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NATIONAL INSTRUMENTS CORP /DE/
Form 10-K/A
March 13, 2001

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

FORM 10-K/A
Amendment No. 1

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT
OF 1934

For the fiscal year ended: December 31, 2000

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE
ACT OF 1934

For the transition period from _____ to _____

Commission File Number 0-25426

NATIONAL INSTRUMENTS CORPORATION
(Exact name of registrant as specified in its charter)

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

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

Securities registered pursuant to Section 12(b) of the Act:
None

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, \$0.01 par value
(Title of Class)

Indicate by check mark if disclosure of delinquent filers pursuant to Item

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405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. []

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

The aggregate market value of voting stock held by non-affiliates of the registrant at the close of business on February 2, 2001, was \$1,483,331,318 based upon the last sales price reported for such date on the NASDAQ National Market System. For purposes of this disclosure, shares of Common Stock held by persons who hold more than 5% of the outstanding shares of Common Stock and shares held by officers and directors of the registrant as of December 31, 2000 have been excluded in that such persons may be deemed to be affiliates. This determination is not necessarily conclusive.

At the close of business on February 2, 2001, registrant had outstanding 50,690,054 shares of Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE

Part I and Part III incorporate certain information by reference from the definitive proxy statement for the Annual Meeting of Stockholders to be held on May 8, 2001 (the "Proxy Statement").

PART I

Certain information required by Part III is omitted from this Report in that the Registrant intends to file a definitive proxy statement pursuant to Regulation 14A with the Securities and Exchange Commission (the "Proxy Statement") relating to its annual meeting of stockholders not later than 120 days after the end of the fiscal year covered by this Report, and such information is incorporated by reference herein.

ITEM 1. BUSINESS

National Instruments Corporation (the "Company" or "National Instruments") is a leading supplier of measurement and automation products that engineers and scientists use in a wide range of industries. These industries are spread across a large and diverse market for test and measurement ("T&M") and industrial automation ("IA") applications. The Company provides flexible application software and modular, multifunction hardware that users combine with industry-standard computers, networks and the Internet to create measurement and automation systems, which the Company also refers to as "virtual instruments."

A virtual instrument is a user-defined measurement and automation system that consists of an industry standard computer or workstation equipped with the Company's user-friendly application software, cost-effective hardware and driver software. Virtual instrumentation represents a fundamental shift from traditional hardware-centered instrumentation systems to software-centered systems that exploit the computational, display, productivity and connectivity capabilities of computers, networks and the Internet. Because virtual instruments exploit these computation, connectivity, and display capabilities,

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users can define and change the functionality of their instruments, rather than being restricted by fixed-functions imposed by traditional instrument vendors. The Company's products empower users to monitor and control traditional instruments, create innovative computer-based systems that can replace traditional instruments at a lower cost, and develop systems that integrate measurement functionality with industrial automation. The Company believes that giving users flexibility to create their own user-defined virtual instruments for an increasing number of applications in a wide variety of industries, and letting users leverage the latest technologies from computers, networking and communications shortens system development time and reduces both short- and long-term costs of developing, owning and operating measurement and automation systems, and improves efficiency and precision of applications spanning research, design, production and service.

The Company is based in Austin, Texas and was incorporated under the laws of the State of Texas in May 1976 and was reincorporated in Delaware in June 1994. On March 13, 1995, the Company completed an initial public offering of shares of its Common Stock. The Company's Common Stock, \$0.01 par value, is quoted on the NASDAQ National Market System under the trading symbol NATI.

Industry Background

Engineers and scientists have long used instruments to observe, better understand and manage the real-world phenomena, events and processes related to their industries or areas of expertise. Instruments measure and control electrical signals, such as voltage, current and power, and physical phenomena, such as temperature, pressure, speed, flow, volume, torque and vibration. Common instruments include voltmeters, signal generators, oscilloscopes, dataloggers, spectrum analyzers, cameras, and temperature and pressure monitors and controllers. Instruments generally perform three basic functions: data acquisition and control; data analysis; and presentation of results. Instruments are used pervasively in research, education, manufacturing and service applications in numerous fields including electronics, automotive, aerospace, telecommunications, medical research and pharmaceutical, semiconductor and petrochemical.

Instruments and systems are used to facilitate research as well as product design, production and service. In research and development settings, scientists and engineers use instruments and systems to collect and analyze experimental data and simulate manufacturing processes or techniques. In manufacturing environments, engineers use instruments and systems to test and verify the proper operation of the products being

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manufactured and to monitor and control the manufacturing machines and processes. In service contexts, instruments and systems are used to monitor, troubleshoot and repair products and processes.

Traditional Instrument Applications for Measurement and Automation

Instrument applications can be generally categorized as either T&M or IA. T&M applications generally involve testing during the design, manufacture and service of a wide variety of products. IA applications generally involve automating the machinery and processes used in the production and distribution of a wide variety of products and materials.

A typical T&M instrument is a stand-alone unit that has input, output and analysis capabilities; knobs, switches and push buttons for user operation; and gauges, meters or other displays for visual data presentation. Traditionally, most T&M instruments were vendor-defined, fixed-function devices designed to

address specific applications. As a result, users had limited flexibility to adapt their instruments to changing requirements. In the 1960's, vendors began to incorporate integrated circuits, including programmable microcontrollers, to increase instrument flexibility. In the mid-1970's, the General Purpose Interface Bus ("GPIB" or "IEEE 488") was developed as a standard interface to connect instruments to external computers. The first computer controllers for GPIB instruments were based on proprietary hardware architectures. In the later 1970's, some minicomputers with general purpose but complex operating systems were equipped for GPIB instrument control. In the early 1980's, personal computers with limited processing power equipped with MS-DOS, a standard, character-based operating system, began replacing minicomputers as the preferred platforms for instrument control applications. In the 1990s, personal computers with Windows operating systems and graphics-based application software grew in popularity and became the dominant platforms for instrument control applications. In the late 1990s, connectivity to the Internet and the ability for personal computers to integrate and share data throughout the enterprise further increased the popularity and use of PC-based instrumentation systems, and new web-enabled tools enabled users to begin to easily leverage the internet for networked and distributed measurement applications.

IA systems have long included mechanical devices, analog gauges and meters, and since the 1960's, have also included electronic instruments such as data loggers and strip chart recorders. In the 1970's, programmable logic controllers ("PLCs"), special-purpose, proprietary stand-alone industrial computers, were introduced and were used primarily for "discrete" manufacturing applications such as automobile assembly. PLCs have traditionally had primitive operator interface panels incorporating buttons, lights and indicators. In parallel, sophisticated instrumentation systems called distributed control systems ("DCSs") were also adopted to provide computer control of large-scale continuous processes, such as those found in oil refineries. DCSs integrated a variety of sensors and control elements using both analog and digital connections, all controlled by a central computer running proprietary software. In the mid-1980's, another approach became available when industrial PC-based IA systems came into use. These early PC-based systems generally ran proprietary, vendor-defined software and incorporated plug-in data acquisition boards or interfaced to PLCs. In the 1990's, Ethernet networks grew in popularity as a standard for connectivity between IA devices, instruments, and systems, and personal computers with high-speed processors running Windows based operating systems. In addition, graphics-based application software grew in popularity as platforms for supervision and control of IA systems and applications. Finally, just as in T&M applications, in the late 1990's connectivity to the internet enabled users to leverage networked applications via the internet.

Limitations of Traditional Approaches to Instrumentation

Instruments and systems for both T&M and IA applications have historically shared common limitations, including: fixed, vendor-defined functionality; proprietary, closed architectures that were generally difficult to program and integrate with other systems; and inflexible operator interfaces that were usually cumbersome to operate and change. These problems have been further complicated in IA applications because specialized data transfer and communications standards have not evolved rapidly or been widely adopted. For example, PLCs,

while greatly improving control of individual processes, created multiple "islands of information" that were generally unable to communicate or share data with other systems throughout the manufacturing enterprise. Furthermore, proprietary instrumentation systems have traditionally been very expensive,

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with IA system prices ranging as high as several million dollars and T&M instrumentation system prices often ranging in the hundreds of thousands of dollars. In addition, the limitations on programmability of traditional systems means that adopting these systems to changing requirements is both expensive and time consuming, and users are often required to purchase multiple single-purpose instruments.

Although desktop computers in the 1980's typically were based on open architectures, until the 1990's they lacked higher-level application software development tools and intuitive graphical user interfaces ("GUIs"). Consequently, the process of creating intuitive operator interface and control panels was difficult and expensive. These early desktop computers also lacked the power to rapidly process and analyze the volume of data characteristic of many high data rate T&M and IA applications. In addition, desktop computers were difficult to network reliably until standard network operating systems evolved late in the decade. For all of these reasons, users and vendors were relatively slow to incorporate desktop computers in their instrumentation systems.

In the 1990's, desktop and portable computers improved significantly in data and graphics processing power, storage, communication, and networking capabilities, user-friendliness and reliability. Nevertheless, users accustomed to the flexibility, efficiency, power and open architecture of these later-generation computers, and the highly evolved application software available for business computing needs, have been generally frustrated in their efforts to integrate these computers into measurement and automation solutions. Standard desktop computers were not equipped with the hardware connections required to control many types of instruments and lacked instrumentation-specific application development tools, including GUI development environments. Neither standard programming languages such as C/ C++ and Visual Basic, nor operating systems such as Windows, Linux and UNIX, are "measurement aware." Without the aid of instrumentation-specific software to facilitate the integration of various instrumentation system capabilities and components, engineers and scientists could not easily utilize the full potential of computers, networks and the Internet to meet their measurement and automation requirements.

The Company's Approach to Measurement and Automation

The Company pioneered a new computer-based approach to measurement and automation called virtual instrumentation in 1986 when it introduced its LabVIEW application software, which is a graphical programming environment that empowers users to easily build their own computer-based instruments and systems to meet their specific measurement and automation needs. While a traditional instrument bundles the data acquisition, analysis and presentation functions in a single, stand-alone unit, "virtual instrument" system consists of industry standard computers or workstations equipped with the Company's user-friendly application software, cost-effective hardware and driver software that together perform the functions of instruments. By unbundling the key instrumentation functions, virtual instruments represent a fundamental shift from hardware-centered instrumentation systems to software-centered systems that exploit the computational, display, productivity and connectivity capabilities of computers, networks and the Internet. The Company's application software products give users the power and flexibility to define, implement, modify and control the core data acquisition, analysis, and presentation functions of instruments with their computer. Users can mix and match their choice of the Company's DAQ, GPIB, VXI, PXI, image acquisition, motion control or industrial communications products to create virtual instrumentation systems that meet their specific instrumentation needs. The Company's products empower users to monitor and control instruments, create innovative computer-based systems that can replace instruments at a lower cost, and integrate measurement functionality with industrial automation and standard network connectivity to improve efficiency and precision of applications spanning research, design,

production and service. Because much of the instrumentation functionality resides in the software, in a significant sense, the software is the instrument.

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User Benefits

Compared with traditional solutions, the Company believes its products and computer-based, virtual instrumentation approach provide the following significant customer benefits:

Performance, Ease-of-Use and Efficiency

The Company's virtual instrument application software brings the power and ease-of-use of computers, networks and the Internet to the instrumentation market. With features such as graphical programming, automatic code generation capabilities, graphical tools libraries, ready-to-use example programs and libraries of specific instrumentation functions, users can quickly build a virtual instrument system that meets their individual application needs. For example, a user may build the data acquisition and analysis functions of an instrument by selecting and connecting icons representing particular instrumentation functions and may customize the display on the computer's monitor to reflect the desired presentation. With faster time to solution, users have more time to optimize system functionality and performance, and can devote more time to their core work rather than to programming instruments. In addition, the continuous improvement in performance of PCs and the Internet, which are the core platform for the Company's approach, result in direct performance benefits for virtual instrument users in the form of faster execution for software-based measurement and automation applications, resulting in shorter test times and faster automation, and higher manufacturing throughput.

Modularity, Reusability and Reconfigurability

The Company's products include reusable hardware and software modules that offer considerable flexibility in configuring systems. This ability to reuse and reconfigure instrument systems allows users to reduce development time and maximize efficiency by eliminating duplicated programming efforts and to quickly adapt their instruments to new and changing needs. In addition, these features help protect both hardware and software investments against obsolescence.

Mix and Match Capabilities

The flexibility of the Company's virtual instrumentation approach permits users to mix and match many combinations of GPIB, VXI, DAQ, PXI, image acquisition, motion control and industrial communications products to build customized measurement and automation solutions. The Company's open product architecture provides a high level of integration between the Company's products and other industry standard instrumentation products. This approach provides users with the flexibility to mix and match the Company's and third-party hardware components when developing custom virtual instrumentation systems.

Long-Term Compatibility Across Multiple Computer Platforms

The Company offers a variety of multi-platform software products so users can choose the platform and programming methodology that best meets their needs and skills. These software products also have portable, open architectures so users can move their applications among multiple platforms and operating

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systems. In addition, the Company strives to ensure long-term compatibility between its products and the latest industry-standard computers, operating systems, programming languages and tools, as well as backward compatibility with its own product offerings.

Network and Integrate with Customers' Computing Environments

The Company's products facilitate connectivity of measurement and automation systems with the enterprise by utilizing industry communication standards such as the Web, Ethernet and TCP/IP. The Company's products provide integrated Web support, data and file transfer between computers, distributed access to databases and remote test and measurement and process monitoring capabilities. In addition, the

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Company's products are also compatible with a wide variety of familiar, easy-to-use software applications such as word processors, spreadsheets, Web browsers, and databases. In many cases, a single computer or workstation can serve both the instrumentation and general purpose computing needs of scientists and engineers.

Large User Base

The Company supports and encourages the sharing of ideas, derived software libraries and modules among its broad user base through its NI.com Web site, user groups, newsletters, conferences and seminars. This large base of users stimulates the expansion of the Company's network of approximately 600 third party system integrators and consultants, who can save users time and money by providing value-added expertise, software programs and integration of systems for use with the Company's products.

Lower Total Solution Cost

The Company believes that its products and solutions offer price/performance advantages over traditional instrumentation. Virtual instrumentation provides users the ability to utilize industry standard computers and workstations equipped with modular and reusable application software, cost-effective hardware and driver software that together perform the instrumentation functions that would otherwise be performed by costly, proprietary instrumentation systems. In addition, virtual instrumentation gives users the flexibility and portability to adapt to changing needs, whereas traditional closed systems are both expensive and time consuming to adapt, if adaptable at all.

Strategy

The Company's objective is to be a leading supplier of measurement and automation products and solutions to engineers, scientists and others in both T&M and IA applications. To achieve this objective, the Company is pursuing a strategy that includes the following elements:

Expand Broad Customer Base

Serve A Large and Diverse Market. The Company's products and services are designed to serve a broad customer base across many industries. The Company defines product features and capabilities by working closely with technically sophisticated customers and seeks to achieve high unit volumes by selling these same products to a large base of customers with diverse measurement and automation needs.

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Support Many Computer and Instrument Options. The Company diversifies its customer base by accommodating many popular computer platforms and a variety of instrumentation options. In addition, the Company expects to continue to create or adapt products for computer systems and instrumentation options that gain market acceptance. Customers are provided a range of price/performance options through the Company's extensive line of products.

Provide Worldwide Marketing and Distribution. The Company uses multiple coordinated distribution channels in its major world markets. The Company devotes significant resources to direct sales activities in the United States and in key international markets. In addition to its direct sales channel, the Company's other distribution channels include distributors, OEMs, VARs and systems integrators and consultants. By using this broad range of channels, the Company seeks to develop and maintain relations with its customers and prospects and to provide the levels of support, training and education required by the market. To address the range of sales opportunities, the Company expects to continue to pursue value-added sales channels through formal relationships with OEMs, VARs, consultants or other third parties when such relationships can add significant value to its products or revenues. The Company intends to expand each of these distribution networks to take advantage of market opportunities.

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Acquire New Technologies. The Company has in the past acquired companies, products, and technologies to augment its product offerings, and intends to continue to seek opportunities to satisfy customer needs and build market penetration through acquisitions of new products and technologies in the future. In connection with these acquisitions, the Company has leveraged its established sales channels in an effort to accelerate the delivery of the acquired product to the market and build market share.

Target Academic Environments. The Company markets and sells its products to colleges and universities, increasing the potential for future growth as students gain experience using the Company's products before entering the work force.

Maintain High Levels of Customer Satisfaction

Offer Innovative Modular and Integrated Solutions. The Company intends to continue to deliver innovative, modular software and hardware tools with open, portable architectures that can be easily integrated to create instrumentation systems and solutions. The Company solicits regular feedback from its customers, resulting in the addition of new product features and enhanced performance, to help ensure that existing and new products meet or surpass customer expectations.

Provide Global Customer Support and Education. The Company's sales and marketing engineers have the technical expertise necessary to understand customers' instrumentation application needs and work with them to identify cost-effective solutions using the virtual instrumentation approach. The Company also offers comprehensive customer support, including technical support via the NI.com Web site, electronic mail, bulletin boards, fax and telephone, newsletters, warranty service and repair, upgrade programs, free and paid seminars and technical classes. In 2000 the Company continued to invest heavily to leverage the Web for customer support. Through the Company's NI.com Web site, customers have access to a growing range of support options to solve their own problems directly over the Web, including software downloads, upgrades and bug fixes, automated product configuration tools, knowledge databases of common questions and answers, online seminars, and discussion forums.

