BOB'S NOTES on

COGNEX'S ANNUAL REPORT 2000

Bob's® NOTES INC.

YOUR ULTIMATE GUIDE TO MACHINE VISION

A Note to the Reader

Bob's Notes has created this unique series of concise annual report summaries just for you…the very busy shareholders and potential investors in America's leading public companies. We know you're interested in the plots, characters, and yearly accomplishments of the world's leading companies…but you don't have the time or energy to spend slogging through their original, overly detailed (and usually quite boring) annual reports.

With **Bob's Notes**' best-selling **Annual Report Series**, students of public companies can quickly and conveniently get all the information they need in an "easy to swallow," condensed form…free of the jargon and corporate-speak that can often cloud the "real" story. In **Bob's Notes** you won't find those carefully worded letters from corporate CEOs with their positive spin on the prior year's results; you won't find slick (and expensive) photos of the company's smiling employees or its products; and you won't find those scripted endorsements from satisfied customers. Instead you'll find the information you need about the company's products, people, and performance in the year past…all in the simple executive-summary format that's made **Bob's Notes** the preferred source of corporate information for leading executives, financial analysts, and fund managers worldwide.

Many readers have found that by using **Bob's Notes** they have more time to spend on other, more important endeavors, such as deleting unwanted e-mails or reading the manuals that came with their cell phones. And, some readers have actually reported that by relying on **Bob's Notes**, they have increased both the quality and the quantity of their sleep. (Although we cannot confirm this claim in general, we do know that the shareholders of Cognex Corporation, the subject of this issue, have had worry-free nights throughout 2000 because of Cognex's superb performance.)

In previous issues of the **Bob's Notes** series on Cognex Corporation, readers learned that Cognex was founded in 1981 and grew to become the world's leader in the vision industry by working harder and smarter to meet customers' needs. In this issue, you'll learn how this unique corporation fared in the first year of the new millennium. You'll discover how Cognex increased its lead over the competition and turned in a superb performance, breaking all previous company records for number of new customers, revenue, profits, and end-of-year backlog.

We're confident that after reading **Bob's Notes on Cognex's Annual Report 2000**, you'll be as excited as we are about Cognex and the increasingly important role that it plays in the world of factory automation.

Best regards, and happy reading!

Robert J. Shillman ("Dr. Bob")
Editor of Bob's Notes*

**In addition to his day job as Editor of Bob's Notes, Dr. Shillman works nights and weekends at Cognex Corporation where he is President, CEO, and Chairman.*

COGNEX'S
ANNUAL REPORT 2000

including

- *Major Characters*
- *Chronology*
- *Synopsis*
- *Chapter Summaries*
- *Review Questions and Essay Topics*
- *Management's Discussion of Financial Condition and Results of Operations*
- *Financial Statements and Supplementary Data*
- *Company Information*

Bob's® NOTES INC.

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President, CEO & Chairman
Cognex Corporation

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1. Due to regulations by the Securities and Exchange Commission, each issue in Bob's Notes Annual Report Series is required to contain the next three sections in their original, uncondensed forms. Our concise summaries of these sections appear in Chapters 8, 9, and 10. The publisher of Bob's Notes apologizes for the inconvenience of these extra pages when our summaries would do just fine. As a convenience, we have perforated these pages so that they can be easily removed and discarded. (Bob's Notes supports recycling; please dispose of pages responsibly.)

COGNEX'S ANNUAL REPORT 2000
NOTES

GLOSSARY OF IMPORTANT TERMS

Editor's Note: To make Bob's Notes even easier to use, you can refer to this glossary any time that you come to a word printed in **bold type** in the text.

ASAP
Acronym for Application-Specific Accelerated Product. This is a vision system with only one particular capability. For example, Cognex's acuReader is an ASAP used by manufacturers of semiconductors to track silicon wafers by reading tiny code numbers etched on the surface.

Cognerd
1. A Cognoid (see below) who's also an engineer.
2. A designer of the best machine vision systems in the world.

Cognex
The largest and most successful machine vision company in the world [from English, "Cognition Experts" ca. 1981].

Cognex Customers
The smart people and companies that purchase Cognex vision systems for their automation needs. Cognex has two different types of customers: OEMs (see below) and end users (see below).

Cognex's Mission
To be the largest and most successful machine vision company in the world, and to be acknowledged as a company that has the highest ethical standards in its relationships with its customers, employees, vendors, neighbors, and shareholders.

Cognex's Motto
"To Preserve and Enhance Vision." (Editor's Note: There are two different levels of interpretation of this motto. The most obvious is to preserve and enhance machine vision; i.e., to make better machine vision systems. The second, deeper meaning, is to preserve and enhance Cognex's vision of what a great company can be…innovative, dynamic, successful, and a reliable and trustworthy partner to all its stakeholders.)

Cognex's Ten Values
Every Cognoid's guidelines for being "the best of the best." They are: Customer First, Excellence, Perseverance, Enthusiasm, Creativity, Pride, Integrity, Recognition, Sharing, and Fun.

Cognoid
1. A Cognex employee.
2. See "Winner."

Cognut
1. A Cognoid who is just NUTS about Cognex and machine vision.
2. The character portrayed by Dr. Bob at the Cognex Halloween Party in 2000.

End-User Customers (alt. “End Users” or “Factory Floor Customers”)
Cognex customers who purchase Cognex vision systems and install them directly on production lines in their manufacturing facilities to inspect products and to control the manufacturing process.

End-User Products
Cognex vision systems designed specifically for Cognex’s end-user customers. Cognex’s principal end-user products are Checkpoint and In-Sight, both general-purpose vision systems. Cognex also sells Application-Specific Accelerated Products (“ASAPs”…see definition on page 5) to many end users.

Excellence
1. Cognex’s goal in everything that it does.
2. What Cognex expects from each Cognoid.
3. What each Cognoid expects from him or herself.

Good
Not good enough! (See “Excellence.”)

Half a Workday
12 hours.

Halloween
Cognex’s favorite (and official) holiday, celebrated with elaborate costumes, decorations, and parties (see “Work Hard, Play Hard”).

In-Sight
Cognex’s new and unbelievably cool vision sensor that’s inexpensive, powerful, and easy to use. In-Sight set new Cognex booking records in 2000.

Machine Vision System
A high-tech product, consisting of a camera along with computer hardware and very sophisticated software, which has the ability to “see.” These systems are used to inspect and control the production of items on manufacturing lines. The system’s camera first captures the image of each item on the manufacturing line. The vision system analyzes the image in a fraction of a second, and then sends information about what it saw to other equipment on the manufacturing line. For example, a vision system might guide a robotic arm to pick up a windshield from a pallet and then accurately insert it in a car chassis as it’s moving down an assembly line. (Syn. “vision system” or “computer vision system.”)

Modular Vision System
Machine vision system used for automating the manufacture and assuring the quality of a wide range of discrete items. Virtually everything from computer chips to chocolate chips can be inspected by these systems.

OEM Customers (alt. “OEMs”)
The term “OEM” is an acronym for Original Equipment Manufacturer; it refers to a Cognex customer that manufactures complex automation machines, each one of which includes a Cognex vision system which provides that machine with the ability to “see.” Each one of Cognex’s OEM customers purchases numerous Cognex vision systems and then incorporates them into the equipment they manufacture. The OEMs then sell their completed machines (each of which includes a Cognex vision system) to their customers.

OEM Products
Cognex vision systems designed specifically for OEM customers. Cognex's OEM products include the Cognex 4000 Series, 5000 Series, and 8000 Series.

Portnoid
A Cognoid who works in Cognex's office in Portland, Oregon.

SmartView ICN
Cognex's new state-of-the-art surface inspection system. Introduced in 2000, SmartView was the most successful launch ever for a Cognex surface inspection product. (See "Surface Inspection System.")

Success
25% better than whatever Cognex has just achieved.

Surface Inspection System (alt. "Web Inspection System")
A machine vision system that is used to inspect the surfaces of materials produced in a continuous fashion (i.e. "webs"), such as metals, paper, and plastics. These systems are capable of detecting minute flaws on the surfaces of materials even when the web is 20 feet wide and moving at speeds of over 60 m.p.h.!

Vision Guru
An individual (usually a software engineer or computer scientist) who is a leading expert in the field of machine vision. (See "Bill" and "John" under "Major Characters." See also "Cognerd.")

Vision Sensor (alt. "Intelligent Sensor")
A machine vision system that includes a specialized camera, cables, and vision processor that is a) compact (ranging in size from a laptop computer to a cellular phone), b) low in cost (under $5,000), c) capable of solving a variety of simple vision tasks (such as measuring the positions of keys on a cellular phone), and d) easy to use (menu driven as opposed to programmed).

Wall of Fame
A prominent display of champagne bottles, patent awards, and framed articles which illustrate important Cognex achievements and milestones. There is a Wall of Fame located in the lobby at Cognex's Natick headquarters and in each major regional office around the world.

Whiner
1. Not a Cognoid.
2. Antonym: Winner.

Winner
1. Every Cognoid.
2. Antonym: Whiner.

Work Hard, Play Hard
Motto upon which Cognex's unique corporate culture is based.

MAJOR CHARACTERS (IN ORDER OF APPEARANCE AT COGNEX)

Dr. Bob
What Cognoids call Dr. Robert J. Shillman, Cognex founder, President, CEO, and Chairman. Cognex Employee #1.

Bill
William Silver, Cognex founder, Senior Vice President of R&D, and Chief Technology Officer. Cognex Employee #2.

Marilyn
Marilyn Matz, Cognex founder and Senior Vice President of Engineering. Cognex Employee #3.

Dave
David Schatz, Vice President of Corporate Development.

Justin
Justin Testa, Senior Vice President of Marketing.

Mike
Michael Steir, Vice President of Corporate Legal Services.

Kris
Kris Nelson, Vice President of North American Sales.

John
John McGarry, Senior Vice President and General Manager of Cognex's In-Sight Products Group.

Patrick
Patrick Alias, Executive Vice President of Worldwide Sales and Marketing.

Eric
Eric Ceyrolle, President of Cognex International.

Roy
Roy Baessler, Vice President of Operations.

Stan the Man
Stan Luboda, Vice President of North American Sales for Cognex's Surface Inspection products.

Hisataka
Hisataka Shitara, Vice President in charge of Surface Inspection Systems at Cognex KK, the company's wholly-owned subsidiary in Japan.

Markku
Markku Jaaskelainen, Corporate Vice President and General Manager of Cognex's Surface Inspection Systems group.

Dick
Richard Morin, Vice President of Finance, Chief Financial Officer, and Treasurer.

Akira
Akira Nakamura, President of Cognex KK.

Board of Directors

Robert J. Shillman – President, Chief Executive Officer, and Chairman, Cognex Corporation.

Anthony Sun – General Partner, Venrock Associates.

William A. Krivsky – Principal, Kellogg, Krivsky & Buttler, Inc.

Reuben Wasserman – Business Consultant.

Jerald G. Fishman – President and Chief Executive Officer, Analog Devices, Inc.

Officers

Robert J. Shillman – President, Chief Executive Officer, and Chairman.

Patrick A. Alias – Executive Vice President, Worldwide Sales and Marketing.

William Silver – Senior Vice President and Chief Technology Officer.

John McGarry – Senior Vice President and General Manager, In-Sight Products Group.

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

Marilyn Matz – Senior Vice President of Engineering.

Clerk/Secretary of the Board

Anthony J. Medaglia, Jr. – Corporate Partner, Hutchins, Wheeler & Dittmar.

CHRONOLOGY

For those readers who have not read Bob's Notes on Cognex's Annual Reports for the years prior to 2000, we have provided this chronology which contains highlights of Cognex's past 20 years in the business.

1981 Dr. Robert J. Shillman, a post-doctoral researcher in machine vision and a lecturer in computer science at the Massachusetts Institute of Technology, leaves academia and invests $87,000…his life savings…to start Cognex. Dr. Shillman convinces two graduate students, Bill Silver and Marilyn Matz, to leave M.I.T. for the summer to help him start the company by offering them free bicycles!

