COGNEX CORP

FORM 10-K
(Annual Report)

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Symbol	CGNX
SIC Code	3823 - Industrial Instruments for Measurement, Display, and Control of Process Variables; and Related Products
Industry	Scientific & Technical Instr.
Sector	Technology
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

☑ **Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
for the fiscal year ended December 31, 2005

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 0-17869

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

Massachusetts	**04-2713778**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

One Vision Drive
Natick, Massachusetts 01760-2059
(508) 650-3000
(Address, including zip code, and telephone number, including area code, of principal executive offices)

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

Securities registered pursuant to Section 12(g) of the Act: Common Stock, par value $.002 per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes ☑ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes ☐ No ☑

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

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

Large accelerated filer ☑ Accelerated filer ☐ Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☑

Aggregate market value of voting stock held by non-affiliates of the registrant
as of July 3, 2005: $1,106,581,000

$.002 par value common stock outstanding as of February 26, 2006: 46,806,184 shares

Documents incorporated by reference:

The registrant intends to file a Definitive Proxy Statement pursuant to Regulation 14A within 120 days of the end of the fiscal year ended December 31, 2005. Portions of such Proxy Statement are incorporated by reference in Part III of this report. Portions of the registrant's Annual Report to Shareholders for the year ended December 31, 2005 are incorporated by reference in Part I and Part II of this report.

COGNEX CORPORATION ANNUAL REPORT ON
FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 2005

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PART I

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the Federal Securities Laws. Readers can identify these forward-looking statements by the Company's use of the words "expects," "anticipates," "estimates," "believes," "projects," "intends," "plans," "will," "may," "shall," and similar words and other statements of a similar sense. The Company's future results may differ materially from current results and from those projected in the forward-looking statements as a result of known and unknown risks and uncertainties. Readers should pay particular attention to considerations described in the section captioned "Risk Factors," appearing in Part IA — Item I of this Annual Report on Form 10-K.

ITEM 1. BUSINESS

Corporate Profile

Cognex ® Corporation ("Cognex" or the "Company," each of which includes, unless the context indicates otherwise, Cognex Corporation and its subsidiaries) was incorporated in Massachusetts in 1981. Its corporate headquarters are located at One Vision Drive, Natick, Massachusetts 01760 and its telephone number is (508) 650-3000.

The Company designs, develops, manufactures, and markets machine vision systems, or computers that can "see," which are used to automate a wide range of manufacturing processes where vision is required. Machine vision is important for applications in which human vision is inadequate to meet requirements for feature size, accuracy, or speed, or in instances where substantial cost savings are obtained through the reduction of direct labor or improved product quality. Today, many types of manufacturing equipment require machine vision because of the increasing demands for speed and accuracy in manufacturing processes, as well as the decreasing feature size of items being manufactured.

The Company has two operating divisions: the Modular Vision Systems Division (MVSD), based in Natick, Massachusetts, and the Surface Inspection Systems Division (SISD), based in Alameda, California. MVSD designs, develops, manufactures, and markets modular vision systems that are used to automate the manufacture of discrete items, such as semiconductor chips, cellular phones, and light bulbs, by locating, identifying, inspecting, and measuring them during the manufacturing process. SISD designs, develops, manufactures, and markets surface inspection vision systems that are used to inspect the surfaces of materials processed in a continuous fashion, such as paper, metals, plastics, and non-wovens, to ensure there are no flaws or defects on the surfaces. Historically, MVSD has been the source of the majority of the Company's revenue, representing approximately 84% of total revenue in 2005.

What is Machine Vision?

Since the beginning of the Industrial Revolution, human vision has played an indispensable role in the process of manufacturing products. Human eyes did what no machines could do themselves: locating and positioning work, tracking the flow of parts, and inspecting output for quality and consistency. Today, however, the requirements of many manufacturing processes have surpassed the limits of human eyesight. Manufactured items often are produced too quickly or with tolerances too small to be analyzed by the human eye. In response to manufacturers' needs, "machine vision" technology emerged, providing manufacturing equipment with the gift of sight. The Company believes that virtually every manufacturer that makes products in an automated process can achieve better quality and manufacturing efficiency by using machine vision.

Machine vision systems combine cameras with intelligent software to collect images and then answer questions about these images, such as:

Question	Description	Example
GUIDANCE Where is it?	Determining the exact physical location and orientation of an object.	Determining the position of a printed circuit board so that a robot can automatically be guided to insert electronic components.
IDENTIFICATION What is it?	Identifying an object by analyzing its shape or by reading a serial number.	Identifying the serial number on an automotive airbag so that it can be tracked and processed correctly through manufacturing.
INSPECTION How good is it?	Inspecting an object for flaws or defects.	Inspecting the paper that US currency is printed on.
GAUGING What size is it?	Determining the dimensions of an object.	Determining the diameter of a bearing prior to final assembly.

Machine Vision Market

Cognex serves a wide array of markets around the world that use the Company's products to replace human vision in a variety of industrial applications. While machine vision systems were first widely embraced by manufacturers of electronic components who needed this technology to produce computer chips with decreasing geometries, advances in technology and easy-to-use interfaces have made machine vision available to a broader range of users. Today, the Company's products are at work solving vision applications in many industries, including semiconductors, electronics, automotive, food and beverage, healthcare, pharmaceuticals, and high-speed inspection of materials, such as paper and metals.

The Company's customers can be classified into three markets: semiconductor and electronics capital equipment, discrete factory automation, and surface inspection. Semiconductor and electronics capital equipment manufacturers purchase Cognex machine vision systems and integrate them into the capital equipment that they manufacture and then sell to their customers in the semiconductor and electronics industries that either make computer chips or make printed circuit boards containing computer chips. Although the Company sells to original equipment manufacturers (OEMs) in a number of industries, these semiconductor and electronics OEMs have historically been large consumers of the Company's products. Sales to semiconductor and electronics capital equipment manufacturers represented approximately 27% of the Company's total revenue in 2005.

Discrete manufacturers in the factory automation area include a wide array of manufacturers who use machine vision for applications in a variety of industries, including the automotive, consumer electronics, food and beverage, healthcare, pharmaceutical, and aerospace industries. The majority of these customers are end users who purchase Cognex machine vision systems and install them directly on their production lines. These customers, who typically have limited computer programming or machine vision experience, purchase Cognex products from the Company's direct sales force, from a distributor, or from a system integrator or machine builder that is experienced in machine vision technology. System integrators are hired by end users to help them develop a vision application for their production line, whereas machine builders are hired by end users to build a complete, custom machine that incorporates machine vision. Sales to discrete factory automation customers represented approximately 57% of the Company's total revenue in 2005.

The last category, surface inspection customers, includes manufacturers of materials processed in a continuous fashion, such as paper, metals, plastics, and nonwovens. These customers need sophisticated machine vision to detect and classify defects in the surfaces of those materials as they are being processed at high speeds. Surface inspection sales represented approximately 16% of the Company's total revenue in 2005.

Business Strategy

The Company's goal is to expand its position as a leading worldwide supplier of machine vision systems for factory automation by offering a complete family of machine vision products to a broad base of manufacturers. Semiconductor and electronics equipment manufacturers have historically been large consumers of the Company's products. Over the past few years, however, the Company has diversified its customer base beyond the semiconductor and electronics capital equipment sector. Demand from these capital equipment manufacturers is highly cyclical, with periods of investment followed by temporary downturns. At its revenue peak in 2000, sales to semiconductor and electronics capital equipment manufacturers represented approximately 61% of the Company's total revenue, compared to approximately 27% in 2005, 42% in 2004, and 34% in 2003.

The Company believes that long-term, sustained revenue growth will come from a broad base of manufacturers outside of the semiconductor and electronics capital equipment manufacturer sector. Accordingly, the Company has invested in expanding its product offerings to its discrete factory automation customers, who demand a wide range of easy-to-use products of varying capability and price, and in developing a strong worldwide sales and support infrastructure.

On May 9, 2005, the Company completed is largest acquisition to date when it purchased DVT ® Corporation. In recent years, the Company has expanded its product line by adding low-cost, easy-to-use vision products, such as its In-Sight ® and Checker ® products. However, reaching the many prospects for these products in factories around the world requires a large third-party distribution channel to supplement the Company's own direct end-user sales force. During 2004, the Company started to build a third-party distribution channel and prior to the DVT acquisition had signed over 40 distributors, primarily in North America. With the acquisition of DVT Corporation, the Company immediately gained a worldwide network of more than 150 additional distributors, all fully trained in selling and supporting machine vision products. The Company believes that it can accelerate its growth in the rapidly developing discrete factory automation market by selling its expanding line of low-cost, easy-to-use products, including the acquired DVT vision sensors, through this newly acquired worldwide distribution channel.

The Company intends to continue to defend its strong position in the semiconductor and electronics capital equipment sector, while selectively expanding into new machine vision applications through the internal development of new products, as well as the acquisition of businesses and technologies.

Products

Cognex offers a full range of machine vision systems designed to meet customer needs at virtually any stage of the manufacturing process and virtually any capability/price point.

Vision Sensors

The Company believes it is firmly positioned in the fast-growing market for vision sensors with its In-Sight and DVT product lines. Vision sensors are machine vision systems that combine a digital camera, software, vision processor, and input/output capability in a low-cost, compact, easy-to-use package. These general-purpose vision sensors are designed to be easily programmed to perform a wide range of vision tasks including part location, identification, measurement, assembly verification, and robotic guidance.

In 2005, the Company expanded the In-Sight 5000 series to include stainless steel vision sensors for the food and beverage industry and high-resolution cameras, while continuing to increase processing power in a rugged, industrial-grade package that meets high standards for shock, vibration, and dust and wash-down protection. The acquisition of the DVT product line complements In-Sight with increased ease of use and color capabilities, in a lower cost package.

Vision sensors are sold to end users, system integrators, and machine builders located in North America, Japan, Europe, and Southeast Asia in a wide range of general manufacturing applications, such as automotive parts and assembly, consumer packaged goods, electronic components, medical devices, and pharmaceuticals.

Expert Sensors

Unlike general-purpose vision sensors that can be programmed to solve a wide variety of vision tasks, expert sensors are designed to deliver very simple, low-cost solutions for specific sensor problems. Because of its low price and ease of use, the Company expects to solve many new manufacturing problems with its Checker series of products.

In 2004, the Company introduced Checker 101, designed to detect the presence or absence of product features. Checker detects or inspects parts by understanding what they look like, providing high reliability and eliminating many of the drawbacks of traditional photoelectric sensors. Late in 2005, the Company introduced Checker 101E, which expands Checker's capability to include the tracking and rejecting of parts. This capability provides significant value to the customer since it eliminates the need for other industrial equipment, providing higher ease of use and a lower cost solution. Checker is sold through distributors to end users and system integrators located in North America, Japan, Europe, and Southeast Asia in a wide range of general manufacturing industries.

The CPS-1000 is a vision sensor designed for door security; it detects and counts people as they pass through an access-controlled doorway. The CPS-1000 utilizes Cognex's existing vision software, as well as patented 2D and 3D vision technology that Cognex developed specifically for "people sensing" applications. The CPS-1000 is currently sold to OEMs located in North America.

ID Products

The Company's ID products are designed to quickly and reliably read codes (e.g. one-dimensional bar codes on labels or two-dimensional marks on parts) that have been stamped, scribed, etched, printed, or otherwise formed directly on the surfaces of manufactured goods ranging from pharmaceutical items to aircraft components to semiconductor wafers. Industrial ID is an increasingly critical tool to ensure the appropriate manufacturing processes are performed in the correct sequence on the right parts. In addition, it can be used to create a history of the part from the beginning of its life to the end, and for use in supply chain management and repair.

In 2005, the Company introduced the In-Sight 5411 and In-Sight 5413 high-resolution, fixed-mount Industrial ID readers. Each model incorporates IDMax™ software, Data Matrix code-reading software based upon Cognex PatMax® technology. IDMax reads reliably despite degradations to the appearance of the code. In addition, the Company introduced the In-Sight 1721 Wafer ID reader that identifies and tracks semiconductor wafers through the manufacturing process.

Early in 2006, the Company introduced the DataMan ™ 7500 Series Direct Part Mark hand-held readers for part traceability. Dataman reads everything from the most challenging marks on parts to the easiest printed bar codes. These rugged, self-contained readers incorporate IDMax software and the new UltraLight® illumination system to optimally illuminate marks on various part surfaces.

ID products are sold to OEMs, system integrators, machine builders, and end users located in North America, Japan, Europe, and Southeast Asia in a broad range of industries.

PC-Based Vision Systems

The Company sells a full range of PC-based vision systems that combine the vision power of Cognex's most advanced vision tools with the processing power of high-speed PCs, provide the flexibility to choose from the widest range of contemporary analog and digital cameras for image acquisition, and facilitate seamless integration of vision into capital equipment.

These products offer the most extensive suite of patented and unique vision software tools featuring PatMax, high-accuracy pattern location software that can locate objects that vary in size and orientation or whose appearance is degraded; PatFlex ®, which enables a vision system to locate a pattern, or read or verify a code on curved objects, or warped, wrinkled, or lumpy packages; and PatInspect ®, which can accurately detect extremely small or subtle manufacturing defects.

PC-based vision is sold both to OEMs located in North America, Japan, Europe, and Southeast Asia who integrate the machine vision systems into capital equipment for the semiconductor and electronics industries, as well as to system integrators and machine builders located in North America, Japan, Europe, and Southeast Asia who integrate them into capital equipment for end users in a wide range of industries.

VisionPro Product Family

VisionPro ® facilitates rapid application development and installation of integrated PC vision solutions, speeding time to market for OEMs, system integrators, machine builders, and advanced manufacturing engineers. VisionPro's easy-to-use application development software offers both the power and flexibility of advanced programming and the simplicity of a graphical programming environment. VisionPro's extensive suite of patented vision tools enables solving the most challenging machine vision applications. VisionPro works with both Cognex MVS-8000 ® Series frame grabbers and with direct connect FireWire PC systems.

MVS-8000 Product Family

The MVS-8000 family of programmable machine vision systems provide industrial-grade fast and reliable image capture and vision processing for the most demanding machine vision applications. Designed for high throughput, the 8000 series frame grabbers support the widest range of high-speed and high-resolution digital and analog acquisition, including CameraLink, area scan, linescan, color, and multi-camera acquisition.

Application Specific PC-based Vision Systems

The Company offers a variety of application-specific systems that combine Cognex PC-based hardware and software to create a solution that is tailored to the particular requirements of certain vision applications. A partial list of application-specific vision systems is as follows:

ProofRead™ with *OCVMax*™ and *IDMax* is a complete system for ensuring label accuracy and product traceability for the pharmaceutical, food and beverage, and personal care industries.

DisplayInspect ® inspects the small, high-resolution displays commonly found on cellular phones, pagers, medical test instruments, and other electronic devices.

SMD 4 ® guides the placement of surface mount devices onto printed circuit boards and other assemblies, as well as inspects parts prior to placement. *BGA II* ® inspects ball grid array devices for missing, misplaced, or improperly formed solder balls. *PMI* inspects probe marks after electrical testing of wafers to detect damage to bond pads or indicate damaged probe cards.

TIS-8000™ *Tire Identification System and WIS-8000*™ *Wheel Identification System* are high-performance identification systems for automatically identifying tires and wheels by their unique characteristics. These systems ensure the presence of correct tires or wheels at any point in the manufacturing or assembly process.

Application-specific systems are targeted to OEMs, system integrators, and end users located in North America, Japan, Europe, and Southeast Asia in a wide range of industries, depending upon the application.

Surface Inspection Systems

The SmartView ® surface/web inspection system provides reliable detection, identification, and visualization of defects and monitoring and visualization of surface quality on products that are manufactured in a continuous process. The SmartView system provides greyscale imaging capability to visualize the defects, as well as a high-quality snapshot of the surface or web. Most advanced open data access capabilities embedded into the SmartView system ensure real-time inspection control and data access between the SmartView system and other business, production, and quality systems in the mill. The SmartView system is a modular and scalable system on a Microsoft Windows-based platform that enables the Company to expand into more complex vision applications in the paper, metals, plastics, and nonwovens industries.

SmartView is sold primarily to end users located in North America, Japan, Europe, and Southeast Asia in the paper, metals, plastics, and nonwovens industries. In addition, SmartView is sold to end users located in Europe and Asia in the paper industry through an OEM relationship with Honeywell International, Inc.

Research, Development, and Engineering

The Company engages in research, development, and engineering (R,D&E) to enhance its existing products and to develop new products and functionality to meet market opportunities. In addition to internal research and development efforts, the Company intends to continue its strategy of gaining access to new technology through strategic relationships and acquisitions where appropriate. The Company considers its on-going efforts in R,D&E to be a key component of its strategy.

At December 31, 2005, the Company employed 166 professionals in R,D&E, most of whom are software developers. The Company's R,D&E expenses totaled $27,640,000, $27,063,000, and $24,719,000, or approximately 13%, 14%, and 17% of revenue, in 2005, 2004, and 2003, respectively.

Manufacturing

The Company's MVSD manufacturing organization utilizes a turnkey operation whereby the majority of component procurement, subassembly, final assembly, and initial testing are performed under agreement by third-party contract manufacturers. After the completion of initial testing, the contract manufacturers deliver the products to the Company's Natick, Massachusetts facility for final testing, quality control, and shipment to the customer. Late in 2005, the Company began moving these activities to Ireland to be closer to its primary contract manufacturer. The contract manufacturers use specified components and assembly and test documentation created and controlled by the Company. From time to time, the Company will procure large quantities of end-of-life components for strategic purposes that will not be consumed within one year. Certain components are presently available only from a single source

The Company's SISD products are manufactured at its Alameda, California facility, with the exception of the frames on which the cameras and the lights used to illuminate the web are mounted. The manufacturing process at the Alameda facility consists of system design, configuration management and control, component procurement, and subassembly. After the completion of subassembly at the Alameda facility, some of the systems are delivered to the Company's Kuopio, Finland facility where the frames and lights are manufactured. The manufacturing process at the Kuopio facility consists of system integration final testing, quality control, and shipment to the customer. Certain products are manufactured by third-party contract manufacturers using documentation created and controlled by the Company. Certain servicemarks, and trademarks referenced in this document are the property of their respective owners.

Sales and Service

The Company sells its MVSD and SISD products through a direct sales force in North America, Japan, Europe, and Southeast Asia. Certain of the Company's low-cost MVSD products are also sold through a worldwide distribution network. At December 31, 2005, the Company's direct sales force consisted of 241 professionals, including sales and application engineers. The majority of the Company's sales force holds engineering or science degrees. Sales engineers call directly on targeted accounts and coordinate the activity of the application engineers.

Sales to customers based outside of the United States represented approximately 63% of total revenue in 2005, compared to approximately 69% in 2004 and approximately 66% in 2003. No customer accounted for greater than 10% of revenue in 2005, 2004, or 2003. Although international sales may from time to time be subject to federal technology export regulations, to date the Company has not suffered significant delays or prohibitions in sales to any of its foreign customers. Financial information about segments and geographic areas may be found in the Notes to the Consolidated Financial Statements, appearing on pages 46 and 47 of the Annual Report to Shareholders for the year ended December 31, 2005, which is attached as Exhibit 13 hereto, and is incorporated herein by reference.

The Company's MVSD service offerings include maintenance and support, education, and consulting services. Maintenance and support programs include hardware support programs that entitle customers to have failed product repaired, as well as software support programs that provide customers with application support and software updates on the latest software releases. Education services include a variety of product courses that are available at the Company's offices worldwide, at customer facilities, and on computer-based tutorials, video, and the Internet. The Company provides consulting services that range from a specific area of functionality to a completely integrated machine vision application.

The Company's SISD service offerings include maintenance and support and education services similar to those provided by MVSD, as well as installation services. The installation services group supervises the physical installation of the hardware at the customer location, configures the software application to detect the customer's defects, validates that the entire integrated system with the peripheral components is functioning according to the specifications, and performs operator training.

Intellectual Property

Because the Company relies on the technical expertise, creativity, and knowledge of its personnel, it utilizes patent, trademark, copyright, and trade secret protection to safeguard its competitive position. At December 31, 2005, the Company had obtained 231 patents on various innovations in the field of machine vision technology and had more than 151 patent applications pending. In addition, the Company makes use of non-disclosure agreements with customers, suppliers, employees, and consultants. The Company attempts to protect its intellectual property by restricting access to its proprietary information by a combination of technical and internal security measures. There can be no assurance, however, that any of the above measures will be adequate to protect the proprietary technology of the Company. Moreover, effective patent, trademark, copyright, and trade secret protection may be unavailable in certain foreign countries.

The Company's trademark and servicemark portfolio includes various registered marks, including but not limited to, Cognex ®, DVT ®, In-Sight ®, Checker ®, PatMax ®, VisionPro ®, and SmartView ®, as well as many common-law marks, including but not limited to, DataMan ™, IDMax ™, and Proofread ™. In addition, the Company has sought and obtained a number of trademark registrations outside of the United States. All third-party brand names, servicemarks, and trademarks referenced in this document are the property of their respective owners.