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Deliver Long-Term Compatibility. The Company emphasizes consistency in the implementation of its products across different platforms and strives to maintain a high degree of backward compatibility between existing and new products, engendering a high degree of customer loyalty.

Leverage External and Internal Technology

Leverage Generally Available Technology. The Company leverages the research and development efforts of vendors of personal computers and workstations, operating systems, programming languages and software development tools, and their suppliers. By integrating Web, networking and communications capabilities directly in its software and hardware products, the Company's products allow users of its virtual instrument approach to easily distribute measurement and automation capabilities throughout factories and around the world, easily integrate measurement and automation data throughout their organization and across the enterprise and achieve advanced solutions at a lower development cost.

Support Open Architecture on Multiple Platforms. The Company approaches the market with an open architecture so users have the flexibility to combine the Company's products with those from instrument suppliers, computer vendors and competitors.

Leverage Core Technologies. The Company designs proprietary ASICs to optimize performance and reduce production costs. The Company utilizes these ASICs and its other internally developed hardware and software components in multiple products to achieve consistency and compatibility between products.

Develop and Support Industry Standards. The Company actively participates in efforts to standardize key technologies by participating in industry consortia and serving on standards committees, such as IEEE 488,

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VXI, Compact PCI, PXI, PICmg, the Interchangeable Virtual Instrumentation Foundation, also called IVI, Foundation Fieldbus, OPC, and ASAM, a new automotive measurement standard. The Company's ongoing strategy is to conform its products to established and emerging standards in both the general computer and the instrumentation industries.

Products and Technology

The Company offers an extensive line of measurement and automation products. Engineers, scientists and other users involved in T&M and IA applications can use these products with computers, networks and the Internet to develop customer-defined virtual instrument solutions. The Company's products consist of application software, and hardware components together with related driver software. In T&M applications, the Company's products can be used to monitor and control traditional instruments or to create computer-based instruments that can replace the traditional instruments. In IA applications, the Company's products can be used in the same ways as in T&M and can also be used to integrate measurement functionality with process automation capabilities. The Company's products are designed to work either in an integrated solution or separately. The Company believes that the flexibility, functionality and ease of use of its application software promotes sales of the Company's other software and hardware products.

Application Software

The Company believes that application software is playing an increasingly

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important role in the development of computer-based instruments and systems in measurement and automation applications. The Company's application software products leverage the increasing capability of computers, networks and the Internet for data analysis, connectivity and presentation power to bring increasing efficiency and precision to measurement and automation applications. The Company's application software products include LabVIEW, Measurement Studio, Lookout, Measure, Virtual Bench, TestStand, DIAdem and DASyLab. The Company's application software products are integrated with the Company's hardware/driver software.

The Company offers a variety of software products for developing measurement and automation applications to meet the different programming and computer preferences of its customers. LabVIEW and Measurement Studio are programming environments with which users can develop GUIs, control instruments and acquire, analyze and present data. With these software products, users can design custom virtual instruments by creating a GUI on the computer screen through which they operate the actual program and control selected hardware. Users can customize front panels with knobs, buttons, dials and graphs to emulate control panels of instruments or add custom graphics to visually represent the control and operation of processes. LabVIEW and Measurement Studio also have ready-to-use libraries for controlling hundreds of programmable instruments, including serial, GPIB and VXI, the Company's plug-in DAQ boards and PXI/PCI computer-based instruments. Once created, virtual instruments can be modified or used as components of another program by the original developer or another user.

The principal difference between LabVIEW and Measurement Studio is in the way users develop programs. With LabVIEW, users program graphically, developing application programs by connecting icons to create "block diagrams" which are natural design notations for scientists and engineers. With Measurement Studio, a software package which upgraded and replaced LabWindows/CVI and ComponentWorks, users may program with the conventional, text-based language of C. Measurement Studio also includes application-specific OLE or ActiveX controls and libraries to the Microsoft Visual Basic, Visual C++ and Borland Delphi development environments.

The latest revisions of LabVIEW and Measurement Studio software packages feature enhanced capabilities to allow users to more easily integrate the Web into their computer-based instrumentation applications. In 2000, the Company introduced a version of LabVIEW--LabVIEW 6i. LabVIEW 6i allows the customer to easily communicate, share and control measurement and automation systems and information with anyone on the Web, and customers can use the Internet and Intranets to build distributed, networked systems throughout their

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enterprise. In addition, in 2000 the Company expanded the capabilities of its LabVIEW Real Time software product to include support for the PXI hardware platform to allow users who have exceptional response requirements to reliably execute an expanded range of system-level applications even if the PC operating system crashes--solving a key objection some potential users have had in the past to using PC technology for embedded devices or for mission critical measurement and automation applications, and extending the range of applications for computer-based measurement and automation.

The Company also sells a range of optional add-on products for LabVIEW and Measurement Studio, such as advanced analysis libraries, database tools and Internet integration. In 2000, the Company also introduced the LabVIEW Datalogging and Supervisory Control Module, an add-on module for high channel count applications in research and development and manufacturing.

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The Company's instrumentation software products also include DASyLab and DIAdem. DASyLab is a schematic environment by which users can quickly configure simple DAQ applications using both the Company's and third-party DAQ boards. In 1999, the Company added DIAdem to its line of instrumentation software products. DIAdem is an easy to use, rapid development environment for data acquisition, monitoring, visualization, open and closed loop control, analysis, automation and documentation. DIAdem features extensive off-line analysis capabilities, including analysis functions specific to automotive test.

The Company also offers a software product called TestStand targeted for T&M applications in a manufacturing environment. TestStand is a test management environment for organizing, controlling, and running automated production test systems on the factory floor. It also generates customized test reports and integrates product and test data across the customers' enterprise and across the Internet. TestStand manages tests that are written in LabVIEW and Measurement Studio, C and C++, and VisualBasic, so test engineers can easily share and re-use test code throughout their organization and from one product to the next. TestStand is a key element of the Company's strategy to broaden the reach of its application software products across the corporate enterprise.

The Company's Lookout software product is targeted specifically for IA applications. Lookout is a non-programming solution. Lookout is a human machine interface/supervisory control and data acquisition ("HMI/SCADA") software product that requires no programming or script writing. Lookout provides a scalable architecture for applications ranging from HMIs to large, sophisticated SCADA applications.

Hardware Products and Related Driver Software

The Company's hardware and related driver software products include GPIB, VXI, DAQ, PXI, image acquisition, motion control, and industrial communications. The Company believes it can deliver significant cost/performance benefits to users and clearly distinguish its products from competitive products by designing proprietary ASICs for use in its hardware products. Software drivers are necessary to link hardware to the operating system and the Company's application software. The high level of integration between the Company's products provides users with the flexibility to mix and match hardware components when developing custom virtual instrumentation systems.

GPIB Interfaces/Driver Software. GPIB, also known as the IEEE 488 standard, has existed since 1975 and defines the protocol for transferring data between certain instruments and computers over an industry-standard cable. The computer must be equipped with a GPIB interface. Driver software controls the interface and the transfer of data between the instrument and the computer. GPIB is largely used in T&M applications.

The Company began selling GPIB products in 1977 and is a leading supplier of GPIB interface boards and driver software to control traditional GPIB instruments. These traditional instruments are manufactured by a variety of third-party vendors and are used primarily in T&M applications. The Company's diverse portfolio of hardware and software products for GPIB instrument control is available for a wide range of computers, workstations and minicomputers. The Company's GPIB product line also includes products for portable

computers such as a PCMCIA-GPIB interface card, and products for controlling GPIB instruments using the computer's standard parallel USB, IEEE 1394 (Firewire) and Ethernet ports.

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Portability of GPIB application programs is provided by the Company's NI-488.2 driver software, considered a de facto industry standard, and NI-VISA driver software. The Company offers networking capabilities through its GPIB products. With these products, users can communicate with and control GPIB instruments from any point on an Ethernet-based TCP/IP network. The Company also offers a variety of GPIB support products, including converters, expanders, extenders, data buffers and GPIB system analyzers as well as cables and other accessories.

VXI Modules/Driver Software. VXI is an industry standard high-end instrumentation platform developed in 1987 through an industry consortium to take advantage of the computation, connectivity and display capabilities of desktop computers and workstations. With VXI, the physical size of multiple instrument systems can be decreased and communication between instruments and computers can be dramatically improved. Like GPIB, VXI is supported by a variety of traditional third-party instrument manufacturers and is largely used in T&M applications.

VXI instruments are modular in design and can be inserted into an industry-standard chassis. Unlike GPIB instruments, VXI modules do not have a front panel for manual operation or visual data presentation. Therefore, software is necessary for users to create, define the functionality of and operate VXI instrumentation systems. Today, VXI is being used primarily to supplement or replace high-end GPIB products in T&M applications.

The Company is a leading supplier of VXI computer controller hardware and the accompanying NI-VXI and NI-VISA driver software. The Company also offers a variety of VXI DAQ modules with NI-DAQ driver software, as well as LabVIEW, Measurement Studio and TestStand software products for VXI systems.

DAQ Hardware/Driver Software. DAQ hardware and driver software products are "instruments on a board" that users can combine with sensors, signal conditioning hardware and software to acquire analog data and convert it into a digital format that can be accepted by a computer. The Company believes that computer-based DAQ products are typically a lower-cost solution than traditional instrumentation.

The Company believes that applications suitable for automation with computer-based DAQ products are widespread throughout many industries, and that many systems currently using traditional instrumentation (either manual or computer-controlled) could be displaced by computer-based DAQ systems. The Company offers a range of computer-based DAQ products, including models for digital, analog and timing input-output, and for transferring data directly to a computer's random-access memory.

The Company's DAQ products provide a range of price/performance options, and include products for high-speed applications such as on-line monitoring and control as well as products designed for long-term recording of slowly changing data such as temperatures. The Company also offers products with features comparable to stand-alone traditional instruments such as oscilloscopes, DMMs, and function and arbitrary waveform generators. The Company offers DAQ hardware/driver software products for numerous desktop and notebook computers. The Company also offers SCXI (signal conditioning extensions for instrumentation) hardware, which expands the types and quantity of sensors that can be connected to the Company's data acquisition boards.

PXI Modular Instrumentation. The Company's PXI modular instrument platform, which was introduced in 1997, is a desktop PC packaged in a small, rugged form factor with expansion slots and instrumentation extensions. It combines mainstream PC software and PCI hardware with advanced instrumentation capabilities designed in the VXI architecture. In essence, PXI is an instrumentation PC with plenty of expansion slots to enable the company to

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pursue complete system-level opportunities and deliver a much higher percentage of the overall system content using the company's own products. PXI delivers many of

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the benefits of VXI in a much smaller package and at lower prices. The Company continues to expand its PXI product offerings with new modules, which address a wide variety of measurement and automation applications. Also, PXI continues to gain acceptance as an open industry standard, with endorsements from over 50 suppliers.

Machine Vision/Image Acquisition. In late 1996, the Company introduced its first image acquisition hardware. With the advanced technologies in personal computers and the Company's vision products, it is cost-effective for end-users to integrate vision into their measurement and automation applications. The Company's vision software is designed to work with many different environments, including LabVIEW and Measurement Studio. Image acquisition is commonly used in applications for quality control of manufactured products.

Motion Control. During 1997, the Company acquired technologies and assets that resulted in the addition of a line of motion control hardware, software and peripheral products. This intelligent PC-based motion control hardware is programmable from industry standard development environments including LabVIEW and Measurement Studio. The Company's software tools for motion are easily integrated with the Company's other product lines, allowing motion to be combined with image acquisition, test, measurement, data acquisition and automation. As in many areas, motion control is moving to PC-based systems and the motion products allow users to leverage standard hardware and software in measurement and automation applications to create robust, flexible solutions.

Industrial Communications Interfaces. In mid-1995, the Company began shipping its first interface boards for communicating with serial devices, such as dataloggers and PLCs targeted for IA applications, and benchtop instruments, such as oscilloscopes, targeted for T&M applications. Industrial applications need the same high-quality, easy-to-use hardware and software tools for communicating with industrial devices such as process instrumentation, PLCs, single-loop controllers, and a variety of I/O and DAQ devices. National Instruments offers three hardware and driver software product lines for communication with industrial devices--Controller Area Network (CAN), Foundation Fieldbus, and RS-485 and RS-232. The Company's industrial communication products are designed to work with standard serial software drivers, and Windows versions of LabVIEW and Measurement Studio.

Distributed Input/Output Hardware/Software. The Company introduced its FieldPoint product for distributed I/O applications in mid-1997. FieldPoint is an intelligent, distributed, and modular I/O system that gives industrial system developers an economical solution for distributed data acquisition, monitoring and control applications. The FieldPoint system includes isolated analog and digital I/O modules, terminal base options, and network modules. FieldPoint software includes a server that provides seamless integration into the LabVIEW Datalogging and Supervisory Control Module, driver libraries for support under LabVIEW, Measurement Studio and Lookout, and an OPC server that provides wide compatibility of FieldPoint hardware with other industrial automation software packages.

Customer Training Courses

The Company offers fee-based training classes and self-paced course kits for many of its software and hardware products. On-site courses are quoted per customer requests. The Company also offers programs to certify programmers and

instructors for its products.

Markets and Applications

The Company's products are used across many industries in a variety of applications from research and development to production testing and industrial control.

Customers

The Company has a broad customer base, with no customer accounting for more than 3% of the Company's sales in 2000, 1999, or 1998.

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Marketing

Through its worldwide marketing efforts, the Company strives to educate engineers and scientists about the benefits of the Company's virtual instrumentation philosophy, products and technology, and to highlight the performance, ease of use and cost advantages of its products. The Company also seeks to present its position as a technological leader among producers of instrumentation software and hardware and to help promulgate industry standards that will benefit users of computer-based instrumentation.

The Company reaches its intended audience through its Web site at NI.com as well as the distribution of written and electronic materials including demonstration versions of its software products, participation in tradeshow and technical conferences and training and user seminars. An in-house staff develops the NI.com Web site, advertising, publicity, and promotional materials that the Company uses worldwide. The primary marketing/sales tool is the Company's Web site at NI.com. Throughout 1998, 1999, and 2000, the Company invested aggressively to enhance the content, performance, and features of NI.com as well as to integrate E-commerce as a core component of the Company's business model. Through NI.com, customers can view the Company's complete on-line catalog, interactively configure systems, obtain pricing in a number of currencies, place orders, track the status of orders, register products and obtain software upgrades. The Company believes its direct business model provides the opportunity to leverage the Web heavily to reach customers and improve operations.

The primary printed marketing/sales tool is the Company's catalog, published annually and distributed worldwide. The catalog is over 900 pages, with detailed tutorial information that educates readers about the Company's integrated product architecture and virtual instrumentation concept. Short-form versions of the catalog are typically also available in languages of major international markets, including French, German, Spanish and Japanese.

The Company also uses quarterly newsletters to educate current and prospective customers about its products and technologies. These newsletters include new product information, feature articles that educate readers about new instrumentation technology, user solution case studies of real-world applications, product news from Alliance Program members and key customers, and event and customer education schedules. These newsletters are available in print form and via email subscription. There are also many books available on the Company's technology in English, German, French and other languages.

The Company actively markets its products in higher education environments, and identifies many colleges, universities and trade and technical schools as key accounts. The Company offers special academic pricing and products to enable universities to utilize Company products in their classes and

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laboratories. The Company believes its prominence in the higher education area can contribute to its future success because students gain experience using the Company's products before they enter the work force.

Sales and Distribution

The Company distributes its software and hardware products primarily through a direct sales organization. The Company also uses independent distributors, OEMs, VARs, system integrators and consultants to market its products. The Company has sales offices in the United States and sales offices and distributors in key international markets. Sales outside of North America accounted for approximately 47%, 47%, and 44% of the Company's revenues in 2000, 1999, and 1998, respectively. The Company expects that a significant portion of its total revenues will continue to be derived from international sales. See Note 13 of Notes to Consolidated Financial Statements for details concerning the geographic breakdown of the Company's net sales, operating income and identifiable assets.

Through all of its sales channels, the Company seeks to approach potential customers with a highly technical sales force. The Company believes that the majority of sales are made directly to those persons within an organization who actually use the Company's products to integrate their own systems. The Company

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identifies and targets major end-user accounts as those having a large number of actual or potential end users, and believes that it achieves a high level of repeat customer sales. The Company targets major accounts with a variety of targeted sales and marketing campaigns such as seminars, user groups, newsletters and direct mail.

Throughout 2000, the Company continued to invest aggressively to integrate the Web as a core component of its direct sales model. The Company provides worldwide on-line pricing for products in a number of currencies, allows customers to order the complete catalog of products via the Web, provides a variety of Web-based configuration tools to allow customers to more easily select and order multiple compatible products for their systems, and offers Prime Access business-to-business capabilities to allow key customers to conduct business directly with the Company through secure, private pages at NI.com.

Direct Sales

The Company directly markets and sells its products in the Americas, Europe and Asia. The Company has sales offices located throughout the United States and in key international markets. Many of the Company's international sales offices employ application engineering technical support specialists as well as sales, marketing and administrative personnel.

