

CYBEROPTICS CORP
Form 10-Q
August 10, 2012

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Check One)

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

For the quarterly period ended June 30, 2012

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

For the transition period from _____ to _____

COMMISSION FILE NO. (0-16577)

CYBEROPTICS CORPORATION

(Exact name of registrant as specified in its charter)

Minnesota

(State or other jurisdiction of
incorporation or organization)

**5900 Golden Hills Drive
MINNEAPOLIS, MINNESOTA**

(Address of principal executive offices)

41-1472057

(I.R.S. Employer
Identification No.)

55416

(Zip Code)

(763) 542-5000

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or such shorter period that the registrant was required to file such reports), and (2) has been subject to

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such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. At July 31, 2012, there were 6,957,875 shares of the registrant's Common Stock, no par value, issued and outstanding.

PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

CONDENSED CONSOLIDATED BALANCE SHEETS

CYBEROPTICS CORPORATION

(Unaudited)

| (In thousands except share information) | June 30, 2012 | December 31, 2011 |
|---|------------------|----------------------|
| ASSETS | | |
| Cash and cash equivalents | \$ 10,863 | \$ 13,791 |
| Marketable securities | 10,859 | 10,640 |
| Accounts receivable, less allowance for doubtful accounts of \$860 at June 30, 2012 and \$940 at December 31, 2011 | 8,627 | 11,909 |
| Inventories | 12,249 | 11,052 |
| Income tax refunds receivable | 539 | 196 |
| Other current assets | 1,433 | 1,238 |
| Deferred tax assets, net | 2,372 | 2,518 |
| Total current assets | 46,942 | 51,344 |
| Marketable securities, long-term | 10,566 | 6,106 |
| Equipment and leasehold improvements, net | 1,520 | 1,400 |
| Intangible and other assets, net | 227 | 230 |
| Goodwill | 569 | 569 |
| Other assets | 138 | 137 |
| Deferred tax assets, net | 3,045 | 3,130 |
| Total assets | \$ 63,007 | \$ 62,916 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Accounts payable | \$ 4,740 | \$ 4,081 |
| Advance customer payments | 590 | 655 |
| Accrued expenses | 2,385 | 3,657 |
| Total current liabilities | 7,715 | 8,393 |
| Deferred rent | 462 | 327 |
| Deferred warranty revenue | 197 | 353 |
| Deferred tax liability | 34 | 34 |
| Reserve for income taxes | 820 | 840 |
| Total liabilities | 9,228 | 9,947 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Preferred stock, no par value, 5,000,000 shares authorized, none outstanding | | |
| Common stock, no par value, 25,000,000 shares authorized, 6,938,116 shares issued and outstanding at June 30, 2012 and 6,933,029 shares issued and outstanding at December 31, 2011 | 31,131 | 30,965 |
| Accumulated other comprehensive loss | (517) | (926) |
| Retained earnings | 23,165 | 22,930 |
| Total stockholders' equity | 53,779 | 52,969 |
| Total liabilities and stockholders' equity | \$ 63,007 | \$ 62,916 |

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

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
CYBEROPTICS CORPORATION
(Unaudited)

| (In thousands, except per share amounts) | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|-----------|------------------------------|-----------|
| | 2012 | 2011 | 2012 | 2011 |
| Revenues | \$ 13,003 | \$ 16,859 | \$ 24,283 | \$ 30,209 |
| Cost of revenues | 7,474 | 9,352 | 13,519 | 16,095 |
| Gross margin | 5,529 | 7,507 | 10,764 | 14,114 |
| Research and development expenses | 2,062 | 1,947 | 3,979 | 3,765 |
| Selling, general and administrative expenses | 3,369 | 3,671 | 6,595 | 7,328 |
| Amortization of intangibles | | 45 | | 90 |
| Income from operations | 98 | 1,844 | 190 | 2,931 |
| Interest income and other | (76) | (7) | (41) | 79 |
| Income before income taxes | 22 | 1,837 | 149 | 3,010 |
| Income tax provision (benefit) | (121) | 439 | (86) | 766 |
| Net income | \$ 143 | \$ 1,398 | \$ 235 | \$ 2,244 |
| Net income per share Basic | \$ 0.02 | \$ 0.20 | \$ 0.03 | \$ 0.33 |
| Net income per share Diluted | \$ 0.02 | \$ 0.20 | \$ 0.03 | \$ 0.32 |
| Weighted average shares outstanding Basic | 6,935 | 6,894 | 6,934 | 6,893 |
| Weighted average shares outstanding Diluted | 6,994 | 6,948 | 6,988 | 6,941 |

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

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
CYBEROPTICS CORPORATION
(Unaudited)

| (In thousands) | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|----------|------------------------------|----------|
| | 2012 | 2011 | 2012 | 2011 |
| Net income | \$ 143 | \$ 1,398 | \$ 235 | \$ 2,244 |
| Other comprehensive income (loss), before tax: | | | | |
| Foreign currency translation adjustments | (79) | 145 | 132 | 243 |
| Unrealized gains (losses) on available-for-sale securities: | | | | |
| Unrealized gains (losses) on available-for-sale securities for the period | 5 | 42 | (1) | 51 |
| Reclassification adjustment for (gains) included in net income | (4) | | (4) | |
| Total unrealized gains (losses) on available-for-sale securities | 1 | 42 | (5) | 51 |
| Unrealized gains (losses) on foreign exchange forward contracts: | | | | |
| Unrealized gains (losses) on foreign exchange forward contracts for the period | (69) | 218 | 254 | 190 |
| Reclassification adjustment for (gains) losses included in net income | 95 | (68) | 170 | (39) |
| Total unrealized gains on foreign exchange forward contracts | 26 | 150 | 424 | 151 |
| Other comprehensive income (loss), before tax | (52) | 337 | 551 | 445 |
| Income tax expense related to items of other comprehensive income | (6) | (66) | (142) | (68) |
| Other comprehensive income (loss), net of tax | (58) | 271 | 409 | 377 |
| Total comprehensive income | \$ 85 | \$ 1,669 | \$ 644 | \$ 2,621 |

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

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
CYBEROPTICS CORPORATION
(Unaudited)

| (In thousands) | Six Months Ended June 30, | |
|---|---------------------------|----------|
| | 2012 | 2011 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$ 235 | \$ 2,244 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 913 | 1,136 |
| Provision for doubtful accounts | (80) | |
| Deferred taxes | | 327 |
| Foreign currency transaction (gains) losses | 57 | (36) |
| Realized gains on available for sale securities | (4) | |
| Stock compensation costs | 253 | 248 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 3,361 | (2,257) |
| Inventories | (1,441) | (216) |
| Income tax refunds receivable | (343) | 48 |
| Other assets | (143) | 213 |
| Accounts payable | 622 | 152 |
| Advance customer payments | (221) | (48) |
| Accrued expenses | (747) | 287 |
| Net cash provided by operating activities | 2,462 | 2,098 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Proceeds from maturities of available-for-sale marketable securities | 6,460 | 5,109 |
| Proceeds from sales of available-for-sale marketable securities | 2,304 | 1,848 |
| Purchases of available-for-sale marketable securities | (13,497) | (9,381) |
| Additions to equipment and leasehold improvements | (612) | (216) |
| Additions to patents | (75) | (54) |
| Net cash used in investing activities | (5,420) | (2,694) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from exercise of stock options | | 12 |
| Net cash provided by financing activities | | 12 |
| Effects of exchange rate changes on cash and cash equivalents | 30 | 15 |
| Net decrease in cash and cash equivalents | (2,928) | (569) |
| Cash and cash equivalents beginning of period | 13,791 | 8,427 |
| Cash and cash equivalents end of period | \$ 10,863 | \$ 7,858 |

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

NOTES TO THE (UNAUDITED) INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CYBEROPTICS CORPORATION

1. INTERIM REPORTING:

The interim condensed consolidated financial statements presented herein as of June 30, 2012, and for the three and six month periods ended June 30, 2012 and 2011, are unaudited, but in the opinion of management, include all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of financial position, results of operations and cash flows for the periods presented.

The results of operations for the three and six month periods ended June 30, 2012 do not necessarily indicate the results to be expected for the full year. The December 31, 2011 consolidated balance sheet data was derived from audited consolidated financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. These unaudited interim condensed consolidated financial statements should be read in conjunction with our consolidated financial statements and notes thereto, contained in our Annual Report on Form 10-K for the year ended December 31, 2011.