The Company's software products are protected by various security schemes and are primarily licensed to customers pursuant to an agreement that restricts the use of the products to the customer's purposes, as well as imposes strict limitations on the customer's use of the Company's trade secret, proprietary, and other confidential business information to which the customer may have access. The Company has made portions of its source code available to certain customers under very limited circumstances and for restricted uses. If the source code is released to a customer, the customer is required by contract to maintain its confidentiality and, in general, to use the source code solely for internal purposes or for maintenance.

Numerous users of the Company's products have received notice of patent infringement from the Lemelson Medical, Educational, & Research Foundation, Limited Partnership (the "Partnership") alleging that their use of the Company's products infringes certain patents transferred to the Partnership by the late

Jerome H. Lemelson. The Company does not believe its products infringe any valid and enforceable claims of the Partnership's patents.

As a result of continuing assertions against current and potential Cognex customers, the Company decided to initiate action against the Partnership in order to preserve its right to sell machine vision products without the threat of legal action against the Company or its customers. Accordingly, on September 23, 1998, the Company filed a complaint against the Partnership seeking a declaration that Lemelson's machine vision patents are invalid, unenforceable, and not infringed by either Cognex or by any users of Cognex products.

On January 23, 2004, the U.S. District Court of Nevada issued a court order ruling in favor of Cognex and finding that all of the Lemelson patent claims in suit are unenforceable, invalid, and not infringed by Cognex. The Partnership filed a notice of appeal with respect to this decision with the U.S. Court of Appeals for the Federal Circuit. A sub-panel of three of the judges of the Court of Appeals rendered its decision in favor of Cognex on September 9, 2005. On November 16, 2005, the U.S. Court of Appeals denied the Partnership's petition for a rehearing by the entire bench. On December 22, 2005, the Partnership informed the District Court of Arizona, where related cases are pending, that it will not seek further review of the U.S. Court of Appeals' decision. Furthermore, the deadline for requesting review by the the U.S. Supreme Court has expired. Accordingly, no further appeals are available to Lemelson and the matter has been finally resolved in Cognex's favor.

Compliance with Environmental Provisions

The Company's capital expenditures, earnings, and competitive position are not materially affected by compliance with federal, state, and local environmental provisions which have been enacted or adopted to regulate the distribution of materials into the environment.

Competition

The machine vision market is highly fragmented and the Company's competitors vary depending upon market segment, geographic region, and application niche. The Company's competitors are typically other vendors of machine vision systems and manufacturers of image processing systems and sensors. In addition, in the semiconductor and electronics capital equipment market, the Company also competes with the internal engineering efforts of current or prospective customers. Any of these competitors may have greater financial and other resources than the Company. Although the Company considers itself to be one of the leading machine vision companies in the world, reliable estimates of the machine vision market and the number of competitors are not available.

The Company's ability to compete depends upon its ability to design, manufacture, and sell high-quality products, as well as its ability to develop new products that meet evolving customer requirements. The primary competitive factors affecting the choice of a machine vision system include vendor reputation, product functionality and performance, ease of use, price, and post-sales support. The importance of each of these factors varies depending upon the specific customer's needs.

Backlog

At December 31, 2005, the Company's backlog totaled $33,069,000, compared to $29,023,000 at December 31, 2004. Backlog reflects purchase orders for products scheduled for shipment primarily within three months at MVSD and primarily within six months at SISD. The level of backlog at any particular date is not necessarily indicative of future revenue of the Company. The Company's low-cost vision sensors typically ship within one week of when the order is booked. In addition, delivery schedules may be extended and orders may be canceled at any time subject to certain cancellation penalties.

Employees

At December 31, 2005, the Company employed 740 persons, including 375 in sales, marketing, and service activities; 166 in research, development, and engineering; 81 in manufacturing and quality assurance; and 118 in information technology, finance, and administration. Of the Company's 740 employees, 261 are based outside of the United States. None of the Company's employees are represented by a labor union and the Company has experienced no work stoppages. The Company believes that its employee relations are good.

Available Information

The Company maintains a website on the World Wide Web at www.cognex.com . The Company makes available, free of charge, on its website in the section captioned "Investors — SEC Filings" its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after such reports are electronically filed with, or furnished to, the SEC. The Company's reports filed with, or furnished to, the SEC are also available at the SEC's website at www.sec.gov . Information contained on the Company's website is not a part of, or incorporated by reference into, this Annual Report on Form 10-K.

ITEM 1A. RISK FACTORS

The risks and uncertainties described below and not the only ones that we face. Additional risks and uncertainties that we are unaware of, or that we currently deem immaterial, also may become important factors that affect our company in the future. If any of these risks were to occur, our business, financial condition, or results of operations could be materially and adversely affected. This section includes or refers to certain forward-looking statements; you should read the explanation of the qualifications and limitations on such forward-looking statements found in the section captioned "Management's Discussion and Analysis of Financial Condition and Results of Operations," appearing on page 14 of the Annual Report to Shareholders for the year ended December 31, 2005, which is attached as Exhibit 13 hereto, and is incorporated herein by reference.

Unless the context otherwise requires, the words "Cognex," "we," "our," "us," and "our company" refer to Cognex Corporation and its consolidated subsidiaries.

Unfavorable changes in economic conditions and capital spending may negatively impact our operating results.

Our revenue is dependent upon the capital spending trends of manufacturers in a number of industries and regions. These spending levels are, in turn, impacted by global economic conditions. Our operating results have been materially adversely affected in the past, and could be materially adversely affected in the future, as a result of unfavorable economic conditions and reduced capital spending by manufacturers worldwide.

Downturns in the semiconductor and electronics industries may adversely affect our business.

In 2005, approximately 27% of our revenue was derived from semiconductor and electronics capital equipment manufacturers. This concentration was as high as 61% in 2000 during its revenue peak. The semiconductor and electronics industries are highly cyclical and have historically experienced periodic downturns, which have often had a severe effect on demand for production equipment that incorporates our products. While we have been successful in recent years in diversifying our business beyond OEM customers who serve the semiconductor and electronics industries, our business is still impacted by capital expenditures in these industries, which, in turn, are dependent upon the market demand for products containing computer chips. As a result, our operating results in the foreseeable future could be significantly and adversely affected by a slowdown in either of these industries.

Economic, political, and other risks associated with international sales and operations could adversely affect our business and operating results.

In 2005, approximately 63% of our revenue was derived from customers located outside of the United States. We anticipate that international sales will continue to account for a significant portion of our revenue. We intend to continue to expand our operations outside of the United States and may enter additional international markets, which will require significant management attention and financial resources. As a result, our operations are subject to the risks inherent in international sales, including, among other things,

- various regulatory requirements,
- transportation delays,
- difficulties in staffing and managing foreign sales operations, and
- potentially adverse tax consequences.

In addition, fluctuations in foreign currency exchange rates may render our products less competitive relative to local product offerings, or could result in significant foreign currency losses if not properly hedged. We are also subject to the political risks inherent in international operations and their impact on the global economy, including economic disruption from acts of war or terrorism, particularly in the aftermath of the terrorist attacks of September 11, 2001. Any of these factors could have a material adverse effect on our operating results.

Fluctuations in foreign exchange rates could materially affect our reported results.

We face exposure to adverse movements in foreign currency exchange rates as a significant portion of our revenue, expenses, assets, and liabilities are denominated in currencies other than the functional currencies of our company. In certain instances, we utilize derivative instruments to hedge against foreign currency fluctuations. These contracts are used to reduce our risk associated with foreign currency exchange rate changes, as the gains or losses on the derivative are intended to offset the losses or gains on the underlying exposure. We do not engage in foreign currency speculation. The success of our foreign currency risk management program depends upon forecasts of transaction activity denominated in various currencies. To the extent that these forecasts are overstated or understated during periods of currency volatility, we could experience unanticipated foreign currency gains or losses that could have a material impact on our results of operations. In addition, our failure to identify new exposures and hedge them in a timely manner may result in material foreign currency gains or losses.

The loss of a large customer could have an adverse effect on our operating results.

In 2005, our top five customers accounted for approximately 9% of total revenue. In recent years, our expansion into the end-user marketplace has reduced its reliance upon the revenue from any one of our larger OEM customers. Nevertheless, the loss of, or significant curtailment of purchases by, any one or more of our larger customers could have a material adverse effect on our operating results.

The failure of a key supplier to deliver quality product in a timely manner or our inability to obtain components for our products could adversely affect our operating results.

A significant portion of our MVSD inventory is manufactured by a third-party contractor. As a result, we are dependent upon this contractor to provide quality product and meet delivery schedules. We engage in extensive product quality programs and processes, including actively monitoring the performance of our third-party manufacturers; however, we may not detect all product quality issues through these programs and processes. In addition, a variety of components used in our products are only available from a single source. The announcement by a single-source supplier of a last-time component buy could result in our purchase of a significant amount of inventory that, in turn, could lead to an increased risk of inventory obsolescence. An interruption in, termination of, or material change in the purchase terms of any single-source components could have a material adverse effect on our operating results.

Our business could suffer if we lose the services of, or fail to attract, key personnel.

We are highly dependent upon the management and leadership of Robert J. Shillman, our Chief Executive Officer and Chairman of the Board of Directors, as well as other members of our senior management team, including James F. Hoffmaster who was promoted to President of Cognex Corporation during 2004 with full responsibility for running our day-to-day operations. Although we have retained many experienced and qualified senior managers, the loss of key personnel could have a material adverse effect on our company. Our continued growth and success also depends upon our ability to attract and retain skilled employees and on the ability of our officers and key employees to effectively manage the growth of our business through the implementation of appropriate management information systems and internal controls.

Our products may contain design or manufacturing defects, which could result in reduced demand, significant delays, or substantial costs.

If flaws in either the design or manufacture of our products were to occur, we could experience a rate of failure in our products that could result in significant delays in shipment and material repair or replacement costs. While we engage in extensive product quality programs and processes, including actively monitoring and evaluating the quality of our component suppliers and contract manufacturers, these actions may not be sufficient to avoid a product failure rate that results in:

- substantial delays in shipment,
- significant repair or replacement costs, or
- potential damage to our reputation,

any of which could have a material adverse effect on our operating results.

Our failure to accurately forecast customer demand could result in inventory obsolescence and resulting charges.

In recent years, we have expanded our presence in the end-user marketplace. Our end-user business typically operates with a relatively short backlog and our production plans are based on internal forecasts of customer demand. Due to these factors, we have in the past, and may again in the future, fail to accurately forecast demand, in terms of both volume and configuration for either our legacy or next-generation products. Our failure to accurately forecast customer demand has led to, and may again in the future lead to, an increased risk of inventory obsolescence and resulting charges.

Our failure to develop new products and to respond to technological changes could result in the loss of our market share and a decrease in our revenues.

The market for our products is characterized by rapidly changing technology. Accordingly, we believe that our future success will depend upon our ability to develop or acquire new products with improved price/performance and introduce them to the marketplace in a timely manner. We may not be able to introduce and market new products successfully and respond effectively to technological changes or new product introductions by competitors. Our ability to keep pace with the rapid rate of technological change in the high-technology marketplace could have a material adverse effect on our operating results.

If we fail to successfully defend our intellectual property, our competitive position and operating results could suffer.

We rely heavily on our proprietary software technology and hardware designs, as well as the technical expertise, creativity, and knowledge of our personnel. Although we use a variety of methods to protect our intellectual property, we rely most heavily on patent, trademark, copyright, and trade secret protection, as well as non-disclosure agreements with customers, suppliers, employees, and consultants. We also attempt to protect our intellectual property by restricting access to our proprietary information by a combination of technical and internal security measures. These measures, however, may not be adequate to:

- protect our proprietary technology,
- protect our patents from challenge, invalidation, or circumvention, or
- ensure that our intellectual property will provide us with competitive advantages.

Any of these adverse circumstances could have a material effect on our operating results. We refer you to the section captioned “Intellectual Property,” appearing in Part I — Item I of this report.

Our company may be subject to costly litigation.

From time to time, we may be subject to various claims and lawsuits by competitors, customers, or other parties arising in the ordinary course of business, including lawsuits charging patent infringement. These matters can be time-consuming, divert our management's attention and resources, and cause us to incur significant expenses. Furthermore, the results of any of these actions may have a material adverse effect on our operating results.

Increased competition may result in decreased demand or prices for our products and services.

We compete with other vendors of machine vision systems, the internal engineering efforts of our current or prospective customers, and the manufacturers of image processing systems and sensors. Any of these competitors may have greater financial and other resources than we do. In recent years, ease-of-use and product price have become significant competitive factors in the end-user marketplace. We may not be able to compete successfully in the future and our investments in research and development, sales and marketing, and service activities may be insufficient to enable us to maintain our competitive advantage. In addition, competitive pressures could lead to price erosion that could materially and adversely affect our operating results. We refer you to the section captioned "Competition," appearing in Part I — Item 1 of this report.

Implementation of our acquisition strategy may not be successful, which could affect our ability to increase our revenue or profitability.

We have in the past acquired, and will in the future consider the acquisition of, businesses and technologies in the machine vision industry. If we acquire other businesses or technologies in the future, our business may be negatively impacted by risks related to those acquisitions. These risks include, among others:

- the diversification of management's attention from other operational matters,
- the inability to realized expected synergies resulting from the acquisition,
- the failure to retain key customers or employees, and
- the impairment of acquired intangible assets resulting from technological obsolescence or lower-than-expected cash flows from the acquired assets.

Acquisitions are inherently risky and the inability the effectively manage these risks could have a material adverse effect on our operating results.

Attractive acquisition opportunities may not be available to us.

Our business strategy includes selective expansion into other machine vision applications through the acquisition of businesses and technologies. Since 1995, we have completed ten business and technology acquisitions, including the acquisition of DVT Corporation in 2005. We plan to continue to seek opportunities to expand our product line, customer base, distribution network, and technical talent through acquisitions in the machine vision industry. However, we may not have the opportunity to make suitable acquisitions on favorable terms in the future, which could negatively impact the growth of our business. We expect that other companies in the machine vision industry will compete with us to acquire compatible businesses. This competition could increase prices for businesses and technologies that we would likely pursue, and our competitors may have greater resources than we do.

The trading price of our common stock may be volatile.

The price of our common stock has historically experienced significant volatility due to:

- fluctuations in our revenue and earnings,
- changes in the market's expectations for our growth,
- overall equity market conditions,
- conditions relating to the market for technology stocks,
- general economic conditions, and
- other factors unrelated to our operations.

The stock markets have experienced extreme price volatility in recent years. This volatility has had a substantial effect on the market prices of securities issued by many technology companies, such as our company, often for reasons unrelated to the operating results of the specific company.

ITEM 1B. UNRESOLVED STAFF COMMENTS

The Company did not receive written comments from the Commission staff regarding its periodic or current reports under the Securities Exchange Act of 1934 during the year ended December 31, 2005, and there are no unresolved staff comments as of the date of this report.

ITEM 2: PROPERTIES

In 1994, the Company purchased and renovated a 100,000 square-foot building located in Natick, Massachusetts that serves as its corporate headquarters. In 1997, the Company completed construction of a 50,000 square-foot addition to this building.

In 1995, the Company purchased an 83,000 square-foot office building adjacent to its corporate headquarters. The building is currently largely occupied with tenants who have lease agreements that expire at various dates through 2009. The Company uses a portion of the space for storage and product demonstrations.

In 1997, the Company purchased a three and one-half acre parcel of land situated on Vision Drive, adjacent to the Company’s corporate headquarters. This land is being held for future expansion.

ITEM 3: LEGAL PROCEEDINGS

To the Company’s knowledge, there are no pending legal proceedings, other than as described in the section captioned “Intellectual Property,” appearing in Part I — Item I of this Annual Report on Form 10-K, which are material to the Company. From time to time, however, the Company may be subject to various claims and lawsuits by competitors, customers, or other parties arising in the ordinary course of business, including lawsuits charging patent infringement. There can be no assurance as to the outcome of any of this litigation.

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

There were no matters submitted during the fourth quarter of the year ended December 31, 2005 to a vote of security holders through solicitation of proxies or otherwise.

ITEM 4A: EXECUTIVE OFFICERS AND OTHER MEMBERS OF THE MANAGEMENT TEAM OF THE REGISTRANT

The following table sets forth the names, ages, and titles of the Company's executive officers at December 31, 2005:

Name	Age	Title
Robert J. Shillman	59	Chief Executive Officer and Chairman of the Board of Directors
James F. Hoffmaster	54	President and Chief Operating Officer
Richard A. Morin	56	Senior Vice President of Finance and Administration, Chief Financial Officer, and Treasurer

Messrs. Shillman and Morin have been employed by the Company in their present or other capacities for no less than the past five years.

Mr. Hoffmaster joined the Company in 2001 as Chief Operating Officer and President, MVSD, and was promoted to President of Cognex Corporation in 2004. Prior to joining the Company, Mr. Hoffmaster was the Chief Executive Officer of Fibersense, a Massachusetts-based company specializing in the application of fiber optic technology to gyroscopes and other sensors. Prior to that, Mr. Hoffmaster served as President of Fisher-Rosemount Systems, a division of Emerson Electric. He holds a Masters of Computer and Information Science degree and a Bachelor of Arts degree in Economics from Cleveland State University.

Executive officers are elected annually by the Board of Directors. There are no family relationships among the directors and executive officers of the Company.

Other members of the senior management team include the following individuals, all of whom have been employed by the Company in their present or other capacities for no less than the past five years:

Name	Age	Title
Patrick Alias	60	Senior Vice President
Eric Ceyrolle	52	President, International Operations
Markku Jaaskelainen	51	Senior Vice President and General Manager, SISD
Marilyn Matz	52	Senior Vice President, PC Vision
E. John McGarry	49	Senior Vice President, Research and Development
Akira Nakamura	61	President, Cognex K.K.
Kris Nelson	58	Senior Vice President, Vision Sensors
William Silver	52	Senior Vice President and Senior Fellow
Justin Testa	53	Senior Vice President, ID Products

PART II

ITEM 5: MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

Information with respect to this item may be found in the sections captioned "Selected Quarterly Financial Data (Unaudited)" and "Company Information," appearing on pages 53 and 56 of the Annual Report to Shareholders for the year ended December 31, 2005, which is attached as Exhibit 13 hereto, and is incorporated herein by reference.

The following table sets forth information as of and for the quarter ended December 31, 2005 with respect to the Company's stock repurchase program.

Period of Repurchase	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Approximate Dollar Value of Shares that May Yet be Purchased under the Plans or Programs
October 3 - October 30, 2005	—	—	—	
October 31 - November 27, 2005	233,501	$ 30.45	233,501	
November 28 - December 31, 2005	150,407	30.35	150,407	
	383,908	$ 30.44	383,908	$ 61,885,000

(1) On December 12, 2000, the Company's Board of Directors authorized the repurchase of up to $100,000,000 of the Company's common stock.

ITEM 6: SELECTED FINANCIAL DATA

Information with respect to this item may be found in the section captioned "Five-Year Summary of Selected Financial Data," appearing on page 52 of the Annual Report to Shareholders for the year ended December 31, 2005, which is attached as Exhibit 13 hereto, and is incorporated herein by reference.

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

Information with respect to this item may be found in the section captioned "Management's Discussion and Analysis of Financial Condition and Results of Operations," appearing on pages 14 through 25 of the Annual Report to Shareholders for the year ended December 31, 2005, which is attached as Exhibit 13 hereto, and is incorporated herein by reference.

ITEM 7A: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Information with respect to this item may be found in the section captioned "Quantitative and Qualitative Disclosures About Market Risk," appearing on pages 24 and 25 of the Annual Report to Shareholders for the year ended December 31, 2005, which is attached as Exhibit 13 hereto, and is incorporated herein by reference.

ITEM 8: FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Information with respect to this item, which includes the consolidated financial statements and notes thereto, reports of independent registered public accounting firms, and supplementary data, may be found on pages 26 through 53 of the Annual Report to Shareholders for the year ended December 31, 2005, which is attached as Exhibit 13 hereto, and is incorporated herein by reference.

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

There were no disagreements with accountants on accounting or financial disclosure during 2005 or 2004.

ITEM 9A: CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

As required by Rules 13a-15 and 15d-15 of the Securities Exchange Act of 1934, the Company has evaluated with the participation of management, including the Chief Executive Officer and the Chief Financial Officer, the effectiveness of its disclosure controls and procedures as of the end of the period covered by this report. Based on such evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that such disclosure controls and procedures are effective in ensuring that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported, within the time periods specified in the SEC's rules and forms. From time to time, the Company reviews the disclosure controls and procedures, and may from time to time make changes aimed at enhancing their effectiveness and to ensure that the Company's systems evolve with its business.

Management's Report on Internal Control over Financial Reporting

Information with respect to this item may be found in the section captioned "Report of Management on Internal Control Over Financial Reporting," appearing on page 50 of the Annual Report to Shareholders for the year ended December 31, 2005, which is attached as Exhibit 13 hereto, and is incorporated herein by reference.

Registered Public Accounting Firm's Report on Internal Control Over Financial Reporting

Information with respect to this item may be found in the section captioned "Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting," appearing on page 51 of the Annual Report to Shareholders for the year ended December 31, 2005, which is attached as Exhibit 13 hereto, and is incorporated herein by reference.

