ZEBRA TECHNOLOGIES CORP/DE
Form 10-Q
November 08, 2006

# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D. C. 20549**

# FORM 10-Q

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

**For the quarterly period ended September 30, 2006**

**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: 000-19406**

# Zebra Technologies Corporation

**(Exact name of registrant as specified in its charter)**

| | |
|---|---|
| **Delaware** | **36-2675536** |
| **(State or other jurisdiction of incorporation or organization)** | **(I.R.S. Employer Identification No.)** |

**333 Corporate Woods Parkway, Vernon Hills, IL 60061**

**(Address of principal executive offices) (Zip Code)**

**Registrant s telephone number, including area code: (847) 634-6700**

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 x No ¨

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

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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

As of October 27, 2006, shares outstanding were as follows:

Class A Common Stock, $.01 par value 70,438,674

**ZEBRA TECHNOLOGIES CORPORATION**

**QUARTER ENDED SEPTEMBER 30, 2006**

**INDEX**

**PART I - FINANCIAL INFORMATION**

**Item 1. Consolidated Financial Statements**

**ZEBRA TECHNOLOGIES CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

(Amounts in thousands)

| | September 30, 2006 (Unaudited) | December 31, 2005 (restated see Note 2) (Unaudited) |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 39,557 | $ 25,621 |
| Investments and marketable securities | 165,169 | 518,618 |
| Accounts receivable, net | 116,612 | 111,551 |
| Inventories, net | 82,072 | 63,638 |
| Deferred income taxes | 9,468 | 8,188 |
| Income taxes receivable | 6,002 | |
| Prepaid expenses | 6,680 | 5,098 |
| Total current assets | 425,560 | 732,714 |
| Property and equipment at cost, less accumulated depreciation and amortization | 55,700 | 49,643 |
| Long-term deferred income taxes | 6,347 | 6,216 |
| Goodwill | 69,097 | 69,097 |
| Other intangibles, net | 34,104 | 19,002 |
| Long-term investments and marketable securities | 342,897 | |
| Other assets | 54,358 | 41,743 |
| **Total assets** | $ 988,063 | $ 918,415 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 25,160 | $ 24,885 |
| Accrued liabilities | 37,105 | 28,928 |
| Income taxes payable | | 535 |
| Total current liabilities | 62,265 | 54,348 |
| Deferred rent | 567 | 574 |
| Other long-term liabilities | 6,219 | 5,521 |
| **Total liabilities** | 69,051 | 60,443 |
| Stockholders equity: | | |
| Preferred Stock | | |
| Class A Common Stock | 722 | 722 |
| Additional paid-in capital | 137,512 | 139,433 |
| Treasury stock | (52,542) | (64,013) |
| Retained earnings | 828,953 | 779,453 |
| Accumulated other comprehensive income | 4,367 | 2,377 |

| | | |
|---|---|---|
| **Total stockholders equity** | 919,012 | 857,972 |
| **Total liabilities and stockholders equity** | $ 988,063 | $ 918,415 |

See accompanying notes to consolidated financial statements.

**ZEBRA TECHNOLOGIES CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF EARNINGS (LOSS)**

(Amounts in thousands, except per share data)

(Unaudited)

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 30, 2006 | October 1, 2005 (restated see Note 2) | September 30, 2006 | October 1, 2005 (restated see Note 2) |
| Net sales | $ 186,386 | $ 175,636 | $ 549,621 | $ 522,977 |
| Cost of sales | 98,600 | 88,103 | 289,611 | 259,169 |
| Gross profit | 87,786 | 87,533 | 260,010 | 263,808 |
| Operating expenses: | | | | |
| Selling and marketing | 23,467 | 21,291 | 69,086 | 65,905 |
| Research and development | 11,774 | 11,818 | 36,191 | 35,256 |
| General and administrative | 14,642 | 15,631 | 44,372 | 49,234 |
| Amortization of intangible assets | 789 | 509 | 2,259 | 1,543 |
| Litigation settlement | 53,392 | | 53,392 | |
| Exit costs | | 283 | | 1,941 |
| Total operating expenses | 104,064 | 49,532 | 205,300 | 153,879 |
| Operating income (loss) | (16,278) | 38,001 | 54,710 | 109,929 |
| Other income (expense): | | | | |
| Investment income | 6,008 | 3,254 | 16,202 | 9,603 |
| Interest expense | (5) | (41) | (236) | (71) |
| Foreign exchange gains | 457 | 334 | 187 | 1,199 |
| Other, net | (287) | 251 | (912) | (296) |
| Total other income | 6,173 | 3,798 | 15,241 | 10,435 |
| Income (loss) before income taxes and cumulative effect of accounting change | (10,105) | 41,799 | 69,951 | 120,364 |
| Income tax (benefit) | (5,842) | 13,724 | 21,770 | 41,025 |
| Income (loss) before cumulative effect of accounting change | (4,263) | 28,075 | 48,181 | 79,339 |
| Cumulative effect of accounting change (net of tax effect of $694) | | | 1,319 | |
| Net income (loss) | $ (4,263) | $ 28,075 | $ 49,500 | $ 79,339 |
| Basic earnings (loss) per share before cumulative effect of accounting change | $ (0.06) | $ 0.39 | $ 0.68 | $ 1.11 |
| Diluted earnings (loss) per share before cumulative effect of accounting change | $ (0.06) | $ 0.39 | $ 0.68 | $ 1.10 |
| Basic earnings (loss) per share | $ (0.06) | $ 0.39 | $ 0.70 | $ 1.11 |
| Diluted earnings (loss) per share | $ (0.06) | $ 0.39 | $ 0.70 | $ 1.10 |
| Basic weighted average shares outstanding | 70,802 | 71,263 | 70,702 | 71,653 |
| Diluted weighted average and equivalent shares outstanding | 70,802 | 71,817 | 71,152 | 72,311 |

See accompanying notes to consolidated financial statements.

**ZEBRA TECHNOLOGIES CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

(Amounts in thousands)

(Unaudited)

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | **September 30, 2006** | **October 1, 2005 (restated see Note 2)** | **September 30, 2006** | **October 1, 2005 (restated see Note 2)** |
| Net income (loss) | $ (4,263) | $ 28,075 | $ 49,500 | $ 79,339 |
| Other comprehensive income (loss): | | | | |
| Foreign currency translation adjustment | 701 | (452) | 4,140 | (5,094) |
| Changes in unrealized gains and (losses) on hedging transactions, net of tax | 831 | (779) | (559) | 2,266 |
| Changes in unrealized gains and (losses) on investments, net of tax | 1,990 | 644 | (1,591) | 672 |
| Comprehensive income (loss) | $ (741) | $ 27,488 | $ 51,490 | $ 77,183 |

See accompanying notes to consolidated financial statements.