2. MARKETABLE SECURITIES:

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

| June 30, 2012 | | | | |
|---|-----------|---------------------|----------------------|------------|
| (In thousands) | Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| <u>Short-Term</u> | | | | |
| U.S. government and agency obligations | \$ 7,017 | \$ 17 | \$ | \$ 7,034 |
| Corporate debt securities and certificates of deposit | 3,820 | 5 | | 3,825 |
| Marketable securities short-term | \$ 10,837 | \$ 22 | \$ | \$ 10,859 |
| <u>Long-Term</u> | | | | |
| U.S. government and agency obligations | \$ 8,872 | \$ 33 | \$ (1) | \$ 8,904 |
| Corporate debt securities and certificates of deposit | 1,609 | 5 | (1) | 1,613 |
| Equity security | 84 | | (35) | 49 |
| Marketable securities long-term | \$ 10,565 | \$ 38 | \$ (37) | \$ 10,566 |

| December 31, 2011 | | | | |
|---|-----------|---------------------|----------------------|------------|
| (In thousands) | Cost | Unrealized Gains | Unrealized Losses | Fair Value |
| <u>Short-Term</u> | | | | |
| U.S. government and agency obligations | \$ 6,495 | \$ 8 | \$ | \$ 6,503 |
| Corporate debt securities and certificates of deposit | 4,133 | 4 | | 4,137 |
| Marketable securities short-term | \$ 10,628 | \$ 12 | \$ | \$ 10,640 |
| <u>Long-Term</u> | | | | |
| U.S. government and agency obligations | \$ 3,653 | \$ 28 | \$ (1) | \$ 3,680 |
| Corporate debt securities and certificates of deposit | 2,353 | 9 | (2) | 2,360 |
| Equity security | 84 | | (18) | 66 |
| Marketable securities long-term | \$ 6,090 | \$ 37 | \$ (21) | \$ 6,106 |

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Our investments in marketable debt securities all have maturities of less than three years. At June 30, 2012, marketable debt securities valued at \$17,655,000 were in an unrealized gain position totaling \$60,000 and marketable debt securities valued at \$3,721,000 were in an insignificant unrealized loss position totaling \$2,000 (all had been in an unrealized loss position for less than twelve months). At December 31, 2011, marketable debt securities valued at \$14,207,000 were in an unrealized gain position totaling \$49,000 and marketable debt securities valued at \$2,473,000 were in an insignificant unrealized loss position totaling \$3,000 (all had been in an unrealized loss position for less than twelve months).

Our equity security investment was in an unrealized loss position of \$35,000 at June 30, 2012 and \$18,000 at December 31, 2011, due to weak economic and stock market conditions. We intend to hold this security indefinitely and expect a recovery in value as economic and market conditions improve.

Net pre-tax unrealized gains for marketable securities of \$23,000 at June 30, 2012 and \$28,000 at December 31, 2011 were recorded as a component of accumulated other comprehensive income (loss) in stockholders' equity. In the three months ended June 30, 2012 we received proceeds of \$954,000 from the sale of marketable securities. In the six months ended June 30, 2012 we received proceeds of \$2,304,000 from the sale of marketable securities. In the three months ended June 30, 2011 we received proceeds of \$800,000 from the sale of marketable securities. In the six months ended June 30, 2011 we received proceeds of \$1,848,000 from the sale of marketable securities. We recognized a \$4,000 gain from the sale of marketable securities in the six months ended June 30, 2012. No gain or loss was recognized on any of the sales during the six months ended June 30, 2011.

Investments in marketable securities classified as cash equivalents of \$2,977,000 at June 30, 2012 and \$685,000 at December 31, 2011 consist of the following:

| (In thousands) | Cost | June 30, 2012 | | Recorded Basis |
|---|----------|------------------|-------------------|----------------|
| | | Unrealized Gains | Unrealized Losses | |
| U.S. government and agency obligations | \$ 543 | \$ | \$ | \$ 543 |
| Corporate debt securities and certificates of deposit | 2,434 | | | 2,434 |
| | \$ 2,977 | \$ | \$ | \$ 2,977 |

| (In thousands) | Cost | December 31, 2011 | | Recorded Basis |
|---|--------|-------------------|-------------------|----------------|
| | | Unrealized Gains | Unrealized Losses | |
| U.S. government and agency obligations | \$ 30 | \$ | \$ | \$ 30 |
| Corporate debt securities and certificates of deposit | 655 | | | 655 |
| | \$ 685 | \$ | \$ | \$ 685 |

Cash held in foreign accounts totaled \$3,893,000 at June 30, 2012 and \$2,296,000 at December 31, 2011.

3. DERIVATIVES:

We enter into foreign exchange forward contracts to hedge against the effect of exchange rate fluctuations on cash flows denominated in foreign currencies and certain intercompany financing transactions associated with our subsidiaries in the United Kingdom and Singapore. These transactions are designated as cash flow hedges. The effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income and reclassified into earnings in the same period during which the hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings. Hedge ineffectiveness and the amounts excluded from effectiveness testing recognized in income on cash flow hedges were not material for the three and six month periods ended June 30, 2012 and June 30, 2011.

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The maximum length of time over which we hedge our exposure to the variability in future cash flows is 12 months. Accordingly, at June 30, 2012 and June 30, 2011, all of our open foreign exchange forward contracts had maturities of one year or less. The dollar equivalent gross notional amount of our foreign exchange forward contracts designated as cash flow hedges was approximately \$10.7 million at June 30, 2012 and \$9.2 million at June 30, 2011.

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

| (In thousands) | Three Months Ended June 30, 2012 | | |
|--------------------------|---|---|--|
| | Pretax Gain (Loss) Recognized in Other Comprehensive Income on Effective Portion of Derivative | Pretax Gain (Loss) Recognized in Income on Effective Portion of Derivative as a Result of Reclassification from Accumulated Other Comprehensive Income | Ineffective Portion of Gain (Loss) on Derivative and Amount Excluded from Effectiveness Testing Recognized in Income |
| Cost of sales | \$ (50) | \$ (69) | \$ |
| Research and development | (10) | (15) | |
| Sales and marketing | (9) | (11) | |
| Total | \$ (69) | \$ (95) | \$ |

| (In thousands) | Three Months Ended June 30, 2011 | | |
|--------------------------|---|---|--|
| | Pretax Gain (Loss) Recognized in Other Comprehensive Income on Effective Portion of Derivative | Pretax Gain (Loss) Recognized in Income on Effective Portion of Derivative as a Result of Reclassification from Accumulated Other Comprehensive Income | Ineffective Portion of Gain (Loss) on Derivative and Amount Excluded from Effectiveness Testing Recognized in Income |
| Cost of sales | \$ 164 | \$ 56 | \$ |
| Research and development | 39 | 15 | |
| Sales and marketing | 32 | 14 | |
| Other income | (17) | (17) | |
| Total | \$ 218 | \$ 68 | \$ |

| (In thousands) | Six Months Ended June 30, 2012 | | |
|--------------------------|--|--|--|
| | Pretax Gain (Loss) Recognized in Other Comprehensive Income on Effective Portion of Derivative | Pretax Gain (Loss) Recognized in Income on Effective Portion of Derivative as a Result of Reclassification from Accumulated Other Comprehensive Income | Ineffective Portion of Gain (Loss) on Derivative and Amount Excluded from Effectiveness Testing Recognized in Income |
| Cost of sales | \$ 179 | \$ (120) | \$ |
| Research and development | 43 | (29) | |
| Sales and marketing | 32 | (21) | |
| Total | \$ 254 | \$ (170) | \$ |

| (In thousands) | Six Months Ended June 30, 2011 | | |
|--------------------------|--|--|--|
| | Pretax Gain (Loss) Recognized in Other Comprehensive Income on Effective Portion of Derivative | Pretax Gain (Loss) Recognized in Income on Effective Portion of Derivative as a Result of Reclassification from Accumulated Other Comprehensive Income | Ineffective Portion of Gain (Loss) on Derivative and Amount Excluded from Effectiveness Testing Recognized in Income |
| Cost of sales | \$ 166 | \$ 57 | \$ |
| Research and development | 40 | 16 | |
| Sales and marketing | 32 | 14 | |
| Other income | (48) | (48) | |
| Total | \$ 190 | \$ 39 | \$ |

Amounts recorded in accumulated other comprehensive income (loss) for the after tax net unrealized loss associated with cash flow hedging instruments was \$46,000 as of June 30, 2012 and \$323,000 as of December 31, 2011. We expect to reclassify the June 30, 2012 after tax net unrealized gain (loss) recorded in accumulated other comprehensive income (loss) to earnings over the next 12 months with the impact offset by cash flows from underlying hedged items. The fair value of our foreign exchange forward contracts representing a loss in the amount of \$70,000 as of June 30, 2012 and \$493,000 as of December 31, 2011 has been recorded in accrued expenses in the accompanying consolidated balance sheets.

Additional information with respect to the impact of derivative instruments on other comprehensive income is included in Note 11. Additional information with respect to the fair value of derivative instruments is included in Note 4.

