

FLIR SYSTEMS INC  
Form 10-Q  
July 27, 2018  
UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended June 30, 2018

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number 0-21918

FLIR Systems, Inc.  
(Exact name of Registrant as specified in its charter)

Oregon 93-0708501  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

27700 SW Parkway Avenue, 97070  
Wilsonville, Oregon  
(Address of principal executive offices) (Zip Code)  
(503) 498-3547  
(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company   
Emerging growth company

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the

Exchange Act. Yes " No "

As of July 20, 2018, there were 138,019,573 shares of the registrant's common stock, \$0.01 par value, outstanding.

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INDEX

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements	
<u>Consolidated Statements of Income - Three and Six Months Ended June 30, 2018 and 2017 (unaudited)</u>	<u>1</u>
<u>Consolidated Statements of Comprehensive Income - Three and Six Months Ended June 30, 2018 and 2017 (unaudited)</u>	<u>2</u>
<u>Consolidated Balance Sheets - June 30, 2018 and December 31, 2017 (unaudited)</u>	<u>3</u>
<u>Consolidated Statements of Cash Flows - Six Months Ended June 30, 2018 and 2017 (unaudited)</u>	<u>4</u>
<u>Notes to the Consolidated Financial Statements (unaudited)</u>	<u>5</u>
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>21</u>
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	<u>27</u>
Item 4. <u>Controls and Procedures</u>	<u>28</u>
PART II. OTHER INFORMATION	
Item 1. <u>Legal Proceedings</u>	<u>29</u>
Item 1A. <u>Risk Factors</u>	<u>29</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>39</u>
Item 3. <u>Defaults Upon Senior Securities</u>	<u>39</u>
Item 4. <u>Mine Safety Disclosures</u>	<u>39</u>
Item 5. <u>Other Information</u>	<u>39</u>
Item 6. <u>Exhibits</u>	<u>40</u>
<u>Signature</u>	<u>41</u>

## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## FLIR SYSTEMS, INC.

## CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share amounts)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Revenue	\$452,707	\$434,124	\$892,325	\$840,938
Cost of goods sold	220,156	227,392	441,860	442,885
Gross profit	232,551	206,732	450,465	398,053
Operating expenses:				
Research and development	46,429	43,046	90,990	85,029
Selling, general and administrative	97,456	97,056	205,139	187,308
Loss on sale of business	—	—	10,178	—
Total operating expenses	143,885	140,102	306,307	272,337
Earnings from operations	88,666	66,630	144,158	125,716
Interest expense	3,992	4,472	8,044	8,925
Interest income	(656 )	(355 )	(1,612 )	(626 )
Other expense (income), net	2,377	(1,027 )	158	(1,687 )
Earnings before income taxes	82,953	63,540	137,568	119,104
Income tax provision	11,390	12,127	26,810	25,120
Net earnings	\$71,563	\$51,413	\$110,758	\$93,984
Net earnings per share:				
Basic	\$0.52	\$0.38	\$0.80	\$0.69
Diluted	\$0.51	\$0.37	\$0.79	\$0.68
Weighted average shares outstanding:				
Basic	137,749	136,865	138,124	136,613
Diluted	140,149	138,449	140,564	138,266

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

1

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FLIR SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net earnings	\$71,563	\$51,413	\$110,758	\$93,984
Other comprehensive income (loss), net of tax:				
Fair value adjustment on interest rate swap contracts	—	—	—	187
Unrealized gain on available-for-sale investments	—	—	—	(1 )
Foreign currency translation adjustments	(45,541 )	22,593	(31,604 )	35,795
Total other comprehensive (loss) income	(45,541 )	22,593	(31,604 )	35,981
Comprehensive income	\$26,022	\$74,006	\$79,154	\$129,965

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

2

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FLIR SYSTEMS, INC.  
CONSOLIDATED BALANCE SHEETS  
(in thousands, except for par value)  
(Unaudited)

	June 30, 2018	December 31, 2017
<b>ASSETS</b>		
Current assets:		
Cash, cash equivalents and restricted cash	\$ 507,942	\$ 519,090
Accounts receivable, net	304,265	346,687
Inventories	384,242	372,183
Assets held for sale, net	—	67,344
Prepaid expenses and other current assets	89,385	81,915
Total current assets	1,285,834	1,387,219
Property and equipment, net	252,478	263,996
Deferred income taxes, net	22,574	21,001
Goodwill	903,849	909,811
Intangible assets, net	154,958	168,130
Other assets	85,382	59,869
Total assets	\$ 2,705,075	\$ 2,810,026
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 106,721	\$ 106,389
Deferred revenue	27,299	25,614
Accrued payroll and related liabilities	66,849	71,310
Accrued product warranties	15,148	15,024
Advance payments from customers	20,913	20,672
Accrued expenses	36,501	37,089
Accrued income taxes	32,066	64,136
Liabilities held for sale	—	39,544
Other current liabilities	10,593	15,155
Total current liabilities	316,090	394,933
Long-term debt	421,316	420,684
Deferred income taxes	15,294	12,496
Accrued income taxes	90,185	87,483
Pension and other long-term liabilities	67,024	59,872
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, \$0.01 par value, 10,000 shares authorized; no shares issued at June 30, 2018, and December 31, 2017	—	—
Common stock, \$0.01 par value, 500,000 shares authorized, 138,017 and 138,869 shares issued at June 30, 2018, and December 31, 2017, respectively, and additional paid-in capital	10,388	91,162
Retained earnings	1,929,742	1,856,756
Accumulated other comprehensive loss	(144,964 )	(113,360 )
Total shareholders' equity	1,795,166	1,834,558
Total liabilities and shareholders' equity	\$ 2,705,075	\$ 2,810,026

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





FLIR SYSTEMS, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(in thousands)  
(Unaudited)

	Six Months Ended June 30,	
	2018	2017
<b>CASH PROVIDED BY OPERATING ACTIVITIES:</b>		
Net earnings	\$ 110,758	\$ 93,984
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	33,055	35,008
Stock-based compensation arrangements	14,400	14,854
Deferred income taxes	3,189	(150 )
Other, net	(6,844 )	(19,211 )
Increase (decrease) in cash, net of acquisitions, resulting from changes in:		
Accounts receivable	49,623	24,525
Inventories	(13,640 )	(26,935 )
Prepaid expenses and other current assets	1,645	(3,108 )
Other assets	(1,717 )	15,322
Accounts payable	(11,093 )	(1,937 )
Deferred revenue	2,731	(3,304 )
Accrued payroll and other liabilities	(11,123 )	2,938
Accrued income taxes	(33,078 )	(18,642 )
Pension and other long-term liabilities	15,438	(8,090 )
Net cash provided by operating activities	153,344	105,254
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Additions to property and equipment, net	(13,435 )	(23,627 )
Proceeds from sale of business	25,920	—
Business acquisitions, net of cash acquired	(14,195 )	—
Other investments	(9,500 )	2,859
Net cash used by investing activities	(11,210 )	(20,768 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Repayment of long-term debt	—	(11,250 )
Repurchase of common stock	(99,957 )	—
Dividends paid	(44,330 )	(41,013 )
Proceeds from shares issued pursuant to stock-based compensation plans	16,890	7,035
Tax paid for net share exercises and issuance of vested restricted stock units	(12,113 )	(9,022 )
Other financing activities	(11 )	(4 )
Net cash used by financing activities	(139,521 )	(54,254 )
Effect of exchange rate changes on cash	(13,761 )	12,010
Net (decrease) increase in cash, cash equivalents and restricted cash	(11,148 )	42,242
Cash, cash equivalents and restricted cash, beginning of year	519,090	361,349
Cash, cash equivalents and restricted cash, end of period	\$ 507,942	\$ 403,591

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



FLIR SYSTEMS, INC.  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

Note 1. Basis of Presentation

The accompanying consolidated financial statements of FLIR Systems, Inc. and its consolidated subsidiaries (the "Company") are unaudited and have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, these statements have been prepared on the same basis as the audited consolidated financial statements and include all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the Company's consolidated financial position and results of operations for the interim periods. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations. These consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2017.

The accompanying consolidated financial statements include the accounts of FLIR Systems, Inc. and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated. The results of operations for the interim periods presented are not necessarily indicative of the operating results to be expected for any subsequent interim period or for the year ending December 31, 2018.

Recently Adopted Accounting Pronouncements

Financial Accounting Standards Board ("FASB") Accounting Standards Update ("ASU") No. 2016-18, "Statement of Cash Flows (Topic 230): Restricted Cash" ("ASU 2016-18"). Effective January 1, 2018, the Company adopted ASU 2016-18 on a retrospective basis. This update clarifies guidance on the classification and presentation of restricted cash in the statement of cash flows. The amendment requires restricted cash be included in an entity's cash and cash-equivalent balances in the statement of cash flows and also requires an entity to disclose information about the nature of the restrictions. Further, a reconciliation between the statement of financial position and the statement of cash flows must be disclosed when the statement of financial position includes more than one line item for cash, cash equivalents, restricted cash, and restricted cash equivalents. The Company's adoption of ASU 2016-18 did not have a material impact on the consolidated financial statements.

FASB ASU No. 2017-01, "Business Combinations (Topic 805): Clarifying the Definition of a Business" ("ASU 2017-01"). Effective January 1, 2018, the Company adopted ASU 2017-01. The amendments in this update clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The Company's adoption of ASU 2017-01 did not have a material impact on the consolidated financial statements.

FASB ASU No. 2014-09, "Revenue - Revenue from Contracts with Customers" ("ASU 2014-09"). Effective January 1, 2018, the Company adopted ASU 2014-09 and all the related amendments ("new revenue standard" or "ASC 606") using the modified retrospective method to those contracts not yet completed as of January 1, 2018. As a result, the Company recognized the cumulative effect of initially applying the new revenue standard as an adjustment to the opening balance of retained earnings in the amount of approximately \$1.0 million as of January 1, 2018. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods. The Company expects the impact of the adoption of the new standard to be immaterial to net income on an ongoing basis.

FASB ASU No. 2016-16, "Intra-Entity Transfers of Assets Other Than Inventory" ("ASU 2016-16"). Effective January 1, 2018, the Company adopted ASU 2016-16, which eliminates the exception of recognizing, at the time of transfer, current and deferred income taxes for intra-entity asset transfers other than inventory. This new standard has been applied on a modified retrospective transition basis with an adjustment to the opening balance of retained earnings in the amount of approximately \$5.6 million as of January 1, 2018.



## FLIR SYSTEMS, INC.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

## Note 1. Basis of Presentation - (Continued)

## Recently Adopted Accounting Pronouncements - (Continued)

The cumulative effect of the changes made to the Company's consolidated January 1, 2018 balance sheet for the adoption of ASU 2014-09, "Revenue - Revenue from Contracts with Customers" and ASU 2016-16, "Intra-Entity Transfers of Assets Other Than Inventory" were as follows (in thousands):

	Balance at December 31, 2017	Adjustments Due to ASU 2014-09	Adjustments Due to ASU 2016-16	Balance at January 1, 2018
<b>Assets</b>				
Accounts receivable, net	\$ 346,687	\$ 981	\$ —	\$ 347,668
Inventories	372,183	(524 )	—	371,659
Other assets	59,869	—	(1,005 )	58,864
<b>Liabilities</b>				
Deferred revenue	25,614	(788 )	—	24,826
Deferred income taxes	12,496	290	1,422	14,208
Pension and other long-term liabilities	59,872	—	(8,030 )	51,842

## Shareholders' Equity

Retained earnings	1,856,756	955	5,603	1,863,314
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In accordance with the new revenue standard requirements, the disclosure of the impact of adoption on our consolidated income statement and balance sheet was as follows (in thousands):

	Three Months Ended June 30, 2018			Six Months Ended June 30, 2018		
	As Reported	Balances Without Adoption of ASC 606	Effect of Change Higher/(Lower)	As Reported	Balances Without Adoption of ASC 606	Effect of Change Higher/(Lower)
<b>Income Statement</b>						
Revenue	\$452,707	\$452,198	\$ 509	\$892,325	\$891,169	\$ 1,156
Cost of goods sold	220,156	220,043	113	441,860	441,653	207
Income tax provision	11,390	11,309	81	26,810	26,610	200
Net earnings	71,563	71,248	315	110,758	110,009	749

## June 30, 2018

	As Reported	Balances Without Adoption of ASC 606	Effect of Change Higher/(Lower)
<b>Balance Sheet</b>			
<b>Assets</b>			
Accounts receivable, net	\$304,265	\$302,128	\$ 2,137
Inventories	384,242	384,449	(207 )
<b>Liabilities</b>			
Deferred revenue	27,299	27,299	—

## Balance Sheet

## Assets

Accounts receivable, net	\$304,265	\$302,128	\$ 2,137
Inventories	384,242	384,449	(207 )

## Liabilities

Deferred revenue	27,299	27,299	—
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Deferred income taxes	15,294	14,804	490
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Equity

Retained earnings	1,929,742	1,928,302	1,440
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For additional disclosures required by the new revenue standard see Note 2, "Revenue."

6

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FLIR SYSTEMS, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

## Note 2. Revenue

### Revenue Recognition

The Company designs, markets and sells products primarily as commercial, off-the-shelf products. Certain customers request different system configurations, based on standard options or accessories that the Company offers. Revenue is recognized upon transfer of control of promised products or services to customers in an amount that reflects the consideration the Company expects to receive in exchange for those products or services. The Company regularly enters into contracts that can include various combinations of products and services, which are generally capable of being distinct and accounted for as separate performance obligations. In such situations, contract values are allocated to each performance obligation based on its relative estimated standalone selling price. The vast majority of the Company's revenues are recognized at a point in time when goods are transferred to a customer. However, for certain contracts that include highly customized components, if performance does not create an asset with an alternative use and termination for convenience clauses provide an enforceable right to payment for performance completed to date, revenue is recognized over time as the performance obligation is satisfied.

