Allied World Assurance Co Holdings, AG
Form DEF 14A
February 22, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of
the Securities Exchange Act of 1934 (Amendment No.)

Filed by the Registrant ý

Filed by a Party other than the Registrant o

Check the appropriate box:

o Preliminary Proxy Statement

o **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

ý Definitive Proxy Statement

o Definitive Additional Materials

o Soliciting Material under §240.14a-12

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG

(Exact name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

ý No fee required.

o Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.
(1) Title of each class of securities to which transaction applies:

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

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

(4) Proposed maximum aggregate value of transaction:

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o Fee paid previously with preliminary materials.

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(1) Amount Previously Paid:

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

(3) Filing Party:

(4) Date Filed:

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG
Park Tower, 15th floor, Gubelstrasse 24
6300 Zug, Switzerland

February 22, 2017

Dear Shareholder:

We are pleased to invite you to attend the extraordinary general meeting of shareholders of Allied World Assurance Company Holdings, AG (Allied World, the company, we, our or us), a Swiss corporation, which will be held at Allied World s corporate headquarters, Park Tower, 15th floor, Gubelstrasse 24, 6300 Zug, Switzerland, on March 22, 2017, at 2:00 p.m., local time (the Special Shareholder Meeting).

The Special Shareholder Meeting is being called to vote on the items described below in connection with the proposed exchange offer (the offer) by a wholly-owned subsidiary (Bid Sub) of Fairfax Financial Holdings Limited, a corporation existing under the laws of Canada (Fairfax), to acquire all of the outstanding common shares, par value CHF 4.10 per share, of Allied World (common shares), pursuant to the terms, and subject to the conditions, of that certain Agreement and Plan of Merger, dated as of December 18, 2016, between Fairfax and Allied World, as may be amended from time to time.

At the Special Shareholder Meeting, holders of our common shares will be asked to consider and vote on: (i) a proposal to amend Articles 8 and 14 of the company s Articles of Association to remove the limitation on the voting rights of a holder of 10% or more of our common shares (the Amendment Proposal); and (ii) a proposal for Allied World to pay, as soon as possible after the closing of the offer, a special dividend of $5.00 per common share to holders of our outstanding common shares as of immediately prior to the closing of the offer and to forgo the $0.26 quarterly dividend (the Special Dividend Proposal). Each proposal is conditioned on the closing of the offer.

The Board unanimously recommends that the shareholders of the company vote FOR the Amendment Proposal and vote FOR the Special Dividend Proposal.

Completion of the offer is conditioned on, among other things, the approval of each of these proposals. Please note that by voting on these proposals, you are not making a decision with respect to the offer. You will have the opportunity to elect whether to tender your shares in the offer at a later date once the offer is commenced. See Important Note Regarding the Special Shareholder Meeting.

Your vote is very important. Whether or not you expect to attend in person, we urge you to submit a proxy to vote your shares as promptly as possible by signing and returning the enclosed proxy card in the postage-paid envelope provided, so that your shares may be represented and voted at the Special Shareholder Meeting. If your shares are held in an Allied World plan or in the name of a bank, brokerage firm or other nominee, please follow the instructions on the voting instruction card furnished by the plan trustee or administrator, or record holder, as appropriate.

If you have any questions or need assistance in voting your shares, please contact our proxy solicitor, Georgeson LLC, at (800) 248-7690.

Thank you for your continued support.

Sincerely,

Scott A. Carmilani
Chairman, President and Chief Executive Officer
Allied World Assurance Company Holdings, AG

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, AG

NOTICE OF SPECIAL SHAREHOLDER MEETING

February 22, 2017

DATE: **Wednesday, March 22, 2017**
TIME: **2:00 p.m., local time**
PLACE: **Corporate headquarters: Park Tower, 15th floor, Gubelstrasse 24, 6300 Zug, Switzerland**
ITEMS OF BUSINESS:

Amend the Articles of Association to remove the limitation on the voting rights of a holder of 10% or more of the company s common shares; and

Approve the payment of a $5.00 special dividend and forgo the $0.26 quarterly dividend.

RECORD DATE: Only shareholders of record holding common shares, as shown on our transfer books, as of the close of business on February 17, 2017 are entitled to vote at the Special Shareholder Meeting.

MATERIALS TO REVIEW: This document contains our Notice of Special Shareholder Meeting and Proxy Statement.

PROXY VOTING: It is important that your shares be represented and voted at the Special Shareholder Meeting. Please promptly sign, date and return the enclosed proxy card in the return envelope furnished for that purpose whether or not you plan to attend the meeting. If you later desire to revoke your proxy for any reason, you may do so in the manner described in the attached proxy statement.

By Order of the Board of Directors,

Theodore Neos
Corporate Secretary

IMPORTANT NOTE REGARDING THE SPECIAL SHAREHOLDER MEETING

While the closing of the offer is conditioned on (among other things) the approval of the Amendment Proposal and the Special Dividend Proposal, shareholders should be aware that a vote in favor of the Amendment Proposal or the Special Dividend Proposal at the Special Shareholder Meeting is not a vote in favor of, or a tender of our common shares into, the offer. The offer has not commenced. At the time the offer is commenced, Fairfax will file with the U.S. Securities and Exchange Commission (the SEC): (i) a registration statement on Form F-4, which will include a prospectus of Fairfax in respect of the Fairfax shares to be issued in the offer; and (ii) a tender offer statement on Schedule TO (together with related documents, including an offer to exchange and a related form of letter of transmittal), and Allied World will file with the SEC a Solicitation/Recommendation Statement on Schedule 14D-9 with respect to the offer. These documents will contain important information about the offer that should be read carefully before any decision is made with respect to the offer. By voting on the proposals in this proxy statement, you are not making a decision with respect to the offer. You will have the opportunity to elect whether to tender your shares in the offer at a later date once the offer is commenced.

PROXY STATEMENT

SPECIAL MEETING INFORMATION

Q:

Why am I receiving these materials?

A:

You are receiving these materials because you are a shareholder of Allied World Assurance Company Holdings, AG as of the Record Date (as defined below). The Board is soliciting the enclosed proxy to be voted at the Extraordinary General Meeting of the company s shareholders to be held at 2:00 p.m., local time, on Wednesday, March 22, 2017 at the company s corporate headquarters, Park Tower, 15th floor, Gubelstrasse 24, 6300 Zug, Switzerland (the Special Shareholder Meeting). This Proxy Statement summarizes the information you need to know to vote at the Special Shareholder Meeting.

When the enclosed proxy card is properly executed and returned, the company s registered voting shares (the common shares) it represents will be voted, subject to any direction to the contrary, at the Special Shareholder Meeting **FOR** the matters specified in the Notice of Special Shareholder Meeting attached hereto and described more fully herein.

This Proxy Statement, the attached Notice of Special Shareholder Meeting and the enclosed proxy card are being first mailed to shareholders on or about February 22, 2017.

Except as the context otherwise requires, references in this Proxy Statement to we, us, our and the company refer to Allied World Assurance Company Holdings, AG and its direct and indirect subsidiaries on a consolidated basis. Also, in this Proxy Statement, $ and USD refer to U.S. dollars, CHF refers to Swiss francs and local time means the time in Switzerland.

Q:

Who is entitled to vote?

A:

The Board has set February 17, 2017, as the record date for the Special Shareholder Meeting (the Record Date). Holders of our common shares as of the close of business on the Record Date will be entitled to vote at the Special Shareholder Meeting. As of January 31, 2017, there were outstanding 87,134,058 common shares.

Beneficial owners of our common shares and shareholders registered in our share register with common shares at the close of business on the Record Date are entitled to vote at the Special Shareholder Meeting. Shareholders not registered in our share register as of the Record Date will not be entitled to attend, vote or grant proxies to vote at the Special Shareholder Meeting. No shareholder will be entered in our share register as a shareholder with voting rights between the close of business on the Record Date and the opening of business on the day following the Special Shareholder Meeting. Continental Stock Transfer & Trust Company, as transfer agent, which maintains our share register, will, however, continue to register transfers of our registered shares in the share register in its capacity as transfer agent during this period.

Q:

What is the difference between holding shares as a shareholder of record and as a beneficial owner?

A:

Most of our shareholders hold their shares through a bank, brokerage firm or other nominee rather than directly in their own name. As summarized below, there are some differences between shares held of record and those owned beneficially.

Shareholder of Record

If your common shares are registered directly in your name, as registered shares entitled to voting rights, in our share register operated by our transfer agent, Continental Stock Transfer & Trust Company, you are considered, with respect to those shares, the shareholder of record and these proxy materials are being sent to you directly by us. As the shareholder of record, you have the right to grant your voting proxy directly to the independent proxy mentioned in the proxy card (see How do I appoint and vote via an independent proxy if I am a shareholder of record? below), grant your voting proxy to any other person (who does not need to be a shareholder) or vote in person at the Special Shareholder Meeting.

Beneficial Owner

If your common shares are held by a bank, brokerage firm or other nominee, you are considered the beneficial owner of shares held in street name, and these proxy materials are being forwarded to you by your bank, brokerage firm or other nominee who is considered, with respect to those shares, the shareholder of record. As the beneficial owner, you have the right to direct your bank, broker or other nominee on how to vote your common shares and are also invited to attend the Special Shareholder Meeting. However, since you are not the shareholder

of record, you may only vote these common shares in person at the Special Shareholder Meeting if you follow the instructions described below under the heading How do I vote? Your bank, brokerage firm or other nominee has enclosed a voting instruction card for you to use in directing your bank, broker or other nominee as to how to vote your common shares, which may contain instructions for voting by telephone or electronically.

Q:

How many votes are required to transact business at the Special Shareholder Meeting?

A:

A quorum is required to transact business at the Special Shareholder Meeting. Without giving effect to the limitation on voting rights described below, the quorum required at the Special Shareholder Meeting is two or more persons present in person and representing in person or by proxy throughout the meeting more than 50% of the total issued and outstanding common shares registered in our share register.

Q:

What will I be voting on, what vote is required and how will abstentions and broker non-votes be counted?

A:

The following chart describes the proposals to be considered at the meeting, the vote required to adopt each proposal and the manner in which the votes will be counted:

	Proposal	Vote Required	Effect of Abstentions	Effect of Broker Non-Votes
1	Amendment Proposal	2/3 of shares represented(1)	Vote against	Vote not counted
2	Special Dividend Proposal	Majority of votes cast(2)	Vote not counted	Vote not counted

(1)

The approval of this proposal requires the approval of at least 66 $^{2}/_{3}$% of the votes represented at the Special Shareholder Meeting and a majority of the nominal value of the Allied World shares represented at such meeting.

(2)

The approval of this proposal requires the approval of the simple majority of the votes cast at the Special Shareholder Meeting.

- Abstentions and broker non-votes will be counted toward the presence of a quorum at the Special Shareholder Meeting.
- Broker non-votes are shares held by banks or brokers for which voting instructions have not been received from the beneficial owners or the persons entitled to vote those shares and for which the bank or broker does not have discretionary voting power under rules applicable to broker-dealers. If you own shares through a bank or brokerage firm and you do not instruct your bank or broker how to vote, your bank or broker will not have discretion to vote on any of the proposals in this proxy statement as they are non-routine matters.

Q: **What are the voting recommendations of the Board?**

A: Your Board unanimously recommends that you vote FOR each of the Amendment Proposal and the Special Dividend Proposal.

Q: **How does the voting take place at the Special Shareholder Meeting?**

A: A vote will be taken on all matters properly brought before the Special Shareholder Meeting. Each shareholder present who elects to vote in person and each person holding a valid proxy is entitled to one vote for each common share owned or represented.

Q: **How many votes do I have?**

A: Holders of our common shares are entitled to one vote per share on each matter to be voted upon by the shareholders at the Special Shareholder Meeting, unless you own Controlled Shares that constitute 10% or more of the issued common shares, in which case your voting rights with respect to those Controlled Shares will be limited, in the aggregate, to a voting power of approximately 10% pursuant to a formula specified in Article 14 of our Articles of Association. Our Articles of Association define Controlled Shares generally to include all shares of the company directly, indirectly or constructively owned or beneficially owned by any person or group of persons.

Q: **How do I vote?**

A: The manner in which your shares may be voted depends on how your shares are held. If you own shares of record, meaning that

your common shares are represented by certificates or book entries in your name so that you appear as a shareholder of record in the company s share register maintained by our transfer agent, Continental Stock Transfer & Trust Company, a proxy card for voting those shares will be included with this Proxy Statement. You may direct how your shares are to be voted by completing, signing and returning the proxy card in the enclosed envelope. You may also vote your common shares in person at the Special Shareholder Meeting.

If you own shares through a bank, brokerage firm or other nominee, you may instead receive from your bank, brokerage firm or nominee a voting instruction form with this Proxy Statement that you may use to instruct them as to how your shares are to be voted. As with a proxy card, you may direct how your shares are to be voted by completing, signing and returning the voting instruction form in the envelope provided. Many banks, brokerage firms and other nominees have arranged for internet or telephonic voting of shares and provide instructions for using those services on the voting instruction form. If you want to vote your shares in person at the meeting, you must obtain a proxy from your bank, broker or nominee giving you the right to vote your common shares at the Special Shareholder Meeting.

We have requested that banks, brokers and other nominees forward solicitation materials to the beneficial owners of common shares and will reimburse the banks, brokers and other nominees for their reasonable out-of-pocket expenses for forwarding the materials.

Q: **Who will count the vote?**

A: A representative from Baker McKenzie Zurich, a law firm, will act as the inspector of elections and will be responsible for tabulating the votes cast by proxy (which will have been certified by our independent transfer agent) or in person at the Special Shareholder Meeting. Under Swiss law, we are responsible for determining whether or not a quorum is present and the final voting results.

Q: **What does it mean if I receive more than one set of the Proxy Statement and proxy card?**

A: Generally, it means that you hold shares registered in more than one account. You should complete, sign and return each proxy card you receive to ensure that all of your shares are voted.

Q: **What happens if I sign and return my proxy card but do not indicate how to vote my shares?**

A: If no instructions are provided in an executed proxy card, the common shares represented by the proxy will be voted at the Special Shareholder Meeting in accordance with the Board s recommendation for each proposal. As to any other business that may properly come before the Special Shareholder Meeting, you may provide general instructions, as indicated on the proxy card, as to how such other business is to be voted. If you provide no instruction, the common shares represented by the proxy will be voted in accordance with the Board s recommendation as to such business.

Q: **How do I appoint and vote via an independent proxy if I am a shareholder of record?**

A: If you are a shareholder of record as of the Record Date, under Swiss law you may authorize the independent proxy, Buis Buergi AG, Muehlebachstrasse 8, P.O. Box 672, CH-8024 Zurich, Switzerland, e-mail at proxy@bblegal.ch, with full rights of substitution, to vote your common shares on your behalf. If you authorize the independent proxy to vote your shares without giving instructions (or without giving clear instructions), your shares will be voted in accordance with the recommendations of the

Board with regard to the items listed in the notice of meeting. If new agenda items (other than those in the notice of meeting) or new proposals or motions with respect to those agenda items set forth in the notice of meeting are being put forth before the Special Shareholder Meeting, you may provide general instructions, as indicated on the proxy card, as to how such other business is to be voted. If you provide no instruction, the common shares represented by the proxy will be voted in accordance with the Board s recommendation as to such business. Proxy cards authorizing the independent proxy to vote your shares must be sent directly to the independent proxy, arriving no later than 6:00 a.m., local time, on March 22, 2017. If sending by e-mail to the independent proxy, you must attach the executed proxy card in order for your vote to be counted.

Q: **Can I change my vote after I have mailed my signed proxy card or otherwise instructed how my shares are to be voted?**

A: Yes. You may change your vote:

- By providing the Corporate Secretary with written notice of revocation, by voting in person at the Special Shareholder Meeting or by executing a later-dated proxy card; *provided*, *however*, that the action is taken in sufficient time to permit the necessary examination and tabulation of the subsequent proxy or revocation before the vote is taken;
- If you have granted your proxy to the independent proxy, by providing Buis Buergi AG with written notice of revocation, by voting in person at the Special Shareholder Meeting or by executing a later-dated independent proxy card. Revocation of, or changes to, proxies issued to the independent proxy must be received by the independent proxy by 6:00 a.m., local time, on March 22, 2017 either by mail to Buis Buergi AG, Muehlebachstrasse 8, P.O. Box 672, CH-8024 Zurich, Switzerland or by e-mail at proxy@bblegal.ch; or

- If you own shares through a bank, brokerage firm or other nominee, by obtaining a proxy from your bank, broker or nominee giving you the right to vote your common shares at the Special Shareholder Meeting.

Attendance at the Special Shareholder Meeting by a shareholder who has executed and delivered a proxy card to the independent proxy shall not in and of itself constitute a revocation of such proxy. Only your vote at the Special Shareholder Meeting will revoke your proxy.

Q: **Who pays the costs of soliciting proxies?**

A: We will bear the cost of the solicitation of proxies. Solicitation will be made by mail,

and may be made by our directors, officers and employees, personally or by telephone, facsimile or other electronic means, for which our directors, officers and employees will not receive any additional compensation. Proxy cards and materials also will be distributed to beneficial owners of common shares through banks, brokers, custodians, nominees and other parties, and the company expects to reimburse such parties for their reasonable charges and expenses. Georgeson LLC has been retained to assist us in the solicitation of proxies at a fee not expected to exceed $25,000, plus out-of-pocket expenses.

Organizational Matters Required by Swiss Law

Admission to the Special Shareholder Meeting

Shareholders who are registered in our share register on the Record Date will receive the Proxy Statement and proxy card from Continental Stock Transfer & Trust Company, our transfer agent. Beneficial owners of shares will receive instructions from their bank, brokerage firm or other nominee acting as shareholder of record to indicate how they wish their shares to be voted. Beneficial owners who wish to vote in person at the Special Shareholder Meeting must obtain a power of attorney from their bank, brokerage firm or other nominee that authorizes them to vote the shares held by them on their behalf. In addition, you must bring to the Special Shareholder Meeting an account statement or letter from your bank, brokerage firm or other nominee indicating that you are the owner of the common shares. Shareholders of record registered in our share register are entitled to participate in and vote at the Special Shareholder Meeting. Each share is entitled to one vote. The exercise of voting rights is subject to the voting restrictions set out in the company s Articles of Association, a summary of which is contained in How many votes do I have? Please see the questions and answers provided under Special Meeting Information for further information.

Granting a Proxy

If you are a shareholder of record, please see How do I vote? and How do I appoint and vote via an independent proxy if I am a shareholder of record? above in the Proxy Statement for more information on appointing an independent proxy.

Registered shareholders who have appointed the independent proxy as a proxy may not vote in person at the Special Shareholder Meeting or send a proxy of their choice to the meeting unless they revoke or change their proxies. Revocations to the independent proxy must be received by him by no later than 6:00 a.m., local time, on March 22, 2017 either by mail to Buis Buergi AG, Muehlebachstrasse 8, P.O. Box 672, CH-8024 Zurich, Switzerland or by e-mail at proxy@bblegal.ch.

As indicated on the proxy card, with regard to the items listed on the agenda and without any explicit instructions to the contrary, the independent proxy will vote according to the recommendations of the Board. If new agenda items (other than those on the agenda) or new proposals or motions regarding agenda items set out in the invitation to the Special Shareholder Meeting are being put forth before the meeting, the independent proxy will vote in accordance with the position of the Board in the absence of other specific instructions.

Beneficial owners who have not obtained a power of attorney from their bank, brokerage firm or other nominee are not entitled to participate in or vote at the Special Shareholder Meeting.

Admission Office

The admission office opens on the day of the Special Shareholder Meeting at 1:30 p.m. local time. Shareholders of record attending the meeting are kindly asked to present their proxy card as proof of admission at the entrance.

Adjournments

The Board or chairman of the Board may postpone the Special Shareholder Meeting with sufficient factual reason, provided that notice of postponement is given to the shareholders in the same form as the invitation before the time for such meeting. A new notice is then required to hold the postponed meeting.

