

CYBEROPTICS CORP  
Form 10-Q  
November 06, 2015

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

(Check One)

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

For the quarterly period ended September 30, 2015

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

COMMISSION FILE NO. (0-16577)

CYBEROPTICS CORPORATION  
(Exact name of registrant as specified in its charter)  
Minnesota  
(State or other jurisdiction of  
incorporation or organization)

41-1472057  
(I.R.S. Employer  
Identification No.)

5900 Golden Hills Drive  
MINNEAPOLIS, MINNESOTA  
(Address of principal executive offices)  
(763) 542-5000  
(Registrant's telephone number, including area code)

55416  
(Zip 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 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 (§232.405 of this chapter) 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 definition of "accelerated filer" or "large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller Reporting Company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. At October 31, 2015, there were 6,730,711 shares of the registrant's Common Stock, no par value, issued and outstanding.

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## PART I. FINANCIAL INFORMATION

## ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## CONDENSED CONSOLIDATED BALANCE SHEETS

## CYBEROPTICS CORPORATION

(Unaudited)

(In thousands, except share information)	September 30, 2015	December 31, 2014
<b>ASSETS</b>		
Cash and cash equivalents	\$ 3,308	\$5,171
Marketable securities	5,009	5,285
Accounts receivable, less allowance for doubtful accounts of \$573 at September 30, 2015 and \$561 at December 31, 2014	8,283	7,945
Inventories	12,432	11,657
Other current assets	1,677	1,202
Deferred tax assets	82	82
Total current assets	30,791	31,342
Marketable securities, long-term	8,341	9,889
Equipment and leasehold improvements, net	2,423	2,918
Intangible assets, net	584	642
Goodwill	1,366	1,366
Other assets	178	188
Deferred tax assets	47	67
Total assets	\$ 43,730	\$46,412
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Accounts payable	\$ 4,761	\$4,713
Advance customer payments	588	490
Accrued expenses	2,236	3,201
Total current liabilities	7,585	8,404
Deferred rent	241	285
Deferred warranty revenue	7	26
Deferred tax liability	134	119
Reserve for income taxes	140	140
Total liabilities	8,107	8,974
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, no par value, 5,000,000 shares authorized, none outstanding	—	—
Common stock, no par value, 25,000,000 shares authorized, 6,730,711 shares issued and outstanding at September 30, 2015 and 6,643,851 shares issued and outstanding at December 31, 2014	31,003	30,145
Accumulated other comprehensive loss	(1,888	) (1,271
Retained earnings	6,508	8,564
Total stockholders' equity	35,623	37,438
Total liabilities and stockholders' equity	\$ 43,730	\$46,412

SEE THE ACCOMPANYING NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

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CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
CYBEROPTICS CORPORATION  
(Unaudited)

(In thousands, except per share amounts)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Revenues	\$9,937	\$11,657	\$29,736	\$34,755
Cost of revenues	5,698	6,361	16,367	19,024
Gross margin	4,239	5,296	13,369	15,731
Research and development expenses	1,956	2,266	5,858	6,669
Selling, general and administrative expenses	2,987	3,527	9,663	10,536
Amortization of intangibles	17	17	50	37
Loss from operations	(721	) (514	) (2,202	) (1,511
Interest income and other	228	75	207	2
Loss before income taxes	(493	) (439	) (1,995	) (1,509
Income tax provision	21	9	61	63
Net loss	\$(514	) \$(448	) \$(2,056	) \$(1,572
Net loss per share – Basic	\$(0.08	) \$(0.07	) \$(0.31	) \$(0.24
Net loss per share – Diluted	\$(0.08	) \$(0.07	) \$(0.31	) \$(0.24
Weighted average shares outstanding – Basic	6,717	6,609	6,694	6,555
Weighted average shares outstanding – Diluted	6,717	6,609	6,694	6,555

SEE THE ACCOMPANYING NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS  
 CYBEROPTICS CORPORATION  
 (Unaudited)

(In thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net loss	\$(514	) \$(448	) \$(2,056	) \$(1,572
Other comprehensive income (loss), before tax:				
Foreign currency translation adjustments	(576	) (233	) (747	) (64
Unrealized gains (losses) on available-for-sale securities:				
Unrealized gains (losses)	(9	) 24	(14	) 36
Reclassification adjustment	—	—	—	—
Total unrealized gains (losses) on available-for-sale securities	(9	) 24	(14	) 36
Unrealized gains (losses) on foreign exchange forward contracts:				
Unrealized losses	(217	) (190	) (322	) (121
Reclassification adjustment for (gains) losses included in net loss	161	(3	) 466	29
Total unrealized gains (losses) on foreign exchange forward contracts	(56	) (193	) 144	(92
Other comprehensive loss, before tax	(641	) (402	) (617	) (120
Income tax provision related to items of other comprehensive loss	—	—	—	—
Other comprehensive loss, net of tax	(641	) (402	) (617	) (120
Total comprehensive loss	\$(1,155	) \$(850	) \$(2,673	) \$(1,692

SEE THE ACCOMPANYING NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
CYBEROPTICS CORPORATION  
(Unaudited)

(In thousands)	Nine Months Ended September 30,	
	2015	2014
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss	\$(2,056	) \$(1,572
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,430	1,386
Provision for doubtful accounts	13	(14
Deferred taxes	35	40
Foreign currency transaction gains	(329	) (96
Stock compensation costs	386	378
Changes in operating assets and liabilities, net of acquisition:		
Accounts receivable	(351	) (2,715
Inventories	(1,618	) (1,566
Other assets	(513	) (366
Accounts payable	147	2,559
Advance customer payments	98	(415
Accrued expenses	(844	) 393
Net cash used in operating activities	(3,602	) (1,988
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Proceeds from maturities of available-for-sale marketable securities	3,505	4,391
Proceeds from sales of available-for-sale marketable securities	1,517	5,047
Purchases of available-for-sale marketable securities	(3,221	) (4,816
Acquisition of Laser Design, Inc. (LDI)	—	(3,108
Additions to equipment and leasehold improvements	(399	) (975
Additions to patents	(75	) (66
Net cash provided by investing activities	1,327	473
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from exercise of stock options	294	628
Proceeds from issuance of common stock under employee stock purchase plan	178	113
Net cash provided by financing activities	472	741
Effects of exchange rate changes on cash and cash equivalents	(60	) 57
Net decrease in cash and cash equivalents	(1,863	) (717
Cash and cash equivalents – beginning of period	5,171	3,101
Cash and cash equivalents – end of period	\$3,308	\$2,384
SEE THE ACCOMPANYING NOTES TO UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.		

NOTES TO THE UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
CYBEROPTICS CORPORATION

1. INTERIM REPORTING:

The interim condensed consolidated financial statements presented herein as of September 30, 2015, and for the three and nine month periods ended September 30, 2015 and 2014, are unaudited, but in the opinion of management, include all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of financial position, results of operations and cash flows for the periods presented.

The results of operations for the three and nine month periods ended September 30, 2015 do not necessarily indicate the results to be expected for the full year. The December 31, 2014 consolidated balance sheet data was derived from audited consolidated financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. These unaudited interim condensed consolidated financial statements should be read in conjunction with our consolidated financial statements and notes thereto, contained in our Annual Report on Form 10-K for the year ended December 31, 2014.

2. ACQUISITION:

On March 14, 2014 we acquired substantially all of the assets of Laser Design, Inc. (LDI), a privately held company based in Minneapolis, Minnesota for aggregate consideration of \$2,633,000 in cash plus the assumption of certain current liabilities of \$1,073,000. We also paid aggregate signing bonuses of \$475,000 to key executives of LDI which have been accounted for as acquisition consideration. LDI provides scanning systems and services to the global 3D scanner and services metrology market and enables us to enter the growing market for general purpose 3D metrology. We also intend to leverage our proprietary 3D sensor technology in LDI's products to enable differentiated offerings. Under the acquisition method of accounting, the total purchase price is allocated to the net tangible and intangible assets acquired, based upon their estimated fair values as of March 14, 2014. During the three months ended June 30, 2014, we completed our valuation work and management review of the assets acquired and liabilities assumed and finalized the purchase price adjustment for the net working capital acquired. Adjustments to provisional amounts reflected in our preliminary purchase price allocation as of March 31, 2014 included a \$24,000 decrease in intangible assets and a \$46,000 increase in goodwill, among other adjustments. These measurement period adjustments require the revision of comparative financial information for the quarter ended March 31, 2014. The adjustment to intangible assets decreased amortization expense in the three months ended March 31, 2014 by less than \$300. None of the other adjustments to the provisional amounts had any impact on our results of operations for the first quarter of 2014.