Changes in Internal Control Over Financial Reporting

There have been no changes in the Company's internal control over financial reporting that occurred during the fourth quarter of the year ended December 31, 2005 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART III

ITEM 10: DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Information with respect to Directors and Executive Officers of the Company required by Item 10 shall be included in the Company's definitive Proxy Statement for the Special Meeting in Lieu of the 2006 Annual Meeting of Shareholders to be held on April 25, 2006 and is incorporated herein by reference. In addition, certain information with respect to Executive Officers of the Company may be found in the section captioned "Executive Officers and Other Members of the Management Team of the Registrant," appearing in Part I — Item 4A of this Annual Report on Form 10-K.

The Company has adopted a Code of Business Conduct and Ethics covering all employees, which is available, free of charge, on the Company's website, www.cognex.com . The Company intends to disclose any amendments to or waivers of the Code of Business Conduct and Ethics on behalf of the Company's Chief Executive Officer, Chief Financial Officer, Controller, and persons performing similar functions on the Company's website.

ITEM 11: EXECUTIVE COMPENSATION

Information with respect to executive compensation required by Item 11 shall be included in the Company's definitive Proxy Statement for the Special Meeting in Lieu of the 2006 Annual Meeting of Shareholders to be held on April 25, 2006 and is incorporated herein by reference.

ITEM 12: SECURITY OWNERSHIP AND CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Information with respect to security ownership and the other matters required by Item 12 shall be included in the Company's definitive Proxy Statement for the Special Meeting in Lieu of the 2006 Annual Meeting of Shareholders to be held on April 25, 2006 and is incorporated herein by reference.

The following table provides information as of December 31, 2005 regarding shares of common stock that may be issued under the Company's existing equity compensation plans.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants, and rights	Weighted-average exercise price of outstanding options, warrants, and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by shareholders	10,387,955(1)	$ 25.48	2,648,993(2)
Equity compensation plans not approved by shareholders	286,840(3)	21.20	7,500,000(4)
	10,674,795	$ 25.36	10,148,993

(1) Includes shares to be issued upon exercise of outstanding options under the Company's 1991 Isys Controls, Inc. Long-Term Equity Incentive Plan, 1993 Stock Option Plan, 1993 Stock Option Plan for Non-Employee Directors, 1998 Stock Incentive Plan, and 1998 Non-Employee Director Stock Option Plan. Does not include purchase rights accruing under the Employee Stock Purchase Plan (ESPP) because the purchase price (and therefore the number of shares to be purchased) will not be determined until the end of the purchase period.

(2) Includes shares remaining available for future issuance under the Company's 1998 Stock Incentive Plan and 1998 Non-Employee Director Stock Option Plan. Includes 228,279 shares available for future issuance under the ESPP.

(3) Includes shares to be issued upon the exercise of outstanding options under the Company's 2001 Interim General Stock Incentive Plan.

(4) Includes shares remaining available for future issuance under the Company's 2001 General Stock Option Plan.

The 2001 General Stock Option Plan was adopted by the Board of Directors on December 11, 2001 without shareholder approval. This plan provides for the granting of nonqualified stock options to any employee who is actively employed by the Company and is not an officer or director of the Company. The maximum number of shares of common stock available for grant under the plan is 7,500,000 shares. All option grants must have an exercise price per share that is no less than the fair market value per share of the Company's common stock on the grant date and must have a term that is no longer than fifteen years from the grant date. No stock options have been granted under the 2001 General Stock Option Plan.

The 2001 Interim General Stock Incentive Plan was adopted by the Board of Directors on July 17, 2001 without shareholder approval. This plan provides for the granting of nonqualified stock options to any employee who is actively employed by the Company and is not an officer or director of the Company. The maximum number of shares of common stock available for grant under the plan is 400,000 shares. All option grants have an exercise price per share that is no less than the fair market value per share of the Company's common stock on the grant date and must have a term that is no longer than fifteen years from the grant date. All 400,000 stock options have been granted under the 2001 Interim General Stock Incentive Plan.

ITEM 13: CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Information with respect to certain relationships and related transactions required by Item 13 shall be included in the Company's definitive Proxy Statement for the Special Meeting in Lieu of the 2006 Annual Meeting of Shareholders to be held on April 25, 2006 and is incorporated herein by reference.

ITEM 14: PRINCIPAL ACCOUNTANT FEES AND SERVICES

Information with respect to principal accountant fees and services required by Item 14 shall be included in the Company's definitive Proxy Statement for the Special Meeting in Lieu of the 2006 Annual Meeting of Shareholders to be held on April 25, 2006 and is incorporated herein by reference.

PART IV

ITEM 15: EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(1) Financial Statements

The following consolidated financial statements of Cognex Corporation and the reports of independent public accounting firms relating thereto are included in the Company's Annual Report to Shareholders for the year ended December 31, 2005, which is attached as Exhibit 13 hereto, and are incorporated herein by reference:

Consolidated Statements of Operations for the years ended December 31, 2005, 2004, and 2003

Consolidated Balance Sheets at December 31, 2005 and 2004

Consolidated Statements of Cash Flows for the years ended December 31, 2005, 2004, and 2003

Consolidated Statements of Shareholders' Equity for the years ended December 31, 2005, 2004, and 2003

Notes to Consolidated Financial Statements

Reports of Independent Public Accounting Firms

(2) Financial Statement Schedule

Included at the end of this report are the following:

Report of Independent Registered Public Accounting Firm on the Financial Statement Schedule

Schedule II — Valuation and Qualifying Accounts

Other schedules are omitted because of the absence of conditions under which they are required or because the required information is given in the consolidated financial statements or notes thereto.

(3) Exhibits

The Exhibits filed as part of this Annual Report on Form 10-K are listed in the Exhibit Index, immediately preceding such Exhibits.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

COGNEX CORPORATION

By: /s/ Robert J. Shillman
Robert J. Shillman
Chief Executive Officer and Chairman of the Board of Directors

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Robert J. Shillman Robert J. Shillman	Chief Executive Officer and Chairman of the Board of Directors (principal executive officer)	March 1, 2006
/s/ Richard Morin Richard A. Morin	Senior Vice President of Finance and Administration, Chief Financial Officer, and Treasurer (principal financial and accounting officer)	March 1, 2006
/s/ Patrick Alias Patrick Alias	Director	March 1, 2006
/s/ Jerald Fishman Jerald Fishman	Director	March 1, 2006
/s/ William Krivsky William Krivsky	Director	March 1, 2006
/s/ Anthony Sun Anthony Sun	Director	March 1, 2006
/s/ Reuben Wasserman Reuben Wasserman	Director	March 1, 2006

COGNEX CORPORATION — SCHEDULE II — VALUATION AND QUALIFYING ACCOUNTS

Description	Balance at Beginning of Period	Additions: Charged to Costs and Expenses	Additions: Charged to Other Accounts	Deductions	Other	Balance at End of Period
			(Dollars in thousands)			
Reserve for Uncollectible Accounts:						
2005	$ 2,596	$ —	$—	$ (81)(a)	$ (145)(b)	$ 2,370
2004	2,613	—	—	(167)(a)	150(b)	2,596
2003	2,207	459	—	(283)(a)	230(b)	2,613
Reserve for Inventory Obsolescence:						
2005	$14,772	$1,334	$—	$(1,577)(c)	$ (759)(d)	$13,770
2004	17,408	375	—	(2,206)(c)	(805)(d)	14,772
2003	20,478	914	—	(2,694)(c)	(1,290)(d)	17,408

(a) Specific write-offs

(b) Foreign exchange rate changes

(c) Specific dispositions

(d) Sale of previously reserved inventory

EXHIBIT INDEX

EXHIBIT NUMBER	
2A	Agreement and Plan of Merger, dated May 9, 2005, by and among Cognex, Tango Acquisition Corp. and DVT Corporation (excluding schedules and exhibits which the registrant agrees to furnish supplementally to the Commission upon request) (incorporated by reference to Exhibit 2.1 of Cognex's Current Report on Form 8-K filed on May 11, 2005 [File No. 0-17869])
3A	Restated Articles of Organization of Cognex Corporation effective June 27, 1989, as amended April 30, 1991, April 21, 1992, April 25, 1995, April 23, 1996, and May 8, 2000 (incorporated by reference to Exhibit 3A of Cognex's Annual Report on Form 10-K for the year ended December 31, 2002 [File No. 0-17869])
3B	By-laws of the Company, as amended March 16, 1998 (incorporated by reference to Exhibit 3B of Cognex's Annual Report on Form 10-K for the year ended December 31, 2002 [File No. 0-17869])
4	Specimen Certificate for Shares of Common Stock (incorporated by reference to Exhibit 4 to the Registration Statement on Form S-1 [Registration No. 33-29020])
10A	Cognex Corporation 1993 Stock Option Plan for Non-Employee Directors (incorporated by reference to Exhibit 4A to the Registration Statement on Form S-8 [Registration No. 33-81150])
10B	Cognex Corporation 1993 Stock Option Plan, as amended November 14, 1995 and February 25, 1996 (incorporated by reference to Exhibit 4A to the Registration Statement on Form S-8 [Registration No. 333-04621])
10C	1991 Isys Controls, Inc. Long-Term Equity Incentive Plan (incorporated by reference to Exhibit 4A to the Registration Statement on Form S-8 [Registration No. 333-02151])
10D	Amendment to the Cognex Corporation 1993 Stock Option Plan for Non-Employee Directors (incorporated by reference to Exhibit 10E of Cognex's Annual Report on Form 10-K for the year ended December 31, 2002 [File No. 0-17869])
10E	Amendment to the Cognex Corporation 1993 Stock Option Plan (incorporated by reference to Exhibit 10F of Cognex's Annual Report on Form 10-K for the year ended December 31, 2002 [File No. 0-17869])
10F	Cognex Corporation 1998 Non-Employee Director Stock Option Plan (incorporated by reference to Exhibit 4.1 to the Registration Statement on Form S-8 [Registration No. 333-60807])
10G	Cognex Corporation 1998 Stock Incentive Plan (incorporated by reference to Exhibit 4.2 to the Registration Statement on Form S-8 [Registration No. 333-60807])
10H	First Amendment to the Cognex Corporation 1998 Stock Incentive Plan (incorporated by reference to Exhibit 4.3 to the Registration Statement on Form S-8 [Registration No. 333-60807])
10I	Cognex Corporation 2000 Employee Stock Purchase Plan (incorporated by reference to Exhibit 4 to the Registration Statement on Form S-8 [Registration No. 333-44824])
10J	First Amendment to 2000 Employee Stock Purchase Plan (incorporated by reference to Exhibit 10.2 of Cognex's Quarterly Report on Form 10-Q for the quarter ended July 3, 2005 [File No. 0-17869])
10K	Cognex Corporation 2001 Interim General Stock Incentive Plan (incorporated by reference to Exhibit 4.1 to the Registration Statement on Form S-8 [Registration No. 333-68158])
10L	Cognex Corporation 2001 General Stock Option Plan (incorporated by reference to Exhibit 4.1 to the Registration Statement on Form S-8 [Registration No. 333-100709])

EXHIBIT NUMBER	
10M	Transition Loan Agreement between James F. Hoffmaster and Cognex Corporation, dated May 24, 2001 (incorporated by reference to Exhibit 10M of Cognex's Annual Report on Form 10-K for the year ended December 31, 2002 [File No. 0-17869])
10N	Termination Agreement between James F. Hoffmaster and Cognex Corporation dated June 4, 2001 (incorporated by reference to Exhibit 10N of Cognex's Annual Report on Form 10-K for the year ended December 31, 2002 [File No. 0-17869])
10O	Form of Stock Option Agreement (Non-Qualified) under 1998 Stock Incentive Plan (incorporated by reference to Exhibit 10.1 of Cognex's Quarterly Report on Form 10-Q for the quarter ended October 3, 2004 [File No. 0-17869])
10P	Form of Stock Option Agreement (Non-Qualified) under 1998 Non-Employee Director Stock Plan (incorporated by reference to Exhibit 10.2 of Cognex's Quarterly Report on Form 10-Q for the quarter ended October 3, 2004 [File No. 0-17869])
10Q	Supplemental Retirement and Deferred Compensation Plan effective April 1, 1995 (incorporated by reference to Exhibit 10P of Cognex's Annual Report on Form 10-K for the year ended December 31, 2004 [File No. 0-17869])
10R	Description of Annual Bonus Program *
13	Annual Report to Shareholders for the year ended December 31, 2005 (which is not deemed to be "filed" except to the extent that portions thereof are expressly incorporated by reference in this Annual Report on Form 10-K) *
14	Code of Business Conduct and Ethics as amended March 12, 2004 (incorporated by reference to Exhibit 14 of Cognex's Annual Report on Form 10-K for the year ended December 31, 2004 [File No. 0-17869])
21	Subsidiaries of the registrant *
23.1	Consent of Ernst & Young LLP *
31.1	Certification of Chief Executive Officer*
31.2	Certification of Chief Financial Officer*
32.1	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (CEO)**
32.2	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (CFO)**

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* Filed herewith

** Furnished herewith

EXHIBIT 10R

COGNEX CORPORATION
ANNUAL BONUS PROGRAM

Cognex Corporation (the "Company") provides selected employees, including the Company's executive officers, with an opportunity to earn cash bonuses pursuant to an annual bonus program (the "Bonus Program"). Each participant in the Bonus Program is assigned a target annual cash bonus. Participants may earn their bonuses based on the achievement of certain financial goals set forth in the Company's annual budget related to the Company's operating income as a percentage of revenue.

In 2005, the target bonus under the Bonus Program for Robert J. Shillman, the Chief Executive Officer of the Company, was $210,000, with the opportunity to earn 0-300% of this amount based on the achievement of the Company's financial goals; the target bonus under the Bonus Program for James F. Hoffmaster, the President and Chief Operating Officer of the Company, was $175,000, with the opportunity to earn 0-250% of this amount based on the achievement of the Company's financial goals; and the target bonus under the Bonus Program for Richard A. Morin, Senior Vice President of Finance and Administration, Chief Financial Officer, and Treasurer of the Company, was $92,000, with the opportunity to earn 0-200% of this amount based on the achievement of the Company's financial goals.

In accordance with the Bonus Program, on February 16, 2006, Robert J. Shillman, James F. Hoffmaster and Richard A. Morin each were entitled to a payout under the Bonus Program for 2005 of $181,650, $151,375, and $79,580, respectively. Dr. Shillman elected to forgo his bonus and requested that the Company make a contribution to a public charity instead.

Exhibit 13

COGNEX CORPORATION: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

Certain statements made in this report, as well as oral statements made by the Company from time to time, constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Readers can identify these forward-looking statements by the Company's use of the words "expects," "anticipates," "estimates," "believes," "projects," "intends," "plans," "will," "may," "shall," and similar words and other statements of a similar sense. These statements are based upon the Company's current estimates and expectations as to prospective events and circumstances, which may or may not be in the Company's control and as to which there can be no firm assurances given. These forward-looking statements involve known and unknown risks and uncertainties that could cause actual results to differ materially from those projected. Such risks and uncertainties include: (1) global economic conditions that impact the capital spending trends of manufacturers in a variety of industries; (2) the cyclicality of the semiconductor and electronics industries; (3) the inability to achieve significant international revenue; (4) fluctuations in foreign exchange rates; (5) the loss of, or a significant curtailment of purchases by, any one or more principal customers; (6) the reliance upon certain sole-source suppliers to manufacture and deliver critical components for the Company's products; (7) the inability to attract and retain skilled employees; (8) the inability to design and manufacture high-quality products; (9) inaccurate forecasts of customer demand; (10) the technological obsolescence of current products and the inability to develop new products; (11) the inability to protect the Company's proprietary technology and intellectual property; (12) the Company's involvement in time-consuming and costly litigation; (13) the impact of competitive pressures; (14) the challenges in integrating acquired businesses and achieving expected results from acquisitions; and (15) the inability to find attractive acquisition opportunities. The foregoing list should not be construed as exhaustive and the Company encourages readers to refer to the detailed discussion of risk factors included in Part I - Item 1A of the Company's Annual Report on Form 10-K. The Company cautions readers not to place undue reliance upon any such forward-looking statements, which speak only as of the date made. The Company disclaims any obligation to subsequently revise forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date such statements are made.

EXECUTIVE OVERVIEW

Cognex Corporation (the "Company") designs, develops, manufactures, and markets machine vision systems, or computers that can "see," which are used to automate a wide range of manufacturing processes where vision is required. The Company's Modular Vision Systems Division (MVSD) specializes in machine vision systems that are used to automate the manufacturing of discrete items, while the Company's Surface Inspection Systems Division (SISD) specializes in machine vision systems that are used to inspect the surfaces of materials processed in a continuous fashion.

In addition to product revenue derived from the sale of machine vision systems, the Company also generates revenue by providing maintenance and support, education, consulting, and installation services to its customers. The Company's customers can be classified into three markets: semiconductor and electronics capital equipment, discrete factory automation, and surface inspection. Semiconductor and electronics capital equipment manufacturers purchase Cognex machine vision systems and integrate them into the capital equipment that they manufacture and then sell to their customers in the semiconductor and electronics industries that either make computer chips or make printed circuit boards containing computer chips. Although the Company sells to original equipment manufacturers (OEMs) in a number of industries, these semiconductor and electronics OEMs have historically been large consumers of the Company's products. Discrete manufacturers in the factory automation area include a wide array of manufacturers who use machine vision for applications in a variety of industries, including the automotive, consumer electronics, food and beverage, healthcare, and pharmaceutical industries. The majority of these customers are end users who purchase Cognex machine vision systems and install them directly on their production lines. The last category, surface inspection customers, includes manufacturers of materials processed in a continuous fashion, such as paper and metals.

COGNEX CORPORATION: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Over the past few years, the Company has been successful in diversifying its customer base beyond semiconductor and electronics capital equipment manufacturers. Demand from these capital equipment manufacturers is highly cyclical, with periods of investment followed by temporary downturns. During the first half of 2004, the Company experienced an increase in orders from these customers that has since been curtailed. Although demand from capital equipment manufacturers has increased sequentially in each quarter of 2005, it is still well below the level experienced in the first half of 2004, resulting in a 33% decrease in sales to this sector for the year ended December 31, 2005 as compared to the prior year.

Despite the 33% decrease in sales to semiconductor and electronics capital equipment manufacturers from the prior year, the Company's total revenue in 2005 increased 7% from 2004 to $217 million due to growth in the discrete factory automation and surface inspection markets, as well as the acquisition of DVT Corporation on May 9, 2005. This acquisition provided the Company with a worldwide network of distributors to sell its expanding line of low-cost, easy-to-use products to the discrete factory automation market. Excluding revenue from acquired DVT products, discrete factory automation and surface inspection sales each grew by 22% from the prior year.

During 2005, the Company continued to focus its spending in strategic areas that help drive revenue growth in the discrete factory automation market. Although the growth in factory automation revenue exceeded the Company's investment in sales and marketing, net income decreased from $0.80 per share in 2004 to $0.74 per share in 2005 due to the dramatic decline in the semiconductor and electronics capital equipment business.

The following table sets forth certain consolidated financial data as a percentage of revenue:

Year ended December 31,	2005	2004	2003
Revenue	100%	100%	100%
Cost of revenue	29	28	33
Gross margin	71	72	67
Research, development, and engineering expenses	13	14	17
Selling, general, and administrative expenses	38	35	37
Operating income	20	23	13
Nonoperating income	2	3	3
Income before taxes	22	26	16
Income tax provision	6	7	5
Net income	16%	19%	11%

RESULTS OF OPERATIONS

YEAR ENDED DECEMBER 31, 2005 COMPARED TO YEAR ENDED DECEMBER 31, 2004

REVENUE

Revenue for the year ended December 31, 2005 increased 7% to $216,875,000 from $201,957,000 for the year ended December 31, 2004. Although sales to customers who make capital equipment for the semiconductor and electronics industries declined by $29,566,000, or 33%, from the prior year, this decrease was offset by increased sales to discrete manufacturing customers in the factory automation area (including approximately $19,000,000 of revenue from acquired DVT products) and higher sales to surface inspection customers. Demand from these capital equipment manufacturers is highly cyclical, with periods of investment followed by temporary downturns. During the first half of 2004, the Company experienced an increase in orders from these customers that has since been curtailed. However, sales to discrete factory automation customers increased $38,221,000, or 45%, from 2004 and sales to surface inspection customers increased $6,263,000, or 22%, from the prior year. As a result, revenue from customers outside of the semiconductor and electronics capital equipment sector grew from the prior year and represented the majority of the company's total revenue in 2005, increasing as a percentage of total revenue to 73% in 2005 from 58% in 2004. Geographically, revenue increased in all of the Company's major regions except in Japan, where many of the Company's semiconductor and electronics capital equipment customers are located.