See Note 18. "Operating Segments and Related Information - Revenue and Long-Lived Assets by Geographic Area" for information related to the Company's revenues disaggregated by significant geographical region and operating segment.

Revenue includes certain shipping and handling costs and is stated net of third party agency fees. Shipping and handling costs associated with outbound freight after control over a product has transferred to a customer are accounted for as a fulfillment cost and are included in cost of goods sold. Revenue is recognized net of allowances for returns and net of taxes collected from customers which are subsequently remitted to governmental authorities.

### Contract Balances

The timing of revenue recognition, billings and cash collections results in billed accounts receivable, unbilled receivables and deferred revenue and advance payments from customers on the Consolidated Balance Sheets. Contract assets and liabilities are reported on a contract-by-contract basis. The Company had no material deferred contract costs recorded on the Consolidated Balance Sheet as of June 30, 2018.

**Contract assets:** The Company recognizes unbilled receivables as contract assets when the Company has rights to consideration for work completed but has not yet billed at the reporting date. Unbilled receivables are included within accounts receivable, net on the Consolidated Balance Sheets. The balance of unbilled receivables as of June 30, 2018 and at the date of adoption of were \$10.2 million and \$14.5 million, respectively.

**Contract Liabilities:** The Company records contract liabilities when cash payments are received or due in advance of the Company's performance. Contract liabilities include deferred revenue and advance payments from customers. Contract liabilities are classified as either current or long-term in the Consolidated Balance Sheets based on the timing of when the Company expects to recognize revenue. As of June 30, 2018 and at the date of the adoption of ASC 606, contract liability balances classified as long-term totaled \$13.8 million and \$13.8 million, respectively, and are included within pension and other long-term liabilities in the accompanying Consolidated Balance Sheets. Approximately \$29.8 million of revenue recognized during the six month period ended June 30, 2018 was included in the combined opening contract liability balances adjusted for the ASC 606 adoption impacts.

### Remaining Performance Obligations



Remaining performance obligations related to ASC 606 represent the aggregate transaction price allocated to performance obligations with an original contract term greater than one year which are fully or partially unsatisfied at the end of the period. While the remaining performance obligation disclosure is similar in concept to backlog, the definition of remaining performance obligations excludes contracts that provide the customer with the right to cancel or terminate for convenience with no substantial penalty, even if historical experience indicates the likelihood of cancellation or termination is remote. The Company has elected to exclude contracts with customers with an original term of one year or less from remaining performance obligations while these contracts are included within backlog.

FLIR SYSTEMS, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

Note 2. Revenue - (Continued)

Remaining Performance Obligations - (Continued)

As of June 30, 2018, the aggregate amount of the transaction price allocated to remaining performance obligations was approximately \$68.2 million. The Company expects to recognize revenue on approximately 86 percent of the remaining performance obligations over the next twelve months, and the remainder recognized thereafter.

Note 3. Stock-based Compensation

Stock Incentive Plans

The Company has a stock-based compensation program that provides equity incentives for employees, consultants and directors. This program includes incentive and non-statutory stock options and non-vested stock awards (referred to as restricted stock unit awards) granted under two plans: the FLIR Systems, Inc. 2002 Stock Incentive Plan (the “2002 Plan”) and the FLIR Systems, Inc. 2011 Stock Incentive Plan (the “2011 Plan”). The Company has discontinued issuing awards out of the 2002 Plan but previously-granted awards under the 2002 Plan remain outstanding.

The Company has granted time-based options, time-based restricted stock unit awards, market-based restricted stock unit awards and performance-based restricted stock unit awards. Options generally expire ten years from the grant date. Time-based options and restricted stock unit awards generally vest over a three year period. Market-based restricted stock unit awards may be earned based upon the Company's total shareholder return compared to the total shareholder return of the component company at the 60th percentile level in the S&P 500 Index over a three year period. Performance-based restricted stock unit awards granted during the year ended December 31, 2016 may be earned based upon the Company's return on invested capital over a three year period. Performance-based restricted stock unit awards granted during the year ended December 31, 2017 may be earned based upon the Company's operating margin performance over a three year period. Performance-based restricted stock unit awards granted during the quarter ended June 30, 2018 may be earned based upon a combination of the Company's revenue and operating performance over a three year period. Certain shares vested under the performance-based restricted stock unit awards and the market-based restricted stock unit awards must be held by the participant for a period of one year from the vest date.

Employee Stock Purchase Plan

The Company has an Employee Stock Purchase Plan (the “ESPP”) which allows employees to purchase shares of the Company's common stock at 85 percent of the fair market value at the lower of either the date of enrollment or the purchase date. The ESPP provides for six-month offerings commencing on May 1 and November 1 of each year with purchases on April 30 and October 31 of each year. Shares purchased under the ESPP must be held by employees for a period of at least 18 months after the date of purchase.

The following table sets forth the stock-based compensation expense recognized in the Consolidated Statements of Income (in thousands):

	Three Months		Six Months	
	Ended June 30,		Ended June 30,	
	2018	2017	2018	2017
Cost of goods sold	\$775	\$631	\$1,470	\$1,032
Research and development	1,638	1,299	3,047	2,476
Selling, general and administrative	6,056	6,678	9,883	11,346
Stock-based compensation expense before income taxes	\$8,469	\$8,608	\$14,400	\$14,854

Stock-based compensation expense capitalized in the Consolidated Balance Sheets is as follows (in thousands):

	June 30,	
	2018	2017

Capitalized in inventory \$ 1,068 \$ 1,053

8

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## FLIR SYSTEMS, INC.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

## Note 3. Stock-based Compensation - (Continued)

As of June 30, 2018, the Company had approximately \$63.4 million of total unrecognized stock-based compensation costs, net of estimated forfeitures, to be recognized over a weighted average period of 2.4 years.

## Note 4. Net Earnings Per Share

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Numerator for earnings per share:				
Net earnings for basic and diluted earnings per share	\$71,563	\$51,413	\$110,758	\$93,984
Denominator for earnings per share:				
Weighted average number of common shares outstanding	137,749	136,865	138,124	136,613
Assumed exercise of stock options and vesting of restricted stock awards, net of shares assumed reacquired under the treasury stock method	2,400	1,584	2,440	1,653
Diluted shares outstanding	140,149	138,449	140,564	138,266

The effect of stock-based compensation awards for the six months ended June 30, 2018 that aggregated 89,000 shares; three and six months ended June 30, 2017, which in the aggregate consisted of 162,000 and 265,000 shares, respectively, have been excluded for purposes of diluted earnings per share since the effect of their inclusion would have been anti-dilutive. There were no shares excluded for the three months ended June 30, 2018.

## Note 5. Fair Value of Financial Instruments

Factors used in determining the fair value of financial assets and liabilities are summarized into three broad categories in accordance with FASB ASC Topic 820, "Fair Value Measurements":

Level 1 – quoted prices in active markets for identical securities as of the reporting date;

Level 2 – other significant directly or indirectly observable inputs, including quoted prices for similar securities, interest rates, prepayment speeds, credit risk, and observable market prices for identical instruments that are traded in less active markets; and

Level 3 – significant inputs that are generally less observable than objective sources, including our own assumptions in determining fair value.

The factors or methodology used for valuing securities are not necessarily an indication of the risk associated with investing in those securities.

The Company had \$97.3 million and \$140.7 million of cash equivalents at June 30, 2018 and December 31, 2017, respectively, which were primarily investments in money market funds and overnight deposits. The Company has categorized its cash equivalents as a Level 1 financial asset, measured at fair value based on quoted prices in active markets of identical assets. All cash equivalents are in instruments that are convertible to cash daily. The fair value of the Company's foreign currency contracts as of June 30, 2018 and December 31, 2017, are disclosed in Note 6, "Derivative Financial Instruments," and are based on Level 2 inputs. The fair value of the Company's senior unsecured notes as described in Note 14, "Long-Term Debt," is approximately \$421.4 million and \$427.5 million based upon Level 2 inputs at June 30, 2018 and December 31, 2017, respectively. The Company does not have any other significant financial assets or liabilities that are measured at fair value.

## FLIR SYSTEMS, INC.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

Note 6. Derivative Financial Instruments  
Foreign Currency Exchange Rate Risk

The Company enters into foreign currency forward contracts not formally designated as hedges to manage the consolidated exchange rate risk associated with the remeasurement of non-functional currency denominated monetary assets and liabilities. Changes in fair value of foreign currency forward contracts are recognized in income at the end of each reporting period based on the difference between the contract rate and the spot rate. In general, these gains and losses are offset in the Consolidated Statements of Income by the reciprocal gains and losses from the underlying assets or liabilities which originally gave rise to the exposure. The net amount of the gains and losses related to derivative instruments recorded in other income, net for the three and six months ended June 30, 2018 were net losses of \$4.0 million and \$8.6 million, respectively. The net losses for the three and six months ended June 30, 2017 were \$6.5 million and \$7.5 million, respectively.

The table below presents the net notional amounts of the Company's outstanding foreign currency forward contracts by currency (in thousands):

	June 30, 2018	December 31, 2017
European euro	\$ 107,746	\$ 34,800
Swedish kroner	15,247	59,373
Canadian dollar	10,829	7,426
Brazilian real	7,800	7,794
Norwegian kroner	7,591	3,095
British pound sterling	4,542	34,317
Japanese yen	1,708	3,362
Australian dollar	1,395	2,817
	\$ 156,858	\$ 152,984

At June 30, 2018, the Company's foreign currency forward contracts, in general, had maturities of three months or less. The carrying amounts of the foreign exchange contracts included in the Consolidated Balance Sheets are as follows (in thousands):

	June 30, 2018	December 31, 2017
	Prepaid Expenses and Other Current Assets	Prepaid Expenses and Other Current Assets
	Other Current Liabilities	Other Current Liabilities
Foreign exchange contracts	\$ 517 \$ 2,703	\$ 1,760 \$ 579

## Note 7. Accounts Receivable

Accounts receivable are net of an allowance for doubtful accounts of \$5.1 million and \$7.6 million at June 30, 2018 and December 31, 2017, respectively.

## Note 8. Inventories

Inventories consist of the following (in thousands):

	June 30, 2018	December 31, 2017
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Raw material and subassemblies	\$213,149	\$ 210,615
Work-in-progress	50,698	47,400
Finished goods	120,395	114,168
	\$384,242	\$ 372,183

10

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FLIR SYSTEMS, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

## Note 9. Property and Equipment

Property and equipment are net of accumulated depreciation of \$319.2 million and \$306.2 million at June 30, 2018 and December 31, 2017, respectively.

## Note 10. Goodwill

In August 2017, the Company announced a realignment of its business operations into three reportable operating segments effective as of January 1, 2018. Because of this realignment, the Company reassigned its reported goodwill as of January 1, 2018 to its new reportable segments based on the relative fair value of the respective operating segments at that time. Goodwill was reallocated as follows (in thousands):

	January 1, 2018
Industrial	\$389,575
Government and Defense	291,229
Commercial	229,007
	\$909,811

After the reassignment of goodwill, the Company performed an impairment test of the new reporting units as of January 1, 2018. As a result of this analysis, no impairment was identified. The reassignment and impairment test were completed during the three months ended June 30, 2018. See Note 18, "Operating Segments and Related Information" of the Notes to the Consolidated Financial Statements for additional information on the three new reportable operating segments.

The carrying value of goodwill and the activity for the six months ended June 30, 2018 are as follows (in thousands):

Balance, December 31, 2017	\$909,811
Currency (translation ) adjustments	(5,962)
Balance, June 30, 2018	\$903,849

## Note 11. Intangible Assets

Intangible assets are net of accumulated amortization of \$95.6 million and \$84.5 million at June 30, 2018 and December 31, 2017, respectively.

## Note 12. Credit Agreement

On February 8, 2011, the Company entered into a credit agreement with Bank of America, N.A., U.S. Bank National Association, JPMorgan Chase Bank N.A. and other lenders, as amended on April 5, 2013, October 27, 2015 and May 31, 2016 (the "Credit Agreement") which provides for a \$500.0 million revolving line of credit. At June 30, 2018, the Company had no amounts outstanding under its revolving credit facility and had \$15.5 million of letters of credit outstanding governed by the facility, which reduces the total available revolving credit under the Credit Agreement to \$484.5 million.





## FLIR SYSTEMS, INC.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

## Note 13. Accrued Product Warranties

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

	Three Months		Six Months Ended	
	Ended June 30,		June 30,	
	2018	2017	2018	2017
Accrued product warranties, beginning of period	\$18,513	\$19,971	\$18,051	\$20,845
Amounts paid for warranty services	(5,198 )	(4,362 )	(8,477 )	(8,991 )
Warranty provisions for products sold	5,366	3,782	8,902	7,491
Currency translation adjustments and other	(182 )	139	23	185
Accrued product warranties, end of period	\$18,499	\$19,530	\$18,499	\$19,530
Current accrued product warranties, end of period			\$15,148	\$16,262
Long-term accrued product warranties, end of period			\$3,351	\$3,268

## Note 14. Long-Term Debt

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

	June 30,	December 31,
	2018	2017
Unsecured notes	\$425,000	\$ 425,000
Unamortized discounts and issuance costs of unsecured notes	(3,684 )	(4,316 )
Long-term debt	\$421,316	\$ 420,684

In June 2016, the Company issued \$425 million aggregate principal amount of its 3.125 percent senior unsecured notes due June 15, 2021 (the "2016 Notes"). The net proceeds from the issuance of the 2016 Notes were approximately \$421.0 million, after deducting underwriting discounts and offering expenses, which are being amortized over a period of five years. Interest on the 2016 Notes is payable semiannually in arrears on December 15 and June 15. The proceeds from the 2016 Notes were used to repay the principal amount of the notes issued in August 2011 and outstanding in July 2016 and are being used for general corporate purposes, including working capital and capital expenditure needs, business acquisitions and repurchases of the Company's common stock.