The purchase price allocation for our acquisition of LDI is as follows:

(In thousands)

Accounts receivable	\$662
Inventories	551
Equipment and leasehold improvements	1,507
Other assets	91
Intangible assets	573
Identifiable assets acquired	3,384
Accounts payable	640
Accrued expenses and advance customer payments	433
Liabilities assumed	1,073
Net identifiable assets acquired	2,311
Goodwill	797
Purchase price	\$3,108



The allocation of the purchase price resulted in recognition of the following identified intangible assets:

	(In thousands)	Weighted Average Life-Years
Software	\$206	7
Patent	165	7
Marketing assets and customer relationships	101	9
Non-compete agreements	101	4
	\$573	7

The fair value of the above identified intangible assets was estimated using an income approach. Under the income approach, an intangible asset's fair value is equal to the present value of future economic benefits to be derived from ownership of the asset. Indications of value are developed by discounting future net cash flows to their present value at market-based rates of return. The software, patent and marketing intangible assets have been appraised using a relief from royalty income methodology; the non-competes using a "with and without" income methodology; and, customer relationships using a multi period excess earnings methodology. The goodwill recognized as a result of the LDI acquisition is primarily attributable to the value of the workforce, as well as unidentifiable intangible assets. We paid a premium over the net tangible and identifiable intangible assets acquired (i.e. goodwill) because owning LDI enables us to have initial access to the general purpose 3D metrology market and allows us to leverage our proprietary 3D sensor technology in LDI's products.

All of the goodwill is expected to be deductible for income tax purposes over a 15 year period. The useful life of the intangible assets was determined based on management's best estimate of the expected cash flows used to measure the fair value of the intangible assets, adjusted as appropriate for entity-specific factors, including competitive, economic or other factors that may limit the useful life of the intangible assets.

In the three months ended September 30, 2015, LDI contributed \$1,651,000 to our revenue and \$68,000 to our net loss. In the three months ended September 30, 2014, LDI contributed \$1,304,000 to our revenue and \$206,000 to our net loss. In the nine months ended September 30, 2015, LDI contributed \$4,597,000 to our revenue and \$452,000 to our net loss. In the nine months ended September 30, 2014, LDI contributed \$3,480,000 to our revenue and \$432,000 to our net loss.

The following unaudited pro forma consolidated financial information presents our revenue and net loss as if the acquisition of LDI occurred on January 1, 2014. The unaudited pro forma consolidated financial information has been prepared for illustrative purposes only and does not purport to be indicative of the results that would have been achieved had the acquisition occurred on January 1, 2014, or of future results. The unaudited pro forma consolidated financial information does not reflect any operating efficiencies and cost savings that may be realized from integration of LDI.

(In thousands, except per share amounts)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Revenue	\$9,937	\$11,657	\$29,736	\$36,135
Net loss	(514)	(448)	(2,056)	(1,377)
Basic and diluted loss per share	\$(0.08)	\$(0.07)	\$(0.31)	\$(0.21)

We incurred approximately \$117,000 in LDI related acquisition costs. Approximately \$47,000 of these costs are recorded as selling, general and administrative expenses in the first quarter of 2014, with the remaining balance recorded as selling, general and administrative expense in 2013. The pro forma consolidated net loss for the three and nine months ended September 30, 2014 reflected in the table above was adjusted to exclude all acquisition related costs and the impact of the fair value adjustment to acquisition date inventories of \$222,000.



## 3. MARKETABLE SECURITIES:

Our investments in marketable securities are classified as available-for-sale and consist of the following:

(In thousands)	September 30, 2015			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Short-Term				
U.S. government and agency obligations	\$3,917	\$4	\$—	\$3,921
Corporate debt securities and certificates of deposit	1,086	2	—	1,088
Marketable securities – short-term	\$5,003	\$6	\$—	\$5,009
Long-Term				
U.S. government and agency obligations	\$5,909	\$23	\$—	\$5,932
Corporate debt securities and certificates of deposit	1,304	3	—	1,307
Asset backed securities	1,039	1	(1)	1,039
Equity security	42	21	—	63
Marketable securities – long-term	\$8,294	\$48	\$(1)	\$8,341

(In thousands)	December 31, 2014			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Short-Term				
U.S. government and agency obligations	\$3,378	\$2	\$—	\$3,380
Corporate debt securities and certificates of deposit	1,903	2	—	1,905
Marketable securities – short-term	\$5,281	\$4	\$—	\$5,285
Long-Term				
U.S. government and agency obligations	\$5,761	\$3	\$(5)	\$5,759
Corporate debt securities and certificates of deposit	1,867	1	(1)	1,867
Asset backed securities	2,156	1	(1)	2,156
Equity security	42	65	—	107
Marketable securities – long-term	\$9,826	\$70	\$(7)	\$9,889

Our investments in marketable debt securities all have maturities of less than five years. At September 30, 2015, marketable debt securities valued at \$12,489,000 were in an unrealized gain position totaling \$33,000 and marketable debt securities valued at \$798,000 were in an unrealized loss position totaling \$1,000 (all had been in an unrealized loss position for less than 12 months). At December 31, 2014, marketable debt securities valued at \$9,287,000 were in an unrealized gain position totaling \$9,000 and marketable debt securities valued at \$5,780,000 were in an unrealized loss position totaling \$7,000 (all had been in an unrealized loss position for less than 12 months).

Net pre-tax unrealized gains for marketable securities of \$53,000 at September 30, 2015 and \$67,000 at December 31, 2014 were recorded as a component of accumulated other comprehensive loss in stockholders' equity. We received proceeds from the sale of marketable securities of \$801,000 in the three months ended September 30, 2015, \$1,893,000 in the three months ended September 30, 2014, \$1,517,000 in the nine months ended September 30, 2015 and \$5,047,000 in the nine months ended September 30, 2014. No gain or loss was recognized on any of the sales during the three or nine months ended September 30, 2015 or September 30, 2014.

Investments in marketable securities classified as cash equivalents of \$791,000 at September 30, 2015 and \$321,000 at December 31, 2014 consist of the following:

(In thousands)	September 30, 2015			
	Cost	Unrealized Gains	Unrealized Losses	Recorded Basis
Corporate debt securities and certificates of deposit	\$791	\$—	\$—	\$791
	\$791	\$—	\$—	\$791



(In thousands)	December 31, 2014			
	Cost	Unrealized Gains	Unrealized Losses	Recorded Basis
Corporate debt securities and certificates of deposit	\$321	\$—	\$—	\$321
	\$321	\$—	\$—	\$321

Cash and marketable securities held by foreign subsidiaries totaled \$862,000 at September 30, 2015 and \$1,095,000 at December 31, 2014.

#### 4. DERIVATIVES:

We enter into foreign exchange forward contracts to hedge against the effect of exchange rate fluctuations on cash flows denominated in foreign currencies associated with our subsidiary in Singapore. These transactions are designated as cash flow hedges and are recorded in the accompanying balance sheet at fair value. The effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income (loss) and reclassified into earnings in the same period during which the hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings. Hedge ineffectiveness and the amounts excluded from effectiveness testing recognized in earnings on cash flow hedges were not material for the three and nine month periods ended September 30, 2015 and September 30, 2014.

The maximum length of time over which we hedge our exposure to the variability in future cash flows is 12 months. Accordingly, at September 30, 2015 and December 31, 2014, all of our open foreign exchange forward contracts had maturities of one year or less. The dollar equivalent gross notional amount of our foreign exchange forward contracts designated as cash flow hedges was approximately \$3.0 million at September 30, 2015 and \$7.1 million at December 31, 2014.

