that's going to ease somewhat in the second half of the year? Is it--am I--is that a correct way to categorize it?

Rob Willett: It is, you know. You know us very well, Jim. You know that we're about great technology that's easy to adopt in high gross margin, So, you know, we don't really look to be doing a lot of applications engineering unless it's for a very good reason and we see it as--in the short--term as being a very good thing to do in the logistics market. But that's not where we intend to edit--end up in terms of gross margin.

John Racici: Got it. And then, just related to that, Rob would you anticipate the logistics business having the same kind of growth profile that you saw last year in 2018--that 50% type growth?

Rob Willett: Yeah. What we said is we see our business growing and 50% annually for the foreseeable future.

John Racici: OK. Thank you.

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

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Paul Coster: Yes, thanks very much. Can you tell us a little bit about the backlog which looks [unintelligible] and what the composition might tell us about the trends that you're seeing? And so, that--to the extent you can, how much business have you got? I imagine it's not much more than the quarter, but can I have your thoughts about it please?

John Curran: Yeah. So, we usually don't get into the details of backlog. But, you know, in terms of our poor visibility, it's consistent with our poor visibility in other periods. It's really 3-6 months out. Things obviously get more clear the closer we get, but.

Paul Coster: And so, the mix is similar to the mix that we've seen in business previously which just assumes otherwise advice.

John Curran: Yeah. I mean, the mix would--obviously as logistics grow, the mix of our backlog would, you know. Logistics as a percentage of backlog would grow.

Paul Coster: OK. Maybe I'll just go back to comments made well, about the application specific--what was being done in the logistic space displaying temporarily on margins. It sounds like it goes by the second half of the year. Why is that? Would you actually--do you actually productize the developments you've made and then just sort of make it cookie cutter easy to use or is there some other reason why it starts to get easier in the second half?

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Rob Willet: I think there's a number of reasons, not all of which I want to talk about-- competitive reasons. But certainly, one is when teaching customers to apply our technology. And then, we're letting them get on with it, right? So, that's certainly one reason that we don't need to do so much application engineering. But other things have to do with our technology roadmap.

Paul Coster: OK, all right. And my last question is have you seen any difference in the behavior between large customers [unintelligible] and the smaller customers in those same verticals? In other words, is this hesitancy we're seeing? And we've heard this on our call last night. Is the hesitancy sort of specific to the large customer or is it all based?

John Curran: And I'll discuss your question in two geographic areas. So, in China, it doesn't seem specific to large versus small customers. The area where it is notable is more in America where we're seeing a notably fewer large projects breaking loose and more, you know, projects over \$100,000 in scope which might be large capital projects when you consider all the automation that's getting matched up. We're seeing those being deferred at a much larger rate than they were in any recent period.

Paul Coster: OK, good. Thank you very much.

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

John Giordano: Hey guys, how you doing?

Unknown: Hey, John.

John Giordano: I just want to clarify something, and we talked about the margin delusion from logistics a bit here. That's--is there anything on the products specifically being sold into that vertical that's lower margin or is this solely the impact of you guys spending the time to install?

Rob Willett: In general, the products we sell into logistics are I.D. products and very similar or the same as the technology that we sell into factual automation. And they have great gross margins. And what we do see in logistics is sometimes the use of more objects--mirrors, field of view expanders which in themselves aren't particularly, you know, margin different. But the setting them up, the applying them, that is--requires much more service what--which is P & L in gross margin per service expense which is at lower gross margin.

And as we're learning to deploy these, you know, we're becoming more efficient, right? So, that's sort of the dynamic that's going on.

John Giordano: OK. That's helpful. When I think about R & D, given the amount of development over the last several years, would you say that incremental information from here is structurally more expensive than it used to be?

Rob Willett: No, I wouldn't. I think there's economies of scale, you know, that go with what we do. But in other aspects, there are technologies that are much more complex and newer. I think in particularly a deep learning in 3D where, you know, where we're investing and, you know. It's a new frontier for vision.

So overall, I don't see the profile changing. We're very--getting very good and we're doing the same things that we've been doing for 36 years. But applying that into some of these new areas can be--can have a higher level of expense as we get into them.

John Giordano: If I can just sneak in one more, you know. There's a lot of talk just about geopolitical tensions about perhaps some major companies. And I'm not trying to talk about anyone specifically, but potentially moving production bases back to the U.S. And just curious if that's coming through in any of your discussions or if it's even high--level thoughts on the topic for you guys?

