

FLIR SYSTEMS INC  
Form 10-Q  
November 09, 2010  
[Table of Contents](#)

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

**FORM 10-Q**

(Mark one)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the quarterly period ended September 30, 2010

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 0-21918

**FLIR Systems, Inc.**

(Exact name of Registrant as specified in its charter)

Edgar Filing: FLIR SYSTEMS INC - Form 10-Q

**Oregon**  
(State or other jurisdiction of  
incorporation or organization)

**93-0708501**  
(I.R.S. Employer  
Identification No.)

**27700 SW Parkway Avenue, Wilsonville, Oregon**  
(Address of principal executive offices)

**97070**  
(Zip Code)

**(503) 498-3547**

(Registrant's telephone number, including area code)

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 ☒ No ☐

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definition of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one)

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☐

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

At October 29, 2010, there were 158,594,966 shares of the Registrant's common stock, \$0.01 par value, outstanding.

**Table of Contents**

**INDEX**

**PART I. FINANCIAL INFORMATION**

|         |                                                                                                                     |    |
|---------|---------------------------------------------------------------------------------------------------------------------|----|
| Item 1. | <u>Financial Statements</u>                                                                                         |    |
|         | <u>Consolidated Statements of Income Three Months and Nine Months Ended September 30, 2010 and 2009 (unaudited)</u> | 1  |
|         | <u>Consolidated Balance Sheets September 30, 2010 and December 31, 2009 (unaudited)</u>                             | 2  |
|         | <u>Consolidated Statements of Cash Flows Nine Months Ended September 30, 2010 and 2009 (unaudited)</u>              | 3  |
|         | <u>Notes to the Consolidated Financial Statements (unaudited)</u>                                                   | 4  |
| Item 2. | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                        | 17 |
| Item 3. | <u>Quantitative and Qualitative Disclosures about Market Risk</u>                                                   | 21 |
| Item 4. | <u>Controls and Procedures</u>                                                                                      | 21 |

**PART II. OTHER INFORMATION**

|          |                                                                    |    |
|----------|--------------------------------------------------------------------|----|
| Item 1.  | <u>Legal Proceedings</u>                                           | 22 |
| Item 1A. | <u>Risk Factors</u>                                                | 22 |
| Item 2.  | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 22 |
| Item 3.  | <u>Defaults Upon Senior Securities</u>                             | 22 |
| Item 5.  | <u>Other Information</u>                                           | 22 |
| Item 6.  | <u>Exhibits</u>                                                    | 23 |
|          | <u>Signature</u>                                                   | 24 |

**Table of Contents****PART 1. FINANCIAL INFORMATION****Item 1. Financial Statements****FLIR SYSTEMS, INC.****CONSOLIDATED STATEMENTS OF INCOME****(In thousands, except per share amounts)****(Unaudited)**

|                                      | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|--------------------------------------|---------------------------------------------|-------------|--------------------------------------------|-------------|
|                                      | <b>2010</b>                                 | <b>2009</b> | <b>2010</b>                                | <b>2009</b> |
| Revenue                              | \$ 332,497                                  | \$ 285,553  | \$ 950,928                                 | \$ 835,527  |
| Cost of goods sold                   | 150,389                                     | 122,736     | 420,143                                    | 353,047     |
| Gross profit                         | 182,108                                     | 162,817     | 530,785                                    | 482,480     |
| Operating expenses:                  |                                             |             |                                            |             |
| Research and development             | 28,520                                      | 21,294      | 81,632                                     | 66,935      |
| Selling, general and administrative  | 67,801                                      | 52,204      | 189,209                                    | 158,199     |
| Total operating expenses             | 96,321                                      | 73,498      | 270,841                                    | 225,134     |
| Earnings from operations             | 85,787                                      | 89,319      | 259,944                                    | 257,346     |
| Interest expense                     | 349                                         | 1,238       | 2,472                                      | 5,743       |
| Other (income) expense, net          | (1,085)                                     | 1,664       | (3,318)                                    | 1,732       |
| Earnings before income taxes         | 86,523                                      | 86,417      | 260,790                                    | 249,871     |
| Income tax provision                 | 23,568                                      | 26,382      | 82,486                                     | 79,912      |
| Net earnings                         | \$ 62,955                                   | \$ 60,035   | \$ 178,304                                 | \$ 169,959  |
| Net earnings per share:              |                                             |             |                                            |             |
| Basic                                | \$ 0.40                                     | \$ 0.40     | \$ 1.15                                    | \$ 1.14     |
| Diluted                              | \$ 0.39                                     | \$ 0.38     | \$ 1.11                                    | \$ 1.07     |
| Weighted average shares outstanding: |                                             |             |                                            |             |
| Basic                                | 158,215                                     | 151,573     | 155,223                                    | 148,475     |
| Diluted                              | 160,925                                     | 160,287     | 161,440                                    | 161,477     |

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



**Table of Contents**

**FLIR SYSTEMS, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
(In thousands, except par value)  
(Unaudited)

|                                                                                                                                                                                         | September 30,<br>2010 | December 31,<br>2009 |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------|----------------------|
| <b><u>ASSETS</u></b>                                                                                                                                                                    |                       |                      |
| Current assets:                                                                                                                                                                         |                       |                      |
| Cash and cash equivalents                                                                                                                                                               | \$ 379,903            | \$ 422,047           |
| Accounts receivable, net                                                                                                                                                                | 272,501               | 234,974              |
| Inventories                                                                                                                                                                             | 264,757               | 216,500              |
| Prepaid expenses and other current assets                                                                                                                                               | 85,641                | 93,276               |
| Deferred income taxes, net                                                                                                                                                              | 15,893                | 13,231               |
| Total current assets                                                                                                                                                                    | 1,018,695             | 980,028              |
| Property and equipment, net                                                                                                                                                             | 176,586               | 139,112              |
| Deferred income taxes, net                                                                                                                                                              | 17,878                | 5,322                |
| Goodwill                                                                                                                                                                                | 366,431               | 262,331              |
| Intangible assets, net                                                                                                                                                                  | 124,579               | 59,180               |
| Other assets                                                                                                                                                                            | 28,891                | 48,571               |
|                                                                                                                                                                                         | \$ 1,733,060          | \$ 1,494,544         |
| <b><u>LIABILITIES AND SHAREHOLDERS' EQUITY</u></b>                                                                                                                                      |                       |                      |
| Current liabilities:                                                                                                                                                                    |                       |                      |
| Accounts payable                                                                                                                                                                        | \$ 78,428             | \$ 53,319            |
| Deferred revenue                                                                                                                                                                        | 15,398                | 20,986               |
| Accrued payroll and related liabilities                                                                                                                                                 | 38,860                | 39,809               |
| Accrued product warranties                                                                                                                                                              | 18,147                | 9,438                |
| Advance payments from customers                                                                                                                                                         | 13,737                | 8,616                |
| Accrued expenses                                                                                                                                                                        | 31,980                | 25,941               |
| Accrued income taxes                                                                                                                                                                    | 5,236                 | 15,504               |
| Other current liabilities                                                                                                                                                               | 11,768                | 13,273               |
| Total current liabilities                                                                                                                                                               | 213,554               | 186,886              |
| Long-term debt                                                                                                                                                                          |                       | 57,991               |
| Deferred tax liability, net                                                                                                                                                             | 23,952                | 2,222                |
| Accrued income taxes                                                                                                                                                                    | 8,732                 | 4,550                |
| Pension and other long-term liabilities                                                                                                                                                 | 46,695                | 39,146               |
| Commitments and contingencies                                                                                                                                                           |                       |                      |
| Shareholders' equity:                                                                                                                                                                   |                       |                      |
| Preferred stock, \$0.01 par value, 10,000 shares authorized; no shares issued at September 30, 2010, and December 31, 2009                                                              |                       |                      |
| Common stock, \$0.01 par value, 500,000 shares authorized, 158,469 and 152,826 shares issued at September 30, 2010, and December 31, 2009, respectively, and additional paid-in capital | 444,910               | 389,316              |