**ZEBRA TECHNOLOGIES CORPORATION AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Amounts in thousands)

(Unaudited)

| | Nine Months Ended | |
|---|---|---|
| | September 30, 2006 | October 1, 2005 (restated see Note 2) |
| Cash flows from operating activities: | | |
| Net income | $ 49,500 | $ 79,339 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 11,338 | 9,559 |
| Stock-based compensation | 5,272 | 6,088 |
| Excess tax benefit from share-based compensation | (1,570) | (1,802) |
| Cumulative effect of accounting change (net of tax) | (1,319) | |
| Deferred income taxes | (1,345) | (1,765) |
| Changes in assets and liabilities: | | |
| Accounts receivable, net | (1,146) | (5,441) |
| Inventories | (16,746) | (5,548) |
| Other assets | (1,157) | (7,317) |
| Accounts payable | (1,387) | 136 |
| Accrued liabilities | 7,527 | (775) |
| Income taxes payable | (6,149) | (1,990) |
| Other operating activities | (2,063) | 1,560 |
| Net cash provided by operating activities | 40,755 | 72,044 |
| Cash flows from investing activities: | | |
| Purchases of property and equipment | (14,640) | (9,236) |
| Acquisition of assets of Retail Systems International, Inc. | | (7,657) |
| Acquisition of intangible assets | (18,091) | (13,754) |
| Purchases of investments and marketable securities | (860,250) | (805,368) |
| Maturities of investments and marketable securities | 583,582 | 520,470 |
| Sales of investments and marketable securities | 275,601 | 303,606 |
| Net cash used in investing activities | (33,798) | (11,939) |
| Cash flows from financing activities: | | |
| Purchase of treasury stock | (4,069) | (70,421) |
| Proceeds from exercise of stock options and stock purchase plan purchases | 9,050 | 9,252 |
| Excess tax benefit from share-based compensation | 1,570 | 1,802 |
| Payments for obligation under capital lease | | (40) |
| Net cash provided by (used in) financing activities | 6,551 | (59,407) |
| Effect of exchange rate changes on cash | 428 | (232) |
| Net increase in cash and cash equivalents | 13,936 | 466 |
| Cash and cash equivalents at beginning of period | 25,621 | 17,983 |
| Cash and cash equivalents at end of period | $ 39,557 | $ 18,449 |

| | | |
|---|---|---|
| Supplemental disclosures of cash flow information: | | |
| Interest paid | $ 236 | $ 71 |
| Income taxes paid | 29,402 | 46,191 |

See accompanying notes to consolidated financial statements.

**ZEBRA TECHNOLOGIES CORPORATION AND SUBSIDIARIES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

**Note 1 Basis of Presentation**

Management prepared these unaudited interim consolidated financial statements for Zebra Technologies Corporation and subsidiaries (Zebra) according to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information required in full-year audited financial statements is omitted, as allowed by SEC rules and regulations. These omissions relate to required annual disclosures, which have not materially changed since our Form 10-K was filed with the SEC. See our Form 10-K for the year ended December 31, 2005, for these additional disclosures.

The consolidated balance sheet as of December 31, 2005, in this Form 10-Q is taken from the audited consolidated balance sheet in our Form 10-K, as restated for SFAS No. 123(R) as described below. These interim financial statements include all normal, recurring adjustments necessary to present fairly Zebra s consolidated financial position as of September 30, 2006, the consolidated results of operations for the three and nine months ended September 30, 2006 and October 1, 2005, and cash flows for the nine months ended September 30, 2006 and October 1, 2005. These results, however, are not necessarily indicative of results for the full year.

**Note 2 Stock-Based Compensation**

As of September 30, 2006, we had two stock-based compensation plans available for future grants. Prior to January 1, 2006, we accounted for these plans using the intrinsic value method in accordance with the recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees,* and related interpretations, as permitted by SFAS No. 123, *Accounting for Stock Based Compensation*. Accordingly, we recognized no compensation cost as all options granted under these plans had grant prices equal to the market value of the underlying common stock on the date of grant and the number of shares was fixed.

Effective January 1, 2006, Zebra adopted SFAS No. 123(R), *Share-Based Payments,* utilizing the modified retrospective approach, which requires the prior period financial statements to be restated to recognize compensation costs in the amounts previously reported in the pro forma footnote disclosures. Zebra recognizes compensation costs using the straight-line method over the vesting period of 2 to 5 years. The following tables summarize the adjustments made to the consolidated financial statements as a result of these restatements:

| **(In thousands)** | **December 31, 2005** | | |
|---|---|---|---|
| | **As Previously Reported** | **Share-Based Compensation** | **As Restated** |
| **Selected Balance Sheet Data:** | | | |
| Long-term deferred income tax (liability) asset | $ (1,242) | $ 7,458 | $ 6,216 |
| Additional paid-in capital | 93,336 | 46,097 | 139,433 |
| Retained Earnings | 818,092 | (38,639) | 779,453 |

| **(In thousands, except per share data)** | **For the Three Months Ended October 1, 2005** | | |
|---|---|---|---|
| | **As Previously Reported** | **Share-Based Compensation** | **As Restated** |
| **Selected Statement of Earnings Data:** | | | |
| Cost of sales | $ 87,959 | $ 144 | $ 88,103 |
| Gross profit | 87,677 | (144) | 87,533 |
| Selling and marketing | 20,800 | 491 | 21,291 |
| Research and development | 11,501 | 317 | 11,818 |
| General and administration | 14,489 | 1,142 | 15,631 |
| Total operating expenses | 47,582 | 1,950 | 49,532 |
| Operating income | 40,095 | (2,094) | 38,001 |
| Income before income taxes | 43,893 | (2,094) | 41,799 |
| Income taxes | 14,453 | (729) | 13,724 |
| Net income | 29,440 | (1,365) | 28,075 |
| Basic earnings per share | $ 0.41 | $ (0.02) | $ 0.39 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Diluted earnings per share | $ | 0.41 | $ | (0.02) | $ | 0.39 |

| (In thousands, except per share data) | For the Nine Months Ended October 1, 2005 | | |
|---|---|---|---|
| | As Previously Reported | Share-Based Compensation | As Restated |
| **Selected Statement of Earnings Data:** | | | |
| Cost of sales | $ 258,587 | $ 582 | $ 259,169 |
| Gross profit | 264,390 | (582) | 263,808 |
| Selling and marketing | 64,421 | 1,484 | 65,905 |
| Research and development | 34,222 | 1,034 | 35,256 |
| General and administration | 46,246 | 2,988 | 49,234 |
| Total operating expenses | 148,373 | 5,506 | 153,879 |
| Operating income | 116,017 | (6,088) | 109,929 |
| Income before income taxes | 126,452 | (6,088) | 120,364 |
| Income taxes | 43,143 | (2,118) | 41,025 |
| Net income | 83,309 | (3,970) | 79,339 |
| Basic earnings per share | $ 1.16 | $ (0.05) | $ 1.11 |
| Diluted earnings per share | $ 1.15 | $ (0.05) | $ 1.10 |