Reclassifications of amounts from accumulated other comprehensive loss into earnings include accumulated gains (losses) at the time earnings are impacted by the forecasted transaction. The location in the consolidated statements of operations and consolidated statements of comprehensive loss and amounts of gains and losses related to derivative instruments designated as cash flow hedges are as follows:

(In thousands)	Three Months Ended September 30, 2015	
	Pretax Loss Recognized in Other Comprehensive Income (Loss) on Effective Portion of Derivative	Pretax Loss Recognized in Earnings on Effective Portion of Derivative as a Result of Reclassification from Accumulated Other Comprehensive Loss
Cost of revenues	\$(135	) \$(102
Research and development	(56	) (32
Selling, general and administrative	(26	) (27
Total	\$(217	) \$(161

(In thousands)	Three Months Ended September 30, 2014	
	Pretax Loss Recognized in Other Comprehensive Income (Loss) on Effective Portion of Derivative	Pretax Gain Recognized in Earnings on Effective Portion of Derivative as a Result of Reclassification

		from Accumulated Other Comprehensive Loss
Cost of revenues	\$(119	) \$3
Research and development	(36	) —
Selling, general and administrative	(35	) —
Total	\$(190	) \$3

Nine Months Ended September 30, 2015

(In thousands)	Pretax Loss Recognized in Other Comprehensive Income (Loss) on Effective Portion of Derivative	Pretax Loss Recognized in Earnings on Effective Portion of Derivative as a Result of Reclassification from Accumulated Other Comprehensive Loss
Cost of revenues	\$(200)	) \$(289)
Research and development	(78)	) (93)
Selling, general and administrative	(44)	) (84)
Total	\$(322)	) \$(466)

Nine Months Ended September 30, 2014

(In thousands)	Pretax Loss Recognized in Other Comprehensive Income (Loss) on Effective Portion of Derivative	Pretax Loss Recognized in Earnings on Effective Portion of Derivative as a Result of Reclassification from Accumulated Other Comprehensive Loss
Cost of revenues	\$(75)	) \$(15)
Research and development	(22)	) (7)
Selling, general and administrative	(24)	) (7)
Total	\$(121)	) \$(29)

Amounts recorded in accumulated other comprehensive loss for the after tax net unrealized loss associated with cash flow hedging instruments was \$268,000 at September 30, 2015 and \$412,000 at December 31, 2014. We expect to reclassify the September 30, 2015 pretax unrealized loss of \$211,000 recorded in accumulated other comprehensive loss to earnings over the next 12 months with the impact offset by cash flows from underlying hedged items. The fair value of our foreign exchange forward contracts representing losses in the amount of \$184,000 at September 30, 2015 and \$352,000 at December 31, 2014 has been recorded in accrued expenses.

Additional information with respect to the impact of derivative instruments on other comprehensive income (loss) is included in Note 11. Additional information with respect to the fair value of derivative instruments is included in Note 5.

Our foreign exchange forward contracts contain credit risk to the extent that our bank counter-parties may be unable to meet the terms of the agreements. We minimize such risk by limiting our counter-parties to major financial institutions. We do not expect material losses as a result of defaults by other parties.

## 5. FAIR VALUE MEASUREMENTS:

We determine the fair value of our assets and liabilities based on the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value maximize the use of observable inputs and minimize the use of unobservable inputs. We use a fair value hierarchy with three levels of inputs, of which the first two are considered observable and the last unobservable, to measure fair value. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1). The next highest priority is based on quoted prices for similar assets or liabilities in active markets or quoted prices for identical or similar assets or liabilities in non-active markets or other observable inputs (Level 2). The lowest priority is given to unobservable inputs (Level 3). The following provides information regarding fair value measurements for our marketable securities and foreign exchange forward contracts as of September 30, 2015 and December 31, 2014 according to the three-level fair value hierarchy:

(In thousands)	Fair Value Measurements at September 30, 2015 Using			
	Balance September 30, 2015	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Marketable securities:				
U.S. government and agency obligations	\$9,853	\$—	\$9,853	\$—
Corporate debt securities and certificates of deposit	2,395	—	2,395	—
Asset backed securities	1,039	—	1,039	—
Equity security	63	63	—	—
Total marketable securities	\$13,350	\$63	\$13,287	\$—

## Derivative instruments-liabilities:

Foreign exchange forward contracts	\$184	\$—	\$184	\$—
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(In thousands)	Fair Value Measurements at December 31, 2014 Using			
	Balance December 31, 2014	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Marketable securities:				
U.S. government and agency obligations	\$9,139	\$—	\$9,139	\$—
Corporate debt securities and certificates of deposit	3,772	—	3,772	—
Asset backed securities	2,156	—	2,156	—
Equity security	107	107	—	—
Total marketable securities	\$15,174	\$107	\$15,067	\$—

## Derivative instruments-liabilities:

Foreign exchange forward contracts	\$352	\$—	\$352	\$—
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During the nine months ended September 30, 2015 and the year ended December 31, 2014 there were no transfers within the three level hierarchy. A significant transfer is recognized when the inputs used to value a security have been



changed which merit a transfer between the disclosed levels of the valuation hierarchy.

The fair value for our U.S. government and agency obligations, corporate debt securities and certificates of deposit and asset backed securities are determined based on valuations provided by external investment managers who obtain them from a variety of industry standard data providers. The fair value for our equity security is based on a quoted market price obtained from an active market.

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The fair value for our foreign exchange forward contracts is based on foreign currency spot and forward rates obtained from reputable financial institutions, with resulting valuations periodically validated by obtaining foreign currency spot rate and forward quotes from other industry standard sources or third party or counterparty quotes. The fair value of our foreign exchange forward contracts representing losses in the amount of \$184,000 as of September 30, 2015 and \$352,000 as of December 31, 2014 has been recorded in accrued expenses.

The carrying amounts of financial instruments such as cash equivalents, accounts receivable, other assets, accounts payable, accrued expenses and other liabilities approximate their related fair values due to the short-term maturities of these instruments. Non-financial assets such as equipment and leasehold improvements, goodwill and intangible assets are subject to non-recurring fair value measurements if they are deemed impaired. We had no re-measurements of non-financial assets to fair value during the nine months ended September 30, 2015 or September 30, 2014.

#### 6. ACCOUNTING FOR STOCK-BASED COMPENSATION:

We have four stock-based compensation plans, including two stock incentive plans that are administered under the supervision of the Compensation Committee of the Board of Directors, and under which we have granted options and restricted stock units, an employee stock purchase plan administered by the Committee, and a Stock Grant Plan for Directors that provides for automatic grants. New shares are issued for all option exercises, upon vesting of restricted stock units, for share issuances to board members and for issuances under our employee stock purchase plan.

##### Stock Incentive Plans

As of September 30, 2015, there are 819,062 shares of common stock reserved in the aggregate for issuance of awards to employees, officers and others under our two stock incentive plans. Although our Compensation Committee has authority to issue options, restricted stock, restricted stock units, share grants and other share based benefits under these plans, it has only issued restricted stock units and options under the plans during the past ten years. As of September 30, 2015, there were 305,040 shares of common stock available for future awards that may be granted under these plans to employees, officers and others. Reserved shares underlying outstanding awards, including options and restricted shares, that are forfeited are available under our active plan for future grant.

##### Stock Options

Options are granted under our plans at an option price per share equal to or greater than the market value of our common stock on the date of grant. Generally, options granted to employees vest over a four-year period and expire seven years after the date of grant. The plans allow for option holders to tender shares of our common stock as consideration for the option price, provided that the tendered shares have been held by the option holder at least six months.

The following is a summary of stock option activity for the nine months ended September 30, 2015:

	Options Outstanding	Weighted Average Exercise Price Per Share
Outstanding, December 31, 2014	578,901	\$8.30
Granted	—	—
Exercised	(40,001	) 7.36
Expired	(58,000	) 11.35
Forfeited	(11,250	) 7.71
Outstanding, September 30, 2015	469,650	\$8.02
Exercisable, September 30, 2015	191,922	\$7.97

The intrinsic value of an option is the amount by which the market price of the underlying stock exceeds its exercise price. For options outstanding at September 30, 2015, the weighted average remaining contractual term of all outstanding options was 4.29 years and their aggregate intrinsic value was \$108,000. At September 30, 2015, the weighted average remaining contractual term of options that were exercisable was 2.51 years and their aggregate intrinsic value was \$75,000. The aggregate intrinsic value of stock options exercised was \$121,000 in the nine months ended September 30, 2015. We received proceeds from stock option exercises of \$294,000 in the nine months ended September 30, 2015 and \$628,000 in the nine months ended September 30, 2014. No tax benefit was realized from the exercise of these stock options and no amounts were credited to additional paid-in capital. The total fair value of options that vested was \$139,000 in the nine months ended September 30, 2015.