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

4. FAIR VALUE MEASUREMENTS:

We determine the fair value of our assets and liabilities based on the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value maximize the use of observable inputs and minimize the use of unobservable inputs. We use a fair value hierarchy with three levels of inputs, of which the first two are considered observable and the last unobservable, to measure fair value: The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1). The next highest priority is based on quoted prices for similar assets or liabilities in active markets or quoted prices for identical or similar assets or liabilities in non-active markets or other observable inputs (Level 2). The lowest priority is given to unobservable inputs (Level 3). The following provides information regarding fair value measurements for our marketable securities and foreign exchange forward contracts as of June 30, 2012 and December 31, 2011 according to the three-level fair value hierarchy:

Fair Value Measurements at June 30, 2012 Using

| (In thousands) | Balance June 30, 2012 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|--------------------------------------|---|--|--|
| Marketable securities: | | | | |
| U.S. government and agency obligations | \$ 15,938 | \$ | \$ 15,938 | \$ |
| Corporate debt securities and certificates of deposit | 5,438 | | 5,438 | |
| Equity security | 49 | 49 | | |
| Total marketable securities | \$ 21,425 | \$ 49 | \$ 21,376 | \$ |
| Derivative instruments-liabilities: | | | | |
| Foreign exchange forward contracts | \$ (70) | \$ | \$ (70) | \$ |

Fair Value Measurements at December 31, 2011 Using

| (In thousands) | Balance December 31, 2011 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|--|---|--|--|
| Marketable securities: | | | | |
| U.S. government and agency obligations | \$ 10,183 | \$ | \$ 10,183 | \$ |
| Corporate debt securities and certificates of deposit | 6,497 | | 6,497 | |
| Equity security | 66 | 66 | | |
| Total marketable securities | \$ 16,746 | \$ 66 | \$ 16,680 | \$ |
| Derivative instruments-liabilities: | | | | |
| Foreign exchange forward contracts | \$ (493) | \$ | \$ (493) | \$ |

During the six months ended June 30, 2012 there were no significant transfers to or from the three level hierarchy. A significant transfer is recognized when the inputs used to value a security have been changed which merit a transfer between the disclosed levels of the valuation hierarchy.

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

The fair value for our foreign exchange forward contracts is based on foreign currency spot and forward rates obtained from reputable financial institutions with resulting valuations periodically validated by obtaining foreign currency spot rate and forward quotes from other industry standard sources or third party or counterparty quotes. The fair value of our foreign exchange forward contracts representing a loss in the amount of \$70,000 as of June 30, 2012 and \$493,000 as of December 31, 2011 has been recorded in accrued expenses in the accompanying consolidated balance sheets.

The carrying amounts of financial instruments such as cash equivalents, accounts receivable, other assets, accounts payable, accrued expenses and other current liabilities approximate the related fair values due to the short-term maturities of these instruments. Non-financial assets such as equipment and leasehold improvements, goodwill and intangible assets are subject to non-recurring fair value measurements if they are deemed impaired. We had no re-measurements of non-financial assets to fair value during the six months ended June 30, 2012 or June 30, 2011.

5. ACCOUNTING FOR STOCK-BASED COMPENSATION:

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

Equity based compensation expense in the three months ended June 30, 2012 totaled \$148,000 and includes \$65,000 for stock option awards, \$15,000 for our employee stock purchase plan, \$27,000 for unvested restricted stock units and \$41,000 for shares issued to our non-employee directors. Equity based compensation expense in the six months ended June 30, 2012 totaled \$253,000 and includes \$130,000 for stock option awards, \$29,000 for our employee stock purchase plan, \$53,000 for unvested restricted stock units and \$41,000 for shares issued to our non-employee directors upon their re-election to our board in May 2012.

Equity based compensation expense in the three months ended June 30, 2011 totaled \$143,000 and includes \$56,000 for stock option awards, \$27,000 for our employee stock purchase plan, \$20,000 for unvested restricted stock units and \$40,000 for shares issued to our non-employee directors. Equity based compensation expense in the six months ended June 30, 2011 totaled \$248,000 and includes \$113,000 for stock option awards, \$53,000 for our employee stock purchase plan, \$42,000 for unvested restricted stock units and \$40,000 for shares issued to our non-employee directors upon their re-election to our board in May 2011.

At June 30, 2012, the total unrecognized compensation cost related to non-vested equity based compensation arrangements was \$807,000 and the related weighted average period over which it is expected to be recognized is 1.84 years.

Stock Options

We have two stock incentive plans that are administered under the supervision of the Compensation Committee of the Board of Directors. In May 2012, our shareholders approved an amendment to our active stock incentive plan to increase the number of shares that may be issued under the plan by 350,000. Including the newly approved shares, there are 1,064,689 shares of common stock reserved in the aggregate for issuance of options and other stock based benefits under these plans, including restricted stock units and share grants to employees, officers and others. Reserved shares underlying canceled options are available for future grant under our active plan. Options are granted at an option price per share equal to or greater than the market value on the date of grant. Generally, options granted to employees vest over a four-year period and expire five, seven, or ten years after the date of grant. As of June 30, 2012, there were 516,663 shares of common stock available under these plans for future issuance to employees, officers and others.

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The following is a summary of stock option activity during the six months ended June 30, 2012:

| | Options Outstanding | Weighted Average Exercise Price Per Share |
|--------------------------------|------------------------|---|
| Outstanding, December 31, 2011 | 515,987 | \$ 10.07 |
| Granted | 105,833 | 7.30 |
| Exercised | | |
| Expired | (114,500) | 11.88 |
| Forfeited | | |
| Outstanding, June 30, 2012 | 507,320 | \$ 9.08 |
| Exercisable, June 30, 2012 | 295,463 | \$ 10.16 |

The intrinsic value of an option is the amount by which the fair value of the underlying stock exceeds its exercise price. At June 30, 2012, the weighted average remaining contractual term of all outstanding options was 4.11 years and their aggregate intrinsic value was \$617,854. At June 30, 2012, the weighted average remaining contractual term of options that were exercisable was 3.05 years and their aggregate intrinsic value was \$365,345. We received no proceeds from the exercise of stock options in the six months ended June 30, 2012. We received proceeds of \$12,000 from the exercise of stock options in the six months ended June 30, 2011. The excess tax benefit associated with the exercise of stock options in the six months ended June 30, 2011 was inconsequential.

The fair values of the options granted to our employees were estimated on the date of grant using the Black-Scholes model. The Black-Scholes valuation model incorporates ranges of assumptions that are disclosed in the table below. The risk-free interest rate is based on the United States Treasury yield curve at the time of grant with a remaining term equal to the expected life of the awards. For options granted in the six months ending June 30, 2012, we estimated the expected term for our graded vesting options, representing the length of time in years that the options are expected to be outstanding, using historical experience. Previously, we used the simplified method for expected term because our historical exercise experience was not expected to be representative of future exercise patterns. Expected volatility was computed based on historical fluctuations in the daily price of our common stock.

For stock options granted during the six months ended June 30, 2012, we utilized the fair value of our common stock on the date of grant and employed the following key assumptions in computing fair value using the Black-Scholes option-pricing model:

| | 2012 |
|---|--------|
| Risk-free interest rates | 0.86% |
| Expected life in years | 4.95 |
| Expected volatility | 45.81% |
| Dividend yield | 0.00% |
| Weighted average fair value on grant date | \$2.94 |

Restricted Stock Units

Our 1998 Stock Incentive Plan also permits our Compensation Committee to grant other stock-based benefits, including restricted stock units. Restricted stock units are valued at a price equal to the fair market value of our common stock on the date of grant, vest over a four year period provided the employee is still working for the company and entitle the holders to one share of our common stock for each restricted stock unit. The aggregate fair value of outstanding restricted stock units as of June 30, 2012 was \$344,000.

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A summary of activity in non-vested restricted stock units for the six months ended June 30, 2012 is as follows:

| Non-vested restricted stock units | Shares | Weighted Average Grant Date Fair Value |
|-----------------------------------|--------|---|
| Non-vested at December 31, 2011 | 19,404 | \$ 7.58 |
| Granted | 21,389 | 7.30 |
| Vested | (87) | 7.71 |
| Forfeited | | |
| Non-vested at June 30, 2012 | 40,706 | \$ 7.43 |

Employee Stock Purchase Plan

We have an Employee Stock Purchase Plan available to eligible U.S. employees. Under terms of the plan, eligible employees may designate from 1% to 10% of their compensation to be withheld through payroll deductions, up to a maximum of \$6,500 in each plan year, for the purchase of common stock at 85% of the lower of the market price on the first or last day of the offering period. There were no shares issued under this plan in the six months ended June 30, 2012 or June 30, 2011. As of June 30, 2012, 186,341 shares remain available for future issuance under this plan.

Stock Grant Plan for Non-Employee Directors

Our stock grant plan for non-employee directors provides for automatic grants of 1,000 shares of our common stock to each of our non-employee directors upon their re-election to the board of directors. The plan provides for a total of 30,000 shares of our common stock for issuance to directors and will expire on May 19, 2018. We issued a total of 5,000 shares of common stock under this plan in connection with our annual meeting in May 2012, resulting in \$41,000 of stock compensation expense in the three and six months ended June 30, 2012. There are presently 11,000 shares of common stock reserved in the aggregate for future issuance under this plan.