The impact of compensation expense and the adoption of SFAS No. 123(R) on the income statement for the three and nine months ended September 30, 2006, was as follows:

| Three Months Ended September 30, 2006 (in thousands) | |
|---|---|
| Cost of sales | $ 163 |
| Gross profit | (163) |
| Selling and marketing | 445 |
| Research and development | 276 |
| General and administration | 903 |
| Total operating expenses | 1,624 |
| Operating loss | (1,787) |
| Loss before income taxes and the cumulative effect of accounting change | (1,787) |
| Income tax benefit | (625) |
| Net loss before cumulative effect of accounting change | (1,162) |
| Net loss | $ (1,162) |
| Basic loss per share before cumulative effect of accounting change | $ (0.02) |
| Diluted loss per share before cumulative effect of accounting change | $ (0.02) |
| Basic loss per share | $ (0.02) |
| Diluted loss per share | $ (0.02) |

| Nine Months Ended September 30, 2006 (in thousands) | |
|---|---|
| Cost of sales | $ 489 |
| Gross profit | (489) |
| Selling and marketing | 1,307 |
| Research and development | 802 |
| General and administration | 2,674 |
| Total operating expenses | 4,783 |
| Operating income | (5,272) |
| Income before income taxes and the cumulative effect of accounting change | (5,272) |
| Income taxes | (1,804) |
| Net income before cumulative effect of accounting change | (3,468) |
| Cumulative effect of accounting change | 1,319 |
| Net income | $ (2,149) |
| Basic earnings per share before cumulative effect of accounting change | $ (0.05) |
| Diluted earnings per share before cumulative effect of accounting change | $ (0.05) |
| Basic earnings per share | $ (0.03) |
| Diluted earnings per share | $ (0.03) |

Prior to adopting SFAS 123(R), Zebra presented all tax benefits of deductions resulting from the exercise of stock grants as operating cash flows in the consolidated statements of cash flows. SFAS 123(R) requires the cash flows resulting from the tax benefits from tax deductions in excess of the compensation cost recognized (excess tax benefits) to be classified as financing cash flows. As a result, $1,570,000 of excess tax benefits for the nine months ended September 30, 2006, have been classified as financing cash flows. In accordance with the modified retrospective method of SFAS 123(R), the cash flow statement has been restated to show an excess tax benefit of $1,802,000 for the nine months ended October 1, 2005 as a financing cash flow.

SFAS 123(R) requires entities to estimate the number of forfeitures expected to occur and record expense based upon the number of awards expected to vest. Prior to the adoption of SFAS No. 123(R), Zebra accounted for forfeitures as they occurred as permitted under previous accounting standards. The requirement to estimate forfeitures is classified as an accounting change under APB Opinion No. 20, *Accounting Changes*, which requires a one-time adjustment in the period of adoption. The one-time adjustment (cumulative effect of accounting change) related to the change in estimating forfeitures increased income by $1,319,000, net of applicable taxes, for the nine months ended September 30, 2006.

*Compensation Plans*

On May 9, 2006, the stockholders of Zebra approved the 2006 Zebra Technologies Corporation Incentive Compensation Plan (the 2006 Plan). The 2006 Plan became effective immediately and superseded the 1997 Stock Option Plan (the 1997 Plan) and the 2002 Non-Employee Director Stock Option Plan (the 2002 Director Plan), except that the prior plans will remain in effect with respect to stock options granted under the prior plans until such options have been exercised, forfeited, cancelled, expired or otherwise terminated in accordance with the terms of such grants. The types of awards available under the 2006 Plan are incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock, performance shares and units and performance-based cash bonuses. Employees, directors and consultants of the Company and its subsidiaries would be eligible to participate in the 2006 Plan. As of September 30, 2006, 5,466,826 shares were available for grant, and options for 33,174 shares were outstanding under the 2006 Plan.

The options granted under the 2006 Plan have an exercise price equal to the closing market price of Zebra s stock on the date of grant. The options granted to employees generally vest over a five-year period. These options expire on the earlier of (a) ten years following the grant date, (b) immediately if the employee is terminated for cause, (c) ninety days if the employee is terminated involuntarily other than for cause, (d) thirty days if the employee voluntarily terminates his or her employment, or (e) one year if the employee s employment terminates due to death, disability, or retirement. The Compensation Committee of the Board of Directors administers the plan.

On October 20, 2006, 53,793 shares of restricted stock were granted under the Plan to certain executive officers and other managers. These restricted stock awards will vest one year after the grant date if the executive remains employed by Zebra throughout the one-year period, but will vest before the end of the one-year period in the event of death, disability, resignation for good reason, a change in control (as defined in the 2006 Plan), or termination by Zebra other than for Cause, as defined in the restricted stock agreement entered into by Zebra with each executive officer who was granted restricted stock (the Restricted Stock Agreement). The restricted stock is forfeited in certain situations specified in the Restricted Stock Agreement, including, if before the restricted stock vests, the executive s employment is terminated by Zebra for Cause (as defined in the Restricted Stock Agreement) or if the executive resigns for other than good reason.

The 1997 Plan was superseded by the 2006 Plan. As of September 30, 2006, options for 2,283,095 shares were outstanding and exercisable under the 1997 Plan. These options expire on the earlier of (a) ten years following the grant date, (b) immediately if the employee is terminated for cause, (c) ninety days if the employee is terminated involuntarily other than for cause, (d) thirty days if the employee voluntarily terminates his or her employment, or (e) one year if the employee s employment terminates due to death, disability, or retirement.

The 1997 Director Plan was terminated on February 1, 2002. As of September 30, 2006, options for 3,750 shares issued under the 1997 Director Plan remained outstanding and unexercised. These options expire on the earlier of (a) ten years following the grant date, or (b) the second anniversary of the termination of the non-employee director s directorship for any reason other than due to death or disability (as defined in the 1997 Director Plan).

The 2002 Director Plan was superseded by the 2006 Plan. As of September 30, 2006, options for 186,068 shares were outstanding and exercisable under the 2002 Director Plan. Unless otherwise provided in an option agreement, options granted under the 2002 Director Plan become exercisable in five equal increments beginning on the date of the grant and on each of the four anniversaries thereafter. All options expire on the earlier of (a) ten years following the grant date, (b) the first anniversary of the termination date of the non-employee director s directorship for any reason other than those listed in clause (c) below, or (c) the termination of the non-employee director s directorship by Zebra s stockholders for cause, or resignation for cause, in each case as defined in the option agreement.

The Board of Directors and stockholders adopted the 2001 Stock Purchase Plan and reserved 1,125,000 shares of Class A Common Stock for issuance under the plan. Under this plan, employees who work a minimum of 20 hours per week may elect to withhold up to 10% of their cash compensation through regular payroll deductions to purchase shares of Class A Common Stock from Zebra over a period not to exceed 12 months at a purchase price per share equal to the lesser of: (1) 85% of the fair market value of the shares as of the date of the grant, or (2) 85% of the fair market value of the shares as of the date of purchase. As of September 30, 2006, 425,709 shares have been purchased under the plan.