1982 Cognex introduces its first **Machine Vision System**, known as DataMan. The system reads numbers, letters and symbols on product surfaces for applications ranging from identifying cardboard shipping cartons to silicon wafers. By 1984, DataMan becomes "the industry standard" for reading codes that are laser-etched on semiconductor wafers.

1986 Cognex introduces the Cognex 2000…the world's first **Machine Vision System** to be built on a single printed circuit board. Cognex developed this product for Original Equipment Manufacturers (**OEMs**) to integrate into capital equipment they build for **End Users**. Targeting **OEMs**, who had the technical expertise to program machine vision, ensured Cognex's initial **Success**, while its competitors continued to sell directly to **End Users**, who in the early days of machine vision, required costly technical support and custom engineering.

1989 Cognex goes public on the NASDAQ exchange at $1.38 per share (accounting for the three 2:1 stock splits since that time). Within one year, the company's stock price triples. To celebrate this stellar performance, Cognex's President, Bob Shillman, makes each employee "rich for a night." A chauffeur-driven limousine picks up each **Cognoid** and a guest and takes them to their choice of one of Boston's most exclusive restaurants for an evening of champagne and fine dining…all at Cognex's expense.

1994 Cognex introduces Checkpoint, its first **Machine Vision System** targeted to the **End-User** market. Checkpoint is designed for automation engineers who need machine vision to control manufacturing systems on the factory floor. Checkpoint is the first product of its kind that enables customers with neither computer programming nor machine vision experience to configure and install a vision system on their production lines.

Cognex expands and moves into its current headquarters in Natick, Massachusetts.

1995 Cognex completes its first acquisition, Acumen, Inc., a Portland, Oregon-based developer of **Machine Vision Systems** for the semiconductor industry.

Cognex surpasses $100,000,000 in annual revenue.

1996 Cognex expands its business into surface inspection by acquiring Isys Controls, Inc. of Alameda, California, a supplier of ultra-high performance **Surface Inspection Systems**.

Cognex expands again…building a 50,000 square foot addition to its headquarters.

1997 Cognex introduces PatMax, a revolutionary technology developed by Cognex Vice President of Research and Development, Bill Silver. PatMax enables a vision system to accurately locate objects in the camera's field of view…even though the items may vary in size, color, or orientation, or even when the items are only partially visible!

1998 More expansion…Cognex acquires the machine vision business of Rockwell Automation and becomes the preferred supplier of **Machine Vision Systems** to Rockwell's factory automation customers worldwide. Rockwell's entire staff of machine vision experts joins the Cognex team.

Cognex introduces the MVS-8000 Product Family, which offers a choice of host-based or embedded vision processing and a full library of MMX-accelerated software tools.

1999 Cognex ships its 100,000th **Machine Vision System**.

2000 Cognex becomes the leading provider of **Machine Vision Systems** to **End Users** in Japan by acquiring the machine vision business of Komatsu. Komatsu's entire staff of machine vision experts joins Cognex's team in Japan.

Cognex expands its **End-User** business in Europe by acquiring Image Industries, a U.K.-based developer of very low-cost vision systems.

Cognex expands its surface inspection business by acquiring Roibox, the surface inspection division of Honeywell.

Cognex enters the low-cost **Vision Sensor** market with the introduction of **In-Sight**, and introduces **SmartView ICN**, a flexible new high-performance surface inspection product targeted at the paper-manufacturing industry. And, this new product drives Cognex's surface inspection product line to profitability.

Cognex surpasses $1 billion in cumulative revenue since the company's founding in 1981.

2001 Editor's Note: As this issue of Bob's Notes was headed to press, Cognex shipped its 150,000th **Machine Vision System**.

SYNOPSIS

THE COMPANY

Cognex Corporation is the world leader in the design, development, and sale of **Machine Vision Systems**, or computers that can "see." **Machine Vision Systems** are used in factories around the world to automate a wide variety of tasks where vision is required. In fact, virtually everything that is made in an automated fashion…from computer chips to chocolate chips…can benefit from machine vision, which helps all kinds of manufacturers make their products better, faster, and at a lower cost.

Cognex has installed more than 150,000 **Machine Vision Systems** worldwide, resulting in over $1 billion in cumulative revenue since the company's founding in 1981. And, with more than 100 patents issued and 140 pending, it has also set the standard for innovation in the machine vision industry. Cognex is headquartered in Natick, Massachusetts, with 70 offices around the world that provide customers with a global sales and support network. Cognex has achieved an incredible record of 55 successive quarters of profitability since going public in July of 1989 (excluding non-recurring charges, of course). And, with only a few exceptions, the net profitability has been in excess of 20% of revenue in each of those quarters!

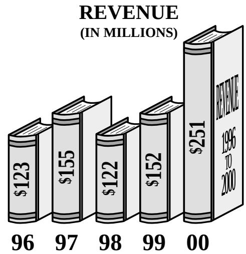
Cognex is a highly innovative company whose creative approach isn't limited just to the development of technology. Cognex also has a unique corporate culture that fosters taking a creative approach to everything it does. How many companies make their annual reports not only informative, but also unique and interesting to read? How many companies reward the exceptional performance of their employees by paying cash bonuses directly from an armored car? How many CEOs show up in mid-summer driving an ice cream truck to pass out goodies to their employees? And, how many companies reward perseverance by sending their long-term employees (and a guest) around the world to see the Great Wall of China or the Pyramids of Egypt? Cognex's unique culture is reflected in **Cognex's Ten Values**, a set of well-documented principles which all **Cognoids** are expected to embrace.

YEAR 2000

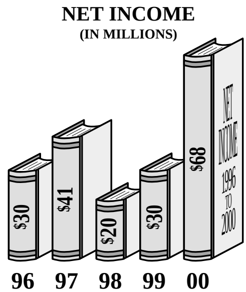
2000 was a winning year for Cognex, highlighted by key acquisitions, several important product introductions, and new company records in revenue, profits, and earnings per share.

Cognex's business during 2000 started off strong, and continued to grow throughout most of the year. During Q1, Cognex reported the highest quarterly revenue in the company's history. In this quarter, the company also acquired the machine vision group of Komatsu, a leading Japanese manufacturer of electronics and industrial equipment. And, Cognex introduced two new products for the **End-User** market: **In-Sight**, a low-cost machine **Vision Sensor**, and **SmartView ICN**, a state-of-the-art **Surface Inspection System**.

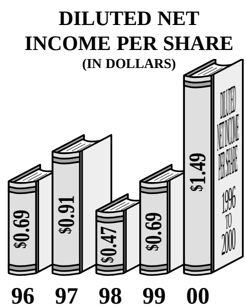
In Q2 the pace quickened. In addition to breaking the revenue and earnings records that were just established in Q1, Cognex signed a record number of new customers. Cognex also made its second acquisition of 2000 by purchasing Image Industries, the leading supplier of **End-User Machine Vision Systems** in the United Kingdom. And, to help meet the growing demand for its products, Cognex accelerated its efforts to hire new sales engineers (and ended the year with an international sales force of 146 quota-carrying sales engineers).



In Q3 and Q4 the fast pace continued. Cognex completed its third acquisition of the year…Roibox, the surface inspection business of Honeywell. Like the acquisitions of Komatsu and Image Industries, Cognex's purchase of Roibox was aimed at expanding the company's global market presence in the factory-floor business. In addition, the company opened new sales offices in Hong Kong and Spain, further positioning itself for future global growth. Expanding geographically not only brings Cognex closer to its customers, it also improves the company's ability to compete with local vision companies.

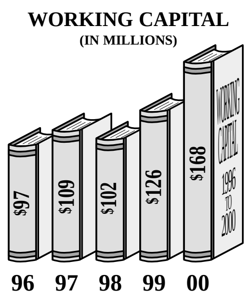


In summary, during calendar year 2000, Cognex recorded the best financial performance in its 20-year history. Total revenue grew to an all-time high of $250.7 million (a 65% increase over 1999's revenue of $152.1 million). The company reported an incredible net income of $68.1 million (a 124% increase over 1999), and earnings per share grew to $1.49 in 2000 from $0.69 in 1999 (a 116% year-over-year increase). Cognex ended the year with a company record of 848 new customers…nearly double the previous record of 428 new customers, set in 1999.



And, throughout the year, Cognex also continued actively recruiting new hires in every department and in every office. By year's end, the company's overall headcount was 781, an increase of over 150 employees compared to the end of 1999.

These are some of the highlights of Cognex's **Success** in 2000, and some of the reasons why Cognex has been on the machine vision industry's "best seller" list since its founding in 1981. In the following chapter-by-chapter summaries on the year 2000, you'll find more information on how Cognex achieved its record-breaking results.



CHAPTER SUMMARIES

CHAPTER 1 − OEM BUSINESS BOOMS IN 2000

Summary

During 2000, Cognex's **OEM** customers experienced record demand for their products. As a result, these manufacturers dramatically increased their orders for Cognex machine vision. Revenue from **OEM** customers in 2000 increased 68% to $156.9 million, from the 1999 level of $93.2 million.

Although a large number of new **OEM** customers were closed in 2000, most of the revenue growth resulted from an increase in the number of **Machine Vision Systems** ordered by Cognex's existing **OEM** customers. Cognex's **OEM** customers integrate Cognex vision into high-speed, high-accuracy automated equipment that they manufacture and sell to their customers. For example, in the electronics segment of Cognex's business, machine vision guides robotic equipment to place electronic components on printed circuit boards…at up to 60,000 parts per hour. And, in the semiconductor industry, Cognex vision is used to automatically guide the attachment of fine wires onto semiconductor chips.

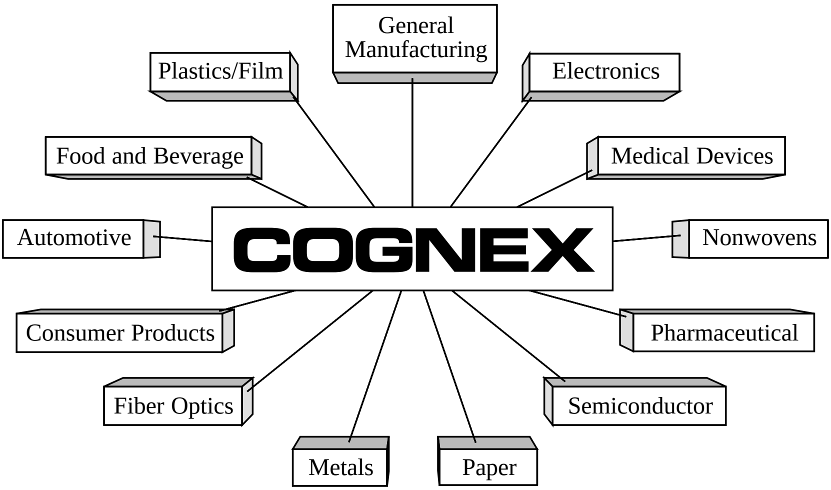
Cognex has a track record of developing the most reliable vision solutions in the world for these and other applications. As a result, Cognex is the largest supplier of machine vision to **OEM** customers around the world…more than 60% of **OEMs** who purchase machine vision buy their vision systems from Cognex.

In addition to dramatically increasing Cognex's business with existing **OEM** customers, Cognex also signed 92 new **OEM** customers during 2000. These new customers were either won from competitors, or were "captives" (**OEMs** who develop their own machine vision). Converting captives into customers represents the largest potential source of new **OEM** business for Cognex. As component geometries get smaller and production speeds get faster, many **OEMs** are finding that they cannot internally design their own machine vision systems. As a result, each year more of these companies are turning to Cognex for their machine vision needs.

Toward the end of 2000, orders from capital equipment makers began to slow down as it became evident that the anticipated demand for their equipment…most of which is used in the making of computer chips…was not as strong as predicted. Consequently, Cognex's growth also slowed from the record pace set in the first three quarters of the year.