Recent Developments: Merger Agreement with Fairfax

Bid Sub will offer to acquire all of the outstanding common shares of Allied World upon the terms and subject to the conditions set out in the the Agreement and Plan of Merger, dated as of December 18, 2016, between Fairfax and Allied World, as may be amended from time to time (the Merger Agreement).

Pursuant to the Merger Agreement, Allied World shareholders will be offered a combination of cash and stock consideration for each common share, including:

- cash consideration of $5.00, without interest (the Cash Consideration);
- a special cash dividend of $5.00, without interest, payable as soon as possible after the Acceptance Time (as defined below) to holders of common shares as of immediately prior to the Acceptance Time;
- a portion of the stock consideration of fully paid and nonassessable subordinate voting shares of Fairfax (Fairfax Shares) having a value of $14.00 based on the closing price of Fairfax as of December 16, 2016 (the Fairfax Closing Price), payable at a fixed exchange ratio of 0.030392 (the Fixed Exchange Stock Consideration); and
- the remaining portion of the stock consideration equal to the quotient of (x) $30.00 and (y) the volume weighted average closing price of Fairfax shares on the Toronto Stock Exchange (the TSX) for the 20 consecutive trading days immediately preceding the trading day before the date on which Bid Sub first accepts tendered common shares for exchange (the Acceptance Time), converted from Canadian dollars to U.S. dollars using the average Bank of Canada USD/CAD noon exchange rate over such 20-day period, rounded to the nearest one-hundredth of one cent (provided that this volume weighted average price is greater than $435.65 and less than $485.65 per Fairfax Share) (the Fixed Value Stock Consideration). If this volume weighted average price of Fairfax Shares during this period is greater than or equal to $485.65 per Fairfax Share, this portion of the consideration will be fixed at 0.061772 Fairfax Shares for each common share. If this volume weighted average price of Fairfax shares during this period is less than or equal to $435.65 per Fairfax Share, this portion of the consideration will be fixed at 0.068862 Fairfax shares for each common share. Fairfax may elect, in its sole discretion, at any time on or prior to March 3, 2017, to increase the amount of the Cash Consideration from $5.00 to an amount not exceeding $35.00, which will correspondingly serve to reduce the Fixed Value Stock Consideration.

If, following completion of the offer, Fairfax has acquired or controls, directly or indirectly, at least 90% of all outstanding common shares of the company (excluding shares held by the company), no actions or proceedings are pending with respect to the exercisability of the voting rights associated with those common shares and no other legal impediment to a squeeze-out merger under Swiss law exists, Fairfax will, subject to the satisfaction or waiver of the other conditions set forth in the Merger Agreement, indirectly through a company to be incorporated under the laws of Switzerland and an indirect wholly-owned subsidiary of Fairfax (Merger Sub), effect a squeeze-out merger under Swiss law (the Squeeze-Out Merger). The Squeeze-Out Merger will be effected pursuant to a merger agreement to be entered into by Allied World, Bid Sub and Merger Sub, whereby any remaining holders of our common shares (except for Allied World, Fairfax, Bid Sub and Merger Sub, which will not receive any compensation for any Allied World shares directly or indirectly held by them) will receive the same consideration described above in exchange for such common shares.

The obligation of Fairfax to consummate the offer is subject to other conditions, including (i) approval by Allied World s shareholders of the Amendment Proposal and the Special Dividend Proposal; (ii) approval by Allied World s shareholders to elect the individuals designated by Fairfax to Allied World s board of directors upon or after completion of the offer, such approval to be addressed in a separate proxy statement in connection with a vote at a separate special shareholder meeting, as may be waived by Fairfax; (iii) to the extent required by applicable laws and regulations (based on the total number of Fairfax Shares to be issued as consideration for the transactions), approval by Fairfax s shareholders of the issuance of Fairfax Shares as consideration for the transactions; (iv) a number of our common shares having been validly tendered and not properly withdrawn that represents 90% of our common shares outstanding (provided that, in the event all of the other conditions to the offer have been satisfied or waived, Fairfax, through Bid Sub, may elect in its sole and absolute discretion to reduce the 90% threshold to $66^{2}/_{3}$%); (v) receipt of governmental consents and approvals required to consummate the transactions; and (vi) other customary conditions set forth in the Merger Agreement. The obligation of each party to consummate the transactions is also conditioned upon the other party s representations and warranties being true and correct and the other party having performed in all material respects its obligations under the Merger Agreement.

The Merger Agreement provides for certain payments upon termination of the Merger Agreement under specified circumstances. If the Merger Agreement is terminated by Allied World or Fairfax as a result of an adverse change in the recommendation of the other party s board of directors, Allied World may be required to pay to Fairfax, or Fairfax may be required to pay to Allied World, a termination fee of $196 million.

Shareholders should be aware that a vote in favor of any of these proposals, including the Amendment Proposal and the Special Dividend Proposal, is not a vote in favor of, or a tender of our common shares into, the offer. The offer has not commenced. At the time the offer is commenced, Fairfax will file with the SEC: (i) a registration statement on Form F-4, which will include a prospectus of Fairfax in respect of the Fairfax shares to be issued in the offer; and (ii) a tender offer statement on Schedule TO (together with related documents, including an offer to exchange and a related form of letter of transmittal), and Allied World will file with the SEC a Solicitation/Recommendation Statement on Schedule 14D-9 with respect to the offer. These documents will contain important information about the offer that should be read carefully before any decision is made with respect to the offer. By voting on the proposals in this proxy statement, you are not making a decision with respect to the offer. You will have the opportunity to elect whether to tender your shares in the offer at a later date once the offer is commenced.

For a more complete description of the Merger Agreement and the transactions contemplated thereby, see our Current Report on Form 8-K filed on December 20, 2016 with the SEC (including the complete text of the Merger Agreement, which is attached as Exhibit 2.1 thereto).

PROPOSAL 1

AMEND THE ARTICLES OF ASSOCIATION TO REMOVE THE LIMITATION ON THE VOTING RIGHTS OF A HOLDER OF 10% OR MORE OF THE COMPANY S COMMON SHARES

Pursuant to the Merger Agreement, the company has agreed to submit a proposal to the company s shareholders to amend Article 14 of the Articles of Association to permit a holder of 10% or more of our common shares to register its common shares on the company s shareholder register with full voting rights for all shares held by such holder (or any of its affiliates or controlled persons as defined in Article 14 of the Articles of Association). The Board proposes that the shareholders amend Article 14 of the Articles of Association so that subparagraphs b), c), e) and f) will be deleted and not replaced and amend certain subparagraphs of Article 8 of the Articles of Association that refer to subparagraphs b), c), e) and f) of Article 14 of the Articles of Association. These amendments will provide assurance to Fairfax that Bid Sub or any other Fairfax-controlled company that holds common shares will, subject to and immediately upon the closing of the offer, be registered as a shareholder of Allied World with voting rights for all shares acquired in the offer or otherwise held by it. Under the current Articles of Association, holders of controlled shares that constitute 10% or more of our issued common shares have limited voting rights with respect to such controlled shares . Such voting right is limited, in the aggregate, to a voting power of approximately 10% pursuant to a formula specified in Article 14 of the Articles of Association. The Articles of Association define controlled shares generally to include all common shares directly, indirectly or constructively owned or beneficially owned by any person or group of persons.

Pursuant to Swiss law, we are required to submit to you for your approval both the English version and the (authoritative) German version of the proposed amendments to the Articles of Association. Upon the approval of this proposal, Articles 8 and 14 of the Articles of Association will be amended to read as follows:

Artikel 8 Aktienregister und Beschränkungen der Übertragbarkeit

a) Für die Namenaktien wird ein Register (Aktienbuch) geführt. Darin werden die Eigentümer und Nutzniesser mit Namen und Vornamen, Wohnort, Adresse und Staatsangehörigkeit (bei juristischen Personen mit Sitz) eingetragen.

b) Zur Eintragung ins Aktienbuch als Aktionär mit Stimmrecht ist die Zustimmung des Verwaltungsrats notwendig. Die Eintragung als Aktionär mit Stimmrecht kann in den in Artikel 8 lit. ~~c, e,~~ f) und g) der Statuten festgehaltenen Fällen abgelehnt werden. Lehnt der Verwaltungsrat die Eintragung des Erwerbers als Aktionär mit Stimmrecht ab, benachrichtigt er diesen innerhalb von 20 Tagen seit dem Eingang des Eintragungsgesuchs. Nicht anerkannte Erwerber werden als

Article 8 Share Register and Transfer Restrictions

a) Registered shares are registered in a share register. The name of the owner or the usufructuary shall be entered in the share register with his/her name, address, domicile and citizenship (domicile in case of legal entities).

b) Entry in the share register of registered shares with voting rights is subject to the approval of the Board of Directors. Entry of registered shares with voting rights may be refused based on the grounds set out in Article 8 paragraph ~~c), e),~~ f) and g) of the Articles of Association. If the Board of Directors refuses to register the acquirer as shareholder with voting rights it shall notify the acquirer of such refusal within 20 days upon receipt of the application. Non-recognized acquirers shall be entered in

Aktionäre ohne Stimmrecht ins Aktienbuch eingetragen. Die entsprechenden Aktien gelten in der Generalversammlung als nicht vertreten.

the share register as shareholders without voting rights. The corresponding shares shall be considered as not represented in the General Meeting of Shareholders.

c) [gelöscht]~~Eine natürliche oder juristische Person wird in dem Umfang nicht als Aktionärin mit Stimmrecht im Aktienbuch eingetragen, in welchem die von ihr direkt oder indirekt im Sinne von Artikel 14 der Statuten gehaltene oder sonstwie kontrollierte Beteiligung 10% oder mehr des im Handelsregister eingetragenen Aktienkapitals beträgt. Dabei gelten Personen, die durch Absprache, Kapital, Stimmkraft, Leitung, Syndikat oder auf andere Weise miteinander verbunden sind, als eine Person. Im Umfang, in welchem eine derartige Beteiligung 10% oder mehr des Aktienkapitals beträgt, werden die entsprechenden Aktien ohne Stimmrecht ins Aktienbuch eingetragen.~~

c) [deleted]~~No individual or legal entity may, directly or through Constructive Ownership (as defined in Article 14 of the Articles of Association below) or otherwise control voting rights with respect to 10% or more of the registered share capital recorded in the Commercial Register. Those associated through capital, voting power, joint management or in any other way, or joining for the acquisition of shares, shall be regarded as one person. The registered shares exceeding the limit of 10% shall be entered in the share register as shares without voting rights.~~

d) [reserviert]

d) [reserved]

e) [gelöscht]~~Die oben erwähnte 10%-Limite gilt auch bei der Zeichnung oder dem Erwerb von Aktien, welche mittels Ausübung von Options- oder Wandelrechten aus Namen- oder Inhaberpapieren oder sonstigen von der Gesellschaft oder Dritten ausgestellten Wertpapieren oder welche mittels Ausübung von erworbenen Bezugsrechten aus Namen- oder Inhaberaktien gezeichnet oder erworben werden. Im Umfang, in welchem eine daraus resultierende Beteiligung 10% oder mehr des Aktienkapitals beträgt, werden die entsprechenden Aktien ohne Stimmrecht ins Aktienbuch eingetragen.~~

e) [deleted]~~The limit of 10% of the registered share capital also applies to the subscription for, or acquisition of, registered shares by exercising option or convertible rights arising from registered or bearer securities or any other securities issued by the Company or third parties, as well as by means of exercising purchased pre-emptive rights arising from either registered or bearer shares. The registered shares exceeding the limit of 10% shall be entered in the share register as shares without voting rights.~~

f) Der Verwaltungsrat verweigert die Eintragung ins Aktienbuch als Aktionär mit Stimmrecht oder entscheidet über die Löschung eines bereits eingetragenen Aktionärs mit Stimmrecht aus dem Aktienbuch, wenn der Erwerber auf sein Verlangen hin nicht ausdrücklich erklärt, dass er die Aktien im eigenen Namen und auf eigene Rechnung erworben hat.

f) The Board of Directors shall reject entry of registered shares with voting rights in the share register or shall decide on their cancellation when the acquirer or shareholder upon request does not expressly state that he/she has acquired or holds the shares in his/her own name and for his/her own account.

g) Der Verwaltungsrat verweigert die Eintragung natürlicher und juristischer Personen, welche Namenaktien für Dritte halten und dies schriftlich gegenüber der Gesellschaft erklären, als Treuhänder/Nominees mit unbeschränktem

g) The Board of Directors shall reject entry of individuals and legal entities who hold registered shares for third parties and state this in writing to the Company, as nominees in the share register with voting rights without

Stimmrecht ins Aktienbuch oder entscheidet über die Löschung aus dem Aktienbuch, wenn sie sich nicht dazu verpflichten, gegenüber der Gesellschaft auf deren schriftliches Verlangen hin jederzeit die Namen, Adressen und Beteiligungsquoten derjenigen Personen offenzulegen, für welche sie die Namenaktien halten.

limitation or shall decide on their cancellation when the nominee does not undertake the obligation to disclose at any time to the Company at its written request the names, addresses and share holdings of each person for whom such nominee is holding shares.

h) Der Verwaltungsrat kann in besonderen Fällen Ausnahmen von den obgenannten Beschränkungen (Artikel 8 lit. ~~c), e),~~ f) und g) der Statuten) genehmigen. Sodann kann der Verwaltungsrat nach Anhörung der betroffenen Personen deren Eintragungen im Aktienbuch als Aktionäre rückwirkend streichen, wenn diese durch falsche Angaben zustande gekommen sind oder wenn die betroffene Person die Auskunft gemäss Artikel 8 lit. f) der Statuten verweigert.

h) The Board of Directors may in special cases approve exceptions to the above regulations (Article 8 paragraph ~~c), e),~~ f) and g) of the Articles of Association). The Board of Directors is in addition authorized, after due consultation with the person concerned, to delete with retroactive effect entries in the share register which were effected on the basis of false information and/or to delete entries in case the respective person refuses to make the disclosers according to Article 8 paragraph f) of the Articles of Association.

i) Solange ein Erwerber nicht Aktionär mit Stimmrecht im Sinne von Artikel 8 der Statuten geworden ist, kann er weder die entsprechenden Stimmrechte noch die weiteren mit diesem in Zusammenhang stehenden Rechte wahrnehmen.

i) Until an acquirer becomes a shareholder with voting rights for the shares in accordance with this Article 8 of the Articles of Association, he/she may neither exercise the voting rights connected with the shares nor other rights associated with the voting rights.

Artikel 14 Stimmrecht und Vertreter

Article 14 Voting Rights and Shareholders Proxies

a) Jede Aktie berechtigt, unter Vorbehalt der Einschränkungen gemäss Artikel 8 der Statuten ~~und Artikel 14 lit. b) und c) untenstehend,~~ zu einer Stimme. Jeder stimmberechtigte Aktionär kann seine Aktien durch einen unabhängigen Stimmrechtsvertreter oder eine andere von ihm schriftlich bevollmächtigte Person vertreten lassen, welche kein Aktionär sein muss.

a) Each share is entitled to one vote subject to the provisions of Article 8 of the Articles of Association ~~and Article 14 paragraph b) and c) below~~. Each shareholder may be represented at the General Meeting of Shareholders by an Independent Proxy or another person who is authorized by a written proxy and who does not need to be a shareholder.

b) [gelöscht]~~Ungeachtet lit. a) vorstehend gilt Folgendes: Sobald und solange eine natürliche oder juristische Person Namenaktien entsprechend 10% oder mehr des im Handelsregister eingetragenen Aktienkapitals der Gesellschaft kontrolliert, ist diese bei ordentlichen oder ausserordentlichen Generalversammlungen maximal zu den gemäss nachfolgender Formel zu eruierenden~~

b) [deleted]~~Notwithstanding paragraph a) above, if and so long as there are Controlled Shares representing 10% or more of the registered share capital recorded in the Commercial Register, regardless of the identity of the holder thereof, such Controlled Shares shall be entitled to cast votes at any General Meeting of Shareholders or Extraordinary General Meeting of Shareholders in the aggregate equal to the~~

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	~~Stimmen (abgerundet auf die nächst tiefere, runde Zahl) berechtigt:~~		~~number (rounded down to the nearest whole number) ob="bottom" width="52%" style="PADDING-BOTTOM: 2px">~~		
			~~Software maintenance~~		
			~~1,523~~	~~1,423~~	~~3,966~~ ~~4,034~~
Total cost of sales	51,903	41,899	143,784	123,268	
Gross profit	168,546	123,136	479,473	351,729	
Operating expenses:					
Sales and marketing	$ 79,494	$ 65,126	$ 233,166	$ 199,089	
Research and development	39,971	35,016	114,912	99,252	
General and administrative	17,392	12,306	49,701	42,838	
Total operating expenses	136,857	112,448	397,779	341,179	
Operating income	31,689	10,688	81,694	10,550	
Other income (expense):					
Interest income	$ 380	$ 339	$ 1,051	$ 1,335	
Net foreign exchange gain (loss)	426	940	(2,475)	1,301	
Other income, net	160	482	970	979	
Income before income taxes	32,655	12,449	81,240	14,165	
Provision for (benefit from) income taxes	4,522	2,518	10,152	(554)	
Net income	$ 28,133	$ 9,931	$ 71,088	$ 14,719	
Basic earnings per share	$ 0.36	$ 0.13	$ 0.91	$ 0.19	
Weighted average shares outstanding - basic	78,176	77,653	77,832	77,497	
Diluted earnings per share	$ 0.36	$ 0.13	$ 0.90	$ 0.19	
Weighted average shares outstanding - diluted	78,862	78,103	78,848	77,842	
Dividends declared per share	$ 0.13	$ 0.12	$ 0.39	$ 0.36	

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

NATIONAL INSTRUMENTS CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Nine months Ended September 30, 2010	Nine months Ended September 30, 2009
Cash flow from operating activities:		
Net income	$ 71,088	$ 14,719
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	28,220	28,536
Stock-based compensation	14,194	15,238
Tax expense (benefit) from deferred income taxes	1,174	(6,802)
Tax expense from stock option plans	599	1,445
Changes in operating assets and liabilities:		
Accounts receivable	(17,298)	30,758
Inventories	(14,712)	18,632
Prepaid expenses and other assets	(15,328)	3,920
Accounts payable	9,171	(5,444)
Deferred revenue	6,698	3,588
Taxes and other liabilities	33,938	(14,245)
Net cash provided by operating activities	117,744	90,345
Cash flow from investing activities:		
Capital expenditures	(14,404)	(12,331)
Capitalization of internally developed software	(14,300)	(10,611)
Additions to other intangibles	(2,253)	(4,009)
Acquisition, net of cash received	(2,191)	—
Purchases of short-term and long-term investments	(88,226)	(38,876)
Sales and maturities of short-term and long-term investments	63,519	10,034
Net cash (used by) investing activities	(57,855)	(55,793)
Cash flow from financing activities:		
Proceeds from issuance of common stock	38,368	16,351

Repurchase of common stock		(41,862)		(18,200)
Dividends paid		(30,417)		(27,958)
Tax (benefit) from stock option plans		(599)		(1,445)
Net cash (used by) financing activities		(34,510)		(31,252)
Net change in cash and cash equivalents		25,379		3,300
Cash and cash equivalents at beginning of period		201,465		229,400
Cash and cash equivalents at end of period	$	226,844	$	232,700

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

NATIONAL INSTRUMENTS CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 – Basis of presentation

The accompanying unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2009, included in our annual report on Form 10-K, filed with the Securities and Exchange Commission. In our opinion, the accompanying consolidated financial statements reflect all adjustments (consisting only of normal recurring items) considered necessary to present fairly our financial position at September 30, 2010 and December 31, 2009, and the results of our operations for the three month and nine month periods ended September 30, 2010 and September 30, 2009 and the cash flows for the nine month periods ended September 30, 2010 and September 30, 2009. Operating results for the three month and nine month periods ended September 30, 2010, are not necessarily indicative of the results that may be expected for the year ending December 31, 2010.