For purposes of calculating the compensation cost consistent with SFAS No. 123(R), the fair value of each stock option granted prior to January 1, 2005, is estimated on the date of grant using the Black-Scholes option-pricing model. For stock options granted on or after January 1, 2005, fair value is estimated on the date of grant using a binomial model. Volatility is based on an average of the implied volatility in the open market and the annualized volatility of Zebra s stock prices over our entire stock history. The following table shows the weighted-average assumptions used for stock option grants as well as the fair value of the options granted based on those assumptions:

| | **Nine Months Ended** | |
|---|---|---|
| | **September 30, 2006** | **October 1, 2005** |
| Expected dividend yield | 0% | 0% |
| Forfeiture rate | 7.43% | 0% |
| Volatility | 38.30% | 38.44% |
| Risk free interest rate | 4.58% | 3.74% |
| - Range of interest rates | 4.38% - 4.73% | 2.36% - 4.50% |
| Expected weighted-average life | 4.58 years | 4.83 years |
| Fair value of options granted | $5,802,000 | $9,701,000 |
| Weighted-average grant date fair value of options granted | $14.22 | $17.16 |

The fair value of the employees purchase rights issued under the Stock Purchase Plan are estimated with the following weighted-average assumptions used for purchase rights granted. Expected lives of three months to one year have been used along with these assumptions.

| | **2006** | **2005** |
|---|---|---|
| Fair market value | $ 34.16 | $ 47.49 |
| Option price | $ 29.04 | $ 40.37 |
| Expected dividend yield | 0% | 0% |
| Expected volatility | 28% | 30% |
| Risk free interest rate | 4.49% | 2.73% |

Stock option activity for the period ended September 30, 2006, was as follows:

| | **2006** | | |
|---|---|---|---|
| **Fixed Options** | **Shares** | **Weighted-Average Exercise Price** | |
| Outstanding at beginning of year | 2,552,689 | $ | 31.04 |
| Granted | 408,046 | | 43.15 |
| Exercised | (353,381) | | 21.05 |
| Forfeited | (91,434) | | 40.89 |
| Expired | (9,833) | | 47.96 |
| Outstanding at end of period | 2,506,087 | $ | 34.00 |
| Options exercisable at end of period | 1,060,203 | $ | 26.32 |

The following table summarizes information about fixed stock options outstanding at September 30, 2006:

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| Range of Exercise Prices | Number of Shares | Weighted-Average Remaining Contractual Life | Weighted-Average Exercise Price | Number of Shares | Weighted-Average Exercise Price |
| $ 10.89-$21.02 | 257,860 | 3.30 years | $ 15.64 | 257,860 | $ 15.64 |
| $ 21.31-$24.21 | 466,934 | 5.35 years | 21.67 | 282,020 | 21.65 |
| $ 24.21-$33.03 | 548,217 | 5.62 years | 26.10 | 293,902 | 26.24 |
| $ 33.03-$45.62 | 616,964 | 8.58 years | 42.94 | 101,740 | 39.10 |
| $ 45.62-$53.92 | 616,112 | 8.09 years | 49.10 | 124,681 | 48.74 |
| | 2,506,087 | | | 1,060,203 | |

| | Options Outstanding | Options Exercisable |
|---|---|---|
| Aggregate intrinsic value | $ 17,633,000 | $ 12,356,000 |
| Weighted-average remaining contractual term | 6.7 years | 5.1 years |

As of September 30, 2006, there was $14,431,000 of unearned compensation cost related to stock options granted under the plans. That cost is expected to be recognized over a weighted-average period of 1.7 years.

**Note 3 Inventories**

The components of inventories are as follows (in thousands):

| | September 30, 2006 | December 31, 2005 |
|---|---|---|
| Raw materials | $ 52,325 | $ 39,779 |
| Work in process | 124 | 134 |
| Finished goods | 29,623 | 23,725 |
| Total inventories | $ 82,072 | $ 63,638 |

**Note 4 Business Combinations**

*Retail Systems International, Inc.* On February 11, 2005, Zebra acquired certain assets of Retail Systems International, Inc. (RSI) for $7,797,000. Located in Chula Vista, California, RSI manufactured labels, ribbons, tags and other printed media. The consolidated statements of earnings (loss) reflect the results of operations of RSI since the effective date of the purchase. The pro forma impact of this acquisition was not significant.

The following table (in thousands) summarizes the adjusted fair values of the assets acquired at the date of purchase.

| | At February 11, 2005 |
|---|---|
| Inventory | $ 238 |
| Property and equipment | 469 |
| Intangible assets | 1,073 |
| Goodwill | 6,017 |
| Total assets acquired | $ 7,797 |

The purchase price was allocated to identifiable tangible and intangible assets acquired based on their estimated fair values. The intangible assets of $1,073,000 consist mainly of customer relationships with a useful life of 5 years. The goodwill is fully deductible for tax purposes.

**Note 5 Investments and Marketable Securities**

We classify the majority of our investments and marketable securities as available-for-sale in accordance with the classifications defined in SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities.* As of September 30, 2006, investments and marketable securities with maturities greater than one year are classified as long-term in the balance sheet. This classification does not restrict our ability to sell these securities before maturity.

SFAS No. 115 requires that changes in the market value of available-for-sale securities are reflected in the accumulated other comprehensive income caption of stockholders equity in the balance sheet, until we dispose of the securities. Once these securities are disposed of, either by sale or maturity, the accumulated changes in market value are transferred to investment income. On the cash flow statements, changes in the balances of *available-for-sale* securities are shown as purchases, sales and maturities of investments and marketable securities under investing activities.

Changes in market value of *trading* securities are recorded in investment income as they occur, and the related cash flow statement includes changes in the balances of trading securities as operating cash flows.

Unrealized gains and losses on investment securities are included in these financial statements as follows (in thousands):

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | **September 30, 2006** | **October 1, 2005** | **September 30, 2006** | **October 1, 2005** |
| Changes in unrealized gain and losses on available-for-sale securities, net of tax, recorded in accumulated other comprehensive income (loss) | $ 1,990 | $ 644 | $ (1,591) | $ 672 |

**Note 6 Stockholders Equity**

Share count and par value data related to stockholders equity are as follows:

| | **September 30, 2006** | **December 31, 2005** |
|---|---|---|
| Preferred Stock | | |
| Par value per share | $ 0.01 | $ 0.01 |
| Shares authorized | 10,000,000 | 10,000,000 |
| Shares outstanding | | |
| Common Stock - Class A | | |
| Par value per share | $ 0.01 | $ 0.01 |
| Shares authorized | 150,000,000 | 150,000,000 |
| Shares issued | 72,151,857 | 72,151,857 |
| Shares outstanding | 70,739,544 | 70,451,124 |
| Treasury stock | | |
| Shares held | 1,412,313 | 1,700,733 |

During the third quarter of 2006, Zebra repurchased 116,800 shares for $4,069,000. Treasury shares are being reissued for exercise of stock options and purchases under the stock purchase plan.

**Note 7 Other Comprehensive Income (Loss)**

Stockholders equity includes certain items classified as other comprehensive income, including:

**Foreign currency translation adjustment** relates to our non-U.S. subsidiary companies that have designated a functional currency other than the U.S. dollar. We are required to translate the subsidiary functional currency financial statements to dollars using a combination of historical, month-end, and average foreign exchange rates. This combination of rates creates the foreign currency translation adjustment component of other comprehensive income.

**Unrealized gains (losses) on foreign currency hedging activities** relate to derivative instruments used to hedge the currency exchange rates for forecasted euro sales. These hedges are designated as cash flow hedges, and we have deferred income statement recognition of gains and losses until the hedged transaction occurs. See Note 10 for more details.

**Unrealized gains (losses) on investments classified as available-for-sale** are deferred from income statement recognition until the gains or losses are realized. See Note 5 above for more details.