To help lessen the impact of such cyclical downturns in the semiconductor market on the company's business, Cognex has been working hard to increase sales of machine vision to general manufacturers. This strategy is discussed in Chapters 2, 3, 4, and 5.

MAJOR MARKETS SERVED BY COGNEX



CHAPTER 2 – END-USER BUSINESS CLIMBS TO NEW HEIGHTS

Summary

While the **OEM** business currently represents the largest portion of Cognex's total revenue (63%), the company believes that **End Users** offer far larger potential for growth in the future. In fact, the company believes that the untapped **End-User** business for machine vision is in excess of $1 billion annually. Developing this market has been a key objective for Cognex since 1994, and in 2000 the company succeeded in growing its revenue from **End-User** customers to $93.8 million…an increase of 59% over 1999 levels.

In order to take advantage of growing market opportunities in the **End-User** segment, Cognex expanded its **End-User** sales force in 2000. Due to this expansion, as well as to the development of new products targeted to **End Users**, Cognex succeeded in signing an astounding 756 new **End-User** customers in 2000...most of which had never before purchased machine vision from Cognex.

Many of these new accounts are in key industries where machine vision has become essential…either from a regulatory standpoint or an economic standpoint…for controlling the manufacturing process to ensure high quality and/or low manufacturing cost. An example of a manufacturing process where machine vision is used to meet mandated quality standards is in the pharmaceutical industry, where vision systems are used to control the packaging and labeling of drugs to ensure that FDA regulations are met and that consumer safety is assured.

An example where machine vision is a must-have because manufacturers require low production cost and high quality is in the manufacture of disposable items such as shavers, pens, cosmetic brushes, and plastic dinnerware. These products are made at very high speeds (five or more items per second), and they must sell for such a low price that it would be both physically and economically impossible to have humans inspect each and every product made. Yet, if these products are not inspected, then the manufacturer runs the risk of producing hundreds of thousands of bad items each day. And what's worse, if there's a problem in the production process that causes defects, then without some sort of inspection, those defective products would be packaged and shipped to retail stores before anyone realizes they are flawed. The negative consequences of not relying on machine vision are quite dramatic, and therefore, Cognex's **Machine Vision Systems** are easily justified to **End Users**…they are low in cost and immediately increase the quality of manufactured goods, while at the same time they reduce manufacturing costs.

To continue winning even more customers on the factory floor, Cognex is developing new generations of products that make using machine vision easier than ever. For more on the topic of new product development at Cognex, see Chapters 3 and 4.

CHAPTER 3 – IN-SIGHT REVOLUTIONIZES MACHINE VISION FOR END USERS

Summary

This chapter describes one of the most exciting developments at Cognex in 2000…the introduction of Cognex's first **Vision Sensor**, **In-Sight**.

The market for **Vision Sensors** represents the fastest growing area for machine vision in the **End-User** segment. Cognex's first **Vision Sensor**, **In-Sight**, was introduced in January of 2000 in response to requests from many **End Users** for an inexpensive and easy-to-use vision system that could be readily integrated at many points on their production lines. And, the market's response to **In-Sight** has exceeded Cognex's expectations; Cognex received more than $12 million in orders for **In-Sight** during 2000, breaking all previous records at Cognex for new product bookings.

Customers for **In-Sight** ranged from the leading manufacturers in industries such as automotive and electronics, to consumer products and pharmaceuticals. For example, a major automaker was encountering production problems when workers mistakenly installed the wrong model air conditioners in their minivans. Depending on the consumer's choice of options in the van, one of four different air conditioning units would be specified. However, workers often installed the incorrect unit because the units all looked quite similar. The car manufacturer turned to Cognex for help, and after integrating **In-Sight** (in just a single afternoon), the error was completely eliminated. Since it was installed, **In-Sight** has accurately identified each air conditioning unit prior to installation, and has ensured that each and every minivan gets the correct unit...100% of the time.

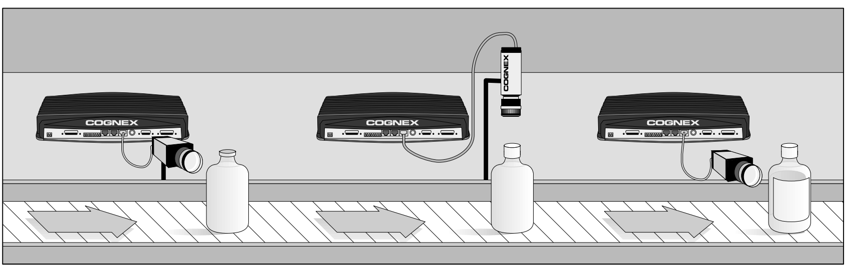
In the pharmaceutical industry, where the FDA requires an automated method of counting and inspecting drug vials, **In-Sight** is being used to count and sort vials of medicine before they are packaged and shipped to hospitals. And, while **In-Sight** is counting the vials, it is simultaneously inspecting the vials for scratches and for leaks.

Because it's affordable and easy to integrate, **In-Sight** provides an excellent starting point for manufacturers who are interested in exploring the benefits of machine vision. In fact, 70% percent of **In-Sight** customers in 2000 were new to Cognex and were in new industries, outside of the company's core markets of semiconductors and electronics.

In the coming year, Cognex will expand its offerings in the **Vision Sensor** space with three new models of **In-Sight**. Each of these new models will have networking functionality, which means that each new **In-Sight** model can be configured remotely and can send data to any device or PC that is connected to the corporation's network. This capability has enormous utility. For example, with these network-capable **In-Sights**, the head of manufacturing for a global corporation can immediately view real-time images of products passing in front of Cognex vision systems in plants anywhere around the world. More importantly, he could look at the inspection results of each **In-Sight** and plot the status, the quality metrics, and the productivity of each of his worldwide manufacturing lines...all from his office PC. He could then easily compare the results from different plants and determine how to maximize productivity across the entire enterprise.

In addition to serving the low-cost vision needs for **End Users** in 2000, Cognex continued to meet its customers' needs for solutions to complex automation problems with its Checkpoint line of **Machine Vision Systems**. During 2000, Cognex released Checkpoint II, a second-generation version of its PC-based vision system which was first introduced in 1994. Designed for very demanding applications, Checkpoint II is capable of inspecting up to 11,000 parts per minute and analyzing images from four different cameras simultaneously.

HOW IN-SIGHT IS USED ON A MANUFACTURING LINE



In-Sight vision sensors, deployed at numerous points on the production line, obtain key data so that manufacturers can carefully monitor the manufacturing process and instantly respond to production problems.

CHAPTER 4 − SMARTVIEW ICN OPENS A NEW CHAPTER IN SURFACE INSPECTION

Summary

While the Oregon-based development team working on Cognex's modular vision products was busy creating **In-Sight**, Cognex's **Surface Inspection Systems** team in Alameda, California was hard at work on its own new product **Success** story, **SmartView ICN**. **SmartView ICN** is a state-of-the-art **Surface Inspection System** that is used to automatically detect, identify, and display defects in materials such as plastics, nonwovens, paper, and metals as they are being produced.

Introduced in February of 2000, **SmartView** offers manufacturers significant advances over previously available **Surface Inspection Systems** in several areas. First, it offers superior performance over every other system in its price range. Second, it is modular, or "scalable," so that customers can start with a small investment and simply add on as their needs increase.

SmartView was designed specifically to meet the needs of manufacturers in the mid-range of the surface inspection market…the largest section of the market in both number of customers and potential revenue. Companies in this market typically have applications too sophisticated for a low-end **Surface Inspection System**, yet investing in an expensive high-performance system is not cost-effective. With **SmartView**, users get performance far superior to anything previously available in its price range.

In designing **SmartView**, Cognex challenged its engineering team to create a product that was not only affordable, but robust enough to handle high-accuracy inspection of nonwoven materials. Nonwovens are bonded fiber materials used to make items such as surgical masks, air filters, and diapers. Because of their porous structure and surface variations, accurate inspection of nonwovens has traditionally posed a great challenge to machine vision. In fact, no other machine vision company has been able to successfully do it! That meant that the machine vision market for nonwovens was wide open. And, if the **SmartView** development team was successful in designing a product reliable enough for nonwoven inspection, Cognex was confident that the technology could easily be rolled out to other industries where the inspection challenges were not as rigorous.

Of course, Cognex's engineering team rose to the challenge! Since its introduction in February of 2000, **SmartView** has become the market leader in the nonwoven industry. And Cognex has also begun the process of introducing **SmartView** into other industries as well. By the end of 2000, **SmartView** was successfully installed on the production lines of three highly demanding international paper companies…passing all of their tests for performance and reliability. Furthermore, Cognex's acquisition of Roibox (Honeywell's surface inspection business) will help the company accelerate acceptance of **SmartView** among paper manufacturers worldwide in the coming year.

CHAPTER 5 − ACQUISITIONS STRENGTHEN THE TEAM AND BROADEN THE TECHNOLOGY

Summary

Cognex believes that the worldwide need for machine vision is so large that the company can accelerate its growth by selectively acquiring other companies (or divisions of companies) that specialize in machine vision. In this way, Cognex can quickly add new technology, products, and experienced sales and engineering personnel to fuel its future growth.

During 2000, Cognex made three key acquisitions, all aimed at increasing the company's share in the **End-User** market for machine vision.

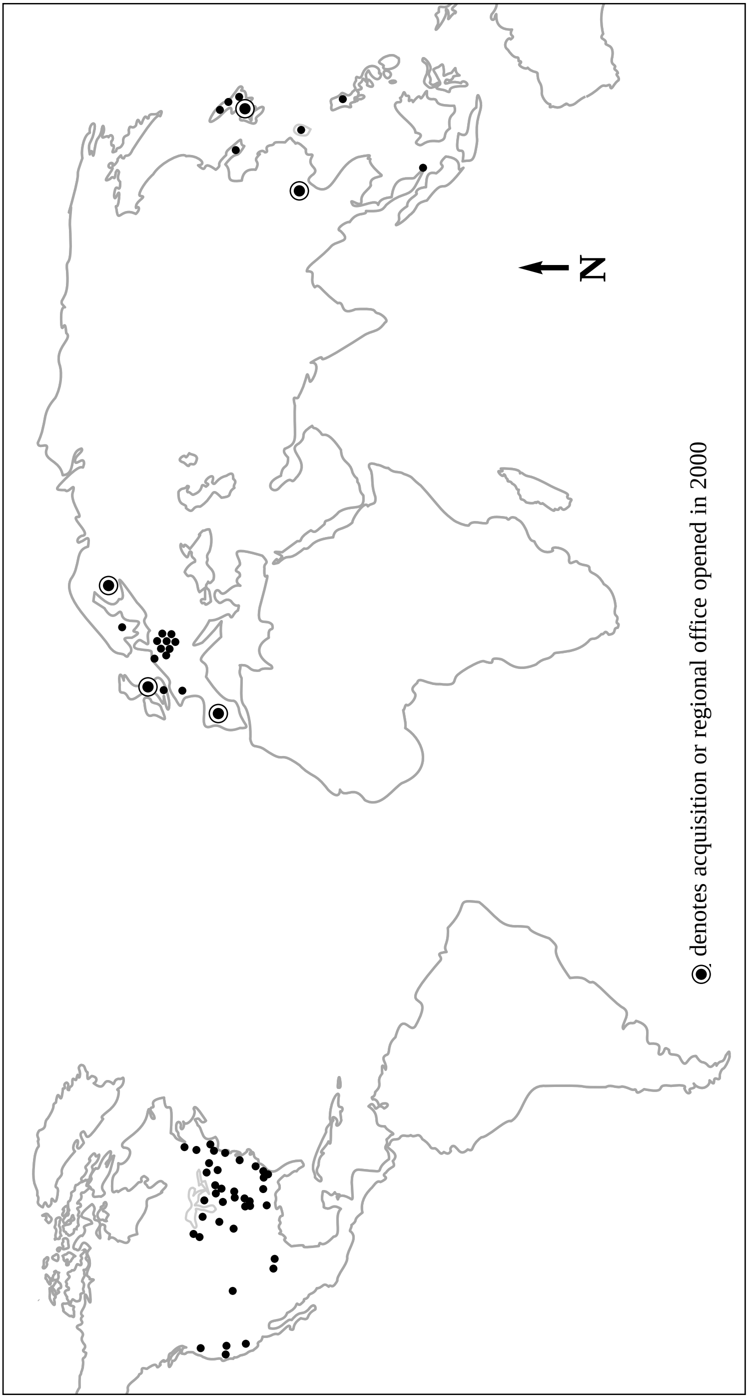
In March of 2000, Cognex acquired the machine vision group of Japan-based Komatsu, Ltd. Komatsu, well known as a leading Japanese manufacturer of heavy industrial machinery and electronic equipment, was also one of the largest and most successful suppliers of **Machine Vision Systems** to **End Users** in Japan's semiconductor industry. This acquisition increased Cognex's access to the large **End-User** market in Japan. And, just as important, Cognex added 21 skilled salespeople and product development engineers…all with extensive machine vision experience…to the Cognex team in Japan. Sales of the Komatsu-designed products that Cognex acquired are proceeding ahead of projections. And, in addition to serving Komatsu's existing customer base, Cognex has successfully closed new customer accounts with these products as well.