Product revenue for the year ended December 31, 2005 increased 9% to $192,804,000 from $176,569,000 for the year ended December 31, 2004. The increase in product revenue was due to a higher volume of machine vision systems sold to discrete manufacturers in the factory automation area, as well as a higher volume of sales to surface inspection customers. Service revenue, which is derived from the sale of maintenance and support, education, consulting, and installation services, decreased 5% to $24,071,000 in 2005 from $25,388,000 in 2004 due principally to lower revenue generated by maintenance and support programs. In recent years, the Company has expanded its MVSD product offerings to include a wider range of easy-to-use products that require less maintenance and support, and this trend has resulted in a decline in service revenue. Service revenue decreased as a percentage of total revenue to 11% in 2005 from 13% in 2004.

MVSD revenue for the year ended December 31, 2005 increased 5% to $182,544,000 from $173,889,000 for the year ended December 31, 2004. The increase in MVSD revenue was due to a higher volume of modular vision systems sold to discrete manufacturing customers in the factory automation area. SISD revenue increased 22% to $34,331,000 in 2005 from $28,068,000 in 2004. The increase in SISD revenue was due principally to a higher volume of SmartView(R) system deliveries and installations. SISD revenue increased as a percentage of total revenue to 16% in 2005 compared to 14% in 2004.

GROSS MARGIN

Gross margin as a percentage of revenue was 71% for 2005 compared to 72% for 2004. The decrease in gross margin was primarily due to a higher percentage of total revenue from the sale of surface inspection systems, which have lower margins than the sale of modular vision systems, as well as a decline in MVSD service margins.

Product gross margin as a percentage of revenue was 75% for 2005 compared to 76% for 2004. The decrease in product margin was primarily due to a shift in product mix to lower-margin surface inspection systems. Service gross margin as a percentage of revenue was 36% for 2005 compared to 43% for 2004. The decrease in service margin was due principally to lower maintenance and support revenue that is sold bundled with MVSD products, without a corresponding decrease in expenses.

MVSD gross margin as a percentage of revenue was 75% for 2005 compared to 76% for 2004. The decrease in MVSD margin was primarily due to lower maintenance and support revenue. SISD gross margin as a percentage of revenue was 48% for 2005 compared to 45% for 2004. The increase in SISD margin was due principally to the higher sales volume with relatively flat overhead costs.

OPERATING EXPENSES

Research, development, and engineering (R,D&E) expenses for the year ended December 31, 2005 increased 2% to $27,640,000 from $27,063,000 for the year ended December 31, 2004. MVSD R,D&E expenses increased $498,000, or 2%, from the prior year primarily due to additional engineering personnel resulting from the acquisition of DVT Corporation on May 9, 2005, partially offset by lower company bonus accruals in 2005. SISD R,D&E expenses increased $79,000, or 3%, from the prior year due principally to increased compensation costs.

R,D&E expenses as a percentage of revenue were 13% in 2005 and 14% in 2004. The Company believes that a continued commitment to R,D&E activities is essential in order to maintain product leadership with our existing products and to provide innovative new product offerings, and therefore, we expect to continue to make significant R,D&E investments in the future. Although the Company targets its R,D&E spending to be between 10% and 15% of revenue, this percentage is impacted by revenue cyclicality. At any point in time, the Company has numerous research and development projects underway, and we believe that none of these projects is material on an individual basis.

Selling, general, and administrative (S,G&A) expenses for the year ended December 31, 2005 increased 16% to $82,332,000 from $70,674,000 for the year ended December 31, 2004. MVSD S,G&A expenses increased $12,570,000, or 23%, from the prior year, while SISD S,G&A expenses decreased $30,000 from 2004. Corporate expenses that are not allocated to a division decreased $882,000, or 11%, from the prior year.

The increase in MVSD expenses was primarily due to investments in sales and marketing intended to drive revenue growth in the discrete factory automation market, including the acquisition of DVT Corporation on May 9, 2005. This acquisition resulted in additional sales and marketing expenses related to managing a worldwide distribution network, as well as additional amortization expense of $2,517,000 related to the acquired intangible assets. In addition to the personnel added as a result of the DVT acquisition, the Company also made investments during 2005 in its direct factory automation sales force and in marketing activities, such as advertising, telemarketing, customer seminars, and trade shows.

The decrease in corporate expenses was principally due to the reversal of a $1,000,000 reserve established for possible indemnification of the Company's customers from patent infringement claims by the Lemelson Partnership, as well as lower company bonus accruals in 2005. These decreases were partially offset by higher professional fees in 2005.

NONOPERATING INCOME

Investment and other income for the year ended December 31, 2005 increased 10% to $5,130,000 from $4,670,000 for the year ended December 31, 2004. Although the average invested balance declined in 2005 due to $111,607,000 in net cash outlays related to the acquisition of DVT Corporation on May 9, 2005, investment and other income increased over the prior year because the Company earned higher yields on its portfolio of debt securities.

The foreign currency loss for the year ended December 31, 2005 was $888,000 compared to a gain of $1,641,000 for the year ended December 31, 2004. The Company recognizes foreign currency gains and losses on the revaluation and settlement of accounts receivable and payable balances that are reported in one currency and collected or paid in another, as well as intercompany transactions between its subsidiaries. The gain in 2004 was primarily due to the revaluation and settlement of intercompany balances between the Company and its Irish subsidiary. During 2004, the Euro Dollar strengthened versus the U.S. Dollar, resulting in foreign currency gains on the Irish subsidiary's books when these intercompany balances were revalued and paid. During 2005, the U.S. Dollar gained strength versus the Euro Dollar in the months that large intercompany transactions occurred, resulting in foreign currency losses on the Irish subsidiary's books. These losses were not as significant as the gains experienced in the prior year because foreign exchange rates did not fluctuate as significantly in 2005.

INCOME TAXES

The Company's effective tax rate for 2005 was 26% compared to 29% for 2004. The decrease in the effective tax rate was primarily due to more of the Company's profits being earned and taxed in lower tax jurisdictions.

**YEAR ENDED DECEMBER 31, 2004 COMPARED
TO YEAR ENDED DECEMBER 31, 2003**

REVENUE

Revenue for the year ended December 31, 2004 increased 35% to $201,957,000 from $150,092,000 for the year ended December 31, 2003. The majority of this growth came from sales to semiconductor and electronics capital equipment manufacturers, which increased $33,001,000, or 64%, from the prior year. While sales to these customers contributed most significantly to the Company's revenue growth in 2004, sales to discrete manufacturing customers also increased by $19,872,000, or 29%, from 2003. Surface inspection sales, however, decreased $1,008,000, or 3%, from the prior year. Although sales to customers outside of the semiconductor and electronics capital equipment sector grew from the prior year and represented the majority of the Company's total revenue in 2004, they decreased as a percentage of total revenue to 58% in 2004 from 66% in 2003 due to the significant increase in sales to semiconductor and electronics capital equipment manufacturers. Geographically, revenue increased from the prior year in all of the Company's major regions, but most significantly in Japan, where many of the Company's semiconductor and electronics capital equipment customers are located.

Product revenue for the year ended December 31, 2004 increased 35% to $176,569,000 from $130,670,000 for the year ended December 31, 2003. The increase in product revenue was due to a higher volume of machine vision systems sold to customers in the semiconductor, electronics, automotive, and other industries. Service revenue, which is derived from the sale of maintenance and support, education, consulting, and installation services, increased 31% to $25,388,000 from $19,422,000 due principally to higher revenue generated by maintenance and support programs that are sold bundled with product offerings. Service revenue remained constant as a percentage of total revenue at 13% in both 2003 and 2004.

MVSD revenue for the year ended December 31, 2004 increased 44% to $173,889,000 from $121,016,000 for the year ended December 31, 2003. The increase in MVSD revenue was due to a higher volume of modular vision systems sold to customers in the semiconductor, electronics, automotive and other industries. Although surface inspection orders increased from the prior year, the timing of shipments and installations resulted in a 3% decline in SISD revenue to $28,068,000 in 2004 from $29,076,000 in 2003. As a result of the increase in MVSD revenue, SISD revenue decreased as a percentage of total revenue to 14% in 2004 compared to 19% in 2003.

GROSS MARGIN

Gross margin as a percentage of revenue was 72% for 2004 compared to 67% for 2003. The increase in gross margin was primarily due to the impact of the higher sales volume without a proportional increase in manufacturing overhead costs, as well as a greater percentage of total revenue from the sale of modular vision systems, which have higher margins than the sale of services and surface inspection systems.

Product gross margin as a percentage of revenue was 76% for 2004 compared to 71% for 2003. The increase in product margin was primarily due to the increased sales volume, as well as the shift in product mix to higher-margin modular vision systems. Service gross margin as a percentage of revenue was 43% for 2004 compared to 37% for 2003. Many of the Company's products are sold with bundled maintenance and support programs for which the revenue is recognized over the program period. The increasing volume of product sales in 2003 and 2004 has resulted in higher service revenue derived from these maintenance and support programs. Although service costs increased to support the additional revenue, the increase in revenue was greater than the increase in costs.

MVSD gross margin as a percentage of revenue was 76% for 2004 compared to 71% for 2003. The increase in MVSD margin was primarily due to the higher sales volume of modular vision systems. SISD gross margin as a percentage of revenue was 45% for 2004 compared to 48% for 2003. The decrease in SISD margin was due principally to the impact of the lower revenue, while costs increased slightly.

OPERATING EXPENSES

Research, development, and engineering (R,D&E) expenses for the year ended December 31, 2004 increased 9% to $27,063,000 from $24,719,000 for the year ended December 31, 2003. MVSD R,D&E expenses increased $2,156,000, or 10%, from the prior year primarily due to higher personnel-related costs, including the additional engineering personnel resulting from the acquisition of the machine vision business of Gavitec AG on December 1, 2003 and the accrual of company bonuses for 2004. SISD R,D&E expenses increased $188,000, or 7%, from the prior year due principally to the accrual of company bonuses for 2004.

Selling, general, and administrative (S,G&A) expenses for the year ended December 31, 2004 increased 27% to $70,674,000 from $55,724,000 for the year ended December 31, 2003. MVSD S,G&A expenses increased $11,577,000, or 27%, from the prior year, while SISD S,G&A expenses increased $1,031,000, or 14%, from 2003. Corporate expenses that are not allocated to a division increased $2,342,000, or 41%, from the prior year. The increase in MVSD expenses was primarily due to the hiring of additional sales personnel and increased marketing spending to grow the Company's base of discrete manufacturing customers, higher commissions related to the increased sales volume, and the accrual of company bonuses for 2004, as well as the unfavorable impact of foreign exchange rates on the Company's international operations. A significant amount of the Company's sales and marketing costs are denominated in currencies other than the U.S. Dollar, primarily the Euro Dollar and Japanese Yen. During 2004, the Euro Dollar and Japanese Yen strengthened versus the U.S. Dollar, resulting in a higher level of expenses when these amounts were translated into U.S. Dollars. The increase in SISD expenses was primarily due to higher personnel-related costs, as well as the accrual of company bonuses for 2004. The increase in corporate expenses was principally due to the accrual of company bonuses for 2004, as well as higher professional fees related to services required to ensure the Company's compliance with the Sarbanes-Oxley Act of 2002.

NONOPERATING INCOME

Investment and other income for the year ended December 31, 2004 decreased 14% to $4,670,000 from $5,450,000 for the year ended December 31, 2003. This decrease was due principally to lower average interest rates on the Company's portfolio of debt securities.

The foreign currency gain for the year ended December 31, 2004 was $1,641,000 compared to a loss of $1,712,000 for the year ended December 31, 2003. The loss in 2003 was primarily due to the revaluation and settlement of the Company's Irish subsidiary's accounts receivable denominated in U.S. Dollars and Japanese Yen. During 2003, the Euro Dollar strengthened versus the U.S. Dollar and Japanese Yen, resulting in foreign currency losses on the Irish subsidiary's books when these receivables were revalued and collected. Although the Company experienced similar losses in 2004, they were offset by gains on the revaluation and settlement of intercompany balances and gains on forward contracts.

INCOME TAXES

The Company's effective tax rate for 2004 was 29% compared to 31% for 2003. The decrease in the effective tax rate was primarily due to more of the Company's profits being earned and taxed in lower tax jurisdictions.

LIQUIDITY AND CAPITAL RESOURCES

The Company has historically been able to generate positive cash flow from operations, which has funded the Company's operating activities and other cash requirements and has resulted in an accumulated cash, cash equivalent, and investment balance of $312,258,000 at December 31, 2005, representing 62% of shareholders' equity. The Company has established guidelines relative to credit ratings, diversification, and maturities of its investments that maintain liquidity.

The Company's cash requirements during the year ended December 31, 2005 were met with the Company's existing cash, cash equivalent, and investment balances, as well as positive cash flow from operations and the proceeds from the issuance of common stock under stock option and stock purchase plans. Cash requirements primarily consisted of operating activities, capital expenditures, the payment of dividends, the repurchase of common stock, and the purchase of DVT Corporation. Capital expenditures in 2005 totaled $3,819,000 and consisted primarily of expenditures for computer hardware.

The Company believes that its existing cash, cash equivalent, and investment balance, together with continued positive cash flow from operations, will be sufficient to meet its operating, investing, and financing activities in 2006 and the foreseeable future.

The following table summarizes the Company's material contractual obligations, both fixed and contingent (in thousands):

Year Ended December 31,	Limited Partnership Interest	Inventory Purchase Commitments	Leases	Total
2006	$ 5,050	$ 10,297	$ 4,836	$ 20,183
2007	-	-	4,504	4,504
2008	-	-	2,682	2,682
2009	-	-	1,517	1,517
2010	-	-	938	938
Thereafter	-	-	2,575	2,575
	$ 5,050	$ 10,297	$ 17,052	$ 32,399

On June 30, 2000, Cognex Corporation became a Limited Partner in Venrock Associates III, L.P. (Venrock), a venture capital fund. A director of the Company is a Managing General Partner of Venrock Associates. In the original agreement with Venrock, the Company committed to a total investment in the limited partnership of up to $25,000,000, with the commitment period expiring on January 1, 2005. In January 2005, the Company signed an amendment to the original agreement with Venrock, which reduces its commitment to $22,500,000 and extends the commitment period through December 31, 2010. The Company does not have the right to withdraw from the partnership prior to December 31, 2010. As of December 31, 2005, the Company had contributed $17,450,000 to the partnership, including $1,575,000 during 2005. The remaining commitment of $5,050,000 can be called by Venrock in any period through 2010.

In addition to the obligations described above, the following items may also result in future material uses of cash:

STOCK REPURCHASE PROGRAM

On December 12, 2000, the Company's Board of Directors authorized the repurchase of up to $100,000,000 of the

Company's common stock. The Company repurchased 383,908 shares at a cost of $11,690,000 in 2005 and 1,768,452 shares at a cost of $26,425,000 in 2002 under this program. The Company may repurchase additional shares under this program in future periods depending upon a variety of factors, including the market value of the Company's common stock and the average return on the Company's invested balances.

DIVIDENDS

Beginning in the third quarter of 2003, the Company's Board of Directors has declared and paid a cash dividend in each quarter, including the first quarter of 2006. Dividend payments amounted to $14,960,000 during 2005 and $3,784,000 in the first quarter of 2006. These payments represented a dividend of $0.08 per share in each quarter. Future dividends will be declared at the discretion of the Board of Directors and will depend upon such factors as the Board deems relevant.

STANDBY LETTERS OF CREDIT AND INCOME TAXES

On March 23, 2005, the Company provided standby letters of credit totaling 3,264,887,000 Yen (or approximately $27,683,000 based upon the exchange rate at December 31, 2005) to taxing authorities in Japan that are collateralized by investments on the Consolidated Balance Sheet. The Tokyo Regional Taxation Bureau (TRTB) has asserted that Cognex Corporation has a permanent establishment in Japan that would require certain income, previously reported on U.S. tax returns for the years ended December 31, 1997 through December 31, 2001, to be subject instead to taxation in Japan. The Company disagrees with this position and believes that this assertion is inconsistent with principles under the U.S.
- Japan income tax treaty. The Company has filed a notice of objection and request for deferral of tax payment and intends to contest this assessment vigorously, although no assurances can be made that the Company will prevail in this matter. In September 2003, the Company also filed a request with the Internal Revenue Service Tax Treaty Division for competent authority assistance. Until this matter is resolved, the Company is required to provide collateral for these tax assessments. These letters of credit expire in approximately one year and will be renewed as required. Should the TRTB prevail in its assertion, the income in question would be taxable in Japan and the Company would be required to pay approximately $27,683,000 in taxes, interest, and penalties to Japanese taxing authorities. The Company would then be entitled to recoup the majority of this amount from taxing authorities in the U.S. The Company has not provided any additional accrual or reserve related to this matter.

DERIVATIVE INSTRUMENTS

In certain instances, the Company enters into forward contracts and currency swaps to hedge against foreign currency fluctuations. Although the settlement of these instruments may result in significant cash inflows and outflows, they should not expose the Company to significant foreign currency net gains or losses because the terms of the derivative instrument and the underlying exposure are generally matched at inception.

ACQUISITIONS

On March 31, 2003, the Company acquired the wafer identification business of Siemens Dematic AG for 7,000,000 Euros in cash (or approximately $7,630,000) paid at closing, with the potential for an additional cash payment of up to 1,700,000 Euros (or approximately $2,013,000) depending upon the achievement of certain performance criteria. The Company reviewed these performance criteria during the fourth quarter of 2005 and concluded that they were not met. Accordingly, the Company does not expect to make additional payments related to this acquisition. During the first quarter of 2006, Siemens is exercising its right to review the Company's documentation supporting this conclusion.

OFF-BALANCE SHEET ARRANGEMENTS

As of December 31, 2005, the Company had no off-balance sheet arrangements.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Company's discussion and analysis of its financial condition and results of operations are based upon its consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue, and expenses, and related disclosure of contingent assets and liabilities. Management bases its estimates on historical experience and various other assumptions believed to be 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. Actual results could differ from these estimates under different assumptions or circumstances resulting in charges that could be material in future reporting periods. The Company believes the following critical accounting policies require the use of significant estimates and judgments in the preparation of its consolidated financial statements.

REVENUE RECOGNITION

The Company recognizes revenue from product sales upon delivery if a signed customer contract or purchase order has been received, the fee is fixed or determinable, and collection of the resulting receivable is probable. If the arrangement contains customer-specified acceptance criteria, then revenue is deferred until the Company can demonstrate that the customer's criteria have been met. The Company maintains reserves against revenue for potential product returns. Revenue from maintenance and support programs is deferred and recognized ratably over the program period. Revenue from education and consulting services is recognized over the period the services are provided. Revenue from installation services is recognized when the customer has signed off that the installation is complete. The Company has established vendor-specific objective evidence of fair value for each undelivered element.

While the Company applies the guidance of Statement of Position (SOP) No. 97-2, "Software Revenue Recognition," as amended by SOP No. 98-9, "Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions," management exercises judgment in connection with the determination of the amount of revenue to be recognized each period. Such judgments include, but are not limited to, assessing the probability of collecting the receivable, assessing whether the fee is fixed or determinable, and assessing whether customer-specified acceptance criteria are substantive in nature.

INVESTMENTS

At December 31, 2005, the Company's investment balance totaled $239,402,000, of which $229,019,000 consisted of municipal bonds, commercial paper, and other debt securities. Debt securities are reported at fair value, with unrealized gains and losses, net of tax, recorded in shareholders' equity as other comprehensive income (loss). At December 31, 2005, the Company's portfolio of debt securities had gross unrealized losses totaling $1,172,000.

The remaining investment balance of $10,383,000 represented a limited partnership interest in Venrock Associates III, L.P., a venture capital fund. A director of the Company is a Managing General Partner of Venrock Associates. The Company's limited partnership interest is accounted for using the cost method because the Company's investment is less than 5% of the partnership and the Company has no influence over the partnership's operating and financial policies. At December 31, 2005, the carrying value of this investment was $10,383,000 compared to an estimated fair value of $12,017,000.

The fair value of the Company's limited partnership interest is based upon valuations of the partnership's investments as determined by the General Partner. The Company understands that the General Partner adjusts the investment valuations at least quarterly to reflect both realized and unrealized gains and losses on partnership investments. Securities of public companies are valued at market, subject to appropriate discounts to reflect limitations on liquidity. Securities of private companies are valued at an estimated fair value, which initially is at cost, adjusted for subsequent transactions that indicate a higher or lower value is warranted. The value of private securities may be discounted when, in the General Partner's judgment, the carrying value of such private securities has been impaired by specific events.

The Company monitors the carrying value of its investments compared to their fair value to determine whether an other-than-temporary impairment has occurred. In considering whether a decline in fair value is other than temporary, the Company considers many factors, both qualitative and quantitative in nature. Some of these factors include the duration and extent of the fair value decline, the length of the Company's commitment to the investment, and general economic, stock market, and interest rate trends. In the case of the Company's limited partnership investment, specific communications from the General Partner are also considered in this evaluation. If a decline in fair value is determined to be other-than-temporary, an impairment charge would be recorded in current operations. There were no other-than-temporary impairments of investments in 2005, 2004, or 2003.