The Company's international sales are subject to inherent risks, including fluctuations in local economies; 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 Company's sales outside of North America are denominated in local currencies, and accordingly, the Company is subject to the risks associated with fluctuations in currency rates. In particular, increases in the value of the dollar against foreign currencies decrease the dollar value of foreign sales requiring the Company either to increase its price in the local currency, which could render the Company's product prices noncompetitive, or to

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suffer reduced revenues and gross margins as measured in US dollars. These dynamics have adversely affected revenue growth in international markets in recent years. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Note 12 of Notes to Consolidated Financial Statements.

Distributors

The Company utilizes distributors primarily to market its products in geographic areas not served by the Company's direct sales organization. Generally, the Company's indirect sales customers do not maintain significant inventory levels.

OEMs

The Company utilizes OEMs such as traditional instrument manufacturers who offer integrated systems and/or services to their customer bases. The Company approaches OEM accounts with its standard product lines and offers quantity discounts based on volume commitments and technical support capabilities and requirements. The Company also promotes its sales and marketing capabilities to its OEMs by providing specialized product training, documentation, packaging and part numbers to simplify ordering, flexible shipping and warranty repair options and joint promotion.

VARs, System Integrators and Consultants

The Company has relationships with third-party VARs, system integrators and consultants who offer add-on products and system integration services. These third-party developers expand the Company's market and sales opportunities by adding value to the Company's standard products, making them suitable for vertical market applications such as manufacturing automation or image processing and analysis. The Company maintains a formal third-party sales/marketing/training program, called the Alliance Program, which it uses to

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work with many of the VARs, system integrators and consultants. Applicants must be sponsored for membership by a Company sales engineer, pass qualification criteria and pay a nominal annual membership fee. In late 1998, the Company introduced an elite level of its Alliance Program called Select Integrators. Select Integrators must qualify for the program based upon their level of business with the Company. As of December 31, 2000, the Company's Alliance Program had approximately 600 members including several Select Integrators. The Company publishes on-line directories on its NI.com Web site of third-party Alliance Program member products and services for use by its sales force and its end users to locate additional products and/or services compatible with the Company's products. The Company makes available to qualified third-parties the opportunity to participate in joint marketing and sales programs, such as trade shows, customer sales events and the Company's newsletters. In addition to its relationships with third party VAR, system integrators and consultants, the Company has a direct presence in the German systems integration market through its Datalog and GfS subsidiaries.

Customer Support

The Company believes the ability to provide comprehensive service and support to its customers is an important factor in its business. The Company permits customers to return products within 30 days from receipt for a refund of the purchase price less a restocking charge, and generally provides a two-year warranty on GPIB hardware products, a one-year warranty on other hardware products, and a 90-day warranty on cables and software (medium only). Customers

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may also purchase a one-year extended warranty on hardware products. Historically, warranty costs have not been material. Some of the key elements of the Company's service and support strategy include:

Customer Technical Support

The Company maintains a large staff of application engineers at its corporate facility, all of whom are highly qualified technical professionals. Application engineers are also assigned to the Company's major international offices. These application engineers provide customer support by telephone, fax, electronic mail and world-wide Web forums, and electronic bulletin boards, and are trained in both instrumentation and computer technology. In 2000, the Company continued to invest heavily to leverage the Web for customer support. Through the Company's NI.com web site, customers have access to a growing range of support options to solve their own problems directly over the Web, including software downloads, upgrades and bug fixes, automated product configuration tools, knowledge databases of common questions and answers, live Web chat capabilities, and discussion forums.

Upgrades

The Company typically offers programs in which existing customers can upgrade to the latest Company products for an upgrade fee that is a discount from the list price. Application software customers have the option of purchasing a one-year renewable maintenance and support program, which entitles them to software upgrades and priority access to the Company's technical support hotline.

Customer Education

The Company offers a variety of fee-based training classes ranging in scope from basic and introductory courses for new users to advanced courses for experienced users.

Competition

The markets in which the Company operates are characterized by intense competition from numerous competitors, some of which are divisions of large corporations having far greater resources than the Company, and the Company expects to face further competition from new market entrants in the future. A key competitor is Agilent Technologies Inc. ("Agilent"). The Company believes Agilent is the dominant supplier of GPIB and

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VXI-compatible instruments and systems. Agilent is also a leading supplier of equipment used in data acquisition and control applications. Agilent offers its own line of GPIB instrument controllers, as well as hardware and software add-on products for third-party desktop computers and workstations that directly compete with the Company's products. Agilent is aggressively advertising and marketing its products and system integration services. Because of Agilent's dominance in the instrumentation business, changes in its marketing strategy or product offerings could have a material adverse affect on the Company. The Company also faces competition from a variety of other competitors.

Certain of the Company's competitors have substantial competitive advantages in terms of breadth of technology, sales, marketing and support capability and resources, including the number of sales and technical personnel and their ability to cover a geographic area and/or particular account more extensively and with more complete solutions than the Company can offer, and more extensive warranty support, system integration and service capabilities than those of the

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Company. In addition, large competitors can often enter into strategic alliances with key customers or target accounts of the Company, which can potentially have a negative impact on the Company's success with those accounts.

The Company believes its ability to compete successfully depends on a number of factors both within and outside its control, including: 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; success in leveraging the Web; strategic relationships with other suppliers; timing of new product introductions by the Company and its competitors; protection of the Company's products by effective use of intellectual property laws; general market and economic conditions; and events related to weather and government actions throughout the world. There can be no assurance that the Company will be able to compete successfully in the future.

The Company is continually designing new and improved products to maintain its competitive position. Because of the rapidly changing computer technology for which many of the Company's products are designed, the Company believes that its future success will depend in part on its ability to continue to improve its products and technologies. In the past, certain competitors have cloned some of the Company's hardware products at much lower prices, and promoted these hardware products as being capable of running the Company's software. The Company has responded to this tactic in the past by releasing new and improved versions of its products designed around proprietary ASICs that have improved performance and functionality in an effort to surpass the competition.

Research and Development

The Company believes that its long-term growth and success depends, in part, on delivering high quality software and hardware products on a timely basis. The Company intends to focus its 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 and price/performance.

The Company's research and development staff strives to build quality into products at the design stage in an effort to reduce overall development and manufacturing costs. The Company's research and development staff also designs proprietary ASICs, many of which are designed for use in several products. The goal of the ASIC design program is to further differentiate the Company's products from competing products, to improve manufacturability and to reduce costs. The Company seeks to reduce the time to market for new and enhanced products by sharing its internally developed hardware and software components across multiple products.

In the past, the Company has experienced significant delays in the introduction of new products. The Company's strategy of developing products based primarily on third parties' commercially available technologies is substantially dependent on the Company's ability to gain pre-release access to, and to develop expertise in, current and future product developments of such companies. There can be no assurance that the Company will continue to receive such pre-release access from any of these companies, or, even with such

access, that the Company will be able to develop products on a timely basis that are compatible with future releases.

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The Company has implemented certain programs, including pre-release bug analysis measures and enhanced project-tracking efforts, in order to improve the product development process and to permit more accurate product development scheduling. Nonetheless, there can be no assurance that the Company's research and development efforts will not encounter delays or other difficulties, that development efforts will result in commercially successful products, or that the Company's products will not be rendered obsolete by changing technology or new product announcements by other companies.

As of December 31, 2000, the Company employed 672 people in product research and development. The Company's research and development expenses were \$56.0 million, \$45.5 million, and \$34.8 million for 2000, 1999, and 1998 respectively.

Intellectual Property

The Company relies on a combination of patent, trade secret, copyright and trademark law, contracts and technical measures to establish and protect its proprietary rights in its products. The Company believes that legal protection through means such as the patent and copyright laws will be less influential on the Company's ability to compete than such factors as the creativity of its development staff, its ability to expand its market share, develop new markets and serve its customers.

As of December 31, 2000, the Company held 126 United States patents (121 utility patents and 5 design patents) and 6 patents in foreign countries (3 patents registered in Europe in various countries; 1 patent in Canada, and 2 patents in Japan), and had 118 patent applications pending in the United States and foreign countries. Thirty-five of such United States patents are software patents related to LabVIEW, and cover fundamental aspects of the graphical programming approach used in LabVIEW. The Company's patents expire from 2007 to 2019. No assurance can be given that the Company's pending patent applications will result in the issuance of patents. The Company also owns certain registered trademarks in the United States and abroad.

Although the Company relies to some extent on trade secret protection for much of its technology, and regularly obtains confidentiality agreements with key customers who wish to know more about the Company's product development philosophy and/or future directions, there can be no assurance that third parties will not either independently develop the same or similar technology, obtain unauthorized access to the Company's proprietary technology or misuse the technology to which the Company has granted access.

The laws of certain foreign countries treat the protection of proprietary rights of the Company in its products differently from those in the United States, and in many cases the protection afforded by such foreign laws is not as strong as in the United States. The Company believes that its products and their use do not infringe the proprietary rights of third parties. There can be no assurance, however, that infringement claims will not successfully be made.

Manufacturing and Suppliers

The Company manufactures a majority of its products at its facilities in Austin, Texas. Product manufacturing operations at the Company can be divided into four areas: electronic circuit card and module assembly; cable assembly; technical manuals and product support documentation; and software duplication. The Company manufactures most of the electronic circuit card assemblies and modules in-house, although subcontractors are used from time to time. The Company manufactures some of its electronic cable assemblies in-house, but many assemblies are produced by subcontractors. The Company primarily subcontracts its software duplication and packaging functions. Reliance on contract manufacturers entails risks of quality problems, less control of product

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pricing, and potential unavailability of or delays in delivery of products, any of which could have a material adverse effect on the Company's results of operations. There can be no

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assurance that the Company, together with its third-party manufacturers, will be able to produce sufficient quantities of the Company's products in a timely manner.

During 2001, the Company will be working to establish a new manufacturing operation in Hungary. The new Hungarian operation will be the Company's second manufacturing facility. This new facility will be required to meet the expected customer demand in Q4, 2001. Any delay in bringing this facility into production could have a material adverse effect on the results of operations.

The marketplace dictates that many of the Company's products be shipped very quickly after an order is received. Since purchased component and manufacturing lead times are typically much longer than the short order fulfillment time, the Company is required to keep adequate amounts of finished goods inventory and must use an accurate system for forecasting demand for those products in its production planning operations. Fluctuations in demand for the Company's products typically result from month-to-month variations in the quantity and mix of products and from normal, seasonal variations. A variety of circumstances, including inaccurate forecasts of customer demand, poor availability of purchased components, supplier quality problems, production equipment problems, carrier strikes or damage to products in manufacturing operations, could create a buildup of excess finished goods on the one hand or an inability to timely deliver product on the other. See "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Engineering refinements to the Company's new hardware and software products are fairly common. These changes can result in the disruption of the manufacturing operation and concurrent delays in delivery dates. Finished goods inventory at the Company's international warehouses and branches typically has a short shelf life due to engineering changes and product upgrades initiated by the Company's product development operation, and, if managed incorrectly, can result in significant quantities of obsolete inventory. This relatively short shelf life, and the resulting requirement to properly manage the quantity of inventory to meet customer demand while minimizing inventory obsolescence, has been and continues to be a challenge to the Company and its branch offices. See "Management's Discussion and Analysis of Financial Condition and Results of Operations."

The Company obtains most of its electronic components from suppliers located principally in the United States and Asia. Some of the components purchased by the Company, including ASICs, are sole-sourced. Any disruption of the Company's supply of sole or limited source components, whether resulting from business demand, quality, production or delivery problems, could adversely affect the Company's ability to manufacture its products, which could in turn adversely affect the Company's business and results of operations. See "Managements Discussion and Analysis of Financial Condition and Results of Operations."

Backlog

The Company typically ships products shortly following the receipt of an order. Accordingly, the Company does not have a material amount of backlog. Backlog should not be viewed as an indicator of future sales.

Employees

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As of December 31, 2000, the Company had 2,511 employees, including 672 in research and development, 1,185 in sales and marketing and customer support, 347 in manufacturing and 307 in administration and finance. None of the Company's employees is represented by a labor union and the Company has never experienced a work stoppage. The Company considers its employee relations to be good.

ITEM 2. PROPERTIES

The Company's principal administrative, sales, marketing, manufacturing, research and development activities are conducted at three Company-owned buildings in Austin, Texas. The Company owns

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approximately 69 acres of land in north Austin, Texas, at which are a 232,000 square foot office facility and a 140,000 square foot manufacturing facility. The Company is in the process of constructing a new R&D building, a 380,000 square foot office facility with estimated completion during the first quarter of 2002, and is also working on a plan and design of a second manufacturing facility to be located in Hungary, estimated to be completed by Q4 of 2001. The Company also owns a 136,000 square foot office building in Austin, Texas in which it houses certain of its sales operations. A portion of the 136,000 square foot office building is currently leased to Trilogy, Inc. During 2000, the Company's German subsidiary, GfS Systemtechnik GmbH & Co. completed construction of a 25,500 square foot office building in Aachen, Germany in which a majority of its activities are conducted. GfS also owns another 19,375 square foot office building, a portion of which is partially leased to BMS Modern Games. The remainder of this office building is used by GfS.

As of December 31, 2000, the Company also leased a number of sales and support offices in the United States and overseas. The Company believes existing field sales and support facilities are adequate to meet its current requirements.

ITEM 3. LEGAL PROCEEDINGS

On May 2, 2000, the Company was served by Cognex Corporation asserting patent infringement of two Cognex patents, copyright infringement, trademark infringement and unfair competition. Cognex seeks preliminary and permanent injunctive relief, actual monetary damages in an unspecified amount, and attorney's fees and costs. On June 21, 2000, the Company filed a response to their lawsuit denying all claims. A trial has been scheduled for October 23, 2001. The Company is defending this lawsuit vigorously. The Company is unable to predict the outcome of the litigation at this time. Based on the facts we have reviewed to date, management does not expect the resolution of this matter to have a material adverse effect on the Company's business or financial condition. However, because the plaintiff has indicated an unwillingness to withdraw these claims, the Company has accrued \$2.5 million of anticipated patent defense costs that are probable of being incurred.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matter was submitted to a vote of security holders during the fourth quarter of the fiscal year covered by this report.

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PART II

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ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company's Common Stock, \$0.01 par value, began trading on the Nasdaq National Market System under the symbol NATI effective March 13, 1995. Prior to that date, there was no public market for the Common Stock. The high and low closing prices for the Common Stock in the following table, as reported by Nasdaq, have been retroactively restated to reflect the three-for-two stock split declared by the Company's Board of Directors on July 22, 1999 for holders of record as of the close of business on August 5, 1999.

| | High | Low |
|--------------------------|--------|--------|
| | ----- | ----- |
| 2000 | | |
| First Quarter 2000..... | 50.188 | 34.938 |
| Second Quarter 2000..... | 56.75 | 33.00 |
| Third Quarter 2000..... | 48.875 | 40.813 |
| Fourth Quarter 2000..... | 52.438 | 37.063 |
| | | |
| | High | Low |
| | ----- | ----- |
| 1999 | | |
| First Quarter 1999..... | 23.083 | 17.417 |
| Second Quarter 1999..... | 27.50 | 18.167 |
| Third Quarter 1999..... | 35.344 | 26.167 |
| Fourth Quarter 1999..... | 38.25 | 27.25 |

At the close of business on February 2, 2001, there were approximately 798 holders of record of the Common Stock and approximately 6,800 shareholders of beneficial interest.

The Company believes factors such as quarterly fluctuations in results of operations, announcements by the Company or its competitors, technological innovations, new product introductions, governmental regulations, litigation or changes in earnings estimates by analysts may cause the market price of the Common Stock to fluctuate, perhaps substantially. In addition, stock prices for many technology companies fluctuate widely for reasons that may be unrelated to their operating results. These broad market and industry fluctuations may adversely affect the market price of the Company's Common Stock.

To date, the Company has not paid any cash dividends on its Common Stock. The Company currently anticipates that it will retain any available funds to finance the growth and operation of its business and does not anticipate paying any cash dividends in the immediate future.

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ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The following selected consolidated financial data should be read in conjunction with the consolidated financial statements, including the Notes to Consolidated Financial Statements. The information set forth below is not necessarily indicative of results of future operations. The information should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations."