## Note 15. Shareholders' Equity

The following table summarizes the common stock and additional paid-in capital activity during the six months ended June 30, 2018 (in thousands):

Common stock and additional paid-in capital, December 31, 2017	\$91,162
Common stock issued pursuant to stock-based compensation plans, net	4,777
Stock-based compensation	14,406
Repurchase of common stock	(99,957 )
Common stock and additional paid-in capital, June 30, 2018	\$10,388

During the three months ended June 30, 2018, the Company repurchased 0.3 million shares of the Company's common stock through open market transactions, including 0.2 million shares received upon the settlement of the accelerated share repurchase program, entered in March 2018 at a notional amount of \$50.0 million. The Company received a total of 1.0 million shares under the accelerated share repurchase program. The repurchases were under the February 2017 authorization by the Company's Board of Directors which authorized the repurchase of up to 15.0 million shares of the Company's outstanding common stock. This authorization expires in February 2019.



FLIR SYSTEMS, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

Note 15. Shareholders' Equity - (Continued)

On June 8, 2018, the Company paid a dividend of \$0.16 per share on its outstanding common stock to the shareholders of record as of the close of business on May 25, 2018. The total cash payments for dividends during the six months ended June 30, 2018 were \$44.3 million.

Note 16. Contingencies

Raytheon Litigation

FLIR Systems, Inc. and its subsidiary, FLIR Commercial Systems, Inc. (formerly known as Indigo Systems Corporation) (together, the "FLIR Parties"), were named in a lawsuit filed by Raytheon Company ("Raytheon") on March 2, 2007, in the United States District Court for the Eastern District of Texas (the "District Court"). Raytheon's complaint, as amended, asserted claims for tortious interference, patent infringement, trade secret misappropriation, unfair competition, breach of contract, and fraudulent concealment. The FLIR Parties filed an answer to the complaint on September 2, 2008, in which they denied all material allegations. On October 27, 2010, the FLIR Parties and Raytheon entered into a settlement agreement that resolved the patent infringement claims (the "Patent Claims") pursuant to which the FLIR Parties paid \$3 million to Raytheon and entitles the FLIR Parties to certain license rights in the patents that were the subject of the Patent Claims. On October 28, 2014, a four-week trial began with respect to Raytheon's remaining claims of misappropriation of trade secrets and claims related to 31 alleged trade secrets. On November 24, 2014, a jury in the District Court rejected Raytheon's claims and determined that 27 of the alleged trade secrets were not in fact trade secrets and that neither of the FLIR Parties infringed any of the trade secrets claimed and awarded Raytheon no damages. On March 31, 2016, the District Court issued a Final Judgment denying Raytheon's claims and awarding FLIR court costs and denying each of Raytheon's and FLIR's Renewed Motions for Judgment as a Matter of Law and denying FLIR's Amended Rule 54(d) Motion for Attorneys' Fees and Costs Under the Texas Theft Liability Act.

On April 29, 2016, Raytheon filed a Notice of Appeal to the United States Court of Appeals for the Federal Circuit (the "Court of Appeals") of the denial by the District Court of Raytheon's Renewed Motion for Judgment as a Matter of Law, or in the Alternative, Motion for New Trial. On May 11, 2016, the FLIR Parties filed a Notice of Appeal to the Court of Appeals of the Order of the District Court Denying the FLIR Parties' Amended Rule 54(d) Motion for Attorneys' Fees and Costs under the Texas Theft Liability Act, the Order Denying the FLIR Parties' Renewed Motion for Judgment as a Matter of Law, and the Final Judgment to the extent it denied the FLIR Parties Attorneys' Fees and Costs under the Texas Theft Liability Act. The Court of Appeals heard the matter on January 12, 2018, and on July 12, 2018 the Court of Appeals affirmed the rulings of the District Court and its finding of no liability on the part of the FLIR parties. The matter remains subject to appeal but as a result of the decision of the Court of Appeals, the Company believes that ultimate resolution of the matter will not result in material loss or gain to FLIR.

Matters Involving the United States Department of State and Department of Commerce

On October 22, 2014, the Company initially contacted the United States Department of State Office of Defense Trade Controls Compliance ("DDTC"), pursuant to International Traffic in Arms Regulation ("ITAR") § 127.12(c), regarding the unauthorized export of technical data and defense services to dual and third country nationals in at least four facilities of the Company. On April 27, 2015, the Company submitted its initial report to DDTC regarding the details of the issues raised in the October 22, 2014, submission. DDTC subsequently notified the Company that it was considering administrative proceedings under Part 128 of ITAR and requested a tolling agreement, which the Company executed on June 16, 2015 and referenced certain Company disclosures in addition to the submissions made in conjunction with the October 24, 2014 initial notification. On June 6, 2016, the Company executed a subsequent tolling agreement extending the tolling period for matters to be potentially included in an administrative proceeding for an additional 18 months and at the request of DDTC on December 1, 2017, further extended the tolling agreement

for an additional six months through May 9, 2018. On April 24, 2018, the Company entered into a Consent Agreement with the DDTC to resolve these issues. The Consent Agreement has a four-year term and provides for: (i) a civil penalty of \$30 million with \$15 million of this amount suspended on the condition that the funds have or will be used for Department-approved Consent Agreement remedial compliance measures, (ii) the appointment of an external Special Compliance Official to oversee compliance with the Consent Agreement and the ITAR; (iii) two external audits of the Company's ITAR compliance program; and (iv) continued implementation of ongoing remedial compliance measures and additional remedial compliance measures related to automated systems and ITAR compliance policies, procedures, and training. During the three month period ended March 31, 2018, the Company recorded a \$15 million charge for the portion of the penalty that is not subject to suspension. As of June 30, 2018, the remaining amount payable of \$14 million has been recorded in pension and other long-term liabilities. The Company expects recent and future investments in remedial compliance measures will be sufficient to cover the \$15 million suspension amount.

FLIR SYSTEMS, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

Note 16. Contingencies - (Continued)

As part of the Consent Agreement DDTC acknowledged that the Company voluntarily disclosed certain alleged Arms Export Control Act and ITAR violations, which are resolved pursuant to the Consent Agreement, cooperated in, and instituted a number of compliance program improvements during the course of DDTC's review.

In May 2017, the Company submitted an initial notification to DDTC regarding potential violations related to certain export classifications obtained through the commodity jurisdiction process and a final voluntary disclosure in August 2017. DDTC acknowledged the notification and at the request of DDTC, the Company executed a tolling agreements for this matter, suspending the statute of limitations through January 13, 2019. This matter was not resolved pursuant to the Consent Agreement identified above and remains under review.

In June 2017, the United States Department of Commerce Bureau of Industry and Security informed the Company of additional export licensing requirements that restrict the Company's ability to sell certain thermal products without a license to customers in China not identified on a list maintained by the United States Department of Commerce. This action was precipitated by concerns of sale without a license or potential diversion of some of the Company's products to prohibited end users and to countries subject to economic and other sanctions implemented by the United States. The United States Department of Commerce Bureau of Industry and Security subsequently favorably modified these restrictions to reduce the applicability of the restrictions to sales of FLIR's Tau camera cores (as opposed to finished products containing Tau camera cores) to customers in China not identified on a list maintained by the United States Department of Commerce and persons in a country other than those in EAR Country Group A:5 (Supplement No. 1 to Part 740 of the EAR). If the Company is found to have violated applicable rules and regulations with respect to customers and limitations on the end use of the Company's products, the Company could be subject to substantial fines and penalties, suspension of existing licenses or other authorizations and/or loss or suspension of export privileges.

The Company is unable to reasonably estimate the time it may take to resolve these matters or the amount or range of potential loss, penalty or other government action, if any, that may be incurred in connection with these matters. However, an unfavorable outcome could result in substantial fines and penalties or loss or suspension of export privileges or of particular authorizations that could be material to the Company's financial position, results of operations or cash flows in and following the period in which such an outcome becomes estimable or known.

SkyWatch Product Quality Matters

In March 2016, the Company learned of potential quality concerns with respect to as many as 315 Level III and Level IV SkyWatch Surveillance Towers sold by FLIR and companies acquired by FLIR from 2002 through 2014. The Company notified customers who purchased the affected SkyWatch Towers of the potential concerns and, as a precautionary measure, also temporarily suspended production of all Level III and Level IV SkyWatch Towers pending the completion of its review and the implementation of any necessary remedial measures. The Company identified the cause of these quality issues, notified customers of their option to request repair and modification of their in-field units, and has begun in-field repairs of identified affected units. While there still remains uncertainty related to estimating the costs associated with a potential remedy and number of units which may require such remedy, the Company currently estimates the range of potential loss on remaining units to be between \$5.8 million and \$13.1 million. As no single amount within the range is a better estimate than any other amount within the range, the Company has recorded a liability of \$5.8 million as of June 30, 2018. Factors underlying this estimated range of loss may change from time to time, and actual results may vary significantly from this estimate.

Other Matters

The Company is also subject to other legal and administrative proceedings, investigations, claims and litigation arising in the ordinary course of business not specifically identified above. In these identified matters and others not specifically identified, the Company records a liability with respect to a matter when management believes it is both probable that a liability has been incurred and the Company can reasonably estimate the amount of the loss. The Company believes it has recorded adequate provisions for any probable and estimable losses for matters in existence on the date hereof. The Company reviews these provisions to reflect the impact of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular matter. While the outcome of each of these matters is currently not determinable, the Company does not expect that the ultimate resolution of any such matter will individually have a material adverse effect on the Company's financial position, results of operations or cash flows. The costs to resolve all such matters may in the aggregate have a material adverse effect on the Company's financial position, results of operations or cash flows.

## FLIR SYSTEMS, INC.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

## Note 17. Income Taxes

The provision for income taxes was as follows:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Income tax provision	\$11,390	\$12,127	\$26,810	\$25,120
Effective tax rate	13.7	% 19.1	% 19.5	% 21.1

The effective tax rate for the three and six months ended June 30, 2018, is lower than the United States Federal tax rate of 21.0 percent mainly due to excess tax benefits from stock compensation, offset partially by state taxes, higher tax rates applied to income earned in certain foreign jurisdictions, and other discrete items.

New tax legislation, commonly referred to as the Tax Cuts and Jobs Act (the “Tax Act”), was enacted on December 22, 2017. In connection with the Company's initial analysis of the impact of the Tax Act, the Company recorded provisional net tax expense of \$94.4 million for the period ended December 31, 2017. This amount consists of net expense of \$66.5 million for the transition tax and net expense of \$12.8 million for the remeasurement of the Company's net deferred tax assets using the reduced United States tax rate. In addition, the Company also recorded net tax expense of \$15.1 million for state income and foreign taxes estimated to be due upon distribution of approximately \$1.0 billion of previously undistributed foreign earnings no longer permanently reinvested as of December 31, 2017. These provisional amounts may be impacted by the need for further analysis and future clarification and guidance regarding available tax accounting methods and elections, earnings and profits computations, foreign tax credit calculations, and state tax conformity to federal tax changes. As of June 30, 2018, the Company has not completed the accounting for the tax effects of the Tax Act described above and there have been no material changes to estimated amounts.

As of June 30, 2018, the Company had approximately \$63.3 million of unrecognized tax benefits, all of which would affect the Company's effective tax rate if recognized. The Company anticipates approximately \$44.7 million of its net unrecognized tax benefits will be recognized within 12 months as the result of settlements or effective settlements with various tax authorities, the closure of certain audits and the lapse of the applicable statute of limitations.

The Company classifies interest and penalties related to unrecognized tax benefits in the income tax provision. As of June 30, 2018, the Company had \$6.7 million of accrued interest and penalties related to unrecognized tax benefits that are recorded as current and non-current accrued income taxes on the Consolidated Balance Sheet.

In 2016, the Company recorded discrete tax charges totaling \$39.6 million related to the January 11, 2016 announcement from the European Commission of a decision concluding that certain rules under Belgian tax legislation were deemed to be incompatible with European Union regulations on state aid. As a result of this decision, the European Commission directed the Belgian Government to recover past taxes from certain entities, reflective of disallowed state aid, which impacts one of the Company's international subsidiaries. The Belgian Government announced they have appealed this decision and filed action for an annulment in the General Court of the European Union, and in July 2016 the Company filed a separate appeal with the General Court of the European Union. In accordance with FASB ASC Topic 740, “Income Taxes,” the Company recorded discrete tax expense of \$39.6 million during 2016, related to this matter and on January 10, 2017, received tax assessments from the Belgium government for a similar amount, which the Company has classified as current taxes payable on the Consolidated Balance Sheet as of June 30, 2018. The Company has filed a complaint against the Belgian tax assessments, and the result of this complaint, the appeal with the General Court of the European Union, new information received from the Belgian Government, or other future events may cause the income tax provision associated with the decision to be entirely or partially reversed. At June 30, 2018, the Company held the euro equivalent of \$35.3 million in a restricted cash account. Those amounts, or portions thereof, could become unrestricted depending on the outcome of this matter.

FLIR SYSTEMS, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

Note 17. Income Taxes - (Continued)

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

	Tax Years:
United States Federal	2014 - 2016
State of California	2013 - 2016
State of Massachusetts	2013 - 2016
State of Oregon	2014 - 2016
Sweden	2013 - 2016
United Kingdom	2013 - 2016
Belgium	2011 - 2016

Note 18. Operating Segments and Related Information

Operating Segments

The Company has three reportable operating segments as follows:

Industrial Business Unit

The Industrial business unit develops and manufactures thermal and visible-spectrum imaging camera cores and components that are utilized by third parties to create thermal, industrial, and other types of imaging systems. The segment also develops and manufactures devices that image, measure, and assess thermal energy, gases, and other environmental elements for industrial, commercial, and scientific applications, imaging payloads for Unmanned Aerial Systems ("UAS"), machine vision cameras, people counting and tracking, and thermal imaging solutions for use by consumers in the smartphone and mobile devices markets. Products include thermal imaging cameras, gas detection cameras, firefighting cameras, process automation cameras, and environmental test and measurement devices.