ACCOUNTS RECEIVABLE

The Company maintains reserves against its accounts receivable for potential credit losses. Ongoing credit evaluations of customers are performed and the Company has historically not experienced significant losses related to the collection of its accounts receivable. Allowances for specific accounts determined to be at risk for collection are estimated by management taking into account the length of time receivables have been outstanding, the risks associated with selling to smaller customers, and the economic conditions of the primary regions and industries sold to, as well as general economic conditions. An adverse change in any of these factors may result in the need for additional bad debt provisions.

INVENTORIES

Inventories are stated at the lower of cost or market. The Company estimates excess and obsolescence exposures based upon assumptions about future demand, product transitions, and market conditions and records reserves to reduce the carrying value of inventories to their net realizable value. The failure to accurately forecast demand, in terms of both volume and configuration, and adjust material requirement plans in a timely manner may lead to additional excess and obsolete inventory and future charges.

LONG-LIVED ASSETS

The Company has long-lived assets including property, plant, and equipment, as well as acquired goodwill and other intangible assets. These assets are susceptible to shortened estimated useful lives and changes in fair value due to changes in their use, market or economic changes, or other events or circumstances. In addition, the fair value of goodwill is susceptible to changes in the fair value of the reporting units in which the goodwill resides, which are also reportable segments. The Company evaluates the potential impairment of its long-lived assets annually, as required, or whenever events or circumstances indicate their carrying value may not be recoverable. If events or circumstances occur which would require a significant reduction in the estimated useful lives of these assets or a significant decrease in fair value below their carrying value, an adjustment to the lives or carrying values would result in a charge to income in the period of determination.

WARRANTY OBLIGATIONS

The Company records the estimated cost of fulfilling product warranties at the time of sale based upon historical costs to fulfill warranty obligations. Provisions may also be recorded subsequent to the time of sale whenever specific events or circumstances impacting product quality become known that would not have been taken into account using historical data. While the Company engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of its component suppliers and third-party contract manufacturers, the Company's warranty obligation is affected by product failure rates, material usage, and service delivery costs incurred in correcting a product failure. An adverse change in any of these factors may result in the need for additional warranty provisions.

CONTINGENCIES

Estimated losses from contingencies are accrued by management based upon the likelihood of a loss and the ability to reasonably estimate the amount of the loss. Estimating potential losses, or even a range of losses, is difficult and involves a great deal of judgment. The Company relies primarily on assessments made by its internal and external legal counsel to make its determination as to whether a loss contingency arising from litigation should be recorded or disclosed. Should the resolution of a contingency result in a loss that the Company did not accrue because management did not believe that the loss was probable or capable of being reasonably estimated, then this loss would result in a charge to income in the period the contingency was resolved.

INCOME TAXES

As part of the process of preparing consolidated financial statements, management is required to estimate income taxes in each of the jurisdictions in which the Company operates. This process involves estimating the current tax liability, as well as assessing temporary differences arising from the different treatment of items for financial statement and tax purposes. These differences result in deferred tax assets and liabilities, which are recorded on the Consolidated Balance Sheet.

At December 31, 2005, the Company had net deferred tax assets of $17,894,000, primarily resulting from temporary differences between the financial statement and tax bases of assets and liabilities. Management has evaluated the realizability of these deferred tax assets and has determined that it is more likely than not that these assets will be realized. In reaching this conclusion, management has evaluated relevant criteria, including the Company's historical profitability, current projections of future profitability, and the lives of tax credits, net operating and capital losses, and other carryforwards, certain of which have indefinite lives. Should the Company fail to generate sufficient pre-tax profits in future periods, the Company may be required to record material adjustments to these deferred tax assets, resulting in a charge to income in the period of determination.

Significant judgment is required in determining worldwide income tax expense based upon tax laws in the various jurisdictions in which the Company operates. The Company has established reserves to provide for additional income taxes that may be due in future years as these previously filed tax returns are audited. These reserves have been established based upon management's assessment as to the potential exposure attributable to permanent differences and interest applicable to both permanent and temporary differences. All tax reserves are analyzed periodically and adjustments are made as events occur that warrant modification, such as the completion of audits or the expiration of statues of limitations, which may result in future charges or credits to tax expense.

DERIVATIVE INSTRUMENTS

In certain instances, the Company enters into forward contracts and currency swaps to hedge against foreign currency fluctuations. These contracts are used to reduce the Company's risk associated with foreign currency exchange rate changes, as the gains or losses on these contracts are intended to offset the losses or gains on the underlying exposures. The Company does not engage in foreign currency speculation.

The Company recorded net foreign currency losses of $888,000 in 2005, net foreign currency gains of $1,641,000 in 2004, and net foreign currency losses of $1,712,000 in 2003. The Company's exposure to foreign currency gains and losses has increased in recent years as a greater portion of its revenues, expenses, assets, and liabilities are denominated in currencies other than the functional currencies of the Company or its subsidiaries. In addition, foreign exchange rates have fluctuated significantly in recent years.

Administering the Company's foreign currency risk management program requires the use of estimates and the application of judgment, including compiling forecasts of transaction activity denominated in various currencies. The failure to identify foreign currency exposures and construct effective hedges may result in material foreign currency gains or losses.

NEW PRONOUNCEMENTS

SFAS NO. 123R, "SHARE-BASED PAYMENT"

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 123R, "Share-Based Payment," which is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation." SFAS No. 123R requires companies to recognize compensation cost for all share-based payments to employees (including stock option and employee stock purchase plans) at fair value. SFAS No. 123R will be effective for public companies no later than the beginning of the first fiscal year after June 15, 2005. The Company will adopt SFAS No. 123R beginning in the first quarter of 2006 using the modified prospective method in which compensation cost is recognized beginning on the effective date.

The Company currently recognizes compensation costs using the intrinsic value based method and, as such, generally recognizes no compensation cost. Accordingly, the adoption of SFAS No. 123R's fair value based method will have a significant impact on the Company's results of operations, although it will have no impact on its overall financial position. Had the Company adopted SFAS No. 123R in prior periods, the impact of that standard would have approximated the impact of SFAS No. 123 as described in the disclosure of pro forma net income and net income per share in Note 1 to the Company's consolidated financial statements. The impact of the adoption of SFAS No. 123R in future periods will depend, in part, upon the level of share-based payments granted in the future. Based upon preliminary estimates of stock option grants in 2006, as well as preliminary valuation assumptions, such as expected stock price volatility, option lives, and forfeiture rates, the Company anticipates total pre-tax share-based compensation costs for 2006 to approximate $12,000,000.

SFAS NO. 151, "INVENTORY COSTS"

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs, an Amendment of Accounting Research Bulletin (ARB) No. 43, Chapter 4." SFAS No. 151 amends the guidance in ARB No. 43, Chapter 4, "Inventory Pricing" to clarify that abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage) should be recognized as current-period charges. In addition, SFAS No. 151 requires that the allocation of fixed production overhead to the costs of conversion be based on the normal capacity of the production facilities. The provisions of SFAS No. 151 are effective for fiscal years beginning after June 15, 2005. The Company has adopted the provisions of SFAS No. 151 and its adoption did not have a material impact on the Company's financial condition or results of operations.

AJCA OF 2004

In October 2004, the American Jobs Creation Act of 2004 (the "AJCA") was passed. The AJCA provides a deduction for income from qualified domestic production activities, which is being phased in from 2005 through 2010. The AJCA also provides for a two-year phase-out of the existing extra-territorial income exclusion for foreign sales that was viewed to be inconsistent with international trade protocols by the European Union. In December 2004, the FASB issued FASB Staff Position (FSP) No. 109-1, "Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004." FSP No. 109-1 treats the deduction as a "special deduction" as described in SFAS No. 109. This special deduction has no effect on deferred tax assets and liabilities existing at the enactment date and the effect of this deduction will be reported in the same period in which the deduction is claimed in the Company's tax return.

The AJCA also creates a temporary incentive for U.S. corporations to repatriate accumulated income earned abroad by providing an 85% dividends received deduction for certain dividends from controlled foreign corporations. This deduction is subject to a number of limitations. After careful review of the AJCA temporary incentive for repatriation of accumulated income, the Company has determined that there will be no immediate changes to its current policy to reinvest the accumulated earnings of its foreign subsidiaries.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

FOREIGN CURRENCY RISK

The Company faces exposure to adverse movements in foreign currency exchange rates as a significant portion of its revenues, expenses, assets, and liabilities are denominated in currencies other than the functional currencies of the Company or its subsidiaries. These exposures may change over time as business practices evolve. The Company evaluates its foreign currency exposures on an ongoing basis and makes adjustments to its foreign currency risk management program as circumstances change.

In certain instances, the Company enters into forward contracts and currency swaps to hedge against foreign currency fluctuations. Currency swaps are used to hedge long-term transactions between the Company and its subsidiaries. Forward contracts are used to provide a hedge against transactions denominated in currencies other than the functional currencies of the Company or its subsidiaries. These forward contracts and currency swaps are used to reduce the Company's risk associated with foreign currency exchange rate changes, as the gains or losses on these contracts are intended to offset the losses or gains on the underlying exposures. The Company does not engage in foreign currency speculation.

The success of the Company's foreign currency risk management program depends upon forecasts of transaction activity denominated in various currencies. To the extent that these forecasts are overstated or understated during periods of currency volatility, the Company could experience unanticipated foreign currency gains or losses that could have a material impact on the Company's results of operations. In addition, the failure to identify new exposures and hedge them in a timely manner may result in material foreign currency gains or losses.

The Company enters into currency swaps to hedge the foreign currency exposure of its long-term intercompany loans between the parent and certain of its European subsidiaries. Currency swaps to exchange a total of 41,340,000 Euro Dollars for U.S. Dollars at a weighted-average settlement price of 1.02 USD/Euro, with original terms of approximately four to five years, were outstanding at December 31, 2005. These instruments had a fair value of an $8,987,000 loss at December 31, 2005, which was materially offset by gains on the Company's intercompany loans. In addition, the Company enters into forward contracts to hedge the foreign currency exposure of its Irish subsidiary's accounts receivable denominated in U.S. dollars and Japanese Yen. Forward contracts to exchange 1,234,500,000 Japanese Yen for Euro Dollars at a weighted-average settlement price of 137.54 Yen/Euro and contracts to exchange 6,060,000 U.S. dollars for Euro Dollars at a weighted-average settlement price of 1.19 USD/Euro, both with terms of one to six months, were outstanding at December 31, 2005. These instruments had a fair value of a $131,000 gain at December 31, 2005.

INTEREST RATE RISK

The Company's investment portfolio includes municipal bonds, commercial paper, and other debt securities. Debt securities with original maturities greater than three months are designated as available-for-sale and are reported at fair value. At December 31, 2005, the fair value of the Company's portfolio of debt securities amounted to $229,019,000, with principal amounts totaling $233,100,000, maturities that do not exceed three years, and a yield to maturity of 2.61%. Differences between the fair value and principal amounts of the Company's portfolio of debt securities are primarily attributable to discounts and premiums arising at the acquisition date, as well as unrealized gains and losses at the balance sheet date.

Given the relatively short maturities and investment-grade quality of the Company's portfolio of debt securities at December 31, 2005, a sharp rise in interest rates should not have a material adverse effect on the fair value of these instruments. As a result, the Company does not currently hedge these interest rate exposures.

The following table presents the hypothetical change in the fair value of the Company's portfolio of debt securities arising from selected potential changes in interest rates (in thousands). This modeling technique measures the change in fair value that would result from a parallel shift in the yield curve plus or minus 50 and 100 basis points (BP) over a twelve-month time horizon.

Type of security	Valuation of securities given an interest rate decrease		No change in interest rates	Valuation of securities given an interest rate increase	
	(100 BP)	(50 BP)		50 BP	100 BP
Municipal Bonds, Commercial Paper, and Other Debt Securities	$242,445	$242,586	$243,718	$241,799	$241,936

OTHER MARKET RISKS

The Company's investment portfolio also includes a limited partnership interest in Venrock Associates III, L.P., a venture capital fund with an investment focus on Information Technology and Health Care and Life Sciences. The majority of the partnership's portfolio consists of investments in early stage, private companies characterized by a high degree of risk, volatility, and illiquidity. A director of the Company is a Managing General Partner of Venrock Associates.

The fair value of the Company's limited partnership interest is based upon valuations of the partnership's investments as determined by the General Partner. The Company understands that the General Partner adjusts the investment valuations at least quarterly to reflect both realized and unrealized gains and losses on partnership investments.

Securities of public companies are valued at market, subject to appropriate discounts to reflect limitations on liquidity. Securities of private companies are valued at an estimated fair value, which initially is at cost, adjusted for subsequent transactions that indicate a higher or lower value is warranted. The value of private securities may be discounted when, in the General Partner's judgment, the carrying value of such private securities has been impaired by specific events.

At December 31, 2005, the carrying value of this investment was $10,383,000 compared to an estimated fair value, as determined by the General Partner, of $12,017,000. Should the fair value of this investment decline in future periods below its carrying value, the Company will determine whether this decline is other-than-temporary and future impairment charges may be required.

COGNEX CORPORATION: CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)

Year Ended December 31,	2005	2004	2003
Revenue			
Product	$ 192,804	$ 176,569	$ 130,670
Service	24,071	25,388	19,422
	216,875	201,957	150,092
Cost of revenue			
Product	47,611	42,788	37,870
Service	15,288	14,583	12,269
	62,899	57,371	50,139
Gross margin			
Product	145,193	133,781	92,800
Service	8,783	10,805	7,153
	153,976	144,586	99,953
Research, development, and engineering expenses	27,640	27,063	24,719
Selling, general, and administrative expenses	82,332	70,674	55,724
Operating income	44,004	46,849	19,510
Investment and other income	5,130	4,670	5,450
Foreign currency gain (loss)	(888)	1,641	(1,712)
Income before taxes	48,246	53,160	23,248
Income tax provision	12,544	15,416	7,297
Net income	$ 35,702	$ 37,744	$ 15,951
Net income per common and common equivalent share:			
Basic	$ 0.76	$ 0.83	$ 0.37
Diluted	$ 0.74	$ 0.80	$ 0.36
Weighted-average common and common equivalent shares outstanding:			
Basic	46,709	45,480	43,173
Diluted	47,935	47,358	44,466
Cash dividends per common share	$ 0.32	$ 0.28	$ 0.12

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

COGNEX CORPORATION: CONSOLIDATED BALANCE SHEETS
(In thousands)

December 31,	2005	2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 72,856	$ 54,270
Short-term investments	169,156	180,409
Accounts receivable, less reserves of $2,370 and $2,596 in 2005 and 2004, respectively	42,051	33,816
Inventories, net	18,819	20,091
Deferred income taxes	7,667	9,504
Prepaid expenses and other current assets	16,104	14,871
Total current assets	326,653	312,961
Long-term investments	70,246	156,397
Property, plant, and equipment, net	24,175	23,995
Deferred income taxes	10,227	21,516
Intangible assets, net	50,049	7,506
Goodwill	79,807	7,033
Other assets	3,405	3,900
	$ 564,562	$ 533,308
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 7,118	$ 5,563
Accrued expenses	43,476	55,779
Customer deposits	2,142	3,445
Deferred revenue	5,305	5,714
Total current liabilities	58,041	70,501
Commitments (Notes 4, 9, 10, 11, 14, and 17)		
Shareholders' equity:		
Common stock, $.002 par value - Authorized: 140,000 shares, issued: 47,171 and 46,155 shares in 2005 and 2004, respectively	94	92
Additional paid-in capital	216,031	192,860
Retained earnings	304,454	283,712
Accumulated other comprehensive loss	(14,058)	(13,857)
Total shareholders' equity	506,521	462,807
	$ 564,562	$ 533,308

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

COGNEX CORPORATION - CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(In thousands)

	Common Stock Shares	Common Stock Par Value	Additional Paid-in Capital	Treasury Stock Shares	Treasury Stock Cost	Retained Earnings	Accumulated Other Comprehensive Loss	Comprehensive Income	Total Shareholders' Equity
Balance at December 31, 2002	46,877	$ 94	$ 184,595	4,249	$ (72,311)	$ 248,010	$ (5,868)		$ 354,520
Issuance of common stock under stock option, stock purchase, and other plans	1,309	2	20,782	-	-	-	-	-	20,784
Tax benefit from exercise of stock options	-	-	4,302	-	-	-	-	-	4,302
Payment of dividends	-	-	-	-	-	(5,237)	-	-	(5,237)
Common stock received for payment of stock option exercises	-	-	-	4	(134)	-	-	-	(134)
Comprehensive income:									
Net income	-	-	-	-	-	15,951	-	$ 15,951	15,951
Losses on currency swaps, net of gains on long-term intercompany loans, net of tax of $367	-	-	-	-	-	-	(625)	(625)	(625)
Net unrealized gain on available-for- sale investments, net of tax of $299	-	-	-	-	-	-	509	509	509
Foreign currency translation adjustment	-	-	-	-	-	-	(5,076)	(5,076)	(5,076)
Comprehensive income								$ 10,759	
Balance at December 31, 2003	48,186	$ 96	$ 209,679	4,253	$ (72,445)	$ 258,724	$ (11,060)		$ 384,994
Issuance of common stock under stock option, stock purchase, and other plans	2,232	4	44,213	-	-	-	-	-	44,217
Tax benefit from exercise of stock options	-	-	11,722	-	-	-	-	-	11,722
Payment of dividends	-	-	-	-	-	(12,756)	-	-	(12,756)
Common stock received for payment of stock option exercises	-	-	-	10	(317)	-	-	-	(317)
Retirement of treasury stock	(4,263)	(8)	(72,754)	(4,263)	72,762	-	-	-	-
Comprehensive income:									
Net income	-	-	-	-	-	37,744	-	37,744	37,744
Losses on currency swaps, net of gains on long-term intercompany loans, net of tax of $1,016	-	-							
Net unrealized loss on available-for-sale investments, net of tax of $696	-	-							
Foreign currency translation adjustment	-	-							
Comprehensive income									
Balance at December 31, 2004	46,155	$ 92							
Issuance of stock under stock option, stock purchase, and other plans	1,400	2							
Tax benefit from exercise of stock options	-	-							
Payment of dividends	-	-							
Repurchase of common stock	(384)	-							
Comprehensive income:									
Net income	-	-							
Gains on long-term intercompany loans, net of losses on currency swaps, net of tax of $82	-	-							
Net unrealized loss on available-for-sale investments, net of tax of $31	-	-							
Foreign currency translation adjustment	-	-							
Comprehensive income									
Balance at December 31, 2005	47,171	$ 94							

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

-	-	-	-	(1,730)	(1,730)	(1,730)
-	-	-	-	(1,185)	(1,185)	(1,185)
-	-	-	-	118	118	118
					$ 34,947	
$ 192,860	-	$ -	$ 283,712	$ (13,857)		$ 462,807
27,213	-	-	-	-	-	27,215
7,648	-	-	-	-	-	7,648
-	-	-	(14,960)	-	-	(14,960)
(11,690)	-	-	-	-	-	(11,690)
-	-	-	35,702	-	35,702	35,702
-	-	-	-	139	139	139
-	-	-	-	(52)	(52)	(52)
-	-	-	-	(288)	(288)	(288)
					$ 35,501	
$ 216,031	-	$ -	$ 304,454	$ (14,058)		$ 506,521

COGNEX CORPORATION: CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

Year Ended December 31,	2005	2004	2003
Cash flows from operating activities:			
Net income	$ 35,702	$ 37,744	$ 15,951
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation of property, plant, and equipment	4,387	4,548	5,422
Amortization of intangible assets	4,283	1,526	1,012
Amortization of investments	2,755	3,896	3,728
Tax benefit from exercise of stock options	7,648	11,722	4,302
Deferred income tax benefit	(2,996)	(2,568)	(432)
Net loss (gain) on investment in limited partnership	-	(154)	1,031
Changes in current assets and current liabilities:			
Accounts receivable	(5,770)	(5,417)	(4,775)
Inventories	1,048	(3,642)	5,833
Accounts payable	735	(290)	1,482
Accrued expenses	(7,089)	15,785	148
Other current assets and current liabilities	1,694	(49)	(2,783)
Other operating activities	364	75	45
Net cash provided by operating activities	42,761	63,176	30,964
Cash flows from investing activities:			
Purchase of investments	(1,437,264)	(805,621)	(316,481)
Maturity and sale of investments	1,531,830	716,714	276,529
Purchase of property, plant, and equipment	(3,819)	(3,120)	(2,462)
Cash paid for business acquisitions, net of cash acquired	(111,842)	(123)	(11,787)
Net cash used in investing activities	(21,095)	(92,150)	(54,201)
Cash flows from financing activities:			
Issuance of common stock under stock option, stock purchase, and other plans	27,215	43,900	20,650
Repurchase of common stock	(11,690)	-	-
Payment of dividends	(14,960)	(12,756)	(5,237)
Net cash provided by financing activities	565	31,144	15,413
Effect of exchange rate changes on cash	(3,645)	2,120	(660)
Net increase (decrease) in cash and cash equivalents	18,586	4,290	(8,484)
Cash and cash equivalents at beginning of year	54,270	49,980	58,464
Cash and cash equivalents at end of year	$ 72,856	$ 54,270	$ 49,980

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

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying consolidated financial statements reflect the application of the significant accounting policies described below.