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| | Years Ended December 31, | | | | |
|--|---------------------------------------|-----------|-----------|-----------|-----------|
| | 2000 | 1999 | 1998 | 1997 | 1996 |
| | (in thousands, except per share data) | | | | |
| Statements of Income Data: | | | | | |
| Net sales: | | | | | |
| North America..... | \$215,960 | \$175,873 | \$153,435 | \$141,784 | \$114,382 |
| Europe..... | 133,799 | 108,801 | 86,961 | 66,318 | 58,108 |
| Asia Pacific..... | 60,390 | 44,909 | 33,834 | 32,777 | 28,225 |
| Consolidated net sales..... | 410,149 | 329,583 | 274,230 | 240,879 | 200,715 |
| Cost of sales..... | 98,326 | 76,040 | 65,187 | 55,096 | 49,755 |
| Gross profit..... | 311,823 | 253,543 | 209,043 | 185,783 | 150,960 |
| Operating expenses: | | | | | |
| Sales and marketing..... | 147,377 | 120,886 | 100,783 | 87,096 | 72,067 |
| Research and development.... | 55,954 | 45,531 | 34,757 | 30,296 | 24,387 |
| General and administrative.. | 32,077 | 24,258 | 20,455 | 18,508 | 17,129 |
| Total operating expenses.... | 235,408 | 190,675 | 155,995 | 135,900 | 113,583 |
| Operating income..... | 76,415 | 62,868 | 53,048 | 49,883 | 37,377 |
| Other income (expense): | | | | | |
| Interest income..... | 6,390 | 4,759 | 3,439 | 3,455 | 2,405 |
| Interest expense..... | (533) | (404) | (463) | (502) | (844) |
| Net foreign exchange (loss) gain and other..... | (1,159) | 130 | (224) | (2,649) | (899) |
| Income before income taxes and cumulative effect of accounting change..... | 81,113 | 67,353 | 55,800 | 50,187 | 38,039 |
| Provision for income taxes... | 25,956 | 21,553 | 18,414 | 16,562 | 12,553 |
| Income before cumulative effect of accounting change..... | 55,157 | 45,800 | 37,386 | 33,625 | 25,486 |
| Cumulative effect of accounting change, net of tax..... | -- | (552) | -- | -- | -- |
| Net income..... | \$ 55,157 | \$ 45,248 | \$ 37,386 | \$ 33,625 | \$ 25,486 |
| Basic earnings per share: | | | | | |
| Income before cumulative effect of accounting change..... | \$ 1.10 | \$ 0.92 | \$ 0.76 | \$ 0.69 | \$ 0.53 |
| Cumulative effect of accounting change, net of tax..... | -- | (0.01) | -- | -- | -- |
| Basic earnings per share.... | \$ 1.10 | \$ 0.91 | \$ 0.76 | \$ 0.69 | \$ 0.53 |
| Diluted earnings per share: | | | | | |
| Income before cumulative effect of accounting change..... | \$ 1.03 | \$ 0.88 | \$ 0.73 | \$ 0.67 | \$ 0.52 |

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| | | | | | |
|---|---------|---------|---------|---------|---------|
| Cumulative effect of accounting change, net of tax..... | -- | (0.01) | -- | -- | -- |
| Diluted earnings per share.. | \$ 1.03 | \$ 0.87 | \$ 0.73 | \$ 0.67 | \$ 0.52 |
| Weighted average shares outstanding: | | | | | |
| Basic..... | 50,332 | 49,776 | 49,248 | 48,845 | 48,539 |
| Diluted..... | 53,564 | 52,203 | 51,150 | 50,484 | 49,415 |

| | December 31, | | | | |
|--|----------------|-----------|-----------|-----------|-----------|
| | 2000 | 1999 | 1998 | 1997 | 1996 |
| | (in thousands) | | | | |
| Balance Sheet Data: | | | | | |
| Cash and cash equivalents.... | \$ 75,277 | \$ 45,309 | \$ 51,538 | \$ 31,943 | \$ 30,211 |
| Short-term investments..... | 79,525 | 83,525 | 49,158 | 51,067 | 48,956 |
| Working capital..... | 220,208 | 173,761 | 133,510 | 112,142 | 99,294 |
| Total assets..... | 389,350 | 318,753 | 249,786 | 204,490 | 169,225 |
| Long-term debt, net of current portion..... | -- | 4,301 | 4,379 | 5,151 | 9,175 |
| Total stockholders' equity... | 321,023 | 254,235 | 204,184 | 161,754 | 126,953 |

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The discussion in this document contains trend analysis and other forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Actual results could differ materially from those projected in the forward-looking statements throughout this document as a result of a number of important factors. For a discussion of important factors that could affect the Company's results, please refer to the risk factors set forth below in Factors Affecting the Company's Business, in the financial line item discussions below and elsewhere in this document.

Overview

National Instruments Corporation designs, develops, manufactures and markets instrumentation and automation software and hardware for general commercial, industrial and scientific applications. The Company offers hundreds of products used to create virtual instrumentation systems for measurement and automation. The Company has identified a large and diverse market for test and measurement ("T&M") and industrial automation ("IA") applications. The Company's products are used in a variety of applications from research and development to production testing and industrial control. In test and measurement applications, the Company's products can be used to monitor and control traditional instruments or to create computer-based instruments that can replace traditional instruments. In industrial automation applications, the Company's products can be used in the same ways as in test and measurement and can also be used to integrate measurement functionality with process automation capabilities. The Company sells to a large number of customers in a wide variety of industries. No single customer accounted for more than 3% of the

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Company's sales in 2000, 1999 or 1998.

The Company's revenues have grown every year since 1977 and the Company has been profitable in every year since 1990. There can be no assurance that the Company's net sales will continue to grow or that the Company will remain profitable in future periods. As a result, the Company believes historical results of operations should not be relied upon as indications of future performance.

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Results of Operations

The following table sets forth, for the periods indicated, the percentage of net sales represented by certain items reflected in the Company's consolidated statements of income:

| | Years Ended December 31, | | |
|--|--------------------------|--------|--------|
| | 2000 | 1999 | 1998 |
| Net sales: | | | |
| North America..... | 52.7 % | 53.4 % | 56.0 % |
| Europe..... | 32.6 | 33.0 | 31.7 |
| Asia Pacific..... | 14.7 | 13.6 | 12.3 |
| | ----- | ----- | ----- |
| Consolidated net sales..... | 100.0 | 100.0 | 100.0 |
| Cost of sales..... | 24.0 | 23.1 | 23.8 |
| | ----- | ----- | ----- |
| Gross profit..... | 76.0 | 76.9 | 76.2 |
| Operating expenses: | | | |
| Sales and marketing..... | 35.9 | 36.7 | 36.7 |
| Research and development..... | 13.7 | 13.8 | 12.7 |
| General and administrative..... | 7.8 | 7.3 | 7.5 |
| | ----- | ----- | ----- |
| Total operating expenses..... | 57.4 | 57.8 | 56.9 |
| | ----- | ----- | ----- |
| Operating income..... | 18.6 | 19.1 | 19.3 |
| Other income (expense): | | | |
| Interest income..... | 1.5 | 1.4 | 1.3 |
| Interest expense..... | (0.1) | (0.1) | (0.2) |
| Net foreign exchange gain (loss)..... | (0.3) | -- | (0.1) |
| | ----- | ----- | ----- |
| Income before income taxes and cumulative effect of accounting change..... | 19.7 | 20.4 | 20.3 |
| Provision for income taxes..... | 6.3 | 6.5 | 6.7 |
| | ----- | ----- | ----- |
| Income before cumulative effect of accounting change..... | 13.4 | 13.9 | 13.6 |
| Cumulative effect of accounting change, net of tax..... | -- | (0.2) | -- |
| | ----- | ----- | ----- |
| Net income..... | 13.4 % | 13.7 % | 13.6 % |
| | ===== | ===== | ===== |

Net Sales. In 2000, net sales for the Company's products reached \$410.1 million, a 24% increase from the level achieved in 1999, which followed an

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increase in net sales of 20% in 1999 over the level achieved in 1998. This year marks the twenty-fourth year of consecutive double-digit annual sales growth. The Company believes the increase in sales in these periods is primarily attributable to the introduction of new and upgraded products in each period, increased market acceptance of the Company's products in each of the major geographical areas in which the Company operates, and an expanded customer base. The Company believes the increase in the revenue growth rate to 24% from 20% in 1999, is attributable to expansion of its sales force, a broad increase in demand for the Company's products resulting in unit sales growth in all regions and significant growth from market acceptance of recently introduced product areas such as PXI, Machine Vision, Motion Control, FieldPoint and PC based instruments.

North American revenue was \$216.0 million in 2000, an increase of 23% from 1999, following a 15% increase in 1999 over 1998. The Company believes the increase in sales and in the revenue growth rate in North America in 2000 is primarily attributable to market acceptance of the Company's recently introduced products, an expanded sales force and a recovery from an industry downturn in early 1999.

European revenue was \$133.8 million in 2000, an increase of 23% over 1999, following a 25% increase in 1999 from 1998. The Company believes the increase in revenue in Europe in 2000 is primarily attributable to market acceptance of its recently introduced products, stronger local economies than in 1999 and the Company's expansion in its European sales force.

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Asia Pacific revenue grew 35% to \$60.4 million in 2000, which followed a 33% increase in 1999 over 1998 levels. The Company believes the increase in the Asia Pacific revenue growth rate during 2000 is primarily attributable to market acceptance of its recently introduced products, an expanded sales force and the continued improvement in the state of the Asian economies. See the discussion below for more information concerning the impact of foreign currency fluctuations on sales growth.

International sales (sales to customers outside of North America) accounted for 47%, 47% and 44% of the Company's consolidated net sales for 2000, 1999 and 1998, respectively. The Company intends to continue to expand its international operations by increasing market presence in existing markets, and continuing to use distributors to sell its products in countries in which the sales volume does not justify direct sales activities.

The Company's international sales are subject to inherent risks, including fluctuations in local economies; 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 Company's sales outside of North America are denominated in local currencies, and accordingly, the Company is subject to the risks associated with fluctuations in currency rates. In particular, increases in the value of the dollar against foreign currencies decrease the U.S. dollar value of foreign sales requiring the Company either to increase its price in the local currency, which could render the Company's product prices noncompetitive, or to suffer reduced revenues and gross margins as measured in U.S. dollars. These dynamics have adversely affected revenue growth in international markets in 2000 and in previous years. The Company's foreign currency hedging program includes both foreign currency forward and purchased option contracts to reduce the effect of exchange rate fluctuations. However, the hedging program will not eliminate all of the Company's foreign exchange risks. (See "Foreign Exchange

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Gain/Loss" below and Note 12 of Notes to Consolidated Financial Statements.)

Sales made by the Company's direct sales offices in Europe and Asia Pacific are denominated in local currencies, and accordingly, the U.S. dollar equivalent of these sales is affected by changes in the weighted average value of the U.S. dollar. This weighted average is calculated as the percentage change in the value of the currency relative to the dollar, multiplied by the proportion of international sales recorded in the particular currency. Between 2000 and 1999 this weighted average value of the U.S. dollar increased by 8.2%, causing an equivalent decrease in the U.S. dollar value of the Company's foreign currency sales and expenses. If the weighted average value during 2000 had been the same as that in 1999, on a pro-forma basis, the Company's growth rate for 2000 would have been 26.6%. Pro-forma European sales for 2000 would have increased by 32% over 1999 sales. Pro-forma Asia Pacific sales for 2000 would have increased by 29% over 1999 sales. If the weighted average value of the dollar during 2000 had been the same as that in 1999, on a pro-forma basis, the Company's consolidated operating expenses would have been \$236.4 million, representing an increase of \$1.0 million. The preceding pro-forma amounts and percentages are not presented in accordance with Generally Accepted Accounting Principles but are presented for comparative purposes.

Gross Profit. As a percentage of sales, gross profit represented 76%, 77% and 76% in 2000, 1999, and 1998, respectively. The relatively high software content of the Company's products is demonstrated in the gross margins achieved by the Company. Approximately 60% of the lower margin in 2000 is attributable to unfavorable foreign currency exchange rates. The remaining fraction of the lower margin is primarily attributable to lost capacity and increased overhead costs related to delayed receipt of components from suppliers. In 1999, improved production efficiencies and favorable foreign currency exchange rate fluctuations resulted in higher margins. There can be no assurance that the Company will maintain its historical margins.

The marketplace for the Company's products dictates that many of the Company's products be shipped very quickly after an order is received. As a result, the Company is required to maintain significant inventories. Therefore, inventory obsolescence is a risk for the Company due to frequent engineering changes, shifting customer demand, the emergence of new industry standards and rapid technological advances including the

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introduction by the Company or its competitors of products embodying new technology. While the Company maintains valuation allowances for excess and obsolete inventory and management continues to monitor the adequacy of such valuation allowances, there can be no assurance that such valuation allowances will be sufficient.

The Company is currently working to establish a new manufacturing facility in Hungary in Q4 of 2001. This new facility will be required in order to meet the customer demand anticipated in Q4, 2001. Any delay in making this capacity available could have a material adverse effect on the results of operations.

Sales and Marketing. Sales and marketing expense in 2000 increased 22% from 1999, which followed an increase of 20% in 1999 from 1998. The increase in the expense in absolute amounts during 2000 and 1999 is substantially all attributable to increases in sales and marketing personnel both internationally and in North America, and, to a much lesser extent, increased marketing for new products and web marketing and sales activities. Sales and marketing personnel increased by 237 during 2000 from 948 at December 31, 1999 to 1,185 at December 31, 2000. Sales and marketing expense, as a percentage of revenue was 36% in 2000, down from 37% in 1999 and 1998.

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The Company expects sales and marketing expenses in future periods to increase in absolute dollars, and to fluctuate as a percentage of sales based on new recruiting, initial marketing and advertising campaign costs associated with major new product releases and entry into new market areas, investment in the web sales and marketing efforts, increasing product demonstration costs and the timing of domestic and international sales conferences and trade shows.

Research and Development. Research and development expense in 2000 increased 23% compared to 1999 following an increase of 31% in 1999 over 1998. Excluding the pre-tax charge for the write-off of in-process research and development, on a pro-forma basis, research and development expense grew 29%, 28% and 12% during 2000, 1999 and 1998, respectively. (See Note 8 of Notes to Consolidated Financial Statements for a description of the Company's acquisitions.) The increase in research and development expenditures (excluding the acquisition related charges in 1998) in absolute amounts and as a percentage of sales in each period was primarily due to increases in personnel costs from hiring of additional product development engineers. Research and development personnel increased from 501 at December 31, 1999 to 672 at December 31, 2000. The Company believes that a significant, ongoing investment in research and development is required to remain competitive and continue revenue growth.

The Company capitalizes software development costs in accordance with Statement of Financial Accounting Standards No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed." The Company amortizes such costs over the related product's estimated economic useful life, generally three years, beginning when a product becomes available for general release. Software amortization expense totaled \$2.6 million, \$2.3 million and \$2.8 million during 2000, 1999 and 1998, respectively. Software development costs capitalized during such years were \$5.0 million, \$2.8 million and \$3.3 million, respectively. The increased levels of capitalization for 2000 were primarily a result of the development of LabVIEW 6i, NI-DAQ 6.9 and MAX 2.1. The significant items capitalized in 1999 were primarily the result of NI-DAQ 6.6, Lookout 4.0 and purchased software development costs related to the GfS acquisition. (See Note 5 of Notes to Consolidated Financial Statements for a description of intangibles.)

General and Administrative. General and administrative expenses in 2000 increased 32% from 1999, which followed an increase of 19% in 1999 from 1998. A significant amount of the increase was due to the increase in legal costs primarily from a \$2.5 million accrual for anticipated patent defense costs. The increase was also comprised of cost attributable to staffing increases in the information system, finance, legal and human resources departments and significant increases in recruiting costs due to the continued growth in the target number of engineering recruits. Continued development of web and e-commerce offerings were the main areas of focus for incremental investment in the information system department in 2000. The 2000 increase followed a 19% increase in 1999, which was primarily driven by support of the new management information systems and web based applications. General and administrative expenses as a percentage of revenue increased to 7.8%

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during 2000 from 7.3% in 1999. The increase in 2000 was primarily due to the \$2.5 million accrual for future patent defense costs recorded in the fourth quarter of 2000. The Company expects that general and administrative costs will continue to increase in absolute amounts and to fluctuate as a percentage of revenue as the Company continues to invest in maintaining its existing systems, developing the infrastructure for the new Hungarian manufacturing facility, and developing web based commerce and management information systems.

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Interest Income and Expense. Interest income increased 34% in 2000 from 1999, which followed an increase of 38% in 1999 from 1998. The primary source of interest income is from the investment of proceeds from the Company's issuance of common stock under an initial public offering in March 1995 and cash flow generated from operations. Net cash provided by operating activities in 2000 totaled \$55.0 million. During 2000, interest income increased due to the investment of cash generated from operations. Interest expense increased 32% from 1999, which followed a decrease of 13% in 1999 from 1998. Interest expense represents less than 1% of net sales and fluctuates as a result of bank borrowings and interest terms thereon. (See Note 6 of Notes to Consolidated Financial Statements for a description of the Company's debt.)

Net Foreign Exchange Gain/Loss. The Company experienced net foreign exchange losses of \$1.5 million in 2000, compared to gains of \$130,000 in 1999 and losses of \$224,000 in 1998. These results are attributable to movements between the U.S. dollar and the local currencies in countries in which the Company's sales subsidiaries are located. The Company recognizes the local currency as the functional currency of its international subsidiaries.

The Company utilizes foreign currency forward contracts to hedge a majority of its foreign currency-denominated receivables in order to reduce its exposure to significant foreign currency fluctuations. The Company typically limits the duration of its "receivables" foreign exchange forward contracts to 90 days.

The Company also utilizes foreign currency forward contracts and foreign currency purchased option contracts in order to reduce its exposures to fluctuations in future foreign currency cash flows. The Company purchases these contracts for up to 100% of its forecasted cash flows in selected currencies (primarily the euro, yen and pound sterling) and limits the duration of these contracts to 30 months. The foreign currency purchased option contracts are purchased "at-the-money" or "out-of-the-money". As a result, the Company's hedging activities only partially address its risks in foreign currency transactions, and there can be no assurance that this strategy will be successful. The Company does not invest in contracts for speculative purposes. (See Note 12 of Notes to Consolidated Financial Statements for a description of the Company's forward and purchased option contracts and hedged positions.) The Company's hedging strategy reduced the foreign exchange loss for December 31, 2000 by \$10.2 million and reduced the net foreign exchange loss for December 31, 1999 by \$3.3 million.