6. INVENTORIES AND WARRANTIES:

Inventories consist of the following:

| (In thousands) | June 30, 2012 | December 31, 2011 |
|-----------------------------------|---------------|-------------------|
| Raw materials and purchased parts | \$ 7,135 | \$ 6,893 |
| Work in process | 1,254 | 1,007 |
| Finished goods | 3,860 | 3,152 |
| Total inventories | \$ 12,249 | \$ 11,052 |
| Warranty costs: | | |

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

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

| (In thousands) | Six Months Ended June 30, | |
|------------------------------------|---------------------------------|-----------|
| | 2012 | 2011 |
| Balance at beginning of period | \$985 | \$702 |
| Accrual for warranties | 466 | 522 |
| Settlements made during the period | (537) | (467) |
| Balance at end of period | \$914 | \$757 |
| Deferred warranty revenue: | | |

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

| (In thousands) | Six Months Ended June 30, | |
|--|---------------------------------|-----------|
| | 2012 | 2011 |
| Balance at beginning of period | \$806 | \$787 |
| Revenue deferrals | 94 | 222 |
| Amortization of deferred revenue | (214) | (223) |
| Total deferred warranty revenue | 686 | 786 |
| Current portion of deferred warranty revenue | (489) | (464) |
| Long-term deferred warranty revenue | \$197 | \$322 |

7. INTANGIBLE ASSETS:

Intangible assets consist of the following:

| (In thousands) | June 30, 2012 | | | December 31, 2011 | | |
|----------------------|-----------------------------|-----------------------------|--------|-----------------------------|-----------------------------|--------|
| | Gross Carrying Amount | Accumulated Amortization | Net | Gross Carrying Amount | Accumulated Amortization | Net |
| Developed technology | \$ 7,775 | \$ (7,775) | \$ | \$ 7,775 | \$ (7,775) | \$ |
| Patents | 2,809 | (2,582) | 227 | 2,734 | (2,504) | 230 |
| | \$ 10,584 | \$ (10,357) | \$ 227 | \$ 10,509 | \$ (10,279) | \$ 230 |

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Amortization expense for the three and six month periods ended June 30, 2012 and 2011 is as follows:

| (In thousands) | Three Months Ended June 30, | | Six Months Ended June 30, | |
|----------------------|--------------------------------|-------|------------------------------|--------|
| | 2012 | 2011 | 2012 | 2011 |
| Developed technology | \$ | \$ 45 | \$ | \$ 90 |
| Patents | | 37 | | 110 |
| | \$ | \$ 37 | \$ | \$ 200 |

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

Amortization of patents and trademarks has been classified as research and development expense in the accompanying statement of operations. Estimated aggregate amortization expense based on current intangibles for the next four years is expected to be as follows: \$73,000 for the remainder of 2012, \$99,000 in 2013, \$46,000 in 2014, and \$9,000 in 2015.

8. BUSINESS SEGMENTS AND SIGNIFICANT CUSTOMERS:

We determine our segments using the management approach, which designates a segment as an internal organization that is used by management for making operating decisions and assessing performance. We have determined that our business operates as two reportable segments. The electronic assembly segment is the design, manufacture and sale of optical process control sensors and inspection systems for the electronic assembly and photovoltaic cell equipment markets. The semiconductor segment is the design, manufacture and sale of optical and other process control sensors and related equipment for the semiconductor capital equipment market.

Information regarding our segments is as follows:

| (In thousands) | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---------------------------------------|--------------------------------|-----------|------------------------------|-----------|
| | 2012 | 2011 | 2012 | 2011 |
| Revenue: | | | | |
| Electronic Assembly | | | | |
| OEM Sensors | \$ 4,037 | \$ 6,174 | \$ 8,215 | \$ 12,266 |
| SMT Systems | 7,348 | 9,032 | 12,899 | 14,411 |
| Total Electronic Assembly | 11,385 | 15,206 | 21,114 | 26,677 |
| Semiconductor | 1,618 | 1,653 | 3,169 | 3,532 |
| Total | \$ 13,003 | \$ 16,859 | \$ 24,283 | \$ 30,209 |
| Income (loss) from operations: | | | | |
| Electronic Assembly | \$ (429) | \$ 1,294 | \$ (825) | \$ 1,879 |
| Semiconductor | 527 | 550 | 1,015 | 1,052 |
| Total income from operations | 98 | 1,844 | 190 | 2,931 |
| Interest income and other | (76) | (7) | (41) | 79 |
| Income before taxes | \$ 22 | \$ 1,837 | \$ 149 | \$ 3,010 |
| Depreciation and amortization: | | | | |
| Electronic Assembly | \$ 456 | \$ 441 | \$ 819 | \$ 1,027 |
| Semiconductor | 47 | 52 | 94 | 109 |
| Total | \$ 503 | \$ 493 | \$ 913 | \$ 1,136 |

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Export sales were 87% of revenue in the three and six months ended June 30, 2012. Export sales were 88% of revenue in the three months ended June 30, 2011 and 87% of revenue in the six months ended June 30, 2011. Virtually all of our export sales are negotiated, invoiced and paid in U.S. dollars. Export sales by geographic area are summarized as follows:

| (In thousands) | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---------------------------|--------------------------------|------------------|------------------------------|------------------|
| | 2012 | 2011 | 2012 | 2011 |
| Americas | \$ 608 | \$ 392 | \$ 1,105 | \$ 866 |
| Europe | 3,540 | 4,073 | 6,926 | 8,603 |
| Asia | 6,939 | 9,953 | 12,739 | 16,114 |
| Other | 231 | 393 | 375 | 589 |
| Total export sales | \$ 11,318 | \$ 14,811 | \$ 21,145 | \$ 26,172 |

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

We are dependent upon three electronic assembly customers, Juki, Assembleon, and LaserTek, a distributor of our inspection systems in China, for a significant portion of our total revenue. For the six months ended June 30, 2012, sales to Juki accounted for 15% of our total revenue, sales to Assembleon accounted for 14% of our total revenue and sales to LaserTek accounted for 13% of our total revenue.

9. SUBSEQUENT EVENT RE-ORGANIZATION AND RESTRUCTURE CHARGE:

We have initiated steps in the third quarter of 2012 to fully consolidate our Portland-based semiconductor operations into our Minneapolis headquarters facility. We estimate that this consolidation will result in a restructuring charge of approximately \$300,000 in the third quarter of 2012. Due to the consolidation initiative, we will no longer manage our semiconductor operations as a separate segment, and we will no longer report semiconductor segment information beginning with the third quarter of 2012.

10. NET INCOME PER SHARE:

Basic net income per share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Net income per diluted share is computed by dividing net income by the weighted average number of common and common equivalent shares outstanding during the period. Common equivalent shares consist of common shares to be issued upon exercise of stock options, restricted stock units and from participation in our employee stock purchase plan, as calculated using the treasury stock method. The components of net income per basic and diluted share are as follows:

| (In thousands except per share amounts) | Net Income | Weighted Average Shares Outstanding | Per Share Amount |
|---|------------|---|---------------------|
| Three Months Ended June 30, 2012: | | | |
| Basic | \$ 143 | 6,935 | \$ 0.02 |
| Dilutive effect of common equivalent shares | | 59 | |
| Dilutive | \$ 143 | 6,994 | \$ 0.02 |

| (In thousands except per share amounts) | Net Income | Weighted Average Shares Outstanding | Per Share Amount |
|---|------------|---|---------------------|
| Three Months Ended June 30, 2011: | | | |
| Basic | \$ 1,398 | 6,894 | \$ 0.20 |
| Dilutive effect of common equivalent shares | | 54 | |
| Dilutive | \$ 1,398 | 6,948 | \$ 0.20 |

| (In thousands except per share amounts) | Net Income | Weighted Average Shares Outstanding | Per Share Amount |
|---|------------|---|---------------------|
| Six Months Ended June 30, 2012: | | | |
| Basic | \$ 235 | 6,934 | \$ 0.03 |
| Dilutive effect of common equivalent shares | | 54 | |
| Dilutive | \$ 235 | 6,988 | \$ 0.03 |

| (In thousands except per share amounts) | Net Income | Weighted Average Shares Outstanding | Per Share Amount |
|---|------------|---|---------------------|
| Six Months Ended June 30, 2011: | | | |
| Basic | \$ 2,244 | 6,893 | \$ 0.33 |
| Dilutive effect of common equivalent shares | | 48 | (.01) |
| Dilutive | \$ 2,244 | 6,941 | \$ 0.32 |

The calculation of diluted net income per common share excludes 332,000 potentially dilutive shares for the three months ended June 30, 2012, 293,000 potentially dilutive shares for the three months ended June 30, 2011, 347,000 potentially dilutive shares for the six months ended June 30, 2012 and 307,000 potentially dilutive shares for the six months ended June 30, 2011 because their effect would be anti-dilutive.