Government and Defense Business Unit

The Government & Defense business unit develops and manufactures enhanced imaging and recognition solutions for a wide variety of military, law enforcement, public safety, and other government customers around the world for the protection of borders, troops, and public welfare. The segment also develops and manufactures sensor instruments and integrated platform solutions for the detection, identification, and suppression of chemical, biological, radiological, nuclear, and explosives ("CBRNE") threats for military force protection, homeland security, and commercial applications. Offerings include airborne, land, maritime, and man-portable multi-spectrum imaging systems, radars, lasers, imaging components, integrated multi-sensor system platforms, CBRNE detectors, nano-class UAS solutions, and services related to these systems.

Commercial Business Unit

The Commercial business unit develops and manufactures cameras, video recording systems, and video management systems for use in commercial and critical infrastructure, electronics and imaging instruments for the recreational and commercial maritime market, intelligent traffic monitoring and signal control systems, and hand-held and weapon-mounted thermal imaging systems for use in a variety of applications. Products include thermal and visible-spectrum security cameras, digital and networked video recorders, and related software and accessories, a full suite of networked marine electronic systems including multi-function helm displays, navigational instruments, autopilots, radars, sonar systems, thermal and visible imaging systems, and communications equipment for boats of all sizes, traffic cameras, sensors and associated traffic management software, and thermal scopes and handheld thermal cameras.

The Company's chief operating decision maker ("CODM"), its Chief Executive Officer, evaluates each of its segments' performance and allocates resources based on revenue and segment operating income. Intersegment revenues are recorded at cost and are eliminated in consolidation. The Company and each of its segments employ consistent accounting policies.





## FLIR SYSTEMS, INC.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

## Note 18. Operating Segments and Related Information - (Continued)

## Operating Segments - (Continued)

The following tables present revenue, operating income, and assets for the three segments. Operating income as reviewed by the CODM is revenue less cost of goods sold and operating expenses, excluding general corporate expenses, amortization of purchased intangible assets, amortization of acquisition-related inventory step-up, loss on sale of a business and restructuring and other charges. Net accounts receivable, inventories and demonstration assets for the operating segments are regularly reviewed by management and are reported below as segment assets. All remaining assets, liabilities, capital expenditures, and depreciation are managed on a Company-wide basis.

Operating segment information is as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 30, 2018	2017	June 30, 2018	2017
Revenue—External Customers:				
Industrial	\$188,421	\$164,736	\$359,079	\$319,521
Government and Defense	161,027	145,715	320,358	283,896
Commercial	103,259	123,673	212,888	237,521
	\$452,707	\$434,124	\$892,325	\$840,938
Revenue—Intersegments:				
Industrial	\$6,164	\$4,786	\$12,496	\$9,728
Government and Defense	4,573	3,896	6,101	7,163
Commercial	3,601	4,265	8,081	8,065
Eliminations	\$(14,338)	\$(12,947)	\$(26,678)	\$(24,956)
	\$—	\$—	\$—	\$—
Segment operating income:				
Industrial	\$58,096	\$47,047	\$103,550	\$89,865
Government and Defense	45,548	38,153	91,730	71,473
Commercial	17,367	15,475	31,839	25,463
	\$121,011	\$100,675	\$227,119	\$186,801

A reconciliation of the Company's consolidated segment operating income to consolidated earnings before income taxes is as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 30, 2018	2017	June 30, 2018	2017
Consolidated segment operating income	\$121,011	\$100,675	\$227,119	\$186,801
Unallocated corporate expenses	(22,488)	(25,016)	(57,435)	(43,241)
Amortization of purchased intangible assets	(6,099)	(7,016)	(12,086)	(13,751)
Amortization of acquisition-related inventory step-up	—	—	—	(1,992)
Loss on sale of business	—	—	(10,178)	—
Restructuring and other charges	(3,758)	(2,013)	(3,262)	(2,101)
Consolidated earnings from operations	88,666	66,630	144,158	125,716
Interest and non-operating expenses, net	(5,713)	(3,090)	(6,590)	(6,612)
Consolidated earnings before income taxes	\$82,953	\$63,540	\$137,568	\$119,104

Unallocated corporate expenses include general corporate expenses, acquisition related costs and executive transition costs.

## FLIR SYSTEMS, INC.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

## Note 18. Operating Segments and Related Information - (Continued)

## Operating Segments - (Continued)

	June 30, 2018	December 31, 2017
Operating segment assets:		
Net accounts receivable, inventories and demonstration assets:		
Industrial	\$279,060	\$287,439
Government and Defense	303,170	332,044
Commercial	143,355	136,942
	\$725,585	\$756,425
Goodwill <sup>(1)</sup> :		
Industrial	386,753	—
Government and Defense	290,908	—
Commercial	226,188	—
	\$903,849	—
Total operating segment assets	\$1,629,434	\$756,425
Assets not allocated:		
Cash, cash equivalents and restricted cash	\$507,942	\$519,090
Assets held for sale, net	—	67,344
Prepaid expenses and other current assets	52,307	44,360
Property and equipment, net	252,478	263,996
Deferred income taxes	22,574	21,001
Goodwill <sup>(1)</sup>	—	909,811
Intangible assets, net	154,958	168,130
Other assets	\$85,382	\$59,869
Total assets	\$2,705,075	\$2,810,026

(1) Due to the realignment of the Company's business operations effective as of January 1, 2018, goodwill as of December 31, 2017 is presented as an asset not allocated to the operating segments in this table. See Note 10. "Goodwill" for additional information and goodwill by operating segments as of January 1, 2018.

## Revenue and Long-Lived Assets by Geographic Area

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

	Three Months Ended June 30, 2018				Six Months Ended June 30, 2018			
	Industrial	Government and Defense	Commercial	Total	Industrial	Government and Defense	Commercial	Total
United States	\$89,259	\$102,798	\$41,478	\$233,535	\$175,555	\$197,931	\$85,493	\$458,979
Europe	32,610	18,701	41,678	92,989	68,153	35,903	86,455	190,511
Asia	49,655	13,696	9,339	72,690	83,711	32,049	18,303	134,063
Middle East/Africa	4,873	24,088	6,448	35,409	8,538	51,270	12,008	71,816
Canada/Latin America	12,024	1,744	4,316	18,084	23,122	3,205	10,629	36,956
	\$188,421	\$161,027	\$103,259	\$452,707	\$359,079	\$320,358	\$212,888	\$892,325



## FLIR SYSTEMS, INC.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

## Note 18. Operating Segments and Related Information - (Continued)

## Revenue and Long-Lived Assets by Geographic Area - (Continued)

	Three Months Ended June 30, 2017				Six Months Ended June 30, 2017			
	Industrial	Government and Defense	Commercial	Total	Industrial	Government and Defense	Commercial	Total
United States	\$77,212	\$ 87,806	\$ 59,007	\$224,025	\$154,187	\$ 179,039	\$ 112,630	\$445,856
Europe	31,086	20,495	39,460	91,041	64,344	32,578	77,391	174,313
Asia	39,170	11,968	8,583	59,721	72,395	23,989	17,261	113,645
Middle East/Africa	7,423	19,613	8,212	35,248	9,754	37,838	12,798	60,390
Canada/Latin America	9,845	5,833	8,411	24,089	18,841	10,452	17,441	46,734
	\$164,736	\$ 145,715	\$ 123,673	\$434,124	\$319,521	\$ 283,896	\$ 237,521	\$840,938

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

	June 30, 2018	December 31, 2017
United States	\$711,292	\$797,816
Europe	461,800	343,208
Other foreign	223,575	260,782
	\$1,396,667	\$1,401,806

## Major Customers

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
United States government	\$120,244	\$111,824	\$239,199	\$228,059

## Note 19. Business Acquisitions and Divestitures

## Business Acquisition

On March 26, 2018, the Company completed a transaction to acquire 100% of the outstanding stock of a privately held technology company for approximately \$7.1 million in cash. The allocation of the purchase price to identifiable intangible assets and goodwill is subject to the final determination of the valuation of the assets acquired and liabilities assumed. The primary areas of the purchase price allocation that are not yet finalized relate to the valuation of intangible assets and related taxes. The final allocation of the purchase price to the assets acquired and liabilities assumed will be completed when the final assessments of the intangible assets and related taxes are completed during the year ended December 31, 2018. Goodwill and intangibles will be recorded in the Commercial business unit. The excess purchase price of approximately \$6.8 million has been preliminarily reported in other assets as of June 30, 2018. In addition, during the three months ended March 31, 2018, the Company made a number of minority interest investments in private technology companies totaling approximately \$9.5 million.

On April 3, 2018, the Company completed a transaction to acquire 100% of the outstanding stock of a startup technology company for approximately \$7.1 million in cash. The allocation of the purchase price to identified intangible assets and goodwill is subject to the final determination of the valuation of the assets acquired and liabilities assumed. The primary areas of the purchase price allocation that are not yet finalized relate to the valuation of intangible assets and related taxes. The final allocation of the purchase price to the assets acquired and liabilities assumed will be completed when the final assessments of the intangible assets and related taxes are completed during the year ended December 31, 2018. Goodwill and intangibles will be recorded in the Commercial business unit. The

unallocated purchase price of approximately \$7.1 million has been preliminarily reported in other assets as of June 30, 2018.

19

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FLIR SYSTEMS, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(Unaudited)

## Note 19. Business Acquisitions and Divestitures

## Divestitures of the Consumer and Small and Medium-Sized Security Businesses

On February 6, 2018 the Company sold the Consumer and Small and Medium-sized ("SMB") Security businesses within the Commercial segment for total cash consideration of approximately \$28.8 million. As a result of this combined sale, the Company recognized a pre-tax loss of \$10.2 million in the first quarter of 2018. This group of assets was previously classified as held for sale during the fourth quarter of 2017, when the Company recorded an estimated pre-tax loss on net assets held for sale of \$23.6 million. This disposal does not qualify as discontinued operations and therefore, its operating results are included in the Company's continuing operations for all periods presented through the date of the sale.

The carrying amounts of the assets and liabilities that were expected to be included in the sale were classified as held for sale as of December 31, 2017 as follows (in thousands):

Accounts receivable, net	\$20,414
Inventories	43,050
Other current assets	1,031
Property and equipment, net	4,888
Intangible assets, net	8,359
Goodwill	13,090
Loss on assets	(23,488 )
Total assets	\$67,344

Accounts payable and accrued expenses	\$39,544
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Total liabilities	\$39,544
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## Note 20. Subsequent Events

On July 19, 2018, the Company's Board of Directors declared a quarterly dividend of \$0.16 per share on its common stock, payable on September 7, 2018, to shareholders of record as of the close of business on August 24, 2018. The total cash payment of this dividend will be approximately \$22.1 million.

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

Forward-Looking Statements

This Quarterly Report on Form 10-Q (the "Report"), including "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Part I, Item 2, contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 regarding future events and the future results of FLIR Systems, Inc. and its consolidated subsidiaries ("FLIR" or the "Company") that are based on management's current expectations, estimates, projections and assumptions about the Company's business. Words such as "expects," "anticipates," "intends," "plans," "believes," "sees," "estimates" and variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements due to numerous factors including, but not limited to, those discussed in "Risk Factors" section in Part II, Item 1A of this Report, "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Part I, Item 2, and elsewhere in this Report as well as those discussed from time to time in the Company's other Securities and Exchange Commission filings and reports. In addition, such statements could be affected by general industry, economic, and market conditions. Such forward-looking statements speak only as of the date of this Report or, in the case of any document incorporated by reference, the date of that document, and the Company does not undertake any obligation to update any forward-looking statement to reflect events or circumstances after the date of this Report, or for changes made to this document by wire services or Internet service providers. If the Company updates or corrects one or more forward-looking statements, investors and others should not conclude that the Company will make additional updates or corrections with respect to other forward-looking statements.

Consolidated Operating Results

The following discussion of operating results provides an overview of our operations by addressing key elements in our Consolidated Statements of Income. The "Segment Operating Results" section that follows describes the contributions of each of our business segments to our consolidated revenue and earnings from operations. Given the nature of our business, we believe revenue and earnings from operations (including operating margin percentage) are most relevant to an understanding of our performance at a segment level. Additionally, at the segment level we disclose backlog, which represents orders received for products or services for which a sales agreement is in place and delivery is expected within twelve months. Backlog is not an absolute indicator of future revenue because a portion of the orders in backlog could be canceled at the customer's discretion. While the backlog is subject to order cancellations, we have not historically experienced a significant number of order cancellations.

In August 2017, we announced a realignment of our business which resulted in reducing our number of operating segments from six to three, effective as of January 1, 2018. The three operating segments are: Industrial business unit, Government & Defense business unit, and Commercial business unit. See Note 18, "Operating Segments and Related Information" of the Notes to the Consolidated Financial Statements for additional information on the three operating segments. The segment operating results for the three and six months ended June 30, 2017 below have been adjusted to conform to the new operating segment structure.

Revenue. Consolidated revenue for the three months ended June 30, 2018, increased by 4.3 percent year over year, from \$434.1 million in the second quarter of 2017 to \$452.7 million in the second quarter of 2018. Consolidated revenue for the six months ended June 30, 2018 increased by 6.1 percent year over year, from \$840.9 million in the first six months of 2017 to \$892.3 million in the first six months of 2018. Increases in revenues for the three and six month period in our Industrial and Government & Defense business units were partially offset by decline in Commercial business unit as a result of our divestiture of the Consumer and Small and Medium-sized ("SMB") Security business as announced in February 2018.



The timing of orders, scheduling of backlog, and fluctuations in demand in various regions of the world can give rise to quarter to quarter and year over year fluctuations in the mix of revenue. Consequently, year over year comparisons for any given quarter may not be indicative of comparisons using longer time periods. Excluding the divestiture of the Consumer and SMB Security businesses, we currently expect total annual revenue for 2018 to be higher than 2017 revenue and reported revenue including the divested businesses to be about flat or slightly down when compared to prior year. However, unexpected changes in economic conditions from key customer markets or other major unanticipated events may cause total revenue, and the mix of revenue between our segments, to vary from quarter to quarter during the year.