The components of other comprehensive income (loss) included in the Consolidated Statements of Comprehensive Income (Loss) are as follows (in thousands):

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 30, 2006 | October 1, 2005 | September 30, 2006 | October 1, 2005 |
| Foreign currency translation adjustments | $ 701 | $ (452) | $ 4,140 | $ (5,094) |
| Changes in unrealized gains and losses on foreign currency hedging activities: | | | | |
| Gross | $ 1,333 | $ (1,249) | $ (897) | $ 3,540 |
| Income tax (benefit) | 502 | (470) | (338) | 1,274 |
| Net | $ 831 | $ (779) | $ (559) | $ 2,266 |
| Changes in unrealized gains and losses on investments classified as available-for-sale: | | | | |
| Gross | $ 3,191 | $ 1,033 | $ (2,552) | $ 1,090 |
| Income tax (benefit) | 1,201 | 389 | (961) | 418 |
| Net | $ 1,990 | $ 644 | $ (1,591) | $ 672 |

The components of other comprehensive income (loss) included in the Consolidated Balance Sheets are as follows (in thousands):

| | As of | |
|---|---|---|
| | September 30, 2006 | December 31, 2005 |
| Foreign currency translation adjustments | $ 5,245 | $ 1,105 |
| Unrealized gains on foreign currency hedging activities: | | |
| Gross | $ 102 | $ 999 |
| Income tax | 38 | 376 |
| Net | $ 64 | $ 623 |
| Unrealized gains and losses on investments classified as available-for-sale: | | |
| Gross | $ (1,511) | $ 1,041 |
| Income tax (benefit) | (569) | 392 |
| Net | $ (942) | $ 649 |

**Note 8 Earnings (Loss) Per Share**

Earnings (loss) per share before cumulative effect of accounting change were computed as follows (in thousands, except per share amounts):

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 30, 2006 | October 1, 2005 (restated see Note 2) | September 30, 2006 | October 1, 2005 (restated see Note 2) |
| **Basic earnings (loss) per share:** | | | | |
| Income (loss) before cumulative effect of accounting change | $ (4,263) | $ 28,075 | $ 48,181 | $ 79,339 |
| Weighted average common shares outstanding | 70,802 | 71,263 | 70,702 | 71,653 |
| Per share amount | $ (0.06) | $ 0.39 | $ 0.68 | $ 1.11 |
| **Diluted earnings (loss) per share:** | | | | |
| Income (loss) before cumulative effect of accounting change | $ (4,263) | $ 28,075 | $ 48,181 | $ 79,339 |
| Weighted average common shares outstanding | 70,802 | 71,263 | 70,702 | 71,653 |
| Add: Effect of dilutive securities stock options | | 554 | 450 | 658 |
| Diluted weighted average and equivalent shares outstanding | 70,802 | 71,817 | 71,152 | 72,311 |
| Per share amount | $ (0.06) | $ 0.39 | $ 0.68 | $ 1.10 |

Earnings (loss) per share after the cumulative effect of the accounting change were computed as follows (in thousands, except per share amounts):

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 30, 2006 | October 1, 2005 (restated see Note 2) | September 30, 2006 | October 1, 2005 (restated see Note 2) |
| **Basic earnings (loss) per share:** | | | | |
| Net income (loss) | $ (4,263) | $ 28,075 | $ 49,500 | $ 79,339 |
| Weighted average common shares outstanding | 70,802 | 71,263 | 70,702 | 71,653 |
| Per share amount | $ (0.06) | $ 0.39 | $ 0.70 | $ 1.11 |
| **Diluted earnings (loss) per share:** | | | | |
| Net income (loss) | $ (4,263) | $ 28,075 | $ 49,500 | $ 79,339 |
| Weighted average common shares outstanding | 70,802 | 71,263 | 70,702 | 71,653 |
| Add: Effect of dilutive securities stock options | | 554 | 450 | 658 |
| Diluted weighted average and equivalent shares outstanding | 70,802 | 71,817 | 71,152 | 72,311 |
| Per share amount | $ (0.06) | $ 0.39 | $ 0.70 | $ 1.10 |

The calculation of loss per share for the three months ended September 30, 2006 did not include the effect of dilutive securities (stock options) because to do so would have been anti-dilutive.

Potentially dilutive securities that were excluded from the earnings (loss) per share calculation consist of stock options with an exercise price greater than the average market price of the Class A common stock. These options were as follows:

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | **September 30, 2006** | **October 1, 2005** | **September 30, 2006** | **October 1, 2005** |
| Potentially dilutive shares | 1,233,000 | 831,000 | 1,151,000 | 814,000 |

**Note 9 Goodwill and Other Intangible Asset Data**

Intangible asset data are as follows (in thousands):

| | September 30, 2006 | | December 31, 2005 | |
|---|---|---|---|---|
| | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization |
| Amortized intangible assets | | | | |
| Current technology and patents | $ 42,804 | $ (10,958) | $ 26,011 | $ (9,632) |
| Customer relationships | 3,406 | (1,148) | 3,406 | (783) |
| Total | $ 46,210 | $ (12,106) | $ 29,417 | $ (10,415) |
| Unamortized intangible assets | | | | |
| Goodwill | $ 69,097 | | $ 69,097 | |
| Aggregate amortization expense | | | | |
| For the year ended December 31, 2005 | | | $ 2,341 | |
| For the three months ended September 30, 2006 | $ 789 | | | |
| For the nine months ended September 30, 2006 | $ 2,259 | | | |
| Estimated amortization expense | | | | |
| For the year ended December 31, 2006 | 3,572 | | | |
| For the year ended December 31, 2007 | 5,277 | | | |
| For the year ended December 31, 2008 | 5,279 | | | |
| For the year ended December 31, 2009 | 5,182 | | | |
| For the year ended December 31, 2010 | 4,423 | | | |
| Thereafter | 12,630 | | | |

During 2006, we acquired intangible assets in the amount of $18,091,000 for patents and engineering design. These intangible assets will have a commercial life of 4 to 9 years. Also during 2006, we reviewed the usefulness of certain other intangibles and found them to be impaired. Therefore, we incurred a write-off of net intangibles of $730,000.

Included in the acquisition of intangible assets was a payment for the settlement of a lawsuit with Paxar Americas, Inc. A portion ($10,358,000) of this settlement has been applied to future use of patents. This portion of the settlement has been recorded as intangibles and will be amortized over the estimated useful lives of the patents, which range from 4 to 7 years. In some cases, the useful lives may be less than the patent lives. See Note 11 for further discussion of the settlement.

We test the impairment of goodwill each year or whenever events or changes in circumstances indicate that the carrying value may not be recoverable. We completed our last assessment during June 2006. At that time, no adjustment to goodwill was necessary due to impairment.

We evaluate the impairment of identifiable intangibles and other long-lived assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

Factors considered that may trigger an impairment review consist of:

- Significant underperformance relative to expected historical or projected future operating results,
- Significant changes in the manner of use of the acquired assets or the strategy for the overall business,
- Significant negative industry or economic trends,

- Significant decline in Zebra s stock price for a sustained period, and

- Significant decline in market capitalization relative to net book value.

If we believe that one or more of the above indicators of impairment have occurred, we measure impairment based on a projected discounted cash flow methodology using a discount rate that incorporates the risk inherent in the cash flows.

**Note 10 Derivative Instruments**

In the normal course of business, portions of Zebra s operations are subject to fluctuations in currency values. We manage these risks using derivative financial instruments.