Note 2 – Earnings per share

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

The reconciliation of the denominators used to calculate basic EPS and diluted EPS for the three month and nine month periods ended September 30, 2010 and 2009, respectively, are as follows (in thousands):

	Three Months Ended September 30, (unaudited)		Nine months Ended September 30, (unaudited)	
	2010	2009	2010	2009
Weighted average shares outstanding-basic	78,176	77,653	77,832	77,497
Plus: Common share equivalents				
Stock options, restricted stock units	686	450	1,016	345
Weighted average shares outstanding-diluted	78,862	78,103	78,848	77,842

Stock options to acquire 478,000 shares and 3,509,000 shares for the three month periods ended September 30, 2010 and 2009, respectively, and 568,000 and 3,619,000 shares for the nine month periods ended September 30, 2010 and 2009, respectively, were excluded in the computations of diluted EPS because the effect of including the stock options would have been anti-dilutive.

Note 3 – Cash, cash equivalents and short-term investments

Cash, cash equivalents and short-term investments consist of the following (in thousands):

	As of September 30, 2010	As of December 31, 2009

	(unaudited)	
Cash and cash equivalents:		
Cash	$81,264	$85,612
Cash equivalents:		
Money market accounts	145,580	115,853
Total cash and cash equivalents	226,844	201,465
Short-term investments:		
Municipal bonds	19,952	12,549
Corporate bonds	42,040	7,587
U.S. treasuries and agencies	14,235	21,033
Foreign government bonds	33,224	34,674
Time deposits	2,452	2,753
Auction rate securities	-	8,177
Auction rate securities put option	-	423
Total short-term investments	111,903	87,196
Total cash, cash equivalents and investments	$338,747	$288,661

The following table summarizes unrealized gains and losses related to our investments designated as available-for-sale (in thousands):

	As of September 30, 2010 (unaudited)				
	Adjusted Cost	Gross Unrealized Gain	Gross Unrealized Loss	Cumulative Translation Adjustment	Fair Value
Municipal bonds	$19,923	$33	$(4)	$-	$19,952
Corporate bonds	41,988	58	(6)	-	42,040
U.S. treasuries and agencies	14,217	18	-	-	14,235
Foreign government bonds	36,065	16	(134)	(2,723)	33,224
Time deposits	2,452	-	-	-	2,452
Total investments	$114,645	$125	$(144)	$(2,723)	$111,903

	As of December 31, 2009				
	Adjusted Cost	Gross Unrealized Gain	Gross Unrealized Loss	Cumulative Translation Adjustment	Fair Value
Municipal bonds	$12,491	$58	$-	$-	$12,549
Corporate bonds	7,478	110	(1)	-	7,587
U.S. treasuries and agencies	21,080	-	(47)	-	21,033
Foreign government bonds	36,105	76	-	(1,507)	34,674
Time deposits	2,753	-	-	-	2,753
Auction rate securities	8,600	-	(423)	-	8,177
Auction rate securities put option	-	423	-	-	423
Total investments	$88,507	$667	$(471)	$(1,507)	$87,196

The following table summarizes the contractual maturities of our investments designated as available-for-sale (in thousands):

	As of September 30, 2010		As of December 31, 2009	
	Adjusted Cost	Fair Value	Adjusted Cost	Fair Value
Due in less than 1 year	$81,762	$80,460	$44,029	$43,267
Due in 1 to 5 years	32,883	31,443	44,478	43,929
Total investments	$114,645	$111,903	$88,507	$87,196

Due in less than 1 year	Adjusted Cost	Fair Value	Adjusted Cost	Fair Value
Municipal bonds	$16,910	$16,940	$4,103	$4,110
Corporate bonds	36,604	36,640	5,384	5,473
U.S. treasuries and agencies	8,199	8,205	5,065	5,057
Foreign government bonds	17,597	16,223	18,124	17,274
Time deposits	2,452	2,452	2,753	2,753
Auction rate securities	-	-	8,600	8,177
Auction rate securities put option	-	-	-	423
Total investments	$81,762	$80,460	$44,029	$43,267

Due in 1 to 5 years	Adjusted Cost	Fair Value	Adjusted Cost	Fair Value
Municipal bonds	$3,013	$3,012	$8,388	$8,439
Corporate bonds	5,384	5,400	2,094	2,114
U.S. treasuries and agencies	6,018	6,030	16,015	15,976
Foreign government bonds	18,468	17,001	17,981	17,400
Total investments	$32,883	$31,443	$44,478	$43,929

Note 4 – Fair value measurements

FASB ASC 820, Fair Value Measurements and Disclosures (FASB ASC 820) clarifies the definition of fair value, prescribes methods for measuring fair value, establishes a fair value hierarchy based on the inputs used to measure fair value and expands disclosures about the use of fair value measurements. Effective January 1, 2010, we adopted the update to FASB ASC 820 that required additional disclosures and clarified existing disclosures regarding fair value measurements. The additional disclosures include transfers in and out of Level 1 and 2 as well as activity within Level 3 fair value measurements. The update also provides amendments that clarify existing disclosures on level of disaggregation and disclosures about inputs and valuation techniques. The adoption of the update to FASB ASC 820 did not have a material impact on our consolidated financial position or results of operations.

The following tables present our assets and liabilities that are measured at fair value on a recurring basis and are categorized using the fair value hierarchy. The fair value hierarchy has three levels based on the reliability of the inputs used to determine fair value (in thousands). We did not have any items that were measured at fair value on a nonrecurring basis at September 30, 2010 and December 31, 2009.

		Fair Value Measurements at Reporting Date Using (unaudited)		
Description	September 30, 2010	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)

		(Level 1)		
Assets				
Money Market Funds	$145,580	$145,580	$-	$ -
Short-term investments available for sale:				
Municipal bonds	19,952	19,952	-	-
Corporate bonds	42,040	42,040	-	-
U.S. treasuries and agencies	14,235	14,235	-	-
Foreign government bonds	33,224	33,224	-	-
Time deposits	2,452	2,452	-	-
Derivatives	5,569	-	5,569	-
Total Assets	$263,052	$257,483	$5,569	$ -
Liabilities				
Derivatives	$(5,456)	$-	$(5,456)	$ -
Total Liabilities	$(5,456)	$-	$(5,456)	$ -

		Fair Value Measurements at Reporting Date Using		
Description	December 31, 2009	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Money Market Funds	$115,853	$115,853	$-	$ -
Short-term investments available for sale:				
Municipal bonds	12,549	12,549	-	-
Corporate bonds	7,587	7,587	-	-
U.S. treasuries and agencies	21,033	21,033	-	-
Foreign government bonds	34,674	34,674	-	-
Time deposits	2,753	2,753	-	-
Auction rate securities	8,177	-	-	8,177
Auction rate securities put option	423	-	-	423
Derivatives	11,016	-	11,016	-
Total Assets	$214,065	$194,449	$11,016	$ 8,600
Liabilities				
Derivatives	$(318)	$-	$(318)	$ -
Total Liabilities	$(318)	$-	$(318)	$ -

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)

	Short-term investments available for sale (unaudited)
Beginning Balance at December 31, 2009	$ 8,600
Total gains or (losses) (realized/unrealized)	
Included in earnings	-
Included in other comprehensive income	-
Total losses (realized/unrealized)	
Included in earnings	-
Included in other comprehensive income	-
Purchases, issuances and settlements	(8,600)
Transfer in and/or out of Level 3	-
Ending Balance at September 30, 2010	$ -
The amount of total gains or (losses) for the period included in earnings (or changes in net assets) attributable to the change in unrealized gains or losses relating to assets still held at the reporting date	-
	$ -

Short-term investments available-for-sale are valued using a market approach (Level 1) based on the quoted market prices of identical instruments when available or other observable inputs such as trading prices of identical instruments in active markets. Short-term investments available-for-sale consists of debt securities issued by states of the U.S. and political subdivisions of the U.S., corporate debt securities and debt securities issued by U.S. government corporations and agencies as well as debt securities issued by foreign governments. All short-term investments available-for-sale have contractual maturities of less than 24 months. There were not any transfers in or out of Level 1 during the nine months ended September 30, 2010.

Derivatives include foreign currency forward and option contracts. Our foreign currency forward contracts are valued using an income approach (Level 2) based on the spot rate less the contract rate multiplied by the notional amount. Our foreign currency option contracts are valued using a market approach based on the quoted market prices which are derived from observable inputs including current and future spot rates, interest rate spreads as well as quoted market prices of identical instruments. There were not any transfers in or out of Level 2 during the nine months ended September 30, 2010.

The short-term investments available-for-sale included in Level 3 at December 31, 2009, were reported at their fair market value and consisted of auction rate securities backed by education loan revenue bonds. Auction rate securities are variable rate debt instruments whose interest rates are typically reset approximately every 7 to 35 days.

In November 2008, we accepted the UBS Auction Rate Securities Rights (the “Rights”) agreement offered by UBS as a liquidity alternative to the failed auction process for our auction rate securities. The Rights agreement included a nontransferable right to sell our auction rate securities, at par value, back to UBS at any time during the period June 30, 2010, through July 2, 2012. Under the terms of this Rights agreement, UBS purchased back from us our auction rate securities on June 14, 2010, and July 1, 2010. We received the full par value of $8.6 million from UBS in accordance with the terms of our Rights agreement.

The estimated fair market value of the auction rate securities and the Rights agreement was determined using significant unobservable inputs (Level 3). We considered many factors in determining the fair market value of our auction rate securities as well as our corresponding Rights agreement at December 31, 2009, including the fact that the debt instruments underlying the auction rate securities have redemption features which call for redemption at 100% of par value, current credit curves for like securities and discount factors to account for the illiquidity of the market for these securities.

Note 5 – Derivative instruments and hedging activities

FASB ASC 815, Derivatives and Hedging, (FASB ASC 815) requires companies to recognize all of their derivative instruments as either assets or liabilities in the statement of financial position at fair value. The accounting for changes in the fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, cash flow hedge, or a hedge of a net investment in a foreign operation.

We have operations in over 40 countries. Sales outside of the Americas as a percentage of consolidated sales were 56% and 54% in each of the three month periods ended September 30, 2010 and 2009, respectively, and 57% and 55% in each of the nine month periods ended September 30, 2010 and 2009, respectively. Our activities expose us to a variety of market risks, including the effects of changes in foreign-currency exchange rates. These financial risks are monitored and managed by us as an integral part of our overall risk management program.

We maintain a foreign currency risk management strategy that uses derivative instruments (foreign currency forward and purchased option contracts) to help protect our earnings and cash flows from fluctuations caused by the volatility in currency exchange rates. Movements in foreign currency exchange rates pose a risk to our operations and competitive position, since exchange rate changes may affect our profitability and cash flow, and the business or pricing strategies of our non-U.S. based competitors.

The vast majority of our foreign sales are denominated in the customers' local currency. We purchase foreign currency forward and option contracts as hedges of forecasted sales that are denominated in foreign currencies and as hedges of foreign currency denominated receivables. These contracts are entered into to help protect against the risk that the eventual dollar-net-cash inflows resulting from such sales or firm commitments will be adversely affected by changes in exchange rates. We also purchase foreign currency forward contracts as hedges of forecasted expenses that are denominated in foreign currencies. These contracts are entered into to help protect against the risk that the eventual dollar-net-cash outflows resulting from foreign currency operating and cost of revenue expenses will be adversely affected by changes in exchange rates.

We designate foreign currency forward and purchased option contracts as cash flow hedges of forecasted revenues or forecasted expenses. In addition, we hedge our foreign currency denominated balance sheet exposures using foreign currency forward contracts. These derivatives are not designated as hedging instruments under FASB ASC 815. None of our derivative instruments contain a credit-risk-related contingent feature.

Cash flow hedges

To help protect against the reduction in value caused by a fluctuation in foreign currency exchange rates of forecasted foreign currency cash flows resulting from international sales or expenses over the next one to two years, we have instituted a foreign currency cash flow hedging program. We hedge portions of our forecasted revenue and forecasted expenses denominated in foreign currencies with forward and purchased option contracts. For forward contracts, when the dollar strengthens significantly against the foreign currencies, the change in the present value of future foreign currency cash flows may be offset by the change in the fair value of the forward contracts designated as hedges. For option contracts, when the dollar strengthens significantly against the foreign currencies, the change in the present value of future foreign currency cash flows may be offset by the change in the fair value of the option contracts net of the premium paid designated as hedges. Our foreign currency purchased option contracts are purchased "at-the-money" or "out-of-the-money". From time to time, we purchase foreign currency forward and option contracts for up to 100% of our forecasted exposures in selected currencies (primarily in Euro, Japanese yen, British pound sterling, South Korean won and Hungarian forint) and limit the duration of these contracts to 40 months or less.

For derivative instruments that are designated and qualify as a cash flow hedge, the effective portion of the gain or loss on the derivative is reported as a component of accumulated other comprehensive income ("OCI") and reclassified into earnings in the same line item (net sales, operating expenses, or cost of sales) associated with the forecasted transaction and in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings or expenses during the current period and are classified as a component of "net foreign exchange gain (loss)". Hedge effectiveness of foreign currency forwards and purchased option contracts designated as cash flow hedges are measured by comparing the hedging instrument's cumulative change in fair value from inception to maturity to the forecasted transaction's terminal value.

We held forward contracts with a notional amount of $31.2 million dollar equivalent of Euro, $7.1 million dollar equivalent of British pound sterling, $22.2 million dollar equivalent of Japanese yen, and $32.8 million dollar equivalent of Hungarian forint at September 30, 2010. These contracts are for terms of up to 24 months. At December 31, 2009, we held forward contracts with a notional amount of $28.6 million dollar equivalent of Euro, $4.0 million dollar equivalent of British pound sterling, $24.4 million dollar equivalent of Japanese yen, and $17.8 million dollar equivalent of Hungarian forint.

We held purchased option contracts with a notional amount of $8.7 million dollar equivalent of Euro at September 30, 2010. These contracts are for terms of up to 12 months. At December 31, 2009, we held purchased option contracts with a notional amount of $28.4 million dollar equivalent of Euro.

At September 30, 2010, we expect to reclassify $580,000 of losses on derivative instruments from accumulated other comprehensive income to net sales during the next twelve months when the hedged international sales occur, $1.1 million of gains on derivative instruments from accumulated OCI to cost of sales when the cost of sales are incurred and $584,000 of gains on derivative instruments from accumulated OCI to operating expenses during the next twelve months when the hedged operating expenses occur. Expected amounts are based on derivative valuations at September 30, 2010. Actual results may vary as a result of changes in the corresponding exchange rate subsequent to this date.

We did not record any gains or losses due to the ineffectiveness of our hedges during the nine months ended September 30, 2010. During the nine months ended September 30, 2009, hedges with a notional amount of $18.9 million were determined to be ineffective. As a result, we recorded a net gain of $1.2 million related to these hedges as a component of "net foreign exchange gain (loss)" during the nine months ended September 30, 2009.

Other Derivatives

Other derivatives not designated as hedging instruments under FASB ASC 815 consist primarily of foreign currency forward contracts that we use to hedge our foreign denominated net receivable or net payable positions to help protect against the change in value caused by a fluctuation in foreign currency exchange rates. We typically hedge up to 90% of our outstanding foreign denominated net receivables or net payables and typically limit the duration of these foreign currency forward contracts to approximately 90 days. The gain or loss on the derivatives as well as the offsetting gain or loss on the hedge item attributable to the hedged risk is recognized in current earnings under the line item "net foreign exchange gain (loss)". As of September 30, 2010 and December 31, 2009, we held foreign currency forward contracts with a notional amount of $29.9 million and $45.2 million, respectively.

The following table presents the fair value of derivative instruments on our Consolidated Balance Sheets and the effect of derivative instruments on our Consolidated Statements of Income.

Fair Values of Derivative Instruments (in thousands):

	Asset Derivatives			
	September 30, 2010 (unaudited)		December 31, 2009	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments				
Foreign exchange contracts - ST forwards	Prepaid expenses and other current assets	$2,849	Prepaid expenses and other current assets	$7,947
Foreign exchange contracts - LT forwards	Other long-term assets	871	Other long-term assets	274
Foreign exchange contracts - ST options	Prepaid expenses and other current assets	877	Prepaid expenses and other current assets	1,821
Total derivatives designated as hedging instruments		$4,597		$10,042
Derivatives not designated as hedging instruments				
Foreign exchange contracts - ST forwards	Prepaid expenses and other current assets	$972	Prepaid expenses and other current assets	$974
Total derivatives not designated as hedging instruments		$972		$974
Total derivatives		$5,569		$11,016

	Liability Derivatives			
	September 30, 2010 (unaudited)		December 31, 2009	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments				
Foreign exchange contracts - ST forwards	Accrued expenses and other liabilities	$(2,156)	Accrued expenses and other liabilities	$-
Foreign exchange contracts - LT forwards	Other long-term liabilities	(850)	Other long-term liabilities	-
Total derivatives designated as hedging instruments		$(3,006)		$-
Derivatives not designated as hedging instruments				
Foreign exchange contracts - ST forwards	Accrued expenses and other liabilities	$(2,450)	Accrued expenses and other liabilities	$(318)

Total derivatives not designated as hedging instruments	$(2,450)	$(318)
Total derivatives	$(5,456)	$(318)

The following unaudited table shows the effect of derivative instruments on the Consolidated Statements of Income for the three month periods ended September 30, 2010 and 2009, respectively (in thousands):

September 30, 2010
(unaudited)

Derivatives in Cash Flow Hedging Relationship	Gain or (Loss) Recognized in OCI on Derivative (Effective Portion) 2010	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) 2010	Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion)	Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion) 2010
Foreign exchange contracts - forwards and options	$ (6,201)	Net sales	$ 1,358	Net foreign exchange gain (loss)	$ -
Foreign exchange contracts - forwards and options	2,558	Cost of sales	374	Net foreign exchange gain (loss)	-
Foreign exchange contracts - forwards and options	1,299	Operating expenses	266	Net foreign exchange gain (loss)	-
Total	$ (2,344)		$ 1,998		$ -

September 30, 2009
(unaudited)

Derivatives in Cash Flow Hedging Relationship	Gain or (Loss) Recognized in OCI on Derivative (Effective Portion) 2009	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) 2009	Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion)	Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion) 2009
Foreign exchange contracts - forwards and options	$ (5,037)	Net sales	$ (401)	Net foreign exchange gain (loss)	$ 181

Foreign exchange contracts - forwards and options	1,465	Cost of sales	(72)	Net foreign exchange gain (loss)	395
Foreign exchange contracts - forwards and options	82	Operating expenses	380	Net foreign exchange gain (loss)	81
Total	$ (3,490)		$ (93)		$ 657

Derivatives not Designated as Hedging Instruments	Location of Gain (Loss) Recognized in Income	Amount of Gain (Loss) Recognized in Income September 30, 2010 (unaudited)	Amount of Gain (Loss) Recognized in Income September 30, 2009 (unaudited)
Foreign exchange contracts - forwards	Net foreign exchange gain/(loss)	$ (2,233)	$ (1,607)
Total		$ (2,233)	$ (1,607)

The following unaudited table shows the effect of derivative instruments on the Consolidated Statements of Income for the nine month periods ended September 30, 2010 and 2009, respectively (in thousands):

		September 30, 2010 (unaudited)			
Derivatives in Cash Flow Hedging Relationship	Gain or (Loss) Recognized in OCI on Derivative (Effective Portion) 2010	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) 2010	Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion)	Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion) 2010
Foreign exchange contracts - forwards and options	$ (4,457)	Net sales	$ 4,407	Net foreign exchange gain (loss)	$ -
Foreign exchange contracts - forwards and options	(2,152)	Cost of sales	1,785	Net foreign exchange gain (loss)	-
Foreign exchange contracts - forwards and options	(1,095)	Operating expenses	853	Net foreign exchange gain (loss)	-
Total	$ (7,704)		$ 7,045		$ -

September 30, 2009
(unaudited)

Derivatives in Cash Flow Hedging Relationship	Gain or (Loss) Recognized in OCI on Derivative (Effective Portion) 2009	Location of Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Gain or (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) 2009	Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion)	Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion) 2009
Foreign exchange contracts - forwards and options	$ (8,822)	Net sales	$ 2,578	Net foreign exchange gain (loss)	$ 1,132
Foreign exchange contracts - forwards and options	2,776	Cost of sales	(740)	Net foreign exchange gain (loss)	(44)
Foreign exchange contracts - forwards and options	1,747	Operating expenses	184	Net foreign exchange gain (loss)	81
Total	$ (4,299)		$ 2,022		$ 1,169

Derivatives not Designated as Hedging Instruments	Location of Gain (Loss) Recognized in Income	Amount of Gain (Loss) Recognized in Income September 30, 2010 (unaudited)	Amount of Gain (Loss) Recognized in Income September 30, 2009 (unaudited)
Foreign exchange contracts - forwards	Net foreign exchange gain/(loss)	$ (857)	$ (1,791)
Total		$ (857)	$ (1,791)

Note 6 – Inventories

Inventories, net at September 30, 2010 and December 31, 2009, consist of the following (in thousands):

	September 30, 2010 (unaudited)	December 31, 2009
Raw materials	$48,054	$42,121
Work-in-process	4,351	2,042
Finished goods	49,127	42,352
	$101,532	$86,515

Note 7 – Intangibles

Intangibles at September 30, 2010 and December 31, 2009, are as follows:

	September 30, 2010 (unaudited)			December 31, 2009		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Capitalized software development costs	$53,883	$ (28,321)	$25,562	$38,928	$ (20,455)	$18,473
Acquired technology	32,853	(23,995)	8,858	28,022	(20,967)	7,055
Patents	20,464	(6,078)	14,386	19,033	(5,377)	13,656
Leasehold equipment and other	13,936	(10,189)	3,747	12,577	(8,371)	4,206
	$121,136	$ (68,583)	$52,553	$98,560	$ (55,170)	$43,390

Software development costs capitalized during the three month periods ended September 30, 2010 and 2009, were $3.4 million and $1.3 million, respectively, and related amortization expense was $2.8 million and $2.5 million, respectively. Capitalized software development costs for the three month periods ended September 30, 2010 and 2009, included costs related to stock based compensation of $144,000 and $71,000, respectively. During the nine month periods ended September 30, 2010 and 2009, we capitalized software development costs of $15.0 million and $11.2 million, respectively, and related amortization expense was $7.9 million and $6.6 million, respectively. Capitalized software development costs for the nine month periods ended September 30, 2010 and 2009, included costs related to stock based compensation of $655,000 and $617,000, respectively. Amortization of capitalized software development costs is computed on an individual product basis for those products available for market and is recognized based on the product's estimated economic life, generally three years. Patents are amortized using the straight-line method over their estimated period of benefit, generally ten to seventeen years.