International sales accounted for 48.4 percent and 48.4 percent of total revenue for the quarters ended June 30, 2018 and 2017, respectively. The proportion of our international revenue compared to total revenue will fluctuate from quarter to quarter

due to normal variation in order activity across various regions as well as specific factors that may affect one region and not another. Overall, we anticipate that revenue from international sales will continue to comprise a significant percentage of total revenue.

Cost of goods sold. Cost of goods sold for the three and six months ended June 30, 2018 were \$220.2 million and \$441.9 million, compared to cost of goods sold for the three and six months ended June 30, 2017 of \$227.4 million and \$442.9 million, respectively. The decrease in cost of goods sold for the three and six month periods is primarily related to favorable product mix in 2018.

Gross profit. Gross profit for the quarter ended June 30, 2018, was \$232.6 million compared to \$206.7 million for the same quarter last year. Gross profit for the six months ended June 30, 2018 was \$450.5 million compared to \$398.1 million for the six month period ended June 30, 2017. Gross margin, defined as gross profit divided by revenue, increased from 47.6 percent in the second quarter of 2017 to 51.4 percent in the second quarter of 2018 and increased from 47.3 percent for the six months ended June 30, 2017 to 50.5 percent during the six months ended June 30, 2018. The increase in gross margin for the three and six month periods was primarily due to strong volume growth and favorable product mix.

Research and development expenses. Research and development expenses for the second quarter of 2018 totaled \$46.4 million, compared to \$43.0 million in the second quarter of 2017. Research and development expenses in the first six months of 2018 were \$91.0 million compared to \$85.0 million for the first six months of 2017. Research and development expenses as a percentage of revenue were 10.3 percent for the three months ended June 30, 2018 and 9.9 percent for the three months ended June 30, 2017. Research and development expenses as a percentage of revenue for the first six months of 2018 were 10.2 percent compared to 10.1 percent during the first six months of 2017. We have, and will continue to have, fluctuations in quarterly spending depending on product development needs and overall business spending priorities and believe that annual spending levels are most indicative of our commitment to research and development. Over the past five annual periods through December 31, 2017, our annual research and development expenses have varied between 8.5 percent and 9.9 percent of revenue, and we currently expect these expenses to remain within that approximate range, on an annual basis, for the foreseeable future.

Selling, general, and administrative expenses. Selling, general, and administrative expenses were \$97.5 million and \$97.1 million for the quarters ended June 30, 2018 and 2017, respectively. Selling, general, and administrative expenses were \$205.1 million and \$187.3 million for the six months ended June 30, 2018 and June 30, 2017, respectively. The increase in selling, general, and administrative expenses for the six month period is primarily attributed to \$15.0 million recorded in the first quarter of 2018 for the costs of a regulatory settlement described further in Note 16, "Contingencies" of the Notes to the Consolidated Financial Statements. Selling, general, and administrative expenses as a percentage of revenue were 21.5 percent and 22.4 percent for the quarters ended June 30, 2018 and 2017, respectively. Selling, general, and administrative expenses as a percentage of revenue were 23.0 percent and 22.3 percent for the six months periods ended June 30, 2018 and 2017, respectively. Over the past five annual periods through December 31, 2017, our annual selling, general and administrative expenses have varied between 19.4 percent and 21.7 percent of revenue, and excluding the impact of the \$15.0 million regulatory settlement cost described above, we currently expect these expenses to remain within that approximate range, on an annual basis, for the foreseeable future.

Loss on sale of business. During the first half of 2018, we recorded an additional pre-tax loss on the sale of our Consumer and SMB Security businesses of \$10.2 million. See Note 19, "Business Acquisitions and Divestitures," of the Notes to the Consolidated Financial Statements for additional information.

Interest expense. Interest expense for the three months ended June 30, 2018, was \$4.0 million, compared to \$4.5 million for the same period of 2017. Interest expense for the six months ended June 30, 2018, was \$8.0 million, compared to \$8.9 million for the same period of 2017. Interest expense for the three and six month periods in 2018 was primarily associated with the \$425 million aggregate principal amount of our 3.125 percent senior unsecured notes. Interest expense for the same periods in 2017 was primarily associated with the \$425 million aggregate principal amount of our 3.125 percent senior unsecured notes and amounts drawn under our credit facility. There were no drawings on our credit facility for the 2018 periods.

Income taxes. Our income tax provision of \$11.4 million and \$26.8 million for the three and six months ended June 30, 2018, represents an effective tax rate of 13.7 percent and 19.5 percent. Our income tax provision for the three

and six months ended June 30, 2017 was \$12.1 million and \$25.1 million, which represented an effective tax rate of 19.1 percent and 21.1 percent. The effective tax rate for the three and six months ended June 30, 2018 is lower than the United States Federal tax rate of 21 percent mainly due to excess tax benefits from stock compensation, offset partially by state taxes, higher tax rates applied to income earned in certain foreign jurisdictions, and other discrete items.

In 2016, we recorded discrete tax charges totaling \$39.6 million related to the January 11, 2016, announcement from the European Commission of a decision concluding that certain rules under Belgian tax legislation were deemed to be incompatible with European Union regulations on state aid. As a result of this decision, the European Commission directed the Belgian Government to recover past taxes from certain entities, reflective of disallowed state aid, which impacts one of our international subsidiaries. The Belgian Government announced they have appealed this decision and filed action for an annulment in the General Court of the European Union, and in July 2016 we filed a separate appeal with the General Court of the European Union. In accordance with FASB ASC Topic 740, "Income Taxes," we recorded discrete tax expense of \$39.6 million during 2016, related to this matter and on January 10, 2017, received tax assessments from the Belgium government for a similar amount, which we have classified as current taxes payable on the Consolidated Balance Sheet as of June 30, 2018. We have filed a complaint against the Belgian tax assessments, and the result of this complaint, the appeal with the General Court of the European Union, new information received from the Belgian Government, or other future events may cause the income tax provision associated with the decision to be entirely or partially reversed. At June 30, 2018, we held the euro equivalent of \$35.3 million in a restricted cash account. Those amounts, or portions thereof, could become unrestricted depending on the outcome of this matter.

### Segment Operating Results

The Company is currently organized into three reportable segments. See Note 18, "Operating Segments and Related Information," of the Notes to the Consolidated Financial Statements for a description of each operating segment, including the types of products and services from which each operating segment derives its revenues. In August 2017, we announced our plans to realign the business operations into three principle businesses: Industrial business unit, Government and Defense business unit, and Commercial business unit. The Industrial business unit consists of the former Instruments and OEM and Emerging segments, excluding the Intelligent Traffic Systems ("ITS") business; The Government and Defense business unit consists of the former Surveillance and Detection segments, excluding the Outdoor and Tactical Systems ("OTS") business; and the Commercial business unit consists of the former Maritime and Security segments, along with the ITS and OTS businesses. With this re-alignment, we intend to reduce complexity, realize greater operating synergies, and enhance management focus.

#### Industrial

Industrial business unit operating results are as follows (in millions, except percentages):

	Three Months		Six Months Ended	
	Ended June 30,		June 30,	
	2018	2017	2018	2017
Revenue	\$188.4	\$164.7	\$359.1	\$319.5
Earnings from operations	58.1	47.0	103.6	89.9
Operating margin	30.8	% 28.6	% 28.8	% 28.1
Backlog, end of period			181	185

Industrial business unit revenue for the quarter ended June 30, 2018 increased by 14.4 percent compared to the same period of 2017. Industrial business unit revenue for the six months ended June 30, 2018 increased by 12.4 percent compared to the same period of 2017. The increase in revenue for the three month period was predominately attributable to strength in the Instruments UAS, gas finders, science and automation product lines and sales to automotive OEMs. The increase in revenue for the six month period was predominately attributable to strong performance in the Instruments and OEM product lines. The increase in earnings from operations for the three and six months ended June 30, 2018, compared to the same periods of 2017, was primarily due to strong revenue growth coupled with product mix in the Instruments and OEM products.

## Government and Defense

Government and Defense business unit operating results are as follows (in millions, except percentages):

	Three Months		Six Months Ended	
	Ended June 30,		June 30,	
	2018	2017	2018	2017
Revenue	\$161.0	\$145.7	\$320.4	\$283.9
Earnings from operations	45.5	38.2	91.7	71.5
Operating margin	28.3	% 26.2	% 28.6	% 25.2
Backlog, end of period			352	399

Government and Defense business unit revenue for the quarter ended June 30, 2018 increased by 10.5 percent compared to the same period of 2017. Government and Defense business unit revenue for the six months ended June 30, 2018 increased by 12.8 percent compared to the same period of 2017. The increase in revenue for the three and six month periods ended June 30, 2018, compared to the same periods of 2017 was driven by strong results in land and CBRNE related systems. The increase in earnings from operations for the three and six month periods ended June 30, 2018, compared to the same periods in 2017, was primarily due to higher revenues, favorable product mix and controlled spending. The decrease in year-over-year backlog is primarily driven by the timing of large US Government orders under a CBRNE program during 2017 and subsequent delivery timing. Additionally, there was a large international order in current backlog as of June 30, 2017, which was moved to non-current backlog in late 2017.

## Commercial

Commercial business unit operating results are as follows (in millions, except percentages):

	Three Months		Six Months Ended	
	Ended June 30,		June 30,	
	2018	2017	2018	2017
Revenue	\$103.3	\$123.7	\$212.9	\$237.5
Earnings from operations	17.4	15.5	31.8	25.5
Operating margin	16.8	% 12.5	% 15.0	% 10.7
Backlog, end of period			64	61

Commercial business unit revenue for the quarter ended June 30, 2018 decreased by 16.5 percent compared to the same period of 2017. Commercial business unit revenue for the six months ended June 30, 2018 decreased 10.4 percent compared to the same period of 2017. The decrease in revenue for the three and six month periods ended June 30, 2018 was predominately due to the divestitures of our Consumer and SMB Security businesses during the period ended March 31, 2018, partially offset by strong growth in marine electronics and intelligent transportation related products. The increase in earnings from operations for the three and six months ended June 30, 2018, compared to the same periods of 2017, was primarily due to favorable product mix, led by marine electronics.

## Liquidity and Capital Resources

At June 30, 2018, we had a total of \$507.9 million in cash, cash equivalents and restricted cash, \$217.3 million of which resided in the United States and \$290.6 million at our foreign subsidiaries, compared to cash and cash equivalents at December 31, 2017, of \$519.1 million, of which \$228.9 million resided in the United States and \$290.2 million at our foreign subsidiaries. At June 30, 2018, the restricted cash balance was \$35.3 million and we had no amounts designated as restricted cash at December 31, 2017. The decrease in cash, cash equivalents and restricted cash during the six months ended June 30, 2018, was primarily due to share repurchases of \$100.0 million, dividend payments of \$44.3 million, business acquisitions of \$14.2 million, minority interest investments of \$9.5 million and capital expenditures of \$13.4 million, partially offset by cash provided from operations

of \$153.3 million, cash received from the sale of our Consumer and SMB Security businesses of \$25.9 million and proceeds of \$16.9 million from shares issued under our stock compensation plans.

Cash provided by operating activities during the six months ended June 30, 2018 totaled \$153.3 million, which primarily consisted of net earnings, adjusted for depreciation and amortization, stock-based compensation, other non-cash items and changes in working capital. The increase of cash provided by operating activities in 2018 over 2017 was due to an increase in net income and improvement in working capital.

Cash used by investing activities for the six months ended June 30, 2018 totaled \$11.2 million, which consisted of business acquisitions, minority interest investments and capital expenditures in the ordinary course of business, offset by \$25.9 million generated from the sale of our Consumer and SMB Security businesses.

Cash used by financing activities for the six months ended June 30, 2018 totaled \$139.5 million, which primarily consisted of cash used for the repurchase of shares of our common stock and the payment of quarterly dividends.

On February 8, 2011, we entered into a Credit Agreement (“Credit Agreement”) with Bank of America, N.A., U.S. Bank National Association, JPMorgan Chase Bank N.A. and other Lenders. The Credit Agreement provides for a \$200 million, five-year revolving line of credit. On April 5, 2013, the Credit Agreement was amended to extend the maturity of the revolving credit facility from April 8, 2016 to April 5, 2018, in addition to incorporating a \$150 million term loan facility maturing April 5, 2019. On May 31, 2016, the Credit Agreement was further amended to increase the borrowing capacity to \$500 million and to extend the maturity of the revolving credit facility from April 5, 2018 to May 31, 2021. The amendment also incorporated a revised schedule of fees and interest rate spreads. We have the right, subject to certain conditions, including approval of additional commitments by qualified lenders, to increase the revolving line of credit under the Credit Agreement by an additional \$200 million until May 31, 2021. The Credit Agreement allows us and certain designated subsidiaries to borrow in United States dollars, European euros, Swedish kronor, British pound sterling, Japanese yen, Canadian dollars, Australian dollars, and other agreed upon currencies. Interest rates under the Credit Agreement are determined based on the type of borrowing. Interest associated with borrowings can be based on either the prime lending rate of Bank of America, N.A. or the published Eurocurrency rate (i.e. LIBOR). The borrowings have an applicable margin that ranges from 0.125 percent to 2.125 percent depending on the applicable base rate and our consolidated total leverage ratio. Including the respective spreads, the one-month Eurocurrency-based borrowing rate was 3.469 percent per annum and the prime lending-based borrowing rate was 5.375 percent per annum at June 30, 2018. The Credit Agreement requires us to pay a commitment fee on the amount of unused revolving commitments at a rate, based on our total leverage ratio, which ranges from 0.150 percent to 0.300 percent of unused revolving commitments. At June 30, 2018, the commitment fee on the amount of unused revolving credit was 0.175 percent per annum. The Credit Agreement contains two financial covenants that require the maintenance of a total leverage ratio and an interest coverage ratio, with which the Company was in compliance at June 30, 2018. The credit facilities available under the Credit Agreement are unsecured.