Effective January 1, 1999, the Company elected to adopt SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." (See Note 11 and Note 12 of Notes to Consolidated Financial Statements.)

Provision for Income Taxes. The provision for income taxes reflects an effective tax rate of 32% in 2000 and 1999 and 33% in 1998. The effective tax rate is lower than the Federal Statutory rate primarily as a result of tax-exempt interest and reduced tax rates in certain international locations. (See Note 7 of Notes to Consolidated Financial Statements).

Liquidity and Capital Resources

The Company is currently financing its operations and capital expenditures through cash flow from operations. At December 31, 2000, the Company had working capital of approximately \$220.2 million compared to \$173.8 million at December 31, 1999.

Accounts receivable increased to \$74.7 million at December 31, 2000 from \$58.3 million at December 31, 1999, as a result of higher sales levels. Receivable days outstanding at December 31, 2000 increased to 60 days

from 58 days at December 31, 1999. Consolidated inventory balances have increased to \$33.3 million at December 31, 2000 from \$26.2 million at December 31, 1999. Inventory turns of 3.3 per year for 2000 represent a decrease from turns of 3.6 per year for 1999 and reflect the planned increase in the level of inventory related to allocated components and increased procurement of end-of-life components. The Company expects these high inventory levels to persist until the component supply situation has eased significantly.

Cash used for investing activities in 2000 includes \$27.6 million for the purchase of property and equipment and capitalization of software development costs of \$5.0 million.

In October of 2000, the Company began construction of an office building ("Mopac C") located on the North Austin campus. It is currently anticipated that a significant portion of the construction costs will be paid out of the Company's existing working capital. The Company estimates the total cost for the new building, including furniture, fixtures and equipment, will range from \$58 million to \$62 million. In October of 2000, the Company entered into firm commitments of approximately \$60 million for the new building. The Company has incurred approximately \$6.6 million in construction costs as of December 31, 2000, with the remainder becoming payable in 2001. The actual level of spending may vary depending on a variety of factors, including unforeseen difficulties in construction. Upon completion of the Mopac C building, the Company intends to vacate its existing 136,000 sq. ft. Millennium office building. The Company has signed an agreement to lease the Millennium building to a third party and currently estimates that the net rental income from this lease will offset approximately 30% of the projected operating costs from the Mopac C building.

The Company also plans to construct a second manufacturing facility to be located in Hungary. The Company estimates that this European manufacturing facility will be operational by Q4 of 2001, and that by 2003 will source a significant portion of the Company's international sales. The location of the facility has a cost base and tax rate significantly lower than in the U.S., which should have the effect of reducing the cost of manufacturing and lowering the consolidated tax rate. However, there can be no assurance that the actual manufacturing costs will be lower. It is currently anticipated that a significant portion of the construction costs will be paid out of the Company's existing working capital with any remaining costs being funded through credit from the Company's current financial institutions. The Company estimates the total cost for the new facility, including furniture, fixtures and equipment, will be approximately \$17.0 million. The actual level of spending may vary depending on a variety of factors, including unforeseen difficulties in construction.

The Company currently expects to fund expenditures for capital requirements as well as liquidity needs created by changes in working capital from a combination of available cash and short-term investment balances and internally generated funds. As of December 31, 2000, the Company had no debt outstanding to financial institutions. (See Note 6 of Notes to Consolidated Financial Statements for additional information regarding the Company's debt.)

The Company believes that the cash flow from operations, if any, existing cash balances and short-term investments, will be sufficient to meet its cash requirements for at least the next twelve months. Cash requirements for periods beyond the next twelve months depend on the Company's profitability, its ability to manage working capital requirements and its rate of growth.

Market Risk

The Company is exposed to a variety of risks, including foreign currency

fluctuations and changes in the market value of its investments. In the normal course of business, the Company employs established policies and procedures to manage its exposure to fluctuations in foreign currency values and changes in the market value of its investments.

Foreign Currency Hedging Activities. The Company's objective in managing its exposure to foreign currency exchange rate fluctuations is to reduce the impact of adverse fluctuations in such exchange rates on the Company's earnings and cash flow. Accordingly, the Company utilizes purchased foreign currency option

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contracts and forward contracts to hedge its exposure on anticipated transactions and firm commitments. The principal currencies hedged are the euro, British pound and Japanese yen. The Company monitors its foreign exchange exposures regularly to ensure the overall effectiveness of its foreign currency hedge positions. However, there can be no assurance the Company's foreign currency hedging activities will substantially offset the impact of fluctuations in currency exchange rates on its results of operations and financial position. Based on the foreign exchange instruments outstanding at December 31, 2000, 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 fair market value of all instruments outstanding of approximately \$17.9 million. However, as the Company utilizes foreign currency instruments for hedging anticipated and firmly committed transactions, management believes that a loss in fair value for those instruments will be substantially offset by increases in the value of the underlying exposure. (See Note 11 of Notes to Consolidated Financial Statements for a description of the Company's financial instruments at December 31, 2000 and 1999.)

Short-term Investments. The fair value of the Company's investments in marketable securities at December 31, 2000 was \$79.5 million. The Company's investment policy is to manage its investment portfolio to preserve principal and liquidity while maximizing the return on the investment portfolio through the full investment of available funds. The Company diversifies the marketable securities portfolio by investing in multiple types of investment-grade securities. The Company's investment portfolio is primarily invested in short-term securities with at least an investment grade rating to minimize interest rate and credit risk as well as to provide for an immediate source of funds. Based on the Company's investment portfolio and interest rates at December 31, 2000, a 100 basis point increase or decrease in interest rates would result in a decrease or increase of less than \$400,000, respectively, in the fair value of the investment portfolio. Although changes in interest rates may affect the fair value of the investment portfolio and cause unrealized gains or losses, such gains or losses would not be realized unless the investments are sold.

Recently Issued Accounting Pronouncement

In the fourth quarter of 2000, the Company adopted Staff Accounting Bulletin ("SAB") No. 101, Revenue Recognition in Financial Statements, which provides guidance in applying generally accepted accounting principles to certain revenue recognition issues. The adoption of SAB 101 did not have a material impact on the Company's financial position or overall trends in results of operations.

Factors Affecting the Company's Business

U.S./Global Economic Slowdown. As has occurred in the past, most recently in 1998 when the Asian economic situation and its effects on the U.S. economy resulted in a slowdown in automated test equipment, semiconductor and other markets, the markets in which the Company does business could again experience

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the negative effects of a slowdown in the U.S. and/or Global economies. Downturns in the U.S. or Global economies could have a material adverse effect on the Company's operating results.

Risk of Component Shortages. As has occurred in the past, most recently in the quarter ended December 31, 2000, supply shortages of components including sole source components can result in significant additional costs and inefficiencies in manufacturing. Component shortages, including components from Analog Devices, Inc., have continued in the first quarter and if the Company is unsuccessful in resolving these issues, it will experience a significant impact on the timing of revenue and/or an increase in manufacturing costs, either of which would have a material adverse impact on the Company's operating results.

Expansion of Manufacturing Capacity. The Company is working to establish a new manufacturing facility which is to be located in Hungary. It is anticipated that this facility will be in operation by Q4, 2001. This additional capacity is required to meet anticipated customer demand in Q4, 2001. Any delay in bringing this facility into production could have a material adverse effect on the Company's results of operations. Factors, which could result in a delay in bringing this new facility into production, include possible delays in construction, difficulties in recruiting and training the local work force and possible difficulties in establishing the required information systems.

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Fluctuations in Quarterly Results. The Company's 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 mix of products sold; the availability and pricing of components from third parties (especially sole sources); the timing of orders; level of pricing of international sales; fluctuations in foreign currency exchange rates; the difficulty in maintaining margins, including the higher margins traditionally achieved in international sales; and changes in pricing policies by the Company, its competitors or suppliers. Specifically, if the local currencies in which the Company sells weaken against the U.S. dollar, and if the local sales prices cannot be raised, the Company will experience a deterioration of its gross and net profit margins. The Company expects the strength of the U.S. dollar to have a negative effect on gross and net profit margins in future quarters.

As has occurred in the past and as may be expected to occur in the future, new software products of the Company or new operating systems of third parties on which the Company's products are based, often contain bugs or errors that can result in reduced sales and/or cause the Company's support costs to increase, either of which could have a material adverse impact on the Company's operating results. Furthermore, the Company has significant revenues from customers in industries such as semiconductors, automated test equipment, telecommunications, aerospace, defense and automotive which are cyclical in nature. Downturns in these industries could have a material adverse effect on the Company's operating results.

In recent years, the Company's revenues have been characterized by seasonality, with revenues typically being relatively constant in the first, second and third quarters, growing in the fourth quarter and being relatively flat or declining from the fourth quarter of the year to the first quarter of the following year. If this historical pattern continues, revenues and earnings for the first quarter of 2001 may not exceed revenues from the fourth quarter of 2000. Also, the Company's results of operations in the third quarter of 2001 may be adversely affected by lower sales levels in Europe, which typically occur during the summer months. The Company believes the seasonality of its revenue results from the international mix of its revenue and the variability of the budgeting and purchasing cycles of its customers throughout each

international region. In addition, total operating expenses have in the past tended to be higher in the second and third quarters of each year, due to college recruiting and significantly increased intern personnel expenses.

New Product Introductions and Market Acceptance. The market for the Company's 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. The Company's success is dependent in part on its 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. In the past, the Company has 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 the Company's operating results. There can be no assurance that the Company 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 new products to achieve or sustain market acceptance could have a material adverse effect on the Company's operating results. Moreover, there can be no assurance that the Company's international sales will continue at existing levels or grow in accordance with the Company's efforts to increase foreign market penetration.

Risks associated with Increased Development of Web site. The Company has devoted significant resources in developing its Web site as a key marketing and sales tool and expects to continue to do so in the future. There can be no assurance that the Company will be successful in its attempt to leverage the Web to increase sales. The Company hosts its Web site internally. Failure to successfully maintain the Web site and to protect it from hackers could have a significant impact on the Company's results.

Operation in Intensely Competitive Markets. The markets in which the Company operates are characterized by intense competition from numerous competitors, some of which are divisions of large

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corporations having far greater resources than the Company, and the Company expects to face further competition from new market entrants in the future. A key competitor is Agilent Technologies Inc. ("Agilent"). Agilent offers its own line of instrument controllers, and also offers hardware and software add-on products for third-party desktop computers and workstations that provide solutions that directly compete with the Company's virtual instrumentation products. Agilent is aggressively advertising and marketing products that are competitive with the Company's 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 the Company's operating results.

The Company believes its ability to compete successfully depends on a number of factors both within and outside its control, including: new product introductions by competitors; 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 new product introductions by the Company; protection of the Company's products by effective use of intellectual property laws; general market and economic conditions; and government actions throughout the

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

Management Information Systems. During 2000, the Company devoted significant resources to the continued development of web and e-commerce offerings. In 2001, the Company will focus on implementing information systems to support its new manufacturing facility in Europe and upgrading its worldwide business applications suite to Oracle's latest web-based release 11i. The Company will also be implementing an advanced planning system to enhance predictability of material flow in its manufacturing operations and will continue to devote significant resources to the development of the web. Failure to successfully implement these initiatives could have a material adverse effect on the results of operations.

The Company relies on three primary regional centers for its management information systems. As with any information system, unforeseen issues may arise that could affect management's ability to receive adequate, accurate and timely financial information, which in turn could inhibit effective and timely decisions. Furthermore, it is possible that one or more of the Company's three regional information systems could experience a complete or partial shutdown. If such a shutdown occurred near the end of a quarter it could impact the Company's product shipments and revenues, as product distribution is heavily dependent on the integrated management information systems in each region. Accordingly, operating results in that quarter would be adversely impacted due to the shipments, which would not occur until the following period. The Company is working to achieve reliable regional management information systems to control costs and improve the ability to deliver its products in substantially all of its direct markets worldwide. No assurance can be given that the Company's efforts will be successful. The failure to receive adequate, accurate and timely financial information could inhibit management's ability to make effective and timely decisions.

Risks Associated with International Operations and Foreign Economies. International sales are subject to inherent risks, including fluctuations in local economies, 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. 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. Sales made by the Company's international direct sales offices are denominated in local currencies, and accordingly, the U.S. dollar equivalent of these sales is affected by changes in the weighted average value of the U.S. dollar. This weighted average is calculated as the percentage change in the value of the currency relative to the dollar, multiplied by the proportion of international sales recorded in the particular currency. Between 2000 and 1999 this weighted average value of the U.S. dollar increased by 8.2%, causing an equivalent decrease in the U.S. dollar value of the Company's foreign currency sales and expenses. If the weighted average value during 2000 had been the same as that in 1999, the Company's growth rate for 2000 would have been 26.6%. If the weighted average value during 2000

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had been the same as that in 1999, the Company's consolidated operating expenses would have been \$236.4 million, representing an increase of \$1.0 million. If the U.S. dollar strengthens again in the future, it could have a materially adverse effect on the operating results of the Company.

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Dependence on Key Suppliers. The Company's manufacturing processes use large volumes of high-quality components and subassemblies supplied by outside sources. Several of these components are available through sole or limited sources. Sole-source components purchased by the Company include custom application-specific integration circuits ("ASICS") and other components. The Company has in the past experienced delays and quality problems in connection with sole-source components, and there can be no assurance that these problems will not recur in the future. Accordingly, the failure to receive sole-source components from suppliers could result in a material adverse effect on revenues and results of operations.

Proprietary Rights and Intellectual Property Litigation. The Company's success depends in part on its ability to obtain and maintain patents and other proprietary rights relative to the technologies used in its principal products. Despite the Company's efforts to protect its proprietary rights, unauthorized parties may have in the past infringed or violated certain of the Company's intellectual property rights. As is typical in the industry, the Company from time to time may be notified that it is infringing certain patent or intellectual property rights of others. On May 2, 2000, the Company was served by Cognex Corporation, asserting patent infringement of two Cognex patents, copyright infringement, trademark infringement and unfair competition. Cognex seeks preliminary and permanent injunctive relief, actual monetary damages in an unspecified amount and attorney's fees and costs. In the fourth quarter of 2000, the Company accrued \$2.5 million, the estimated legal fees for defending this litigation. The Cognex litigation and any other intellectual property litigation initiated in the future may cause significant litigation expense, liability and a diversion of management's attention which may have a material adverse effect on results of operations.

Dependence on Key Management and Technical Personnel. The Company's success depends to a significant degree upon the continued contributions of its key management, sales, marketing, research and development and operational personnel including Dr. Truchard and other members of senior management and key technical personnel. The Company has no agreements providing for the employment of any of its key employees for any fixed term and the Company's key employees may voluntarily terminate their employment with the Company at any time. The loss of the services of one or more of the Company's key employees in the future could have a material adverse effect on operating results. The Company also believes its future success will depend in large part upon its 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, including companies acquired through acquisition, as well as training, motivating and supervising the employees. In addition, the recruiting environment for software engineering, sales and other technical professionals is very competitive. Competition for qualified software engineers is particularly intense and is likely to result in increased personnel costs. Failure to attract or retain qualified software engineers could have an adverse effect on the Company's operating results. The Company also recruits and employs foreign nationals to achieve its hiring goals primarily for engineering and software positions. There can be no guarantee that the Company will continue to be able to recruit foreign nationals to the current degree. These factors further intensify competition for key personnel, and there can be no assurance that the Company will be successful in retaining its existing key personnel or attracting and retaining additional key personnel. Failure to attract and retain a sufficient number of technical personnel could have a material adverse effect on the results of operations.

Risk of Product Liability Claims. The Company's products are designed in part to provide information upon which the users may rely. The Company attempts to assure the quality and accuracy of the processes contained in its products, and to limit its product liability exposure through contractual limitations on liability, including disclaimers in its "shrink wrap" license agreements with

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end-users. If future products contain errors that produce incorrect results on which users rely, customer acceptance of the Company's products could be adversely affected. Further, the Company could be subject to liability claims that could have a material adverse effect on the Company's operating results or financial position. Although the Company maintains liability

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insurance, there can be no assurance that such insurance or the contractual provisions used by the Company to limit its liability will be sufficient.

ITEM 7(a). MARKET RISK

Response to this item is included in "Item 7--Management's Discussion and Analysis of Financial Condition and Results of Operations--Market Risk" above.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The information required by this item is incorporated by reference to the Consolidated Financial Statements set forth on pages F-1 through F-19 hereof.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

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PART III

Certain information required by Part III is omitted from this Report in that the Registrant intends to file a definitive proxy statement pursuant to Regulation 14A with the Securities and Exchange Commission (the "Proxy Statement") relating to its annual meeting of stockholders not later than 120 days after the end of the fiscal year covered by this Report, and such information is incorporated by reference herein.

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information concerning the Company's directors required by this Item is incorporated by reference to the Company's Proxy Statement under the heading "Election of Directors."

The information concerning the Company's executive officers required by this Item is incorporated by reference to the Company's Proxy Statement under the heading "Executive Officers."

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated by reference to the Company's Proxy Statement under the heading "Election of Directors."

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

From time to time the Company's 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. Starting in the fourth quarter of 2000, William C. Nowlin, Jr., Jeffrey L. Kodosky and James J. Truchard have made periodic sales of the Company's stock pursuant to such plans.