Total intangible assets amortization expenses were $5.2 million and $4.7 million during the three month periods ended September 30, 2010 and 2009, respectively, and $13.4 million and $12.2 million during the nine month periods ended September 30, 2010 and 2009, respectively.

Acquired core technology and intangible assets are amortized over their useful lives, which range from three to eight years. Amortization expense for intangible assets acquired was approximately $1.0 million and $1.0 million for the three month periods ended September 30, 2010 and 2009, respectively, of which approximately $921,000 and $853,000 was recorded in cost of sales, respectively, and approximately $89,000 and $125,000 was recorded in operating expenses, respectively. For the nine month periods ended September 30, 2010 and 2009, amortization expense for intangible assets acquired was approximately $2.9 million and $3.0 million, respectively, of which approximately $2.6 million and $2.6 million was recorded in cost of sales, respectively, and approximately $311,000 and $377,000 was recorded in operating expenses, respectively.

Note 8 – Goodwill

The carrying amount of goodwill as of September 30, 2010, is as follows (in thousands):

	Amount
Balance as of December 31, 2009	$64,779
Acquisitions	5,013
Divestitures	-
Foreign currency translation impact	(409)
Balance as of September 30, 2010	$69,383

The excess purchase price over the fair value of assets acquired is recorded as goodwill. As we have one operating segment, we allocate goodwill to one reporting unit for goodwill impairment testing. Goodwill is tested for impairment on an annual basis, and between annual tests if indicators of potential impairment exist, using a fair-value-based approach based on the market capitalization of the reporting unit. Our annual impairment test was performed as of February 28, 2010. No impairment of goodwill has been identified during the period presented. Goodwill is deductible for tax purposes in certain jurisdictions.

On February 1, 2010, we acquired all of the outstanding shares of a privately-held company for $2.2 million in net cash, $3.0 million in shares of our common stock with the remainder to be paid in cash over the next four years. The purchase price allocation for this acquisition included net working capital of $1.1 million, amortizable intangible assets of $5.0 million, and goodwill of $5.0 million. Our consolidated financial statements include the operating results of the acquired company from the date of acquisition.

Note 9 – Income taxes

We account for income taxes under the asset and liability method. Deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts. Valuation allowances are established when necessary to reduce deferred tax assets to amounts which are more likely than not to be realized.

FASB ASC 740, Income Taxes (FASB ASC 740) addresses the accounting for uncertainty in income taxes recognized in an entity’s financial statements and prescribes a recognition threshold and measurement attribute for financial statement disclosure of tax positions taken or expected to be taken on a tax return. We had $11.6 million and $11.1 million of unrecognized tax benefits at September 30, 2010 and December 31, 2009, respectively, all of which would affect our effective income tax rate if recognized. We recorded a gross decrease in unrecognized tax benefits of $2.4 million and $3.5 million for the three and nine month periods ended September 30, 2010, as a result of the closing of open tax years and a settlement with a taxing authority. As of September 30, 2010, it is deemed reasonable that we will recognize tax benefits in the amount of $3.5 million in the next twelve months due to the closing of open tax years. The nature of the uncertainty is related to deductions taken on returns that have not been examined by the applicable tax authority. Our continuing policy is to recognize interest and penalties related to income tax matters in income tax expense. As of September 30, 2010, we have approximately $652,000 accrued for interest related to uncertain tax positions. The tax years 2003 through 2009 remain open to examination by the major taxing jurisdictions to which we are subject.

Our provision for income taxes reflected an effective tax rate of 14% and 20% for the three month periods ended September 30, 2010 and 2009, respectively, and 12% and (4)% for the nine month periods ended September 30, 2010 and 2009, respectively. For the three months ended September 30, 2010, our effective tax rate was lower than the U.S. federal statutory rate of 35% as a result of the partial release of a deferred tax asset valuation allowance, an enhanced deduction for certain research and development expenses, profits in foreign jurisdictions with reduced income tax rates and a decrease in unrecognized tax benefits for uncertain tax positions. For the nine months ended September 30, 2010, our effective tax rate was lower than the U.S. federal statutory rate of 35% as a result of the partial release of a deferred tax asset valuation allowance, an enhanced deduction for certain research and development expenses and profits in foreign jurisdictions with reduced income tax rates. For the three and nine month periods ended September 30, 2009, our effective tax rate was lower than the U.S. federal statutory rate of 35% due to a partial release of a deferred tax asset valuation allowance, the research credit and a decrease in unrecognized tax benefits for uncertain tax positions. These benefits were partially offset by non-deductible stock-based compensation expenses, losses in foreign jurisdictions with reduced income tax rates and a valuation allowance related to a deferred tax asset for which a tax benefit was previously recognized.

The tax position of our Hungarian operation continues to benefit from assets created by the restructuring of our operations in Hungary. In addition, effective January 1, 2010, a new tax law in Hungary provides for an enhanced deduction for the qualified research and development expenses of NI Hungary Software and Hardware Manufacturing Kft. ("NI Hungary"). Partial release of the valuation allowance on assets from the restructuring and the enhanced tax deduction for research expenses resulted in income tax benefits of $4.5 million and $1.7 million for the three month periods ended September 30, 2010 and 2009, respectively and $12.3 million and $5.9 million for the nine month periods ended September 30, 2010 and 2009, respectively.

Note 10 – Comprehensive income

Our comprehensive income is comprised of net income, foreign currency translation, unrealized gains and losses on forward and option contracts and unrealized gains and losses on our investments designated as available for sale. Comprehensive income for the three and nine month periods ended September 30, 2010 and September 30, 2009, was as follows (in thousands):

	Three Months Ended September 30, (unaudited)		Nine months Ended September 30, (unaudited)	
	2010	2009	2010	2009
Comprehensive income:				
Net income	$28,133	$9,931	$71,088	$14,719
Foreign currency translation gains (losses), net of taxes	8,792	2,413	(2,577)	2,908
Unrealized gains (losses) on derivative instruments, net of taxes	(908)	(1,987)	(8,000)	(1,838)
Unrealized gains (losses) on investments designated as available for sale, net of taxes	(536)	241	235	115
Total comprehensive income	$35,481	$10,598	$60,746	$15,904

Note 11 – Stock-based compensation plans

Stock option plans

Our stockholders approved the 1994 Incentive Stock Option Plan (the "1994 Plan") on May 9, 1994. At the time of approval, 9,112,500 shares of our common stock were reserved for issuance under this plan. In 1997, an additional 7,087,500 shares of our common stock were reserved for issuance under this plan, and an additional 750,000 shares were reserved for issuance under this plan in 2004. The 1994 Plan terminated in May 2005, except with respect to outstanding awards previously granted thereunder.

Awards under the plan were either incentive stock options within the meaning of Section 422 of the Internal Revenue Code or nonqualified options. The right to purchase shares vests over a five to ten-year period, beginning on the date of grant. Vesting of ten year awards may accelerate based on the Company's previous year's earnings and revenue growth but shares cannot accelerate to vest over a period of less than five years. Stock options must be exercised within ten years from date of grant. Stock options were issued with an exercise price which was equal to the market price of our common stock at the grant date. We estimate potential forfeitures of stock grants and adjust compensation cost recorded accordingly. The estimate of forfeitures will be adjusted over the requisite service period to the extent that actual forfeitures differ, or are expected to differ, from such estimates. Changes in estimated forfeitures will be recognized through a cumulative catch-up adjustment in the period of change and will also impact the amount of stock compensation expense to be recognized in future periods. During the nine months ended September 30, 2010, we did not make any changes in accounting principles or methods of estimates.

Restricted stock plans

Our stockholders approved our 2005 Incentive Plan (the “2005 Plan”) on May 10, 2005. At the time of approval, 2,700,000 shares of our common stock were reserved for issuance under this plan, as well as the number of shares which had been reserved but not issued under the 1994 Plan (our incentive stock option plan which terminated in May 2005), and any shares that returned to the 1994 Plan as a result of termination of options or repurchase of shares issued under such plan. The 2005 Plan, administered by the Compensation Committee of the Board of Directors, provided for granting of incentive awards in the form of restricted stock and restricted stock units (“RSUs”) to directors, executive officers and employees of the Company and its subsidiaries. Awards vest over a three, five or ten-year period, beginning on the date of grant. Vesting of ten year awards may accelerate based on the Company’s previous year’s earnings and growth but ten year awards cannot accelerate to vest over a period of less than five years. The 2005 Plan terminated on May 11, 2010, except with respect to outstanding awards previously granted thereunder. There were 2,241,536 share of common stock that were reserved but not issued under the 1994 Plan and the 2005 Plan as of May 11, 2010.

Our stockholders approved our 2010 Incentive Plan (the “2010 Plan”) on May 11, 2010. At the time of approval, 2,000,000 shares of our common stock were reserved for issuance under this plan, as well as the 2,241,536 share of common stock that were reserved but not issued under the 1994 Plan and the 2005 Plan as of May 11, 2010, and any shares that are returned to the 1994 Plan and the 2005 Plan as a result of forfeiture or termination of options or RSUs or repurchase of shares issued under these plans. The 2010 Plan, administered by the Compensation Committee of the Board of Directors, provides for granting of incentive awards in the form of restricted stock and RSUs to employees, directors and consultants of the Company and employees and consultants of any parent or subsidiary of the Company. Awards vest over a three, five or ten-year period, beginning on the date of grant. Vesting of ten year awards may accelerate based on the Company’s previous year’s earnings and growth but ten year awards cannot accelerate to vest over a period of less than five years. There were 4,188,716 shares available for grant under the 2010 Plan at September 30, 2010.

We estimate potential forfeitures of RSUs and adjust compensation cost recorded accordingly. The estimate of forfeitures will be adjusted over the requisite service period to the extent that actual forfeitures differ, or are expected to differ, from such estimates. Changes in estimated forfeitures will be recognized through a cumulative catch-up adjustment in the period of change and will also impact the amount of stock compensation expense to be recognized in future periods. During the nine months ended September 30, 2010, we did not make any changes in accounting principles or methods of estimates related to the 2010 Plan.

Employee stock purchase plan

Our employee stock purchase plan permits substantially all domestic employees and employees of designated subsidiaries to acquire our common stock at a purchase price of 85% of the lower of the market price at the beginning or the end of the purchase period. The plan has quarterly purchase periods beginning on February 1, May 1, August 1 and November 1 of each year. Employees may designate up to 15% of their compensation for the purchase of common stock under this plan. We had 1,237,994 shares of common stock reserved for future employee purchases under this plan at September 30, 2010. We issued 517,077 shares under this plan in the nine months ended September 30, 2010. The weighted average fair value of the employees’ purchase rights was $24.84 per share and was estimated using the Black-Scholes model. During the nine months ended September 30, 2010, we did not make any changes in accounting principles or methods of estimates related to the employee stock purchase plan.

For the three and nine month periods ended September 30, 2010 and September 30, 2009, stock-based compensation recorded as a component of cost of sales, sales and marketing, research and development, and general and administrative was as follows (in thousands):

	Three Months Ended September 30,	Nine months Ended September 30,

	(unaudited)		(unaudited)	
	2010	2009	2010	2009
Stock-based compensation				
Cost of sales	$332	$335	$1,014	$975
Sales and marketing	1,960	2,210	6,060	6,626
Research and development	1,771	1,929	5,129	5,349
General and administrative	672	728	1,991	2,288
Provision for income taxes	(1,295)	(409)	(4,422)	(5,288)
Total	$3,440	$4,793	$9,772	$9,950

Authorized Preferred Stock and Preferred Stock Purchase Rights Plan

We have 5,000,000 authorized shares of preferred stock. On January 21, 2004, our Board of Directors designated 750,000 of these shares as Series A Participating Preferred Stock in conjunction with its adoption of a Preferred Stock Rights Agreement (the "Rights Agreement") and declaration of a dividend of one preferred share purchase right (a "Right") for each share of common stock outstanding held as of May 10, 2004 or issued thereafter. Each Right will entitle its holder to purchase one one-thousandth of a share of National Instruments' Series A Participating Preferred Stock at an exercise price of $200, subject to adjustment, under certain circumstances. The Rights Agreement was not adopted in response to any effort to acquire control of National Instruments.

The Rights only become exercisable in certain limited circumstances following the tenth day after a person or group announces acquisitions of or tender offers for 20% or more of our common stock. In addition, if an acquirer (subject to certain exclusions for certain current stockholders of National Instruments, an "Acquiring Person") obtains 20% or more of our common stock, then each Right (other than the Rights owned by an Acquiring Person or its affiliates) will entitle the holder to purchase, for the exercise price, shares of our common stock having a value equal to two times the exercise price. Under certain circumstances, our Board of Directors may redeem the Rights, in whole, but not in part, at a purchase price of $0.01 per Right. The Rights have no voting privileges and are attached to and automatically traded with our common stock until the occurrence of specified trigger events. The Rights will expire on the earlier of May 10, 2014 or the exchange or redemption of the Rights.

Note 12 – Segment information

We determine operating segments using the management approach. The management approach designates the internal organization that is used by management for making operating decisions and assessing performance as the source of our operating segments. It also requires disclosures about products and services, geographic areas and major customers.

We have defined our operating segment based on geographic regions. We sell our products in three geographic regions. Our sales to these regions share similar economic characteristics, similar product mix, similar customers, and similar distribution methods. Accordingly, we have elected to aggregate these three geographic regions into a single operating segment. Revenue from the sale of our products which are similar in nature and software maintenance are reflected as total net sales in our Consolidated Statements of Income.

Total net sales, operating income, interest income and long-lived assets, classified by the major geographic areas in which we operate, are as follows (in thousands):

	Three Months Ended September 30, (unaudited)		Nine Months Ended September 30, (unaudited)	
	2010	2009	2010	2009

Net sales:				
Americas:				
Unaffiliated customer sales	$97,031	$75,459	$266,300	$211,991
Europe:				
Unaffiliated customer sales	59,882	46,683	177,681	143,026
Asia Pacific:				
Unaffiliated customer sales	63,536	42,893	179,276	119,980
	$220,449	$165,035	$623,257	$474,997

	Three Months Ended September 30, (unaudited)		Nine Months Ended September 30, (unaudited)	
	2010	2009	2010	2009
Operating income:				
Americas	$21,395	$15,058	$52,689	$28,658
Europe	31,347	20,087	87,409	52,562
Asia Pacific	18,918	10,559	56,508	28,582
Unallocated:				
Research and development expenses	(39,971)	(35,016)	(114,912)	(99,252)
	$31,689	$10,688	$81,694	$10,550

	Three Months Ended September 30, (unaudited)		Nine Months Ended September 30, (unaudited)	
	2010	2009	2010	2009
Interest income:				
Americas	$177	$165	$433	$685
Europe	182	145	546	581
Asia Pacific	21	29	72	69
	$380	$339	$1,051	$1,335

	September 30, 2010 (unaudited)	December 31, 2009
Long-lived assets:		
Americas	$100,245	$100,489
Europe	34,773	36,555
Asia Pacific	16,649	16,221
	$151,667	$153,265

Total sales outside the United States for the three month periods ended September 30, 2010 and 2009, were $131.3 million and $95.4 million, respectively. Total sales outside the United States for the nine month periods ended September 30, 2010 and 2009, were $378.9 million and $282.5 million, respectively.

Note 13 – Commitments and contingencies

We offer a one-year limited warranty on most hardware products, with a two or three-year warranty on a subset of our hardware products, which is included in the sales price of many of our products. Provision is made for estimated future warranty costs at the time of the sale, for the estimated costs that may be incurred under the basic limited warranty. Our estimate is based on historical experience and product sales during this period.

The warranty reserve for the nine month periods ended September 30, 2010 and 2009, was as follows (in thousands):.

	Nine Months Ended September 30, (unaudited)	
	2010	2009
Balance at the beginning of the period	$921	$952
Accruals for warranties issued during the period	1,485	1,518
Settlements made(in cash or in kind) during the period	(1,483)	(1,551)
Balance at the end of the period	$923	$919

As of September 30, 2010, we have outstanding guarantees for payment of foreign operating leases, customs and foreign grants totaling approximately $2.0 million.

As of September 30, 2010, we have non-cancelable purchase commitments with various suppliers of customized inventory and inventory components totaling approximately $8.9 million over the next twelve months.

Note 14 – Recently issued accounting pronouncements

In October 2009, the FASB updated FASB ASC 605, Revenue Recognition (FASB ASC 605) that amended the criteria for separating consideration in multiple-deliverable arrangements. The amendments establish a selling price hierarchy for determining the selling price of a deliverable. The selling price used for each deliverable will be based on vendor-specific objective evidence if available, third–party evidence if vendor-specific objective evidence is not available, or estimated selling price if neither vendor-specific objective evidence nor third-party evidence is available. The amendments will change the application of the residual method of allocation and require that arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method. The relative selling price method allocates any discount in the arrangement proportionally to each deliverable on the basis of each deliverable’s selling price. This update will be effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. We are currently evaluating the requirements of this update and have not yet determined the impact on our consolidated financial statements.

In October 2009, the FASB updated FASB ASC 985, Software (FASB ASC 985) that changes the accounting model for revenue arrangements that include both tangible products and software elements. Tangible products containing software components and non-software components that function together to deliver the tangible product’s essential functionality are no longer within the scope of the software revenue guidance in Subtopic 985-605. In addition, the amendments require that hardware components of a tangible product containing software components always be excluded from the software revenue guidance. This update will be effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted. We are currently evaluating the requirements of this update and have not yet determined the impact on our consolidated financial statements.