*Hedging of Net Assets*

We use forward contracts and options to manage exposure related to our pound and euro denominated net assets. We record gains and losses on these contracts and options in income each quarter along with the transaction gains and losses related to our net euro asset position, which would ordinarily offset each other. Summary financial information related to these activities follows (in thousands):

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 30, 2006 | October 1, 2005 | September 30, 2006 | October 1, 2005 |
| Change in gains and losses from foreign exchange derivatives | $ 1,190 | $ (631) | $ 11 | $ 970 |
| Gain (loss) on net foreign currency assets | (733) | 965 | 176 | 229 |
| Net foreign exchange gain | $ 457 | $ 334 | $ 187 | $ 1,199 |

| | As of | |
|---|---|---|
| | September 30, 2006 | December 31, 2005 |
| Notional balance of outstanding contracts: | | |
| Pound/US dollar | £ 2,389 | £ 3,289 |
| Euro/US dollar | 20,000 | 25,000 |
| Euro/Pound | 22,000 | 16,000 |

*Hedging of Anticipated Sales*

We manage the exchange rate risk of anticipated euro denominated sales using forward contracts and option collars. We designate these contracts as cash flow hedges. Gains and losses on these contracts are deferred in other comprehensive income until the contracts are settled and the hedged sales are realized, at which time the deferred gains or losses will be reported as an increase or decrease to sales. Summary financial information related to the cash flow hedges of future revenues follows (in thousands, except percentages):

| | As of | |
|---|---|---|
| | September 30, 2006 | December 31, 2005 |
| Net unrealized gains deferred in other comprehensive income: | | |
| Gross | $ 102 | $ 999 |
| Income tax | 38 | 376 |
| Net | $ 64 | $ 623 |
| Notional balance of outstanding contracts | 42,000 | 30,750 |
| Hedge effectiveness | 100% | 100% |
| | **2006** | **2005** |
| Net gains and (losses) included in revenue for the: | | |
| Three months ended September 30, 2006 | $ (721) | |
| Three months ended October 1, 2005 | | $ 1,413 |
| Nine months ended September 30, 2006 | (553) | |
| Nine months ended October 1, 2005 | | 742 |

**Note 11 Contingencies**

On September 14, 2006, Zebra settled all issues surrounding the litigation with Paxar Americas, Inc., and the case was dismissed with prejudice. Zebra paid Paxar $63,750,000 in exchange for a general release and a fully paid, perpetual, worldwide license to all of the patents in suit, as well as a number of related U.S. and foreign patents that Paxar had not asserted in the suit. The license to sell products in the United States under four U.S. patents not subject to the lawsuit is limited until September 14, 2009. There is no such limitation on the license under the patents in suit. Of the amount paid to Paxar, $10,358,000 was applied to future use of patents based on their estimated fair value and will be amortized over an estimated useful life of 4 to 7 years. The remaining $53,392,000 was recorded as operating expenses in the Consolidated Statement of Earnings (Loss).

On January 31, 2003, a Writ of Summons was filed in the Nantes Commercial Court, Nantes, France, by Printherm, a French corporation, and several of its shareholders (collectively, Printherm ), against Zebra Technologies France ( ZTF ), a French corporation and wholly-owned subsidiary of Zebra. Printherm seeks damages in the amount of 15,304,000 and additional unspecified damages in connection with ZTF s termination of negotiations in December 2000 respecting the proposed acquisition by Zebra of the capital stock of Printherm. The negotiation was terminated based on unsatisfactory results of the ongoing due diligence. We believe that Printherm s claims are without merit and that a loss is not likely to occur. We will vigorously defend the action.

Printherm filed bankruptcy proceedings on August 30, 2004, and the Commercial Court ordered its liquidation on November 30, 2004. The case was put on hold until the Court appointed liquidator filed a submission in August 2005, which started the proceedings again. ZTF filed its answer on November 19, 2005, in anticipation of a Court-ordered December 19, 2005, hearing date. In response to a request by Printherm s liquidator, the Court postponed the hearing date so as to provide time for Printherm to respond to ZTF s answer. The hearing is not expected to occur until sometime during the fourth quarter of 2006.

On July 3, 2006, a Zebra reseller filed for bankruptcy protection. At the time of the filing, the reseller owed various Zebra subsidiaries a total of $12,065,000. The entire balance due to Zebra is guaranteed by a U.K. insurance company. Zebra has initiated a suit in the U.K. courts to enforce the guarantee. We expect full recovery; therefore, no reserve has been recorded against the balance due.

**Note 12 Warranty**

Zebra provides warranty coverage of up to one year on printers against defects in material and workmanship. A provision for warranty expense is recorded at the time of shipment and adjusted quarterly based on historical warranty experience. The following is a summary of Zebra s accrued warranty obligation.

| | Nine Months Ended September 30, 2006 | Nine Months Ended October 1, 2005 |
|---|---|---|
| Balance at the beginning of the year | $ 1,922 | $ 1,691 |
| Warranty expense year-to-date | 3,876 | 4,417 |
| Warranty payments made year-to-date | (3,773) | (4,167) |
| Balance at the end of the period | $ 2,025 | $ 1,941 |

During the third quarter of 2005, Zebra began providing for environmental recycling reserves similar to warranty reserves. In the European Union, we have an obligation in the future to recycle printers. This reserve is based on all new printers sold after August 13, 2005, and printers sold prior to that date that are returned to us upon our sale of a new printer to a customer. The following is a summary of Zebra s accrued recycling obligation.

| | Nine Months Ended September 30, 2006 | Nine Months Ended October 1, 2005 |
|---|---|---|
| Balance at the beginning of the year | $ 632 | $ |
| Recycling expense year-to-date | 1,005 | 318 |
| Recycling payments made year-to-date | | |
| Exchange rate impact | 23 | |
| Balance at the end of the period | $ 1,660 | $ 318 |

**Note 13 Income Taxes**

The effective income tax rate for the third quarter was 57.8% compared to the 32.8% for the third quarter of 2005. The increase in the effective tax rate is a result of the increased impact of permanent tax differences, including tax-exempt interest income, on the effective income tax rate due to the loss before income taxes incurred in the third quarter. In addition, we reduced tax reserves in the amount of $1,189,000 related to the completion of various state tax audits and 2005 state income tax returns. The resulting year-to-date effective income tax rate for 2006 was 31.2% compared to 34.1% for the same period in 2005.

In June 2006, the FASB issued FIN 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109,* which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. This Interpretation will become effective for Zebra during the first quarter of 2007. We are still evaluating the impact of this Interpretation but do not expect it to have a material impact on our financial condition or results of operations.

**Note 14 Subsequent Event**

On October 4, 2006, Zebra acquired all of the outstanding stock of Swecoin AB, a leading supplier of thermal receipt, ticket and document printers for use in kiosks and other unattended printing applications, for a total of $4,186,000, which includes the repayment of all outstanding debt. Swecoin is based in Stockholm, Sweden, with a U.S. office in Rhode Island.

**Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations**

Zebra s consolidated sales growth in the third quarter was 6.1%, boosted by ongoing high sales growth in our Latin America and Europe, Middle East and Africa regions and an improved sales trend in North America. Supplies sales increased 17.9% resulting from our ability to geographically disburse label converter operations and expand capacity. A decline in gross profit margin was caused by changes in product mix, lower average unit prices, and higher raw material costs. Quarterly results were boosted by an increase in investment income but negatively affected by a one-time payment related to settle a legal dispute with Paxar Americas, Inc. We restated all relevant figures for 2005 for the adoption of SFAS No. 123(R), *Share-Based Payments.*

**Results of Operations: Third Quarter of 2006 versus third Quarter of 2005**

*Sales*

Sales by product category, percent change, and percent of total sales for the three and nine months ended September 30, 2006, and October 1, 2005, were (in thousands, except percentages):

| | Three Months Ended | | | | |
|---|---|---|---|---|---|
| **Product Category** | **September 30, 2006** | **October 1, 2005** | **Percent Change** | **Percent of Total Sales - 2006** | **Percent of Total Sales - 2005** |
| Hardware | $ 140,892 | $ 133,488 | 5.5 | 75.6 | 76.0 |
| Supplies | 38,408 | 32,563 | 17.9 | 20.6 | 18.5 |
| Service and software | 6,280 | 6,309 | (0.5) | 3.4 | 3.6 |
| Shipping and handling | 1,527 | 1,863 | (18.0) | 0.8 | 1.1 |
| Cash flow hedging activities | (721) | 1,413 | NM | (0.4) | 0.8 |
| Total sales | $ 186,386 | $ 175,636 | 6.1 | 100.0 | 100.0 |

| | Nine Months Ended | | | | |
|---|---|---|---|---|---|
| **Product Category** | **September 30, 2006** | **October 1, 2005** | **Percent Change** | **Percent of Total Sales - 2006** | **Percent of Total Sales - 2005** |
| Hardware | $ 414,921 | $ 402,874 | 3.0 | 75.5 | 77.1 |
| Supplies | 112,130 | 95,603 | 17.3 | 20.4 | 18.3 |
| Service and software | 18,710 | 19,015 | (1.6) | 3.4 | 3.6 |
| Shipping and handling | 4,413 | 4,743 | (7.0) | 0.8 | 0.9 |
| Cash flow hedging activities | (553) | 742 | NM | (0.1) | 0.1 |
| Total sales | $ 549,621 | $ 522,977 | 5.1 | 100.0 | 100.0 |

Sales to customers by geographic region, percent changes and percent of total sales for the three and nine months ended September 30, 2006, and October 1, 2005, were (in thousands, except percentages):

| | Three Months Ended | | | | |
|---|---|---|---|---|---|
| **Geographic Region** | **September 30, 2006** | **October 1, 2005** | **Percent Change** | **Percent of Total Sales - 2006** | **Percent of Total Sales - 2005** |
| Europe, Middle East and Africa | $ 58,287 | $ 51,571 | 13.0 | 31.3 | 29.4 |
| Latin America | 13,589 | 10,932 | 24.3 | 7.3 | 6.2 |
| Asia-Pacific | 17,736 | 18,983 | (6.6) | 9.5 | 10.8 |
| Total International | 89,612 | 81,486 | 10.0 | 48.1 | 46.4 |
| North America | 96,774 | 94,150 | 2.8 | 51.9 | 53.6 |

| | | | | | |
|---|---|---|---|---|---|
| Total sales | $ 186,386 | $ 175,636 | 6.1 | 100.0 | 100.0 |

| | Nine Months Ended | | | Percent of | |
|---|---|---|---|---|---|
| **Geographic Region** | **September 30, 2006** | **October 1, 2005** | **Percent Change** | **Total Sales - 2006** | **Percent of Total Sales - 2005** |
| Europe, Middle East and Africa | $ 187,016 | $ 170,422 | 9.7 | 34.0 | 32.6 |
| Latin America | 39,765 | 33,956 | 17.1 | 7.2 | 6.5 |
| Asia-Pacific | 47,906 | 47,107 | 1.7 | 8.7 | 9.0 |
| Total International | 274,687 | 251,485 | 9.2 | 49.9 | 48.1 |
| North America | 274,934 | 271,492 | 1.3 | 50.1 | 51.9 |
| Total sales | $ 549,621 | $ 522,977 | 5.1 | 100.0 | 100.0 |

Ongoing strength in international territories, with notable growth in Latin America of 24.3% and Europe, Middle East and Africa (EMEA) of 13.0%, helped drive improved sales growth in the third quarter of 2006. Sales growth benefited from an 8.3% unit volume increase spread broadly across our printer product lines, offset by a decline in average unit prices from changes in product mix. Sales growth also benefited from strong growth in supplies sales, resulting from recently implemented sales and marketing programs and additional label manufacturing capacity. Favorable foreign exchange movements added 1.4 percentage points to consolidated growth and 4.6 percentage points to growth in EMEA.

Zebra is required to comply with two new European Union (EU) directives that pertain to electrical and electronic equipment. The Waste Electrical and Electronic Equipment Directive requires producers of electrical goods to pay for specified collection, recycling, treatment and disposal of past and future covered products. Another directive (RoHs) requires electrical and electronic equipment placed in the EU market after July 1, 2006, to be free of lead, mercury, cadmium, hexavalent chromium (above a threshold limit) and brominated flame retardants. Costs to comply with these new laws affected results during this quarter and may continue to impact future periods.

New printer products (defined as printers released within 18 months prior to the end of the applicable fiscal period) accounted for 11.0% of printer sales in the third quarter of 2006, compared with 9.9% for the third quarter of 2005 and 12.7% for the second quarter of 2006. Year to-date new printer products accounted for 12.7% of printer sales in 2006, compared with 11.9% for the corresponding period in 2005. New product releases planned for upcoming quarters is expected by management to increase this percentage in future periods.

Zebra s international sales are denominated in multiple currencies, primarily the dollar, pound and euro, which subjects our reported sales to fluctuations based on changes in currency rates. We hedge a portion of anticipated euro-denominated sales to protect Zebra against exchange rate movements. Inclusive of all hedging activities, the impact of foreign exchange movements on reported sales during the third quarter was a gain of $2,382,000. The year-to-date impact was a loss of $1,950,000. See Note 10 to the Consolidated Financial Statements included in this Report for a more detailed discussion of the above hedging program.

Printer unit volumes and average selling price information is summarized below:

| | Three Months Ended | | | Nine Months Ended | | |
|---|---|---|---|---|---|---|
| | September 30, 2006 | October 1, 2005 | Percent Change | September 30, 2006 | October 1, 2005 | Percent Change |
| Total printers shipped | 192,710 | 177,941 | 8.3 | 591,788 | 527,723 | 12.1 |
| Average selling price of printers shipped | $ 621 | $ 626 | (0.8) | $ 599 | $ 643 | (6.8) |

For the third quarter of 2006, unit volumes increased in nearly all product lines, while our average selling prices declined in nearly all product lines compared to the third quarter of 2005. This decline in average selling price is primarily related to sales of a relatively higher proportion of lower-priced printers in the product mix for the third quarter of 2006.

*Gross Profit*

Gross profit information is summarized below (in thousands, except percentages):

| | Three Months Ended | | | Nine Months Ended | | |
|---|---|---|---|---|---|---|
| | September 30, 2006 | October 1, 2005 (restated) | Percent Change | September 30, 2006 | October 1, 2005 (restated) | Percent Change |
| Gross Profit | $ 87,786 | $ 87,533 | 0.3 | $ 260,010 | $ 263,808 | (1.4) |
| Gross Margin | 47.1 | 49.8 | | 47.3 | 50.4 | |

For the third quarter and the year to-date, the decline in gross profit margin from the same period a year ago was due to the change in product mix and manufacturing variances. Approximately, 1.4 of the 2.7 percentage point decline in gross profit margin is attributable to mix shifts within the Zebra product line, including the growth in our supplies business. The remaining 1.3 percentage point decline was caused by manufacturing variances, including such items as increased raw material costs for RoHs compliance, higher freight expense (also related to this compliance requirement), and increases to inventory reserves.