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The information required by this Item is incorporated by reference to the Company's Proxy Statement under the heading "Election of Directors."

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Not applicable.

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PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) Documents Filed with Report

1. Financial Statements. See Index to Consolidated Financial Statements at page F-1 of this Form 10-K and the Financial Statements and Notes thereto which are included at pages F-2 to F-19 of this Form 10-K.
2. Exhibits

| Exhibit Number ----- | Description ----- |
|----------------------------|---|
| 3.1* | Certificate of Incorporation of the Company. |
| 3.2* | Bylaws of the Company. |
| 4.1* | Specimen of Common Stock certificate of the Company. |
| 4.2* | Rights Agreement dated as of May 19, 1994, between the Company and The First National Bank of Boston. |
| 10.1* | Form of Indemnification Agreement. |
| 10.2* | 1994 Incentive Plan. |
| 10.3* | 1994 Employee Stock Purchase Plan. |
| 11.0 | Computation of Earnings Per Share. |
| 21.1 | Subsidiaries of the Company. |
| 23.0 | Consent of Independent Accountants. |

* Incorporated by reference to the Company's Registration Statement on Form S-1 (Reg. No. 33-88386) declared effective March 13, 1995.

(b) Reports on Form 8-K

Not Applicable.

(c) Exhibits

See Item 14(a)(2) above.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this Amendment No. 1 on Form 10-K/A to be signed on its behalf by the undersigned thereunto duly authorized.

NATIONAL INSTRUMENTS CORPORATION
Registrant

/s/ Alexander M. Davern

By: _____
Alexander M. Davern
Chief Financial Officer and
Treasurer

Date: March 13, 2001

NATIONAL INSTRUMENTS CORPORATION

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All other schedules are omitted because they are not applicable or the required information is shown in the financial statements or notes thereto.

Report of Independent Accountants

To the Board of Directors and Stockholders of
National Instruments Corporation

In our opinion, the consolidated financial statements listed in the

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accompanying index present fairly, in all material respects, the financial position of National Instruments Corporation and its subsidiaries at December 31, 2000 and 1999, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2000 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP
PricewaterhouseCoopers LLP

Austin, Texas
January 18, 2001

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NATIONAL INSTRUMENTS CORPORATION

CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

| | December 31, | |
|--|--------------|-----------|
| | 2000 | 1999 |
| | ----- | ----- |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents..... | \$ 75,277 | \$ 45,309 |
| Short-term investments..... | 79,525 | 83,525 |
| Accounts receivable, net..... | 74,704 | 58,279 |
| Inventories, net..... | 33,292 | 26,161 |
| Prepaid expenses and other current assets..... | 13,499 | 11,216 |
| Deferred income taxes, net..... | 8,262 | 6,539 |
| | ----- | ----- |
| Total current assets..... | 284,559 | 231,029 |
| Property and equipment, net..... | 84,694 | 69,771 |
| Intangibles and other assets..... | 20,097 | 17,953 |
| | ----- | ----- |
| Total assets..... | \$389,350 | \$318,753 |
| | ===== | ===== |

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:

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| | | |
|--|-----------|-----------|
| Current portion of long-term debt..... | \$ -- | \$ 876 |
| Accounts payable..... | 30,365 | 23,318 |
| Accrued compensation..... | 12,720 | 11,021 |
| Accrued expenses and other liabilities..... | 9,923 | 10,326 |
| Income taxes payable..... | 3,366 | 4,739 |
| Other taxes payable..... | 7,977 | 6,988 |
| | ----- | ----- |
| Total current liabilities..... | 64,351 | 57,268 |
| Long-term debt, net of current portion..... | -- | 4,301 |
| Deferred income taxes, net..... | 3,976 | 2,949 |
| | ----- | ----- |
| Total liabilities..... | 68,327 | 64,518 |
| | ----- | ----- |
| Commitments and contingencies..... | -- | -- |
| Stockholders' equity: | | |
| Common stock: par value \$.01; 180,000,000 shares authorized; 50,634,603 and 50,047,182 shares issued and outstanding, respectively..... | 506 | 500 |
| Additional paid-in capital..... | 69,534 | 58,830 |
| Retained earnings..... | 254,006 | 198,849 |
| Accumulated other comprehensive loss..... | (3,023) | (3,944) |
| | ----- | ----- |
| Total stockholders' equity..... | 321,023 | 254,235 |
| | ----- | ----- |
| Total liabilities and stockholders' equity..... | \$389,350 | \$318,753 |
| | ===== | ===== |

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

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NATIONAL INSTRUMENTS CORPORATION

CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data)

| | For the Years Ended December 31, | | |
|---------------------------------|-------------------------------------|-----------|-----------|
| | 2000 | 1999 | 1998 |
| | ----- | ----- | ----- |
| Net sales..... | \$410,149 | \$329,583 | \$274,230 |
| Cost of sales..... | 98,326 | 76,040 | 65,187 |
| | ----- | ----- | ----- |
| Gross profit..... | 311,823 | 253,543 | 209,043 |
| | ----- | ----- | ----- |
| Operating expenses: | | | |
| Sales and marketing..... | 147,377 | 120,886 | 100,783 |
| Research and development..... | 55,954 | 45,531 | 34,757 |
| General and administrative..... | 32,077 | 24,258 | 20,455 |
| | ----- | ----- | ----- |
| Total operating expenses..... | 235,408 | 190,675 | 155,995 |
| | ----- | ----- | ----- |
| Operating income..... | 76,415 | 62,868 | 53,048 |
| Other income (expense): | | | |
| Interest income..... | 6,390 | 4,759 | 3,439 |
| Interest expense..... | (533) | (404) | (463) |

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| | | | |
|--|-----------|-----------|-----------|
| Net foreign exchange (loss) gain and other.... | (1,159) | 130 | (224) |
| | ----- | ----- | ----- |
| Income before income taxes and cumulative effect of accounting change..... | 81,113 | 67,353 | 55,800 |
| Provision for income taxes..... | 25,956 | 21,553 | 18,414 |
| | ----- | ----- | ----- |
| Income before cumulative effect of accounting change..... | 55,157 | 45,800 | 37,386 |
| Cumulative effect of accounting change, net of tax..... | -- | (552) | -- |
| | ----- | ----- | ----- |
| Net income..... | \$ 55,157 | \$ 45,248 | \$ 37,386 |
| | ===== | ===== | ===== |
| Basic earnings per share: | | | |
| Income before cumulative effect of accounting change..... | \$ 1.10 | \$ 0.92 | \$ 0.76 |
| Cumulative effect of accounting change, net of tax..... | -- | (0.01) | -- |
| | ----- | ----- | ----- |
| Basic earnings per share..... | \$ 1.10 | \$ 0.91 | \$ 0.76 |
| | ===== | ===== | ===== |
| Diluted earnings per share: | | | |
| Income before cumulative effect of accounting change..... | \$ 1.03 | \$ 0.88 | \$ 0.73 |
| Cumulative effect of accounting change, net of tax..... | -- | (0.01) | -- |
| | ----- | ----- | ----- |
| Diluted earnings per share..... | \$ 1.03 | \$ 0.87 | \$ 0.73 |
| | ===== | ===== | ===== |
| Weighted average shares outstanding: | | | |
| Basic..... | 50,332 | 49,776 | 49,248 |
| Diluted..... | 53,564 | 52,203 | 51,150 |

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

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NATIONAL INSTRUMENTS CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

| | For the Years Ended December 31, | | |
|---|-------------------------------------|-----------|-----------|
| | 2000 | 1999 | 1998 |
| | ----- | ----- | ----- |
| Cash flow from operating activities: | | | |
| Net income..... | \$ 55,157 | \$ 45,248 | \$ 37,386 |
| Adjustments to reconcile net income to cash provided by operating activities: | | | |
| Charges to income not requiring cash outlays: | | | |
| Depreciation and amortization..... | 16,345 | 13,026 | 11,638 |
| (Benefit) provision for deferred income taxes..... | (832) | 798 | 1,529 |
| Purchase of in-process research & development..... | -- | 2,130 | -- |

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| | | | |
|--|-----------|-----------|-----------|
| Changes in operating assets and liabilities: | | | |
| Increase in accounts receivable..... | (16,425) | (9,963) | (5,678) |
| Increase in inventory..... | (7,131) | (9,002) | (605) |
| Increase in prepaid expenses and other assets..... | (1,655) | (7,761) | (952) |
| Increase in accounts payable..... | 7,047 | 6,075 | 1,128 |
| Increase in taxes and other liabilities.... | 2,490 | 6,185 | 1,730 |
| | ----- | ----- | ----- |
| Net cash provided by operating activities..... | 54,996 | 46,736 | 46,176 |
| | ----- | ----- | ----- |
| Cash flow from investing activities: | | | |
| Payments for acquisitions, net of cash received..... | -- | (13,072) | (1,519) |
| Capital expenditures..... | (27,631) | (9,452) | (27,985) |
| Additions to intangibles..... | (6,930) | (2,188) | (2,667) |
| Purchases of short-term investments..... | (97,685) | (268,965) | (52,188) |
| Sales of short-term investments..... | 101,685 | 234,808 | 54,097 |
| | ----- | ----- | ----- |
| Net cash used in investing activities.... | (30,561) | (58,869) | (30,262) |
| | ----- | ----- | ----- |
| Cash flow from financing activities: | | | |
| Repayments of long-term debt..... | (5,177) | (1,435) | (824) |
| Net proceeds from issuance of common stock under employee plans..... | 10,710 | 7,339 | 4,505 |
| | ----- | ----- | ----- |
| Net cash provided by financing activities..... | 5,533 | 5,904 | 3,681 |
| | ----- | ----- | ----- |
| Net increase (decrease) in cash and cash equivalents..... | 29,968 | (6,229) | 19,595 |
| Cash and cash equivalents at beginning of period..... | 45,309 | 51,538 | 31,943 |
| | ----- | ----- | ----- |
| Cash and cash equivalents at end of period..... | \$ 75,277 | \$ 45,309 | \$ 51,538 |
| | ===== | ===== | ===== |
| Cash paid for interest and income taxes | | | |
| Interest..... | \$ 601 | \$ 336 | \$ 499 |
| Income taxes..... | \$ 26,776 | \$ 21,283 | \$ 16,008 |

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

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NATIONAL INSTRUMENTS CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(In thousands, except share data)

| | Common Stock (Shares) | Common Stock Amount | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Gain/(Loss) | Total Stockholders' Equity |
|--------------------------------------|-----------------------------|---------------------------|----------------------------------|----------------------|--|----------------------------------|
| | ----- | ----- | ----- | ----- | ----- | ----- |
| Balance at December 31, 1997..... | 48,984,709 | \$490 | \$46,996 | \$116,215 | \$ (1,947) | \$161,754 |
| Net income..... | | | | 37,386 | | 37,386 |

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| | | | | | | |
|---|------------|-------|----------|-----------|------------|-----------|
| Foreign currency translation adjustment (net of \$288 tax expense)..... | | | | | 584 | 584 |
| Unrealized loss on securities available for sale (net of \$0 tax benefit)..... | | | | | (45) | (45) |
| Issuance of common stock under employee plans... | 429,401 | 5 | 4,500 | | | 4,505 |
| | ----- | ---- | ----- | ----- | ----- | ----- |
| Balance at December 31, 1998..... | 49,414,110 | \$495 | \$51,496 | \$153,601 | \$ (1,408) | \$204,184 |
| Net income..... | | | | 45,248 | | 45,248 |
| Foreign currency translation adjustment (net of \$647 tax benefit)..... | | | | | (1,374) | (1,374) |
| Unrealized loss on securities available for sale (net of \$0 tax benefit)..... | | | | | (534) | (534) |
| Unrealized loss on derivative instruments (net of \$295 tax benefit)..... | | | | | (628) | (628) |
| Issuance of common stock under employee plans... | 633,072 | 5 | 7,334 | | | 7,339 |
| | ----- | ---- | ----- | ----- | ----- | ----- |
| Balance at December 31, 1999..... | 50,047,182 | \$500 | \$58,830 | \$198,849 | \$ (3,944) | \$254,235 |
| Net income..... | | | | 55,157 | | 55,157 |
| Foreign currency translation adjustment (net of 1,126 tax benefit)..... | | | | | (2,090) | (2,090) |
| Unrealized gain on securities available for sale (net of \$75 tax expense)..... | | | | | 202 | 202 |
| Unrealized gain on derivative instruments (net of 1,512 tax expense)..... | | | | | 2,809 | 2,809 |
| Issuance of common stock under employee plans... | 587,421 | 6 | 10,704 | | | 10,710 |
| | ----- | ---- | ----- | ----- | ----- | ----- |
| Balance at December 31, 2000..... | 50,634,603 | \$506 | \$69,534 | \$254,006 | \$ (3,023) | \$321,023 |

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

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NATIONAL INSTRUMENTS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1: Operations and summary of significant accounting policies

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National Instruments Corporation (the "Company") is a Delaware Corporation. The Company engages in the design, development, manufacture and marketing of instrumentation software and specialty interface cards and accessories for general commercial, industrial and scientific applications. The Company offers hundreds of products used to create virtual instrumentation systems. The Company's products may be used in different environments, and consequently, specific application of the Company's products is determined by the customer and often is not known to the Company. The Company approaches all markets with essentially the same products, which are used in a variety of applications from research and development to production testing and industrial control. The following industries and applications are served worldwide by the Company: advanced research, automotive, commercial aerospace, computers and electronics, continuous process manufacturing, education, government/defense, medical research/pharmaceutical, power/energy, semiconductors, automated test equipment, telecommunications and others.

Principles of consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

Certain prior year amounts have been reclassified to conform with the 2000 presentation.

Use of estimates

Judgments and estimates by management are required in the preparation of financial statements to conform with generally accepted accounting principles. The estimates and underlying assumptions affect the reported amounts of assets and liabilities, the disclosure of contingencies at the balance sheet date and the reported revenues and expenses for the period. Actual results could differ from those estimates.

Cash and cash equivalents

Cash and cash equivalents include cash and highly liquid investments with maturities of three months or less at the date of acquisition.

Short-term investments

Short-term investments consist of corporate, state and municipal securities with readily determinable fair market values and original maturities in excess of three months. The Company's investments are classified as available-for-sale and accordingly are reported at fair value, with unrealized gains and losses reported as other comprehensive income. Unrealized losses are charged against income when a decline in fair value is determined to be other than temporary. The specific identification method is used to determine the cost of securities sold.

Inventories

Inventories are stated at the lower of cost or market. Cost is determined using standard costs, which approximate the first in, first out (FIFO) method. Cost includes the acquisition cost of purchased components, parts and subassemblies, in-bound freight costs, labor and overhead. Market, with respect to raw materials, is replacement cost and, with respect to work-in-process and finished goods, is net realizable value.

Inventory is shown net of allowance for excess and obsolete inventory of \$2.5 million and \$2.4 million at December 31, 2000 and 1999, respectively.

NATIONAL INSTRUMENTS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Property and equipment

Property and equipment are recorded at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, which range from twenty to forty years for buildings and three to five years for equipment. Leasehold improvements are depreciated over the shorter of the life of the lease or the asset.

Intangible assets

The Company has capitalized costs related to the development and acquisition of certain software products. In accordance with Statement of Financial Accounting Standards ("SFAS") No. 86 "Accounting for the Costs of Computer Software to Be Sold, Leased or Otherwise Marketed," capitalization of costs begins when technological feasibility has been established and ends when the product is available for general release to customers. Amortization is computed on an individual product basis for those products available for market and has been recognized based on the product's estimated economic life, generally three years.

The excess purchase price over the fair value of assets acquired is recorded as goodwill and is amortized using the straight-line method over ten years. Intangible assets are periodically assessed for impairment of value and any loss is recognized upon impairment.

Concentrations of credit risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of foreign currency forward and option contracts, cash and cash equivalents, short-term investments and trade accounts receivable. In management's opinion, no significant concentration of credit risk exists for the Company.

The Company's counterparties in its foreign currency forward and option contracts are major financial institutions. The Company does not anticipate nonperformance by these counterparties. The Company maintains cash and cash equivalents with various financial institutions located in many countries worldwide. Company policy is to limit exposure in foreign countries by transferring cash to the U.S. The Company's short-term investments are diversified among and limited to high-quality securities with high credit ratings. Concentration of credit risk with respect to trade accounts receivable is limited due to the large number of customers and their dispersion across many countries and industries. The amount of sales and trade accounts receivable to any individual customer was not material for the periods presented.

Revenue recognition

Sales revenue is recognized on the date the product is shipped to the customer. Provision is made for estimated sales returns based on actual historical experience. Revenue related to the sale of maintenance contracts is deferred and amortized on a straight-line basis over the service period. Deferred revenue at December 31, 2000 and 1999 is \$3.0 million and \$1.3 million

respectively.

In the fourth quarter, the Company adopted Staff Accounting Bulletin ("SAB") No. 101, Revenue Recognition in Financial Statements, which provides guidance in applying generally accepted accounting principles to certain revenue recognition issues. The adoption of SAB 101 did not have a material impact on the Company's financial position or overall trends in results of operations.

Accounts receivable are net of allowances for doubtful accounts of \$4.5 million and \$4.1 million at December 31, 2000 and 1999, respectively.