## Edgar Filing: FLIR SYSTEMS INC - Form 10-Q

|                                          |              |              |
|------------------------------------------|--------------|--------------|
| Retained earnings                        | 985,607      | 807,303      |
| Accumulated other comprehensive earnings | 9,610        | 7,130        |
| Total shareholders' equity               | 1,440,127    | 1,203,749    |
|                                          | \$ 1,733,060 | \$ 1,494,544 |

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

**Table of Contents****FLIR SYSTEMS, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)****(Unaudited)**

|                                                                                     | <b>Nine Months Ended<br/>September 30,</b> |             |
|-------------------------------------------------------------------------------------|--------------------------------------------|-------------|
|                                                                                     | <b>2010</b>                                | <b>2009</b> |
| Cash flows from operating activities:                                               |                                            |             |
| Net earnings                                                                        | \$ 178,304                                 | \$ 169,959  |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |                                            |             |
| Depreciation and amortization                                                       | 39,466                                     | 30,903      |
| Deferred income taxes                                                               | (8,397)                                    | (2,774)     |
| Stock-based compensation plans                                                      | 19,010                                     | 17,640      |
| Cash inducement on exchange offer for convertible notes                             |                                            | 1,997       |
| Other non-cash items                                                                | 802                                        | (1,566)     |
| Changes in operating assets and liabilities (net of acquisitions):                  |                                            |             |
| (Increase) decrease in accounts receivable                                          | (3,654)                                    | 35,911      |
| Increase in inventories                                                             | (24,463)                                   | (8,339)     |
| Decrease (increase) in prepaid expenses and other current assets                    | 20,395                                     | (14,897)    |
| Increase in other assets                                                            | (5,244)                                    | (12,098)    |
| Increase in accounts payable                                                        | 9,604                                      | 6,630       |
| Decrease in deferred revenue                                                        | (5,659)                                    | (5,933)     |
| Decrease in accrued payroll and other liabilities                                   | (7,291)                                    | (25,975)    |
| (Decrease) increase in accrued income taxes                                         | (11,377)                                   | 1,505       |
| Increase in pension and other long-term liabilities                                 | 8,449                                      | 6,449       |
| Cash provided by operating activities                                               | 209,945                                    | 199,412     |
| Cash flows from investing activities:                                               |                                            |             |
| Additions to property and equipment                                                 | (51,225)                                   | (34,523)    |
| Proceeds from sale of property and equipment                                        | 225                                        | 2,891       |
| Business acquisition, net of cash acquired                                          | (174,696)                                  | (13,148)    |
| Other investments                                                                   | 3,081                                      | 601         |
| Cash used by investing activities                                                   | (222,615)                                  | (44,179)    |
| Cash flows from financing activities:                                               |                                            |             |
| Repayment of capital leases and other long-term debt, net                           | (38)                                       | (23)        |
| Cash inducement on exchange offer for convertible notes                             |                                            | (1,997)     |
| Repurchase of common stock                                                          | (35,725)                                   | (73,169)    |
| Proceeds from shares issued pursuant to stock-based compensation plans              | 11,983                                     | 12,969      |
| Excess tax benefit from stock-based compensation plans                              | 5,592                                      | 6,005       |
| Capital contribution                                                                | 55                                         | 330         |
| Cash used by financing activities                                                   | (18,133)                                   | (55,885)    |

# Edgar Filing: FLIR SYSTEMS INC - Form 10-Q

|                                                      |            |            |
|------------------------------------------------------|------------|------------|
| Effect of exchange rate changes on cash              | (11,341)   | 14,530     |
| Net (decrease) increase in cash and cash equivalents | (42,144)   | 113,878    |
| Cash and cash equivalents, beginning of period       | 422,047    | 289,442    |
| Cash and cash equivalents, end of period             | \$ 379,903 | \$ 403,320 |

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

**Table of Contents****FLIR SYSTEMS, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****Note 1. Basis of Presentation**

The accompanying consolidated financial statements of FLIR Systems, Inc. and its consolidated subsidiaries (the Company) are unaudited and have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, these statements have been prepared on the same basis as the audited consolidated financial statements and include all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the Company's consolidated financial position and results of operations for the interim periods. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations. These consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated. The results of operations for the interim periods presented are not necessarily indicative of the operating results to be expected for any subsequent interim period or for the year ending December 31, 2010.

*Reclassification*

A reclassification of \$9.3 million has been made from other current assets to other current liabilities on the December 31, 2009 balance sheet to properly classify the balance of value added taxes payable as a current liability. This reclassification had no impact on previously reported results of operations or shareholders' equity.

**Note 2. Accounting for Convertible Debt**

In June 2003, the Company issued \$210 million of 3.0 percent senior convertible notes due in 2023. The net proceeds from the issuance were approximately \$203.9 million. The Company determined that the expected life of the notes should be seven years since the notes were first redeemable in June 2010. The Company estimated that its nonconvertible borrowing rate for debt with a seven year maturity issued in June 2003 was 6.0 percent. Accordingly, the value of the liability component of the notes at the time of issuance was \$174.4 million and the value of the equity component was \$35.6 million.

In June 2010, the remaining \$58.8 million of the outstanding convertible notes were converted into 5.3 million shares of the Company's common stock in non-cash transactions.

The carrying amounts of the convertible notes are as follows (in thousands):

|                            | September 30,<br>2010 | December 31,<br>2009 |
|----------------------------|-----------------------|----------------------|
| Liability component:       |                       |                      |
| Principal amount           | \$                    | \$ 58,782            |
| Unamortized discount       |                       | (706)                |
| Unamortized issuance costs |                       | (85)                 |
|                            | \$                    | \$ 57,991            |
| Equity component           | \$ (119,724)          | \$ (119,724)         |



**Table of Contents****FLIR SYSTEMS, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 2. Accounting for Convertible Debt (Continued)**

The unamortized discount and issuance costs were amortized through May 2010. The effective interest rate of the convertible notes was 6 percent. Interest and amortization expense of the convertible notes recognized in the Consolidated Statements of Income are as follows (in thousands):

|                                | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|--------------------------------|---------------------------|-------------|--------------------------|-------------|
|                                | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|                                | <b>2010</b>               | <b>2009</b> | <b>2010</b>              | <b>2009</b> |
| Cash interest (3% coupon)      | \$                        | \$ 466      | \$ 735                   | \$ 2,414    |
| Amortization of discount       |                           | 435         | 706                      | 2,155       |
| Amortization of issuance costs |                           | 53          | 84                       | 270         |
|                                | \$                        | \$ 954      | \$ 1,525                 | \$ 4,839    |

**Note 3. Stock-based Compensation**

Stock-based compensation expense and related tax benefit recognized in the Consolidated Statements of Income are as follows (in thousands):

|                                                           | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|-----------------------------------------------------------|---------------------------|-------------|--------------------------|-------------|
|                                                           | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|                                                           | <b>2010</b>               | <b>2009</b> | <b>2010</b>              | <b>2009</b> |
| Cost of goods sold                                        | \$ 969                    | \$ 824      | \$ 2,836                 | \$ 2,425    |
| Research and development                                  | 1,213                     | 1,298       | 3,734                    | 3,641       |
| Selling, general and administrative                       | 3,906                     | 4,001       | 12,440                   | 11,574      |
| Stock-based compensation expense before income taxes      | 6,088                     | 6,123       | 19,010                   | 17,640      |
| Income tax benefit                                        | (1,900)                   | (1,866)     | (5,993)                  | (5,287)     |
| Total stock-based compensation expense after income taxes | \$ 4,188                  | \$ 4,257    | \$ 13,017                | \$ 12,353   |

Stock-based compensation costs capitalized in inventory are as follows (in thousands):

|                                                         | <b>September 30,</b> |             |
|---------------------------------------------------------|----------------------|-------------|
|                                                         | <b>2010</b>          | <b>2009</b> |
| Stock-based compensation costs capitalized in inventory | \$ 682               | \$ 879      |

## Edgar Filing: FLIR SYSTEMS INC - Form 10-Q

As of September 30, 2010, the Company had \$34.9 million of total unrecognized stock-based compensation costs, net of estimated forfeitures, to be recognized over a weighted average period of 1.9 years.