11. COMPREHENSIVE INCOME (LOSS):

Taxes related to items of other comprehensive income (loss) are as follows:

| (In thousands) | Three months ended June 30, 2012 | | | Three months ended June 30, 2011 | | |
|---|----------------------------------|------------------------------|----------------------|----------------------------------|------------------------------|----------------------|
| | Before Tax | Tax (Expense)/ Benefit | Net of Tax Amount | Before Tax | Tax (Expense)/ Benefit | Net of Tax Amount |
| Foreign currency translation adjustments | \$ (79) | \$ | \$ (79) | \$ 145 | \$ | \$ 145 |
| Unrealized gains (losses) on available-for-sale securities | 5 | 3 | 8 | 42 | (15) | 27 |
| Reclassification adjustment for (gains) on available-for-sale securities included in net income | (4) | | (4) | | | |
| Unrealized gains (losses) on foreign exchange forward contracts | (69) | 23 | (46) | 218 | (74) | 144 |
| Reclassification adjustment for (gains) losses on foreign exchange forward contracts included in net income | 95 | (32) | 63 | (68) | 23 | (45) |
| Other comprehensive income (loss) | \$ (52) | \$ (6) | \$ (58) | \$ 337 | \$ (66) | \$ 271 |

| (In thousands) | Six months ended June 30, 2012 | | | Six months ended June 30, 2011 | | |
|---|--------------------------------|------------------------------|----------------------|--------------------------------|------------------------------|----------------------|
| | Before Tax | Tax (Expense)/ Benefit | Net of Tax Amount | Before Tax | Tax (Expense)/ Benefit | Net of Tax Amount |
| Foreign currency translation adjustments | \$ 132 | \$ | \$ 132 | \$ 243 | \$ | \$ 243 |
| Unrealized gains (losses) on available-for-sale securities | (1) | 5 | 4 | 51 | (17) | 34 |
| Reclassification adjustment for (gains) on available-for-sale securities included in net income | (4) | | (4) | | | |
| Unrealized gains (losses) on foreign exchange forward contracts | 254 | (89) | 165 | 190 | (64) | 126 |
| Reclassification adjustment for (gains) losses on foreign exchange forward contracts included in net income | 170 | (58) | 112 | (39) | 13 | (26) |
| Other comprehensive income (loss) | \$ 551 | \$ (142) | \$ 409 | \$ 445 | \$ (68) | \$ 377 |

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Reclassification adjustments are made to avoid double counting in comprehensive income items that are also recorded as part of net income. Reclassifications to earnings related to cash flow hedging instruments are provided in Note 3. Income taxes are not provided for foreign currency translation adjustments relating to permanent investments in international subsidiaries.

At June 30, 2012 and December 31, 2011 components of accumulated other comprehensive income (loss) are as follows:

| (In thousands) | June 30, 2012 | December 31, 2011 |
|---|------------------|----------------------|
| Unrealized gains on available-for-sale securities | \$ 18 | \$ 18 |
| Unrealized losses on effective portion of foreign exchange forward contracts, net | (46) | (323) |
| Foreign currency translation adjustments | (489) | (621) |
| Balance at end of period | \$ (517) | \$ (926) |

12. INCOME TAXES:

In the six months ended June 30, 2012, we recorded an income tax benefit of \$86,000, reflecting a tax rate of a negative 58%, compared to income tax expense of \$766,000 in the six months ended June 30, 2011, reflecting an effective tax rate of 25%. We have determined that a small fluctuation in our anticipated ordinary loss for one tax jurisdiction would have a significant impact on our 2012 effective tax rate calculation. For this reason, the income tax benefit related to this jurisdiction has been accounted for discretely in the six months ended June 30, 2012. Our effective tax rate for 2012 and 2011 reflects the benefit of having a significant portion of our operations in Singapore where corporate income tax rates are substantially lower than the United States. Fluctuations in the level of income and loss in the United States and Singapore will have an impact on our effective tax rate in any given annual period.

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

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

In analyzing the need for valuation allowances, we first considered our history of profits and losses for U.S. income tax purposes over the past three years and also gave significant consideration to our results for U.S. income tax purposes over the past five years, as the economic cycles in our industry have tended to average five years in length. We also considered our forecasts of future profitability, the duration of statutory carry forward periods and tax planning alternatives. Finally, we considered the length and severity of the global economic crisis in 2008 and 2009, the impact that it had on our operating results and our expectations for the global economy and more specifically the future outlook for our markets. After considering all of these factors, and after considering other significant positive evidence, we concluded that a valuation allowance, with respect to substantially all of our U.S. based deferred tax assets, was not required at June 30, 2012 and December 31, 2011.

Our results in both 2008 and 2009 were negatively impacted by the global economic slowdown, and we incurred a loss in the United States in both 2008 and 2009, where most of our net deferred tax assets are recorded. We recorded a profit in 2010 and 2011. Achievement of ongoing profitability in the United States will be a significant factor in determining our continuing ability to carry these deferred tax assets without recording a valuation allowance. If future results from our operations are less than projected, a valuation allowance may be required against virtually all of our deferred tax assets, which could have a material impact on our results of operations in the period in which it is recorded.

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Deferred tax assets at June 30, 2012 include net operating loss carry forwards incurred in the UK by CyberOptics Ltd., which was acquired in 1999. The utilization of these net operating loss carry forwards is dependent on CyberOptics Ltd.'s ability to generate sufficient UK taxable income during the carry forward period.

Valuation allowances at June 30, 2012 and at December 31, 2011 in the amount of \$833,000 are recorded for various long-term state tax credit carry forwards, state operating loss carry forwards and capital losses for which recovery is not deemed to be more likely than not.

13. CONTINGENCIES:

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

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

14. RECENT ACCOUNTING DEVELOPMENTS:

In June 2011, the FASB issued amended disclosure requirements for the presentation of comprehensive income (ASU No. 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*). The amended guidance eliminates the option to present components of other comprehensive income (OCI) as part of the statement of changes in equity. Under the amended guidance, all changes in OCI are to be presented either in a single continuous statement of comprehensive income or in two separate but consecutive financial statements. The FASB subsequently met on October 21, 2011 and decided that the specific requirement to present items that are reclassified from other comprehensive income to net income alongside their respective components of net income and other comprehensive income will be deferred. We adopted the remaining amended disclosure requirement changes effective January 1, 2012. Our adoption of the amended disclosure requirements had no impact on our consolidated financial results as the amendments relate only to changes in financial statement presentation.

ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

CRITICAL ACCOUNTING POLICIES AND ESTIMATES:

The preparation of the financial information contained in this 10-Q requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We evaluate these estimates on an ongoing basis, including those related to allowances for doubtful accounts and returns, warranty obligations, inventory valuation, the carrying value and any impairment of intangible assets, income taxes and derivatives and hedging activities. These critical accounting policies are discussed in more detail in the Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Form 10-K for the year ended December 31, 2011.

FORWARD LOOKING STATEMENTS:

The following management's discussion and analysis contains a number of estimates and predictions that are forward looking rather than based on historical fact. Among other matters, we discuss (i) our level of anticipated revenues, gross margins, expenses, and net income for full year 2012; (ii) the potential margin improvements resulting from our next-generation solder paste inspection (SPI) and automated optical inspection (AOI) systems; (iii) the timing of initial revenue and margin improvements from other new products that we have under development, that have been recently introduced or we anticipate introducing in the future; (iv) our expectations regarding market acceptance of WaferSense and our other semiconductor products; (v) the size of an expected third quarter restructuring charge related to the closing of our Portland, Oregon office; (vi) our beliefs regarding trends in the general economy and its impact on markets for our equipment; and (vii) the impact of currency fluctuations on our operations. Although we have made these statements based on our experience and best estimate of future events, there may be events or factors that we have not anticipated, and the accuracy of our statements and estimates are subject to a number of risks, including those identified in our Annual Report on Form 10-K for the year ended December 31, 2011.

RESULTS OF OPERATIONS:

General

Our products are sold primarily into the electronics assembly, photovoltaic (solar) cell manufacturing, semiconductor DRAM and Flash memory manufacturing, and semiconductor fabrication capital equipment markets. We sell products in these markets both to original equipment manufacturers of production equipment and to end-user customers that produce circuit boards, solar cells and semiconductor wafers and devices. Historically these markets have been very cyclical, and have experienced periods of rapid growth as worldwide capacity is added to support increased consumer demand for electronic products, and new capital equipment is purchased as a result of technology changes in electronics components, such as miniaturization, and changing production requirements. These periods of growth have historically been followed by periods of excess capacity and reduced capital spending.

Our results in the first six months of 2012 have been impacted by the absence of solar sensor sales and weakness in surface mount technology (SMT) alignment sensors and stand-alone inspection systems due to weak SMT, semiconductor and solar market conditions. We previously believed that the first quarter of 2012 marked the trough of a multi-quarter cyclical downturn in the global electronics industry. However, the extent of the market downturn caused by continued weakening of the global economy negatively affected our second quarter results. Given widespread market weakness, we experienced reduced year-over-year demand for most of our product categories, although revenue was sequentially higher in the second quarter of 2012. A slowing Chinese economy and continued economic turmoil in Europe were significant contributing factors to the lower demand for our sensor and system products. In addition, sensor sales continued to be affected by the absence of solar sensor sales due to persistently sluggish conditions in the solar market.