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Rob Willett: Yeah. So, you know, we work with the most sophisticated manufacturers in the world and--the most sophisticated contract manufacturers in the world. So, certainly they're talking to us about their plans, you know. And certainly, I have heard, you know, have been in discussions in the last few weeks where, you know, major contract manufacturers are talking about more investment in certain markets and moving production from certain markets into others.

In some cases, those relate to just the growth opportunities they see, you know. Electronics in India might be an example. And in other cases, I think due to some of their technology and strategy plans, and, you know, see--I'm seeing some more of that in America.

I've met with a large contract manufacturer recently who clearly has plans for that. So, you know, there definitely is more discussion of that I would say in the last six months than I've seen over my 10 years in this industry.

John Giordano: Great comment. Thank you.

Operator: Our next question comes from the line of Matt Somerfield with DA Davidson. Please proceed with your question.

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Matt Somerfield: Thanks. Just two questions. First outside of CE, auto and logistics, the remainder 25% or so of the company, can you talk about whether you're seeing more broad-based lows on some of those end markets be they general, industrial, food/beverage, pharma, semiconductor, etc.? Can you frame up sort of the other piece of Cognex that hasn't been talked about?

Rob Willett: Yeah, Matt. Sure. Yeah, so it is very broad-based, you know. When we see we-- sometimes that the growth that goes on in those markets can be quite volatile by which I mean, you know, there can be some large projects going on in deployment in certain areas like, you know, product security, and tobacco, or, you know, safe deployments in consumer products that go on. So, that can tend to obscure some of what's going on.

But what's going on underneath over a longer period is those smaller markets have high growth rates. And the reason they do is our products are getting less expensive, easier to use and easier to integrate. And so, we're now coming within the reach of more regular manufacturers who can apply machine vision. And, you know, we focused a lot on that. It's the reason that we really need to grow our sales force and our distribution network, so we can reach all those new customers. So, that's going well.

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Matt Somerfield: My last question is more of a housekeeping item. Can you disclose what effects headwind may have been heading into fourth quarter and what you're anticipating it potentially in terms of Q1 and the guidance you've provided?

John Curran: In the fourth quarters about 1% and we're not anticipating a material impact in the first quarter.

Operator: Our next question comes from the line of Andrew Biscoglia [sp] with Barren Berg [sp] Capital Markets. Please proceed with your question.

Andrew Biscoglia: Hey guys, can you talk a little bit about your SG&E spend? I mean, it was up 19 % or so in 2018--or 2019--or 2018, excuse me, you know. And that's on the heels of a big year last year. So, at what point does this kind of top out where you don't need to be spending as much on that side of your business? And if you could also just go into where you expect to spend more as needed if you do continue to spend at this rate?

Rob Willett: Yes, I think can--Andrew we can see, you know. We kind of invested quite a lot last year in some--in building out our sales network, you know, and building up the number of sales nodes as we call them who are able to reach all of those customers we were just describing to the last--to Matt's question.

So--and then, we invested in--majorly in--obviously in some infrastructure projects whether it's facilities. But of course, our new ERP system is an example. So, you know, I think some of those got behind us all those capital, you know, that will come into the P & L over a longer period.

I would say on--in a big picture like we believe really strongly about the potential of machine vision over the long--term and the long--term growth prospects of this market. So, we're very serious about being the market leader, and making sure that we're doing everything we can to grow our share, and maintain that position. And we see, you know, high gross margin and we see high--lots of growth markets. And we want to make sure we're getting to those.

So, when we think about this type of thing we're not, you know, thinking about trimming things to hit a quarter number so much as we're thinking about a long--term plan.

So, you know, in the long--term certainly there's lots of opportunities we see to go on investing in, and engineering, and in our sales channel to make sure that we're getting great products that are easy to integrate sold to as many customers as can benefit from them.

That said, you know, as top line growth changes and the growth outlook changes, you know, we'll manage our expenses accordingly. And I think you can see that if you look at our

sequential growth of expenses. Over say the last six quarters, you can see that we're sort of tapering to make sure that we're more in--line. But that's how we manage it.

Andrew Biscoglia: And is there a region or a market mainly that you're focused on with this then in 2019 if it says "continue"?

Robert Willett: Well, you know, I mean, certainly logistics, you know, is a great market.

Andrew Biscoglia: Yeah.

Robert Willett: So, you know.