**Table of Contents****FLIR SYSTEMS, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 3. Stock-based Compensation (Continued)**

The fair value of the stock-based awards, as determined under the Black-Scholes model, granted in the three months and nine months ended September 30, 2010 and 2009 was estimated with the following weighted-average assumptions:

|                               | <b>Three Months<br/>Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|-------------------------------|-------------------------------------------------|-------------|--------------------------------------------|-------------|
|                               | <b>2010</b>                                     | <b>2009</b> | <b>2010</b>                                | <b>2009</b> |
| Stock Option Awards:          |                                                 |             |                                            |             |
| Risk-free interest rate       |                                                 | 1.6%        | 1.55%                                      | 1.5%        |
| Expected dividend yield       |                                                 | 0.0%        | 0.0%                                       | 0.0%        |
| Expected term                 |                                                 | 3.3 years   | 4.3 years                                  | 4.3 years   |
| Expected volatility           |                                                 | 48.1%       | 45.1%                                      | 46.9%       |
| Employee Stock Purchase Plan: |                                                 |             |                                            |             |
| Risk-free interest rate       |                                                 |             | 0.3%                                       | 0.3%        |
| Expected dividend yield       |                                                 |             | 0.0%                                       | 0.0%        |
| Expected term                 |                                                 |             | 6 months                                   | 6 months    |
| Expected volatility           |                                                 |             | 23.0%                                      | 60.9%       |

The fair value of stock-based compensation awards granted and vested, and the intrinsic value of options exercised during the period were (in thousands, except per share amounts):

|                                                   | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|---------------------------------------------------|---------------------------------------------|-------------|--------------------------------------------|-------------|
|                                                   | <b>2010</b>                                 | <b>2009</b> | <b>2010</b>                                | <b>2009</b> |
| Stock Option Awards:                              |                                             |             |                                            |             |
| Weighted average grant date fair value per share  | \$                                          | \$ 7.63     | \$ 11.52                                   | \$ 9.96     |
| Total fair value of awards granted                | \$                                          | \$ 140      | \$ 7,299                                   | \$ 10,534   |
| Total fair value of awards vested                 | \$ 80                                       | \$ 215      | \$ 7,281                                   | \$ 6,924    |
| Total intrinsic value of options exercised        | \$ 11,842                                   | \$ 6,655    | \$ 15,577                                  | \$ 17,825   |
| Restricted Stock Unit Awards:                     |                                             |             |                                            |             |
| Weighted average grant date fair value per share  | \$ 30.31                                    | \$ 21.49    | \$ 30.14                                   | \$ 25.37    |
| Total fair value of awards granted                | \$ 73                                       | \$ 774      | \$ 14,986                                  | \$ 16,749   |
| Total fair value of awards vested                 | \$ 413                                      | \$ 237      | \$ 15,763                                  | \$ 17,047   |
| Employee Stock Purchase Plan:                     |                                             |             |                                            |             |
| Weighted average grant date fair value per share  | \$                                          | \$          | \$ 6.73                                    | \$ 8.37     |
| Total fair value of shares estimated to be issued | \$                                          | \$          | \$ 786                                     | \$ 1,073    |

The total amount of cash received from the exercise of stock options in the three months ended September 30, 2010 and 2009 was \$5.6 million and \$4.0 million, respectively, and the related tax benefit realized from the exercise of the stock options was \$2.8 million and \$1.9 million, respectively. The total amount of cash received from the exercise of stock options in the nine months ended September 30, 2010 and 2009 was

## Edgar Filing: FLIR SYSTEMS INC - Form 10-Q

\$9.0 million and \$10.4 million, respectively, and the related tax benefit realized from the exercise of the stock options was \$5.7 million and \$6.1 million, respectively.

**Table of Contents****FLIR SYSTEMS, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 3. Stock-based Compensation (Continued)**

Information with respect to stock option activity is as follows:

|                                                   | <b>Shares<br/>(in<br/>thousands)</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> | <b>Weighted<br/>Average<br/>Remaining<br/>Contractual<br/>Term</b> | <b>Aggregate<br/>Intrinsic<br/>Value<br/>(in thousands)</b> |
|---------------------------------------------------|--------------------------------------|----------------------------------------------------|--------------------------------------------------------------------|-------------------------------------------------------------|
| Outstanding at December 31, 2009                  | 8,387                                | \$ 15.81                                           | 5.6                                                                |                                                             |
| Granted                                           | 633                                  | 30.27                                              |                                                                    |                                                             |
| Exercised                                         | (1,134)                              | 8.01                                               |                                                                    |                                                             |
| Forfeited                                         | (13)                                 | 24.74                                              |                                                                    |                                                             |
| Outstanding at September 30, 2010                 | 7,873                                | \$ 18.09                                           | 5.6                                                                | \$ 67,778                                                   |
| Exercisable at September 30, 2010                 | 6,540                                | \$ 15.93                                           | 4.9                                                                | \$ 67,729                                                   |
| Vested and expected to vest at September 30, 2010 | 7,806                                | \$ 18.00                                           | 5.6                                                                | \$ 67,776                                                   |

Information with respect to restricted stock unit activity is as follows:

|                                   | <b>Shares<br/>(in<br/>thousands)</b> | <b>Weighted<br/>Average<br/>Grant Date<br/>Fair Value</b> |
|-----------------------------------|--------------------------------------|-----------------------------------------------------------|
| Outstanding at December 31, 2009  | 1,226                                | \$ 27.41                                                  |
| Granted                           | 497                                  | 30.14                                                     |
| Vested                            | (522)                                | 26.16                                                     |
| Forfeited                         | (28)                                 | 27.63                                                     |
| Outstanding at September 30, 2010 | 1,173                                | \$ 29.12                                                  |

There were approximately 124,000 shares issued under the 2009 Employee Stock Purchase Plan during the nine months ended September 30, 2010 and there were approximately 4,749,000 shares available at September 30, 2010 for future issuance.

**Table of Contents****FLIR SYSTEMS, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 4. Net Earnings Per Share**

The following table sets forth the reconciliation of the numerator and denominator utilized in the computation of basic and diluted earnings per share (in thousands):

|                                                                                                                                       | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|---------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------|-------------|--------------------------------------------|-------------|
|                                                                                                                                       | <b>2010</b>                                 | <b>2009</b> | <b>2010</b>                                | <b>2009</b> |
| <b>Numerator for earnings per share:</b>                                                                                              |                                             |             |                                            |             |
| Net earnings, as reported                                                                                                             | \$ 62,955                                   | \$ 60,035   | \$ 178,304                                 | \$ 169,959  |
| Interest associated with convertible notes, net of tax                                                                                |                                             | 404         | 935                                        | 3,200       |
| Net earnings available to common shareholders diluted                                                                                 | \$ 62,955                                   | \$ 60,439   | \$ 179,239                                 | \$ 173,159  |
| <b>Denominator for earnings per share:</b>                                                                                            |                                             |             |                                            |             |
| Weighted average number of common shares outstanding                                                                                  | 158,215                                     | 151,573     | 155,223                                    | 148,475     |
| Assumed exercises of stock options and vesting of restricted shares, net of shares assumed reacquired under the treasury stock method | 2,710                                       | 2,996       | 3,151                                      | 3,297       |
| Assumed conversion of convertible notes                                                                                               |                                             | 5,718       | 3,066                                      | 9,705       |
| Diluted shares outstanding                                                                                                            | 160,925                                     | 160,287     | 161,440                                    | 161,477     |

The effect of stock options and restricted stock units for the three and nine months ended September 30, 2010 that aggregated approximately 517,000 shares and 421,000 shares, respectively, and for the three and nine months ended September 30, 2009 that aggregated approximately 830,000 shares and 663,000 shares, respectively, has been excluded for purposes of calculating diluted earnings per share since the effect would have been anti-dilutive.

**Note 5. Fair Value of Financial Instruments**

As of September 30, 2010, the Company had \$259.8 million of cash equivalents, which were primarily investments in money market funds. The Company has categorized its cash equivalents as a Level 1 financial asset, measured at fair value based on quoted prices in active markets of identical assets. The fair value of the Company's forward currency contracts as of September 30, 2010 was not significant. The Company does not have any other financial assets or liabilities that are measured at fair value.