We had \$15.5 million of letters of credit outstanding under the Credit Agreement at June 30, 2018, which reduced the total available revolving credit under the Credit Agreement.

In June 2016, we issued \$425 million aggregate principal amount of our 3.125 percent senior unsecured notes due June 15, 2021 (the “Notes”). The net proceeds from the issuance of the Notes were approximately \$421.0 million, after deducting underwriting discounts and offering expenses, which are being amortized over a period of five years.

Interest on the Notes is payable semiannually in arrears on December 15 and June 15. The proceeds from the Notes were used to repay our 3.75 percent senior unsecured notes that were due September 1, 2016, and are being used for general corporate purposes, which include working capital and capital expenditure needs, business acquisitions, and repurchases of our common stock.

On February 8, 2017, our Board of Directors authorized the repurchase of up to 15.0 million shares of our outstanding common stock. This authorization will expire on February 8, 2019. During the first quarter of 2018, we entered into an accelerated share repurchase program at a notional amount of \$50.0 million, which settled on June 4, 2018, under which we received 1.0 million shares. The repurchases were under the February 2017 authorization. As of June 30, 2018, a total of 2.0 million shares have been repurchased under the February 8, 2017 authorization.

New tax legislation, commonly referred to as the Tax Cuts and Jobs Act (the “Tax Act”), was enacted on December 22, 2017. In accordance with the Tax Act, we have accrued \$66.5 million of United States taxes payable on all previously

undistributed earnings of our foreign subsidiaries, estimated to be approximately \$1.0 billion as of December 31, 2017. We have also recorded deferred tax liabilities of \$14.3 million for state and foreign taxes estimated to be due upon distribution of all accumulated earnings by our foreign subsidiaries.

25

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We have not provided United States, state or foreign income taxes for earnings generated after January 1, 2018 by certain subsidiaries outside the United States as we currently intend to reinvest the earnings in operations and other activities outside of the United States indefinitely. Should we subsequently elect to repatriate such foreign earnings, we would need to accrue and pay state and foreign income taxes, thereby reducing the amount of our cash. United States taxes would generally not be payable due to changes made by the Tax Act.

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

#### Off-Balance Sheet Arrangements

As of June 30, 2018, we leased our non-owned facilities under operating lease agreements. We also leased certain operating machinery and equipment and office equipment under operating lease agreements. Except for these operating lease agreements, we do not have any off-balance sheet arrangements that have or are likely to have a material current or future effect on our financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources.

#### Recent Accounting Pronouncements

##### Recently Issued Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-02, "Leases (Topic 842)" ("ASU 2016-02"). The amendments in this update require the identification of arrangements that should be accounted for as leases by lessees. In general, for lease arrangements exceeding a twelve month term, these arrangements must now be recognized as assets and liabilities on the balance sheet of the lessee. ASU 2016-02 requires the use of the modified retrospective method, which will require adjustment to all comparative periods presented in the consolidated financial statements. ASU 2016-02 is effective for interim and annual reporting periods beginning after December 15, 2018, with early adoption permitted, and the Company currently intends to adopt ASU 2016-02 on January 1, 2019. The Company is assessing the impact ASU 2016-02 will have on its consolidated financial statements and expects that the primary impact upon adoption will be the recognition, on a discounted basis, of its minimum commitments under noncancelable operating leases on its consolidated balance sheets resulting in the recording of right of use assets and lease obligations.

In January 2017, the FASB issued ASU No. 2017-04, "Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment" ("ASU 2017-04"). The amendments in this update simplify the subsequent measurement of goodwill by removing the second step of the two-step impairment test. The amendment requires an entity to perform its annual or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An impairment charge should be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. The amendment should be applied on a prospective basis. ASU 2017-04 is effective for annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The amendments in ASU 2017-04 are to be applied on a prospective basis and are not expected to have a material impact on the Company's consolidated financial statements.

In February 2018, the FASB issued ASU No. 2018-02, "Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income" ("ASU 2018-02"). The standard will permit entities to reclassify tax effects stranded in accumulated other comprehensive income ("AOCI") as a result of U.S. tax reform to retained earnings. The standard is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. The Company is



currently evaluating this guidance to determine the impact it may have on its consolidated financial statements.

In June 2018, the FASB issued ASU No. 2018-07, "Improvements to Nonemployee Share-Based Payment Accounting" ("ASU 2018-07"). The standard more closely aligns the accounting for employee and nonemployee share-based payments. The standard is effective for annual and interim periods in fiscal years beginning after December 15, 2018. Early adoption is permitted. The Company is currently evaluating this guidance to determine the impact it may have on its consolidated financial statements.

#### Critical Accounting Policies and Estimates

Preparation of the financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Management believes the most complex and sensitive judgments, because of their significance to the consolidated financial statements, result primarily from the need to make estimates about the effects of matters that are inherently uncertain. The Company has updated its revenue recognition policy in connection with the adoption of FASB ASU No. 2014-09, "Revenue - Revenue from Contracts with Customers" as further described in Note 2, "Revenue" of the Notes to the Consolidated Financial Statements. Readers should also refer to Management's Discussion and Analysis and the critical accounting policies and its use of estimates as reported in Note 1, "Nature of Business and Significant Accounting Policies" and Note 13, "Contingencies" of the Notes to the Consolidated Financial Statements included in the Form 10-K for the fiscal year ended December 31, 2017. Actual results in these areas could differ materially from management's estimates. There have been no significant changes in the Company's assumptions regarding critical accounting estimates during the first six months of 2018.

#### Contractual Obligations

There were no material changes to the Company's contractual obligations outside the ordinary course of its business during the quarter ended June 30, 2018.

#### Contingencies

See Note 16, "Contingencies," of the Notes to the Consolidated Financial Statements for a description of an ongoing lawsuit filed by Raytheon Company against FLIR Systems, Inc. and its subsidiary, FLIR Commercial Systems, Inc., the disclosure of certain matters by the Company to the United States Department of State Office of Defense Trade Controls Compliance, communications to the Company from the United States Department of Commerce Bureau of Industry and Security, and the Company's current estimates of the range of potential loss associated with quality concerns identified by the Company regarding certain SkyWatch Surveillance Towers.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As of June 30, 2018, the Company has not experienced any changes in market risk exposure that would materially affect the quantitative and qualitative disclosures about market risk presented in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2017.

#### ITEM 4. CONTROLS AND PROCEDURES

##### Evaluation of Disclosure Controls and Procedures

As of June 30, 2018, the Company completed an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and the Company's Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on the evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in the reports it files or submits under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

##### Changes in Internal Control Over Financial Reporting

Beginning January 1, 2018, the Company implemented ASC 606, Revenue from Contracts with Customers. Although the new revenue standard did not have a material impact on the consolidated financial statements, the Company developed new policies and trainings, and enhanced internal controls to ensure an adequate evaluation of customer contracts and a proper assessment of the impact of the new accounting standards related to revenue recognition. These enhancements to the internal controls are not considered significant.

There have been no other changes in the Company's internal control over financial reporting that occurred during the Company's fiscal quarter ended June 30, 2018, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

The Company is subject to legal proceedings, claims and litigation arising in the ordinary course of its business. See Note 16, "Contingencies" of the Notes to the Consolidated Financial Statements for additional information on the Company's legal proceedings.

### ITEM 1A. RISK FACTORS

The following are important factors that could cause actual results or events to differ materially from those contained in any forward-looking statements made by or on behalf of the Company. If we are unable to adequately respond to these risks and uncertainties, our business, financial condition and results of operations could be materially adversely affected. Additionally, we cannot be certain or give any assurance that any actions taken to reduce known risks and uncertainties will be effective.

#### Risks, Uncertainties and Other Factors Related to Our Business

We depend on the United States government for a material portion of our business and changes in government spending could adversely affect our business

We derive significant revenue from contracts or subcontracts funded by United States government agencies. A significant reduction in the purchase of our products by these agencies or contractors for these agencies would have a material adverse effect on our business. For the fiscal years ended December 31, 2017, 2016 and 2015, approximately 26 percent, 25 percent and 21 percent, respectively, of our revenues were derived directly or indirectly from sales to the United States government and its agencies. The funding of contracts awarded to us depends on the overall United States government budget and appropriations process, which is beyond our control. In addition, at its discretion, the United States government may change its spending priorities and/or terminate, reduce or modify contracts.

Substantial uncertainty exists in the spending levels and priorities of the United States government, particularly with respect to military expenditures. Continued and further reductions in military spending could have a material adverse effect on our results from operations.

As a United States government supplier, we are subject to a number of procurement rules and regulations

Government contractors must comply with specific procurement regulations and other requirements and are subject to routine and non-routine audits and investigations by United States government agencies. In addition, violations of these regulations or other unrelated laws and statutes can lead to debarment and other penalties. If we fail to comply with procurement rules and regulations and other laws and statutes, the results could include: reductions in the value of contracts; contract modifications or termination; the assessment of penalties and fines; and/or suspension or debarment from United States government contracting or subcontracting for a period of time or permanently. An adverse action by the United States government could also result in lost sales to non-governmental customers who might disqualify us as a result of such adverse action. The impairment or loss of our government contracts could have a material adverse effect on our business.

Operating margins may be negatively impacted by reduction in sales or by a change in the mix of products sold. Our expense levels are based, in part, on our expectations regarding future sales and these expenses are largely fixed in the short term. Some expenses, such as those related to research and development activities, would likely be maintained in the event of a sales downturn in order to maintain and enhance the long-term competitiveness of the Company. We maintain inventories of finished goods, components and raw materials at levels we believe are necessary to meet anticipated sales. Accordingly, we may not be able to reduce our costs in a timely manner to compensate for any unexpected shortfall between forecasted and actual sales. Any significant shortfall of sales may result in us carrying higher levels of inventories of finished goods, components and raw materials thereby increasing our risk of inventory obsolescence and corresponding inventory write-downs and write-offs. Our fixed costs, including facilities and information technology costs, compliance and public company costs, and depreciation and amortization related to previous acquisitions and capital expenditures, are significant and are difficult to reduce in the short term.



Our operating margins vary by product and substantial changes in the mix of products sold could also have a negative impact on our operating margins.

We may experience impairment in the value of our tangible and intangible assets

Our industry is subject to rapid changes in technology, which may result in unexpected obsolescence or impairment of our assets. Our intangible assets, including goodwill, represent a significant portion of our total assets. Most of these intangibles are the result of acquisitions in which the purchase price exceeded the value of the tangible assets acquired. We amortize certain of these intangibles over their anticipated useful life and review goodwill and indefinite-lived intangible assets for impairment annually or more frequently if warranted by events. To date we have not experienced any impairment of our intangible assets, but there can be no assurance that we will not experience such impairment in the future. In addition, certain of our tangible assets such as inventory and machinery and equipment may experience impairment in their value as a result of such events as the introduction of new products, changes in technology or changes in customer demand patterns. We depreciate our machinery and equipment at levels we believe are adequate; however, there can be no assurance that there will not be a future impairment that may have a material impact on our business, financial condition and results of operations.

Unfavorable results of legal proceedings could materially adversely affect us

We are subject to various legal proceedings and claims that have arisen out of the ordinary conduct of our business and are not yet resolved, and additional claims may arise in the future. Results of legal proceedings cannot be predicted with certainty. Regardless of merit, litigation may be both time-consuming and disruptive to our operations and could cause significant expense and diversion of management attention. From time to time, we are involved in lawsuits concerning intellectual property, torts, contracts, shareholder litigation, administrative and regulatory proceedings and other matters, as well as governmental inquiries and investigations, the outcomes of which may be significant to our results of operations and may limit our ability to engage in our business activities. In recognition of these considerations, we have and may in the future enter into material settlements to avoid ongoing costs and efforts in defending or pursuing a matter. Should we fail to prevail in certain matters, or should several of these matters be resolved against us in the same reporting period, we may be faced with significant monetary damages or injunctive relief against us that could adversely affect our business, financial condition, operating results and cash flows. While we have insurance related to our business operations, it may not apply to or fully cover liabilities we incur as a result of these lawsuits. We record accruals for liabilities where we believe a loss to be probable and reasonably estimable. However, our actual costs may differ materially from these estimates.

We face risks from international sales and business activities

We market and sell our products worldwide and international sales have accounted for, and are expected to continue to account for, a significant portion of our revenue. For the years ended December 31, 2017, 2016 and 2015, international sales accounted for 47 percent, 46 percent and 47 percent, respectively, of our total revenue. We also manufacture certain products and subassemblies in Europe and we have several contract manufacturing agreements with third parties in Europe and in Asia. Certain of these products, particularly our thermal and infrared products, are subject to substantial government regulation and licensing and end use restrictions throughout the world. Our international business activities are subject to a number of risks, including:

- the imposition of and changes to governmental licensing restrictions and controls impacting our technology and products;
- restrictions and prohibitions on the export of technology and products, including recent changes in regulation prohibiting the sale of certain of our products to certain end users without a license;
- international trade restrictions;
- difficulty in collecting receivables and governmental restrictions with respect to currency;
- inadequate protection of intellectual property;
- labor union activities;
- changes in tariffs and taxes;
- restrictions on repatriation of earnings;
- restriction on the importation and exportation of goods and services;
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risks, costs, impacts and obligations associated with the United States Foreign Corrupt Practices Act ("FCPA"), and other anti-bribery and anti-corruption laws applicable to us, and laws applicable to global trade and United States exports and

30

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costs and penalties from violations of such laws and related regulations, including the costs associated with required remedial and other increased compliance activity;

• difficulties in staffing and managing international operations; and  
• political and economic instability.