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Given the prolonged weakness in the global economy, we believe sluggish market conditions will likely extend at least through the end of 2012. Based upon this outlook, we believe our second half sales may be lower than the level posted in this year's first six months. In order for our products to remain competitive, we believe that it is essential to maintain a talented research and development staff and to continue our initiatives to develop next generation AOI and SPI products and, accordingly, we plan to continue funding our product development initiatives at a relatively high level during the second half of 2012. Such spending during cyclical downturns has allowed us to generate significant sales during corresponding economic and market recoveries. Nevertheless, this level of research and development expenditure may cause maintaining profitability in 2012 to be challenging. Longer term, we remain confident about our future, as we prepare for the next upturn of the electronics market by developing a range of important next-generation products. In addition, we are continuing to evaluate strategic acquisition opportunities as a means of entering into new markets with related technologies.

In the third quarter of 2012, we initiated steps to fully consolidate our Portland-based semiconductor operations into our Minneapolis headquarters facility. We believe this move, which we estimate will result in a restructuring charge of approximately \$300,000 in the third quarter, will allow us to accelerate development of our WaferSense products through more efficient access to CyberOptics' sensor engineering talent, while further streamlining our business. This action will have no impact on our global sales and service capabilities. Due to the consolidation initiative, we will no longer manage our semiconductor operations as a separate segment, and we will no longer report semiconductor segment information beginning with the third quarter of 2012. Sales of our WaferSense product line were up 15% sequentially and 17% year-over-year, and our consolidation initiative will enable WaferSense to remain a growing and important component of our product mix.

Segment Results

Operating results for our electronic assembly and semiconductor segments for the three and six month periods ended June 30, 2012 and 2011 are as follows:

| (In thousands) | Three months ended June 30, 2012 | | | Three months ended June 30, 2011 | | |
|--|----------------------------------|--------------------|-----------|----------------------------------|--------------------|-----------|
| | Electronic Assembly | Semi- Conductor | Total | Electronic Assembly | Semi- Conductor | Total |
| Revenues | \$ 11,385 | \$ 1,618 | \$ 13,003 | \$ 15,206 | \$ 1,653 | \$ 16,859 |
| Cost of revenues | 7,054 | 420 | 7,474 | 8,904 | 448 | 9,352 |
| Gross margin | 4,331 | 1,198 | 5,529 | 6,302 | 1,205 | 7,507 |
| Research and development expenses | 1,778 | 284 | 2,062 | 1,674 | 273 | 1,947 |
| Selling, general and administrative expenses | 2,982 | 387 | 3,369 | 3,307 | 364 | 3,671 |
| Amortization of intangibles | | | | 27 | 18 | 45 |
| Income (loss) from operations | \$ (429) | \$ 527 | \$ 98 | \$ 1,294 | \$ 550 | \$ 1,844 |
| (In thousands) | Six months ended June 30, 2012 | | | Six months ended June 30, 2011 | | |
| | Electronic Assembly | Semi- Conductor | Total | Electronic Assembly | Semi- Conductor | Total |
| Revenues | \$ 21,114 | \$ 3,169 | \$ 24,283 | \$ 26,677 | \$ 3,532 | \$ 30,209 |
| Cost of revenues | 12,651 | 868 | 13,519 | 15,047 | 1,048 | 16,095 |
| Gross margin | 8,463 | 2,301 | 10,764 | 11,630 | 2,484 | 14,114 |
| Research and development expenses | 3,411 | 568 | 3,979 | 3,194 | 571 | 3,765 |
| Selling, general and administrative expenses | 5,877 | 718 | 6,595 | 6,503 | 825 | 7,328 |
| Amortization of intangibles | | | | 54 | 36 | 90 |
| Income (loss) from operations | \$ (825) | \$ 1,015 | \$ 190 | \$ 1,879 | \$ 1,052 | \$ 2,931 |

Revenues

Our revenues decreased by 23% to \$13.0 million in the three months ended June 30, 2012 from \$16.9 million in the three months ended June 30, 2011 and decreased by 20% to \$24.3 million in the six months ended June 30, 2012 from \$30.2 million in the six months ended June 30, 2011. The following table sets forth revenues by product line for the three and six month periods ended June 30, 2012 and 2011:

| (In thousands) | Three Months Ended June 30, | | Six Months Ended June 30, | |
|----------------------------|--------------------------------|-----------|------------------------------|-----------|
| | 2012 | 2011 | 2012 | 2011 |
| Electronic Assembly | | | | |
| OEM Alignment Sensors | \$ 4,037 | \$ 6,174 | \$ 8,215 | \$ 12,266 |
| SMT Inspection Systems | 7,348 | 9,032 | 12,899 | 14,411 |
| Total Electronic Assembly | 11,385 | 15,206 | 21,114 | 26,677 |
| Semiconductor | 1,618 | 1,653 | 3,169 | 3,532 |
| Total | \$ 13,003 | \$ 16,859 | \$ 24,283 | \$ 30,209 |

Electronic Assembly

Sales of OEM alignment sensors declined from the year-earlier periods due to sluggish SMT, semiconductor and solar market conditions and continued weakening of the global economy. Sales of SMT alignment sensors decreased by \$1.8 million or 30% to \$4.0 million in the three months ended June 30, 2012, down from \$5.8 million in the three months ended June 30, 2011, and decreased by \$2.0 million or 20% to \$8.2 million in the six months ended June 30, 2012, down from \$10.2 million in the six months ended June 30, 2011. Reflecting the continued impact of excess production capacity in the photovoltaic cell market, we recorded no revenue from sales of solar wafer alignment cameras during the three and six months ended June 30, 2012, compared to revenue of \$400,000 in the second quarter of 2011 and \$2.1 million of revenue in the six months ended June 30, 2011. We do not anticipate any material strengthening in the solar market until 2013. Third quarter sensor sales are forecast to decline on both a sequential quarterly and year-over-year basis as our OEM customers continue to work off their sensor inventories resulting from weak end customer demand and soft global economic conditions. At this time, we believe sales of SMT sensors should start rebounding in the fourth quarter, dependent upon some strengthening of the global economy and the electronics market.

Revenue from sales of our stand-alone SMT inspection systems decreased by \$1.7 million or 19% to \$7.3 million in the three months ended June 30, 2012, down from \$9.0 million in the three months ended June 30, 2011, and decreased by \$1.5 million or 10% to \$12.9 million in the six months ended June 30, 2012, down from \$14.4 million in the six months ended June 30, 2011. Sales of stand-alone SMT inspection systems fell below our expectations in the second quarter of 2012 and have decreased in 2012 when compared to the prior year periods, due to continued weakening of the global economy.

Sales of AOI systems increased by \$176,000 or 4% to \$4.3 million in the three months ended June 30, 2012, from \$4.1 million in the three months ended June 30, 2011, and increased by \$1.0 million or 16% to \$7.4 million in the six months ended June 30, 2012, from \$6.3 million in the six months ended June 30, 2011, led by our next-generation QX500 AOI system and our new QX100 and QX100i AOI tabletop systems. We have continued to increase sales of AOI systems by capitalizing on our existing relationships with several of the world's largest ODMs and by establishing relationships with new AOI customers. The QX family of AOI products is based upon a cost-reduced platform that we believe offers the fastest AOI inspection times currently available. We believe the QX500 will continue to receive favorable market acceptance, particularly with ODMs, where we have an established installed base of SPI systems and where the fast inspection times of the QX500 are required. Our QX100 and QX100i AOI tabletop systems are part of our tiered product strategy and were designed for lower volume production lines that do not require all of the capabilities of our QX500 AOI system. By targeting this segment of the market, we are able to increase our available served market. Revenue from our new AOI tabletop systems totaled \$492,000 and \$816,000, respectively, in the three and six months ended June 30, 2012. Increased sales of AOI systems in the three and six months ended June 30, 2012 were offset by a reduction in sales of our SPI systems.

Sales of SPI systems declined by \$2.1 million or 46% to \$2.5 million in the three months ended June 30, 2012, from \$4.6 million in the three months ended June 30, 2011, and declined by \$2.9 million or 40% in the six months ended June 30, 2012, from \$7.3 million in the six months ended June 30, 2011. We believe these sales decreases were due to an overall sluggish global electronics market and increased competition.

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We believe that ongoing introduction of new system products addressing different tiers of the market will strengthen our competitive position in the inspection market. Recent examples include our new QX100 and QX100i AOI tabletop systems and a higher-performance SPI system based upon a newly developed dual illumination sensor. We intend to maintain our emphasis on new product development, and to work on next-generation products that we believe will position us to capture additional market share.