**Table of Contents****FLIR SYSTEMS, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 6. Foreign Currency Exchange Rate Risk**

The Company's foreign businesses enter into contracts with customers and vendors that are denominated in currencies other than their functional currencies. To protect the functional currency equivalent cash flows associated with certain of these contracts, the Company enters into foreign currency forward contracts. The Company's activities involving foreign currency forward contracts are designed to hedge the changes in the functional currency equivalent cash flows due to movements in foreign exchange rates compared to the functional currency. The foreign currencies hedged are primarily the Euro, the Swedish Kronor, the British Pound Sterling, and the Australian Dollar. The Company manages exposure to counterparty non-performance credit risk by entering into foreign currency forward contracts only with major financial institutions that are expected to fully perform under the terms of such contracts. Gains and losses on foreign currency forward contracts are recognized in income at the end of each reporting period based on the difference between the contract rate and the spot rate. The net amount of the gains and losses related to outstanding derivative instruments recorded in income for the three months and nine months ended September 30, 2010 was a net loss of \$2.1 million and a net loss of \$4.4 million, respectively. These gains and losses are offset on the statement of income by the reciprocal gains and losses from the underlying assets or liabilities which originally gave rise to the exposure.

Notional amounts are used to measure the volume of foreign currency forward contracts and do not represent exposure to foreign currency gains or losses. The table below presents the notional amounts of the Company's outstanding foreign currency forward contracts by currency at September 30, 2010 (in millions):

|                        |         |
|------------------------|---------|
| Euro                   | \$ 61.6 |
| Swedish Kronor         | 15.2    |
| British Pound Sterling | 3.1     |
| Australian Dollar      | 1.0     |
|                        | \$ 80.9 |

At September 30, 2010, the Company's foreign currency forward contracts had maturities of 45 days or less.

**Note 7. Accounts Receivable**

Accounts receivable are net of an allowance for doubtful accounts of \$2.9 million and \$2.0 million at September 30, 2010 and December 31, 2009, respectively.

**Note 8. Inventories**

Inventories consist of the following (in thousands):

|                                | September 30,<br>2010 | December 31,<br>2009 |
|--------------------------------|-----------------------|----------------------|
| Raw material and subassemblies | \$ 170,693            | \$ 144,555           |
| Work-in-progress               | 51,155                | 37,732               |

Edgar Filing: FLIR SYSTEMS INC - Form 10-Q

|                |            |            |
|----------------|------------|------------|
| Finished goods | 42,909     | 34,213     |
|                | \$ 264,757 | \$ 216,500 |

**Table of Contents****FLIR SYSTEMS, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 9. Property and Equipment**

Property and equipment are net of accumulated depreciation of \$131.3 million and \$102.9 million at September 30, 2010 and December 31, 2009, respectively.

**Note 10. Goodwill**

The carrying value of goodwill by reporting segment and the activity for the nine months ended September 30, 2010 is as follows (in thousands):

|                                  | <b>Government<br/>Systems</b> | <b>Thermography</b> | <b>Commercial<br/>Vision<br/>Systems</b> | <b>Raymarine</b> | <b>Total</b> |
|----------------------------------|-------------------------------|---------------------|------------------------------------------|------------------|--------------|
| Balance, December 31, 2009       | \$ 37,584                     | \$ 105,501          | \$ 119,246                               | \$               | \$ 262,331   |
| Business acquisitions            |                               |                     | 14,019                                   | 85,470           | 99,489       |
| Currency translation adjustments | 341                           | (1,027)             | (369)                                    | 5,616            | 4,561        |
| Other                            | 50                            |                     |                                          |                  | 50           |
| Balance, September 30, 2010      | \$ 37,975                     | \$ 104,474          | \$ 132,896                               | \$ 91,086        | \$ 366,431   |

**Note 11. Intangible Assets**

Intangible assets are net of accumulated amortization of \$67.6 million and \$53.0 million at September 30, 2010 and December 31, 2009, respectively.

**Note 12. Accrued Product Warranties**

The following table summarizes the Company's warranty liability and activity (in thousands):

|                                                 | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|-------------------------------------------------|---------------------------------------------|-------------|--------------------------------------------|-------------|
|                                                 | <b>2010</b>                                 | <b>2009</b> | <b>2010</b>                                | <b>2009</b> |
| Accrued product warranties, beginning of period | \$ 17,299                                   | \$ 8,095    | \$ 9,438                                   | \$ 7,826    |
| Amounts paid for warranty services              | (1,022)                                     | (2,515)     | (5,783)                                    | (6,973)     |
| Warranty provisions for products sold           | 1,367                                       | 2,784       | 5,754                                      | 7,454       |
| Accrued product warranties acquired             |                                             |             | 8,247                                      | 151         |
| Currency translation adjustments and other      | 503                                         | 71          | 491                                        | (23)        |
| Accrued product warranties, end of period       | \$ 18,147                                   | \$ 8,435    | \$ 18,147                                  | \$ 8,435    |

**Note 13. Credit Agreements**

At September 30, 2010, the Company had no borrowings outstanding under its Credit Agreement, dated October 6, 2006, with Bank of America, N.A., Union Bank of California, N.A., U.S. Bank National Association and other Lenders, and \$8.5 million of letters of credit outstanding, which reduces the total available credit to \$291.5 million.

On July 7, 2010, the Company entered into an uncommitted letter of credit agreement with Bank of America to support letters of credit whose expiration would extend beyond the current Credit Agreement. At September 30, 2010, the total value of letters of credit outstanding under this facility was \$6.5 million.

**Table of Contents****FLIR SYSTEMS, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 14. Long-Term Debt**

Long-term debt consists of the following (in thousands):

|                                                     | September 30,<br>2010 | December 31,<br>2009 |
|-----------------------------------------------------|-----------------------|----------------------|
| Convertible notes                                   | \$                    | \$ 58,782            |
| Issuance cost and discount of the convertible notes |                       | (791)                |
|                                                     | \$                    | \$ 57,991            |

**Note 15. Shareholders' Equity**

The following table summarizes the common stock and additional paid-in capital activity during the nine months ended September 30, 2010 (in thousands):

|                                                                     |            |
|---------------------------------------------------------------------|------------|
| Common stock and additional paid-in capital, December 31, 2009      | \$ 389,316 |
| Income tax benefit of common stock options exercised                | 5,715      |
| Common stock issued pursuant to stock-based compensation plans, net | 8,055      |
| Stock-based compensation expense                                    | 18,797     |
| Repurchase of common stock                                          | (35,725)   |
| Conversion of convertible debt                                      | 58,752     |
| Common stock and additional paid in capital, September 30, 2010     | \$ 444,910 |

During the nine months ended September 30, 2010, the Company repurchased approximately 1.3 million shares of the Company's common stock under the February 2009 repurchase authorization by the Company's Board of Directors pursuant to which the Company is authorized to repurchase up to 20.0 million shares of the Company's outstanding common stock. This authorization will expire in February 2011.