In January 2010, the FASB updated FASB ASC 820, Fair Value Measurements and Disclosures (FASB ASC 820) that requires additional disclosures and clarifies existing disclosures regarding fair value measurements. The additional disclosures include 1) transfers in and out of Levels 1 and 2 and 2) activity in Level 3 fair value measurements. The update provides amendments that clarify existing disclosures on 1) level of disaggregation and 2) disclosures about inputs and valuation techniques. This update is effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. These disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. We adopted the update on January 1, 2010 as required and concluded it did not have a material impact on our consolidated financial position or results of operations.

In February 2010, the FASB updated FASB ASC 855, Subsequent Events (FASB ASC 855) that requires an entity that is an SEC filer to evaluate subsequent events through the date that the financial statements are issued. For an SEC filer, this guidance also eliminates the required disclosure of the date through which subsequent events are evaluated. This update is effective upon issuance. We adopted the update on January 1, 2010 as required and concluded it did not have a material impact on our consolidated financial position or results of operations.

Note 15 – Litigation

We filed a patent infringement action on January 25, 2001, in the U.S. District Court, Eastern District of Texas (Marshall Division) claiming that The MathWorks, Inc. (“MathWorks”) infringed certain of our U.S. patents. On January 30, 2003, a jury found infringement by MathWorks of three of the patents involved and awarded us specified damages. On September 23, 2003, the District Court entered final judgment in favor of us and entered an injunction against MathWorks’ sale of its Simulink and related products and stayed the injunction pending appeal. Upon appeal, the judgment and the injunction were affirmed by the U.S. Court of Appeals for the Federal Circuit (September 3, 2004). Subsequently the stay of injunction was lifted by the District Court. In November 2004, the final judgment amount of $7.4 million which had been held in escrow pending appeal was released to us.

An action was filed by MathWorks against us on September 22, 2004, in the U.S. District Court, Eastern District of Texas (Marshall Division), claiming that on that day MathWorks had released modified versions of its Simulink and related products, and seeking a declaratory judgment that the modified products do not infringe the three patents adjudged infringed in the District Court's decision of September 23, 2003 (and affirmed by the Court of Appeals on September 3, 2004). On November 2, 2004, MathWorks served the complaint on us. We filed an answer to MathWorks’ declaratory judgment complaint, denying MathWorks’ claims of non-infringement and alleging our own affirmative defenses. On January 5, 2005, the Court denied a contempt motion by us to enjoin the modified Simulink products under the injunction in effect from the first case. On January 7, 2005, we amended our answer to include counterclaims that MathWorks’ modified products are infringing three of our patents, and requested unspecified damages and an injunction. MathWorks filed its reply to our counterclaims on February 7, 2005, denying the counterclaims and alleging affirmative defenses. On March 2, 2005, we filed a notice of appeal regarding the Court's denial of the contempt motion. On March 15, 2005, the Court stayed MathWorks’ declaratory judgment action, pending a decision on the appeal by the Court of Appeals for the Federal Circuit. On February 9, 2006, the Court of Appeals for the Federal Circuit affirmed the District Court’s January 2005 order. On November 22, 2006, the District Court lifted the stay. The case schedule has yet to be set in this action. During the fourth quarter of 2004, we accrued $4 million related to our probable loss from this contingency, which consists entirely of anticipated patent defense costs that are probable of being incurred. In the fourth quarter of 2006, we accrued an additional $600,000 related to this contingency. During the third quarter of 2009, we reduced the accrual by $2 million and during the first quarter of 2010, we reduced the accrual by an additional $1,037,000 to reflect a decrease in the estimated costs that are probable of being incurred in this action. To date, we have charged a cumulative total of $638,000 against this accrual. At September 30, 2010, the remaining accrual was $925,000.

Note 16 – Subsequent events

We have evaluated subsequent events through the date the financial statements were issued.

On October 19, 2010, our Board of Directors declared a quarterly cash dividend of $0.13 per common share, payable on November 19, 2010, to shareholders of record on November 8, 2010.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Any statements contained herein regarding our future financial performance or operations (including, without limitation, statements to the effect that we “believe,” "expect," "plan," "may," "will," "project," "continue," or "estimate" or other variations thereof or comparable terminology or the negative thereof) should be considered forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements as a result of a number of important factors, including those set forth under the heading “Risk Factors” beginning on page 37, and the discussion below. Readers are also encouraged to refer to the documents regularly filed by us with the Securities and Exchange Commission, including our Annual Report on Form 10-K, for further discussion of our business and the risks attendant thereto.

Overview

National Instruments Corporation (“we”, “us” or “our”) is a leading supplier of measurement and automation products that engineers and scientists use in a wide range of industries. These industries comprise a large and diverse market for design, control and test applications. We provide flexible application software and modular, multifunctional hardware that users combine with industry-standard computers, networks and third party devices to create measurement, automation and embedded systems, which we also refer to as “virtual instruments”. Our approach gives customers the ability to quickly and cost-effectively design, prototype and deploy unique custom-defined solutions for their design, control and test application needs. We sell to a large number of customers in a wide variety of industries. No single customer accounted for more than 5% and 4% of our sales in the three and nine month periods ended September 30, 2010, respectively, or 3% of our sales in the years 2009, 2008 or 2007.

The key strategies that management focuses on in running our business are the following:

Expanding our broad customer base

We strive to increase our already broad customer base by serving a large market on many computer platforms, through a global marketing and distribution network. We also seek to acquire new technologies and expertise from time to time in order to open new opportunities for our existing product portfolio.

Maintaining a high level of customer satisfaction

To maintain a high level of customer satisfaction we strive to offer innovative, modular and integrated products through a global sales and support network. We strive to maintain a high degree of backwards compatibility across different platforms in order to preserve the customer’s investment in our products. In this time of intense global competition, we believe it is crucial that we continue to offer products with quality and reliability, and that these products provide cost-effective solutions for our customers.

Leveraging external and internal technology

Our product strategy is to provide superior products by leveraging generally available technology, supporting open architectures on multiple platforms and by leveraging our core technologies such as custom application specific integrated circuits (“ASICs”) across multiple products.

We sell into test and measurement (“T&M”) and industrial/embedded applications in a broad range of industries and as such are subject to the economic and industry forces which drive those markets. It has been our experience that the performance of these industries and our performance is impacted by general trends in industrial production for the global economy and by the specific performance of certain vertical markets that are intensive consumers of measurement technologies. Examples of these markets are semiconductor capital equipment, telecom, defense, aerospace, automotive and others. In assessing our business, we consider the trends in the Global Purchasing Managers Index ("PMI") published by JP Morgan, global industrial production as well as industry reports on the specific vertical industries that we target. Since August 2009, the PMI has had readings above 50 which are indicative of expansion in the industrial global economy, although in recent months, the PMI has been declining. We are unable to predict whether the current expansion cycle, as measured by the PMI, will be sustained throughout 2010 or into 2011.

We distribute our software and hardware products primarily through a direct sales organization. We also use independent distributors, OEMs, VARs, system integrators and consultants to market our products. We have sales offices in the U.S. and sales offices and distributors in key international markets. Sales outside of the Americas accounted for approximately 56% and 54% of our revenues for the three month periods ended September 30, 2010 and 2009, respectively, and approximately 57% and 55% of our revenues for the nine month periods ended September 30, 2010 and 2009, respectively. The vast majority of our foreign sales are denominated in the customers' local currency, which exposes us to the effects of changes in foreign currency exchange rates. We expect that a significant portion of our total revenues will continue to be derived from international sales. (See Note 12 - Segment information of Notes to Consolidated Financial Statements for details concerning the geographic breakdown of our net sales, operating income, interest income and long-lived assets).

We manufacture a substantial majority of our products at our facilities in Debrecen, Hungary. Additional production primarily of low volume or newly introduced products is done in Austin, Texas. Our product manufacturing operations can be divided into four areas: electronic circuit card and module assembly; chassis and cable assembly; technical manuals and product support documentation; and software duplication. We manufacture most of the electronic circuit card assemblies and modules in-house, although subcontractors are used from time to time. We currently use a subcontractor in Asia to manufacture a significant portion of our chassis but we are steadily moving an increasing percentage of this production in-house. We manufacture some of our electronic cable assemblies in-house, but many assemblies are produced by subcontractors. We primarily subcontract our software duplication, our technical manuals and product support documentation.

We believe that our long-term growth and success depend on delivering high quality software and hardware products on a timely basis. Accordingly, we focus significant efforts on research and development. We focus our research and development efforts on enhancing existing products and developing new products that incorporate appropriate features and functionality to be competitive with respect to technology, price and performance. Our success also is dependent on our ability to obtain and maintain patents and other proprietary rights related to technologies used in our products. We have engaged in litigation and where necessary, will likely engage in future litigation to protect our intellectual property rights. In monitoring and policing our intellectual property rights, we have been and may be required to spend significant resources.

We have been profitable in every year since 1990. However, there can be no assurance that our net sales will grow or that we will remain profitable in future periods. Our operating results fluctuate from period to period due to changes in global economic conditions and a number of other factors. As a result, we believe our historical results of operations should not be relied upon as indications of future performance.

Current business outlook

Many of the industries we serve have historically been cyclical and have experienced periodic downturns. Our customers across all industries and geographic regions demonstrated reduced order patterns throughout most of 2009. During the fourth quarter of 2009, we began to see positive trends in the order patterns of our customers and have seen those trends continue during the first nine months of 2010. These positive order trends are consistent with the expansion we have seen in the global industrial economy as measured by the global PMI, which has risen from 50 in July 2009 to 53 in September 2010. We have seen these positive trends across all geographic regions and across all the vertical markets that we serve although the strength of the trend varies by region and by market. We believe it is likely that the peak of the global PMI for this cycle was reached during the second quarter of 2010 when it reached a high of 58. Moving forward, we expect that the global PMI will trend towards its historical mean and reflect a more moderate rate of expansion. Given the relatively low levels of global inventory, we believe the industrial economy is positioned to manage the moderation of the global PMI, and that we are positioned to grow revenue through this moderating trend. If this expansion cannot be sustained, it could have an adverse effect on the spending patterns of businesses including our current and potential customers which could adversely affect our revenues and therefore harm our business and result of operations. Our key strategies in this economic environment are to maintain a stable gross margin, to maintain a disciplined approach toward operating expenses, and to maintain strong employee productivity. As a result, we expect to increase our operating expenses at a rate closer to that of our revenue growth going forward.

Results of Operations

The following table sets forth, for the periods indicated, the percentage of net sales represented by certain items reflected in our Consolidated Statements of Income:

	Three Months Ended September 30,				Nine months Ended September 30,			
	2010		2009		2010		2009	
Net sales:								
Americas	44.0	%	45.7	%	42.7	%	44.6	%
Europe	27.2		28.3		28.5		30.1	
Asia Pacific	28.8		26.0		28.8		25.3	
Consolidated net sales	100.0		100.0		100.0		100.0	
Cost of sales	23.5		25.4		23.1		26.0	
Gross profit	76.5		74.6		76.9		74.0	
Operating expenses:								
Sales and marketing	36.1		39.4		37.4		41.9	
Research and development	18.1		21.2		18.4		20.9	
General and administrative	7.9		7.5		8.0		9.0	
Total operating expenses	62.1		68.1		63.8		71.8	
Operating income	14.4		6.5		13.1		2.2	
Other income (expense):								
Interest income	0.1		0.2		0.2		0.3	
Net foreign exchange gain (loss)	0.2		0.5		(0.4	)	0.3	
Other income, net	0.1		0.3		0.1		0.2	
Income before income taxes	14.8		7.5		13.0		3.0	
Provision for (benefit from) income taxes	2.0		1.5		1.6		(0.1	)
Net income	12.8	%	6.0	%	11.4	%	3.1	%

Net Sales. Net sales were $220 million and $165 million for the three month periods ended September 30, 2010 and 2009, respectively, an increase of 34%. For the nine month periods ended September 30, 2010 and 2009, net sales were $623 million and $475 million, respectively, an increase of 31%. These increases can be attributed to increases in sales volume across all areas of our business. Products in the areas of virtual instrumentation and graphical system design, which comprised approximately 93% of our revenue in the three and nine month periods ended September 30, 2010, saw year-over-year revenue increases of 34% and 31%, respectively. Instrument control products, which comprised approximately 7% of our revenue in each of the three and nine month periods ended September 30, 2010, saw year-over-year revenue increases of 25% and 41%, respectively. For the three and nine month periods ended

September 30, 2009, instrument control products comprised 7% of our revenues, respectively, while virtual instrumentation and graphical system design comprised 93%, respectively. Our instrument control products are the most economically sensitive portion of our revenue. We did not take any significant action with regard to product pricing during the three and nine month periods ended September 30, 2010, and thus, the increase in revenues is attributable to an increase in customer orders.

For the three month periods ended September 30, 2010 and 2009, sales in the Americas were $97 million and $75 million, respectively, an increase of 29%, sales in Europe were $60 million and $47 million, respectively, an increase of 28% and sales in Asia were $64 million and $43 million, respectively, an increase of 48%. We expect sales outside of the Americas to continue to represent a significant portion of our revenue. We intend to continue to expand our international operations by increasing our presence in existing markets, adding a presence in some new geographical markets and continuing the use of distributors to sell our products in some countries. Sales outside of the Americas, as a percentage of consolidated sales, increased to 56% for the three months ended September 30, 2010, from 54% for the same period in 2009.

For the nine month periods ended September 30, 2010 and 2009, sales in the Americas were $266 million and $212 million, respectively, an increase of 26%, sales in Europe were $178 million and $143 million, respectively, an increase of 24% and sales in Asia were $179 million and $120 million, respectively, an increase of 49%. Sales outside of the Americas, as a percentage of consolidated sales, increased to 57% for the nine months ended September 30, 2010 compared to 55% for the comparable period in 2009.

Almost all sales made by our direct sales offices in the non U.S. Americas, in Europe and in Asia Pacific are denominated in local currencies, and accordingly, the U.S. dollar equivalent of these sales is affected by changes in foreign currency exchange rates. For the three months ended September 30, 2010, in local currency terms, our consolidated sales increased by $59 million or 36%, Americas sales increased by $21 million or 28%, European sales increased by $19 million or 40%, and sales in Asia Pacific increased by $19 million or 45% compared to the three months ended September 30, 2009. During this same period, the change in exchange rates had the effect of decreasing our consolidated sales by $5 million or 3%, increasing Americas sales by $602,000 or 1%, decreasing European sales by $7 million or 15%, and increasing sales in Asia Pacific by $1.6 million or 4% compared to the three months ended September 30, 2009.

For the nine months ended September 30, 2010, in local currency terms, our consolidated sales increased by $132 million or 28%, Americas sales increased by $51 million or 24%, European sales increased by $32 million or 23%, and sales in Asia Pacific increased by $50 million or 41% compared to the nine months ended September 30, 2009. During this same period, the change in exchange rates had the effect of increasing our consolidated sales by $12 million or 3%, increasing Americas sales by $3 million or 2%, decreasing European sales by $2 million or 1%, and increasing sales in Asia Pacific by $10 million or 8% compared to the nine months ended September 30, 2009.

To help protect against a reduction in value caused by a fluctuation in foreign currency exchange rates of forecasted foreign currency cash flows resulting from international sales, we have instituted a foreign currency cash flow hedging program. We hedge portions of our forecasted revenue denominated in foreign currencies with forward and purchased option contracts. During the three and nine month periods ended September 30, 2010, these hedges had the effect of increasing our consolidated sales by $1.4 million and $4.4 million, respectively. These increases mostly occurred in Europe. (See Note 5 - Derivative instruments and hedging activities of Notes to Consolidated Financial Statements for further discussion regarding our cash flow hedging program and its related impacted on our consolidated sales for the three and nine month periods ended September 30, 2010 and 2009).

Gross Profit. Gross profit was $169 million and $123 million for the three month periods ended September 30, 2010 and 2009, respectively, an increase of 37%. For the nine month periods ended September 30, 2010 and 2009, gross profit was $479 million and $352 million, respectively, an increase of 36%. As a percentage of net sales, gross margin was 77% and 75% for the three month periods ended September 30, 2010, and 2009, respectively, and 77% and 74%

for the nine month periods ended September 30, 2010, and 2009, respectively. The increases in gross profit in absolute dollars and as a percent of net sales for the three and nine month periods ended September 30, 2010, compared to the same periods in 2009, are attributed to increased sales volumes as well as our continued efforts to reduce costs throughout our manufacturing cycle.

For the three month periods ended September 30, 2010 and 2009, charges related to acquisition related intangibles and stock based compensation included in cost of goods sold were $1.3 million and $1.2 million, respectively. For each of the nine month periods ended September 30, 2010 and 2009, charges related to acquisition related intangibles and stock based compensation included in cost of goods sold were $3.6 million. For the three month and nine month periods ended September 30, 2010, the net impact of foreign currency exchange rates had the effect of increasing our cost of goods sold by $1.3 million and $2.7 million, respectively.

Sales and Marketing. Sales and marketing expenses were $79 million and $65 million for the three month periods ended September 30, 2010 and 2009, respectively, an increase of 22%. For the nine month periods ended September 30, 2010 and 2009, sales and marketing expenses were $233 million and $199 million, respectively, an increase of 17%. As a percentage of net sales, sales and marketing expenses were 36% and 39% for the three month periods ended September 30, 2010 and 2009, respectively and 37% and 42% for the nine month periods ended September 30, 2010 and 2009, respectively. Overall, the decrease in sales and marketing expense as a percentage of net sales were due to the 34% increase in net sales during the three months ended September 30, 2010, and the 31% increase in net sales during the nine months ended September 30, 2010, compared to the same periods in 2009.

For the three months ended September 30, 2010, the increase in sales and marketing expenses in absolute dollars was due to an increase in personnel related expenses of $11 million which includes commissions, variable compensation and benefits as well as an increase in travel related expenses of $1.8 million during the three months ended September 30, 2010, compared to the same period in 2009. These increases were partially offset by a decrease caused by the net impact of changes in foreign currency exchange rates of $63,000. For the nine months ended September 30, 2010, the increase in sales and marketing expenses in absolute dollars was due to an increase in personnel related expenses of $23 million which includes commissions, variable compensation and benefits, as well as an increase caused by the net impact of changes in foreign currency exchange rates of $5 million. In addition, travel expenses increased by $3.5 million during the nine months ended September 30, 2010, compared to the same period in 2009.

We plan to continue to make investments in our field sales force during the remainder of 2010. Our field sales expansion during the remainder of 2010 will likely be targeted to strategic areas of opportunity, whether technical or regional. We expect sales and marketing expenses in future periods to continue to fluctuate as a percentage of sales based on recruiting, marketing and advertising campaign costs associated with major new product releases and entry into new market areas, investment in web sales and marketing efforts, increasing product demonstration costs and the timing of domestic and international conferences and trade shows.

Research and Development. Research and development expenses were $40 million and $35 million for the three month periods ended September 30, 2010 and 2009, respectively, an increase of 14%. For the nine month periods ended September 30, 2010 and 2009, research and development expenses were $115 million and $99 million, respectively, an increase of 16%. As a percentage of net sales, research and development expenses were 18% and 21% for the three month periods ended September 30, 2010 and 2009, respectively and 18% and 21% for the nine month periods ended September 30, 2010 and 2009, respectively. Overall, the decreases in research and development expenses as a percentage of net sales were due to the 34% increase in net sales during the three months ended September 30, 2010, and the 31% increase in net sales during the nine months ended September 30, 2010, compared to the same periods in 2009.

For the three months ended September 30, 2010, the increase in research and development expenses in absolute dollars was due to an increase in personnel related expenses of $7 million which includes variable compensation and benefits, offset slightly by a decrease caused by the net impact of changes in foreign currency exchange rates of

$14,000. For the nine months ended September 30, 2010, the increase in research and development expenses in absolute dollars was due to an increase in personnel related expenses of $17 million which includes commissions, variable compensation and benefits, as well as an increase caused by the net impact of changes in foreign currency exchange rates of $1.4 million. We plan to continue to make additional, targeted investments in our research and development group during the remainder of 2010 and into 2011.