Export revenue from OEM alignment sensors and SMT inspection systems totaled \$10.5 million or 92% of electronic assembly revenue in the three months ended June 30, 2012, compared to \$13.9 million or 91% of electronic assembly revenue in the three months ended June 30, 2011. Export revenue from OEM alignment sensors and SMT inspection systems totaled \$19.6 million or 93% of electronic assembly revenue in the six months ended June 30, 2012, compared to \$24.3 million or 91% of electronic assembly revenue in the six months ended June 30, 2011. Sales to international customers continue to be significant, as manufacturing of electronic components has migrated offshore, particularly to China and other areas of Asia.

Semiconductor

Revenues from sales of our semiconductor products decreased by \$35,000 or 2% to \$1.6 million in the three months ended June 30, 2012, when compared to the three months ended June 30, 2011, and decreased by \$363,000 or 10% to \$3.2 million in the six months ended June 30, 2012, when compared to the six months ended June 30, 2011. The decrease in revenue was primarily due to sluggish market conditions in the global semiconductor market and continued weakening of the global economy.

Growth in our semiconductor revenues, exclusive of changes related to capital procurement cycles, has come from sales of our new WaferSense products, a family of wireless, wafer-like precision measurement tools for in-situ setup, calibration and process optimization in semiconductor processing equipment. In the first quarter of 2012 we introduced our new WaferSense particle sensor and anticipate introducing additional WaferSense products in future periods. WaferSense revenue increased \$171,000 or 17% to \$1.2 million in the three months ended June 30, 2012, from \$1.0 million in the three months ended June 30, 2011 and increased \$63,000 or 3% to \$2.3 million in the six months ended June 30, 2012, from \$2.2 million in the six months ended June 30, 2011.

Export revenue from semiconductor products totaled \$815,000 or 50% of revenue in the three months ended June 30, 2012, compared to \$930,000 or 56% of revenue in the three months ended June 30, 2011. Export revenue from semiconductor products totaled \$1.6 million or 50% of revenue in the six months ended June 30, 2012, compared to \$1.8 million or 52% of revenue in the six months ended June 30, 2011. We anticipate that the percentage of export revenue will grow in the future as a higher proportion of our WaferSense sales come from international customers compared to our other semiconductor products.

Cost of Revenue and Gross Margin

Electronic Assembly

Cost of revenue for our electronic assembly segment decreased by \$1.9 million or 21% to \$7.1 million in the three months ended June 30, 2012 from \$8.9 million in the three months ended June 30, 2011 and decreased by \$2.4 million or 16% to \$12.7 million in the six months ended June 30, 2012 from \$15.0 million in the six months ended June 30, 2011, due to lower sales volume in 2012 compared to the same periods of 2011.

Gross margin as a percentage of electronic assembly sales was 38% in the three months ended June 30, 2012, compared to 41% in the three months ended June 30, 2011, and was 40% in the six months ended June 30, 2012, compared to 44% in the six months ended June 30, 2011. The decrease in gross margin percentage in the three and six months ended June 30, 2012 was due largely to sluggish sales of higher margin SMT alignment sensors, including the absence of revenues from solar wafer alignment cameras. In addition, gross margins on SPI systems have been lower in 2012 due to increased competition. Partially offsetting the negative gross margin impacts noted above, is the ongoing shift in our product mix to higher margin QX AOI systems.

The electronic assembly market is highly price competitive, resulting in continual pressure on our gross margins. We compensate for pricing pressure by introducing new products with more features and improved performance and through manufacturing cost reduction programs. For example, our latest stand-alone SMT inspection system products combine a reduction in cost with enhanced performance. Other recently introduced products, including our off-line and integrated in-line QX100 and QX100i AOI tabletop systems, solar wafer alignment camera, embedded process verification (EPV) technology and the 3D SE500 SPI sensors we sell to Viscom AG, have more favorable margins than our existing products.

Semiconductor

Cost of revenue for our semiconductor segment decreased by \$28,000 or 6% to \$420,000 in the three months ended June 30, 2012 and decreased by \$180,000 or 17% to \$868,000 in the six months ended June 30, 2012, due to lower sales volume when compared to the same periods of 2011. Gross margin as a percentage of semiconductor sales increased to 74% in the three months ended June 30, 2012 from 73% in the three months ended June 30, 2011, and increased to 73% in the six months ended June 30, 2012, compared to 70% in the six months ended June 30, 2011. The gross margin percentage increase was due to increased sales of higher margin WaferSense products in both the three and six months ended June 30, 2012 when compared to the same periods of 2011, and lower scrap charges in the first half of 2012 when compared to the first half of 2011.

Operating Expenses

We believe continued investment in research and development of new products, coupled with continued investment in and development of our sales channel is critical to future growth and profitability. Such spending during cyclical downturns has allowed us to generate significant sales during corresponding economic and market recoveries. Accordingly, we historically have maintained research and development and sales and marketing expenses at relatively high levels, even during periods of recession and downturn in our electronic assembly and semiconductor capital equipment markets, as we continue to fund development of important new products, and continue to invest in our sales channels and develop new sales territories.

Electronic Assembly

Research and development expense for our electronic assembly segment was \$1.8 million in the three months ended June 30, 2012, compared to \$1.7 million in the three months ended June 30, 2011. Research and development expense for our electronic assembly segment was \$3.4 million in the six months ended June 30, 2012, compared to \$3.2 million in the six months ended June 30, 2011. The slight increase in research and development expense in the three and six months ended June 30, 2012 resulted from higher costs for additional wages and benefits due to pay increases and headcount additions, offset in part by lower project development costs for proto-types and contractors.

Selling, general and administrative expense for our electronic assembly segment was \$3.0 million in the three months ended June 30, 2012, compared to \$3.3 million in the three months ended June 30, 2011. Selling, general, and administrative expense for our electronic assembly segment was \$5.9 million in the six months ended June 30, 2012, compared to \$6.5 million in the six months ended June 30, 2011. The decrease in selling, general and administrative expense in the three and six months ended June 30, 2012 was due to a reduction in commissions for third party sales representatives due to the overall decline in SMT system sales in 2012 when compared to 2011. Third party sales commissions were also lower in 2012 as more SMT system sales have been transacted through distribution channels. Incentive compensation and internal sales commissions have been lower in 2012 compared to 2011 due to lower levels of revenue and profitability. Selling, general and administrative expense was reduced by \$45,000 in the six months ended June 30, 2012 and \$76,000 in the six months ended June 30, 2011 due to a reduction in our allowance for doubtful accounts, resulting from partial recovery of a receivable we reserved for in 2009.

Semiconductor

There has been virtually no change in the level of semiconductor research and development spending in the three or six months ended June 30, 2012, when compared to the same periods of 2011. Research and development expense for our semiconductor segment was \$284,000 in the three months ended June 30, 2012, compared to \$273,000 in the three months ended June 30, 2011. Research and development expense for our semiconductor segment was \$568,000 in the six months ended June 30, 2012, compared to \$571,000 in the six months ended June 30, 2011. In the third quarter of 2012, we initiated steps to accelerate development of next-generation WaferSense products by fully consolidating our Portland-based semiconductor operations into our Minneapolis headquarters facility. We believe this move will facilitate more efficient access to our sensor engineering talent, while further streamlining our business.

Selling, general and administrative expense for our semiconductor segment was \$387,000 in the three months ended June 30, 2012 compared to \$364,000 in the three months ended June 30, 2011. Selling, general and administrative expense for our semiconductor segment was \$718,000 in the six months ended June 30, 2012, compared to \$825,000 in the six months ended June 30, 2011. The \$107,000 or 13% reduction in selling, general and administrative expenses for the six months ended June 30, 2012 was due to the reduction in semiconductor sales during this period, and a reduction in employee wage costs.

Consolidation of Portland Semiconductor operations into Minneapolis headquarters facility

We have initiated steps in the third quarter of 2012 to fully consolidate our Portland-based semiconductor operations into our Minneapolis headquarters facility. We believe this consolidation will result in a restructuring charge of approximately \$300,000 that will be recorded in the third quarter of 2012. We believe this move will allow us to accelerate development of our WaferSense products through more efficient access to CyberOptics engineering talent while further streamlining our business. We believe the elimination of duplicate expenses and closer coordination with manufacturing should allow us to improve profitability of the WaferSense product line and be more responsive to customers, and we expect to recover the restructuring charge through cost savings in as little as six months. Due to the consolidation initiative, we will no longer manage our semiconductor operations as a separate segment, and we will no longer report semiconductor segment information beginning with the third quarter of 2012.

On a consolidated basis for the third quarter of 2012, we do not anticipate any significant change in our gross margin percentage or the level of operating expenses we incur, when compared to the second quarter of 2012.

Interest Income and Other

Interest income and other includes interest earned on investments and gains and losses associated with foreign currency transactions and foreign exchange forward contracts used to hedge against the effects of exchange rate fluctuations on intercompany financing transactions associated with our subsidiaries in the United Kingdom and Singapore. Interest income and other decreased in the three and six months ended June 30, 2012, compared to the same periods of 2011, due to losses associated with foreign currency transactions and lower interest income resulting from lower rates of interest earned on invested funds.