In April, Cognex acquired Image Industries, the leading supplier of **End-User Machine Vision Systems** in the United Kingdom. This deal immediately established Cognex as the leading provider of vision systems to **End Users** in the UK. In addition, the acquisition brought to Cognex a team of 12 highly skilled and experienced engineers and salespeople, who are experts in designing and selling low-cost **Vision Sensors** to the **End-User** market. The Image Industries engineers are now collaborating with engineers in Cognex's Portland facility to develop Cognex's next generation of small and very powerful **Vision Sensors**.

Cognex's third acquisition in 2000 was Roibox, the surface inspection business of Honeywell, a deal that Cognex had anticipated for a number of years. This transaction is expected to accelerate the penetration of Cognex's new **SmartView ICN** surface inspection product into the pulp and paper market around the world, which is the single largest opportunity for **Surface Inspection Systems**.

In the years ahead, Cognex plans to continue seeking out opportunities to expand its product line, customer base, and employee team through selective acquisitions in the machine vision industry. In particular, Cognex will look for opportunities to acquire technologies that complement its line of products, or those that provide the company with an enhanced market presence around the world.

COGNEX WORLDWIDE LOCATIONS



CHAPTER 6 − COMPETITION: A DETAILED REPORT

Summary

The list of Cognex’s competitors who are technically competent, well-managed, well-financed, and who the company currently believes represent a significant threat to its business are shown in Table 1 below:

TABLE 1

Cognex’s Competitors

CHAPTER 7 − FUTURE GROWTH OPPORTUNITIES

Summary

This final chapter touches on possible future developments at Cognex, which, if they occur, will be summarized in forthcoming issues of the **Bob’s Notes** series on Cognex Corporation.

Fiber Optics Industry
Analysts are predicting that the market for fiber optic-related communications equipment will grow from $6.6 billion in 1999 to $23 billion in 2003. The fiber optics industry represents an exciting area of potential growth for Cognex because it is large and because it currently lacks...but could strongly benefit from...assembly automation. During 2000, Cognex formed a special Fiber Optics Team aimed at analyzing and then meeting the automation needs of this new industry.

Manufacturing of fiber optic cables and related components is now almost entirely manual; each individual fiber is polished, inspected, aligned, and inserted by hand. Machine vision can be effectively used to automate a wide range of these tasks, and several fiber optics manufacturers and producers of automation equipment have already contacted Cognex to explore the opportunity of using its **Machine Vision Systems** to increase both throughput and yield.

Vision Sensors

Cognex expects to see continuing growth in the demand for low-cost vision from **End Users**. In anticipation, Cognex has already developed “next generation” **In-Sight** systems that it will begin selling in 2001. For example, **In-Sight** 1000 is a general purpose **Vision Sensor** about the size of a cellular phone; it can be installed at numerous points on a factory’s production line to ensure that each production step proceeds correctly. The **In-Sight** 1010 will be the first application-specific version of **In-Sight**. It was designed specifically to read 2D codes and barcodes printed or embossed on parts in order to identify them, and track them throughout the production process.

Surface Inspection Systems

In 2000, **SmartView ICN** was successfully launched in both the nonwovens and plastics markets. Based on this **Success**, Cognex will aggressively market this product to paper and metals manufacturers in the coming year.

Semiconductor and Electronics Applications

Cognex’s engineering team is constantly at work enhancing the company’s products in order to keep pace with the needs of our **OEM** customers, whose machines must produce chips at faster rates each year…even though the chips are smaller and more complex. These customers require vision systems that can keep pace with the higher speeds of automated equipment and with the shrinking geometries of the chips handled by these machines.

And, Cognex has already positioned itself to capture market leadership for equipment needed to process 300mm wafers...the new, larger-sized silicon wafers being adopted as a standard by many chipmakers. In 2000, the company introduced acuReader III, the latest generation of Cognex’s high-performance wafer reading system, which includes enhanced 2D reading to meet the demanding requirements of 300mm wafer fabs.

CHAPTER 8 − MANAGEMENT'S DISCUSSION OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Summary

(a) Cognex's revenue increased a whole lot from 1999 to 2000 because its customers bought a whole lot more of its stuff in 2000 than they did in 1999.

(b) Cognex's operating expenses increased quite a bit from 1999 to 2000 because (i) generally things cost more in 2000 than they did in 1999 (e.g., increases in employees' salaries, increases in energy costs, and increases in the price of a cup of coffee), and (ii) Cognex increased its staff in 2000 to serve its customers' increased requirements.

(c) Cognex's operating expenses grew in 2000, but at a slower rate than Cognex's revenue during that same period.

As a result of (a), (b), and (c) above, Cognex's profits increased at a faster rate from 1999 to 2000 than its revenues.

Note from the Editor: While we have great admiration for Cognex and its management team, and while we don't wish to diminish, in any way, their efforts or accomplishments in 2000, we believe that the large increase in Cognex's business in 2000 and the subsequent dramatic increase in profitability was due more to external causes than to factors which were in the company's control. The primary external factor that drove Cognex's business in 2000 was a booming market for semiconductor devices, electronic products, and computer and telecommunications systems, which then drove up the demand for automated production machines needed to manufacture all of those devices, products, and systems. And, many of those production machines rely on Cognex machine vision to operate reliably and accurately without human intervention.

CHAPTER 9 − FORWARD-LOOKING STATEMENTS

Editor's Note: If you've got nothing better to do, go to page 32 where we have reproduced Cognex's Forward-Looking Statements in their original and uncondensed form. But, for those of you who "have a life," read the Summary below. And, for those of you who want to save even more time, we suggest reading the Executive Summary.

Summary

Cognex is in the business of making and selling **Machine Vision Systems**. Cognex is not in the business of predicting the future of its business…not the distant future, not the mid-term future, not even what will happen to its business the day after tomorrow. Therefore, any communication by any Cognex executive at any time and in any form (whether written, verbal, or by gesture, including, but not limited to, smiles, nods of the head, or winks of the eye) about possible future events should be completely ignored by every living person. Dead people can do as they please.

Executive Summary

Cognex insiders know squat about predicting the future. Don't listen to them.

CHAPTER 10 − FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Summary of P & L Statement

Cognex sold one heck of a lot of stuff in 2000 and made a lot of money doing it.

Summary of Balance Sheet

With more than one quarter of a billion dollars in cash and investments, and with no debt, this company is in better financial shape than most countries!

REVIEW QUESTIONS & ESSAY TOPICS

1. What is the significance of Halloween in Cognex's corporate culture, and how might dressing in costume for a day help bridge the gap between company management and all other Cognoids?

2. Discuss Cognex's philosophy of "Work Hard, Play Hard" in terms of employee motivation.

3. Why might the competition's efforts to equal Cognex's success in the machine vision industry be viewed as a tragedy?

4. What values are embodied in Cognex's "customer first" approach? Does that approach refer only to external customers?

5. What epic qualities are suggested by Cognex's pursuit of excellence?

6. How might the "Mr. Cognut" costume worn by Dr. Bob at Cognex's annual Halloween party be interpreted symbolically?

7. Compare and contrast Bill Silver's hairstyle with John McGarry's. What conclusions can be drawn from that comparison? (Hint: Bill's emphasis has been on OEM products, whereas John has recently focused on products for the end-user market.)

8. Discuss how bicycles have played an important role in the formation of Cognex. (Hint: Did Dr. Bob ever give his co-founders the bicycles that he promised when they joined Cognex?)

9. Envision the future. Write an essay on how Cognex would change if it developed vision systems as small as a cellular telephone, as easy to use as a toaster, and that could be purchased for under $200. (Hint: If you could buy a Cognex vision system for $200, how could you use it in your home, your office, or in your car?)

10. Discuss the apparent paradox of a company that can consistently report high profits while at the same time it has high rates of customer loyalty and satisfaction.

NOTES FOR THE ADVANCED READER

Editor's Note: Due to regulations by the Securities and Exchange Commission, each issue in Bob's Notes Annual Report Series is required to contain the next three sections in their original, uncondensed forms. Our concise summaries of these sections are included in Chapters 8, 9, and 10. The publisher of Bob's Notes apologizes for the inconvenience of these extra pages when our summaries would do just fine. As a convenience, we have perforated these pages so that they can be easily removed and discarded. (Bob's Notes supports recycling; please dispose of pages responsibly.)

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

SUMMARY

Revenue for the year ended December 31, 2000 increased 65% from the prior year due to growth in sales to original equipment manufacturer (OEM) customers, most of whom make capital equipment used in the semiconductor and electronics industries, as well as an increase in sales to end-user customers. Sales to OEM customers increased 68% from 1999, and sales to end-user customers increased 59% from the same period.

During the year, the Company continued to invest in new product development and end-user market penetration. This spending was outpaced, however, by the growth in revenue, resulting in a 152% increase in operating income from 1999. Net income increased 124% from the prior year and represented 27% of revenue in 2000.

The Company's financial position remained strong at December 31, 2000, with $436 million in total assets and $384 million in stockholders' equity. Working capital was $168 million at December 31, 2000, representing an increase of 33% from the prior year.

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

Year ended December 31,	**2000**	1999	1998
Revenue	**100%**	100%	100%
Cost of revenue	**25**	30	31
Gross profit	**75**	70	69
Research, development, and engineering expenses	**13**	18	20
Selling, general, and administrative expenses	**25**	29	31
Amortization of goodwill	**1**		
Charge for acquired in-process technology			2
Operating income	**36**	23	16
Investment and other income	**4**	5	6
Income before provision for income taxes	**40**	28	22
Provision for income taxes	**13**	8	5
Net income	**27%**	20%	17%

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

RESULTS OF OPERATIONS

Year Ended December 31, 2000 Compared to Year Ended December 31, 1999

Revenue for the year ended December 31, 2000 increased 65% to $250,726,000 from $152,125,000 for the year ended December 31, 1999. The increase in revenue was due to higher demand from both the Company's OEM and end-user customers. Sales to OEM customers increased $63,699,000, or 68%, from the prior year due to a higher volume of machine vision systems sold to the Company's core OEM customers who make capital equipment for the semiconductor and electronics industries. Sales to OEM customers represented 63% of total revenue in 2000 compared to 61% of total revenue in 1999. Sales to end-user customers increased $34,902,000, or 59%, from the prior year due largely to the introduction of the In-Sight and SmartView ICN products early in 2000, which are both targeted toward the end-user market.