Some of these factors recently have had an adverse impact on our sales and operations and increased the Company's cost of doing business and subjected the business to additional rules, policies and procedures that impacted the operation of the Company. No assurance can be given that these factors will not have a material adverse effect on our future international sales and operations and, consequently, on our business, financial condition and results of operations. Furthermore, compliance with complex foreign and U.S. laws and regulations that apply to our international operations increases our cost of doing business both in the United States and in international jurisdictions. These regulations include import and export laws, anti-competition laws, anti-corruption laws, such as the FCPA and the U.K. Bribery Act, and other local laws prohibiting corrupt payments to governmental officials, data privacy requirements, tax laws, and accounting, internal control and disclosure requirements. For example, on April 8, 2015, the Company and the Securities and Exchange Commission ("SEC") entered into an agreement through entry of an Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities and Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order (the "SEC Order"). The SEC Order settled charges under the FCPA with respect to incidents of improper travel and gifts involving FLIR's Middle East operation. Pursuant to the SEC Order, the Company is obligated to "cease and desist" from committing any future violations of the Securities Exchange Act of 1934, as amended. Violations of these laws and regulations could result in civil and criminal fines, penalties and sanctions against us, our officers or our employees, prohibitions on the conduct of our business and on our ability to offer our products and services in one or more countries, and could also materially affect our reputation, business and results of operations. In certain foreign jurisdictions, there is a higher risk of fraud or corruption and greater difficulty in maintaining effective internal controls and compliance programs. Further, although we have implemented and continue to implement policies and procedures designed to promote compliance with applicable laws and regulations, there can be no assurance that our employees, contractors or agents will not violate our policies or applicable laws and regulations.

On October 22, 2014, the Company initially contacted the United States Department of State Office of Defense Trade Controls Compliance ("DDTC"), pursuant to International Traffic in Arms Regulation ("ITAR") § 127.12(c), regarding the unauthorized export of technical data and defense services to dual and third country nationals in at least four facilities of the Company. On April 27, 2015, the Company submitted its initial report to DDTC regarding the details of the issues raised in the October 22, 2014, submission. DDTC subsequently notified the Company that it was considering administrative proceedings under Part 128 of ITAR and requested a tolling agreement, which the Company executed on June 16, 2015 and referenced certain Company disclosures in addition to the submissions made in conjunction with the October 24, 2014 initial notification. On June 6, 2016, the Company executed a subsequent tolling agreement extending the tolling period for matters to be potentially included in an administrative proceeding for an additional 18 months and at the request of DDTC on December 1, 2017, further extended the tolling agreement for an additional six months through May 9, 2018. On April 24, 2018, the Company entered into a Consent Agreement with the DDTC to resolve issues related to certain export compliance matters under the ITAR. The Consent Agreement has a four-year term and provides for: (i) a civil penalty of \$30 million with \$15 million of this amount suspended on the condition that the funds have or will be used for Department-approved Consent Agreement remedial compliance measures, (ii) the appointment of an external Special Compliance Official to oversee compliance with the Consent Agreement and the ITAR; (iii) two external audits of the Company's ITAR compliance program; and (iv) continued implementation of ongoing remedial compliance measures and additional remedial compliance measures related to automated systems and ITAR compliance policies, procedures, and training. The Company expects recent and future investments in remedial compliance measures will be sufficient to cover the \$15 million suspension amount. Our failure to comply with these regulations, including the requirements of the Consent Agreement could result in penalties, loss, or suspension of contracts or other consequences which could adversely affect our operations and financial condition.

In addition, our international contracts may include industrial cooperation agreements requiring specific in-country purchases, investments, manufacturing agreements or other financial obligations, known as offset obligations, and



may provide for penalties if we fail to meet such requirements. The impact of these factors is difficult to predict, but one or more of them could have a material adverse effect on our financial position, results of operations, or cash flows.

We face risks from currency fluctuations

Historically, currency fluctuations have affected our operating results. Changes in the value of foreign currencies in which our sales or costs incurred are denominated have in the past caused, and could in the future cause, fluctuations in our operating results. We seek to reduce our exposure to currency fluctuations by denominating, where possible, our international sales in United States dollars, by balancing expenses and revenues in various currencies and by undertaking limited hedging of forecasted currency exposures. With respect to international sales denominated in United States dollars, a decrease in the value of foreign currencies relative to the United States dollar could make our products less price competitive.

We may not be successful in obtaining the necessary export licenses to conduct operations abroad and the United States government may prevent proposed sales to foreign governments and customers

Export licenses and other authorizations are required from United States government agencies under the ITAR, the Export Administration Regulation (“EAR”), the Office of Foreign Assets Control (“OFAC”) Regulations, the Trading with the Enemy Act of 1917, the International Emergency Economic Powers Act (“IEEPA”), the Arms Export Control Act of 1976 (“AECA”), and other similar laws and regulations for the sale, use and export of many of our products and related data and services. Thermal and infrared products and technical data have been subject to the ITAR and EAR, historically under United States Munitions List (“USML”) Category XII and Commerce Control List (“CCL”) Category 6. Recently, the United States Government’s export reform effort resulted in the transition of various Company products from the USML to the CCL, shifting the licensing requirements and restrictions for products regulated by the Department of Commerce under the EAR. This transition has increased the licensing requirements and restrictions on some products and reduced the requirements and restrictions on others. We can give no assurance that we will be successful in obtaining the necessary licenses from the United States Department of State or Department of Commerce required to conduct our business as presently or historically conducted.

The United States export licensing environment has been affected by a number of factors, including but not limited to, the aftermath of 9/11, the rise of terrorism and the changing geopolitical environment, heightened tensions with other countries (which shift and evolve over time), and the United States reliance on the tactical advantage of the night-time war fighter. Some of these factors have affected the thermal imaging and infrared technology industry overall while others have impacted the Company directly. In addition, the Company’s 2014 submission to the United States DDTC pursuant to ITAR § 127.12(c), regarding the unauthorized export of technical data and defense services to dual and third country nationals in at least four facilities of the Company, have led to heightened scrutiny of export licenses for products in our markets and in some cases, has resulted in lengthened drafting and review periods for our license applications, including in countries where we have historically made significant sales. Subsequent engagement with the DDTC as part of the Company’s 2014 submission, the Consent Agreement and related submissions and other communications concerning the Company’s licensing posture overall, highlight DDTC’s focus on the manner in which the Company handles exports of its products, technical data and services subject to the ITAR. In addition, concerns with respect to potential diversion of certain of the Company’s products to prohibited end users and countries subject to economic and other sanctions implemented by the United States government has caused the United States Department of Commerce Bureau of Industry and Security to restrict recently the Company’s ability to sell 9hz thermal products without a license to customers in China not identified on a list maintained by the United States Department of Commerce.

Although we have taken actions and continue to take additional actions necessary to implement policies and procedures to promote an improved compliance culture and programs, there is no guarantee that our actions will be effective or that government agencies will not view our actions and programs with heightened scrutiny, including as a result of events outside the Company’s control. As a result, we may receive more restrictive provisos or limitations on new license requests, wholesale denials of our license requests, suspensions or terminations of our existing licenses, or delays in receiving new licenses resulting from requests for follow-up information, due diligence requests or additional limitations on our sale to third parties. We can give no assurance that we will be successful in obtaining necessary licenses required to facilitate our international business. Failures to obtain or delays in obtaining licenses may prevent or limit our ability to market, sell, export, or transfer our products outside the United States and has had and could continue to have a material adverse effect on our business and our operating results.

General economic conditions may adversely affect our business, operating results and financial condition

Our operations and performance depend significantly on worldwide economic conditions and their impact on levels of capital investment and consumer spending. Economic factors that could adversely influence demand for the Company's products include

32

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uncertainty about global economic conditions leading to reduced levels of investment, changes in government spending levels and/or priorities, the size and availability of government budgets, customers' and suppliers' access to credit, consumer confidence and other macroeconomic factors affecting government, industrial or consumer spending behavior.

In recent years, our performance has been negatively impacted by reduced spending by United States government agencies, global economic weakness, and the Eurozone crisis. Continuation of the conditions that led to reduced spending and potential further reductions in spending globally by either consumers or government agencies could have a material adverse effect on our business, financial condition and results of operations.

Our primary markets are volatile and unpredictable

Our business depends on the demand for our products and solutions in a variety of commercial, industrial and government markets. In the past, the demand for our products in these markets has fluctuated due to a variety of factors, some of which are beyond our control, including:

- the timing, number and size of orders from, and shipments to, our customers, as well as the relative mix of those orders;

- variations in the volume of orders for a particular product or product line in a particular fiscal quarter;

- the size and timing of new contract awards;

- the timing of the release of government funds for procurement of our products; and

- the timing of orders and shipments within a given fiscal quarter.

Seasonal fluctuations in our operating results are an outcome of:

- the seasonal pattern of contracting by the United States government and certain foreign governments;

- the desire of customers to take delivery of equipment prior to fiscal year ends due to funding considerations; and

- the tendency of commercial enterprises to utilize fully annual capital budgets prior to expiration.

Competition in our markets is intense and our failure to compete effectively could adversely affect our business

Competition in the markets for our products is intense. The speed with which companies can identify new applications for thermal imaging, develop products to meet those needs and supply commercial quantities at low prices to the market are important competitive factors. We believe the principal competitive factors in our markets are product performance, price, customer service and training, product reputation, and effective marketing and sales efforts. Many of our competitors have greater financial, technical, research and development, and marketing resources than we do. All of these factors, as well as the potential for increased competition from new market entrants, require us to continue to invest in, and focus on, research and development and new product innovation. No assurance can be given that we will be able to compete effectively in the future and a failure to do so could have a material adverse effect on our business, financial condition and results of operations.

Our products may suffer from defects or errors leading to substantial product liability, damage or warranty claims

We include complex system designs and components in our products that may contain errors or defects, particularly when we incorporate new technology into our products or release new versions. If any of our products are defective, we might be required to redesign or recall those products or pay substantial damages or warranty claims. Such an event could result in significant expenses including expenses arising from product liability and warranty claims. It also could disrupt sales and affect our reputation and that of our products, which could have a material adverse effect on our business, financial condition and results of operations. As we expand our presence into new markets, we may face increased exposure to product liability claims. We maintain product liability insurance but cannot be certain that it will be sufficient or will continue to be available on acceptable terms.

Amounts included in our backlog may not result in actual revenues or translate into profits

Many contracts are subject to cancellation or suspension on short notice at the discretion of the customer, and the contracts in our backlog are subject to changes in the scope of services to be provided as well as adjustments to the costs relating to the contract. We have historically experienced variances in the components of backlog related to delivery delays or cancellations resulting from customer-specific circumstances, external market factors and economic factors beyond our control, and we may experience more



delays or cancellations in the future. Accordingly, there is no assurance that backlog will actually be realized. If our backlog fails to materialize, we could experience a reduction in revenues and a decline in profitability, which could result in a deterioration of our financial position and liquidity.

#### Risks, Uncertainties and Other Factors Related to Our Technology and Intellectual Property

Our inability to protect our intellectual property and proprietary rights and avoid infringing the rights of others could harm our competitive position and our business

Our ability to compete successfully and achieve future revenue growth depends, in part, on our ability to protect our proprietary technology and operate without infringing the rights of others. To accomplish this, we rely on a combination of patent, trademark, copyright and trade secret laws, confidentiality agreements and contractual provisions to protect our proprietary rights. Many of our proprietary rights are held in confidence as trade secrets and are not covered by patents, making them more difficult to protect. Although we currently hold worldwide patents covering certain aspects of our technologies and products, and we are actively pursuing additional patents, we cannot be certain that we will obtain additional patents or trademarks on our technology, products and trade names.

Furthermore, we cannot be certain that our patents or trademarks will not be challenged or circumvented by our competitors or that measures taken by us to protect our proprietary rights will adequately deter their misappropriation or disclosure. Any failure by us to protect our intellectual property could have a material adverse effect on our business, financial condition and results of operations. Moreover, because intellectual property does not necessarily prevent our competitors from entering the markets we serve, there can be no assurance that we will be able to maintain our competitive advantage or that our competitors will not develop capabilities equal or superior to ours.

Litigation over patents and other intellectual property is common in our industry. We have been the subject of patent and other intellectual property litigation in the past and cannot be sure that we will not be subject to such litigation in the future. Similarly, there exists the possibility we will assert claims in litigation to protect our intellectual property.

Lawsuits defending or prosecuting intellectual property claims and related legal and administrative proceedings could result in substantial expense to us and significant diversion of effort of our personnel. An adverse determination in a patent suit or in any other proceeding in which we are a party could subject us to significant liabilities, result in the loss of intellectual property rights we claim or impact our competitive position. Additionally, an adverse determination could require us to seek licenses from third parties. If such licenses are not available on commercially reasonable terms or at all, our business, financial condition and results of operations could be adversely affected.

Our future success will depend on our ability to respond to the rapid technological change in the markets in which we compete, our ability to introduce new or enhanced products and enter into new markets

The markets in which we compete are characterized by rapid technological developments and frequent new product introductions, enhancements and modifications. Our ability to develop new products and technologies that anticipate changing customer requirements, reduce costs and otherwise retain or enhance our competitive position in existing and new markets will be an important factor in our future results from operations. We will continue to make substantial capital expenditures and incur significant research and development costs to improve our manufacturing capability, reduce costs, and develop and introduce new products and enhancements. If we fail to develop and introduce new products and technologies in a timely manner, our business, financial condition and results of operations would be adversely affected. In addition, we cannot be certain that our new products and technologies will be successful or that customers will accept any of our new products.