Losses from foreign currency transactions and foreign exchange forward contracts were \$93,000 in the three months ended June 30, 2012, compared to a loss of \$11,000 in the three months ended June 30, 2011. Losses from foreign currency transactions and foreign exchange forward contracts were \$58,000 in the six months ended June 30, 2012 compared to a gain of \$64,000 in the six months ended June 30, 2011.

Provision for Income Taxes and Effective Income Tax Rate

In the six months ended June 30, 2012, we recorded an income tax benefit of \$86,000, compared to income tax expense of \$766,000 in the same period of last year. We recorded an income tax benefit in the six months ended June 30, 2012, even though we were profitable during this period on a consolidated basis, reflecting a combination of a loss in one tax jurisdiction where tax rates and the resulting tax benefit are high, and the impact of lower overall tax rates in foreign jurisdictions where we are profitable. Fluctuations in the level of income and loss in the United States and foreign jurisdictions will continue to have an impact on the income tax expense or benefit we recognize in any given annual period.

Order Rate and Backlog

Our orders totaled \$11.7 million in the three months ended June 30, 2012, compared to \$12.0 million in the three months ended March 31, 2012 and \$17.9 million in the three months ended June 30, 2011. Backlog totaled \$4.3 million at June 30, 2012, \$5.6 million at March 31, 2012 and \$11.6 million at June 30, 2011. The scheduled shipment (or estimated timing of revenue for systems recognized upon acceptance) for backlog at June 30, 2012 is as follows:

| (In thousands) | Backlog |
|----------------------------|----------|
| 3rd Quarter 2012 | \$ 3,609 |
| 4th Quarter 2012 and after | 671 |
| Total backlog | \$ 4,280 |

LIQUIDITY AND CAPITAL RESOURCES

Our cash and cash equivalents decreased by \$2.9 million in the six months ended June 30, 2012, resulting from \$4.7 million of new marketable security purchases, net of proceeds from maturities and sales of marketable securities and purchases of fixed asset and capitalized patent costs totaling \$687,000, offset in part by \$2.5 million of cash provided by operating activities. Our cash and cash equivalents fluctuate in part because of maturities of marketable securities, and investment of cash balances in marketable securities, or from other sources of cash, in addition to marketable securities. Accordingly, we believe the combined balances of cash and marketable securities provide a more reliable indication of our available liquidity. Combined balances of cash and marketable securities increased by \$1.8 to \$32.3 million as of June 30, 2012 from \$30.5 million as of December 31, 2011.

Operating activities provided \$2.5 million of cash in the six months ended June 30, 2012. Cash provided by operations included net income of \$235,000, which included non-cash expenses totaling \$1.1 million for depreciation and amortization, provision for doubtful accounts, non-cash gains and losses from foreign currency transactions and stock compensation expenses.

Changes in operating assets and liabilities using cash included increases in inventories of \$1.4 million, other assets of \$143,000, income taxes receivable of \$343,000, and decreases in accrued expenses of \$747,000 and advance customer payments of \$221,000. Changes in operating assets and liabilities providing cash included decreases in accounts receivable of \$3.4 million and increases in accounts payable of \$622,000. Inventories have increased as 2012 sales levels have been lower than anticipated. Higher income taxes receivable are due to income tax payments made in 2012 and an increase in estimated refundable income taxes. Accrued expenses and other liabilities decreased due to lower commission and incentive compensation accruals, resulting from lower levels of revenue and profitability in 2012 compared to 2011, and payment of 2011 incentive compensation accruals in the six months ended June 30, 2012. The decrease in accounts receivable was due to lower sales levels in the second quarter of 2012, compared to the fourth quarter of 2011, and an improvement in the timing of cash collections from customers. The increase in accounts payable resulted from increased material purchases and a conscious effort on our part to extend the timing of vendor payments. These materials will be paid for in the third quarter of 2012.

Operating activities provided \$2.1 million of cash in the six months ended June 30, 2011. Cash provided by operations included net income of \$2.2 million, which included non-cash expenses totaling \$1.7 million for depreciation and amortization, deferred taxes, non-cash gains and losses from foreign currency transactions and stock compensation expenses. Changes in operating assets and liabilities using cash included increases in accounts receivable of \$2.3 million and inventories of \$216,000. Changes in operating assets and liabilities providing cash included decreases in other assets of \$213,000, increases in accounts payable of \$152,000 and increases in accrued expenses of \$287,000. The increase in accounts receivable was due to higher sales levels in the second quarter of 2011, compared to the fourth quarter of 2010. Inventories were slightly higher due to lower than planned sales of solar wafer alignment cameras in the second quarter of 2011. The decrease in other assets was due to reductions in recoverable value added tax and accrued interest. The increase in accounts payable resulted from a conscious effort on our part to extend the timing of vendor payments. Accrued expenses and other liabilities increased due to higher warranty, commission and incentive compensation accruals, resulting from higher sales levels and improved operating results.

Investing activities used \$5.4 million of cash in the six months ended June 30, 2012 compared to using \$2.7 million of cash in the same period last year. Changes in the level of investment in marketable securities, resulting from the purchases, sales and maturities of those securities used \$4.7 million of cash in the six months ended June 30, 2012, compared to using \$2.4 million of cash in the same period last year. We used \$687,000 of cash in the six months ended June 30, 2012 for the purchase of fixed asset and capitalized patent costs, compared to using \$270,000 of cash for this purpose in the six months ended June 30, 2011.

There were no significant financing activities in either the six months ended June 30, 2012 or the six months ended June 30, 2011.

At June 30, 2012, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of establishing off-balance sheet arrangements or other contractually narrow or limited purposes.

A table of our contractual obligations was provided in Item 7 in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011. There have been no significant changes to our contractual obligations in the six months ended June 30, 2012. At the present time, we have no material commitments for capital expenditures. Purchase commitments for inventory will vary based on the volume of revenue and resulting inventory requirements.

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Our cash, cash equivalents and marketable securities totaled \$32.3 million at June 30, 2012. We believe that our available balances of cash, cash equivalents and marketable securities will be adequate to fund our cash flow needs for the foreseeable future.

Inflation and Foreign Currency Transactions

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

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

We enter into foreign exchange forward contracts to hedge against the effect of exchange rate fluctuations on cash flows denominated in foreign currencies and certain intercompany financing transactions associated with our subsidiaries in the United Kingdom and Singapore. These transactions are designated as cash flow hedges. The effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income and reclassified into earnings in the same period during which the hedged transaction affects earnings. The maximum length of time over which we hedge our exposure to the variability in future cash flows is 12 months and, accordingly, at June 30, 2012, all of our open foreign exchange forward contracts had maturities of one year or less. The dollar equivalent gross notional amount of our foreign exchange forward contracts designated as cash flow hedges at June 30, 2012 was approximately \$10.7 million.

At June 30, 2012, our open foreign exchange forward contracts were in an unrealized loss position equal to \$70,000 on a pre-tax basis due to a strengthening of the U.S. dollar in relation to the Singapore dollar during the time from when we first entered into these contracts through June 30, 2012. If the exchange rate between the U.S. dollar and the Singapore dollar were to remain unchanged over the next twelve months, we would realize this pre-tax loss through our statement of operations. However, because we do not fully hedge all of our future anticipated cash flows in Singapore dollars, the portion of our costs that we do not hedge would be lower in relation to recent quarters. If the U.S. dollar were to weaken in future periods in relation to the Singapore dollar, the unrealized loss on our open foreign exchange forward contracts would be reduced, but costs that are not hedged would increase. The ultimate impact of any fluctuation in the relationship between the U.S. dollar and Singapore dollar is dependent on the level of Singapore denominated cash flows in future periods.

Recent Accounting Developments

In June 2011, the FASB issued amended disclosure requirements for the presentation of comprehensive income (ASU No. 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*). The amended guidance eliminates the option to present components of other comprehensive income (OCI) as part of the statement of changes in equity. Under the amended guidance, all changes in OCI are to be presented either in a single continuous statement of comprehensive income or in two separate but consecutive financial statements. The FASB subsequently met on October 21, 2011 and decided that the specific requirement to present items that are reclassified from other comprehensive income to net income alongside their respective components of net income and other comprehensive income will be deferred. We adopted the remaining amended disclosure requirement change guidance effective January 1, 2012. Our adoption of the amended disclosure requirements had no impact on our consolidated financial results as the amendments relate only to changes in financial statement presentation.

ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

ITEM 4 CONTROLS AND PROCEDURES

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

b. During the quarter ended June 30, 2012, there has been no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1A RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2011, which could materially affect our business, financial condition or future results.

ITEM 6 EXHIBITS

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

SIGNATURES

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

CYBEROPTICS CORPORATION

/s/ Kathleen P. Iverson

By Kathleen P. Iverson, Chief Executive Officer and Chair
(Principal Executive Officer and Duly Authorized Officer)

/s/ Jeffrey A. Bertelsen

By Jeffrey A. Bertelsen, Chief Financial Officer
(Principal Accounting Officer and Duly Authorized Officer)

Dated: August 10, 2012