We capitalize software development costs in accordance with FASB ASC 985. We amortize such costs over the related product's estimated economic life, generally three years, beginning when a product becomes available for general release. Software amortization expense included in cost of goods sold totaled $2.8 million and $2.5 million during the three month periods ended September 30, 2010 and 2009, respectively, and $8 million and $7 million during the nine month periods ended September 30, 2010 and 2009, respectively. Internally developed software costs capitalized during the three month periods ended September 30, 2010 and 2009, were $3.4 million and $1.3 million, respectively, and $15 million and $11 million during the nine month periods ended September 30, 2010 and 2009, respectively. Capitalization of internally developed software costs varies depending on the timing of when each project reaches technological feasibility and the length and scope of the development cycle of each individual project. (See Note 7 - Intangibles of Notes to Consolidated Financial Statements for a description of intangibles).

General and Administrative. General and administrative expenses were $17 million and $12 million for the three month periods ended September 30, 2010 and 2009, respectively, an increase of 41%. For the nine month periods ended September 30, 2010 and 2009, general and administrative expenses were $50 million and $43 million, respectively, an increase of 16%. As a percentage of net sales, general and administrative expenses were 8% for each of the three month periods ended September 30, 2010 and 2009, and 8% and 9% for the nine month periods ended September 30, 2010 and 2009, respectively. For the three months ended September 30, 2010, the increase in general and administrative expenses in absolute dollars was due to an increase in personnel related expenses of $2.0 million which includes variable compensation and benefits, as well as an increase in legal expenses of $2.0 million. This was partially offset by a decrease caused by the net impact of changes in foreign currency exchange rates of $367,000. For the nine months ended September 30, 2010, the increase in general and administrative expenses in absolute dollars was due to an increase in personnel related expenses of $4.1 million which includes, variable compensation and benefits, as well as an increase in legal expenses and outside services of $2 million. In addition, there was an increase due to net impact of changes in foreign currency exchange rates of $562,000.

Interest Income. Interest income was $380,000 and $339,000 for the three month periods ended September 30, 2010 and 2009, respectively, an increase of 12%. This increase is attributable to an increase in invested funds. For the nine month periods ended September 30, 2010 and 2009, interest income was $1.1 million and $1.3 million, respectively, a decrease of 21%. This decrease is attributable to continued low yields for high quality investment alternatives that comply with our corporate investment policy. We do not expect yields in these types of investments to increase during the remainder of 2010. The source of interest income is from the investment of our cash and short-term and long-term investments.

Net Foreign Exchange Gain (Loss). Net foreign exchange gain/(loss) was $426,000 and $940,000 million for the three month periods ended September 30, 2010 and 2009, respectively. For the nine month periods ended September 30, 2010 and 2009, net foreign exchange gain/(loss) was $(2.5) million and $1.3 million, respectively. These results are attributable to movements in the foreign currency exchange rates between the U.S. dollar and foreign currencies in subsidiaries for which our functional currency is not the U.S. dollar. During the nine months ended September 30, 2010, the movement in many of these exchanges rates was volatile, exceeding 20% in some cases. This volatility reduced the effectiveness of our hedging programs. We cannot predict whether this level of volatility will continue or subside during the remainder of 2010. We recognize the local currency as the functional currency in virtually all of our international subsidiaries.

We utilize foreign currency forward contracts to hedge our foreign denominated net foreign currency balance sheet positions to help protect against the change in value caused by a fluctuation in foreign currency exchange rates. We typically hedge up to 90% of our outstanding foreign denominated net receivable or payable positions and typically limit the duration of these foreign currency forward contracts to approximately 90 days. The gain or loss on these derivatives as well as the offsetting gain or loss on the hedge item attributable to the hedged risk is recognized in current earnings under the line item "Net foreign exchange gain (loss)". Our hedging strategy reduced our foreign exchange gain by $2.2 million and reduced our foreign exchange gain by $1.6 million during the three month periods ended September 30, 2010 and 2009, respectively, and increased our foreign exchange losses by $857,000 and reduced our foreign exchange losses by $4 million during the nine month periods ended September 30, 2010 and 2009, respectively.

To help protect against the change in the value caused by a fluctuation in foreign currency exchange rates of forecasted foreign currency cash flows resulting from international sales and expenses over the next one to two years, we have a foreign currency cash flow hedging program. We hedge portions of our forecasted revenue and forecasted expenses denominated in foreign currencies with forward and option contracts. For forward contracts, when the dollar strengthens significantly against the foreign currencies, the change in the present value of future foreign currency cash flows may be offset by the change in the fair value of the forward contracts designated as hedges. For purchased option contracts, when the dollar strengthens significantly against the foreign currencies, the change in the present value of future foreign currency cash flows may be offset by the change in the fair value of the option contracts designated as hedges, net of the premium paid. Our foreign currency purchased option contracts are purchased "at-the-money" or "out-of-the-money." We purchase foreign currency forward and option contracts for up to 100% of our forecasted exposures in selected currencies (primarily in Euro, Japanese yen, British pound sterling and Hungarian forint) and limit the duration of these contracts to 40 months or less. As a result, our hedging activities only partially address our risks from foreign currency transactions, and there can be no assurance that this strategy will be successful. We do not invest in contracts for speculative purposes. (See Note 5 - Derivative instruments and hedging activities of Notes to Consolidated Financial Statements for a description of our forward and purchased option contracts and hedged positions).

Provision for Income Taxes. Our provision for income taxes reflected an effective tax rate of 14% and 20% for the three month periods ended September 30, 2010 and 2009, respectively, and 12% and (4)% for the nine month periods ended September 30, 2010 and 2009, respectively. The changes in our effective tax rates for the three and nine month periods ended September 30, 2010, compared to September 30, 2009, were due to the following;

	Three Months Ended September 30		Nine months Ended September 30	
Effective tax rate for the three and nine months periods ended September 30, 2009	20	%	(4	)%
Decrease in unrecognized tax benefits for uncertain tax positions as a percent of net income	8	%	8	%
Change in valuation allowance related to deferred tax assets recorded during the period	9	%	37	%
Increased profits in foreign jurisdictions with reduced income tax rates	(17	)%	(17	)%
Decrease in non-deductible stock-based compensation expense as a percentage of net income	(5	)%	(5	)%
Enhanced deduction for certain research and development expenses in 2010	(12	)%	(12	)%
Decrease in the tax benefit from equity awards that do not ordinarily result in a tax benefit	1	%	1	%
Other	5	%	(1	)%
Expiration of the research and development tax credit as of December 31, 2009	5	%	5	%
Effective tax rate for the three and nine month periods ended September 30, 2010	14	%	12	%

(See Note 9 - Income taxes of Notes to Consolidated Financial Statements for further discussion regarding our income taxes).

Liquidity and Capital Resources

Working Capital, Cash and Cash Equivalents and Short-term Investments. The following table presents our working capital, cash and cash equivalents and marketable securities (in thousands):

	September 30, 2010 (unaudited)	December 31, 2009	Increase/ (Decrease)
Working capital	$449,706	$413,759	$35,947
Cash and cash equivalents (1)	226,844	201,465	25,379
Short-term investments (1)	111,903	87,196	24,707
Total cash, cash equivalents and short-term investments	$338,747	$288,661	$50,086

(1) Included in working capital

Our working capital increased by $36 million at September 30, 2010, compared to December 31, 2009, due to the net effect of an increase in current assets of $87 million offset by an increase in current liabilities of $51 million. The increase in our current assets was attributed to the increase in our cash, cash equivalents and short-term investments of $50 million, an increase in accounts receivable of $18 million, an increase in inventory of $15 million and an increase in prepaid expenses and other current assets of $6 million. The increase in our current liabilities was the result of an increase in our accrued compensation of $24 million, an increase in accounts payable and other accruals and liabilities of $20 million and an increase in deferred revenue of $7 million. These increases can be attributed to our overall business growth during the nine months ended September 30, 2010.

Our cash and cash equivalent balances are held in numerous financial institutions throughout the world, including substantial amounts held outside of the U.S., however, the majority of our cash and investments that are located outside of the U.S. are denominated in the U.S. dollar with the exception of $33 million U.S. dollar equivalent that is denominated in Euro. Most of the amounts held outside of the U.S. could be repatriated to the U.S., but under current law, would be subject to U.S. federal income taxes, less applicable foreign tax credits. In some countries, repatriation of certain foreign balances is restricted by local laws. We have provided for the U.S. federal tax liability on these amounts for financial statement purposes, except for foreign earnings that are considered indefinitely reinvested outside of the U.S. Repatriation, and could result in additional U.S. federal income tax payments in future years. We utilize a variety of tax planning and financing strategies with the objective of having our worldwide cash available in the locations in which it is needed.

Cash Provided and (Used) in 2010 and 2009. Cash and cash equivalents increased to $227 million at September 30, 2010 from $201 million at December 31, 2009. The following table summarizes the proceeds and (uses) of cash (in thousands):

	Nine months Ended September 30, 2010 (unaudited)	2009
Cash provided by operating activities	$117,744	$90,345
Cash (used by) investing activities	(57,855)	(55,793)
Cash (used by) financing activities	(34,510)	(31,252)
Net increase in cash equivalents	25,379	3,300
Cash and cash equivalents at beginning of period	201,465	229,400

Cash and cash equivalents at end of period	$226,844	$232,700

For the nine month periods ended September 30, 2010 and 2009, cash provided by operating activities was $118 million and $90 million, an increase of 30%. This increase was primarily due to an increase in net income of $56 million offset by a net use of cash by operating assets and liabilities of $28 million compared to the nine months ended September 30, 2009.

Accounts receivable increased to $122 million at September 30, 2010, compared to $104 million at December 31, 2009. Days sales outstanding was 49 days at September 30, 2010, compared to 61 days at December 31, 2009. We typically bill customers on an open account basis subject to our standard net thirty day payment terms. If, in the longer term, our revenue increases, it is likely that our accounts receivable balance will also increase. Our accounts receivable could also increase if customers delay their payments or if we grant extended payment terms to customers, both of which are more likely to occur during challenging economic times when our customers may face issues gaining access to sufficient funding or credit.

Consolidated inventory balances increased to $102 million at September 30, 2010, from $87 million at December 31, 2009. Inventory turns were 2.0 at September 30, 2010, compared to 1.8 at December 31, 2009. The increase in inventory during the nine months ended September 30, 2010, was driven by an increase in our manufacturing activities in response to the positive order trends we have seen over the first nine months of 2010. Our inventory levels will continue to be determined based upon our anticipated demand for products and our need to keep sufficient inventory on hand to meet our customers' demands. Such considerations are balanced against the risk of obsolescence or potentially excess inventory levels. Rapid changes in customer demand could have a significant impact on our inventory balances in future periods.

For the nine month periods ended September 30, 2010 and 2009, cash used by investing activities was $58 million and $56 million, an increase of 4%. This increase was primarily due to an increase in capital expenditures of $2.1 million and an increase in capitalized software of $3.7 million compared to the nine months ended September 30, 2009. This was offset by a decrease in the net purchase of short-term investments of $4.1 million.

For the nine month periods ended September 30, 2010 and 2009, cash used by financing activities was $35 million and $31 million, an increase of 10%. This increase was primarily due to an increase in proceeds received from the issuance of common stock through our employee stock purchase plan as well as from the exercise of outstanding stock options of $22 million, offset by an increase in cash used for the repurchase of our common stock of $24 million and an increase in dividends paid to our shareholders of $2.5 million, compared to the nine months ended September 30, 2009.

From time to time, our Board of Directors has authorized various programs to repurchase shares of our common stock depending on market conditions and other factors. Under such programs, we repurchased a total of 1,392,732 shares of our common stock at a weighted average price per share of $30.06 during the nine months ended September 30, 2010, and 1,443,441 and 4,110,042 shares of our common stock at weighted average prices of $23.96 and $25.22 per share, in the years ended December 31, 2009 and 2008, respectively.

On April 21, 2010, our Board of Directors approved a new share purchase plan which increased the aggregate number of shares of common stock that we are authorized to repurchase from 674,098 to 3.0 million. This repurchase program does not have an expiration date.

During the nine months ended September 30, 2010, we received increased proceeds from the exercise of stock options compared to the nine months ended September 30, 2009. The timing and number of stock option exercises and the amount of cash proceeds we receive through those exercises are not within our control and in the future, we may not generate as much cash from the exercise of stock options as we have in the past. Moreover, since 2005 it has been our practice to issue RSUs and not stock options to eligible employees which will reduce the number of stock options available for exercise in the future. Unlike the exercise of stock options, the issuance of shares upon vesting of RSUs does not result in any cash proceeds to us. (See Note 11 - Stock-based compensation plans for additional discussion of our various stock-based compensation plans).

Contractual Cash Obligations. Purchase obligations primarily represent purchase commitments for customized inventory and inventory components. As of September 30, 2010, we have non-cancelable purchase commitments with various suppliers of customized inventory and inventory components totaling approximately $9 million. At December 31, 2009, we had non-cancelable purchase commitments with various suppliers of customized inventory and inventory components totaling approximately $7 million.

Guarantees are related to payments of customs and foreign grants. As of September 30, 2010, we have outstanding guarantees for payment of customs and foreign grants totaling approximately $2.0 million. As of December 31, 2009, we had outstanding guarantees for payment of customs and foreign grants totaling approximately $5 million.

Off-Balance Sheet Arrangements. We do not have any debt or off-balance sheet debt. As of September 30, 2010 and December 31, 2009, we did not have any relationships with any unconsolidated entities or financial partnerships, such as entities often referred to as structured finance entities, which would have been established for the purpose of facilitating off-balance sheet arrangements. As such, we are not exposed to any financing, liquidity, market or credit risk that could arise if we were engaged in such relationships.

Prospective Capital Needs. We believe that our existing cash, cash equivalents and marketable securities, together with cash generated from operations and from the exercise of employee stock options and the purchase of common stock through our employee stock purchase plan, will be sufficient to cover our working capital needs, capital expenditures, investment requirements, commitments, payment of dividends to our stockholders and repurchases of our common stock for at least the next 12 months. However, we may choose or be required to raise additional funds by selling equity or debt securities to the public or to selected investors, or by borrowing money from financial institutions. Historically, we have not had to rely on debt, public or private, to fund our operating, financing or investing activities. We could also choose or be required to reduce certain expenditures, such as payments of dividends or repurchases of our common stock. In addition, even though we may not need additional funds, we may still elect to sell additional equity or debt securities or obtain credit facilities for other reasons. If we elect to raise additional funds, we may not be able to obtain such funds on a timely basis or on acceptable terms, if at all. If we raise additional funds by issuing additional equity or convertible debt securities, the ownership percentages of existing stockholders would be reduced. In addition, the equity or debt securities that we issue may have rights, preferences or privileges senior to those of our common stock.

Although we believe that we have sufficient capital to fund our activities for at least the next 12 months, our future capital requirements may vary materially from those now planned. We anticipate that the amount of capital we will need in the future will depend on many factors, including:

- general economic and political conditions and specific conditions in the markets we address, including the continuing fluctuations in the industrial economy, and current general economic conditions and trends in the industrial economy in the various geographic regions in which we do business;
- the inability of certain of our customers who depend on credit to have access to their traditional sources of credit to finance the purchase of products from us, particularly if credit market conditions remain uncertain or worsen, which may lead them to reduce their level of purchases or to seek credit or other accommodations from us;
- the overall levels of sales of our products and gross profit margins;
- our business, product, capital expenditure and research and development plans, and product and technology roadmaps;
- repurchases of our common stock;
- required levels of research and development and other operating costs;
- litigation expenses, settlements and judgments;

- the levels of inventory and accounts receivable that we maintain;
- acquisitions of other businesses, assets, products or technologies;
- capital improvements for new and existing facilities;
- our relationships with suppliers and customers; and,
- the level of exercises of stock options and stock purchases under our employee stock purchase plan.

Recently Issued Accounting Pronouncements

See Note 14 - Recently Issued Accounting Pronouncements in Notes to Consolidated Financial Statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Response to this item is included in "Item 2 - Management's Discussion and Analysis of Financial Conditions and Results of Operations" above.

Financial Risk Management

Our international sales are subject to inherent risks, including fluctuations in local economies; fluctuations in foreign currencies relative to the U.S. dollar; difficulties in staffing and managing foreign operations; greater difficulty in accounts receivable collection; costs and risks of localizing products for foreign countries; unexpected changes in regulatory requirements, tariffs and other trade barriers; difficulties in the repatriation of earnings and burdens of complying with a wide variety of foreign laws. The vast majority of our sales outside of North America are denominated in local currencies, and accordingly, the U.S. dollar equivalent of these sales is affected by changes in the foreign currency exchange rates. The change in exchange rates had the effect of decreasing our consolidated sales by $5 million or 3% and increasing our consolidated sales by $12 million or 3% for the three and nine month periods ended September 30, 2010, compared to the same periods in 2009, respectively. If the local currencies in which we sell our products strengthen against the U.S. dollar, we may need to lower our prices in the local currency to remain competitive in our international markets which could have a material adverse effect on our gross and net profit margins. If the local currencies in which we sell our products weaken against the U.S. dollar and if the local sales prices cannot be raised due to competitive pressures, we will experience a deterioration of our gross and net profit margins. Since most of our international operating expenses are also incurred in local currencies, the change in exchange rates had the effect of decreasing our operating expenses by $416,000 or 0.4% and increasing our operating expenses by $7 million or 2% for the three and nine month periods ended September 30, 2010, compared to the same periods in 2009, respectively. Currently, we are experiencing significant volatility in foreign currency exchange rates in many of the markets in which we do business. This has had a significant impact on the revaluation of our foreign currency denominated firm commitments and on our ability to forecast our U.S. dollar equivalent revenues and expenses. In the past, these dynamics have also adversely affected our revenue growth in international markets and will likely pose similar challenges in the future. To help protect against changes in value caused by a fluctuation in foreign currency exchange rates of forecasted foreign currency cash flows resulting from international sales, we have instituted a foreign currency cash flow hedging program. We hedge portions of our forecasted revenue, cost of sales and operating expenses denominated in foreign currencies with forward and purchased option contracts. During the three and nine month periods ended September 30, 2010, these hedges had the effect of increasing our consolidated sales by $1.4 million and $4.4 million, respectively, decreasing our cost of sales by $374,000 and $1.8 million, respectively, and decreasing our operating expenses by $266,000 and $853,000, respectively. (See Note 5 - Derivative instruments and hedging activities of Notes to Consolidated Financial Statements for further discussion regarding our cash flow hedging program and its related impacted on our consolidated sales, cost of sales and operating expenses for the three and nine month periods ended September 30, 2010 and 2009).

Inventory Management

The marketplace for our products dictates that many of our products be shipped very quickly after an order is received. As a result, we are required to maintain significant inventories. Therefore, inventory obsolescence is a risk for us due to frequent engineering changes, shifting customer demand, the emergence of new industry standards and rapid technological advances including the introduction by us or our competitors of products embodying new technology. While we adjust for excess and obsolete inventories and we monitor the valuation of our inventories, there can be no assurance that our valuation adjustments will be sufficient.

Market Risk

We are exposed to a variety of risks, including foreign currency fluctuations and changes in the market value of our investments. In the normal course of business, we employ established policies and procedures to manage our exposure to fluctuations in foreign currency values and changes in the market value of our investments.