Geographically, revenue increased in all of the Company's regions from 1999. Sales to customers in Japan and North America increased $49,697,000, or 74%, and $30,463,000, or 64%, respectively, primarily due to the increase in sales to the Company's OEM customers, most of whom are located in these regions. Sales to customers in Europe increased $15,836,000, or 48%, due largely to higher demand from European manufacturers of cellular telephones.

During the fourth quarter of 2000, the Company's order rate slowed from the record pace experienced in the third quarter due to delays and cutbacks in capital equipment spending by manufacturers in the semiconductor and electronics industries. Over the past several weeks, the order rate from customers in these industries has continued to decline. In addition, the Company recently began to experience slow order trends from customers in other industries whose businesses are being impacted by the slowing economy. As a result, the Company anticipates that its revenue for the first quarter of 2001 will be approximately 35% lower than that reported in the fourth quarter of 2000. At this time, the Company has limited visibility to customer demand beyond the first quarter of 2001 due to shortened order lead times. Due to this lack of visibility, as well as the high level of uncertainty regarding the timing of a business recovery, the Company is implementing a conservative spending plan for 2001.

Gross profit as a percentage of revenue for 2000 was 75% compared to 70% for 1999. The increase in the gross margin was due primarily to manufacturing efficiencies that resulted from increased product sales without a significant increase in manufacturing overhead, as well as improved gross margins on the Company's surface inspection products, including SmartView ICN.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

RESULTS OF OPERATIONS (continued)

Year Ended December 31, 2000 Compared to Year Ended December 31, 1999 (continued)

Research, development, and engineering expenses for the year ended December 31, 2000 increased 21% to $33,341,000 from $27,536,000 for the year ended December 31,1999. The increase in aggregate expenses was due primarily to higher personnel-related costs to support the Company's continued investment in the research and development of new and existing products. Included in the higher personnel-related costs are the expenses associated with the additional employees from the three acquisitions completed during the year. Expenses as a percentage of revenue decreased from 18% in 1999 to 13% in 2000 as a result of revenue increasing at a faster rate than spending. Due to the conservative spending plan implemented for 2001, the Company anticipates that aggregate expenses will decrease from the level experienced in the fourth quarter of 2000.

Selling, general, and administrative expenses for the year ended December 31, 2000 increased 42% to $61,915,000 from $43,523,000 for the year ended December 31, 1999. The increase in aggregate expenses was due primarily to higher personnel-related costs to support the Company's expanding worldwide operations and to grow the Company's end-user business, as well as increased marketing costs associated with the introduction of the In-Sight and SmartView ICN products. Included in the higher personnel-related costs are the expenses associated with the additional employees from the three acquisitions completed during the year. Expenses as a percentage of revenue declined from 29% in 1999 to 25% in 2000 as a result of revenue increasing at a faster rate than spending. Due to the conservative spending plan implemented for 2001, the Company anticipates that aggregate expenses will decrease from the level experienced in the fourth quarter of 2000.

Amortization of goodwill for the year ended December 31, 2000 totaled $1,964,000 compared to $265,000 for the year ended December 31, 1999. The increase in amortization expense was due to goodwill associated with the three acquisitions completed during the year.

Investment income for the year ended December 31, 2000 increased 44% to $9,494,000 from $6,572,000 for the year ended December 31, 1999. The increase in investment income was due primarily to higher average interest rates on the Company's portfolio of investments, which consists principally of debt securities, as well as a higher average invested balance in 2000.

Other income for the year ended December 31, 2000 totaled $1,038,000 compared to $728,000 for the year ended December 31, 1999. Other income consists primarily of

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

RESULTS OF OPERATIONS (continued)

Year Ended December 31, 2000 Compared to Year Ended December 31, 1999 (continued)

rental income, net of related expenses, from leasing the building adjacent to the Company's corporate headquarters.

The Company's effective tax rate for 2000 was 32% compared to 29% for 1999. The increase in the effective tax rate was due primarily to the higher operating income in 2000, increased investments in the Company's foreign operations, and the diminishing effect of tax-free investments.

Year Ended December 31, 1999 Compared to Year Ended December 31, 1998

Revenue for the year ended December 31, 1999 increased 25% to $152,125,000 from $121,844,000 for the year ended December 31, 1998. During 1999, the Company experienced an increase in demand as its customers recovered from the 1998 slowdown in capital spending by manufacturers in the semiconductor and electronics industries. The increase in revenue of $30,281,000, or 25%, from 1998 was due primarily to a higher volume of machine vision systems sold to the Company's core OEM customers who serve these industries. Sales to OEM customers increased $23,575,000, or 34%, from the prior year and represented 61% of total revenue in 1999 compared to 57% of total revenue in 1998. Sales to end-user customers increased $6,706,000, or 13%, from the prior year as a result of increased volume from customers in general manufacturing industries, such as automotive and consumer products.

While revenue increased in all of the Company's worldwide regions from 1998, the most significant increase was in Japan, where most of the Company's core OEM customers are located. Sales to customers located in Japan increased $18,615,000, or 38%, from the prior year. Sales to customers located in Europe increased $7,816,000, or 31%, from 1998 due primarily to a large general manufacturing customer base in this region. Sales to customers located in the United States increased $1,857,000, or 4%, from the prior year.

Gross profit as a percentage of revenue for 1999 was 70% compared to 69% for 1998. The increase in the gross margin was due primarily to manufacturing efficiencies that resulted from increased product sales without a significant increase in manufacturing overhead, as well as a lower percentage of service revenue which carries a lower gross margin than product revenue.

Research, development, and engineering expenses for the year ended December 31, 1999 increased 12% to $27,536,000 from $24,535,000 for the year ended December 31, 1998.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

RESULTS OF OPERATIONS (continued)

Year Ended December 31, 1999 Compared to Year Ended December 31, 1998 (continued)

The increase in aggregate expenses was due primarily to higher personnel-related costs to support the Company's continued investment in the research and development of new and existing products. Expenses as a percentage of revenue declined from 20% in 1998 to 18% in 1999 as a result of revenue increasing at a faster rate than spending.

Selling, general, and administrative expenses for the year ended December 31, 1999 increased 15% to $43,523,000 from $37,973,000 for the year ended December 31, 1998. The increase in aggregate expenses was due primarily to higher personnel-related costs to support the Company's expanding worldwide operations, including employee bonuses which were reinstated in 1999. Expenses as a percentage of revenue declined from 31% in 1998 to 29% in 1999 as a result of revenue increasing at a faster rate than spending.

Investment income for the year ended December 31, 1999 decreased 3% to $6,572,000 from $6,756,000 for the year ended December 31, 1998. The decrease in investment income was due primarily to lower average interest rates on the Company's portfolio of investments, which consists principally of debt securities.

Other income for the year ended December 31, 1999 remained relatively consistent at $728,000 compared to $733,000 for the year ended December 31, 1998. Other income consists primarily of rental income, net of related expenses, from leasing the building adjacent to the Company's corporate headquarters.

The Company's effective tax rate for 1999 was 29% compared to 26% for 1998. The increase in the effective tax rate was due primarily to the higher operating income in 1999 and the diminishing effect of tax-free investments.

LIQUIDITY AND CAPITAL RESOURCES

The Company's cash requirements during the year ended December 31, 2000 were met through cash generated from operations. Cash and investments increased $57,219,000 from December 31, 1999 as a result of cash generated from operations and the proceeds from the issuance of common stock under stock option and stock purchase plans, partially offset by cash paid for business and technology acquisitions and capital expenditures. Cash generated from operations consists of net income, adjusted for non-cash charges and changes in current assets and current liabilities, most notably an increase in accounts receivable and inventories associated with the growth in revenue in

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

LIQUIDITY AND CAPITAL RESOURCES (continued)

2000. Capital expenditures for the year ended December 31, 2000 totaled $7,755,000 and consisted primarily of expenditures for computer hardware and software.

On March 31, 2000, the Company acquired selected assets of the machine vision business of Komatsu Ltd. for $11,200,000 in cash, with the potential for additional cash payments in 2002 of up to $8,000,000 depending upon certain performance criteria.

On April 20, 2000, the Company acquired all of the outstanding shares of Image Industries, Ltd. for $2,706,000. The purchase price included $1,754,000 in cash payments, $751,000 of which, at December 31, 2000, remained to be paid through 2002.

On September 30, 2000, the Company acquired selected assets of the web inspection business of Honeywell International Inc. for $8,400,000 in cash. The Company paid an additional $1,600,000 at the closing that is contingent upon the achievement of certain performance criteria in 2002. There is the potential for an additional cash payment of up to $1,600,000 in 2002, also depending upon certain performance criteria.

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. As of December 31, 2000, the Company had not repurchased any shares under this program.

The Company believes that its existing cash and investments balance, together with cash generated from operations, will be sufficient to meet the Company's planned working capital, investing, and financing activities through 2001, including the Company's stock repurchase program and potential business acquisitions.

NEW PRONOUNCEMENTS

In June 2000, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard (SFAS) No. 138, "Accounting for Certain Derivative Instruments" – An Amendment of SFAS 133 "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 138 will be effective for all fiscal quarters of all fiscal years beginning after June 15, 2000. The Company does not enter into significant derivative financial instruments, and therefore, does not expect SFAS No. 138 to have a material impact on its financial position and results of operations.

During 2000, the Company adopted Staff Accounting Bulletin (SAB) No. 101, "Revenue Recognition in Financial Statements." SAB No. 101 did not have a material impact on the Company's financial position and results of operations.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

FORWARD-LOOKING STATEMENTS

Certain statements made in this report, as well as oral statements made by the Company from time to time, which are prefaced with words such as "expects," "anticipates," "believes," "projects," "intends," "plans," and similar words and other statements of similar sense, are forward-looking statements. These statements are based on the Company's current expectations and estimates 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, like any other forward-looking statements, involve risks and uncertainties that could cause actual results to differ materially from those projected or anticipated. Such risks and uncertainties include: (1) the loss of, or a significant curtailment of purchases by, any one or more principal customers; (2) the cyclicality of the semiconductor and electronics industries; (3) the Company's continued ability to achieve significant international revenue; (4) the capital spending trends of manufacturing companies; (5) the inability to protect the Company's proprietary technology and intellectual property; (6) the inability to attract or retain skilled employees; (7) the technological obsolescence of current products and the inability to develop new products; (8) the inability to respond to competitive technology and pricing pressures; and (9) the reliance upon certain sole source suppliers to manufacture or deliver critical components of the Company's products. The foregoing list should not be construed as exhaustive and the Company disclaims any obligation subsequently to revise forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events. Further discussions of risk factors are also available in the Company's registration statements and other filings with the Securities and Exchange Commission. The Company wishes to caution readers not to place undue reliance upon any such forward-looking statements, which speak only as of the date made.