**Note 16. Comprehensive Earnings**

The following table sets forth the calculation of comprehensive earnings for the periods indicated (in thousands):

|              | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |            |
|--------------|-------------------------------------|-----------|------------------------------------|------------|
|              | 2010                                | 2009      | 2010                               | 2009       |
| Net earnings | \$ 62,955                           | \$ 60,035 | \$ 178,304                         | \$ 169,959 |

# Edgar Filing: FLIR SYSTEMS INC - Form 10-Q

|                              |            |           |            |            |
|------------------------------|------------|-----------|------------|------------|
| Translation adjustment       | 42,683     | 22,745    | 2,480      | 29,885     |
| Total comprehensive earnings | \$ 105,638 | \$ 82,780 | \$ 180,784 | \$ 199,844 |

**Table of Contents**

**FLIR SYSTEMS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

**Note 17. Contingencies**

The Company and its subsidiary, Indigo Systems Corporation (now known as FLIR Commercial Systems, Inc.), (together, the FLIR Parties ), were named in a lawsuit filed by Raytheon Company ( Raytheon ) on March 2, 2007, in the United States District Court for the Eastern District of Texas. On August 11, 2008, Raytheon Company was granted leave to file a second amended complaint. The complaint, as amended, asserted claims for tortious interference, patent infringement, trade secret misappropriation, unfair competition, breach of contract and fraudulent concealment. The FLIR Parties filed an answer to the second amended complaint and counterclaims on September 2, 2008, in which they denied all material allegations. On August 31, 2009, the court entered an order granting the FLIR Parties motion for summary judgment on Raytheon s trade secret misappropriation claim based on the FLIR Parties statute of limitations defense. Raytheon abandoned all of its other claims except its claims relating to four patents (the Patent Claims ). On August 11, 2010, the FLIR Parties and Raytheon entered into an agreement in principle to resolve the remaining Patent Claims. On October 27, 2010, the parties finalized the agreement which results in a payment of \$3 million by the FLIR Parties to Raytheon. The agreement entitles the FLIR Parties to certain license rights in the patents that were subject of the Patent Claims. It is anticipated that the parties will appeal certain rulings of the district court to the United States Court of Appeals for the Federal Circuit. The Company intends to vigorously defend itself in this matter and is unable to estimate the amount or range of potential loss, if any, which might result if the outcome in this matter is unfavorable.

On July 10, 2008, William J. Parrish and E. Timothy Fitzgibbons (collectively, Plaintiffs ) filed an action against FLIR Systems, Inc. its affiliate Indigo Systems Corporation (now known as FLIR Commercial Systems, Inc.), Earl R. Lewis and James A. Fitzhenry (collectively, Defendants ) in California Superior Court for the County of Santa Barbara asserting claims for negligent and intentional tortious interference with prospective economic relations. The claims arose from a prior action in the same court in which then-defendants Parrish and Fitzgibbons prevailed. On November 20, 2009, Plaintiffs amended their complaint to add a malicious prosecution claim, as well as two additional claims for negligent and intentional tortious interference with prospective economic relations. The original tortious interference claims have been dismissed as have the later-filed tortious interference claims as to the individual defendants. On July 19, 2010, Plaintiffs further amended their complaint to name the Company s former counsel in a prior action as a defendant. The claims against the former counsel were subsequently dismissed without prejudice. The case is currently set for trial in March 2011. Defendants intend to vigorously defend themselves in this matter and are unable to estimate the amount or range of potential loss, if any, which might result if the outcome in this matter is unfavorable.

**Note 18. Income Taxes**

As of September 30, 2010, the Company had approximately \$13.2 million of net unrecognized tax benefits of which all \$13.2 million would affect the Company s effective tax rate if recognized. The Company anticipates a portion of its net unrecognized tax benefits will be recognized within 12 months as the result of settlements or effective settlements with various tax authorities, the closure of certain audits and the lapse of statutes of limitations.

The Company classifies interest and penalties related to uncertain tax positions as income tax expense. As of September 30, 2010, the Company had approximately \$320,000 of net accrued interest related to uncertain tax positions.

The Company currently has the following tax years open to examination by major taxing jurisdictions:

|                        | <b>Tax Years:</b> |      |
|------------------------|-------------------|------|
| US Federal             | 2003              | 2009 |
| State of Oregon        | 2006              | 2009 |
| State of Massachusetts | 2007              | 2009 |

## Edgar Filing: FLIR SYSTEMS INC - Form 10-Q

|                     |      |      |
|---------------------|------|------|
| State of California | 2005 | 2009 |
| Sweden              | 2003 | 2009 |
| United Kingdom      | 2008 | 2009 |
| Germany             | 2004 | 2009 |
| France              | 2006 | 2009 |

**Table of Contents****FLIR SYSTEMS, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 19. Operating Segments and Related Information***Operating Segments*

Operating segment information is as follows (in thousands):

|                                                            | <b>Three Months Ended<br/>September 30,</b> |                     | <b>Nine Months Ended<br/>September 30,</b> |             |
|------------------------------------------------------------|---------------------------------------------|---------------------|--------------------------------------------|-------------|
|                                                            | <b>2010</b>                                 | <b>2009</b>         | <b>2010</b>                                | <b>2009</b> |
| Revenue External Customers:                                |                                             |                     |                                            |             |
| Government Systems                                         | \$ 163,189                                  | \$ 162,985          | \$ 489,418                                 | \$ 485,552  |
| Thermography                                               | 71,015                                      | 69,933              | 217,934                                    | 200,641     |
| Commercial Vision Systems                                  | 61,384                                      | 52,635              | 179,443                                    | 149,334     |
| Raymarine (Note 20)                                        | 36,909                                      |                     | 64,133                                     |             |
|                                                            | \$ 332,497                                  | \$ 285,553          | \$ 950,928                                 | \$ 835,527  |
| Revenue Intersegments:                                     |                                             |                     |                                            |             |
| Government Systems                                         | \$ 4,790                                    | \$ 5,001            | \$ 17,982                                  | \$ 16,169   |
| Thermography                                               | 2,315                                       | 2,975               | 6,591                                      | 8,331       |
| Commercial Vision Systems                                  | 5,371                                       | 4,314               | 19,438                                     | 14,198      |
| Raymarine (Note 20)                                        |                                             |                     |                                            |             |
| Eliminations                                               | (12,476)                                    | (12,290)            | (44,011)                                   | (38,698)    |
|                                                            | \$                                          | \$                  | \$                                         | \$          |
| Earnings from operations:                                  |                                             |                     |                                            |             |
| Government Systems                                         | \$ 62,177                                   | \$ 71,802           | \$ 190,807                                 | \$ 217,597  |
| Thermography                                               | 21,813                                      | 18,265              | 58,660                                     | 49,591      |
| Commercial Vision Systems                                  | 18,055                                      | 11,728              | 51,093                                     | 36,298      |
| Raymarine (Note 20)                                        | 977                                         |                     | 4,420                                      |             |
| Other                                                      | (17,235)                                    | (12,476)            | (45,036)                                   | (46,140)    |
|                                                            | \$ 85,787                                   | \$ 89,319           | \$ 259,944                                 | \$ 257,346  |
|                                                            |                                             |                     |                                            |             |
|                                                            | <b>September 30,</b>                        | <b>December 31,</b> |                                            |             |
|                                                            | <b>2010</b>                                 | <b>2009</b>         |                                            |             |
| Segment assets (accounts receivable, net and inventories): |                                             |                     |                                            |             |
| Government Systems                                         | \$ 300,953                                  | \$ 283,683          |                                            |             |
| Thermography                                               | 97,251                                      | 105,156             |                                            |             |

## Edgar Filing: FLIR SYSTEMS INC - Form 10-Q

|                           |        |        |
|---------------------------|--------|--------|
| Commercial Vision Systems | 90,697 | 62,635 |
| Raymarine (Note 20)       | 48,357 |        |

\$ 537,258      \$ 451,474

### *Revenue and Long-Lived Assets by Geographic Area*

Information related to revenue by significant geographical location, determined by the end customer, is as follows (in thousands):

|                     | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|---------------------|---------------------------------------------|-------------|--------------------------------------------|-------------|
|                     | <b>2010</b>                                 | <b>2009</b> | <b>2010</b>                                | <b>2009</b> |
| United States       | \$ 193,097                                  | \$ 161,207  | \$ 527,530                                 | \$ 496,480  |
| Europe              | 71,737                                      | 59,516      | 220,705                                    | 167,242     |
| Other international | 67,663                                      | 64,830      | 202,693                                    | 171,805     |
|                     | \$ 332,497                                  | \$ 285,553  | \$ 950,928                                 | \$ 835,527  |

**Table of Contents****FLIR SYSTEMS, INC.****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****Note 19. Operating Segments and Related Information - (Continued)**

Long-lived assets by significant geographic locations are as follows (in thousands):

|                     | September 30,<br>2010 | December 31,<br>2009 |
|---------------------|-----------------------|----------------------|
| United States       | \$ 401,435            | \$ 387,169           |
| Europe              | 286,301               | 116,850              |
| Other international | 8,751                 | 5,175                |
|                     | \$ 696,487            | \$ 509,194           |

*Major Customers*

Revenue derived from major customers is as follows (in thousands):

|               | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|---------------|-------------------------------------|------------|------------------------------------|------------|
|               | 2010                                | 2009       | 2010                               | 2009       |
| US Government | \$ 120,741                          | \$ 125,067 | \$ 339,897                         | \$ 375,310 |

**Note 20. Business Acquisitions**

In May 2010, the Company acquired all of the outstanding stock of Raymarine Holdings Limited ( Raymarine ), a leading provider of a comprehensive range of electronic equipment for recreational boating and light commercial marine markets, for approximately \$177.8 million in cash.