Cash, Cash Equivalents and Short-Term Investments

At September 30, 2010, we had $339 million in cash, cash equivalents and short-term investments. We maintain cash and cash equivalents and short-term investments with various financial institutions located in many countries throughout the world. Approximately $176 million or 52% of these amounts were held in domestic accounts with various financial institutions and $163 million or 48% was held in accounts outside of the U.S. with various financial institutions. At September 30, 2010, $81 million or 36% of our cash and cash equivalents was held in cash in various operating accounts throughout the world, and $146 million or 64% was held in money market accounts. The most significant of our operating accounts was our domestic operating account which held approximately $14 million or 6% of our total cash and cash equivalents at a bank that carried an A1 rating at September 30, 2010. Our short-term investment balance was comprised of $59 million or 52% held in our investment accounts in the U.S. and $53 million or 48% held in investment accounts of our foreign subsidiaries.

We maintain an investment portfolio of various types of security holdings and maturities. Cash equivalents and short-term investments available-for-sale are valued using a market approach (Level 1) based on the quoted market prices of identical instruments when available or other observable inputs such as trading prices of identical instruments in active markets.

The goal of our investment policy is to manage our investment portfolio to preserve principal and liquidity while maximizing the return on our investment portfolio through the full investment of available funds. We place our cash investments in instruments that meet credit quality standards, as specified in our corporate investment policy guidelines. These guidelines also limit the amount of credit exposure to any one issue, issuer or type of instrument. Our cash equivalents and short-term investments carried ratings from the major credit rating agencies that were in accordance with our corporate investment policy. Our investment policy allows investments in the following; government and federal agency obligations, repurchase agreements (“Repos”), certificates of deposit and time deposits, corporate obligations, medium term notes and deposit notes, commercial paper including asset-backed commercial paper (“ABCP”), puttable bonds, general obligation and revenue bonds, money market funds, taxable commercial paper, corporate notes/bonds, municipal notes, municipal obligations, variable rate demand notes and tax exempt commercial paper. All such instruments must carry minimum ratings of A1/P1/F1, MIG1/VMIG1/SP1 and A2/A/A, as applicable, all of which are considered “investment grade”. Our investment policy for marketable securities requires that all securities mature in three years or less, with a weighted average maturity of no longer than 18 months with at least 10% maturing in 90 days or less.

We account for our investments in debt and equity instruments under FASB ASC 320 Investments – Debt and Equity Securities (FASB ASC 320). Our investments are classified as available-for-sale and accordingly are reported at fair value, with unrealized gains and losses reported as other comprehensive income, a component of shareholders’ equity. Unrealized losses are charged against income when a decline in fair value is determined to be other than temporary. Investments with maturities beyond one year are classified as short-term based on their highly liquid nature and because such marketable securities represent the investment of cash that is available for current operations. The fair value of our short-term investments at September 30, 2010 and December 31, 2009 was $112 million and $87 million, respectively. The increase was due to the net purchase of $25 million of short-term investments which was done to continue the diversification our holdings from money market accounts to debt securities and to take advantage of higher yields associated with longer maturity debt securities.

We follow the guidance provided by FASB ASC 320 to assess whether our investments with unrealized loss positions are other than temporarily impaired. Realized gains and losses and declines in value judged to be other than temporary are determined based on the specific identification method and are reported in other income (expense), net, in our Consolidated Statements of Income.

Interest Rate Risk

Investments in both fixed rate and floating rate instruments carry a degree of interest rate risk. Fixed rate securities may have their market value adversely impacted due to an increase in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fall short of expectations due to changes in interest rates or if the decline in the fair value of our publicly traded debt investments is judged to be other-than-temporary. We may suffer losses in principal if we are forced to sell securities that have declined in market value due to changes in interest rates. However, because any debt securities we hold are classified as available-for-sale, no gains or losses are realized in our income statement due to changes in interest rates unless such securities are sold prior to maturity or unless declines in value are determined to be other-than-temporary. These securities are reported at fair value with the related unrealized gains and losses included in accumulated other comprehensive income (loss), a component of shareholders' equity, net of tax.

In a declining interest rate environment, as short-term investments mature, reinvestment occurs at less favorable market rates. Given the short-term nature of certain investments, the current interest rate environment of low or declining rates will likely negatively impact our investment income.

In order to assess the interest rate risk associated with our investment portfolio, we performed a sensitivity analysis to determine the impact a change in interest rates would have on the value of our investment portfolio assuming a 100 basis point parallel shift in the yield curve. Based on our investment positions as of September 30, 2010, a 100 basis point increase or decrease in interest rates across all maturities would result in a $887,000 increase or decrease in the fair market value of our portfolio. As of December 31, 2009, a similar 100 basis point shift in the yield curve would have resulted in a $614,000 increase or decrease in the fair market value of our portfolio. Such losses would only be realized if we sold the investments prior to maturity or if there is a other than temporary impairment.

Actual future gains and losses associated with our investments may differ from the sensitivity analyses performed as of September 30, 2010, due to the inherent limitations associated with predicting the changes in the timing and level of interest rates and our actual exposures and positions.

We have noted continued stabilization in the financial markets throughout 2010. As such, we have extended the maturity date of our holdings to include debt securities with maturities of up to 24 months to take advantage of the higher yields associated with longer maturities. However, yields, even at longer maturities, remain at or near historic lows. We weigh the benefit of the higher yields associated with longer maturities against the interest rate risk and credit rating risk, also associated with these longer maturities when making these decisions. We cannot predict when interest rates and investment yields will rise. If yields continue to stay at these low levels, our investment income will continue to be negatively impacted.

Exchange Rate Risk

Our objective in managing our exposure to foreign currency exchange rate fluctuations is to reduce the impact of adverse fluctuations in such exchange rates on our earnings and cash flow. Accordingly, we utilize purchased foreign currency option and forward contracts to hedge our exposure on anticipated transactions and firm commitments. The principal currencies hedged are the Euro, British pound, Japanese yen and Hungarian forint. We monitor our foreign exchange exposures regularly to help ensure the overall effectiveness of our foreign currency hedge positions. There can be no assurance that our foreign currency hedging activities will substantially offset the impact of fluctuations in currency exchanges rates on our results of operations and financial position. Based on the foreign exchange instruments outstanding at September 30, 2010 and December 31, 2009, an adverse change (defined as 20% in the Asian currencies and 10% in all other currencies) in exchange rates would result in a decline in the aggregate settlement value of all of our instruments outstanding of approximately $13 million and $22 million, respectively. However, as we utilize foreign currency instruments for hedging anticipated and firmly committed transactions, we believe that a loss in settlement value for those instruments will be substantially offset by increases in the value of the underlying exposure. (See Note 5 - Derivative instruments and hedging activities of Notes to Consolidated Financial Statements for a further description of our derivative instruments and hedging activities).

Item 4. Controls and Procedures

As of the end of the period covered by this Quarterly Report on Form 10-Q, our Chief Executive Officer, Dr. James Truchard, and our Chief Financial Officer, Alex Davern, based on their evaluation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended), required by paragraph (b) of Rule 13a – 15 or Rule 15d – 15, have concluded that our disclosure controls and procedures were effective at the reasonable assurance level, to ensure the timely collection, evaluation and disclosure of information relating to us that would potentially be subject to disclosure under the Securities Exchange Act of 1934, as amended, and the rules and regulations promulgated thereunder, and that such information is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. These disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports we file or submit is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Our assessment of the effectiveness of our internal control over financial reporting is expressed at the level of reasonable assurance because a control system, no matter how well designed and operated, can provide only reasonable, but not absolute assurance that the control system's objectives will be met. We continue to enhance our internal control over financial reporting in key functional areas with the goal of monitoring our operations at the level of documentation, segregation of duties, and systems security necessary, as well as transactional control procedures required under Auditing Standard No. 5 issued by the Public Company Accounting Oversight Board. We discuss and disclose these matters to the audit committee of our board of directors and to our auditors. During the three months ended September 30, 2010, there were no changes in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of the Rule 13a - 15 or Rule 15d - 15 that have materially affected, or are likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

See Note 15 - Litigation in Notes to Consolidated Financial Statements.

ITEM 1A. RISK FACTORS

Uncertain Economic conditions could materially adversely affect our business. Our business is sensitive to fluctuations in general economic conditions, both in the U.S. and globally. Uncertainty about current global economic conditions poses a risk as businesses may postpone spending in response to tight credit, unemployment, negative financial news, new tax policies, uncertainty in foreign currency markets, and/or declines in income or asset values. This could negatively impact the spending patterns of businesses including our current and potential customers which may have an adverse effect on our revenues and therefore harm our business and results of operations. Other factors that could adversely influence demand for our products include increases in fuel and other energy costs, higher labor and healthcare costs, restricted access to credit, declining consumer confidence, and other macroeconomic factors affecting business spending patterns. Over the last 24 months, the global PMI has reflected these uncertain economic conditions by reaching a low of 33 in December of 2008 and rising to a high of 58 in April 2010. Historically, our business cycles have followed the expansion and contraction cycles in the global Purchasing Managers Index ("PMI"). During the nine months ended September 30, 2010, the PMI had an average reading of 55. A reading above 50 is indicative of expansion in the global industrial economy. Moving forward we expect that the global PMI will trend towards its historical mean and reflect a more moderate rate of expansion. However, we are unable to predict whether the current expansion cycle, as measured by the PMI, will be sustained throughout 2010 and 2011. If this expansion is not sustained, even at moderate levels, it could have an adverse effect on the spending patterns of businesses including our current and potential customers which could adversely affect our revenues and therefore harm our business and result of operations.

We Have Established a Budget and Variations From Our Budget Will Affect Our Financial Results. During the fourth quarter of 2009, we established an operating budget for 2010. Our budgets are established based on the estimated revenue from sales of our products which are based on economic conditions in the markets in which we do business as well as the timing and volume of our new products and the expected penetration of both new and existing products in the marketplace. If demand for our products in the last quarter of 2010 is less than the demand we anticipated in setting our 2010 budget, our operating results could be negatively impacted. If we exceed the level of expenses established in our 2010 operating budget or if we cannot reduce budgeted expenditures in response to a decrease in revenue, our operating results could be adversely affected. Our spending could exceed our budgets due to a number of factors, including:

- additional marketing costs for new product introductions and/or for conferences and tradeshows;
- increased costs from hiring more product development engineers or other personnel;
- additional costs associated with our incremental investment in our field sales force;
- increased manufacturing costs resulting from component supply shortages and/or component price fluctuations;
- increased component costs resulting from vendors increasing prices in response to increased economic activity;
- additional expenses related to intellectual property litigation; and/or
- additional costs related to acquisitions, if any.

We are Subject to Risks Associated with Our Centralization of Inventory and Distribution. Currently, shipments to our customers worldwide are primarily sourced from our warehouse facility in Debrecen, Hungary. Shipments to some of our customers in Asia are currently made either out of local inventory managed by our branch operations in various Asian countries or from a centralized distribution point in Penang, Malaysia. We plan to continue to devote resources to centralizing our distribution to a limited number of shipping points. Our centralization of inventory and distribution from a limited number of shipping points is subject to inherent risks, including:

- burdens of complying with additional and/or more complex VAT and customs regulations; and,
- severe concentration of inventory increasing the risks associated with fire, natural disasters and logistics disruptions to customer order fulfillment.

No assurance can be given that our efforts will be successful. Any difficulties with the centralization of distribution or delays in the implementation of the systems or processes to support this centralized distribution could result in an interruption of our normal operations, including our ability to process orders and ship products to our customers. Any failure or delay in distribution from our facility in Hungary could have a material adverse effect on our operating results.

A Substantial Majority of Our Manufacturing Capacity is Located in Hungary. Our Hungarian manufacturing and warehouse facility sources a substantial majority of our sales. During the nine months ended September 30, 2010, we continued to maintain and enhance the systems and processes that support the direct shipment of product orders to our customers worldwide from our manufacturing facility in Hungary. In order to enable timely shipment of products to our customers we also maintain the vast majority of our inventory at our Hungary warehouse facility. In addition to being subject to the risks of maintaining such a concentration of manufacturing capacity and global inventory, this facility and its operation are also subject to risks associated with doing business internationally, including:

- difficulty in managing manufacturing operations in a foreign country;
- challenges in expanding capacity to meet increased demand;
- difficulty in achieving or maintaining product quality;
- interruption to transportation flows for delivery of components to us and finished goods to our customers;
- changes in the country’s political or economic conditions; and,
- changes in the country’s tax laws.

No assurance can be given that our efforts to mitigate these risks will be successful. We are currently operating our manufacturing facility in Hungary at a high level of capacity utilization and are selectively increasing our capacity to meet anticipated demand for our products. Any failure to effectively deal with the risks above could result in an interruption in the facility’s operation or delays in expanding its capacity, either of which could have a material adverse effect on our operating results and limit our revenue growth opportunities.
In response to significant and frequent changes in the corporate tax law, the unstable political environment, a restrictive labor code, the volatility of the Hungarian forint relative to the U.S. dollar and increasing labor costs, we have doubts as to the long term viability of Hungary as a location for our manufacturing and warehousing operations.

Our long term manufacturing and warehousing capacity planning contemplates a third manufacturing and warehousing facility in Penang, Malaysia. We began warehousing and distribution operations out of Penang, Malaysia via a third party logistics provider on October 1, 2010. We plan to start construction of a manufacturing and logistics facility in Malaysia in the third quarter of 2011, and plan to begin manufacturing operations at our Penang location during the third quarter of 2012. We believe that deployment of our Malaysian manufacturing facility could be accelerated in response to an unfavorable change in the corporate taxation, regulatory or economic environment in Hungary. We can give no assurance that we will be successful deploying our new facility in Malaysia on schedule or in accelerating such deployment if we needed to. Our failure to successfully deploy our new facility in Malaysia or to accelerate the deployment of our Malaysian manufacturing facility in response to unfavorable changes in the corporate taxation, regulatory or economic environment in Hungary, could have a material adverse effect on our ability to meet customer demands, our ability to grow our business as well as our liquidity, capital resources and results of operations. If we succeed in deploying our Malaysian manufacturing facility on schedule and the demand for our products does not grow as expected, we will have excess manufacturing capacity which will cause an increase in overhead that will negatively impact our gross margins and results of operations.

Concentrations of Credit Risk and Uncertain Conditions in the Global Financial Markets May Adversely Affect Our Financial Condition and Result of Operations. By virtue of our holdings of investment securities and foreign currency derivatives, we have exposure to many different counterparties, and routinely execute transactions with counterparties in the financial services industry, including commercial banks and investment banks. Many of these transactions expose us to credit risk in the event of a default of our counterparties. We have policies relating to initial credit rating requirements and to exposure limits to counterparties, which are designed to mitigate credit and liquidity risk. There can be no assurance, however, that any losses or impairments to the carrying value of our financial assets as a result of defaults by our counterparties, would not materially and adversely affect our business, financial position and results of operations.

Our Income Tax Rate is Affected by our Tax Benefits in Hungary. As a result of certain foreign investment incentives available under Hungarian law, the profit from our Hungarian operation was subject to a reduced income tax rate. This special tax status terminated on January 1, 2008, with the merger of our Hungarian manufacturing operations with its Hungarian parent company. In addition, effective January 1, 2010, a new tax law in Hungary provides for an enhanced deduction for the qualified research and development expenses of NI Hungary Software and Hardware Manufacturing Kft. (“NI Hungary”). During the three months ended December 31, 2009, we obtained confirmation of the application of this new tax law for the qualified research and development expenses of NI Hungary. Partial release of the valuation allowance on assets from the restructuring and the enhanced tax deduction for research expenses resulted in income tax benefits of $4.5 million and $1.7 million for the three month periods ended September 30, 2010, and 2009, respectively, and $12.3 million and $5.9 million for the nine month periods ended September 30, 2010, and 2009, respectively.

These benefits may not be available in future periods due to changes in Hungary’s political condition or tax laws. The reduction or elimination of these benefits in Hungary or future changes in U.S. law pertaining to taxation of foreign earnings could result in an increase in our future effective income tax rate which could have a material adverse effect on our operating results.

We Rely on Management Information Systems and any Disruptions in Our Systems Would Adversely Affect Us. We rely on a primary global center for our management information systems and on multiple systems in branches not covered by our global center. As with any information system, unforeseen issues may arise that could affect our ability to receive adequate, accurate and timely financial information, which in turn could inhibit effective and timely decisions. Furthermore, it is possible that our global center for information systems or our branch operations could experience a complete or partial shutdown. If such a shutdown occurred, it would impact our product shipments and revenues, as order processing and product distribution are heavily dependent on our management information systems. Accordingly, our operating results in such periods would be adversely impacted. We are continually working to maintain reliable systems to control costs and improve our ability to deliver our products in our markets worldwide. No assurance can be given that our efforts will be successful.

During the nine months ended September 30, 2010, we continued to devote resources to the development of our systems for manufacturing, sales and product services and to the continued development of our web offerings. There can be no assurance that we will not experience difficulties with our systems or web offerings. Difficulties with our systems or web offerings may interrupt our normal operations, including our ability to provide quotes, process orders, ship products, provide services and support to our customers, bill and track our customers, fulfill contractual obligations and otherwise run our business. Any disruption occurring with these systems or web offerings may have a material adverse effect on our operating results. During the nine months ended September 30, 2010, we devoted significant resources to the upgrade of our Americas business application suite to Oracle’s version R12. This upgrade was completed on July 4, 2010. These types of system wide upgrades have the potential to cause significant business disruptions. We have plans to mitigate these potential business disruptions but there is no certainty that our plans will be effective should such a disruption occur. For the remainder of 2010, we expect to continue to devote resources to the continued development of our web applications and to finalize the upgrade of our Americas business application suite to Oracle's version R12. We currently plan to upgrade our business application suite outside of the Americas to Oracle's version R12 in the second half 2011. Any failure to successfully implement these initiatives could have a material adverse effect on our operating results.

Recent Adoption of Complex Health Care Legislation and Related Regulations and Financial Reform Could Increase our Operating Costs. The recent adoption of the Patient Protection and Affordable Care Act and the related reconciliation measure, the Health Care and Education Reconciliation Act of 2010, and the regulations resulting from such legislation could increase the costs of providing health care to our employees. Due to the complexity of the legislation and the uncertain timing and content of the related regulations, we are unable to predict the amount and timing of any such increased costs. In addition it is likely that we will incur additional administrative costs to comply with certain provisions of this legislation. Due to the fact that many of the rules and regulations have not yet been defined, we are unable to predict the amount of these costs or to what extent we may need to divert other resources to comply with various provisions of this legislation. Additionally, the recently adopted Dodd-Frank Wall Street Reform and Consumer Protection Act could result in increased costs to us either as a result of our efforts to comply with the corporate governance provisions which may be applicable to us or due to the impact of such legislation on the derivative contracts or other financial instruments or financial markets that we utilize in the normal course of our business.

Our Quarterly Results are Subject to Fluctuations Due to Various Factors. Our quarterly operating results have fluctuated in the past and may fluctuate significantly in the future due to a number of factors, including:

- changes in the economy or credit markets in the U.S. or globally;
- changes in the mix of products sold;
- the availability and pricing of components from third parties (especially limited sources);
- fluctuations in foreign currency exchange rates;
- the timing, cost or outcome of intellectual property litigation;
- the difficulty in maintaining margins, including the higher margins traditionally achieved in international sales;
- changes in pricing policies by us, our competitors or suppliers;
- delays in product shipments caused by human error or other factors; and,
- disruptions in transportation channels.

Our Revenues are Subject to Seasonal Variations. In previous years, our revenues have been characterized by seasonality, with revenues typically growing from the first quarter to the second quarter, being relatively constant from the second quarter to the third quarter, growing in the fourth quarter compared to the third quarter and declining in the first quarter of the following year from the fourth quarter of the preceding year. This historical trend has been affected and may continue to be affected in the future by broad fluctuations in the global industrial economy, the economic impact of larger orders as well as the timing of new product introductions and/or acquisitions, if any. For example, our first quarter and second quarter of 2009 had sequential revenue declines from the fourth quarter of 2008 and first quarter of 2009, respectively, and the magnitude of the decline in the first quarter of 2009 was greater than what had occurred in the past. If the global industrial economy continues to grow and maintains stability throughout 2010 and 2011, we would expect to return to our typical historical revenue pattern. However, we cannot predict whether the global industrial economy will continue to grow or maintain stability throughout 2010 and 2011. We believe the historical pattern of seasonality of our revenue results from the international mix of our revenue and the variability of the budgeting and purchasing cycles of our customers throughout each international region. In addition, our total operating expenses have in the past tended to increase in each successive quarter and have fluctuated as a percentage of revenue based on the seasonality of our revenue. During 2009, we were able to reduce our operating costs compared to 2008. Some of the cost cutting measures implemented in 2009, such as salary reductions, were discontinued during the nine months ended September 30, 2010. During 2010, we plan to continue our strategic investments in research and development and field sales while limiting expense growth elsewhere.