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NATIONAL INSTRUMENTS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Warranty expense

The Company offers a one-year limited warranty on most hardware products and a 90-day warranty on software products, which is included in the sales price of many of its products. Provision is made for estimated future warranty costs at the time of sale.

Legal Defense Costs

The Company accrues for legal defense costs on an undiscounted basis, in accordance with Statement of Financial Accounting Standards No. 5, "Accounting for Loss Contingencies" when such costs are considered probable of being incurred and are reasonably estimable. The Company periodically evaluates available information, both internal and external, relative to such contingencies and adjusts this accrual as necessary.

Advertising expense

The Company expenses its costs of advertising as incurred. Advertising expense for the years ended December 31, 2000, 1999 and 1998 is \$35.4 million, \$34.1 million and \$31.3 million, respectively.

Foreign currency translation

The functional currency for the Company's international operations is the applicable local currency. The assets and liabilities of these operations are translated at the rate of exchange in effect on the balance sheet date; sales and expenses are translated at average rates. The resultant gains or losses from translation are included in a separate component of other comprehensive income. Gains and losses resulting from remeasuring monetary asset and liability accounts that are denominated in a currency other than a subsidiary's functional currency are included in determining net income.

Foreign currency hedging instruments

The Company adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," on January 1, 1999. In accordance with the transition provisions of SFAS 133, the Company recorded a net-of-tax cumulative-effect adjustment of \$552,000 in current earnings to recognize the fair value of its derivatives designated as cash-flow hedging instruments at the date of adoption.

All of the Company's derivative instruments are recognized on the balance

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sheet at their fair value. The Company currently uses foreign currency forward and purchased option contracts to hedge its exposure to material foreign currency denominated receivables and forecasted foreign currency cash flows.

On the date the derivative contract is entered into, the Company designates its derivative as either a hedge of the fair value of foreign currency denominated receivables ("fair-value" hedge) or as a hedge of the variability of foreign currency cash flows to be received ("foreign-currency" hedge). Changes in the fair market value of a fair-value hedge are recorded, along with the loss or gain on the re-measurement of foreign-currency-denominated receivables, in current earnings. Changes in the fair value of derivatives that are highly effective as--and that are designated and qualify as--foreign-currency hedges under FAS 133 are recorded in other comprehensive income, with the exception of changes in the time-value of instruments, which are recorded in current earnings. As of December 31, 2000, the Company has not entered into a derivative contract for speculative purposes.

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives that are designated as fair-value or foreign-currency hedges to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Company also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used to hedge forecasted transactions are highly effective in offsetting changes in cash flows of hedged items.

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NATIONAL INSTRUMENTS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

The Company prospectively discontinues hedge accounting if (1) it is determined that the derivative is no longer highly effective in offsetting changes in the fair value or cash flows of a hedged item (including firm commitments or forecasted transactions); (2) the derivative expires or is sold, terminated or exercised; (3) the derivative is de-designated as a hedge instrument, because it is unlikely that a forecasted transaction will occur; (4) the hedged firm commitment no longer meets the definition of a firm commitment; or (5) management determines that designation of the derivative as a hedge instrument is no longer appropriate.

When hedge accounting is discontinued because it is probable that a forecasted transaction will not occur, the derivative will continue to be carried on the balance sheet at its fair value, and gains and losses that were accumulated in other comprehensive income will be recognized immediately in earnings. In all other situations where hedge accounting is discontinued, the derivative will be carried as its fair value on the balance sheet, with changes in its fair value recognized in current-period earnings.

Income taxes

The provision for income taxes is based on pretax financial accounting income. 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.

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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. Common share equivalents include stock options. The number of common share equivalents outstanding relating to stock options is computed using the treasury stock method.

The reconciliation of the denominators used to calculate the basic EPS and diluted EPS for the years ended December 31, 2000, 1999 and 1998, respectively are as follows (in thousands):

| | Years Ended December 31, | | |
|--|-----------------------------|--------|--------|
| | 2000 | 1999 | 1998 |
| Weighted average shares outstanding-basic..... | 50,332 | 49,776 | 49,248 |
| Plus: Common share equivalents | | | |
| Stock options..... | 3,232 | 2,427 | 1,902 |
| Weighted average shares outstanding-diluted..... | 53,564 | 52,203 | 51,150 |
| | ===== | ===== | ===== |

Stock options to acquire 989,545, 57,783 and 1,144,686 shares for the years ended December 31, 2000, 1999 and 1998, respectively were excluded from the computations of diluted earnings per share because the effect of including stock options would have been anti-dilutive.

Stock-based compensation plans

The Company has adopted the disclosure-only provisions of SFAS No. 123, "Accounting for Stock-Based Compensation." As allowed by SFAS No. 123, the Company continues to apply the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock issued to Employees" and related interpretations in accounting for its plans. Accordingly, compensation cost for stock options is measured as the excess, if any, of the quoted market price of the Company's stock at the date of the grant over the amount an employee must pay to acquire the stock.

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NATIONAL INSTRUMENTS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Comprehensive income

The Company has adopted SFAS No. 130, "Reporting Comprehensive Income", which established standards for reporting, in addition to net income, comprehensive income and its components including, as applicable, foreign currency items, minimum pension liability adjustments and unrealized gains and losses on certain investments in debt and equity securities. Total comprehensive income for 2000, 1999 and 1998 was \$56.1 million, \$42.7 million

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and \$37.9 million, respectively.

Note 2: Short-term investments

Short-term investments at December 31, 2000 and 1999, consisting of corporate, state and municipal securities, were acquired at an aggregate cost of \$78.3 million and \$81.5 million, respectively. The contractual maturities of these securities, which are classified as available-for-sale and carried at fair value, are as follows (in thousands):

| | December 31, | |
|------------------------------------|--------------|----------|
| | 2000 | 1999 |
| Less than 90 days..... | \$ 990 | \$ -- |
| 90 days to one year..... | 55,969 | 26,989 |
| One year through two years..... | 19,484 | 41,681 |
| Two years through three years..... | 3,082 | 14,855 |
| | \$79,525 | \$83,525 |
| | ===== | ===== |

Note 3: Inventories

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

| | December 31, | |
|----------------------|--------------|----------|
| | 2000 | 1999 |
| Raw materials..... | \$17,298 | \$11,115 |
| Work-in-process..... | 978 | 2,402 |
| Finished goods..... | 15,016 | 12,644 |
| | \$33,292 | \$26,161 |
| | ===== | ===== |

Note 4: Property and equipment

Property and equipment consist of the following (in thousands):

| | December 31, | |
|-------------------------------|--------------|----------|
| | 2000 | 1999 |
| Land..... | \$ 5,208 | \$ 4,006 |
| Buildings..... | 55,242 | 45,013 |
| Furniture and equipment..... | 78,221 | 68,595 |
| | 138,671 | 117,614 |
| Accumulated depreciation..... | (60,552) | (47,843) |
| Construction-in-progress..... | 6,575 | -- |

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| | |
|-----------|-----------|
| ----- | ----- |
| \$ 84,694 | \$ 69,771 |
| ===== | ===== |

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Depreciation expense for the years ended December 31, 2000, 1999 and 1998, is \$12.8 million, \$10.5 million and \$8.9 million, respectively.

Note 5: Intangibles and other assets

Intangibles at December 31, 2000 and 1999 include capitalized software development costs of \$6.7 million and \$4.4 million, respectively, which are net of accumulated amortization of \$8.5 million and \$6.0 million, respectively, and goodwill of \$6.8 million and \$7.5 million in 2000 and 1999 (net of accumulated amortization of \$900,000 and \$180,000), respectively. Total amortization costs were \$3.5 million, \$2.5 million and \$2.8 million for the years ended December 31, 2000, 1999 and 1998, respectively. Substantially all of these amounts were amortization of software development costs.

Note 6: Debt

Debt consists of the following (in thousands):

| | December 31, | |
|---|--------------|---------|
| | 2000 | 1999 |
| | ----- | ----- |
| Long-term debt: Manufacturing facility loan, LIBOR, \$8,480,000 commitment, half the principal is payable, together with interest, in equal quarterly installments over a five-year term, beginning September 1995, remainder due at maturity at February 28, 2001..... | \$ -- | \$4,515 |
| Other..... | -- | 662 |
| Total debt..... | -- | 5,177 |
| | ----- | ----- |
| Less current portion..... | -- | 876 |
| | ----- | ----- |
| Long-term portion..... | \$ -- | \$4,301 |
| | ===== | ===== |

The manufacturing facility loan was fully repaid in 2000 at its carrying value.

Note 7: Income taxes

The components of income before the provision for income taxes are as follows (in thousands):

| Years Ended December | | |
|----------------------|-------|-------|
| 31, | | |
| 2000 | 1999 | 1998 |
| ----- | ----- | ----- |

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| | | | |
|---------------|----------|----------|----------|
| Domestic..... | \$68,982 | \$57,189 | \$46,817 |
| Foreign..... | 12,131 | 10,164 | 8,983 |
| | ----- | ----- | ----- |
| | \$81,113 | \$67,353 | \$55,800 |
| | ===== | ===== | ===== |

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NATIONAL INSTRUMENTS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

The provision for income taxes charged to operations is as follows (in thousands):

| | Years Ended December | | |
|---------------------------------|----------------------|----------|----------|
| | 31, | | |
| | 2000 | 1999 | 1998 |
| | ----- | ----- | ----- |
| Current tax expense: | | | |
| U.S. federal..... | \$22,902 | \$17,858 | \$11,945 |
| State..... | 2,043 | 1,165 | 1,109 |
| Foreign..... | 1,843 | 1,732 | 3,831 |
| | ----- | ----- | ----- |
| Total current..... | 26,788 | 20,755 | 16,885 |
| | ----- | ----- | ----- |
| Deferred tax expense (benefit): | | | |
| U.S. federal..... | (2,031) | 1,394 | 2,352 |
| State..... | (12) | 115 | 329 |
| Foreign..... | 1,211 | (711) | (1,152) |
| | ----- | ----- | ----- |
| Total deferred..... | (832) | 798 | 1,529 |
| | ----- | ----- | ----- |
| Total provision..... | \$25,956 | \$21,553 | \$18,414 |
| | ===== | ===== | ===== |

Deferred tax liabilities (assets) at December 31, 2000 and 1999 are as follows (in thousands):

| | December 31, | |
|---|--------------|----------|
| | 2000 | 1999 |
| | ----- | ----- |
| Capitalized software..... | \$ 2,202 | \$ 1,194 |
| Unrealized gain on derivative instruments..... | 1,174 | -- |
| Depreciation and amortization..... | 263 | 164 |
| Undistributed earnings of foreign subsidiaries..... | -- | 616 |
| | ----- | ----- |
| Gross deferred tax liabilities..... | 3,639 | 1,974 |
| | ----- | ----- |

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| | | |
|---|------------|------------|
| Operating loss carryforwards..... | (685) | (1,563) |
| Vacation and other accruals..... | (1,835) | (1,711) |
| Inventory valuation and warranty provisions..... | (2,124) | (1,853) |
| Doubtful accounts and sales provisions..... | (1,434) | (1,413) |
| Unrealized exchange loss..... | (436) | (137) |
| Intercompany profit..... | (1,162) | (782) |
| Undistributed earnings of foreign subsidiaries..... | (155) | -- |
| Accrued legal expenses..... | (923) | -- |
| Unrealized loss on derivative instruments..... | -- | (318) |
| Other..... | (442) | (462) |
| | ----- | ----- |
| Gross deferred tax assets..... | (9,196) | (8,239) |
| | ----- | ----- |
| Valuation allowance..... | 332 | 292 |
| | ----- | ----- |
| Net deferred tax asset..... | \$ (5,225) | \$ (5,973) |
| | ===== | ===== |

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NATIONAL INSTRUMENTS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

A reconciliation of income taxes at the U.S. federal statutory income tax rate to the effective tax rate follows:

| | Years Ended December 31, | | |
|---|-----------------------------|------|------|
| | 2000 | 1999 | 1998 |
| | ---- | ---- | ---- |
| U.S. federal statutory tax rate..... | 35% | 35% | 35% |
| Foreign sales corporation benefit..... | (2) | (2) | (2) |
| Foreign taxes less than federal statutory rate..... | (1) | (1) | -- |
| Tax exempt interest..... | (2) | (2) | (2) |
| State income taxes, net of federal tax benefit..... | 2 | 2 | 2 |
| | ---- | ---- | ---- |
| Effective tax rate..... | 32% | 32% | 33% |
| | === | === | === |

As of December 31, 2000, eight of the Company's subsidiaries have available, for income tax purposes, foreign net operating loss carryforwards of approximately \$2.9 million, of which \$1.3 million expire during the years 2002--2010 and \$1.6 million of which may be carried forward indefinitely.

The Company has not provided for U.S. federal income and foreign withholding taxes on approximately \$3.3 million of certain non-U.S. subsidiaries' undistributed earnings as of December 31, 2000. These earnings would become subject to taxes of approximately \$400,000, if they were actually or deemed to be remitted to the parent company as dividends or if the Company should sell its stock in these subsidiaries. The Company currently intends to reinvest indefinitely these undistributed earnings.

Note 8: Acquisitions

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On August 31, 1999, the Company acquired all of the issued and outstanding shares of common stock of GfS Systemtechnik GmbH and related companies. The acquisition was accounted for as a purchase. The Company recorded a \$2.1 million pre-tax charge against earnings during the third quarter of 1999 for the write-off of in-process GfS research and development technology that had not reached the working model stage. The Company also recorded \$1.1 million of capitalized software development costs and \$7.7 million of goodwill related to the acquisition, which are included in intangibles and other assets. The consolidated financial statements include the operating results from the date of acquisition. Pro-forma results of operation have not been presented because the effects of those operations were not material.

Note 9: Stockholders' equity

Common stock

On July 22, 1999, the Company declared a stock split effected in the form of a dividend of one share of common stock for each two shares of common stock outstanding. The dividend was paid on August 20, 1999 to holders of record as of the close of business on August 5, 1999. All share information included in the accompanying consolidated financial statements and notes has been retroactively adjusted to reflect the exchange and stock split.

Stock-based compensation plans

At December 31, 2000, the Company has two active stock-based compensation plans and one inactive plan. The two active stock-based compensation plans are the 1994 Incentive Stock Option Plan and the Employee Stock Purchase Plan. No compensation cost has been recognized in the Company's financial statements for the stock option plan and the stock purchase plan. If compensation cost for the Company's two

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NATIONAL INSTRUMENTS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

active stock-based compensation plans were determined based on the fair value at the grant date for awards under those plans consistent with the method established by SFAS No. 123, the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below (in thousands, except per share data).

| | Years Ended December 31, | | |
|---------------------------------|-----------------------------|----------|----------|
| | 2000 | 1999 | 1998 |
| Net income..... | \$55,157 | \$45,248 | \$37,386 |
| As reported Pro-forma..... | 44,307 | 38,742 | 31,281 |
| Basic earnings per share..... | \$ 1.10 | \$ 0.91 | \$ 0.76 |
| As reported Pro-forma..... | 0.88 | 0.78 | 0.63 |
| Diluted earnings per share..... | \$ 1.03 | \$ 0.87 | \$ 0.73 |
| As reported Pro-forma..... | 0.83 | 0.74 | 0.61 |

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Stock option plans

The stockholders of the Company approved the 1994 Incentive Stock Option Plan on May 9, 1994. At the time of approval, 6,075,000 shares of the Company's common stock were reserved for issuance under this plan. In 1997, an additional 4,725,000 shares of the Company's common stock were reserved for issuance under this plan. The 1994 Plan, administered by the Compensation Committee of the Board of Directors, provides for granting of incentive awards in the form of stock options to directors, executive officers and employees of the Company and its subsidiaries. Awards under the plan must be granted within ten years of the effective date of the 1994 Plan. Options granted may be 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. Stock options must be exercised within ten years from date of grant. Stock options are issued at market price at the grant date. Shares available for grant at December 31, 2000 were 3,326,327.