NATURE OF OPERATIONS

Cognex Corporation (the "Company") designs, develops, manufactures, and markets machine vision systems, or computers that can "see." The Company's products are used to automate a wide range of manufacturing processes where vision is required.

USE OF ESTIMATES IN THE PREPARATION OF FINANCIAL STATEMENTS

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and judgments that affect the reported amounts of assets and liabilities at the balance sheet date and the reported amounts of revenue and expenses during the year. Actual results could differ from those estimates.

BASIS OF CONSOLIDATION

The consolidated financial statements include the accounts of Cognex Corporation and its subsidiaries, all of which are wholly-owned. All intercompany accounts and transactions have been eliminated. Certain amounts reported in prior years have been reclassified to be consistent with the current year presentation.

FOREIGN CURRENCY

The financial statements of the Company's foreign subsidiaries, where the local currency is the functional currency, are translated using exchange rates in effect at the end of the year for assets and liabilities and average exchange rates during the year for results of operations. The resulting foreign currency translation adjustment is recorded in shareholders' equity as other comprehensive income (loss).

CASH, CASH EQUIVALENTS, AND INVESTMENTS

Debt securities purchased with original maturities of three months or less are classified as cash equivalents and are stated at amortized cost. Debt securities with original maturities greater than three months and remaining maturities of one year or less, as well as auction rate securities for which interest rates reset in less than 90 days but for which the maturity date is greater than 90 days, are classified as short-term investments. Despite the long-term nature of their contractual maturities, the Company has the ability to quickly liquidate auction rate securities. Debt securities with remaining maturities greater than one year, as well as a limited partnership interest, are classified as long-term investments. It is the Company's policy to invest in debt securities with contractual maturities that do not exceed three years.

Debt securities with original maturities greater than three months are designated as available-for-sale and are reported at fair value, with unrealized gains and losses, net of tax, recorded in shareholders' equity as other comprehensive income (loss). Realized gains and losses are included in current operations, along with the amortization of the discount or premium arising at acquisition and are calculated using the specific identification method. The Company's limited partnership interest is accounted for using the cost method because the Company's investment is less than 5% of the partnership and the Company has no influence over the partnership's operating and financial policies.

The Company monitors the carrying value of its investments compared to their fair value to determine whether an other-than-temporary impairment has occurred. If a decline in fair value is determined to be other-than-temporary, an impairment charge related to that specific investment is recorded in current operations. There were no other-than temporary impairments of investments in 2005, 2004, or 2003.

ACCOUNTS RECEIVABLE

The Company establishes reserves against its accounts receivable for potential credit losses when it determines receivables are at risk for collection based upon the length of time receivables have been outstanding, as well as various other factors. Receivables are written off against these reserves in the period they are determined to be uncollectible.

INVENTORIES

Inventories are stated at the lower of cost or market. Cost is determined using standard costs, which approximate the first in, first out (FIFO) method. The Company estimates excess and obsolescence exposures based upon assumptions about future demand, product transitions, and market conditions and records reserves to reduce the carrying value of inventories to their net realizable value.

The Company generally disposes of obsolete inventory upon determination of obsolescence. The Company does not dispose of excess inventory immediately, due to the possibility that some of this inventory could be sold to customers as a result of differences between actual and forecasted demand.

When inventory has been written down below cost, such reduced amount is considered the new cost basis for subsequent accounting purposes. As a result, the Company would recognize a higher than normal gross margin if the reserved inventory were subsequently sold.

PROPERTY, PLANT, AND EQUIPMENT

Property, plant, and equipment are stated at cost and depreciated using the straight-line method over the assets' estimated useful lives. Buildings' useful lives are 39 years, building improvements' useful lives are 10 years, and the useful lives of computer hardware, computer software, and furniture and fixtures range from two to five years. Leasehold improvements are depreciated over the shorter of the estimated useful lives or the remaining terms of the leases. Maintenance and repairs are expensed when incurred; additions and improvements are capitalized. Upon retirement or disposition, the cost and related accumulated depreciation of the assets disposed of are removed from the accounts, with any resulting gain or loss included in current operations.

INTANGIBLE ASSETS

Intangible assets are stated at cost and amortized using the straight-line method over the assets' estimated useful lives. Distribution networks' useful lives range from 11-12 years, customer contracts and relationships' useful lives range from 8-12 years, and completed technologies and other intangible assets' useful lives range from three to six years. The Company evaluates the possible impairment of long-lived assets, including intangible assets, whenever events or circumstances indicate the carrying value of the assets may not be recoverable. At the occurrence of a certain event or change in circumstances, the Company evaluates the potential impairment of an asset based upon the estimated future undiscounted cash flows. If an impairment exists, the Company determines the amount of such impairment based upon the present value of the estimated future cash flows using a discount rate commensurate with the risks involved.

GOODWILL

Goodwill is stated at cost. The Company evaluates the possible impairment of goodwill annually each fourth quarter, and whenever events or circumstances indicate the carrying value of the goodwill may not be recoverable. The Company evaluates the potential impairment of goodwill by comparing the fair value of the reporting unit to its carrying value, including goodwill. If the fair value is less than the carrying value, the Company determines the amount of such impairment by comparing the implied fair value of the goodwill to its carrying value.

WARRANTY OBLIGATIONS

The Company warrants its hardware products to be free from defects in material and workmanship for periods ranging from six months to two years from the time of sale based upon the product being purchased and the terms of the customer arrangement. Warranty obligations are accounted for in accordance with Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies," since it is probable that customers will make claims under warranties related to products that have been sold and the amount of these claims can be reasonably estimated based upon experience. Estimated warranty obligations are evaluated and recorded at the time of sale based upon historical costs to fulfill warranty obligations. Provisions may also be recorded subsequent to the time of sale whenever specific events or circumstances impacting product quality become known that would not have been taken into account using historical data.

REVENUE RECOGNITION

The Company recognizes revenue in accordance with Statement of Position (SOP) No. 97-2, "Software Revenue Recognition," as amended by SOP No. 98-9, "Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions," since the software is not incidental to the arrangement and the services in the arrangement do not involve significant production, modification, or customization of the software. The Company recognizes revenue from product sales upon delivery if a signed customer contract or purchase order has been received, the fee is fixed or determinable, and collection of the resulting receivable is probable. If the arrangement contains customer-specified acceptance criteria, then revenue is deferred until the Company can demonstrate that the customer's criteria have been met.

Certain of the Company's products are sold with multiple elements, such as maintenance and support programs, education services, and installation services. The Company accounts for each element separately. The amount allocated to each undelivered element is the price charged when the item is sold separately, with the residual value from the arrangement allocated to the delivered element. The Company has established vendor-specific objective evidence of fair value for each undelivered element. In addition, the Company also provides consulting services. Revenue from maintenance and support programs is deferred and recognized ratably over the program period. Revenue from education and consulting services are recognized over the period the services are provided. Revenue from installation services is recognized when the customer has signed off that the installation is complete.

The Company's products are sold directly to end users, as well as to resellers including original equipment manufacturers (OEMs), system integrators, and distributors. Revenue is recognized upon delivery of the product to the reseller, assuming all other revenue recognition criteria have been met. The Company establishes reserves against revenue for potential product returns in accordance with Statement of Financial Accounting Standards No. 48, "Revenue Recognition When Right of Return Exists," since the amount of future returns can be reasonably estimated based upon experience.

Amounts billed to customers related to shipping and handling, as well as reimbursements received from customers for out-of-pocket expenses, are classified as revenue, with the associated costs included in cost of revenue.

RESEARCH AND DEVELOPMENT

Research and development costs for internally-developed or acquired products are expensed when incurred until technological feasibility has been established for the product. Thereafter, all software costs are capitalized until the product is available for general release to customers. The Company determines technological feasibility at the time the product reaches beta in its stage of development. Historically, the time incurred between beta and general release to customers has been short, and therefore, the costs have been insignificant. As a result, the Company has not capitalized software costs associated with internally-developed products.

INCOME TAXES

The Company accounts for income taxes under the liability method. Under this method, a deferred tax asset or liability is determined based upon the differences between the financial statement and tax bases of assets and liabilities as measured by the enacted tax rates that will be in effect when these differences reverse. Tax credits are recorded as a reduction in income taxes. Valuation allowances are provided if, based upon the weight of available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

NET INCOME PER SHARE

Basic net income per share is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted net income per share is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding for the period plus potential dilutive common shares. All potential dilutive common shares are excluded from the computation of net loss per share because they are antidilutive. Dilutive common equivalent shares consist of stock options and are calculated using the treasury stock method.

COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) is defined as the change in equity of a company during a period from transactions and other events and circumstances, excluding transactions resulting from investments by owners and distributions to owners. Accumulated other comprehensive loss consists of foreign currency translation adjustments of $11,277,000 and $10,989,000 at December 31, 2005 and 2004, respectively, net unrealized losses on available-for-sale investments, net of tax, of $728,000 and $676,000 at December 31, 2005 and 2004, respectively, and losses on currency swaps net of gains on long-term intercompany loans, net of tax, of $2,053,000 and $2,192,000 at December 31, 2005 and 2004, respectively.

CONCENTRATIONS OF RISK

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash, cash equivalents, investments, and trade receivables. The Company primarily invests in municipal obligations of state and local government entities. The Company has established guidelines relative to credit ratings, diversification, and maturities of its debt securities that maintain safety and liquidity. The Company has not experienced any significant realized losses on its debt securities.

A significant portion of the Company's sales and receivables are from customers who are either in or who serve the semiconductor and electronics industries. The Company performs ongoing credit evaluations of its customers and maintains allowances for potential credit losses. The Company has not experienced any significant losses related to the collection of its accounts receivable.

A significant portion of the Company's MVSD inventory is manufactured by a third-party contractor. The Company is dependent upon this contractor to provide quality product and meet delivery schedules. The Company engages in extensive product quality programs and processes, including actively monitoring the performance of its third-party manufacturers.

DERIVATIVE INSTRUMENTS

The Company has adopted the accounting and disclosure requirements of Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 requires that all derivative instruments be recorded on the balance sheet at their fair value. Changes in the fair value of derivatives are recorded each period in current operations or in shareholders' equity as other comprehensive income (loss), depending upon whether the derivative is designated as part of a hedge transaction and, if it is, the type of hedge transaction. Hedges of underlying exposures are designated and documented at the inception of the hedge and are valuated for effectiveness quarterly.

In certain instances, the Company enters into forward contracts and currency swaps to hedge against foreign currency fluctuations. Currency swaps are used to hedge long-term transactions between the Company and its subsidiaries. Forward contracts are used to provide a hedge against transactions denominated in currencies other than the functional currencies of the Company or its subsidiaries. These forward contracts and currency swaps are used to reduce the Company's risk associated with exchange rate changes, as the gains or losses on these contracts are intended to offset the losses or gains on the underlying exposures. The Company does not engage in foreign currency speculation.

STOCK-BASED COMPENSATION PLANS

The Company has adopted the disclosure requirements of Statement of Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock-Based Compensation," and SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure - an amendment of FASB Statement No. 123." The Company continues to recognize compensation costs using the intrinsic value based method described in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees." No compensation costs were recognized in 2005, 2004, or 2003.

Net income and net income per share as reported in these consolidated financial statements and on a pro forma basis, as if the fair value based method described in SFAS No. 123 had been adopted, are as follows (in thousands, except per share amounts):

Year Ended December 31,	2005	2004	2003
Net income, as reported	$ 35,702	$ 37,744	$ 15,951
Less: Total share-based compensation costs determined under fair value based method, net of tax	(9,355)	(13,183)	(14,092)
Net income, pro forma	$ 26,347	$ 24,561	$ 1,859
Basic net income per share, as reported	$ 0.76	$ 0.83	$ 0.37
Basic net income per share, pro forma	$ 0.56	$ 0.54	$ 0.04
Diluted net income per share, as reported	$ 0.74	$ 0.80	$ 0.36
Diluted net income per share, pro forma	$ 0.55	$ 0.52(1)	$ 0.04

(1) Amount was originally reported as $0.49 and has been adjusted to $0.52 for the year ended December 31, 2004 due to a refinement in the calculation.

For the purpose of providing pro forma disclosures, the fair values of stock options granted were estimated using the Black-Scholes option pricing model with the following weighted-average assumptions used for grants:

Year Ended December 31,	2005	2004	2003
Risk-free interest rate	3.4%	2.5%	2.1%
Expected life (in years)	2.8	3.1	2.9
Expected volatility	35%	45%	58%
Expected annualized dividend yield	1.26%	.73%	.85%

TREASURY STOCK

Effective July 1, 2004, the Massachusetts Business Corporation Act (the "Act") eliminated the concept of treasury shares. Under the Act, shares previously classified as treasury shares are to be treated as authorized but unissued shares of common stock. As a result of this change, the Company reclassified its treasury shares to authorized but unissued shares of common stock on the Consolidated Balance Sheet.

NOTE 2: NEW PRONOUNCEMENTS

SFAS NO. 123R, "SHARE-BASED PAYMENT"

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 123R, "Share-Based Payment," which is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation." SFAS No. 123R requires companies to recognize compensation cost for all share-based payments to employees (including stock option and employee stock purchase plans) at fair value. SFAS No. 123R will be effective for public companies no later than the beginning of the first fiscal year after June 15, 2005. The Company will adopt SFAS No. 123R beginning in the first quarter of 2006 using the modified prospective method in which compensation cost is recognized beginning on the effective date.

The Company currently recognizes compensation costs using the intrinsic value based method and, as such, generally recognizes no compensation cost. Accordingly, the adoption of SFAS No. 123R's fair value based method will have a significant impact on the Company's results of operations, although it will have no impact on its overall financial position. Had the Company adopted SFAS No. 123R in prior periods, the impact of that standard would have approximated the impact of SFAS No. 123 as described in the disclosure of pro forma net income and net income per share in Note 1 to the Company's consolidated financial statements. The impact of the adoption of SFAS No. 123R in future periods will depend, in part, upon the level of sharebased payments granted in the future. Based upon preliminary estimates of stock option grants in 2006, as well as preliminary valuation assumptions, such as expected stock price volatility, option lives, and forfeiture rates, the Company anticipates total pre-tax share-based compensation costs for 2006 to approximate $12,000,000.

SFAS NO. 151, "INVENTORY COSTS"

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs, an Amendment of Accounting Research Bulletin (ARB) No. 43, Chapter 4." SFAS No. 151 amends the guidance in ARB No. 43, Chapter 4, "Inventory Pricing" to clarify that abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage) should be recognized as current-period charges. In addition, SFAS No. 151 requires that the allocation of fixed production overhead to the costs of conversion be based on the normal capacity of the production facilities. The provisions of SFAS No. 151 are effective for fiscal years beginning after June 15, 2005. The Company has adopted the provisions of SFAS No. 151 and its adoption did not have a material impact on the Company's financial condition or results of operations.

AJCA OF 2004

In October 2004, the American Jobs Creation Act of 2004 (the "AJCA") was passed. The AJCA provides a deduction for income from qualified domestic production activities, which is being phased in from 2005 through 2010. The AJCA also provides for a two-year phase-out of the existing extra-territorial income exclusion for foreign sales that was viewed to be inconsistent with international trade protocols by the European Union. In December 2004, the FASB issued FASB Staff Position (FSP) No. 109-1, "Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004." FSP No. 109-1 treats the deduction as a "special deduction" as described in SFAS No. 109. This special deduction has no effect on deferred tax assets and liabilities existing at the enactment date and the effect of this deduction will be reported in the same period in which the deduction is claimed in the Company's tax return.

The AJCA also creates a temporary incentive for U.S. corporations to repatriate accumulated income earned abroad by providing an 85% dividends received deduction for certain dividends from controlled foreign corporations. This deduction is subject to a number of limitations. After careful review of the AJCA temporary incentive for repatriation of accumulated income, the Company has determined that there will be no immediate changes to its current policy to reinvest the accumulated earnings of its foreign subsidiaries.

NOTE 3: FOREIGN CURRENCY RISK MANAGEMENT

The Company enters into currency swaps to hedge the foreign currency exposure of its long-term intercompany loans between the parent and certain of its European subsidiaries. These contracts, which relate to the Euro Dollar, have original terms of four to five years. These hedges have been designated for hedge accounting. They are classified as net investment hedges, with the gains or losses on the currency swaps, along with the associated losses or gains on the intercompany loans, net of tax, recorded in shareholders' equity as other comprehensive income (loss) to the extent they are effective as a hedge. The Company recorded net foreign currency gains of $139,000 in 2005 and net foreign currency losses of $1,730,000 and $625,000 in 2004 and 2003, respectively, in other comprehensive income (loss) on the intercompany loans and associated currency swaps.

The Company enters into forward contracts to hedge the foreign currency exposure of its Irish subsidiary's accounts receivable denominated in U.S. Dollars and Japanese Yen. These contracts, which relate to the Euro Dollar and Japanese Yen, generally have terms of one to six months. These hedges have not been designated for hedge accounting. The gains or losses on the forward contracts, along with the associated losses or gains on the revaluation and settlement of the intercompany balances and accounts receivable, are recorded in current operations.

In addition to the transactions described above that are included in the Company's hedging program, the Company enters into other transactions denominated in foreign currencies for which the exchange rate gains or losses are included in current operations. The Company recorded net foreign currency losses of $888,000 in 2005, net foreign currency gains of $1,641,000 in 2004, and net foreign currency losses of $1,712,000 in 2003, representing the total net exchange rate gains or losses that are recognized in current operations.

NOTE 4: CASH, CASH EQUIVALENTS, AND INVESTMENTS

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

December 31,	2005	2004
Cash	$ 72,856	$ 54,270
Cash and cash equivalents	72,856	54,270
Municipal bonds	140,718	180,409
Commercial paper	24,584	-
Corporate bonds	2,500	-
Treasury bills	1,354	-
Short-term investments	169,156	180,409
Municipal bonds	59,863	144,685
Limited partnership interest	10,383	11,712
Long-term investments	70,246	156,397
	$ 312,258	$ 391,076

The following is a summary of the Company's available-for-sale investments at December 31, 2005 (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Municipal bonds	$ 141,296	$ 5	$ (583)	$ 140,718
Commercial paper	24,590	-	(6)	24,584
Corporate bonds	2,500	-	-	2,500
Treasury bills	1,354	-	-	1,354
Short-term investments	169,740	5	(589)	169,156
Long-term municipal bonds	60,434	12	(583)	59,863
	$ 230,174	$ 17	$ (1,172)	$ 229,019

The Company recorded gross realized gains on the sale of debt securities totaling $14,000 in 2005, $392,000 in 2004, and $1,222,000 in 2003. The Company recorded gross realized losses on the sale of debt securities totaling $525,000 in 2005, $90,000 in 2004, and $24,000 in 2003.

On June 30, 2000, Cognex Corporation became a Limited Partner in Venrock Associates III, L.P. (Venrock), a venture capital fund. A director of the Company is a Managing General Partner of Venrock Associates. In the original agreement with Venrock, the Company committed to a total investment in the limited partnership of up to $25,000,000 with an expiration date of January 1, 2005. In January 2005, the Company signed an amendment to the original agreement with Venrock, which reduces its total commitment to $22,500,000 and extends the commitment period through December 31, 2010. The Company does not have the right to withdraw from the partnership prior to December 31, 2010.

As of December 31, 2005, the Company had contributed $17,450,000 to the partnership, including $1,575,000 during 2005. The Company received distributions of $2,904,000 from Venrock during 2005 that were accounted for as a return of capital. At December 31, 2005, the carrying value of this investment was $10,383,000 compared to an estimated fair value, as determined by the General Partner, of $12,017,000.

NOTE 5: INVENTORIES

Inventories consist of the following (in thousands):

December 31,	2005	2004
Raw materials	$ 8,958	$ 6,311
Work-in-process	3,406	6,285
Finished goods	6,455	7,495
	$ 18,819	$ 20,091

In the fourth quarter of 2001, the Company recorded a $16,300,000 charge in "Cost of product revenue" on the Consolidated Statement of Operations for excess inventories and purchase commitments resulting from an extended slowdown in the semiconductor and electronics industries, as well as the expected transition to newer Cognex hardware platforms by the Company's OEM customers. A total of $12,500,000 of this charge represented reserves against existing inventories and was accordingly included in "Inventories" on the Consolidated Balance Sheet at December 31, 2001. The remaining $3,800,000 of the charge represented commitments to purchase excess components and systems from various suppliers and accordingly was included in "Accrued Expenses" on the Consolidated Balance Sheet at December 31, 2001.