The Company has recorded \$63.9 million of identifiable intangible assets and \$85.5 million of goodwill, in conjunction with the Raymarine acquisition, which has been recorded in the Company's Raymarine business segment. Goodwill consists largely of the ability of the Company and Raymarine, working together, to grow the combined businesses through the integration of each other's products, market presence, distribution channels and domain knowledge.

The preliminary allocation of the purchase price is as follows (in thousands):

|                          |          |
|--------------------------|----------|
| Cash                     | \$ 3,171 |
| Accounts receivable, net | 30,929   |
| Inventories              | 20,803   |

## Edgar Filing: FLIR SYSTEMS INC - Form 10-Q

|                                |            |
|--------------------------------|------------|
| Property and equipment, net    | 13,914     |
| Other assets                   | 6,688      |
| Liabilities                    | (25,578)   |
| Net tangible assets            | 49,927     |
| Identifiable intangible assets | 63,936     |
| Goodwill                       | 85,470     |
| Deferred tax liabilities, net  | (21,570)   |
| Purchase price                 | \$ 177,763 |

Certain tax attributes are pending final valuation and are expected to be finalized by December 31, 2010. None of the goodwill recognized is expected to be deductible for income tax purposes. Acquisition-related costs, included in selling, general and administrative expenses, for the nine months ended September 30, 2010 was \$5.2 million.

Table of Contents

## FLIR SYSTEMS, INC.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

## Note 20. Business Acquisitions (Continued)

The identifiable intangible assets and the estimated useful life of each are as follows (in thousands):

|                                 | Estimated<br>Useful Life | Amount    |
|---------------------------------|--------------------------|-----------|
| Trade Name                      | Indefinite               | \$ 30,294 |
| Customer Relationships          | 15 years                 | 31,021    |
| Patented/Proprietary Technology | 5 years                  | 6,408     |
| Internal Software               | 3 years                  | 1,893     |
| Market Rental Rate Adjustment   | 8.6 years                | (5,680)   |
|                                 |                          | \$ 63,936 |

Raymarine's revenue and net earnings included in the Company's consolidated statement of income for the three month and nine month period ended September 30, 2010 were (in thousands):

|              | Three<br>Months | Nine<br>Months |
|--------------|-----------------|----------------|
| Revenue      | \$ 36,909       | \$ 64,133      |
| Net earnings | 977             | 4,420          |

The revenue and net earnings of the combined entity had the acquisition date been January 1, 2009, were (in thousands):

|              | Three Months<br>Ended<br>September 30,<br>2009 | Nine Months Ended<br>September 30,<br>2010 | 2009       |
|--------------|------------------------------------------------|--------------------------------------------|------------|
| Revenue      | \$ 319,380                                     | \$ 1,020,900                               | \$ 963,846 |
| Net earnings | 50,981                                         | 184,596                                    | 160,857    |

In December 2009, the Company acquired all of the outstanding stock of Directed Perception, Inc. for approximately \$20.2 million in cash. During the nine months ended September 30, 2010, the Company completed its allocation of the purchase price and has recorded identifiable intangible assets and goodwill of approximately \$4.8 million and \$14.0 million, respectively, in the Commercial Vision Systems business segment.

The operating results of these acquisitions are included in the Company's results of operations since their respective dates of acquisition. Pro forma financial information has not been provided for the acquisition of Directed Perception as it was not material to the Company's overall financial position.



**Table of Contents**

**FLIR SYSTEMS, INC.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

**Note 21. Subsequent Event**

On October 4, 2010, the Company completed its previously announced acquisition of all of the outstanding shares of common stock of ICx Technologies, Inc. ( ICx ), pursuant to an Agreement and Plan of Merger, dated as of August 12, 2010. The acquisition was completed through a tender offer for all of the outstanding shares of ICx at a price of \$7.55 per share. The tender offer expired on October 1, 2010, and on October 4, 2010, ICx became a wholly owned subsidiary of the Company.

ICx is a provider of integrated advanced sensing technologies for homeland security, force protection and critical infrastructure applications. ICx proprietary sensors detect and identify chemical, biological, radiological, nuclear and explosive threats, and deliver awareness and actionable intelligence for wide area surveillance, intrusion detection and facility security. The acquisition represents an opportunity for the Company to expand its business into adjacent technologies, products and markets represented by ICx.

The aggregate purchase price was approximately \$268 million and was funded with the Company's available cash. The allocation of the purchase price to tangible net assets, identifiable intangible assets and goodwill is subject to the final determination of the opening balance sheet of ICx at the date of acquisition and the valuation of the assets acquired and liabilities assumed.

## **Table of Contents**

### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations** **Forward-Looking Statements**

*This Quarterly Report on Form 10-Q (the "Report"), including Management's Discussion and Analysis of Financial Condition and Results of Operations in Part I, Item 2, contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 regarding future events and the future results of FLIR Systems, Inc. and its consolidated subsidiaries ( "FLIR" or the "Company") that are based on management's current expectations, estimates, projections, and assumptions about the Company's business. Words such as expects, anticipates, intends, plans, believes, sees, estimates and variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements due to numerous factors including, but not limited to, those discussed in the Risk Factors section of the Company's Annual Report on Form 10-K filed for the fiscal year ended December 31, 2009, Management's Discussion and Analysis of Financial Condition and Results of Operations in Part I, Item 2, and elsewhere in this Report as well as those discussed from time to time in the Company's other Securities and Exchange Commission filings and reports. In addition, such statements could be affected by general industry and market conditions. Such forward-looking statements speak only as of the date of this Report or, in the case of any document incorporated by reference, the date of that document, and we do not undertake any obligation to update any forward-looking statement to reflect events or circumstances after the date of this Report, or for changes made to this document by wire services or Internet service providers. If we update or correct one or more forward-looking statements, investors and others should not conclude that we will make additional updates or corrections with respect to other forward-looking statements.*

### **Results of Operations**

**Revenue.** Revenue for the three months ended September 30, 2010 increased by 16.4 percent, from \$285.6 million in the third quarter of 2009 to \$332.5 million in the third quarter of 2010. Revenue for the nine months ended September 30, 2010 increased 13.8 percent, from \$835.5 million in the first nine months of 2009 to \$950.9 million in the first nine months of 2010.

Government Systems revenue increased \$0.2 million, or 0.1 percent, from \$163.0 million in the third quarter of 2009 to \$163.2 million in the third quarter of 2010. Government Systems revenue for the nine months ended September 30, 2010 increased \$3.9 million, or 0.8 percent, from \$485.6 million in the first nine months of 2009 to \$489.4 million in the first nine months of 2010. An increase in revenue from ground-based products and revenue from a business acquired in the fourth quarter of 2009 was partially offset by a decrease in revenue from large stabilized gimbal products and maritime products.

Thermography revenue increased \$1.1 million, or 1.5 percent, from \$69.9 million in the third quarter of 2009 to \$71.0 million in the third quarter of 2010. Thermography revenue for the nine months ended September 30, 2010 increased \$17.3 million, or 8.6 percent, from \$200.6 million in the first nine months of 2009 to \$217.9 million in the first nine months of 2010. The increase in Thermography revenue in the third quarter and the first nine months of 2010 compared to the same periods in 2009 was primarily due to increased revenue in the United States and the Asia-Pacific region across most of the product lines, partially offset by a decline in revenue in Europe.