#### Restricted Stock Units

Restricted stock units are valued at a price equal to the fair market value of our common stock on the date of grant, vest over a four year period provided the employee is still working for the company and entitle the holders to one share of our common stock for each restricted stock unit. There were no restricted stock units granted in the three and nine months ended September 30, 2015. The aggregate fair value of outstanding restricted stock units based on the closing share price of our common stock on September 30, 2015 was \$280,000. The aggregate fair value of restricted stock units that vested, based on the closing share price of our common stock on the vesting date, was \$71,000 in the nine months ended September 30, 2015.

A summary of activity in non-vested restricted stock units for the nine months ended September 30, 2015 is as follows:

	Shares	Weighted Average Grant Date Fair Value
Non-vested restricted stock units		
Non-vested at December 31, 2014	53,718	\$7.43
Granted	—	—
Vested	(7,014	) 7.06
Forfeited	(2,332	) 6.10
Non-vested at September 30, 2015	44,372	\$7.56

#### Employee Stock Purchase Plan

We have an Employee Stock Purchase Plan available to eligible U.S. employees. Under terms of the plan, eligible employees may designate from 1% to 10% of their compensation to be withheld through payroll deductions, up to a maximum of \$6,500 in each plan year, for the purchase of common stock at 85% of the lower of the market price on the first or last day of the offering period. There were 35,845 shares issued under this plan in the nine months ended September 30, 2015 and 22,324 shares issued under this plan in the nine months ended September 30, 2014. As of September 30, 2015, 95,757 shares remain available for future issuance under this plan.

#### Stock Grant Plan for Non-Employee Directors

Our stock grant plan for non-employee directors provides for automatic grants of 1,000 shares of our common stock to each of our non-employee directors upon their re-election to the Board of Directors. The plan allows for the issuance of up to 60,000 shares of our common stock and will expire on May 19, 2018. We issued a total of 4,000 shares of common stock under this plan in connection with our annual meeting in May 2015 and 4,000 shares of common stock in connection with our annual meeting in May 2014. The shares issued in 2015 had a fair market value on the date of grant equal to \$41,000 (weighted average grant date fair value of \$10.36). The shares issued in 2014 had a fair market value on the date of grant equal to \$32,000 (weighted average grant date fair value of \$8.05). As of September 30, 2015, 28,000 shares of common stock are reserved in the aggregate for future issuance under this plan.

#### Stock Based Compensation Information

All equity-based payments to employees and our non-employee directors, including grants of employee stock options and restricted stock units, are recognized as an expense in our consolidated statement of operations based on the grant date fair value of the award. We utilize the straight-line method of expense recognition over the award's service period for our graded vesting options. The fair value of stock options granted has been determined using the Black-Scholes model. The compensation expense recognized for all equity based awards is net of estimated forfeitures, which are based on historical data. We have classified equity based compensation within our statement of operations in the same

manner as our cash based employee compensation costs.

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Equity based compensation expense in the three months ended September 30, 2015 totaled \$110,000 and includes \$63,000 for stock option awards, \$23,000 for our employee stock purchase plan, and \$24,000 for unvested restricted stock units. Equity based compensation expense in the nine months ended September 30, 2015, totaled \$386,000 and includes \$211,000 for stock option awards, \$55,000 for our employee stock purchase plan, \$79,000 for unvested restricted stock units and \$41,000 for shares issued to our non-employee directors.

Equity based compensation expense in the three months ended September 30, 2014 totaled \$117,000 and includes \$74,000 for stock option awards, \$15,000 for our employee stock purchase plan, and \$28,000 for unvested restricted stock units. Equity based compensation expense in the nine months ended September 30, 2014 totaled \$378,000 and includes \$224,000 for stock option awards, \$33,000 for our employee stock purchase plan, \$89,000 for unvested restricted stock units and \$32,000 for shares issued to our non-employee directors.

At September 30, 2015, the total unrecognized compensation cost related to non-vested equity based compensation arrangements was \$1,036,000 and the related weighted average period over which it is expected to be recognized is 2.12 years.

## 7. INVENTORIES AND WARRANTIES:

### Inventories:

(In thousands)	September 30, 2015	December 31, 2014
Raw materials and purchased parts	\$6,389	\$6,581
Work in process	577	503
Finished goods	5,466	4,573
Total inventories	\$12,432	\$11,657

### Warranty costs:

We provide for the estimated cost of product warranties, which extend for periods from one to three years after purchase, at the time revenue is recognized. While we engage in extensive product quality programs and processes, including actively monitoring and evaluating the quality of component suppliers, warranty obligations are affected by product failure rates, material usage and service delivery costs incurred in correcting a product failure. Should actual product failure rates, material usage or service delivery costs differ from our estimates, revisions to the estimated warranty liability would be required and could be material. Our warranty liability is included as a component of accrued expenses. At the end of each reporting period we revise our estimated warranty liability based on these factors.

A reconciliation of the changes in our estimated warranty liability is as follows:

(In thousands)	Nine Months Ended September 30,	
	2015	2014
Balance at beginning of period	\$839	\$513
Accrual for warranties	376	896
Assumed in acquisition	—	5
Warranty revision	10	2
Settlements made during the period	(547	) (640
Balance at end of period	\$678	\$776

Deferred warranty revenue:

The current portion of our deferred warranty revenue is included as a component of advance customer payments. A reconciliation of the changes in our deferred warranty revenue is as follows:

	Nine Months Ended September 30,	
(In thousands)	2015	2014
Balance at beginning of period	\$475	\$444
Revenue deferrals	277	369
Assumed in acquisition	—	89
Amortization of deferred revenue	(518	) (338
Total deferred warranty revenue	234	564
Current portion of deferred warranty revenue	(227	) (519
Long-term deferred warranty revenue	\$7	\$45

8. INTANGIBLE ASSETS:

Intangible assets consist of the following:

	September 30, 2015			December 31, 2014		
(In thousands)	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Patents	\$2,698	\$(2,420	) \$278	\$2,625	\$(2,338	) \$287
Software	206	(45	) 161	206	(23	) 183
Marketing assets and customer relationships	101	(18	) 83	101	(10	) 91
Non-compete agreements	101	(39	) 62	101	(20	) 81
	\$3,106	\$(2,522	) \$584	\$3,033	\$(2,391	) \$642

Amortization expense for the three and nine month periods ended September 30, 2015 and 2014 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2015	2014	2015	2014
Patents	\$27	\$30	\$83	\$84
Software	7	7	22	16
Marketing assets and customer relationships	4	2	9	6
Non-compete agreements	6	7	19	14
	\$44	\$46	\$133	\$120

Amortization of patents has been classified as research and development expense in the accompanying statements of operations. Estimated aggregate amortization expense based on current intangibles for the next five years is expected to be as follows: \$44,000 for the remainder of 2015, \$162,000 in 2016, \$135,000 in 2017, \$80,000 in 2018, \$62,000 in 2019 and \$62,000 in 2020.

Intangible and other long lived assets are reviewed for impairment when events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. An impairment loss would be recognized when future undiscounted cash flows expected to result from use of the asset and eventual disposition are less than the carrying amount.

9. SIGNIFICANT CUSTOMERS:

Export sales were 73% of revenue in the three months ended September 30, 2015 and 73% of revenue in the nine months ended September 30, 2015. Export sales were 70% of revenue in the three months ended September 30, 2014 and 74% of revenue in the nine months ended September 30, 2014. Virtually all of our export sales are negotiated, invoiced and paid in U.S. dollars. Export sales by geographic area are summarized as follows:

(In thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Americas	\$619	\$424	\$888	\$1,118
Europe	3,053	3,172	8,644	8,328
Asia	3,559	4,440	11,912	15,841
Other	41	165	282	538
Total export sales	\$7,272	\$8,201	\$21,726	\$25,825

Our LaserAlign sensor family has historically accounted for a significant portion of our revenues and profitability. Our revenue, results of operations and cash flows would be negatively impacted if our LaserAlign customers are unsuccessful selling the products into which our sensors are incorporated, design their products to function without our sensors, purchase sensors from other suppliers, or otherwise terminate their relationships with us.

We are dependent upon two customers, Juki and Assembleon, for a significant portion of our total revenue. For the nine months ended September 30, 2015, sales to Juki accounted for 13% of our total revenue and sales to Assembleon accounted for 12% of our total revenue.