Our business could be negatively impacted by cybersecurity threats and other security threats and technology disruptions

We face certain security threats and technology disruptions, including threats to our information technology infrastructure, attempts to gain access to our or our customers' proprietary or classified information, threats to the physical security of our facilities and employees, threats of terrorism events, and failures of our technology tools and systems. We are subject to laws and rules issued by various agencies concerning safeguarding and maintaining infrastructure and physical security and information confidentiality. Our information technology networks and related systems are critical to the operation of our business and essential to our ability to successfully perform day-to-day operations. We are also involved with information technology systems for certain customers and other third parties, for which we face similar security threats as for our own. In particular, cybersecurity threats-which include, but are not limited to, computer viruses, spyware and malware, attempts to access information, denial of service attacks and

other electronic security breaches-are persistent and evolve quickly. Such threats have increased in frequency, scope and potential impact

34

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in recent years. Further, a variety of technological tools and systems, including both company-owned information technology and technological services provided by outside parties, support our critical functions. These technologies, as well as our products, are subject to failure and the user's inability to have such technologies properly supported, updated, expanded or integrated into other technologies and may contain open source and third party software which may unbeknownst to us contain defects or viruses that pose unintended risks to our customers. These risks if not effectively mitigated or controlled could materially harm our business or reputation. While we believe that we have implemented appropriate measures and controls, there can be no assurance that such actions will be sufficient to prevent disruptions to critical systems, unauthorized release of confidential information or corruption of data. We require user names and passwords in order to access our information technology systems. We use encryption and authentication technologies designed to secure the transmission and storage of data and prevent access to our data or accounts. These security measures are subject to third-party security breaches, employee error, malfeasance, faulty password management or other irregularities. For example, third parties may attempt to induce by fraud employees or customers into disclosing user names, passwords or other sensitive information, which may in turn be used to access our information technology systems. These security systems cannot provide absolute security. To the extent we were to experience a breach of our systems and were unable to protect sensitive data, such a breach could materially damage business partner and customer relationships, and curtail or otherwise impact the use of our information technology systems. Moreover, if a security breach of our information technology system affects our computer systems or results in the release of personally identifiable or other sensitive information of customers, business partners, employees and other third parties, our reputation and brand could be materially damaged, use of our products and services could decrease, and we could be exposed to a risk of loss, litigation and potential liability. Although we have in the past and continue to be subject to cybersecurity threats and other security threats and technology disruptions, to date none has had a material impact on our business, financial condition or results of operations. Nonetheless, in the future, these types of events could disrupt our operations and customer and other third party information technology systems. They also could require significant management attention and resources, negatively impact our reputation among our customers and the public and challenge our eligibility for future work on sensitive or classified systems, which could have a material adverse effect on our business, financial condition and results of operations.

#### Risks, Uncertainties and Other Factors Related to Our Corporate Structure and Organization

Our future success depends in part on attracting and retaining key senior management and qualified technical, sales and other personnel

Our future success depends in part on the efforts and continued services of our key executives and our ability to attract and retain qualified technical, sales and other personnel. Significant competition exists for such personnel and we cannot assure the retention of our key executives, technical and sales personnel or our ability to attract, integrate and retain other such personnel that may be required in the future. We cannot assure that employees will not leave and subsequently compete against us. If we are unable to attract and retain key personnel, our business, financial condition and results of operations could be adversely affected.

We must successfully manage a complex global organization

As we have grown, the size and scope of our worldwide operations have also increased substantially. We currently design, manufacture and market numerous product lines in locations worldwide. Significant management time and effort is required to manage effectively the increased complexity of the business and our failure to successfully do so could have a material adverse effect on our business, financial condition and results of operations. Our inability to continue to manufacture our products at one or more of our facilities as a result of, for example, a prolonged power outage, earthquake, fire or other natural disaster, or labor or political unrest, could prevent us from supplying products to our customers and could have a material adverse effect on our business, financial condition and results of operations.

We may be unable to integrate successfully recent or future acquisitions into our operations, thereby disrupting our business and harming our financial condition and results of operations

We have made twelve acquisitions of various sizes in the past five years. The integration of businesses, personnel, product lines and technologies can be difficult, time consuming and subject to significant risks. For example, we could lose key personnel from





companies that we acquire, incur unanticipated costs, lose major sources of revenue, fail to integrate critical technologies, suffer business disruptions, fail to capture anticipated synergies, fail to establish satisfactory internal controls, or incur unanticipated liabilities. Any of these difficulties could disrupt our ongoing business, distract our management and employees, increase our expenses and decrease our revenue.

We frequently evaluate strategic opportunities available to us and it is likely that we will make additional acquisitions in the future. Such acquisitions may vary in size and complexity. Any future acquisitions are subject to the risks described above. Furthermore, we might assume or incur additional debt or issue additional equity securities to pay for future acquisitions. Additional debt may negatively impact our results and increase our financial risk, and the issuance of any additional equity securities could dilute our then existing shareholders' ownership. No assurance can be given that we will realize anticipated benefits of any future acquisitions, or that any such acquisition or investment will not have a material adverse effect on our business, financial condition and results of operations.

We have indebtedness as a result of the issuance of our 3.125 percent senior unsecured notes (the "Notes") and borrowings against our unsecured credit facility, and we are subject to certain restrictive covenants under our unsecured credit facility and the indenture governing the Notes which may limit our operational and financial flexibility

Our ability to meet our debt service obligations and comply with the financial covenants under our credit facility will be dependent upon our future performance, which will be subject to financial, business and other factors affecting our operations, many of which are beyond our control. Our inability to meet our debt service obligations or comply with the required covenants could result in a default under the credit facility or indenture. In the event of any such default, under the credit facility, the lenders thereunder could elect to declare all outstanding debt, accrued interest and fees under the facility to be due and immediately payable. In the event of any such default under our indenture, either the trustee or the holders of at least 25 percent of the outstanding principal amount of the Notes could declare the principal amount of all of the Notes to be due and payable immediately.

We may not be able to refinance our indebtedness on favorable terms, if at all, which could materially and adversely affect our liquidity and our ongoing results of operations.

Our ability to refinance indebtedness, including the Notes, will depend in part on our operating and financial performance, which, in turn, is subject to prevailing economic conditions and to financial, business, legislative, regulatory and other factors beyond our control. In addition, prevailing interest rates or other factors at the time of refinancing could increase our interest expense. A refinancing of our indebtedness, including the Notes, could also require us to comply with more onerous covenants and further restrict our business operations. Our inability to refinance our indebtedness or to do so upon favorable terms could materially and adversely affect our business, results of operations, financial condition and cash flows, and make us vulnerable to adverse industry and general economic conditions.

We are effectively self-insured against many potential liabilities

Although we maintain insurance policies with respect to a broad range of risks, including automobile liability, general liability, workers' compensation and employee group health, these policies do not cover all possible claims and certain of the policies are subject to large deductibles. Accordingly, we are effectively self-insured for a substantial number of actual and potential claims. In addition, if any of our insurance carriers defaulted on its obligations to provide insurance coverage by reason of its insolvency or for other reasons, our exposure to claims would increase and our profits would be adversely affected. Our estimates for unpaid claims and expenses are based on known facts, historical trends and industry averages, utilizing the assistance of actuarial services. The determination of such estimated liabilities and their appropriateness are reviewed and updated at least quarterly. However, these liabilities are difficult to assess and estimate due to many relevant factors, the effects of which are often unknown, including the severity of an injury or damage, the determination of liability in proportion to other parties, the timeliness of reported claims, the effectiveness of our risk management and safety programs and the terms and conditions of our insurance policies. Our accruals are based upon known facts, historical trends and our reasonable estimate of future expenses, and we believe such accruals are adequate. However, unknown or changing trends, risks or circumstances, such as increases in claims, a weakening economy, increases in medical costs, changes in case law or legislation or changes in the nature of the work we perform, could render our current estimates and accruals inadequate. In such case, adjustments to our

balance sheet may be required and these increased liabilities would be recorded in the period that the experience becomes known. Insurance carriers may be unwilling, in the future, to provide our current levels of coverage without a significant increase in insurance premiums and/or collateral requirements to

cover our obligations to them. Increased collateral requirements may be in the form of additional letters of credit and/or cash, and an increase in collateral requirements could significantly reduce our liquidity. If insurance premiums increase, and/or if insurance claims are higher than our estimates, our profitability could be adversely affected. Changes in our effective income tax rate may have an adverse effect on our results of operations

We are subject to taxes in the United States and numerous foreign jurisdictions, including Belgium, where a number of our subsidiaries are organized. Due to economic and political conditions, tax rates in various jurisdictions may be subject to significant change. Our future effective tax rate could be affected by changes in the mix of earnings in countries with different statutory tax rates, changes in the valuation of deferred tax assets and liabilities, changes in the enforcement environment, and changes in tax laws or their interpretations, in the United States and in foreign jurisdictions. For example, in January 2016, the European Commission announced a decision concluding that certain rules under Belgian tax legislation are deemed to be incompatible with European Union regulations on state aid. As a result of this decision, the European Commission has directed the Belgian Government to recover past taxes from certain entities, reflective of disallowed state aid, which impacts one of the Company's international subsidiaries. The Belgian Government announced they have appealed this decision and filed action for an annulment in the General Court of the European Union, and in July 2016 the Company filed a separate appeal with the General Court of the European Union. The Company recorded discrete tax expense of \$39.6 million during 2016 related to this matter and on January 10, 2017, received tax assessments from the Belgium government for a similar amount. The Company has filed a complaint against the Belgian tax assessments, and the result of this complaint, the appeal with the General Court of the European Union, new information received from the Belgian Government, or other future events may cause the income tax provision associated with the decision to be entirely or partially reversed. At June 30, 2018, we held the euro equivalent of \$35.3 million in a restricted account. Those amounts, or portions thereof, could become unrestricted based on a similar fact pattern.

Our future effective tax rate may be adversely affected by a number of additional factors including:

- the jurisdictions in which profits are determined to be earned and taxed;
- the resolution of issues arising from tax audits with various tax authorities;
- changes in the valuation of our deferred tax assets and liabilities;
- adjustments to estimated taxes upon finalization of various tax returns;
- increases in expenses not deductible for tax purposes;
- changes in available tax credits;
  - changes in share-based compensation expense;
- changes in tax laws or the interpretation of such tax laws and changes in generally accepted accounting principles;
- changes in foreign tax rates or agreed upon foreign taxable base; and/or
- the repatriation of earnings from outside the United States for which we have not previously provided for United States taxes.

Any significant increase in our future effective tax rates could adversely impact net income for future periods. In addition, the United States Internal Revenue Service ("IRS") and other tax authorities regularly examine our income tax returns. Our financial condition and results of operations could be adversely impacted if any assessments resulting from the examination of our income tax returns by the IRS or other taxing authorities are not resolved in our favor. New tax legislation, commonly referred to as the Tax Cuts and Jobs Act (the "Tax Act"), was enacted on December 22, 2017. The Tax Act, among other things, (i) permanently reduces the US corporate income tax rate to 21% beginning in 2018, (ii) provides for a five year period of 100% bonus depreciation followed by a phase-down of the bonus depreciation percentage, and (iii) provides for more general changes to the taxation of corporations, including changes to the deductibility of interest expense, the adoption of a modified territorial tax system, assessing a repatriation tax or "toll-charge" on undistributed earnings and profits of US-owned foreign corporations, and introducing certain anti-base erosion provisions. The long-term impact of the Tax Act on the general economy cannot be reliably predicted at this time and will require rule-making and interpretation in a number of areas.

The Tax Act requires complex computations not previously required by U.S. tax law. As such, the application of certain accounting guidance is currently evolving. Further, compliance with the Tax Act and the accounting for certain provisions require accumulation of information not previously required or regularly produced. As a result, we have

provided a provisional estimate on the effect of the Tax Act in our financial statements. As additional interpretative guidance is issued by the applicable authorities, we will

37

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continue our analysis on the application of the Tax Act and will revise our current estimates in future periods. The revisions to our current estimates could materially affect our results of operations, cash flow and financial position. State of Oregon law and our charter documents contain provisions that could discourage or prevent a potential takeover, even if the transaction would benefit our shareholders

Other companies may seek to acquire or merge with us. An acquisition or merger of our Company could result in benefits to our shareholders, including an increase in the value of our common stock. Some provisions of our Articles of Incorporation and Bylaws, including our ability to issue preferred stock without further action by our shareholders, as well as provisions of the State of Oregon law, may discourage, delay or prevent a merger or acquisition that a shareholder may consider favorable.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

During the three months ended June 30, 2018, the Company repurchased the following shares:

Period	Total Number of Shares Purchased <sup>(1)</sup>	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs <sup>(1)</sup>	Maximum Number of Shares that May Yet Be Purchased Under the Plan or Programs <sup>(2)</sup>
April 1 to April 30, 2018	100,626	\$ 49.71	100,626	
June 1 to June 30, 2018	155,996	64.10	155,996	
Total	256,622	\$ 58.46	1,978,553	13,021,447

(1) The share repurchases totaling 100,626 shares were through open market transactions. On March 1, 2018, we entered into an uncollared accelerated share repurchase program (“ASR”) at a notional amount of \$50.0 million under which we were to receive a number of shares based on the daily volume weighted average price of common stock, less a discount, over a period beginning on the effective date of the ASR and ending on a date no later than June 4, 2018. Under the ASR, we received the initial shares of 813,670 on March 5, 2018. The ASR was settled on June 4, 2018 and we received an additional 155,996 shares. The average price paid per share for the total shares received under the ASR was \$51.56. These shares received resulted in an immediate reduction of the shares used to calculate our weighted-average common shares outstanding for basic and diluted earnings per share.

(2) All share repurchases are subject to applicable securities law, and are at times and in amounts as management deems appropriate. On February 8, 2017, our Board of Directors authorized the repurchase of up to 15.0 million shares of our outstanding common stock. This authorization will expire on February 8, 2019. During the six months ended June 30, 2018, the Company repurchased 2.0 million shares of the Company's common stock under the February 2017 repurchase authorization by the Company's Board of Directors.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Number	Description
31.1	<u>Principal Executive Officer Certification Pursuant to Sarbanes-Oxley Act of 2002, Section 302.</u>
31.2	<u>Principal Financial Officer Certification Pursuant to Sarbanes-Oxley Act of 2002, Section 302.</u>
32.1	<u>Certification by the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>
32.2	<u>Certification by the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 .</u>
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document



SIGNATURE

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

FLIR SYSTEMS, INC.

Date July 27, 2018 /s/ Carol P. Lowe

Carol P. Lowe

Executive Vice President and Chief Financial Officer

(Duly Authorized and Principal Financial Officer)