Commercial Vision Systems revenue increased \$8.7 million, or 16.6 percent, from \$52.6 million in the third quarter of 2009 to \$61.4 million in the third quarter of 2010. Commercial Vision Systems revenue for the nine months ended September 30, 2010 increased \$30.1 million, or 20.2 percent, from \$149.3 million in the first nine months of 2009 to \$179.4 million in the first nine months of 2010. The increase in Commercial Vision Systems revenue in the third quarter and first nine months of 2010 compared to the same periods in 2009 was primarily due to increased unit sales in our security, transportation and maritime product lines and the introduction in 2010 of the personal night vision systems products.

Raymarine Holdings Limited and its subsidiaries ( "Raymarine") was acquired on May 14, 2010. Raymarine revenue for the three months ended September 30, 2010 was \$36.9 million and was \$64.1 million for the period from the date of acquisition to September 30, 2010.

## **Table of Contents**

The timing of deliveries against large contracts, especially for our Government Systems and Commercial Vision Systems products, can give rise to quarter-to-quarter and year-over-year fluctuations in the mix of revenue. Consequently, year-over-year comparisons for any given quarter may not be indicative of comparisons using longer time periods. While we currently expect an overall increase in total annual revenue for 2010 of approximately 21 percent, the mix of revenue between our business segments and within certain product categories in our business segments will vary from quarter to quarter.

As a percentage of revenue, international sales were 41.9 percent and 43.5 percent for the quarters ended September 30, 2010 and 2009, respectively, and 44.5 percent and 40.6 percent for the nine months ended September 30, 2010 and 2009, respectively. While the percentage of revenue from international sales will continue to fluctuate from quarter to quarter partially due to the timing of shipments under international and domestic government contracts, management anticipates that revenue from international sales as a percentage of total revenue will continue to comprise a significant percentage of revenue.

At September 30, 2010, we had an order backlog of \$533 million. Backlog in the Government Systems, Thermography, Commercial Vision Systems and Raymarine divisions was \$386 million, \$23 million, \$116 million and \$8 million, respectively. Backlog is defined as orders received for products or services for which a sales agreement is in place and delivery is expected within twelve months.

*Gross profit.* Gross profit for the quarter ended September 30, 2010 was \$182.1 million compared to \$162.8 million for the same quarter last year. Gross profit for the nine months ended September 30, 2010 was \$530.8 million compared to \$482.5 million for the same period of 2009. Gross margin, defined as gross profit divided by revenue, decreased from 57.0 percent in the third quarter of 2009 to 54.8 percent in the third quarter of 2010, and from 57.7 percent in the first nine months of 2009 to 55.8 percent in the first nine months of 2010. The decrease in gross margin for both the three and nine month periods in 2010 were primarily due to lower gross margin at Raymarine (which has historically lower gross margins than our other three business segments) and the product mix in our Government Systems division.

*Research and development expenses.* Research and development expenses for the third quarter of 2010 totaled \$28.5 million, compared to \$21.3 million in the third quarter of 2009. Research and development expenses for the first nine months of 2010 and 2009 were \$81.6 million and \$66.9 million, respectively. The increase in research and development expenses was due to increased investment in new product development in all business segments including acquisitions made during 2009 and 2010. As a percentage of revenue, research and development expenses were 8.6 percent and 7.5 percent for the three months ended September 30, 2010 and 2009, respectively, and 8.6 percent and 8.0 percent for the nine months ended September 30, 2010 and 2009, respectively.

*Selling, general and administrative expenses.* Selling, general and administrative expenses were \$67.8 million for the quarter ended September 30, 2010, compared to \$52.2 million for the quarter ended September 30, 2009. Selling, general and administrative expenses for the first nine months of 2010 and 2009 were \$189.2 million and \$158.2 million, respectively. The increase in selling, general and administrative expenses was primarily due to increased spending in each of our business segments to drive future growth, including the operating expenses of businesses acquired during 2009 and 2010, the increased acquisition related costs incurred in 2010 and a \$3.0 million litigation settlement recorded in the third quarter of 2010. Selling, general and administrative expenses as a percentage of revenue were 20.4 percent and 18.3 percent for the quarters ended September 30, 2010 and 2009, respectively, and 19.9 percent and 18.9 percent for the nine months ended September 30, 2010 and 2009, respectively.

*Interest expense.* Interest expense for the third quarter and first nine months of 2010 was \$0.3 million and \$2.5 million, respectively, compared to \$1.2 million and \$5.7 million for the same periods of 2009. Interest expense is primarily attributable to the accrual of interest on the convertible notes that were issued in June 2003 and the amortization of the discounts recorded on the notes and the costs related to the issuance of the notes. The decrease in interest expense in 2010 compared to the same periods of 2009 is primarily due to the conversions of our outstanding convertible notes in 2009 and 2010.

*Other income/expense.* For the quarter and nine months ended September 30, 2010, we recorded other income of \$1.1 million and \$3.3 million, respectively, compared to other expense of \$1.7 million and \$1.7 million for the same periods of 2009. Other income in 2010 and other expense in 2009 primarily consist of foreign currency gains and losses and income earned on investments.

## **Table of Contents**

*Income taxes.* The income tax provision of \$23.6 million for the three months ended September 30, 2010, represents an effective tax rate of 27.2 percent. We expect the annual effective tax rate for the full year of 2010 to be approximately 32 percent to 33 percent. The annual effective tax rate is lower than the US Federal tax rate of 35 percent because of foreign tax rates and the effect of federal, foreign and state tax credits. The effective tax rate for the three months ended September 30, 2010 is lower than our expected annual rate for 2010 primarily due to the release of certain tax reserves due to the expiration of statute of limitations partially offset by the non-deductibility of acquisition costs incurred during the third quarter of 2010.

## **Liquidity and Capital Resources**

At September 30, 2010, we had cash and cash equivalents on hand of \$379.9 million compared to \$422.0 million at December 31, 2009. The decrease in cash and cash equivalents was primarily due to the acquisition of Raymarine, capital expenditures and the purchase of shares of our outstanding common stock, partially offset by cash provided by operations.

Cash provided by operating activities totaled \$209.9 million for the nine months ended September 30, 2010 primarily due to net earnings, adjusted for non-cash charges for depreciation and amortization and stock-based compensation, partially offset by an increase in inventories and decreases in accrued payroll and other liabilities.

Cash used in investing activities of \$222.6 million for the nine months ended September 30, 2010 primarily related to the acquisition of Raymarine and capital expenditures, including \$29.0 million for a facility in Goleta, California for the Commercial Vision Systems division. Cash used in investing activities of \$44.2 million for the nine months ended September 30, 2009 primarily related to capital expenditures and the acquisition of Salvador Imaging, Inc.

On October 4, 2010, we completed the acquisition of ICx Technologies, Inc., a provider of integrated advanced sensing technologies for homeland security, force protection and critical infrastructure applications. The aggregate purchase price was approximately \$268 million and was funded by our available cash.

On October 6, 2006, we entered into a Credit Agreement with Bank of America, N.A., Union Bank of California, N.A., U.S. Bank National Association and other Lenders (the "Credit Agreement"), which provides for a \$300 million, five-year revolving line of credit. We have the right, subject to certain conditions including approval of additional commitments by qualified lenders, to increase the line of credit by an additional \$150 million until October 6, 2011. The Credit Agreement includes a \$100 million sublimit multicurrency option, permitting us and certain of our designated subsidiaries to borrow in Euro, Kronor, Sterling and other agreed upon currencies.

Under the Credit Agreement, borrowings will bear interest based upon the prime lending rate of the Bank of America or Eurodollar rates with a provision for a spread over Eurodollar rates based upon the Company's leverage ratio. The Eurodollar interest rate was 1.04 percent and the prime lending rate was 3.25 percent at September 30, 2010. These rates were 1.001 percent and 3.25 percent, respectively, at December 31, 2009. The Credit Agreement requires us to pay a commitment fee on the amount of unused credit at a rate, based on our leverage ratio, which ranges from 0.175 percent to 0.325 percent. At September 30, 2010 and December 31, 2009, the commitment fee rate was 0.175 percent. The Credit Agreement contains six financial covenants that require the maintenance of certain leverage ratios, in addition to minimum levels of EBITDA and consolidated net worth, a maximum level of capital expenditures and a minimum liquidity of cash and availability under the Credit Agreement. The Credit Agreement is collateralized by substantially all assets of the Company. At September 30, 2010 and December 31, 2009, we had no borrowings outstanding under the Credit Agreement and were in compliance with all of its financial covenants. We had \$8.5 million and \$7.8 million of letters of credit outstanding under the Credit Agreement at September 30, 2010 and December 31, 2009, respectively, which reduces the total available credit thereunder.