10. NET LOSS PER SHARE:

Net loss per basic and diluted share is computed by dividing net loss by the weighted average number of common shares outstanding during the period. Common equivalent shares, consisting of common shares to be issued upon exercise of stock options, restricted stock units and from participation in our employee stock purchase plan, as calculated using the treasury stock method, are excluded from the calculations of net loss per diluted share due to their anti-dilutive effect. The components of net loss per basic and diluted share are as follows:

(In thousands except per share amounts)	Net Loss	Weighted Average Shares Outstanding	Per Share Amount
Three Months Ended September 30, 2015			
Basic	\$(514)	) 6,717	\$(0.08)
Dilutive effect of common equivalent shares	—	—	—
Dilutive	\$(514)	) 6,717	\$(0.08)
Three Months Ended September 30, 2014			
Basic	\$(448)	) 6,609	\$(0.07)
Dilutive effect of common equivalent shares	—	—	—
Dilutive	\$(448)	) 6,609	\$(0.07)
Nine Months Ended September 30, 2015:			
Basic	\$(2,056)	) 6,694	\$(0.31)

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Dilutive effect of common equivalent shares	—	—	—
Dilutive	\$(2,056	) 6,694	\$(0.31 )

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(In thousands except per share amounts)	Net Loss	Weighted Average Shares Outstanding	Per Share Amount
Nine Months Ended September 30, 2014:			
Basic	\$(1,572 )	6,555	\$(0.24 )
Dilutive effect of common equivalent shares	—	—	—
Dilutive	\$(1,572 )	6,555	\$(0.24 )

The calculation of diluted net loss per common share excludes 553,000 and 636,000 potentially dilutive shares for the three months ended September 30, 2015 and 2014, and 562,000 and 694,000 potentially dilutive shares for the nine months ended September 30, 2015 and 2014 because their effect would be anti-dilutive.

#### 11. COMPREHENSIVE INCOME (LOSS):

Reclassification adjustments are made to avoid double counting for items included in comprehensive income that are also recorded as part of net loss. Reclassifications to earnings related to cash flow hedging instruments are discussed in Note 4. There is no tax effect related to any of the items of other comprehensive income in the three and nine months ended September 30, 2015 and 2014. We have recorded a valuation allowance against all of our United States and Singapore based deferred tax assets. Accordingly, we do not expect to record a tax provision for items of other comprehensive income until such time as the valuation allowance is substantially reduced. The effect of the reclassifications from comprehensive income to earnings by line item is as follows:

Details about Components of Accumulated Other Comprehensive Loss	Amount Reclassified from Accumulated Other Comprehensive Loss		Affected Line Item in the Statements of Operations		
	Three Months Ended September 30, 2015	2014	2015	2014	
(In thousands) Unrealized gains (losses) on foreign exchange forward contracts	\$(102 )	\$3	\$(289 )	\$(15 )	Cost of revenues
	(32 )	—	(93 )	(7 )	Research and development expenses
	(27 )	—	(84 )	(7 )	Selling, general and administrative expenses
	(161 )	3	(466 )	(29 )	Total before tax
	—	—	—	—	Income tax provision (benefit)
	\$(161 )	\$3	\$(466 )	\$(29 )	Net of tax

At September 30, 2015 and September 30, 2014, components of accumulated other comprehensive loss is as follows:

(In thousands)	Foreign Currency Translation Adjustments	Available- for-Sale Securities	Foreign Exchange Forward Contracts	Accumulated Other Comprehensive Loss
Balances at December 31, 2014	\$ (920 )	\$61	\$ (412 )	\$ (1,271 )
Other comprehensive loss before reclassifications	(747 )	(14 )	(322 )	(1,083 )
Amounts reclassified from accumulated other comprehensive loss	—	—	466	466
Total change for the period	(747 )	(14 )	144	(617 )
Balances at September 30, 2015	\$ (1,667 )	\$47	\$ (268 )	\$ (1,888 )



(In thousands)	Foreign Currency Translation Adjustments	Available- for-Sale Securities	Foreign Exchange Forward Contracts	Accumulated Other Comprehensive Loss
Balances at December 31, 2013	\$ (456 )	\$ 32	\$ (116 )	\$ (540 )
Other comprehensive income (loss) before reclassifications	(64 )	36	(121 )	(149 )
Amounts reclassified from accumulated other comprehensive loss	—	—	29	29
Total change for the period	(64 )	36	(92 )	(120 )
Balances at September 30, 2014	\$ (520 )	\$ 68	\$ (208 )	\$ (660 )

## 12. INCOME TAXES:

We recorded income tax expense of \$61,000 in the nine months ended September 30, 2015, compared to \$63,000 in the nine months ended September 30, 2014. At September 30, 2015, we continue to have a valuation allowance recorded against all of our United States and Singapore based deferred tax assets. The valuation allowances may be reversed once our operations and outlook materially strengthen. Income tax expense in the three and nine months ended September 30, 2015 and the three and nine months ended September 30, 2014, reflects minimal state income tax expense and foreign income tax expense associated with our subsidiaries in the United Kingdom and China.

We currently have significant deferred tax assets as a result of temporary differences between taxable income on our tax returns and U.S. GAAP income, research and development tax credit carry forwards and federal, state and foreign net operating loss carry forwards. A deferred tax asset generally represents future tax benefits to be received when temporary differences previously reported in our consolidated financial statements become deductible for income tax purposes, or when net operating loss carry forwards are applied against future taxable income, or when tax credit carry forwards are utilized on our tax returns. We assess the realizability of our deferred tax assets and the need for a valuation allowance based on the guidance provided in current financial accounting standards.

Significant judgment is required in determining the realizability of our deferred tax assets. The assessment of whether valuation allowances are required considers, among other matters, the nature, frequency and severity of any current and cumulative losses, forecasts of future profitability, the duration of statutory carry forward periods, our experience with loss carry forwards not expiring unused and tax planning alternatives.

We have concluded that a valuation allowance is needed for all of our United States and Singapore based deferred tax assets due to our recurring losses and our near term financial outlook. In analyzing the need for a valuation allowance, we first considered our history of cumulative operating results for income tax purposes over the past three years in each of the tax jurisdictions where we operate, our financial performance in recent quarters, statutory carry forward periods and tax planning alternatives. Finally, we considered both our near and long-term financial outlook and timing regarding when we might return to profitability. After considering all available evidence both positive and negative, we concluded that a valuation allowance is needed for all of our U.S. and Singapore based deferred tax assets as of September 30, 2015 and December 31, 2014.

Deferred tax assets at September 30, 2015 include net operating loss carry forwards incurred in the UK by CyberOptics Ltd., which was acquired in 1999. A valuation allowance has not been recorded against these deferred tax assets. The utilization of these net operating loss carry forwards is dependent on CyberOptics Ltd.'s ability to generate sufficient UK taxable income during the carry forward period.

Our 2012 income tax return for Singapore is currently being audited by the Inland Revenue Authority of Singapore. We do not presently anticipate that the outcome of this audit will have any impact on our financial position or results of operations.

In October 2015 we repatriated approximately \$3.6 million of the undistributed earnings of our international subsidiaries. The repatriation is not expected to have a significant impact on our financial position or results of operations.

## 13. SHARE REPURCHASE:

In August of 2015, our Board of Directors authorized a \$2.0 million share repurchase program. The common stock may be acquired from time to time in open market transactions, block purchases and other transactions complying with the Securities and Exchange Commission's Rule 10b-18. We adopted a 10b5-1 trading plan to implement the repurchase program. We did not repurchase any of our common stock in the three months ended September 30, 2015.

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14. CONTINGENCIES:

We are periodically a defendant in miscellaneous claims and disputes in the ordinary course of business. While the outcome of these matters cannot be predicted with certainty, management presently believes the disposition of these matters will not have a material effect on our financial position, results of operations or cash flows.

In the normal course of business to facilitate sales of our products and services, we at times indemnify other parties, including customers, with respect to certain matters. In these instances, we have agreed to hold the other parties harmless against losses arising out of intellectual property infringement or other types of claims. These agreements may limit the time within which an indemnification claim can be made, and almost always limit the amount of the claim. It is not possible to determine the maximum potential amount under these indemnification agreements due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each particular agreement. Historically, payments made, if any, under these agreements have not had a material impact on our operating results, financial position or cash flows.