COGNEX CORPORATION –
CONSOLIDATED STATEMENTS OF INCOME

	Year Ended December 31,		
	2000	1999	1998
(In thousands, except per share amounts)			
Revenue	**$ 250,726**	$ 152,125	$ 121,844
Cost of revenue	**63,820**	45,221	37,296
Gross profit	**186,906**	106,904	84,548
Research, development, and engineering expenses	**33,341**	27,536	24,535
Selling, general, and administrative expenses	**61,915**	43,523	37,973
Amortization of goodwill	**1,964**	265	127
Charge for acquired in-process technology			2,100
Operating income	**89,686**	35,580	19,813
Investment income	**9,494**	6,572	6,756
Other income	**1,038**	728	733
Income before provision for income taxes	**100,218**	42,880	27,302
Provision for income taxes	**32,070**	12,435	7,099
Net income	**$ 68,148**	$ 30,445	$ 20,203
Net income per common and common equivalent share:			
Basic	**$ 1.58**	$ .74	$ .49
Diluted	**$ 1.49**	$ .69	$ .47
Weighted-average common and common equivalent shares outstanding:			
Basic	**43,043**	40,932	40,978
Diluted	**45,698**	43,986	43,203

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

COGNEX CORPORATION –
CONSOLIDATED BALANCE SHEETS

	December 31, 2000	1999
(Dollars in thousands)		
ASSETS		
Current assets:		
Cash and cash equivalents	**$ 42,925**	$ 48,665
Short-term investments	**85,429**	62,890
Accounts receivable, less reserves of $2,150 and $2,836 in 2000 and 1999, respectively	**47,031**	28,742
Inventories	**27,664**	10,872
Deferred income taxes	**7,741**	6,445
Prepaid expenses and other current assets	**8,950**	6,149
Total current assets	**219,740**	163,763
Long-term investments	**149,386**	108,966
Property, plant, and equipment, net	**34,012**	31,857
Deferred income taxes	**6,903**	6,688
Other assets	**26,100**	3,548
	$ 436,141	$ 314,822

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

COGNEX CORPORATION –
CONSOLIDATED BALANCE SHEETS (continued)

	December 31, 2000	December 31, 1999
(Dollars in thousands)		
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	**$ 10,127**	$ 4,237
Accrued expenses	**22,953**	18,536
Accrued income taxes	**9,202**	7,470
Customer deposits	**3,074**	2,714
Deferred revenue	**6,471**	4,508
Total current liabilities	**51,827**	37,465
Other liabilities	**365**	733
Stockholders' equity:		
Common stock, $.002 par value – Authorized: 140,000,000 shares, issued: 45,787,568 and 44,220,434 shares in 2000 and 1999, respectively	**92**	88
Additional paid-in capital	**163,815**	122,522
Treasury stock, at cost, 2,365,332 and 2,381,032 shares in 2000 and 1999, respectively	**(42,675)**	(43,550)
Retained earnings	**265,164**	197,016
Accumulated other comprehensive income (loss)	**(2,447)**	548
Total stockholders' equity	**383,949**	276,624
	$ 436,141	$ 314,822

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

COGNEX CORPORATION – CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(Dollars in thousands)	Common Stock Shares	Common Stock Par Value	Additional Paid-in Capital
Balance at December 31, 1997	41,859,395	$ 84	$ 91,082
Issuance of common stock under stock option, stock purchase, and bonus plans	594,585	1	4,385
Tax benefit from exercise of stock options			2,064
Common stock received for payment of stock option exercises			
Repurchase of common stock			
Comprehensive income:			
Net income			
Foreign currency translation adjustment			
Comprehensive income			
Balance at December 31, 1998	42,453,980	85	97,531
Issuance of common stock under stock option, stock purchase, and bonus plans	1,766,454	3	16,125
Tax benefit from exercise of stock options			8,866
Common stock received for payment of stock option exercises			
Comprehensive income:			
Net income			
Unrealized gain on investments, net of tax of $279			
Foreign currency translation adjustment			
Comprehensive income			
Balance at December 31, 1999	44,220,434	88	122,522
Issuance of common stock under stock option and stock purchase plans	1,567,134	4	17,993
Tax benefit from exercise of stock options			23,300
Common stock received for payment of stock option exercises			
Acquisition of Image Industries, Ltd.			
Comprehensive income:			
Net income			
Unrealized loss on investments, net of tax of $978			
Foreign currency translation adjustment, net of tax of $53			
Comprehensive income			
Balance at December 31, 2000	45,787,568	$ 92	$ 163,815

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

Treasury Stock Shares	Treasury Stock Cost	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income	Total Stockholders' Equity
103,139	$ (1,436)	$ 146,368	$ 44		$ 236,142
					4,386
					2,064
2,001	(50)				(50)
2,202,000	(39,867)				(39,867)
		20,203		$ 20,203	20,203
			(3)	(3)	(3)
				20,200	
2,307,140	(41,353)	166,571	41		222,875
					16,128
					8,866
73,892	(2,197)				(2,197)
		30,445		30,445	30,445
			471	471	471
			36	36	36
				30,952	
2,381,032	(43,550)	197,016	548		276,624
					17,997
					23,300
1,919	(77)				(77)
(17,619)	952				952
		68,148		68,148	68,148
			(1,664)	(1,664)	(1,664)
			(1,331)	(1,331)	(1,331)
				$ 65,153	
2,365,332	$ (42,675)	$ 265,164	$ (2,447)		$ 383,949

COGNEX CORPORATION – CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2000	1999	1998
(In thousands)			
Cash flows from operating activities:			
Net income	**$ 68,148**	$ 30,445	$ 20,203
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation of property, plant, and equipment	**6,991**	6,360	6,393
Amortization of intangible assets	**2,883**	1,179	796
Amortization of investments	**2,119**	1,752	1,525
Tax benefit from exercise of stock options	**23,300**	8,866	2,064
Charge for acquired in-process technology			2,100
Deferred income tax provision	**(533)**	(6,960)	(1,343)
Changes in current assets and current liabilities:			
Accounts receivable	**(18,811)**	(6,997)	5,052
Inventories	**(17,902)**	(419)	(3,627)
Accounts payable	**5,850**	1,723	(902)
Accrued expenses	**3,416**	7,394	(1,454)
Accrued income taxes	**1,623**	5,117	(687)
Other current assets and current liabilities	**(305)**	6,303	(271)
Other operating activities	**(355)**	623	(179)
Net cash provided by operating activities	**76,424**	55,386	29,670

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

COGNEX CORPORATION –
CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

	Year Ended December 31,		
	2000	1999	1998
(In thousands)			
Cash flows from investing activities:			
Purchase of investments	**(134,838)**	(97,773)	(81,616)
Maturity of investments	**67,119**	55,566	89,256
Purchase of property, plant, and equipment	**(7,755)**	(3,443)	(7,239)
Long-term deposit	**(1,700)**		
Cash paid for business and technology acquisitions, net of cash acquired	**(22,240)**	(1,723)	(3,954)
Net cash used in investing activities	**(99,414)**	(47,373)	(3,553)
Cash flows from financing activities:			
Issuance of common stock under stock option, stock purchase, and bonus plans	**17,920**	13,931	4,336
Repurchase of common stock			(39,867)
Net cash provided by (used in) financing activities	**17,920**	13,931	(35,531)
Effect of exchange rate changes on cash	**(670)**	(1,086)	(977)
Net increase (decrease) in cash and cash equivalents	**(5,740)**	20,858	(10,391)
Cash and cash equivalents at beginning of year	**48,665**	27,807	38,198
Cash and cash equivalents at end of year	**$ 42,925**	$ 48,665	$ 27,807

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

COGNEX CORPORATION –
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying consolidated financial statements reflect the application of certain 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 generally accepted accounting principles requires management to make estimates and assumptions 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 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. Debt securities with original maturities greater than three months and remaining maturities of one year or less are classified as short-term investments. Debt securities with remaining maturities greater than one year, as well as equity securities and an investment in a limited partnership, are classified as long-term investments.

COGNEX CORPORATION –
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Cash, Cash Equivalents, and Investments (continued)

Debt securities with original maturities greater than three months are stated at amortized cost, which approximates fair value, and are categorized as available-for-sale. Equity securities are stated at fair value and are also categorized as available-for-sale. Changes in unrealized gains or losses on equity securities, net of tax, are recorded as other comprehensive income (loss). The Company's investment in a limited partnership is accounted for using the cost method because the Company has virtually no influence over the partnership's operating and financial policies.

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.

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, which range from two to ten 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.

Warranty Obligations

The Company warrants hardware products of its manufacture 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's contract. Estimated warranty obligations are evaluated and recorded at the time of sale.

COGNEX CORPORATION –
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Revenue Recognition

The Company's revenue is derived primarily from two sources: (1) product sales to both original equipment manufacturer (OEM) customers, who incorporate the Company's product into their product for resale, and end-user customers, and (2) service revenue derived principally from providing maintenance and support, education, consulting, and installation services to OEM and end-user customers.

The Company recognizes revenue from product sales upon shipment if a signed customer purchase order exists, the fee is fixed or determinable, and collection of the resulting receivable is probable. The Company recognizes revenue from maintenance and support programs ratably over the program period. Revenue from education, consulting, and installation services is recognized as the related services are performed. Revenue from construction-type projects is recognized using the percentage-of-completion method. Losses on projects, if any, are recognized when identified.

Research and Development

Research and development costs for internally-developed 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 cost of acquired software is capitalized for products determined to have reached technological feasibility; otherwise the cost is expensed. Capitalized software costs are amortized using the straight-line method over the economic life of the product, which is typically three to five years.

Income Taxes

The Company accounts for income taxes under the liability method. Under this method, a deferred tax asset or liability is determined based on 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 excludes dilution and is computed by dividing net income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted net income per share reflects the potential dilution

COGNEX CORPORATION –
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Net Income Per Share (continued)

that could occur if securities or other contracts to issue common stock were issued, exercised, or converted into common stock. Dilutive common equivalent shares consist of stock options, 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. Other comprehensive income consists of unrealized gains and losses on investments and foreign currency translation adjustments.

FINANCIAL INSTRUMENTS

Fair Value

The Company's financial instruments consist primarily of cash and cash equivalents, investments, trade receivables, trade payables, and forward exchange contracts. The carrying amounts of cash and cash equivalents, investments, trade receivables, and trade payables approximate fair value due to the short maturity of these instruments. Based on year-end exchange rates, the Company estimates the aggregate contract value of the forward exchange contracts to be representative of the fair values of these instruments.

Concentrations of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents, investments, and trade receivables.

The Company primarily invests in municipal obligations of federal and state government entities. The Company has established guidelines relative to credit ratings, diversification, and maturities that maintain safety and liquidity. The Company has not experienced any significant losses on its cash equivalents and investments.

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.

COGNEX CORPORATION –
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

FINANCIAL INSTRUMENTS (continued)

Off-Balance Sheet Risk

In certain instances, the Company enters into forward exchange contracts to hedge against foreign currency fluctuations. These contracts are used to reduce the Company's risk associated with exchange rate movements, as the gains or losses on these contracts are intended to offset the exchange rate losses or gains on the underlying exposures. The Company does not engage in foreign currency speculation. The Company had $16,445,000 and $16,138,000 of foreign exchange contracts outstanding at December 31, 2000 and 1999, respectively. The foreign exchange contracts were in Japanese Yen and Euro Dollar in 2000 and in Japanese Yen in 1999.

Foreign Currency Risk

The Company enters into transactions denominated in foreign currencies and includes the exchange rate gains or losses arising from such transactions in current operations. The Company recorded net exchange rate gains of $99,000 in 2000, $955,000 in 1999, and $127,000 in 1998.

CASH, CASH EQUIVALENTS, AND INVESTMENTS

Cash, cash equivalents, and investments consist of the following:

December 31,	**2000**	1999
(In thousands)		
Cash	**$ 19,204**	$ 19,545
Municipal obligations	**23,721**	29,120
Total cash and cash equivalents	**42,925**	48,665
Municipal obligations	**85,429**	62,890
Total short-term investments	**85,429**	62,890
Municipal obligations	**139,440**	105,392
Equity securities	**5,571**	3,574
Investment in limited partnership	**4,375**	
Total long-term investments	**149,386**	108,966
	$ 277,740	$ 220,521

Equity securities had a cost basis of $7,462,000 and an unrealized loss of $1,891,000 at December 31, 2000, and a cost basis of $2,824,000 and an unrealized gain of $750,000 at December 31, 1999.

COGNEX CORPORATION –
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

CASH, CASH EQUIVALENTS, AND INVESTMENTS (continued)

On June 30, 2000, Cognex Corporation became a Limited Partner in Venrock Associates III, L.P., a venture capital fund. The Company has invested $4,375,000 in the partnership as of December 31, 2000 and has committed to a total investment of up to $25,000,000 over a ten-year period. A director of the Company is affiliated with Venrock Associates III, L.P.

The Company has not experienced any significant realized gains or losses on the sale of its investments in 2000, 1999, and 1998.