The following table summarizes the change in the inventory-related reserve established in the fourth quarter of 2001 (in thousands):

	Balance Sheet		Statement of Operations
	Inventories	Accrued Expenses	Benefits
Initial charge in the fourth quarter of 2001	$ 12,500	$ 3,800	-
Inventory sold to customers	(1,790)	-	$ 1,790
Settlement of purchase commitments	1,506	(2,400)	894
Reserve balance at December 31, 2002	$ 12,216	$ 1,400	
Benefits to cost of product revenue recorded in 2002			$ 2,684
Inventory sold to customers	(1,290)	-	1,290
Inventory sold to brokers	(667)	-	-
Write-off and scrap of inventory	(876)	-	-
Reserve balance at December 31, 2003	$ 9,383	$ 1,400	
Benefits to cost of product revenue recorded in 2003			$ 1,290
Inventory sold to customers	(805)	-	805
Inventory sold to brokers	(387)	-	-
Write-off and scrap of inventory	(743)	-	-
Reserve balance at December 31, 2004	$ 7,448	$ 1,400	
Benefits to cost of product revenue recorded in 2004			$ 805
Inventory sold to customers	(759)	-	759
Inventory sold to brokers	(158)	-	-
Write-off and scrap of inventory	(647)	-	-
Reserve balance at December 31, 2005	$ 5,884	$ 1,400	
Benefits to cost of product revenue recorded in 2005			$ 759

A favorable settlement of the remaining purchase commitments may result in a recovery of a portion of the remaining $1,400,000 accrued at December 31, 2005.

NOTE 6: PROPERTY, PLANT, AND EQUIPMENT

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

December 31,	2005	2004
Land	$ 3,051	$ 3,051
Buildings	17,571	17,571
Building improvements	5,206	4,622
Computer hardware and software	31,976	33,826
Furniture and fixtures	4,314	4,183
Leasehold improvements	2,105	2,197
	64,223	65,450
Less: accumulated depreciation	(40,048)	(41,455)
	$ 24,175	$ 23,995

Buildings include property held for lease with a cost basis of $4,950,000 at December 31, 2005 and 2004 and accumulated depreciation of $1,333,000 and $1,206,000 at December 31, 2005 and 2004, respectively.

NOTE 7: INTANGIBLE ASSETS

Intangible assets consist of the following (in thousands):

	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
December 31, 2005			
Distribution networks	$ 38,060	$ 2,191	$ 35,869
Customer contracts and relationships	12,186	2,520	9,666
Completed technologies	9,028	5,491	3,537
Other	1,264	287	977
	$ 60,538	$ 10,489	$ 50,049
December 31, 2004			
Customer contracts and relationships	$ 8,349	$ 1,522	$ 6,827
Completed technologies	5,440	4,864	576
Other	176	73	103
	$ 13,965	$ 6,459	$ 7,506

Aggregate amortization expense was $4,283,000 in 2005, $1,526,000 in 2004, and $1,012,000 in 2003. Estimated amortization expense for each of the five succeeding fiscal years and thereafter is as follows (in thousands):

Year ended December 31,	Amount
2006	$ 5,634
2007	5,584
2008	5,495
2009	5,280
2010	5,188
Thereafter	22,868
	$ 50,049

NOTE 8: GOODWILL

The Company has two reporting units with goodwill, the Modular Vision Systems Division (MVSD) and the Surface Inspection Systems Division (SISD), which are also reportable segments.

The changes in the carrying value of goodwill are as follows (in thousands):

	MVSD	SISD	Consolidated
Balance at December 31, 2003	$ 4,522	$ 2,700	$ 7,222
Purchase price adjustment (Note 17)	(514)	-	(514)
Foreign exchange rate changes	113	212	325
Balance at December 31, 2004	$ 4,121	$ 2,912	$ 7,033
Business acquisition (Note 17)	73,478	-	73,478
Foreign exchange rate changes	(333)	(371)	(704)
Balance at December 31, 2005	$ 77,266	$ 2,541	$ 79,807

COGNEX CORPORATION: NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 9: ACCRUED EXPENSES

Accrued expenses consist of the following (in thousands):

December 31,	2005	2004
Income taxes	$ 12,653	$ 9,165
Forward contracts and currency swaps	9,026	19,527
Salaries, commissions, and payroll taxes	3,693	3,452
Company bonuses	3,653	5,979
Vacation	3,094	2,775
Consumption taxes	2,624	4,900
Warranty obligations	1,447	1,758
Inventory purchase commitments (Note 5)	1,400	1,400
Professional fees	1,050	1,698
Other	4,836	5,125
	$ 43,476	$ 55,779

The changes in the warranty obligation are as follows (in thousands):

Balance at December 31, 2003	$ 2,119
Provisions for warranties	797
Fulfillment of warranty obligations	(1,298)
Foreign exchange rate changes	140
Balance at December 31, 2004	$ 1,758
Provisions for warranties	696
Warranty obligations assumed in business acquisition (Note 17)	200
Fulfillment of warranty obligations	(1,055)
Foreign exchange rate changes	(152)
Balance at December 31, 2005	$ 1,447

NOTE 10: COMMITMENTS

At December 31, 2005, the Company had purchase orders totaling $10,297,000 to purchase inventory from various vendors. These purchase commitments relate to expected sales in 2006.

At December 31, 2005, the Company had irrevocable letters of credit totaling $444,000 used to guarantee the Company's performance under certain of its SISD sales arrangements.

The Company conducts certain of its operations in leased facilities. These lease agreements expire at various dates through 2016 and are accounted for as operating leases. Certain of these leases contain renewal options. Annual rental expense totaled $5,062,000 in 2005, $4,662,000 in 2004, and $4,427,000 in 2003. Future minimum rental payments under these agreements are as follows (in thousands):

Year ended December 31,	Amount
2006	$ 4,836
2007	4,504
2008	2,682
2009	1,517
2010	938
Thereafter	2,575
	$ 17,052

The Company owns an 83,000 square-foot office building adjacent to its corporate headquarters. The building is currently occupied with tenants who have lease agreements that expire at various dates through 2009. Annual rental income totaled $763,000 in 2005, $818,000 in 2004, and $1,137,000 in 2003. Rental income and related expenses are included in "Investment and other income" on the Consolidated Statement of Operations. Future minimum rental receipts under non-cancelable lease agreements are $313,000 in 2006 and 2007, $258,000 in

2008, and $40,000 in 2009.

NOTE 11: INDEMNIFICATION PROVISIONS

Except as limited by Massachusetts law, the by-laws of the Company require it to indemnify certain current or former directors, officers, and employees of the Company against expenses incurred by them in connection with each proceeding in which he or she is involved as a result of serving or having served in certain capacities. Indemnification is not available with respect to a proceeding as to which it has been adjudicated that the person did not act in good faith in the reasonable belief that the action was in the best interests of the Company. The maximum potential amount of future payments the Company could be required to make under these provisions is unlimited. The Company has never incurred significant costs related to these indemnification provisions. As a result, the Company believes the estimated fair value of these provisions is minimal.

The Company accepts standard limited indemnification provisions in the ordinary course of business, whereby it indemnifies its customers for certain direct damages incurred in connection with third-party patent or other intellectual property infringement claims with respect to the use of the Company's products. The term of these indemnification provisions generally coincides with the customer's use of the Company's products. The maximum potential amount of future payments the Company could be required to make under these provisions is always subject to fixed monetary limits. The Company has never incurred significant costs to defend lawsuits or settle claims related to these indemnification provisions provided to the Company's customers. As a result, the Company believes the estimated fair value of these provisions is minimal.

The Company also accepts limited indemnification provisions from time to time, whereby it indemnifies customers for certain direct damages incurred in connection with bodily injury and property damage arising from the installation of the Company's products. The term of these indemnification provisions generally coincides with the period of installation. The maximum potential amount of future payments the Company could be required to make under these provisions is limited and is likely recoverable under the Company's insurance policies. As a result of this coverage, and the fact that the Company has never incurred significant costs to defend lawsuits or settle claims related to these indemnification provisions, the Company believes the estimated fair value of these provisions is minimal.

NOTE 12: SHAREHOLDERS' EQUITY

PREFERRED STOCK

The Company has 400,000 shares of authorized but unissued $.01 par value preferred stock.

STOCK REPURCHASE PROGRAM

On December 12, 2000, the Company's Board of Directors authorized the repurchase of up to $100,000,000 of the Company's common stock. The Company repurchased 383,908 shares at a cost of $11,690,000 in 2005 and 1,768,452 shares at a cost of $26,425,000 in 2002 under this program.

STOCK OPTION PLANS

At December 31, 2005, the Company had 9,920,714 shares available for grant under the following stock option plans: the 1998 Non-Employee Director Stock Option Plan, 4,000; the 1998 Stock Incentive Plan, 2,416,714; no shares under the 2001 Interim General Stock Incentive Plan; and the 2001 General Stock Option Plan, 7,500,000.

The 2001 General Stock Option Plan was adopted by the Board of Directors on December 11, 2001 without shareholder approval. This plan provides for the granting of nonqualified stock options to any employee who is actively employed by the Company and is not an officer or director of the Company. The maximum number of shares of common stock available for grant under the plan is 7,500,000 shares. All option grants must have an exercise price per share that is no less than the fair market value per share of the Company's common stock on the grant date and must have a term that is no longer than fifteen years from the grant date. No stock options have been granted under the 2001 General Stock Option Plan.

The 2001 Interim General Stock Incentive Plan was adopted by the Board of Directors on July 17, 2001 without shareholder approval. This plan provides for the granting of nonqualified stock options to any employee who is actively employed by the Company and is not an officer or director of the Company. The maximum number of shares of common stock available for grant under the plan is 400,000 shares. All option grants have an exercise price per share that is no less than the fair market value per share of the Company's common stock on the grant date and must have a term that is no longer than fifteen years from the grant date. All 400,000 stock options have been granted under the 2001 Interim General Stock Incentive Plan.

On April 21, 1998, the shareholders approved the 1998 Stock Incentive Plan, under which the Company initially was able to grant stock options and stock awards to purchase up to 1,700,000 shares of common stock. Effective January 1, 1999 and each January 1st thereafter during the term of the 1998 Stock Incentive Plan, the number of shares of common stock available for grants of stock options and stock awards is increased automatically by an amount equal to 4.5% of the total number of issued shares of common stock as of the close of business on December 31st of the preceding year.

Stock options generally vest over four years and generally expire no later than ten years from the date of grant.

The following table summarizes the status of the Company's stock option plans at December 31, 2005, 2004, and 2003, and changes during the years then ended (shares in thousands):

	2005		2004		2003	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Outstanding at beginning of year	10,620	$ 24.74	10,986	$ 22.85	10,381	$ 22.40
Granted at fair market value	1,914	25.22	2,253	29.31	2,402	21.54
Exercised	(1,378)	19.39	(2,210)	19.78	(1,279)	15.84
Forfeited	(481)	28.09	(409)	26.06	(518)	25.75
Outstanding at end of year	10,675	25.36	10,620	24.74	10,986	22.85
Options exercisable at year-end	5,648	25.51	5,074	24.52	5,182	22.37
Weighted-average grant-date fair value of options granted during the year at fair market value	$ 6.01		$ 9.22		$ 8.32	

No stock options were granted above fair market value in 2005, 2004, or 2003.

The following table summarizes information about stock options outstanding at December 31, 2005 (shares in thousands):

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Average Weighted-Remaining Contractual Life (in years)	Weighted-Average Exercise Price	Number Exercisable	Weighted-Average Exercise Price
$ 1.00 - 18.13	1,397	4.8	$ 14.34	1,195	$13.88
18.19 - 21.20	1,478	7.3	21.03	545	20.84
21.42 - 24.93	1,870	6.3	19.13	1,297	23.02
25.02 - 28.51	2,211	8.6	17.79	395	26.46
28.67 - 30.81	2,611	7.3	16.71	1,351	29.31
30.86 - 59.69	1,108	7.2	39.83	865	41.85
	10,675	7.1	25.36	5,648	25.51

EMPLOYEE STOCK PURCHASE PLAN

Under the Company's Employee Stock Purchase Plan (ESPP), employees who have completed six months of continuous employment with the Company may purchase common stock semi-annually at the lower of 85% of the fair market value of the stock at the beginning or end of the six-month payment period through accumulation of payroll deductions. Employees are required to hold common stock purchased under the ESPP for a period of one year from the date of purchase. Effective for the purchase period beginning on January 1, 2006, the purchase price was amended to equal 95% of the fair market value of the stock at the end of the six-month payment period, and the holding period was reduced to three months.

The maximum number of shares of common stock available for issuance under the ESPP is 250,000 shares. Effective January 1, 2001 and each January 1st thereafter during the term of the ESPP, 250,000 shares of common stock will always be available for issuance. Shares purchased under the ESPP totaled 21,721 in 2005, 21,031 in 2004, and 31,667 in 2003. The weighted-average fair value of shares purchased under the ESPP was $7.63 in 2005, $10.61 in 2004, and $9.89 in 2003.

For the purpose of providing pro forma disclosures, the fair values of shares purchased were estimated using the Black-Scholes option-pricing model with the following weighted-average assumptions:

Year Ended December 31,	2005	2004	2003
Risk-free interest rate	3.2%	2.3%	2.0%
Expected life (in months)	12	12	12
Expected volatility	35%	39%	58%
Expected annualized dividend yield	1.15%	1.00%	.85%

NOTE 13: EMPLOYEE SAVINGS PLAN

Under the Company's Employee Savings Plan, a defined contribution plan, employees who have attained age 21 may contribute up to 25% of their salary on a pre-tax basis subject to the annual dollar limitations established by the Internal Revenue Service. The Company contributes fifty cents for each dollar an employee contributes, with a maximum contribution of 3% of an employee's pre-tax salary.

Company contributions vest 20%, 40%, 60%, and 100% after two, three, four, and five years of continuous employment with the Company, respectively. Company contributions totaled $1,060,000 in 2005, $967,000 in 2004, and $917,000 in 2003. Cognex stock is not an investment alternative, nor are Company contributions made in the form of Cognex stock.

NOTE 14: INCOME TAXES

Domestic income before taxes was $19,206,000, $22,507,000, and $24,852,000 and foreign income (loss) before taxes was $29,040,000, $30,653,000, and $(1,604,000) in December 31, 2005, 2004, and 2003, respectively.

The provision for income taxes consists of the following (in thousands):

Year Ended December 31,	2005	2004	2003
Current:			
Federal	$ 3,502	$ 9,662	$ 6,330
State	507	758	431
Foreign	3,279	983	2,181
	7,288	11,403	8,942
Deferred:			
Federal	3,501	(177)	(616)
State	438	306	48
Foreign	1,317	3,884	(1,077)
	5,256	4,013	(1,645)
	$12,544	$15,416	$7,297

A reconciliation of the United States federal statutory corporate tax rate to the Company's effective tax rate is as follows (in thousands):

Year Ended December 31,	2005	2004	2003
Income tax provision at federal statutory rate	35%	35%	35%
State income taxes, net of federal benefit	1	2	1
Tax-exempt investment income	(3)	(3)	(8)
Foreign tax rate differential	(9)	(6)	4
Other	2	1	(1)
Provision for income taxes	26%	29%	31%

Deferred tax assets consist of the following (in thousands):

December 31,	2005	2004
Current deferred tax assets:		
Inventory and revenue related	$ 4,805	$ 6,321
Bonus, commission, and other compensation	943	937
Other	1,919	2,246
Total net current deferred tax assets	$ 7,667	$ 9,504
Noncurrent deferred tax assets:		
Federal and state tax credit carryforwards	$ 11,434	$ 8,138
Net operating loss carryforwards	5,600	3,989
Acquired completed technologies and other intangible assets	3,664	3,180
Federal and state capital loss carryforwards	1,708	1,640
Depreciation	1,478	1,339
Unrealized investment gains and losses	1,390	1,573
Acquired in-process technology	924	972
Other	762	685
	26,960	21,516
Noncurrent deferred tax liabilities:		
Nondeductible intangible assets	(16,703)	-
Other	(30)	-
	(16,733)	-
Total net noncurrent deferred tax assets	$ 10,227	$ 21,516

At December 31, 2005, the Company had federal research and experimentation tax credit carryforwards of approximately $5,091,000, which may be available to offset future federal income tax liabilities and will begin to expire in 2015. The Company also had approximately $2,467,000 of alternative minimum tax credits and approximately $1,824,000 of foreign tax credits, which may be available to offset future regular income tax liabilities. The alternative minimum tax credits have an unlimited life and the foreign tax credits will begin to expire in 2007. In addition, the Company had approximately $2,052,000 of state research and experimentation tax credit carryforwards, which will begin to expire in 2015.

At December 31, 2005, the Company's subsidiaries had net operating loss carryforwards of approximately $16,000,000, which will expire in 2010, representing a tax benefit of $5,600,000.

The Company recorded certain intangible assets as a result of the acquisition of DVT Corporation on May 9, 2005. The amortization of these intangible assets is not deductible for U.S. tax purposes. A deferred tax liability was established to reflect the federal and state liability associated with not deducting the acquisition-related amortization expenses. The balance of this liability at December 31, 2005 was $16,703,000.

The Company did not establish valuation allowances against its deferred tax assets at December 31, 2005 and 2004. While these assets are not assured of realization, the Company has evaluated the realizability of these deferred tax assets and has determined that it is more likely than not that these assets will be realized. In reaching this conclusion, the Company has evaluated certain relevant criteria including the Company's historical profitability, current projections of future profitability, and the lives of tax credits, net operating and capital losses, and other carryforwards. Should the Company fail to generate sufficient pre-tax profits in future periods, the Company may be required to establish valuation allowances against these deferred tax assets, resulting in a charge to income in the period of determination.

The Company has established reserves to provide for additional income taxes that may be due in future years as previously filed income tax returns are audited. These reserves have been established based upon management's assessment as to the potential exposure attributable to permanent differences and interest applicable to both permanent and temporary differences. All tax reserves are analyzed periodically and adjustments are made as events occur that warrant modification, such as the completion of audits or the expiration of statutes of limitations, which may result in future charges or credits to tax expense.

The Company does not provide U.S. income taxes on its foreign subsidiaries' undistributed earnings, as they are deemed to be permanently reinvested outside the U.S. Non-U.S. income taxes are, however, provided on those foreign subsidiaries' undistributed earnings. Upon repatriation, the Company would provide the appropriate U.S. income taxes on these earnings.

On March 23, 2005, the Company provided standby letters of credit totaling 3,264,887,000 Yen (or approximately $27,683,000 based upon the exchange rate at December 31, 2005) to taxing authorities in Japan that are collateralized by investments on the Consolidated Balance Sheet. The Tokyo Regional Taxation Bureau (TRTB) has asserted that Cognex Corporation has a permanent establishment in Japan that would require certain income, previously reported on U.S. tax returns for the years ended December 31, 1997 through December 31, 2001, to be subject instead to taxation in Japan. The Company disagrees with this position and believes that this assertion is inconsistent with principles under the U.S.
- Japan income tax treaty. The Company has filed a notice of objection and request for deferral of tax payment and intends to contest this assessment vigorously, although no assurances can be made that the Company will prevail in this matter. In September 2003, the Company also filed a request with the Internal Revenue Service Tax Treaty Division for competent authority assistance. Until this matter is resolved, the Company is required to provide collateral for these tax assessments. These letters of credit expire in approximately one year and will be renewed as required. Should the TRTB prevail in its assertion, the income in question would be taxable in Japan and the Company would be required to pay approximately $27,683,000 in taxes, interest and penalties to Japanese taxing authorities. The Company would then be entitled to recoup the majority of this amount from taxing authorities in the U.S. The Company has not provided any additional accrual or reserve related to this matter.

NOTE 15: NET INCOME PER SHARE

Net income per share is calculated as follows (in thousands, except per share amounts):

Year Ended December 31,	2005	2004	2003
Net income	$ 35,702	$ 37,744	$ 15,951
Basic:			
Weighted-average common shares outstanding	46,709	45,480	43,173
Net income per common share	$ 0.76	$ 0.83	$ 0.37
Diluted:			
Weighted-average common shares outstanding	46,709	45,480	43,173
Effect of dilutive stock options	1,226	1,878	1,293
Weighted-average common and common equivalent shares outstanding	47,935	47,358	44,466
Net income per common and common equivalent share	$ 0.74	$ 0.80	$ 0.36

Stock options to purchase 3,903,178, 1,656,927, and 2,934,936 shares of common stock were outstanding in 2005, 2004, and 2003, respectively, but were not included in the calculation of diluted net income per share because the options' exercise prices were greater than the average market price of the Company's common stock during those years.

NOTE 16: SEGMENT AND GEOGRAPHIC INFORMATION

The Company has two reportable segments: the Modular Vision Systems Division (MVSD) and the Surface Inspections Systems Division (SISD). MVSD designs, develops, manufactures, and markets modular vision systems that are used to control the manufacturing of discrete items by locating, identifying, inspecting, and measuring them during the manufacturing process. SISD designs, develops, manufactures, and markets surface inspection vision systems that are used to inspect surfaces of materials that are processed in a continuous fashion to ensure there are no flaws or defects in the surfaces. Segments are determined based upon the way that management organizes its business for making operating decisions and assessing performance. The Company evaluates segment performance based upon income or loss from operations, excluding unusual items.