15. RECENT ACCOUNTING DEVELOPMENTS:

In May 2014, the Financial Accounting Standards Board (FASB) issued guidance on the recognition of revenue from contracts with customers (Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers). Revenue recognition will depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance also requires disclosures regarding the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The guidance permits two methods of adoption: retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application. The FASB recently delayed the effective date of the standard by one year to January 1, 2018, with early adoption permitted as of the original effective date of January 1, 2017. We are currently evaluating the method of adoption and the impact of the new guidance on our consolidated financial statements.

In July 2015, the FASB issued guidance on simplifying the measurement of inventory (Accounting Standards Update No. 2015-11, Simplifying the Measurement of Inventory). The guidance requires an entity to measure inventory at the lower of cost or net realizable value, which consists of estimated selling prices in the ordinary course of business, less reasonably predictable cost of completion, disposal, and transportation. The new guidance eliminates unnecessary complexity that exists under current "lower of cost or market" guidance. For public entities, the updated guidance is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The guidance is to be applied prospectively as of the beginning of an interim or annual reporting period, with early adoption permitted. We do not believe the implementation of this standard will have a material impact on our consolidated financial statements.

ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS  
CRITICAL ACCOUNTING POLICIES AND ESTIMATES:

The preparation of the financial information contained in this Form 10-Q requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate these estimates, including those related to revenue recognition, bad debts, warranty obligations, inventory valuation, intangible assets and income taxes. We base these estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Our actual results may differ from these estimates under different assumptions or conditions. These critical accounting policies are discussed in more detail in the Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Form 10-K for the year ended December 31, 2014.

FORWARD LOOKING STATEMENTS:

The following management's discussion and analysis contains a number of estimates and predictions that are forward looking rather than based on historical fact. Among other matters, we discuss (i) our level of anticipated revenues, gross margins, and expenses; (ii) the timing of initial revenue and margin improvements from new products that we have under development, that have been recently introduced or we anticipate introducing in the future; (iii) our beliefs regarding trends in the general economy and its impact on markets for our products and (iv) the impact of currency fluctuations on our operations. Although we have made these statements based on our experience and best estimate of future events, there may be events or factors that we have not anticipated, and the accuracy of our statements and estimates are subject to a number of risks, including those identified in our Annual Report on Form 10-K for the year ended December 31, 2014.

RESULTS OF OPERATIONS

General

Our products are sold primarily into the electronics assembly, DRAM and flash memory, and semiconductor fabrication capital equipment markets. We sell products in these markets both to original equipment manufacturers (OEMs) of production equipment and to end-user customers that assemble circuit boards and semiconductor wafers and devices. On March 14, 2014, we completed our acquisition of Laser Design, Inc. (LDI) for aggregate consideration of approximately \$3.1 million in cash plus the assumption of certain current liabilities. LDI provides 3D scanning solutions and services to the global 3D scanner and services metrology market and enables us to enter the growing market for general purpose 3D metrology.

Our recent and planned product introductions are designed to strengthen our competitive position in our current markets and expand into adjacent markets. We believe 3D inspection represents a high-growth segment of both the electronic assembly market and the semiconductor market. For this reason we are working to strategically reposition ourselves as a developer, manufacturer and global leader of high-precision 3D sensors. A key element in our strategic re-positioning is the development of new high precision 3D sensors based on our proprietary Multi-Reflection Suppression (MRS) technology. MRS technology inhibits reflections that can result in measurement inaccuracies, which is particularly critical for inspecting shiny objects.

We believe that MRS is a break-through technology for optical inspection, with the potential to facilitate expansion of our markets in the future. For our existing markets in surface mount technology (SMT), semiconductor inspection and 3D scanning solutions, we are introducing new products based on MRS technology that we believe present a significant opportunity for growth.

We recently entered into a mutually exclusive agreement to supply KLA-Tencor with high-precision 3D sensor subsystems for its back end semiconductor packaging inspection systems. We also have established a supply

agreement with another OEM customer for 3D sensor subsystems and have sold initial units for testing and demonstration purposes. The sensor subsystems are based on the new MRS technology that we have been developing for the past several years. We intend to expand sales of MRS technology into both the SMT market and adjacent targeted markets that require high precision optical 3D inspection, including through new OEM opportunities.

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Our 3D MRS technology has also been deployed in our new 3D automated optical inspection (AOI) system, the SQ3000, which is designed to expand our presence in markets requiring high precision inspection. In these markets identifying defects has become highly challenging and critical due to smaller electronics packaging and increasing component density on circuit boards. We believe the combination of our MRS technology and sophisticated 3D fusing algorithms will allow us to offer microscopic image quality at production speeds. We recognized our initial revenues from sales of the SQ3000 in the second quarter of 2015, and ended the third quarter with an order backlog of more than \$2.0 million. We are optimistic about the future sales potential of the SQ3000 given the competitive advantages offered by our MRS technology.

Our acquisition of LDI represents another aspect of our 3D strategy. We are incorporating our MRS technology into a new 3D scanning system, CyberGage 360, that we believe will serve a wide range of inspection applications in the general purpose 3D metrology market. Although we have achieved our measurement accuracy targets for CyberGage 360 in a lab environment, further improvement in consistency is required before customer beta testing can be launched. Interest in this product remains strong, and we presently anticipate initial CyberGage 360 sales in the first half of 2016. We believe the unique performance characteristics of MRS that inhibit reflections and enable very accurate measurements at fast speeds, will give CyberGage 360 a competitive advantage in the marketplace for 3D scanning systems relative to speed, accuracy and ease of use.

We also have committed funds to development of new products for inspecting memory modules. To date, we have received orders worth approximately \$3.9 million from one of the world's top four memory manufacturers for our newly-developed MX600 system that will inspect memory modules at the end of the production line after singulation. We recognized our first revenue from the sale of the MX600 system in the third quarter of 2015, and have a total backlog for this product at September 30, 2015 of approximately \$3.4 million.

Due to continued weakness in China's manufacturing sector, our OEM customers are currently forecasting a decline in fourth quarter orders for electronic assembly sensors. However, fourth quarter sales are expected to benefit from our \$10.5 million backlog at September 30, 2015, of which approximately \$5.4 million represents orders for new SQ3000 3D AOI and MX600 system products. We believe customer acceptance will be received in the fourth quarter for a substantial portion of our SQ3000 and MX600 backlog. Assuming customer acceptance is received, revenue from these products would have a favorable impact on our results for the quarter. In addition, we are anticipating a solid rebound in fourth quarter semiconductor sales, following weak third quarter sales reflecting a general slowdown in the semiconductor capital equipment market. Longer term, the anticipated sales growth of our MRS-enabled products and promising outlook for the WaferSense/ReticleSense product lines make us very optimistic about CyberOptics future. We believe that we have the resources required to attain our growth objectives, given our available cash and marketable securities balances totaling \$16.7 million at September 30, 2015.

#### Revenues

Our revenues decreased by 15% to \$9.9 million in the three months ended September 30, 2015, from \$11.7 million in the three months ended September 30, 2014, and decreased by 14% to \$29.7 million in the nine months ended September 30, 2015, from \$34.8 million in the nine months ended September 30, 2014. The following table sets forth revenues by product line for the three and nine month periods ended September 30, 2015 and 2014:

(In thousands)	Three Months Ended September		Nine Months Ended September	
	30, 2015	2014	30, 2015	2014
SMT and High Precision 3D OEM Sensors	\$3,784	\$4,569	\$10,342	\$11,553
Semiconductor Sensors	1,537	1,843	5,521	5,440
SMT Inspection Systems	2,965	3,941	9,276	14,282
3D Scanning Solutions and Services	1,651	1,304	4,597	3,480
Total	\$9,937	\$11,657	\$29,736	\$34,755





Revenue from sales of SMT and high precision 3D OEM sensors decreased by \$785,000 or 17% to \$3.8 million in the three months ended September 30, 2015, from \$4.6 million in the three months ended September 30, 2014, and decreased by \$1.2 million or 10% to \$10.3 million in the nine months ended September 30, 2015, from \$11.6 million in the nine months ended September 30, 2014. Revenue decreases resulted from soft demand for traditional electronic assembly sensors from OEM customers selling into the China market, where market conditions have been challenging. During the three and nine months ended September 30, 2015, we sold additional 3D MRS sensors to KLA-Tencor under our long-term supply agreement. Sales to KLA are expected to increase in 2016 as our sensors are being incorporated into a growing portion of their back-end semiconductor packaging inspections systems. As previously reported, we have established a supply agreement with a new OEM customer for MRS 3D sensor subsystems and have sold initial units for testing and demonstration purposes. Our customer expects to introduce its MRS-equipped inspection system in the fourth quarter, making us believe this new relationship has solid potential. Revenue from sales of semiconductor sensors, principally our WaferSense® and ReticleSense® product lines, decreased by \$306,000 or 17% to \$1.5 million in the three months ended September 30, 2015, from \$1.8 million in the three months ended September 30, 2014, and increased by \$81,000 or 1% to \$5.5 million in the nine months ended September 30, 2015, from \$5.4 million in the nine months ended September 30, 2014. Sales of semiconductor sensors in the three months ended September 30, 2015 were negatively impacted by a general slowdown in the semiconductor capital equipment market. Semiconductor sensor sales were also impacted by production delays for our new Auto Multi Sensor (AMS) line, the first wireless sensors to combine leveling, vibration and humidity measurements. We anticipate that the benefits from growing market awareness and new product introductions will lead to additional WaferSense® and ReticleSense® sales in future periods.