INVENTORIES

Inventories consist of the following:

December 31,	**2000**	1999
(In thousands)		
Raw materials	**$ 14,263**	$ 5,451
Work-in-process	**5,789**	1,987
Finished goods	**7,612**	3,434
	$ 27,664	$ 10,872

PROPERTY, PLANT, AND EQUIPMENT

Property, plant, and equipment consist of the following:

December 31,	**2000**	1999
(In thousands)		
Land	**$ 3,051**	$ 3,051
Buildings	**17,571**	17,571
Building improvements	**3,997**	3,236
Computer hardware and software	**31,061**	28,230
Furniture and fixtures	**3,354**	3,446
Leasehold improvements	**2,049**	1,638
	61,083	57,172
Less: accumulated depreciation	**(27,071)**	(25,315)
	$ 34,012	$ 31,857

Buildings include property held for lease with a cost basis of $4,950,000 and accumulated depreciation of $698,000 at December 31, 2000.

COGNEX CORPORATION –
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

OTHER ASSETS

Other assets consist of the following:

December 31,	2000	1999
(In thousands)		
Goodwill	**$ 20,317**	$ 1,464
Acquired complete technology, workforce, non-compete agreements, and other intangible assets	**7,358**	4,233
	27,675	5,697
Less: accumulated amortization	**(7,037)**	(3,930)
	20,638	1,767
Deposits and other	**5,462**	1,781
	$ 26,100	$ 3,548

ACCRUED EXPENSES

Accrued expenses consist of the following:

December 31,	2000	1999
(In thousands)		
Bonus	**$ 5,964**	$ 4,560
Warranty	**3,127**	3,820
Salaries, commissions, and payroll taxes	**3,010**	2,737
Professional fees	**2,099**	1,963
Vacation	**2,020**	1,753
Other	**6,733**	3,703
	$ 22,953	$ 18,536

COGNEX CORPORATION – NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

LEASES

The Company conducts certain of its operations in leased facilities. These lease agreements expire at various dates through 2014 and are accounted for as operating leases. Annual rent expense totaled $3,717,000 in 2000, $2,620,000 in 1999, and $2,366,000 in 1998. Future minimum rental payments under these agreements are as follows at December 31, 2000 (in thousands):

Year	Amount
2001	$ 3,944
2002	2,109
2003	1,169
2004	1,118
2005	1,046
Thereafter	676
	$ 10,062

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 2002. Annual rental income totaled $1,755,000 in 2000, $1,581,000 in 1999, and $1,499,000 in 1998. Rental income and related expenses are included in “Other income” on the Consolidated Statements of Income. Future minimum rental receipts under non-cancelable lease agreements are $1,382,000 in 2001 and $1,199,000 in 2002.

STOCKHOLDERS’ EQUITY

Preferred Stock

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

Stock Repurchase Programs

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. As of December 31, 2000, the Company had not repurchased any shares under this program.

On April 21, 1998, the Company’s Board of Directors authorized the repurchase of up to $20,000,000 of the Company’s common stock. A total of 882,000 shares were repurchased through May 27, 1998 amounting to $19,937,000, which completed the Company’s stock repurchases under this program. On June 3, 1998, the Board authorized the repurchase of up to an additional 1,500,000 shares of the Company’s common stock. A total of 1,320,000 shares were repurchased through November 6, 1998 amounting to $19,930,000, which completed the Company’s stock repurchases under this second program.

COGNEX CORPORATION –
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

STOCKHOLDERS' EQUITY (continued)

Stock-Based Compensation Plans

The Company has adopted the disclosure requirements of Statement of Financial Accounting Standard (SFAS) No. 123, "Accounting for Stock-Based Compensation." 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 2000, 1999, and 1998.

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:

Year Ended December 31,		**2000**	1999	1998
(In thousands, except per share amounts)				
Net income	As reported	**$ 68,148**	$ 30,445	$ 20,203
	Pro forma	**58,591**	20,203	13,500
Basic net income per share	As reported	**1.58**	.74	.49
	Pro forma	**1.36**	.49	.33
Diluted net income per share	As reported	**1.49**	.69	.47
	Pro forma	**1.34**	.48	.33

Stock Option Plans

At December 31, 2000, the Company had 10,907,351 shares approved by the Board of Directors and stockholders for grant under the following stock option plans: the 1992 Director Plan, 352,000; the 1993 Director Plan, 320,000; the 1993 Employee Plan, 8,000,000; the 1998 Director Plan, 250,000; and the 1998 Stock Incentive Plan, 1,985,351.

On April 21, 1998, the stockholders approved the 1998 Stock Incentive Plan, under which the Company may initially 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 shall be increased automatically to an amount equal to 4.5% of the total number of issued shares of common stock, including shares held in treasury, as of the close of business on December 31st of the preceding year.

COGNEX CORPORATION – NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

STOCKHOLDERS' EQUITY (continued)

Stock Option Plans (continued)

On November 27, 2000, 652,280 options were forfeited by employees. The Company has committed to grant those employees the same number of options approximately seven months later at the then fair market value with similar terms and conditions.

On December 15, 1998, the Company granted 1,320,100 stock options at the current fair market value with similar terms and conditions to previously issued but unexercised grants. In exchange for the new grants, employees agreed to forfeit their prior stock options.

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, 2000, 1999, and 1998, and changes during the years then ended:

	2000		1999		1998	
	Shares	**Weighted-Average Exercise Price**	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Outstanding at beginning of year	**8,046,840**	**$ 16.09**	8,322,335	$ 11.65	7,764,907	$ 11.85
Granted at fair market value	**2,984,890**	**35.65**	2,058,463	28.50	3,587,535	16.63
Granted above fair market value	**60,000**	**59.10**				
Exercised	**(1,621,649)**	**10.78**	(1,764,353)	9.00	(604,714)	6.50
Forfeited	**(1,455,592)**	**36.58**	(569,605)	18.02	(2,425,393)	20.96
Outstanding at end of year	**8,014,489**	**21.04**	8,046,840	16.09	8,322,335	11.65
Options exercisable at year-end	**1,912,997**	**13.05**	2,091,171	9.47	2,502,865	7.45
Weighted-average grant-date fair value of options granted during the year at fair market value	**$ 15.60**		$ 14.06		$ 5.65	
Weighted-average grant-date fair value of options granted during the year above fair market value	**$ 20.39**					

COGNEX CORPORATION –
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

STOCKHOLDERS' EQUITY (continued)

Stock Option Plans (continued)

The following table summarizes information about stock options outstanding at December 31, 2000:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted-Average Remaining Contractual Life (in years)	Weighted-Average Exercise Price	Number Exercisable	Weighted-Average Exercise Price
$ .50 – 7.50	1,498,772	7.2	$ 6.87	761,798	$ 6.52
8.06 – 15.72	1,389,972	6.5	14.80	545,607	14.04
15.88 – 18.13	2,165,244	9.4	17.15	353,894	16.24
18.19 – 30.38	1,470,753	8.9	26.92	217,323	25.09
30.66 – 59.69	1,489,748	11.7	40.98	34,375	33.06
	8,014,489	8.8	21.04	1,912,997	13.05

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 in 2000, 1999, and 1998, respectively: a risk-free interest rate of 6.1%, 5.6%, and 5.1% ; an expected life of 3.1, 4.5, and 4.1 years; an expected volatility of 60%, 54%, and 50%; and no expected dividends.

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. Common stock reserved for future sales totaled 386,108 shares at December 31, 2000. Shares purchased under the ESPP totaled 22,638 in 2000, 24,118 in 1999, and 30,670 in 1998. The weighted-average fair value of shares purchased under the ESPP was $17.22 in 2000, $17.59 in 1999, and $7.52 in 1998.

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 used for purchases in 2000, 1999, and 1998, respectively: a weighted-average risk-free interest rate of 5.9%, 5.3%, and 5.3%; an expected life of six months; an expected volatility of 60%, 54%, and 50%; and no expected dividends.

COGNEX CORPORATION –
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

EMPLOYEE SAVINGS PLAN

Under the Company's Employee Savings Plan, a defined contribution plan, employees who have attained age 21 may contribute 1% to 15% 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 after five years of continuous employment with the Company. Prior to January 1, 2000, company contributions were made at the discretion of management. Company contributions approximated $844,000 in 2000, $490,000 in 1999, and $230,000 in 1998.

INCOME TAXES

The provision for income taxes consists of the following:

Year Ended December 31,	**2000**	1999	1998
(In thousands)			
Current:			
Federal	**$ 29,335**	$ 12,838	$ 5,468
State	**1,467**	2,390	1,617
Foreign	**3,793**	1,154	1,357
	34,595	16,382	8,442
Deferred:			
Federal	**(2,301)**	(2,167)	(1,582)
State	**1,279**	(1,515)	239
Foreign	**(1,503)**	(265)	
	(2,525)	(3,947)	(1,343)
	$ 32,070	$ 12,435	$ 7,099

A reconciliation of the provision for income taxes to the federal statutory rate is as follows:

Year Ended December 31,	**2000**	1999	1998
Provision for income taxes at federal statutory rate	**35%**	35%	35%
State income taxes, net of federal benefit	**2**	2	1
Foreign Sales Corporation benefit	**(4)**	(3)	(3)
Tax-exempt investment income	**(3)**	(5)	(8)
Foreign operations	**2**		1
Provision for income taxes	**32%**	29%	26%

COGNEX CORPORATION –
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

INCOME TAXES (continued)

Deferred income taxes reflect the tax impact of temporary differences between the amount of assets and liabilities for financial reporting purposes and such amounts as measured by tax laws and regulations. The tax effects of the principal items making up deferred income taxes are as follows:

Year Ended December 31,	**2000**	1999
(In thousands)		
Current deferred tax assets:		
Inventory and revenue-related	**$ 4,948**	$ 4,830
Bonus, commission, and other compensation	**793**	271
Other	**2,000**	1,344
Total net current deferred tax asset	**$ 7,741**	$ 6,445
Noncurrent deferred tax assets (liabilities):		
Federal and state credit carryforwards	**$ 3,262**	$ 4,918
Foreign net operating loss carryforwards	**648**	
Acquired complete technology and other intangible assets	**1,783**	209
Acquired in-process technology	**1,395**	1,501
Depreciation	**707**	337
Unrealized investment gains/losses	**(654)**	(277)
Other	**(238)**	
Total net noncurrent deferred tax asset	**$ 6,903**	$ 6,688

The Company's federal credit carryforwards are approximately $1,697,000 and have an unlimited life. The state credit carryforwards, net of federal tax impact, are approximately $1,565,000, a portion of which will begin to expire in 2010. The foreign net operating loss carryforwards have an unlimited life. Approximately $2,660,000 of the Company's credit carryforwards relate to deductions for stock option exercises and, as a result, will be recorded as a benefit to additional paid-in capital when realized.

COGNEX CORPORATION –
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

NET INCOME PER SHARE

Net income per share is calculated as follows:

Year Ended December 31,	2000	1999	1998
(In thousands, except per share amounts)			
Net income	**$ 68,148**	$ 30,445	$ 20,203
Basic:			
Weighted-average common shares outstanding	**43,043**	40,932	40,978
Net income per common share	**$ 1.58**	$ .74	$ .49
Diluted:			
Weighted-average common shares outstanding	**43,043**	40,932	40,978
Effect of dilutive securities: Stock options	**2,655**	3,054	2,225
Weighted-average common and common equivalent shares outstanding	**45,698**	43,986	43,203
Net income per common and common equivalent share	**$ 1.49**	$ .69	$ .47

Stock options to purchase 877,342, 97,672, and 151,550 shares of common stock were outstanding during the years ended December 31, 2000, 1999, and 1998, 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. Although these stock options were antidilutive in 2000, 1999, and 1998, they may be dilutive in future years' calculations.

SEGMENT INFORMATION

The Company has one reportable segment that designs, develops, manufactures, and markets machine vision systems. Operating segments are determined based on the way that management organizes its business for making operating decisions and assessing performance.