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NATIONAL INSTRUMENTS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Transactions under all plans are summarized as follows:

| | Number of shares under option | Weighted average exercise price |
|---------------------------------------|-------------------------------------|--|
| | ----- | ----- |
| Outstanding at December 31, 1997..... | 4,557,272 | \$10.38 |
| Exercised..... | (244,691) | 5.11 |
| Canceled..... | (202,313) | 14.57 |
| Granted..... | 1,481,866 | 22.53 |
| | ----- | ----- |
| Outstanding at December 31, 1998..... | 5,592,134 | 13.69 |
| Exercised..... | (498,514) | 9.94 |
| Canceled..... | (522,905) | 16.22 |
| Granted..... | 946,247 | 20.41 |
| | ----- | ----- |
| Outstanding at December 31, 1999..... | 5,516,962 | 14.95 |
| Exercised..... | (443,544) | 11.56 |
| Canceled..... | (209,966) | 24.98 |
| Granted..... | 1,451,062 | 47.92 |
| | ----- | ----- |
| Outstanding at December 31, 2000..... | 6,314,514 | \$22.40 |
| | ===== | ===== |
| Options exercisable at December 31: | | |
| 1998..... | 1,855,802 | \$10.29 |
| 1999..... | 2,398,305 | 11.99 |
| 2000..... | 2,964,530 | 14.20 |

Weighted
average
fair value

| | | |
|--|-----------|---------|
| ----- | | |
| Weighted average, grant date fair value of options granted during: | | |
| 1998..... | 1,481,866 | \$10.33 |
| 1999..... | 946,247 | 8.57 |
| 2000..... | 1,451,062 | 25.17 |

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NATIONAL INSTRUMENTS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

| | | | | | |
|-----------------------|-------------------------------|---------------------------------|---|-------------------------------|---------------------------------|
| | December 31, 2000 | | | | |
| | ----- | | | ----- | |
| | Options Outstanding | | Options Exercisable | | |
| | ----- | | | ----- | |
| Exercise price | Number of options outstanding | Weighted average exercise price | Weighted average remaining contractual life (yrs) | Number of options exercisable | Weighted average exercise price |
| ----- | ----- | ----- | ----- | ----- | ----- |
| \$ 6.44 - \$ 8.78.... | 693,018 | \$ 6.55 | 4 | 608,380 | \$ 6.55 |
| 8.89 - 14.06.... | 1,040,668 | 9.20 | 5 | 813,887 | 9.17 |
| 14.44 - 14.44.... | 1,155,306 | 14.44 | 6 | 696,036 | 14.44 |
| 14.83 - 22.96.... | 1,879,463 | 20.89 | 8 | 723,060 | 21.16 |
| 23.33 - 51.56.... | 1,546,059 | 46.17 | 9 | 123,167 | 42.97 |
| | ----- | | | ----- | |
| | 6,314,514 | 22.40 | 7 | 2,964,530 | 14.20 |

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

| | | | |
|------------------------------|---------|---------|---------|
| | 2000 | 1999 | 1998 |
| | ----- | ----- | ----- |
| Dividend expense yield..... | 0% | 0% | 0% |
| Expected life..... | 5 years | 5 years | 5 years |
| Expected volatility..... | 40.6% | 35.5% | 33.3% |
| Risk-free interest rate..... | 6.8% | 4.8% | 5.6% |

Employee stock purchase plan

The Company's stock purchase plan became effective March 13, 1995 upon the first date of registration of the Company's Common Stock. The plan permits substantially all domestic employees and employees of designated subsidiaries to acquire the Company's Common Stock at a purchase price of 85% of the lower of the market price at the beginning or the end of the participation period. The semi-annual periods begin on October 1 and April 1 of each year. Employees

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may designate up to 15% of their compensation for the purchase of Common Stock. Common Stock reserved for future employee purchases aggregated 2,461,702 shares at December 31, 2000. Shares issued under this plan were 145,821 in 2000. The weighted average fair value of the employees' purchase rights, as shown below was estimated using the Black-Scholes model with the following assumptions:

| | 2000 | 1999 | 1998 |
|------------------------------|----------|----------|----------|
| Dividend expense yield..... | 0% | 0% | 0% |
| Expected life..... | 6 months | 6 months | 6 months |
| Expected volatility..... | 58% | 38% | 40% |
| Risk-free interest rate..... | 5.6% | 4.2% | 5.3% |

Weighted average, grant date fair value of purchase rights granted under the Employee Stock Purchase Plan:

| | Number of shares | Weighted average fair value |
|-----------|------------------------|-----------------------------------|
| 1998..... | 195,179 | \$ 5.16 |
| 1999..... | 160,830 | 6.79 |
| 2000..... | 158,158 | 14.54 |

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NATIONAL INSTRUMENTS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Stockholders' rights plan

The Board of Directors and stockholders approved and adopted the Rights Agreement prior to the Company's initial public offering (the "offering"). On March 13, 1995, the effective date of the offering, the Board of Directors declared a dividend distribution of one common share purchase right for each outstanding share of Common Stock. The rights become exercisable under certain conditions involving acquisition of the Company's Common Stock. Under certain other conditions where the Company is consolidated or merged, each holder of a right shall have the right to receive, upon exercise of the right, shares of Common Stock of the Company, or acquiring company, having a value of twice the exercise price of the right. The rights expire on March 13, 2005, and may be redeemed in whole by the Company for \$.01 per right. The rights are excluded from earnings per share computations because they qualify as contingent shares and therefore are excluded as long as the conditions that require issuance of the shares are not imminent.

Note 10: Employee retirement plan

The Company has a defined contribution retirement plan pursuant to Section 401(k) of the Internal Revenue Code. Substantially all domestic employees with at least one year of continuous service are eligible to participate and may

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contribute up to 15% of their compensation. The Board of Directors has elected to make matching contributions equal to 50% of employee contributions, which may be applied, to a maximum of 6% of each participant's compensation. Company contributions vest immediately. Company contributions charged to expense were \$1,292,000, \$1,087,000 and \$933,000 in 2000, 1999 and 1998, respectively.

Note 11: Financial instruments

Fair value of financial instruments

The estimated fair value amounts disclosed below have been determined by the Company using available market information and valuation methodologies described below. However, considerable judgment is required in interpreting market data to develop these estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts that the Company could realize in a current market exchange. The use of different market assumptions could have a significant effect on the estimates. For certain financial instruments of the Company, including cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities and the current portion of long-term debt, the carrying amount approximates fair value due to the short-term maturity of these instruments. The estimated fair values of the other assets (liabilities) of the Company's remaining financial instruments at December 31, 2000 and 1999 are as follows (in thousands):

| | December 31, | | | |
|-----------------------------|--------------------|---------------|--------------------|---------------|
| | 2000 | | 1999 | |
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Short-term investments..... | \$79,525 | \$79,525 | \$83,525 | \$83,525 |
| Other assets/liabilities: | | | | |
| Forward contracts..... | 3,293 | 3,293 | (41) | (41) |
| Purchased options..... | 871 | 871 | -- | -- |
| Long-term debt..... | -- | -- | (4,301) | (3,884) |

The fair values of short-term investments and foreign currency forward contracts were estimated based upon quotes from brokers as of the applicable balance sheet date. The fair value of long-term debt was estimated by discounting the future cash flows using rates currently available for debt of similar terms and maturity.

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NATIONAL INSTRUMENTS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Note 12: Derivative instruments and hedging activities

The Company has operations in over 30 countries. Forty-seven percent of the Company's revenues are generated outside North America. The Company's activities expose it to a variety of market risks, including the effects of changes in foreign-currency exchange rates and interest rates. These financial risks are monitored and managed by the Company as an integral part of its

overall risk management program.

The Company maintains a foreign-currency risk management strategy that uses derivative instruments (foreign currency forward and purchased options contracts) to protect its interests from fluctuations in earnings and cash flows caused by the volatility in currency exchange rates. Movements in foreign-currency exchange rates pose a risk to the Company's operations and competitive position, since exchange rate changes may affect the profitability, cash flow, and business and/or pricing strategies of non-U.S. based competitors.

Foreign currency fair value and cash flow hedges

The Company's foreign sales are denominated in the customers' local currency. The Company purchases foreign currency forward and purchased options contracts as hedges of anticipated sales that are denominated in foreign currencies and as hedges of foreign currency denominated receivables. These contracts are entered into to 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.

At December 31, 2000, the Company held forward contracts with a notional amount of \$35.1 million that were designated as foreign currency fair value hedges of the Company's foreign denominated receivables. These contracts, which are for 90-day periods, had a carrying amount of \$(63,000). The Company hedges up to 90% of its outstanding foreign denominated receivables.

At December 31, 2000, the Company held forward contracts with a notional amount of \$65.3 million that were designated as foreign currency cash flow hedges related to the Company's anticipated sales transactions. These contracts, which are for terms up to twenty-four months, had a pre-tax carrying amount of \$3.4 million and a net unrealized deferred gain of \$3.4 million recorded in "Accumulated Other Comprehensive Income." Based on the Company's estimates of future foreign exchange rates, it hedges up to 100% of anticipated cash inflows for the following 1 to 30 months.

As of December 31, 2000, \$38,000 of deferred gains on derivative instruments recorded in Accumulated Other Comprehensive Income are expected to be reclassified to earnings during the next twelve months. The actual foreign sales expected to occur over the next twelve months will necessitate the reclassifying to earnings of these derivative gains.

For the year ended December 31, 2000, the Company recognized a net loss of \$961,000 (reported in the "Net Foreign Exchange Gain/(Loss)" line item in the Consolidated Statement of Income), which represented the total ineffectiveness of all cash-flow hedges.

Note 13: Segment information

In 1998, the Company adopted SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." SFAS 131 supersedes SFAS No. 14 "Financial Reporting for Segments of a Business Enterprise", replacing the "industry segment" approach with 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 the Company's reportable segments. It also requires disclosures about products and services, geographic areas and major customers.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

While the Company sells its products to many different markets, its management has chosen to organize the Company by geographic areas, and as a result has determined that it has one reportable segment. Substantially all of the interest income, interest expense, depreciation and amortization is recorded in North America. Net sales, operating income and identifiable assets, classified by the major geographic areas in which the Company operates, are as follows (in thousands):

| | Years Ended December 31, | | |
|----------------------------------|--------------------------|-----------|-----------|
| | 2000 | 1999 | 1998 |
| Net sales: | | | |
| North America: | | | |
| Unaffiliated customer sales..... | \$ 215,960 | \$175,873 | \$153,435 |
| Geographic transfers..... | 55,524 | 41,739 | 32,451 |
| | ----- | ----- | ----- |
| | 271,484 | 217,612 | 185,886 |
| | ----- | ----- | ----- |
| Europe: | | | |
| Unaffiliated customer sales..... | 133,799 | 108,801 | 86,961 |
| | ----- | ----- | ----- |
| Asia Pacific: | | | |
| Unaffiliated customer sales..... | 60,390 | 44,909 | 33,834 |
| | ----- | ----- | ----- |
| Eliminations..... | (55,524) | (41,739) | (32,451) |
| | ----- | ----- | ----- |
| | \$ 410,149 | \$329,583 | \$274,230 |
| | ===== | ===== | ===== |

| | Years Ended December 31, | | |
|--|--------------------------|-----------|----------|
| | 2000 | 1999 | 1998 |
| Operating income: | | | |
| North America..... | \$ 57,188 | \$ 48,679 | \$44,669 |
| Europe..... | 48,180 | 39,603 | 29,964 |
| Asia Pacific..... | 27,001 | 20,117 | 13,172 |
| Unallocated: | | | |
| Research and development expenses..... | (55,954) | (45,531) | (34,757) |
| | ----- | ----- | ----- |
| | \$ 76,415 | \$ 62,868 | \$53,048 |
| | ===== | ===== | ===== |

| | December 31, | |
|----------------------|--------------|-------|
| | 2000 | 1999 |
| Identifiable assets: | | |
| | ----- | ----- |

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| | | |
|--------------------|-----------|-----------|
| North America..... | \$324,881 | \$261,709 |
| Europe..... | 52,056 | 34,457 |
| Asia Pacific..... | 12,413 | 22,587 |
| | ----- | ----- |
| | \$389,350 | \$318,753 |
| | ===== | ===== |

Total sales outside the United States for 2000, 1999 and 1998 was \$217.3 million, \$171.6 million and \$135.6 million, respectively.

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NATIONAL INSTRUMENTS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Note 14: Commitments and contingencies

The Company has commitments under noncancelable operating leases primarily for office facilities and equipment. Future minimum lease payments as of December 31, 2000, for each of the next five years are as follows (in thousands):

| | |
|-----------------|---------|
| 2001..... | \$1,741 |
| 2002..... | 1,653 |
| 2003..... | 1,539 |
| 2004..... | 1,485 |
| 2005..... | 737 |
| Thereafter..... | -- |
| | ----- |
| | \$7,155 |
| | ===== |

Rent expense under operating leases was approximately \$3.5 million, \$3.6 million and \$2.6 million for the years ended December 31, 2000, 1999 and 1998, respectively.

Note 15: Litigation

On May 2, 2000, the Company was served by Cognex Corporation, asserting patent infringement of two Cognex patents, copyright infringement, trademark infringement and unfair competition. Cognex seeks preliminary and permanent injunctive relief, actual monetary damages in an unspecified amount and attorney's fees and costs. On June 21, 2000, the Company filed a response to their lawsuit denying all claims. A trial has been scheduled for October 23, 2001. The Company is defending this lawsuit vigorously. The Company is unable to predict the outcome of the litigation at this time. Based on the facts we have reviewed to date, management does not expect the resolution of this matter to have a material adverse effect on the Company's business or financial condition. However, because the plaintiff has indicated an unwillingness to withdraw these claims, the Company has accrued \$2.5 million of anticipated patent defense costs that are probable of being incurred. The Company has charged approximately \$270,000 against the Cognex defense accrual during calendar 2000.

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NATIONAL INSTRUMENTS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Note 16: Quarterly results (unaudited)

The following quarterly results have been derived from unaudited consolidated financial statements that, in the opinion of management, reflect all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of such quarterly information. The operating results for any quarter are not necessarily indicative of the results to be expected for any future period. The unaudited quarterly financial data for each of the eight quarters in the two years ended December 31, 2000 are as follows (in thousands, except per share data):

| | Three Months Ended | | | |
|--|--------------------|------------------|------------------|------------------|
| | Mar. 31, 2000 | Jun. 30, 2000 | Sep. 30, 2000 | Dec. 31, 2000 |
| Net sales..... | \$ 94,105 | \$ 99,550 | \$102,247 | \$114,247 |
| Gross profit..... | 71,865 | 75,520 | 77,830 | 86,607 |
| Operating income..... | 18,053 | 20,175 | 18,404 | 19,783 |
| Net income..... | 12,664 | 14,431 | 13,197 | 14,864 |
| Basic earnings per share..... | \$ 0.25 | \$ 0.29 | \$ 0.26 | \$ 0.29 |
| Weighted average shares outstanding- basic..... | 50,112 | 50,274 | 50,364 | 50,567 |
| Diluted earnings per share..... | \$ 0.24 | \$ 0.27 | \$ 0.25 | \$ 0.28 |
| Weighted average shares outstanding- diluted..... | 53,415 | 53,567 | 53,612 | 53,642 |

| | Three Months Ended | | | |
|--|--------------------|------------------|------------------|------------------|
| | Mar. 31, 1999 | Jun. 30, 1999 | Sep. 30, 1999 | Dec. 31, 1999 |
| Net sales..... | \$ 73,686 | \$ 79,777 | \$ 82,724 | \$ 93,396 |
| Gross profit..... | 56,746 | 61,658 | 63,176 | 71,963 |
| Operating income..... | 15,166 | 15,883 | 12,841 | 18,978 |
| Income before cumulative effect of accounting change..... | 10,560 | 11,257 | 9,946 | 14,037 |
| Net income..... | 10,008 | 11,257 | 9,946 | 14,037 |
| Basic earnings per share: | | | | |
| Income before cumulative effect of accounting change..... | \$ 0.21 | \$ 0.23 | \$ 0.20 | \$ 0.28 |
| Cumulative effect of accounting change, net of tax..... | (0.01) | -- | -- | -- |
| Basic earnings per share..... | \$ 0.20 | \$ 0.23 | \$ 0.20 | \$ 0.28 |
| Diluted earnings per share: | | | | |
| Income before cumulative effect of accounting change..... | \$ 0.20 | \$ 0.22 | \$ 0.19 | \$ 0.27 |
| Cumulative effect of accounting change, | | | | |

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| | | | | |
|--------------------------------------|---------|---------|---------|---------|
| net of tax..... | (0.01) | -- | -- | -- |
| | ----- | ----- | ----- | ----- |
| Diluted earnings per share..... | \$ 0.19 | \$ 0.22 | \$ 0.19 | \$ 0.27 |
| | ===== | ===== | ===== | ===== |
| Weighted average shares outstanding: | | | | |
| Basic..... | 49,484 | 49,725 | 49,855 | 50,029 |
| Diluted..... | 51,339 | 51,866 | 52,570 | 52,802 |

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SCHEDULE II

NATIONAL INSTRUMENTS CORPORATION

VALUATION AND QUALIFYING ACCOUNTS
(In thousands)

Allowance for doubtful accounts

| Year | Description | Balance at Beginning of Period | Provision for Bad Debt Expense | Write-Offs Charged to Allowances | Balance at End of Period |
|-----------|---------------------------------|--------------------------------|--------------------------------|----------------------------------|--------------------------|
| ---- | ----- | ----- | ----- | ----- | ----- |
| 1998..... | Allowance for doubtful accounts | \$4,000 | \$ 183 | \$ 513 | \$ 3,670 |
| 1999..... | Allowance for doubtful accounts | 3,670 | 1,455 | 982 | 4,143 |
| 2000..... | Allowance for doubtful accounts | 4,143 | 1,962 | 1,589 | |

Valuation allowances for excess and obsolete inventory

| Year | Description | Balance at Beginning of Period | Provision Charged to Cost of Sales | Write-Offs Charged to Allowances | Balance at End of Period |
|-----------|--|--------------------------------|------------------------------------|----------------------------------|--------------------------|
| ---- | ----- | ----- | ----- | ----- | ----- |
| 1998..... | Valuation allowances for excess and obsolete inventory | \$3,160 | \$ -- | \$1,356 | \$ 1,804 |
| 1999..... | Valuation allowances for excess and obsolete inventory | 1,804 | 1,244 | 694 | 2,354 |
| 2000..... | Valuation allowances for excess and obsolete inventory | 2,354 | 1,090 | 978 | |

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