Andrew Biscoglia: It's awesome.

Robert Willett: And some of the new technologies we've discussed earlier in the call are, you know, also really--warrant some I think, you know, concerted investment. And in, you know, in terms of other areas, you know, we're obviously going to manage that according to where we're let me see. Where I would say we're in other more established areas. That's how you would see us operating perhaps more like a regular company.

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Andrew Biscaglia: OK. And then, just one last one on your, you know. So, you made some interesting acquisitions in Point 17. It's hard to get a sense in where you are in, you know, developing new products and seeing them float through into your business. Can you give us a sense of where, you know, where you are in terms of your strategy of when you picked up those acquisitions and, you know, when you expect, you know, a, you know, robust products to go I guess from the specific deals?

Robert Willett: Yes. So, we made six acquisitions around about two years ago and we're already seeing the first benefits of those products coming into the market. A good example would be Vide [sp]. We talked about the Vide technology being brought up inside vision probe. And we've also, you know, bought a lot more robust and powerful deep learning techniques into the suite itself and tools which you can certainly read about on our website.

So, I'd say that's kind of well down the road from a business that we acquired in April of 2017. But, you know, lots of exciting stuff coming.

And then, we made three acquisitions in the 3D space. So, AQ since [sp], Quarto [sp] and End Shape. And we did formally launch a product I think it was earlier this week--the 3DA5000 which is a very, you know, the highest performance machine--industrial machine vision sensor on the market in terms of the number of pixels and speed with which we can image technology.

So, that was technology that came out of the end shape acquisition. And we've worked over the last--less than two years to improve, and make robust, and integrate within the cosmic platform. So, that's another example of that.

And then, we also acquired a business about--I suppose about 20 months ago from memory called Web scan which is the leader in technology for bar code verification. And we launched a product last year called the AD72E which takes that technology and puts it inside a cosmic's handheld reader on that platform and allows us to help customers gather very precise information about any of the barcodes that they read. And we're in the market with that and we're pleased with the success we're having. And it's certainly resonating with our customers who I think as you know, want to put barcodes on more, and more, and more things.

Example would be consumer electronics and--but automotive also. And they want to hold their suppliers accountable for the quality of those barcodes. And not only is it great that we can help them do that, but it also means that it can help pull through other sales as Cognex barcode readers as we--as we're both helping the supplier meet those standards and verify them. And we're one point of verification from reading at the customer to reading it to the customer themselves. So, now that's another thing that's being very successful for us. Yeah. I think I'm missing an acquisition--yes, the GBI was an automotive--a very sophisticated supplier of vision software to the automotive industry. That was a, you know, a relatively mature and well--

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managed business that already really used a lot of Cognex technology. So, we were able to get out of the blocks very fast on that.

And when we look at the overall, you know, contribution and how we've done against our expectations for those acquisitions and aggregates, it's gone very well.

Andrew Biscoglia: OK. Thanks very much.

Operator: As a reminder, if you would like to ask a question, please press *1 on your telephone keypad. As a reminder, if you would like to ask a question, please press *1 on your telephone keypad. One moment please as we poll for more questions.

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

Ben Rose: Yes, thank you and good afternoon, Dr. Bob, and Rob, John and Susan.

John Curran: Thanks.

Ben Rose: And Happy Valentine's Day to all of you.

John Curran: Thanks.

Ben Rose: At the risk of getting people in trouble by extending this call a little bit more, just ask one kind of follow--up question to Rob. Your comments on the automotive market, if I might troll down just a bit, I think you sounded a little bit more optimistic near term about the opportunity in Europe as opposed to America. And I'm wondering, is there anything structurally in Europe that's going on that would differ from the U.S.? I mean, you know, namely are there any trends effecting the broad market that would make the U.S. slower growth over the course of this year and next?

Rob Willett: Yeah, hi Ben. I think the first thing I alluded to was I think the European Automotive Industry went through, you know, a bit of a challenge last year around kind of diesel emissions and some new emission standards. And that, you know, that led to a lot of dislocation in the supply chain, right?

So, I think in retrospect as we look back, we saw that causing a reduction in purchases in--for Cognex Automotive business in Europe. And we've seen it, you know, bounce back nicely from that to the point where it's now growing again, sequentially in year on year. So, that's going on.