COGNEX CORPORATION –
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

SEGMENT INFORMATION (continued)

During the years ended December 31, 2000, 1999, and 1998, one customer accounted for $25,805,000, $19,611,000, and $17,083,000, or 10%, 13%, and 14%, respectively, of revenue.

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

	United States	Japan	Other	Eliminations	Consolidated
Year Ended December 31, 2000					
Revenue:					
Unaffiliated customers	$ 208,265	$ 42,461			$ 250,726
Intercompany	13,522			$ (13,522)	
Long-lived assets	41,701	2,875	$ 15,537		60,112
Year Ended December 31, 1999					
Revenue:					
Unaffiliated customers	$ 130,618	$ 21,507			$ 152,125
Intercompany	10,162			$ (10,162)	
Long-lived assets	30,614	2,089	$ 2,702		35,405
Year Ended December 31, 1998					
Revenue:					
Unaffiliated customers	$ 104,321	$ 17,523			$ 121,844
Intercompany	5,493			$ (5,493)	
Long-lived assets	33,807	2,035	$ 2,570		38,412

Revenue is presented geographically based on the country in which the sale is recorded. Inventories are transferred to the Company's Japanese subsidiary at previously established transfer prices, resulting in intercompany revenue and receivables for the United States operation.

The Other column represents all long-lived assets in other countries, none of which were significant, and certain deposits that are included in "Other assets" on the Consolidated Balance Sheets.

Deferred tax assets recorded in foreign jurisdictions are not material compared to the Company's consolidated financial position, and therefore, are not presented.

COGNEX CORPORATION –
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

ACQUISITION OF KOMATSU LTD. MACHINE VISION BUSINESS

On March 31, 2000, the Company acquired selected assets of the machine vision business of Komatsu Ltd. for $11,200,000 in cash, with the potential for additional cash payments in 2002 of up to $8,000,000 depending upon certain performance criteria. The purchase price was allocated as follows: $297,000 to tangible equipment, to be depreciated in accordance with the Company’s depreciation policy; $400,000 to workforce, to be amortized over two years; $2,462,000 to complete technology, to be amortized over five years; and $8,041,000 to goodwill, also to be amortized over five years. The contingent consideration will be recorded as purchase price when paid and will be allocated to goodwill to be amortized over the remaining period of expected benefit.

The acquisition was accounted for under the purchase method of accounting. Accordingly, 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 financial position and results of operations of the acquired business were not material compared to the Company’s consolidated financial position and results of operations, and therefore, pro forma results are not presented.

ACQUISITION OF IMAGE INDUSTRIES, LTD.

On April 20, 2000, the Company acquired all of the outstanding shares of Image Industries, Ltd., a privately-held manufacturer of low-cost machine vision systems located in the United Kingdom. The purchase price of $2,706,000 included $876,000 in cash at closing, $878,000 in cash to be paid through 2002, and 17,619 shares of Cognex common stock, issued from treasury, with a fair value of $952,000. At December 31, 2000, $751,000 of the purchase price remained to be paid through 2002. The purchase price was allocated as follows: $671,000 to tangible net assets; $200,000 to workforce, to be amortized over five years; and $1,835,000 to goodwill, also to be amortized over five years.

The acquisition was accounted for under the purchase method of accounting. Accordingly, the results of operations of the acquired company have been included in the Company’s consolidated results of operations since the date of the acquisition. The financial position and results of operations of the acquired company were not material compared to the Company’s consolidated financial position and results of operations, and therefore, pro forma results are not presented.

COGNEX CORPORATION – NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

ACQUISITION OF HONEYWELL INTERNATIONAL INC. WEB INSPECTION BUSINESS

On September 30, 2000, the Company acquired selected assets of the web inspection business of Honeywell International Inc. ("Honeywell") for $8,400,000 in cash. The Company paid an additional $1,600,000 at the closing that is contingent upon the achievement of certain performance criteria in 2002. There is the potential for an additional payment of up to $1,600,000 in 2002, also depending upon the achievement of certain performance criteria. As part of the agreement, the Company and Honeywell also formed an alliance in which the Company will provide its web inspection systems to Honeywell's customers in the pulp and paper industry worldwide. The purchase price was recorded as goodwill to be amortized over ten years. The contingent consideration will be recorded as additional goodwill in the period that the performance criteria are met and will be amortized over the remaining period of the expected benefit.

The acquisition was accounted for under the purchase method of accounting. Accordingly, 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 financial position and results of operations of the acquired business were not material compared to the Company's consolidated financial position and results of operations, and therefore, pro forma results are not presented.

ACQUISITION OF ALLEN-BRADLEY TECHNOLOGY

In July 1998, the Company acquired certain technology of Rockwell Automation's Allen-Bradley machine vision business. The acquired technology related to certain products under development. The technology was valued using a risk-adjusted cash flow model, under which future cash flows were discounted taking into account risks related to existing markets, the technology's life expectancy, future target markets and potential changes thereto, and the competitive outlook for the technology. This analysis resulted in an allocation of $2,100,000 to in-process technology which had not reached technological feasibility and had no alternative future use, and accordingly, was expensed immediately.

SUPPLEMENTAL STATEMENT OF CASH FLOWS DISCLOSURE

Cash paid for income taxes totaled $8,386,000 in 2000, $2,347,000 in 1999, and $10,710,000 in 1998.

Common stock received as payment for stock option exercises totaled $77,000 in 2000, $2,197,000 in 1999, and $50,000 in 1998.

COGNEX CORPORATION –
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

SUPPLEMENTAL STATEMENT OF CASH FLOWS DISCLOSURE (continued)

In 2000, the Company issued 17,619 shares of Cognex treasury stock, with a fair value of $952,000, in connection with the acquisition of Image Industries, Ltd.

In 2000, the Company retired certain fully-depreciated property, plant, and equipment totaling $4,664,000.

NEW PRONOUNCEMENTS

In June 2000, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard (SFAS) No. 138, “Accounting for Certain Derivative Instruments” – An Amendment of SFAS 133 “Accounting for Derivative Instruments and Hedging Activities.” SFAS No. 138 shall be effective for all fiscal quarters of all fiscal years beginning June 15, 2000. The Company does not enter into significant derivative financial instruments, and therefore, does not expect SFAS No. 138 to have a material impact on its financial position and results of operations.

COGNEX CORPORATION – REPORT OF INDEPENDENT ACCOUNTANTS

TO THE BOARD OF DIRECTORS AND STOCKHOLDERS OF COGNEX CORPORATION:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of stockholders' equity and of cash flows present fairly, in all material respects, the financial position of Cognex Corporation and its subsidiaries at December 31, 2000 and 1999, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2000 in conformity with accounting principles generally accepted in the United States of America. 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 of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

Boston, Massachusetts
January 22, 2001

COGNEX CORPORATION –
FIVE-YEAR SUMMARY OF SELECTED FINANCIAL DATA

	Year Ended December 31,				
(In thousands, except per share amounts)	**2000**	1999	1998	1997	1996
Income Statement Data:					
Revenue	**$ 250,726**	$ 152,125	$ 121,844	$ 155,340	$ 122,843
Cost of revenue	**63,820**	45,221	37,296	42,273	38,855
Gross profit	**186,906**	106,904	84,548	113,067	83,988
Research, development and engineering expenses	**33,341**	27,536	24,535	22,311	19,294
Selling, general, and administrative expenses	**61,915**	43,523	37,973	35,810	26,261
Amortization of goodwill	**1,964**	265	127	170	140
Charge for acquired in-process technology			2,100	3,115	
Operating income	**89,686**	35,580	19,813	51,661	38,293
Investment and other income	**10,532**	7,300	7,489	6,665	5,404
Income before provision for income taxes	**100,218**	42,880	27,302	58,326	43,697
Provision for income taxes	**32,070**	12,435	7,099	17,790	13,328
Net income	**$ 68,148**	$ 30,445	$ 20,203	$ 40,536	$ 30,369
Basic net income per share	**$ 1.58**	$ .74	$ .49	$ .98	$ .75
Diluted net income per share	**$ 1.49**	$ .69	$ .47	$ .91	$ .69
Basic weighted-average common shares outstanding	**43,043**	40,932	40,978	41,322	40,594
Diluted weighted-average common shares outstanding	**45,698**	43,986	43,203	44,702	43,814

	December 31,				
(In thousands)	**2000**	1999	1998	1997	1996
Balance Sheet Data:					
Working capital	**$ 167,913**	$ 126,298	$ 101,971	$ 108,970	$ 97,265
Total assets	**436,141**	314,822	247,928	261,840	201,253
Long-term debt	**–**	–	–	–	–
Stockholders' equity	**383,949**	276,624	222,875	236,142	182,689

COGNEX CORPORATION –
SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

Quarter Ended	April 2, 2000	July 2, 2000	October 1, 2000	December 31, 2000
(In thousands, except per share amounts)				
Revenue	$ 54,495	$ 62,187	$ 67,960	$ 66,084
Gross profit	40,577	46,027	50,558	49,744
Operating income	20,626	22,798	25,595	20,667
Net income	15,412	17,358	19,391	15,987
Basic net income per share	.36	.40	.45	.37
Diluted net income per share	.34	.38	.42	.36
Common stock prices:				
High	73.1250	67.5000	56.1875	40.0000
Low	34.6875	46.7500	33.0000	16.1250

Quarter Ended	April 4, 1999	July 4, 1999	October 3, 1999	December 31, 1999
(In thousands, except per share amounts)				
Revenue	$ 27,485	$ 35,271	$ 41,046	$ 48,323
Gross profit	18,757	24,329	29,097	34,721
Operating income	2,455	7,024	10,579	15,522
Net income	3,104	6,189	8,966	12,186
Basic net income per share	.08	.15	.22	.29
Diluted net income per share	.07	.14	.20	.27
Common stock prices:				
High	28.3750	33.5000	35.8750	39.0625
Low	19.0000	23.6250	28.5000	26.1250

COGNEX CORPORATION – COMPANY INFORMATION

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FORM 10-K

A copy of the annual report filed with the Securities and Exchange Commission on Form 10-K is available to stockholders, 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.

The Company's common stock is traded on The NASDAQ Stock Market, under the symbol CGNX. As of February 12, 2001, there were approximately 15,000 registered and non-registered holders of the Company's common stock.

No dividends on the Company's common stock were paid during 2000 and 1999.

COGNEX CORPORATION – COMPANY INFORMATION (continued)

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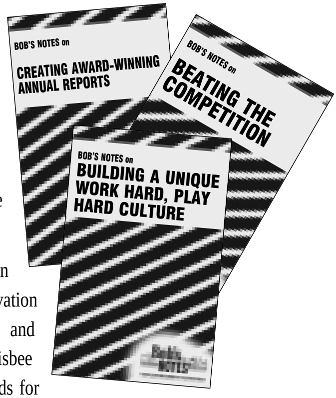

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Bob's Notes on Building a Unique Work Hard, Play Hard Culture focuses on the enormous benefits that can be gained from out-of-the-box employee motivation techniques including rewarding employees with memorable celebrations, and providing them with on-site perks such as a pinball room and an outdoor Frisbee field. Also discussed are financial incentives such as cash-on-the-spot rewards for teamwork and President's Awards (worth up to $10,000!) for the best performers each year. Effective methods for building corporate loyalty, such as rewarding long-term employees with vacations to sites such as the Great Wall of China, the Leaning Tower of Pisa and the Pyramids of Egypt, are analyzed in detail.

Bob's Notes on Beating the Competition provides effective strategies and tactics for winning the battle for increased market share and profitability in an increasingly competitive global marketplace. Chapter 1 shows how to analyze competitors' products, and how to "one-up" them. Chapter 2 describes how to anticipate your customers' needs so that you can marshal your engineering forces and hit the market with the right product in a timely fashion. Chapter 3 provides the "Seven Secrets to Success in Building a Winning Team." And Chapter 4 provides guidance on how to keep everyone on the team focused and paranoid…even after the competition fades into obscurity.

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