The following table summarizes information about the Company's segments (in thousands):

	MVSD	SISD	Reconciling Items	Consolidated
Year Ended December 31, 2005				
Product revenue	$168,342	$24,462	-	$ 192,804
Service revenue	14,202	9,869	-	24,071
Depreciation and amortization	8,168	286	$ 216	8,670
Operating income	46,225	4,956	(7,177)	44,004
Year Ended December 31, 2004				
Product revenue	$155,966	$20,603	-	$ 176,569
Service revenue	17,923	7,465	-	25,388
Depreciation and amortization	5,526	341	$ 207	6,074
Operating income	53,572	1,336	(8,059)	46,849
Year Ended December 31, 2003				
Product revenue	$108,170	$22,500	-	$ 130,670
Service revenue	12,846	6,576	-	19,422
Depreciation and amortization	5,863	392	$ 179	6,434
Operating income	21,397	3,830	(5,717)	19,510

Reconciling items consist of unallocated corporate expenses, which primarily include corporate headquarters costs, professional fees, and patent infringement litigation. Asset information by segment is not produced internally for use by the chief operating decision maker, and therefore, is not presented. Asset information is not provided because the cash and investments are commingled and the divisions share assets and resources in a number of locations around the world.

No customer accounted for greater than 10% of revenue in 2005, 2004, or 2003.

The following table summarizes information about geographic areas (in thousands):

	United States	Japan	Europe	Other	Consolidated
Year Ended December 31, 2005					
Product revenue	$ 70,921	$ 53,761	$ 56,150	$ 11,972	$ 192,804
Service revenue	9,531	6,513	7,299	728	24,071
Long-lived assets	144,432	1,895	10,999	110	157,436
Year Ended December 31, 2004					
Product revenue	$ 52,979	$ 69,270	$ 43,983	$ 10,337	$ 176,569
Service revenue	9,703	8,301	6,596	788	25,388
Long-lived assets	26,221	2,396	13,700	117	42,434
Year Ended December 31, 2003					
Product revenue	$ 42,327	$ 44,968	$ 32,585	$ 10,790	$ 130,670
Service revenue	8,238	5,645	4,808	731	19,422
Long-lived assets	27,936	2,434	14,242	26	44,638

Revenue is presented geographically based upon the customer's country of domicile.

NOTE 17: ACQUISITIONS

ACQUISITION OF DVT CORPORATION VISION SENSOR BUSINESS On May 9, 2005, the Company acquired all of the outstanding shares of DVT Corporation, a provider of low-cost, easy-to-use vision sensors, for approximately $111,607,000, net of $4,702,000 cash acquired. The purchase price consisted of $110,346,000 in cash paid at closing (net of acquired cash) and $1,261,000 in transaction costs. The acquisition was accounted for under the purchase method of accounting. Accordingly, DVT Corporation's results of operations have been included in the Company's consolidated results of operations since the date of acquisition.

In recent years, the Company has expanded its product line by adding low-cost and easy-to-use vision products, such as its In-Sight and Checker products. However, reaching the many prospects for these products in factories around the world requires a large third-party distribution channel to supplement the Company's own direct end-user sales force. During 2004, the Company started to build a third-party distribution channel and prior to this acquisition had signed over 40 distributors, primarily in North America. With the acquisition of DVT Corporation, the Company immediately gained a worldwide network of more than 150 additional distributors, all fully trained in selling and supporting machine vision products. The Company plans to sell its low-cost, easy-to-use vision products, including the acquired DVT's vision sensors, through these distribution networks.

The purchase price was allocated as follows (in thousands):

	Estimated Fair Value	Weighted-Average Amortization Period (in years)
Accounts receivable	$ 5,785	
Inventories	1,995	
Prepaid expenses and other current assets	5,250	
Property, plant, and equipment	766	
Other assets	57	
Intangible assets		
Distribution networks	38,060	11.6
Customer relationships	4,740	12
Completed technologies	3,680	6
Trade names, trademarks, and non-competition agreement	1,110	4
Goodwill	73,478	
Total assets acquired	134,921	
Accounts payable	1,388	
Accrued expenses	6,110	
Net deferred tax liabilities	15,816	
Total liabilities assumed	23,314	
Total purchase price	$ 111,607	

The goodwill is assigned to the MVSD segment. None of the acquired intangible assets, including goodwill, are deductible for tax purposes. The Company obtained third-party valuations of the acquired intangible assets. The allocation of the purchase price is subject to adjustment through the second quarter of 2006.

The following summarized, pro forma results of operations assume the acquisition took place at the beginning of the respective periods (in thousands, except per share amounts).

Year Ended December 31,	2005	2004
Revenue	$ 227,431	$ 230,196
Net income	$ 35,266	$ 36,263
Net income per diluted share	$ 0.74	$ 0.77

ACQUISITION OF SIEMENS DEMATIC AG WAFER IDENTIFICATION BUSINESS

On March 31, 2003, the Company acquired the wafer identification business of Siemens Dematic AG, a subsidiary of Siemens AG. Siemens Dematic is a leading supplier of logistics and factory automation equipment and has been a leading supplier of wafer identification systems to semiconductor manufacturers in Europe. Under the terms of the agreement, the Company acquired the rights to all of Siemens' patented and unpatented wafer identification technology, as well as substantially all of the assets related to its wafer identification business. This acquisition enhances the Company's position as a leading provider of wafer identification systems worldwide. The results of operations of the acquired business have been included in the Company's consolidated results of operations since the date of the acquisition. The historical results of operations of the acquired business were not material compared to the consolidated results of operations, and therefore, pro forma results are not presented.

The original purchase price consisted of 7,000,000 Euros in cash (or approximately $7,630,000) paid at closing, with the potential for an additional cash payment of up to 1,700,000 Euros (or approximately $2,013,000) depending upon the achievement of certain performance criteria. The Company reviewed these performance criteria during the fourth quarter of 2005 and concluded that they were not met. Accordingly, the Company does not expect to make additional payments related to this acquisition. During the first quarter of 2006, Siemens is exercising its right to review the Company's documentation supporting this conclusion. The March 31, 2003 cash payment of 7,000,000 Euros was based upon an estimated balance sheet for the wafer identification business as of March 31, 2003. After receipt of a final March 31, 2003 balance sheet and resolution of certain items in dispute, Siemens reimbursed Cognex 796,000 Euros (or $868,000).

The final purchase price of 6,204,000 Euros (or approximately $6,762,000) was allocated as follows: $616,000 to inventories; $274,000 to receivables; $25,000 to accrued expenses; $4,469,000 to customer contracts and relationships, to be amortized over eight years; $447,000 to completed technologies, to be amortized over five years; $98,000 to patents, to be amortized over five years; $44,000 to non-competition agreements, to be amortized over three years; and $839,000 to goodwill, which is assigned to the MVSD segment and is not deductible for tax purposes.

ACQUISITION OF GAVITEC AG MACHINE VISION BUSINESS

On December 1, 2003, the Company acquired the machine vision business of Gavitec AG. Gavitec produces machine vision products for direct part mark identification (or Industrial ID), which can read markings on the surfaces of manufactured items to collect data about product components during the manufacturing process and trace the manufacturing history of the components during the product's lifetime. Under the terms of the agreement, the Company acquired all of the tangible and intangible assets and assumed certain liabilities associated with Gavitec's machine vision business. This acquisition strengthens the Company's overall market position in Germany and combines Gavitec's experience in the design of easy-to-use Industrial ID products with Cognex's global sales force and engineering support to enable the Company to provide additional products for the growing Industrial ID market. The results of operations of the acquired business have been included in the Company's consolidated results of operations since the date of the acquisition. The historical results of operations of the acquired business were not material compared to the consolidated results of operations, and therefore, pro forma results are not presented.

The purchase price consisted of 3,777,000 Euros in cash (or approximately $4,516,000), including 3,477,000 Euros paid at closing, 100,000 Euros (or approximately $123,000) paid on December 1, 2004, and 200,000 Euros (or approximately $235,000) paid on December 1, 2005. There was the potential for two additional cash payments of up to 250,000 Euros (or approximately $323,000) each in the third quarter of 2004 and first quarter of 2005 depending upon the achievement of certain performance criteria. These criteria were not met, and therefore, these contingent payments were not made.

The purchase price was allocated as follows: $213,000 to inventories; $76,000 to receivables; $60,000 to fixed assets; $114,000 to accrued expenses; $2,726,000 to customer contracts and relationships, to be amortized over nine years; $155,000 to completed technologies, to be amortized over three years; and $1,400,000 to goodwill, which is assigned to the MVSD segment and is not deductible for tax purposes.

NOTE 18: DIVIDENDS

Beginning in the third quarter of 2003, the Company's Board of Directors has declared and paid a cash dividend in each quarter. During the third quarter of 2004, the Company's Board of Directors voted to increase the quarterly cash dividend from $0.06 per share to $0.08 per share. Dividend payments amounted to $14,960,000 in 2005, $12,756,000 in 2004, and $5,237,000 in 2003.

NOTE 19: SUBSEQUENT EVENT

On January 27, 2006, the Company's Board of Directors declared a cash dividend of $0.08 per share. The dividend was paid on February 24, 2006 to all shareholders of record at the close of business on February 10, 2006 and amounted to $3,784,000.

NOTE 20: SUPPLEMENTAL DISCLOSURES

Cash paid for income taxes totaled $2,970,000 in 2005, $2,327,000 in 2004, and $4,169,000 in 2003.

Common stock received as payment for stock option exercises totaled $317,000 in 2004 and $134,000 in 2003.

The Company retired certain fully depreciated property, plant, and equipment totaling $4,234,000 in 2005, $1,824,000 in 2004, and $2,497,000 in 2003.

Advertising costs are expensed as incurred and totaled $3,057,000 in 2005, $2,000,000 in 2004, and $1,684,000 in 2003.

COGNEX CORPORATION:
REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON FINANCIAL STATEMENTS

TO THE BOARD OF DIRECTORS AND SHAREHOLDERS OF COGNEX CORPORATION:

We have audited the accompanying consolidated balance sheets of Cognex Corporation as of December 31, 2005 and 2004, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Cognex Corporation at December 31, 2005 and 2004, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Cognex Corporation's internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 1, 2006 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Boston, Massachusetts
March 1, 2006

REPORT OF MANAGEMENT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Management has evaluated the effectiveness of the Company's internal control over financial reporting based upon the framework in Internal Control -- Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Our evaluation for fiscal year 2005 excluded DVT Corporation, a business which Cognex acquired on May 9, 2005 for approximately $112 million. During the period from the acquisition date to December 31, 2005, approximately $23 million of revenue was recorded on the books of DVT Corporation. Management's report on internal control over financial reporting for fiscal year 2006 will include an evaluation of DVT Corporation.

Based upon our evaluation, management has concluded that the Company's internal control over financial reporting was effective as of December 31, 2005.

Management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2005 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report which is included herein.

COGNEX CORPORATION: REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON INTERNAL CONTROL OVER FINANCIAL REPORTING

TO THE BOARD OF DIRECTORS AND SHAREHOLDERS OF COGNEX CORPORATION:

We have audited management's assessment, included in the accompanying Report of Management on Internal Control Over Financial Reporting, that Cognex Corporation maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Cognex Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As indicated in the accompanying Report of Management on Internal Control Over Financial Reporting, management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of DVT Corporation, a business which Cognex Corporation acquired on May 9, 2005 for approximately $112 million. The results of operations for DVT Corporation are included in the 2005 consolidated financial statements of Cognex Corporation from the date of acquisition and included $23 million of revenues for the period May 9, 2005 through December 31, 2005. During the period from the acquisition date to December 31, 2005, approximately $23 million of revenue was recorded on the books of DVT Corporation. Our audit of internal control over financial reporting of Cognex Corporation also did not include an evaluation of the internal control over financial reporting of DVT Corporation.

In our opinion, management's assessment that Cognex Corporation maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Cognex Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the 2005 consolidated financial statements of Cognex Corporation and our report dated March 1, 2006 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Boston, Massachusetts
March 1, 2006

COGNEX CORPORATION: FIVE-YEAR SUMMARY OF SELECTED FINANCIAL DATA
(In thousands, except per share amounts)

STATEMENT OF OPERATIONS DATA:

Year Ended December 31,	2005	2004	2003	2002	2001
Revenue	$ 216,875	$ 201,957	$ 150,092	$ 114,107	$ 140,729
Cost of revenue	62,899	57,371	50,139	39,859	62,345
Gross margin	153,976	144,586	99,953	74,248	78,384
Research, development, and engineering expenses	27,640	27,063	24,719	25,630	30,094
Selling, general, and administrative expenses	82,332	70,674	55,724	58,376	61,262
Amortization of goodwill	--	--	--	--	3,108
Charge for intangible asset impairment	--	--	--	--	10,932
Operating income (loss)	44,004	46,849	19,510	(9,758)	(27,012)
Nonoperating income	4,242	6,311	3,738	1,554	11,341
Income (loss) before taxes	48,246	53,160	23,248	(8,204)	(15,671)
Income tax provision (benefit)	12,544	15,416	7,297	(2,177)	(4,544)
Net income (loss)	$ 35,702	$ 37,744	$ 15,951	$ (6,027)	$ (11,127)
Basic net income (loss) per share	$ 0.76	$ 0.83	$ 0.37	$ (0.14)	$ (0.25)
Diluted net income (loss) per share	$ 0.74	$ 0.80	$ 0.36	$ (0.14)	$ (0.25)
Basic weighted-average common shares outstanding	46,709	45,480	43,173	43,503	43,639
Diluted weighted-average common shares outstanding	47,935	47,358	44,466	43,503	43,639
Cash dividends per common share	$ 0.32	$ 0.28	$ 0.12	$ --	$ --

BALANCE SHEET DATA:

December 31,	2005	2004	2003	2002	2001
Working capital	$268,612	$242,460	$150,311	$162,808	$143,712
Total assets	564,562	533,308	432,533	385,934	406,904
Long-term debt	--	--	--	--	--
Shareholders' equity	506,521	462,807	384,994	354,520	378,044

COGNEX CORPORATION: SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)
(In thousands, except per share amounts)

2005 QUARTER ENDED	APRIL 3	JULY 3	OCTOBER 2	DECEMBER 31
Revenue	$ 43,198	$ 54,603	$ 58,256	$ 60,818
Gross margin	29,408	38,538	42,501	43,529
Operating income	5,585	9,859	13,926	14,634
Net income	5,294	7,800	10,858	11,750
Basic net income per share	0.11	0.17	0.23	0.25
Diluted net income per share	0.11	0.17	0.22	0.24
Cash dividends per common share	0.08	0.08	0.08	0.08
Common stock prices:				
High	28.44	27.28	33.76	32.70
Low	23.80	21.40	25.43	26.78

2004 Quarter Ended	April 4	July 4	October 3	December 31
Revenue	$ 48,169	$ 54,467	$ 55,412	$ 43,909
Gross margin	33,380	38,562	40,526	32,118
Operating income	10,168	14,339	15,875	6,467
Net income	8,567	10,878	11,655	6,644
Basic net income per share	0.19	0.24	0.26	0.15
Diluted net income per share	0.18	0.23	0.25	0.14
Cash dividends per common share	0.06	0.06	0.08	0.08
Common stock prices:				
High	35.05	38.48	37.06	29.90
Low	28.24	30.09	23.50	23.14

COGNEX CORPORATION: COMPANY INFORMATION

TRANSFER AGENT

National City Bank
Corporate Trust Operations
3rd Floor, North Annex
4100 West 150th Street
Cleveland, OH 44135-1385
Telephone: (216) 257-8663
Toll free: (800) 622-6757

GENERAL COUNSEL

Goodwin Procter LLP
Boston, Massachusetts

INDEPENDENT AUDITORS

Ernst & Young LLP
Boston, Massachusetts

FORM 10-K

A copy of the Annual Report on Form 10-K filed with the Securities and Exchange Commission is available to shareholders, without charge, upon request to:

Department of Investor Relations
Cognex Corporation
One Vision Drive
Natick, MA 01760

Additional copies of this annual report are also available, without charge, upon request to the above address. Or request information on-line at http://www.cognex.com

The Company's common stock is traded on The NASDAQ Stock Market, under the symbol CGNX. As of February 26, 2006, there were approximately 600 shareholders of record of the Company's common stock. The Company believes the number of beneficial owners of the Company's common stock on that date was substantially greater.

The Company declared and paid a cash dividend of $0.06 per share in the first and second quarters of 2004, and $0.08 per share in the third and four quarters of 2004 and in each quarter of 2005. Any future declaration and payment of cash dividends will be subject to the discretion of the Board of Directors and will depend upon such factors as the Board deems relevant.

EXHIBIT 21

COGNEX CORPORATION

SUBSIDIARIES OF THE REGISTRANT

At December 31, 2005, the registrant had the following subsidiaries, the financial statements of which are all included in the consolidated financial statements of the registrant:

NAME OF SUBSIDIARY	STATE/COUNTRY OF INCORPORATION	PERCENT OWNERSHIP
Cognex Technology and Investment Corporation	California	100%
Cognex Canada Technology, Inc.	California	100%
Cognex Foreign Sales Corporation	Barbados	100%
DVT Corporation (name changed to Cognex Distribution Corporation as of February 21, 2006)	Georgia	100%
MTI Acquisition Corporation	Georgia	100%
Vision Drive, Inc.	Delaware	100%
Cognex Canada, Inc.	Delaware	100%
Cognex K.K.	Japan	100%
Cognex International, Inc.	Delaware	100%
Cognex Europe, Inc.	Delaware	100%
Cognex Europe, b.v.	Netherlands	100%
Cognex, Ltd.	Ireland	100%
Cognex Germany, Inc.	Massachusetts	100%
Cognex UK Ltd.	United Kingdom	100%
Cognex Finland Oy	Finland	100%
Cognex Singapore, Inc.	Delaware	100%
Cognex Korea, Inc.	Delaware	100%
Cognex Taiwan, Inc.	Delaware	100%
Cognex Asia, Inc. (formerly Cognex China, Inc.)	Delaware	100%

EXHIBIT 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in this Annual Report (Form 10-K) of Cognex Corporation of our report dated March 1, 2006, with respect to the consolidated financial statements of Cognex Corporation and our report dated March 1, 2006 with respect to Cognex Corporation management's assessment of the effectiveness of internal control over financial reporting and the effectiveness of internal control over financial reporting of Cognex Corporation, included in the 2005 Annual Report to Shareholders of Cognex Corporation.

Our audits also included the financial statement schedule of Cognex Corporation listed in Item 15(a). This schedule is the responsibility of Cognex Corporation's management. Our responsibility is to express an opinion based on our audits. In our opinion, as to which the date is March 1, 2006, the financial statement schedule referred to above, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We consent to the incorporation by reference in the Registration Statements on Form S-8 (File Nos. 33-81150, 333-04621, 333-02151, 333-60807, 33-32815, 333-44824, 333-68158, 333-96961, 333-100709, and 333-126787) of Cognex Corporation of our report dated March 1, 2006, with respect to the consolidated financial statements of Cognex Corporation incorporated herein by reference, our report dated March 1, 2006 with respect to Cognex Corporation management's assessment of the effectiveness of internal control over financial reporting and the effectiveness of internal control over financial reporting of Cognex Corporation incorporated herein by reference, and our report included in the preceding paragraph with respect to the financial statement schedule of Cognex Corporation included in this Annual Report (Form 10-K) of Cognex Corporation.

/s/ Ernst & Young LLP

Boston, Massachusetts
March 1, 2006

EXHIBIT 31.1

CERTIFICATION

I, Robert J. Shillman, Chief Executive Officer and Chairman of the Board of Directors of Cognex Corporation, certify that:

1. I have reviewed this Annual Report on Form 10-K of Cognex Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations, and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 1, 2006

/s/ Robert J. Shillman

Robert J. Shillman
Chief Executive Officer and
Chairman of the Board of Directors

EXHIBIT 31.2

CERTIFICATION

I, Richard A. Morin, Senior Vice President of Finance and Administration, Chief Financial Officer, and Treasurer of Cognex Corporation, certify that:

1. I have reviewed this Annual Report on Form 10-K of Cognex Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations, and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize, and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 1, 2006

/s/ Richard A. Morin

Richard A. Morin
Senior Vice President of Finance and Administration,
Chief Financial Officer, and Treasurer

EXHIBIT 32.1*

CERTIFICATION PURSUANT TO
18 U.S.C. 1350,
AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

The undersigned officer of Cognex Corporation (the "Company") hereby certifies that the Company's Annual Report on Form 10-K for the year ended December 31, 2005 (the "Report"), as filed with the Securities and Exchange Commission on the date hereof, fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended, and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 1, 2006

/s/ Robert J. Shillman

Robert J. Shillman
Chief Executive Officer and
Chairman of the Board of Directors
(principal executive officer)

* This certification shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to the liability of that section, nor shall it be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934.

EXHIBIT 32.2*

CERTIFICATION PURSUANT TO
18 U.S.C. 1350,
AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

The undersigned officer of Cognex Corporation (the "Company") hereby certifies that the Company's Annual Report on Form 10-K for the year ended December 31, 2005 (the "Report"), as filed with the Securities and Exchange Commission on the date hereof, fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended, and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 1, 2006

/s/ Richard A. Morin

Richard A. Morin
Senior Vice President of Finance and Administration,
Chief Financial Officer, and Treasurer
(principal financial officer)

* This certification shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to the liability of that section, nor shall it be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934.