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But then, I think getting to your question, I would say, you know, my perspective on this would be that the European automotive industry has been a little slow to grasp at some of the electric vehicle investments that have been going on and some of the new technologies that have been going on. I think a very good example would be lithium iron batteries, you know, which are the heart--at the heart of electric vehicles where, you know, that to my understanding, there really isn't a major European manufacturer of that technology, right?

Well, you see a lot of Korean, Chinese companies--American of course, and Japanese. If I said Chinese as well in that space. So, you know, and I think now you're seeing a much more concerted effort by European automotive that would be not only both the big brand owners, but more of our business and our industry is with Tier I suppliers. We're seeing them investing seriously and working on automation plans that are starting to see light later than we saw happening in other parts of the world. So, that's one observation I would make.

Ben Rose. OK. Thanks very much.

Operator: Our next question comes from the line of Jerome Nathan with Iowa [sp] Asset Management. Please proceed with your question.

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Jerome Nathan: Yeah, thanks for taking my question. It's Iowa Securities. So, just going back to the operating expense, you know. You had the implementation this year. Do you expect, you know, the--now that it's done, to see some benefit from that no longer being there as an expense item?

John Curran: Yeah, there's obviously some benefit from that. I mean, it was a huge part of our spending this year. I mean, it was--it's about a \$10 million asset that we created. But we do expect to generate productivity gains from leveraging that asset certainly as we move forward.

Jerome Nathan: And, you know, with respect to what kind of long--term margins, I think you had mentioned about to kind of like a kind of a [unintelligible] person kind of long--term target. Is that still in place and how do you see the progression from the current? I think what? 2018 was about 27.5%?

Rob Willett: Yeah, Jerome. I know our operating model is in 27% revenue growth over the long term and 30% or greater operating margin. That was what--is what we're looking for. And that served us well, you know, for many years. And, you know, we managed the company with that in mind over the long--term. And we think it's achievable over the long--term.

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Jerome Nathan: And finally, you know, you mentioned winning a large business number on the mobile terminal side about a couple of quarters back with the first [unintelligible] in the company. Is there any update to that in any additional events that we could talk about?

Rob Willett: Yeah. Hi, yes. Of course, what we had mentioned then was first--our first \$1 million customer in that space. And, you know, we continue to, you know, launch products and grow our customer base in that space.

So, our percentage growth numbers look good--very good, but it's on a small base. So, that's the update on that market.

Jerome Nathan: OK. Thank you.

Operator: Our next question comes from the line of Bobby Eubank with Chevy Based Trucks. Please proceed with your question.

Bobby Eubank: Good evening, everyone and Happy Valentine's Day.

Rob Willett: Hi Bobby.

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Bobby Eubank: Thanks for taking my question. Yeah, if just kind of high level, what would you constitute as a success or failure? Maybe one or two comments on each of those--success and failure over the next 3--5 years? So, you know, what kind of keeps you up at night and what are some of the bigger opportunities that you guys are going after? Thanks so much and Happy Valentine's Day again.

Rob Willett: That's an interesting question and, you know, I think we have an interesting plan we're executing, you know. And it--as you would expect, it's about bringing market leading breakthrough innovation and technology with our, you know, enabling our engineers to do that, and getting ourselves--for us able to do that. And, you know, driving, you know, high gross margin--growth at or above that 20% growth rate over the long term. That's what we're all about.

But I would also say, you know, we're a company that's very proud of our culture. So, you know, we would also measure our success by the culture in the business--our ability to attract, retain, motivate, get the very best out of Cognoids [sp]. So, we certainly think about that and that kind of is--leads me into your, you know, what keeps me up at night would be more, you know, as we grow, we want to make sure that we're, you know, maintaining and developing that wonderful entrepreneurial growth-driven innovative culture that we have.

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So, that, you know, that gets harder as you get bigger. But we--and we focus on it very seriously. And look forward to showing you our annual report which I always think is always a good expression of our culture in the--and that'll be hitting the press in the next few weeks.

Bobby Eubank: Look forward to getting one in the mail. Keep up the great work, guys.

Rob Willett: Thanks, Bobby.

Operator: Ladies and gentlemen, we have reached the end of the call. I will now turn it back over to Dr. Schuman for closing comments.

Dr. Schuman: Well, it's a great year and a great fourth quarter. And I want to thank all of you for attending the call and for covering Cognex. And hope to report better news to you on the subsequent calls. And I'm very happy to see that nobody objected to the Happy Valentine's Day greeting. So, keep going, guys and we'll talk to you down the road. Goodnight.

Operator: This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.