On July 7, 2010, we entered into an uncommitted letter of credit agreement with Bank of America to support letters of credit whose expiration would extend beyond the current Credit Agreement. At September 30, 2010, the total value of letters of credit outstanding under this facility was \$6.5 million.

Our Sweden subsidiary has a 30 million Swedish Kronor (approximately \$4.5 million) line of credit with an interest rate at 1.8 percent at September 30, 2010. At September 30, 2010, the Company had no amounts outstanding on this line of credit. The 30 million Swedish Kronor line of credit is secured primarily by accounts receivable and inventories of the Sweden subsidiary and is subject to automatic renewal on an annual basis.



## **Table of Contents**

In June 2003, we issued \$210 million of 3.0 percent senior convertible notes due in 2023 in a private offering pursuant to Rule 144A under the Securities Act of 1933, as amended. The net proceeds from the issuance were approximately \$203.9 million. Issuance costs were being amortized over a period of seven years. Interest was payable semiannually on June 1 and December 1 of each year. On June 7, 2010, all of the remaining notes were converted into 18.9 million shares of the Company's common stock.

Cash used in financing activities of \$18.1 million and \$55.9 million for the nine months ended September 30, 2010 and 2009, respectively, primarily related to the repurchase of approximately 1.3 million shares and 3.2 million shares, respectively, of our common stock, partially offset by cash provided from our stock-based compensation plans.

On February 4, 2009, our Board of Directors authorized the repurchase of up to 20.0 million shares of our outstanding common stock. As of September 30, 2010, there were approximately 15.5 million shares still authorized for purchase under this authorization, which expires on February 4, 2011.

We believe that our existing cash combined with the cash we anticipate to generate from operating activities and our available credit facilities and financing available from other sources will be sufficient to meet our cash requirements for the foreseeable future. We do not have any significant capital commitments for the current year nor are we aware of any significant events or conditions that are likely to have a material impact on our liquidity.

### **New Accounting Pronouncements**

In October 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2009-13, Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements—a consensus of the FASB Emerging Issues Task Force (ASU 2009-13), which provides amendments to the criteria in Subtopic 605-25, Revenue Recognition—Multiple-Element Arrangements, for separating consideration in multiple-deliverable arrangements and expands the disclosures related to multiple-deliverable revenue arrangements. ASU 2009-13 is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. The Company adopted ASU 2009-13 on January 1, 2010. The Company's adoption of ASU 2009-13 did not have a material impact on its consolidated financial statements.

In October 2009, the FASB issued Accounting Standards Update No. 2009-14, Software (Topic 985): Certain Revenue Arrangements That Include Software Elements—a consensus of the FASB Emerging Issues Task Force (ASU 2009-14), which changes the accounting model for revenue arrangements that include both tangible products and software elements. ASU 2009-14 is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. The Company adopted ASU 2009-14 on January 1, 2010. The Company's adoption of ASU 2009-14 did not have a material impact on its consolidated financial statements.

### **Critical Accounting Policies and Estimates**

The Company reaffirms the critical accounting policies and our use of estimates as reported in our Form 10-K for the year ended December 31, 2009. As described in Note 1 to the Consolidated Financial Statements included in the Form 10-K, the determination of fair value for stock-based compensation awards requires the use of management's estimates and judgments.

### **Contractual Obligations**

As of September 30, 2010, there have been no material changes to our contractual obligations outside the ordinary course of our business since December 31, 2009, except for the conversion of all of our remaining outstanding convertible notes in June 2010 and the operating leases, primarily facility-related, acquired through our acquisition of Raymarine in May 2010.

**Table of Contents**

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

As of September 30, 2010, the Company has not experienced any changes in market risk exposure that would materially affect the quantitative and qualitative disclosures about market risk presented in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2009, except that risks relating to the convertible notes are no longer relevant due to the conversion of the remaining notes during the second quarter of 2010.

**Item 4. Controls and Procedures**  
**Evaluation of Disclosure Controls and Procedures**

As of September 30, 2010, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and the Company's Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures, as such term is defined in Rule 13a-15(e). Based on the evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in the reports it files or submits under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

**Changes in Internal Control Over Financial Reporting**

There has been no change in the Company's internal control over financial reporting that occurred during the Company's fiscal quarter ended September 30, 2010 that has materially affected, or is reasonably likely to materially affect, such internal control over financial reporting. Internal control over financial reporting at Raymarine was excluded from the evaluation for the period ended September 30, 2010.

**Table of Contents****PART II. OTHER INFORMATION****Item 1. Legal Proceedings**

The Company is subject to legal proceedings, claims and litigation arising in the ordinary course of its business. See Note 17, Contingencies, of the Notes to the Consolidated Financial Statements for additional information on the Company's legal proceedings.

**Item 1A. Risk Factors**

There has been no material change in the risk factors previously disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2009, which was filed with the Securities and Exchange Commission on February 26, 2010.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

During the three months ended September 30, 2010, the Company repurchased the following shares:

| Period                            | Total Number<br>of Shares<br>Purchased <sup>(1)</sup> | Average<br>Price Paid<br>per<br>Share | Total Number of<br>Shares<br>Purchased as<br>Part of<br>Publicly<br>Announced<br>Plans or<br>Programs | Maximum Number of<br>Shares<br>that May Yet Be<br>Purchased Under<br>the<br>Plans or Programs |
|-----------------------------------|-------------------------------------------------------|---------------------------------------|-------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------|
| July 1 to July 31, 2010           |                                                       | \$                                    |                                                                                                       |                                                                                               |
| August 1 to August 31, 2010       | 99,410                                                | 24.49                                 | 99,410                                                                                                |                                                                                               |
| September 1 to September 30, 2010 |                                                       |                                       |                                                                                                       |                                                                                               |
|                                   | 99,410                                                | \$ 24.49                              | 99,410                                                                                                | 15,462,172                                                                                    |

(1) All shares were purchased in open market transactions.

All share repurchases are subject to applicable securities law, and are at times and in amounts as management deems appropriate. On February 4, 2009, our Board of Directors authorized the repurchase of up to 20.0 million shares of our outstanding common stock. This authorization will expire on February 4, 2011.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 5. Other Information**

On November 8, 2010, the Company appointed David A. Muessle, age 56, to serve as its Chief Accounting Officer.

## Edgar Filing: FLIR SYSTEMS INC - Form 10-Q

Mr. Muessle will continue to serve as the Company's Vice President and Corporate Controller. Mr. Muessle has been the Company's Corporate Controller since joining the Company in March 2000. He is a certified public accountant and holds a Bachelor of Science and Commerce degree in Accounting from Santa Clara University.

---

**Table of Contents**

**Item 6. Exhibits**

| Number  | Description                                                                                    |
|---------|------------------------------------------------------------------------------------------------|
| 31.1    | Principal Executive Officer Certification Pursuant to Sarbanes-Oxley Act of 2002, Section 302. |
| 31.2    | Principal Financial Officer Certification Pursuant to Sarbanes-Oxley Act of 2002, Section 302. |
| 32.1    | Principal Executive Officer Certification Pursuant to Sarbanes-Oxley Act of 2002, Section 906. |
| 32.2    | Principal Financial Officer Certification Pursuant to Sarbanes-Oxley Act of 2002, Section 906. |
| 101.INS | XBRL Instance Document                                                                         |
| 101.SCH | XBRL Taxonomy Extension Schema Document                                                        |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document                                          |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document                                                |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document                                         |

**Table of Contents**

**SIGNATURES**

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

FLIR SYSTEMS, INC.

Date November 9, 2010

/s/ ANTHONY L. TRUNZO  
Anthony L. Trunzo  
Sr. Vice President, Finance and Chief Financial Officer  
(Duly Authorized and Principal Financial Officer)