We Operate in Intensely Competitive Markets. The markets in which we operate are characterized by intense competition from numerous competitors, some of which are divisions of large corporations having far greater resources than we have, and we may face further competition from new market entrants in the future. A key competitor is Agilent Technologies Inc. ("Agilent"). Agilent offers hardware and software products that provide solutions that directly compete with our virtual instrumentation products. Agilent is aggressively advertising and marketing products that are competitive with our products. Because of Agilent's strong position in the instrumentation business, changes in its marketing strategy or product offerings could have a material adverse effect on our operating results.

We believe our ability to compete successfully depends on a number of factors both within and outside our control, including:

- new product introductions by competitors;
- product pricing;
- the impact of foreign exchange rates on product pricing;
- quality and performance;
- success in developing new products;
- adequate manufacturing capacity and supply of components and materials;
- efficiency of manufacturing operations;
- effectiveness of sales and marketing resources and strategies;
- strategic relationships with other suppliers;
- timing of our new product introductions;
- protection of our products by effective use of intellectual property laws;
- the outcome of any material intellectual property litigation;
- the financial strength of our competitors;
- barriers to entry imposed by competitors with significant market power in new markets;
- general market and economic conditions; and,
- government actions throughout the world.

There can be no assurance that we will be able to compete successfully in the future.

Our Product Revenues are Dependent on Certain Industries. Sales of our products are dependent on customers in certain industries, particularly the telecommunications, semiconductor, automotive, automated test equipment, defense and aerospace industries. As we have experienced in the past, and as we may continue to experience in the future, downturns characterized by diminished product demand in any one or more of these industries may result in decreased sales, and a material adverse effect on our operating results.

Our Success Depends on New Product Introductions and Market Acceptance of Our Products. The market for our products is characterized by rapid technological change, evolving industry standards, changes in customer needs and frequent new product introductions, and is therefore highly dependent upon timely product innovation. Our success is dependent on our ability to successfully develop and introduce new and enhanced products on a timely basis to replace declining revenues from older products, and on increasing penetration in domestic and international markets. As has occurred in the past and as may be expected to occur in the future, we have experienced significant delays between the announcement and the commercial availability of new products. Any significant delay in releasing new products could have a material adverse effect on the ultimate success of a product and other related products and could impede continued sales of predecessor products, any of which could have a material adverse effect on our operating results. There can be no assurance that we will be able to introduce new products in accordance with announced release dates, that new products will achieve market acceptance or that any such acceptance will be sustained for any significant period. Failure of our new products to achieve or sustain market acceptance could have a material adverse effect on our operating results. Moreover, there can be no assurance that our international sales will continue at existing levels or grow in accordance with our efforts to increase foreign market penetration.

Our Business is Dependent on Key Suppliers. Our manufacturing processes use large volumes of high-quality components and subassemblies supplied by outside sources. Several of these components are available through limited sources. Limited source components purchased include custom application specific integrated circuits (“ASICs”), chassis and other components. We have in the past experienced delays and quality problems in connection with limited source components, and there can be no assurance that these problems will not recur in the future. Accordingly, our failure to receive components from limited suppliers could result in a material adverse effect on our revenues and operating results. In the event that any of our limited suppliers experience significant financial or operational difficulties due to adverse global economic conditions or otherwise, our business and operating results would likely be adversely impacted until we are able to secure another source for the required materials.

We May Experience Component Shortages. As has occurred in the past and as may be expected to occur in the future, supply shortages of components used in our products, including limited source components, can result in significant additional costs and inefficiencies in manufacturing. If we are unsuccessful in resolving any such component shortages in a timely manner, we will experience a significant impact on the timing of revenue, a possible loss of revenue, and/or an increase in manufacturing costs, any of which would have a material adverse impact on our operating results.

We are Subject to Risks Associated with Our Web Site. We devote resources to maintain our Web site as a key marketing, sales and support tool and expect to continue to do so in the future. However, there can be no assurance that we will be successful in our attempt to leverage the Web to increase sales. We host our Web site internally. Any failure to successfully maintain our Web site or any significant downtime or outages affecting our Web site could have a material adverse impact on our operating results.

Our Products are Complex and May Contain Bugs or Errors. As has occurred in the past and as may be expected to occur in the future, our new software products or new operating systems of third parties on which our products are based often contain bugs or errors that can result in reduced sales and/or cause our support costs to increase, either of which could have a material adverse impact on our operating results.

We are Subject to Various Risks Associated with International Operations and Foreign Economies. Our international sales are subject to inherent risks, including:

- fluctuations in local economies;
- fluctuations in foreign currencies relative to the U.S. dollar;
- difficulties in staffing and managing foreign operations;
- greater difficulty in accounts receivable collection;
- costs and risks of localizing products for foreign countries;
- unexpected changes in regulatory requirements;
- tariffs and other trade barriers;
- difficulties in the repatriation of earnings; and,
- the burdens of complying with a wide variety of foreign laws.

In many foreign countries, particularly in those with developing economies, it is common to engage in business practices that are prohibited by U.S. regulations applicable to us such as the Foreign Corrupt Practices Act. Although we have policies and procedures designed to ensure compliance with these laws, there can be no assurance that all of our employees, contractors and agents, including those based in or from countries where practices which violate such U.S. laws may be customary, will not take actions in violation of our policies. Any violation of foreign or U.S. laws by our employees, contractors or agents, even if such violation is prohibited by our policies, could have a material adverse effect on our business. We must also comply with various import and export regulations. The application of these various regulations depends on the classification of our products which can change over time as such regulations are modified or interpreted. As a result, even if we are currently in compliance with applicable regulations, there can be no assurance that we will not have to incur additional costs or take additional compliance actions in the future. Failure to comply with these regulations could result in fines and/or termination of import and export privileges, which could have a material adverse effect on our operating results. Additionally, the regulatory environment in some countries is very restrictive as their governments try to protect their local economy and value of their local currency against the U.S. dollar.

The vast majority of our sales outside of North America are denominated in local currencies, and accordingly, the U.S. dollar equivalent of these sales is affected by changes in the foreign currency exchange rates. The change in exchange rates had the effect of decreasing our consolidated sales by $5 million or 3% and increasing our consolidated sales by $12 million or 3% for the three and nine month periods ended September 30, 2010, compared to the same periods in 2009, respectively. If the local currencies in which we sell our products strengthen against the U.S. dollar, we may need to lower our prices in the local currency to remain competitive in our international markets which could have a material adverse effect on our gross and net profit margins. If the local currencies in which we sell our products weaken against the U.S. dollar and if the local sales prices cannot be raised due to competitive pressures, we will experience a deterioration of our gross and net profit margins. Since most of our international operating expenses are also incurred in local currencies, the change in exchange rates had the effect of decreasing our operating expenses by $416,000 or 0.4% and increasing our operating expenses by $7 million or 2% for the three and nine month periods ended September 30, 2010, compared to the same periods in 2009, respectively. Currently, we are experiencing significant volatility in foreign currency exchange rates in many of the markets in which we do business. This has had a significant impact on the revaluation of our foreign currency denominated firm commitments, on our ability to forecast our U.S. dollar equivalent revenues and expenses and on the effectiveness of our hedging programs. In the past, these dynamics have also adversely affected our revenue growth in international markets and will likely pose similar challenges in the future.

Our Business Depends on Our Proprietary Rights and We are Subject to Intellectual Property Litigation. Our success depends on our ability to obtain and maintain patents and other proprietary rights relative to the technologies used in our principal products. Despite our efforts to protect our proprietary rights, unauthorized parties may have in the past infringed or violated certain of our intellectual property rights. We from time to time engage in litigation to protect our intellectual property rights. In monitoring and policing our intellectual property rights, we have been and may be required to spend significant resources. We from time to time may be notified that we are infringing certain patent or intellectual property rights of others. There can be no assurance that any existing intellectual property litigation or any intellectual property litigation initiated in the future, will not result in significant litigation expense, liability, injunction against the sale of some of our products, and a diversion of management's attention, any of which may have a material adverse effect on our operating results.

Our Reported Financial Results May be Adversely Affected by Changes in Accounting Principles Generally Accepted in the United States. We prepare our financial statements in conformity with accounting principles generally accepted in the U.S. These accounting principles are subject to interpretation by the Financial Accounting Standards Board and the Securities and Exchange Commission. A change in these policies or interpretations could have a significant effect on our reported financial results, and could affect the reporting of transactions completed before the announcement of a change.

Compliance With Sections 302 and 404 of the Sarbanes-Oxley Act of 2002 is Costly and Challenging. As required by Section 302 of the Sarbanes-Oxley Act of 2002, this Form 10-Q contains our managements' certification of adequate disclosure controls and procedures as of September 30, 2010. Our most recent annual report on Form 10-K also contains a report by our management on our internal control over financial reporting including an assessment of the effectiveness of our internal control over financial reporting as of December 31, 2009. Our most recent Form 10-K also contains an attestation and report by our external auditors with respect to the effectiveness of our internal control over financial reporting under Section 404 of the Sarbanes-Oxley Act. While these assessments and reports did not reveal any material weaknesses in our internal control over financial reporting, compliance with Sections 302 and 404 is required for each future fiscal year end. We expect that the ongoing compliance with Sections 302 and 404 will continue to be both costly and challenging and there can be no assurance that material weaknesses will not be identified in future periods. Any adverse results from such ongoing compliance efforts could result in a loss of investor confidence in our financial reports and have an adverse effect on our stock price.

Our Business Depends on the Continued Service of Key Management and Technical Personnel. Our success depends upon the continued contributions of our key management, sales, marketing, research and development and operational personnel, including Dr. Truchard, our Chairman and Chief Executive Officer, and other members of our senior management and key technical personnel. We have no agreements providing for the employment of any of our key employees for any fixed term and our key employees may voluntarily terminate their employment with us at any time. The loss of the services of one or more of our key employees in the future could have a material adverse effect on our operating results. We also believe our future success will depend upon our ability to attract and retain additional highly skilled management, technical, marketing, research and development, and operational personnel with experience in managing large and rapidly changing companies, as well as training, motivating and supervising employees. Our failure to attract or retain key technical or managerial talent could have an adverse effect on our operating results. We also recruit and employ foreign nationals to achieve our hiring goals primarily for engineering and software positions. There can be no guarantee that we will continue to be able to recruit foreign nationals at the current rate. There can be no assurance that we will be successful in retaining our existing key personnel or attracting and retaining additional key personnel. Failure to attract and retain a sufficient number of our key personnel could have a material adverse effect on our operating results.

Our Manufacturing Operations are Subject to a Variety of Environmental Regulations and Costs. We must comply with many different governmental regulations related to the use, storage, discharge and disposal of toxic, volatile or otherwise hazardous chemicals used in our manufacturing operations in the U.S. and in Hungary. Although we believe that our activities conform to presently applicable environmental regulations, our failure to comply with present or future regulations could result in the imposition of fines, suspension of production or a cessation of operations. Any such environmental regulations could require us to acquire costly equipment or to incur other significant expenses to comply with such regulations. Any failure by us to control the use of or adequately restrict the discharge of hazardous substances could subject us to future liabilities.

We Are Subject to the Risk of Product Liability Claims. Our products are designed to provide information upon which users may rely. Our products are also used in “real time” applications requiring extremely rapid and continuous processing and constant feedback. Such applications give rise to the risk that a failure or interruption of the system or application could result in economic damage or bodily harm. We attempt to assure the quality and accuracy of the processes contained in our products, and to limit our product liability exposure through contractual limitations on liability, limited warranties, express disclaimers and warnings as well as disclaimers contained in our “shrink wrap” license agreements with end-users. If our products contain errors that produce incorrect results on which users rely or cause failure or interruption of systems or processes, customer acceptance of our products could be adversely affected. Further, we could be subject to liability claims that could have a material adverse effect on our operating results or financial position. Although we maintain liability insurance for product liability matters, there can be no assurance that such insurance or the contractual limitations used by us to limit our liability will be sufficient to cover or limit any claims which may occur.

Our Acquisitions are Subject to a Number of Related Costs and Challenges. We have from time to time acquired, and may in the future acquire, complementary businesses, products or technologies. Achieving the anticipated benefits of an acquisition depends upon whether the integration of the acquired business, products or technology is accomplished efficiently and effectively. In addition, successful acquisitions generally require, among other things, integration of product offerings, manufacturing operations and coordination of sales and marketing and R&D efforts. These difficulties can become more challenging due to the need to coordinate geographically separated organizations, the complexities of the technologies being integrated, and the necessities of integrating personnel with disparate business backgrounds and combining two different corporate cultures. The integration of operations following an acquisition also requires the dedication of management resources, which may distract attention from our day-to-day business and may disrupt key R&D, marketing or sales efforts. The inability of our management to successfully integrate any future acquisition could harm our business. Some of the existing products previously sold by some of the entities we have acquired are of lesser quality than our products and/or could contain errors that produce incorrect results on which users rely or cause failure or interruption of systems or processes that could subject us to liability claims that could have a material adverse effect on our operating results or financial position. Furthermore, products acquired in connection with acquisitions may not gain acceptance in our markets, and we may not achieve the anticipated or desired benefits of such transaction.

Provisions in Our Charter Documents and Delaware Law and Our Stockholder Rights Plan May Delay or Prevent an Acquisition of Us. Our certificate of incorporation and bylaws and Delaware law contain provisions that could make it more difficult for a third party to acquire us without the consent of our Board of Directors. These provisions include a classified Board of Directors, prohibition of stockholder action by written consent, prohibition of stockholders to call special meetings and the requirement that the holders of at least 80% of our shares approve any business combination not otherwise approved by two-thirds of the Board of Directors. Delaware law also imposes some restrictions on mergers and other business combinations between us and any holder of 15% or more of our outstanding common stock. In addition, our Board of Directors has the right to issue preferred stock without stockholder approval, which could be used to dilute the stock ownership of a potential hostile acquirer. Our Board of Directors adopted a stockholders rights plan on January 21, 2004, pursuant to which we declared a dividend of one right for each share of our common stock outstanding as of May 10, 2004. This rights plan replaced a similar rights plan that had been in effect since our initial public offering in 1995. Unless redeemed by us prior to the time the rights are exercised, upon the occurrence of certain events, the rights will entitle the holders to receive upon exercise thereof shares of our preferred stock, or shares of an acquiring entity, having a value equal to twice the then-current exercise price of the right. The issuance of the rights could have the effect of delaying or preventing a change of control of us.

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

The following table provides information as of September 30, 2010 with respect to the shares of our common stock that we repurchased during the third quarter of 2010.

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Maximum number of shares that may yet be purchased under the plans or programs (1)
July 1, 2010 to July 31, 2010	-	-	-	3,000,000
August 1, 2010 to August 31, 2010	378,503	$28.87	378,503	2,621,497
September 1, 2010 to September 30, 2010	-	-	-	2,621,497
Total	378,503	$28.87	378,503	

(1) For the past several years, we have maintained various stock repurchase programs. At December 31, 2009, there were 1,688,327 shares available for repurchase under the program approved in January 2009. On April 21, 2010, our Board of Directors approved a new share repurchase program that increased the aggregate number of shares

of common stock that we are authorized to repurchase from 674,098 to 3.0 million. This repurchase program does not have an expiration date.

ITEM 5. OTHER INFORMATION

From time to time our directors, executive officers and other insiders may adopt stock trading plans pursuant to Rule 10b5-1(c) promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended. Jeffrey L. Kodosky and James J. Truchard have made periodic sales of our stock pursuant to such plans.

ITEM 6. EXHIBITS

3.1(1)	Certificate of Incorporation, as amended, of the Company.
3.2(2)	Amended and Restated Bylaws of the Company.
3.3(3)	Certificate of Designation of Rights, Preferences and Privileges of Series A Participating Preferred Stock of the Company.
4.1(4)	Specimen of Common Stock certificate of the Company.
4.2(5)	Rights Agreement dated as of January 21, 2004, between the Company and EquiServe Trust Company, N.A.
10.1(4)	Form of Indemnification Agreement.
10.2(6)	1994 Incentive Plan, as amended.*
10.3(7)	1994 Employee Stock Purchase Plan.*
10.5(8)	2005 Incentive Plan.*
10.6(9)	National Instruments Corporation Annual Incentive Program.*
10.7(10)	National Instruments Corporation Annual Incentive Program, as amended*
10.8(11)	2005 Form of Restricted Stock Unit Award Agreement (Non-Employee Director).*
10.9(11)	2005 Form of Restricted Stock Unit Award Agreement (Performance Vesting).*
10.10(11)	2005 Form of Restricted Stock Unit Award Agreement (Current Employee).*
10.11(11)	2005 Form of Restricted Stock Unit Award Agreement (Newly Hired Employee).*
10.12(12)	2010 Incentive Plan.*
10.13(13)	2010 Form of Restricted Stock Unit Award Agreement (Non-Employee Director).*
10.14(14)	2010 Form of Restricted Stock Unit Award Agreement (Performance Vesting).*
10.15(15)	2010 Form of Restricted Stock Unit Award Agreement (Current Employee).*
10.16(16)	2010 Form of Restricted Stock Unit Award Agreement (Newly Hired Employee).*
31.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document **
101.SCH	XBRL Taxonomy Extension Schema Document **
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document **
101.LAB	XBRL Taxonomy Extension Label Linkbase Document **
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document **
(1)	Incorporated by reference to the same-numbered exhibit filed with the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2003.
(2)	Incorporated by reference to the same-numbered exhibit filed with the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2007.
(3)	Incorporated by reference to the same-numbered exhibit filed with the Company's Registration Statement on Form 8-A on April 27, 2004.
(4)	Incorporated by reference to the Company's Registration Statement on Form S-1 (Reg. No. 33-88386) declared effective March 13, 1995.
(5)	Incorporated by reference to exhibit 4.1 filed with the Company's Current Report on Form 8-K filed on January 28, 2004.
(6)	Incorporated by reference to the same-numbered exhibit filed with the Company's Form 10-Q on August 5, 2004.
(7)	

	Incorporated by reference to exhibit 10.3 filed with the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2006.
(8)	Incorporated by reference to exhibit A of the Company's Proxy Statement dated and filed on April 4, 2005.
(9)	Incorporated by reference to exhibit 10.1 filed with the Company's Current Report on Form 8-K filed on June 27, 2006.
(10)	Incorporated by reference to exhibit 99.2 filed with the Company's Current Report on Form 8-K filed on October 28, 2008.
(11)	Incorporated by reference to the same-numbered exhibit filed with the Company's Form 10-Q on August 2, 2006.
(12)	Incorporated by reference to exhibit 10.1 filed with the Company's Current Report on Form 8-K filed on May 17, 2010.
(13)	Incorporated by reference to exhibit 10.2 filed with the Company's Current Report on Form 8-K filed on June 24, 2010.
(14)	Incorporated by reference to exhibit 10.3 filed with the Company's Current Report on Form 8-K filed on June 24, 2010.
(15)	Incorporated by reference to exhibit 10.4 filed with the Company's Current Report on Form 8-K filed on June 24, 2010.
(16)	Incorporated by reference to exhibit 10.5 filed with the Company's Current Report on Form 8-K filed on June 24, 2010.
*	Management Contract or Compensatory Plan or Arrangement
**	In accordance with Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability.

SIGNATURE

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

	NATIONAL INSTRUMENTS CORPORATION	
Dated: November 3, 2010	By:	/s/ Alex Davern
		Chief Operating Officer, Executive Vice President, Chief Financial Officer and Treasurer (principal financial and accounting officer)