Revenue from sales of SMT inspection systems decreased by \$1.0 million or 25% to \$3.0 million in the three months ended September 30, 2015, from \$3.9 million in the three months ended September 30, 2014, and decreased by \$5.0 million or 35% to \$9.3 million in the nine months ended September 30, 2015, from \$14.3 million in the nine months ended September 30, 2014. Revenue decreases resulted from lower sales of older more established solder paste inspection (SPI) and 2D AOI systems, offset in part by initial sales of our newly developed MX600 system, that inspects memory modules at the end of the production line, and additional sales of our new 3D AOI system, the SQ3000.

Our backlog of MX600 and SQ3000 system products totaled approximately \$5.4 million at September 30, 2015. The timing of revenue recognition for this backlog is dependent upon receipt of customer acceptance. We believe a substantial portion of this backlog will be recognized as revenue in the fourth quarter of 2015.

We believe the markets for 2D AOI and SPI systems have become highly competitive and a growing number of companies are transitioning from 2D AOI to 3D AOI to meet the increasingly demanding inspection requirements of the electronics and industrial markets. We believe sales of our new 3D MRS enabled AOI products will represent an increasing percentage of our AOI and SPI sales in the future. We believe our differentiated 3D MRS platform technology will provide us with an opportunity to capture meaningful market share in the 3D AOI market, due to the competitive advantages of our MRS technology.

Revenue from sales of 3D scanning solutions and services increased by \$347,000 or 27% to \$1.7 million in the three months ended September 30, 2015, from \$1.3 million in the three months ended September 30, 2014, reflecting a return to more normal levels from unusually low sales in the prior year. Revenue from sales of 3D scanning solutions and services increased significantly in the nine months ended September 30, 2015, when compared to the nine months ended September 30, 2014, due to the timing of our acquisition of LDI, which closed on March 14, 2014. Future revenue growth in 3D scanning solutions and services will be driven in part by our new MRS-equipped CyberGage 360 scanning system. We presently anticipate initial sales of our 3D-equipped CyberGage 360 scanning system in the first half of 2016.

Export revenue totaled \$7.3 million or 73% of total revenue in the three months ended September 30, 2015, compared to \$8.2 million or 70% of total revenue in the three months ended September 30, 2014. Export revenue totaled \$21.7 million or 73% of total revenue in the nine months ended September 30, 2015, compared to \$25.8 million or 74% of total revenue in the nine months ended September 30, 2014. The slight decrease in export revenue as a percentage of total revenue in both periods was due to the decline in sales of SMT systems, which tend to have a higher proportion

of sales outside the United States compared to our other products.

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### Cost of Revenues and Gross Margin

Cost of revenues decreased by \$663,000 or 10% to \$5.7 million in the three months ended September 30, 2015, from \$6.4 million in the three months ended September 30, 2014, and decreased by \$2.6 million or 14% to \$16.4 million in the nine months ended September 30, 2015, from \$19.0 million in the nine months ended September 30, 2014. The decrease in cost of revenues was due to the 15% and 14% decrease in revenues in the three and nine months ended September 30, 2015, when compared to the corresponding period of the preceding year. Items included in cost of revenues that fluctuate with the level of sales include raw materials, direct labor and factory overhead costs. Total gross margin as a percentage of revenues was 43% in the three months ended September 30, 2015, compared to 45% in the three months ended September 30, 2014. The decrease in gross margin percentage was attributable to sales price erosion for our 2D AOI and SPI systems, reflecting competitive market conditions, and a slight change in product mix. Total gross margin as a percentage of revenues was 45% in both the nine months ended September 30, 2015 and the nine months ended September 30, 2014.

Our markets are highly price competitive, particularly the electronic assembly market, resulting in continual pressure on our gross margins. We compensate for pricing pressure by introducing new products with more features and improved performance and through manufacturing cost reduction programs. Many products that we have recently introduced or are about to introduce, including our SQ3000 3D AOI system, CyberGage 360 scanning system, MRS sensor subsystems and WaferSense sensors, have more favorable margins than many of our existing products.

### Operating Expenses

Operating expenses decreased by \$850,000 or 15% to \$5.0 million in the three months ended September 30, 2015, from \$5.8 million in the three months ended September 30, 2014, and decreased by \$1.6 million or 10% to \$15.6 million in the nine months ended September 30, 2015, from \$17.2 million in the nine months ended September 30, 2014.

Research and development expenses were \$2.0 million or 20% of revenue in the three months ended September 30, 2015, compared to \$2.3 million or 19% of revenue in the three months ended September 30, 2014, and \$5.9 million or 20% of revenue in the nine months ended September 30, 2015, compared to \$6.7 million or 19% of revenue in the nine months ended September 30, 2014. Research and development expenses were lower in the three and nine months ended September 30, 2015 due to substantial completion of several critical development programs that required significant investment in 2014, including our new SQ3000 3D AOI system. Current research and development expenditures are focused on continued development of our MRS technology and related products, including 3D sensor subsystems, the CyberGage 360 scanning system and WaferSense® and ReticleSense® product lines.

Selling, general and administrative expenses were \$3.0 million or 30% of revenue in the three months ended September 30, 2015, compared to \$3.5 million or 30% of revenue in the three months ended September 30, 2014, and \$9.7 million or 32% of revenue in the nine months ended September 30, 2015, compared to \$10.5 million or 30% of revenue in the nine months ended September 30, 2014. The expense reductions in the three and nine months ended September 30, 2015 were due to lower professional fees, lower incentive compensation costs due to soft financial results, and cost savings from selective reductions in SMT system sales and marketing personnel that were implemented in the last six months of 2014. For the nine months ended September 30, 2015, these reductions were offset in part by the impact of the LDI acquisition, which accounted for \$600,000 of additional expense, due to the timing of the acquisition last year, which closed on March 14, 2014.

### Interest Income and Other

Interest income and other includes interest earned on investments and gains and losses associated with foreign currency transactions, including intercompany financing transactions associated with our subsidiaries in the United Kingdom and Singapore. Because we maintain our investments in instruments designed to avoid risk of loss of principal, in the current interest rate environment, we have generated very little interest income. We recognized gains from foreign currency transactions, primarily intercompany financing transactions, of \$229,000 in the three months ended September 30, 2015, compared to gains of \$76,000 in the three months ended September 30, 2014. We recognized gains from foreign currency transactions of \$208,000 in the nine months ended September 30, 2015, compared to gains of \$7,000 in the nine months ended September 30, 2014.



#### Income Taxes

We recorded income tax expense of \$21,000 in the three months ended September 30, 2015, compared to \$9,000 in the three months ended September 30, 2014, and \$61,000 in the nine months ended September 30, 2015, compared to \$63,000 in the nine months ended September 30, 2014. At September 30, 2015, we continue to have a valuation allowance recorded against all of our United States and Singapore based net deferred tax assets. The valuation allowances may be reversed once our operations and outlook materially strengthen. Income tax expense in the three and nine months ended September 30, 2015 and September 30, 2014, reflects minimal state income tax expense and foreign income tax expense associated with our subsidiaries in the United Kingdom and China.

Our 2012 income tax return for Singapore is currently being audited by the Inland Revenue Authority of Singapore. We do not presently anticipate that the outcome of this audit will have any impact on our financial position or results of operations.

#### Backlog

Backlog totaled \$10.5 million at September 30, 2015 and \$5.9 million at December 31, 2014. Our products are typically shipped two weeks to two months after receipt of an order. Sales of some SMT inspection system products may require customer acceptance due to performance or other acceptance criteria included in the terms of sale. For these SMT product sales, revenue is recognized at the time of customer acceptance. Our backlog at any time may vary significantly based on the timing of orders from OEM customers. Accordingly, backlog may not be an accurate indicator of performance in the future.

#### Liquidity and Capital Resources

Our cash and cash equivalents decreased by \$1.9 million in the nine months ended September 30, 2015, principally resulting from cash used by operating activities of \$3.6 million, purchases of fixed asset and patent costs totaling \$474,000, offset in part by \$1.8 million of proceeds from sales and maturities of marketable securities, net of purchases of marketable securities, and proceeds from the exercise of stock options and share purchases under our employee stock purchase plan totaling \$472,000. Our cash and cash equivalents fluctuate in part because of sales and maturities of marketable securities, and investment of cash balances in marketable securities, or from other sources of cash. Accordingly, we believe the combined balances of cash and marketable securities provide a more reliable indication of our available liquidity. Combined balances of cash and marketable securities decreased by \$3.7 million to \$16.7 million as of September 30, 2015 from \$20.3 million as of December 31, 2014.

Operating activities used \$3.6 million of cash in the nine months ended September 30, 2015. Cash used by operations included our net loss of \$2.1 million, which included non-cash expenses totaling \$1.5 million for depreciation and amortization, provision for doubtful accounts, deferred income taxes, non-cash gains from foreign currency transactions and stock compensation expenses. Changes in operating assets and liabilities using cash included an increase in accounts receivable of \$351,000, an increase in inventories of \$1.6 million, an increase in other assets of \$513,000, and a decrease in accrued expenses of \$844,000. Changes in operating assets and liabilities providing cash included an increase in accounts payable of \$147,000 and an increase in advance customer payments of \$98,000. Accounts receivable increased because it took us longer to collect our sales in the third quarter of 2015, when compared to the fourth quarter of 2014. Inventories were driven higher due to initial stocking requirements for new products, including MRS sensors, SQ3000 3D AOI systems and MX600 memory inspection systems. Other assets increased because of deposits paid to a key supplier in connection with our backlog of MX600 memory inspection systems. Accrued expenses decreased due to payment of calendar year 2014 incentive compensation accruals and LDI stay bonuses in the nine months ended September 30, 2015, and lower warranty accruals resulting from reduced sales levels. Accounts payable increased due to the timing of quarter end inventory purchases and payments to suppliers. Advance customer payments increased because of an initial cash deposit received against an order for SQ3000 3D AOI systems.

Investing activities provided \$1.3 million of cash in the nine months ended September 30, 2015. Changes in the level of investment in marketable securities, resulting from the purchases, sales and maturities of those securities provided \$1.8 million of cash in the nine months ended September 30, 2015. We used \$474,000 of cash in the nine months ended September 30, 2015 for the purchase of fixed assets and capitalized patent costs.

Financing activities provided \$472,000 of cash in the nine months ended September 30, 2015 from the exercise of employee stock options and share purchases under our employee stock purchase plan.

At September 30, 2015 we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of establishing off-balance sheet arrangements or other contractually narrow or limited purposes.

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Except for obligations under facility leases and purchase contracts, we had no material commitments for expenditures as of September 30, 2015. Purchase commitments for inventory can vary based on the volume of revenue and resulting inventory requirements. We continually evaluate investment opportunities that come to our attention and could make a significant commitment in the future.

Our Board of Directors has authorized a \$2.0 million share repurchase program. The common stock may be acquired from time to time in open market transactions, block purchases and other transactions complying with the Securities and Exchange Commission's Rule 10b-18. We adopted a 10b5-1 trading plan to implement the repurchase program. As of September 30, 2015, no shares have been repurchased under this authorization.

Our cash, cash equivalents and marketable securities totaled \$16.7 million at September 30, 2015. We believe that on-hand cash, cash equivalents and marketable securities, coupled with anticipated future cash flow from operations, will be adequate to fund our cash flow needs for the foreseeable future, including contractual obligations discussed above.

#### Inflation and Foreign Currency Transactions

Changes in our revenues have resulted primarily because of changes in the level of unit shipments due to competitive factors and the relative strength or weakness of the worldwide electronics and semiconductor fabrication capital equipment markets. We believe that inflation has not had a significant effect on our operations.

Most of our international export sales are negotiated, invoiced and paid in U.S. dollars. We manufacture our SMT inspection system products in Singapore and a portion of our raw material purchases are denominated in Singapore dollars. We also have R&D and sales personnel located in Singapore and sales offices located in other parts of the world. Although currency fluctuations do not significantly affect our revenue, they can impact our costs and influence the price competitiveness of our products and the willingness of existing and potential customers to purchase units.

We enter into foreign exchange forward contracts to hedge against the effect of exchange rate fluctuations on cash flows denominated in foreign currencies associated with our subsidiary in Singapore. These transactions are designated as cash flow hedges. The effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income (loss) and reclassified into earnings in the same period during which the hedged transaction affects earnings. The maximum length of time over which we hedge our exposure to the variability in future cash flows is 12 months and, accordingly, at September 30, 2015, all of our open foreign exchange forward contracts had maturities of one year or less. The dollar equivalent gross notional amount of our foreign exchange forward contracts designated as cash flow hedges at September 30, 2015 was approximately \$3.0 million.

At September 30, 2015, our open foreign exchange forward contracts were in an unrealized loss position equal to \$184,000 on a pre-tax basis due to a strengthening of the U.S. dollar in relation to the Singapore dollar during the time from when we first entered into these contracts through September 30, 2015. If the exchange rate between the U.S. dollar and the Singapore dollar were to remain unchanged over the next twelve months, we would realize this pre-tax loss through our statement of operations. If the U.S. dollar were to further strengthen, the unrealized loss on our open foreign exchange forward contracts would increase. However, if the U.S. dollar strengthens, our costs, when converted from Singapore dollars to U.S. dollars, would decline, and because we do not fully hedge all of our future anticipated cash flows that are denominated in Singapore dollars, the decline in costs would normally exceed the increased loss from hedging. Conversely, if the U.S. dollar were to weaken in future periods in relation to the Singapore dollar, the loss on our open foreign exchange forward contracts would be reduced, but our costs would increase and the increased costs in U.S. dollar terms would normally exceed the reduction in the loss from hedging. The ultimate impact of any fluctuation in the relationship between the U.S. dollar and Singapore dollar is dependent on the level of Singapore denominated cash flows in future periods.



**ITEM 3 – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Not applicable.

**ITEM 4 – CONTROLS AND PROCEDURES**

a. Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the “Exchange Act”). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective in ensuring that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in applicable rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, in a manner that allows timely decisions regarding required disclosure.

b. There was no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that occurred during the period covered by this quarterly report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION**

**ITEM 1A – RISK FACTORS**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2014, which could materially affect our business, financial condition or future results.

ITEM 6 – EXHIBITS

- 31.1: Certification of Chief Executive Officer pursuant to Rule 15d-14(a)(17 CFR 240.15d-14(a)) and Section 302 of the Sarbanes Oxley Act of 2002
- 31.2: Certification of Chief Financial Officer pursuant to Rule 15d-14(a)(17 CFR 240.15d-14(a)) and Section 302 of the Sarbanes Oxley Act of 2002
- 32: Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes Oxley Act of 2002
- 101: Financial statements formatted in Extensible Business Reporting Language: (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statement of Operations, (iii) the Condensed Consolidated Statements of Comprehensive Loss, (iv) the Condensed Consolidated Statements of Cash Flows and (v) the Notes to the Interim Condensed Consolidated Financial Statements.

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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.

CYBEROPTICS CORPORATION

/s/ Subodh Kulkarni

By Subodh Kulkarni, President and Chief Executive Officer

(Principal Executive Officer and Duly Authorized Officer)

/s/ Jeffrey A. Bertelsen

By Jeffrey A. Bertelsen, Vice President, Chief Financial Officer and Chief Operating Officer

(Principal Accounting Officer and Duly Authorized Officer)

Dated: November 6, 2015