*Selling and Marketing Expenses*

Selling and marketing expenses are summarized below (in thousands, except percentages):

| | Three Months Ended | | | Nine Months Ended | | |
|---|---|---|---|---|---|---|
| | September 30, 2006 | October 1, 2005 (restated) | Percent Change | September 30, 2006 | October 1, 2005 (restated) | Percent Change |
| Selling and marketing expenses | $ 23,467 | $ 21,291 | 10.2 | $ 69,086 | $ 65,905 | 4.8 |
| Percent of sales | 12.6 | 12.1 | | 12.6 | 12.6 | |

During the third quarter of 2006, selling and marketing expenses increased due to higher payroll costs of $1,056,000, an increase in advertising costs of $538,000 and higher payouts for market development funds of $510,000. For the year to-date, we also saw increases in outside commissions and decreases in consulting expenses and travel costs, compared to the same period a year ago. Most of these costs are related to implementation of our strategy of geographic expansion and targeting high growth vertical markets.

*Research and Development Costs*

The development of new products and enhancement of existing products are vital to Zebra s business and growth prospects. To maintain and build our product pipeline, we made investments in research and development, summarized below (in thousands, except percentages):

| | Three Months Ended | | | Nine Months Ended | | |
|---|---|---|---|---|---|---|
| | September 30, 2006 | October 1, 2005 (restated) | Percent Change | September 30, 2006 | October 1, 2005 (restated) | Percent Change |
| Research and development costs | $ 11,774 | $ 11,818 | (0.4) | $ 36,191 | $ 35,256 | 2.7 |
| Percent of sales | 6.3 | 6.7 | | 6.6 | 6.7 | |

Quarterly product development expenses fluctuate widely depending on the status of on-going projects. We are committed to a long-term strategy of significant investment in product development. For the third quarter of 2006 although total research and development costs were constant compared to the third quarter of 2005, payroll and benefits increased by $965,000 with a related increase in headcount. Offsetting this increase was a decrease in project expenses of $1,038,000. For the year to-date, professional services costs also decreased.

*General and Administrative Expenses*

General and administrative expenses are summarized in the table below (in thousands, except percentages):

| | Three Months Ended | | | Nine Months Ended | | |
|---|---|---|---|---|---|---|
| | September 30, 2006 | October 1, 2005 (restated) | Percent Change | September 30, 2006 | October 1, 2005 (restated) | Percent Change |
| General and administrative expenses | $ 14,642 | $ 15,631 | (6.3) | $ 44,372 | $ 49,234 | (9.9) |
| Percent of sales | 7.9 | 8.9 | | 8.1 | 9.4 | |

The decrease in general and administrative expenses this quarter is the result of lower legal expenses ($2,681,000) largely related to decline in litigation activity with Paxar as described in Note 11 to the Consolidated Financial Statements. Offsetting this decrease is an increase in payroll costs of $603,000 and information system expenditures of $520,000. For the year to-date, legal expenses declined $6,278,000 from the same period in 2005, offset by increases in payroll and information system expenses

*Settlement and Licensing Agreement with Paxar Americas, Inc.*

During the third quarter of 2006, Zebra paid $63,750,000 to settle all issues surrounding the litigation with Paxar Americas, Inc. Of this amount, $53,392,000 was included as operating expense. The remaining $10,358,000 was capitalized as an intangible asset related to future use of these patents and will be amortized over 4 to 7 years resulting in an incremental charge of $456,000 per quarter. For further information, see Notes 9 and 11 to the Consolidated Financial Statements.

*Operating Income (Loss)*

Operating income (loss) is summarized in the following table (in thousands, except percentages):

| | Three Months Ended | | | Nine Months Ended | | |
|---|---|---|---|---|---|---|
| | September 30, 2006 | October 1, 2005 (restated) | Percent Change | September 30, 2006 | October 1, 2005 (restated) | Percent Change |
| Operating income (loss) | $ (16,278) | $ 38,001 | NM | $ 54,710 | $ 109,929 | (50.2) |
| Percent of sales | (8.7) | 21.6 | | 10.0 | 21.0 | |

*Non-operating Income and Expenses*

Zebra s non-operating income and expense items are summarized in the following table (in thousands):

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 30, 2006 | October 1, 2005 | September 30, 2006 | October 1, 2005 |
| Investment income | $ 6,008 | $ 3,254 | $ 16,202 | $ 9,603 |
| Interest expense | (5) | (41) | (236) | (71) |
| Foreign exchange gain | 457 | 334 | 187 | 1,199 |
| Other, net | (287) | 251 | (912) | (296) |
| Total other income | $ 6,173 | $ 3,798 | $ 15,241 | $ 10,435 |
| **Rate of Return Analysis:** | | | | |
| Average cash and marketable securities balances | $ 566,235 | $ 551,767 | $ 545,931 | $ 543,858 |
| Annualized rate of return | 4.2% | 2.4% | 4.0% | 2.4% |

*Income Tax (Benefit)*

The effective income tax rate for the third quarter was 57.8% compared to the 32.8% for the third quarter of 2005. The increase in the effective tax rate is a result of the increased impact of permanent tax differences, including tax-exempt interest income, on the effective income tax rate due to the loss before income taxes incurred in the third quarter. In addition, we reduced tax reserves in the amount of $1,189,000 related to the completion of various state tax audits and 2005 state income tax returns. The resulting year-to-date effective income tax rate for 2006 was 31.2% compared to 34.1% for the same period in 2005.

*Income (loss) before Cumulative Effect of Accounting Change*

Zebra s income (loss) before cumulative effect of accounting change is summarized below (in thousands, except per share amounts):

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 30, 2006 | October 1, 2005 (restated) | September 30, 2006 | October 1, 2005 (restated) |
| Income (loss) before cumulative effect of accounting change | $ (4,263) | $ 28,075 | $ 48,181 | $ 79,339 |
| Diluted earnings (loss) per share | $ (0.06) | $ 0.39 | $ 0.68 | $ 1.10 |

*Cumulative Effect of Accounting Change*

During the first quarter of 2006, Zebra adopted SFAS No. 123(R), *Share-Based Payments,* using the modified retrospective approach. SFAS No. 123(R) requires entities to estimate the number of forfeitures expected to occur and record expense based upon the number of awards expected to vest. Prior to the adoption of SFAS No. 123(R), Zebra accounted for forfeitures as they occurred as permitted under previous accounting standards. The requirement to estimate forfeitures is classified as an accounting change under APB Opinion No. 20, *Accounting Changes*, which requires a one-time adjustment in the period of adoption. The one-time adjustment (cumulative effect of accounting change) related to the change in estimating forfeitures increased income by $1,319,000, net of applicable taxes.

*Net Income (Loss)*

Zebra s net income (loss) is summarized below (in thousands, except per share amounts):

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 30, 2006 | October 1, 2005 (restated) | September 30, 2006 | October 1, 2005 (restated) |
| Net income (loss) | $ (4,263) | $ 28,075 | $ 49,500 | $ 79,339 |
| Diluted earnings (loss) per share | $ (0.06) | $ 0.39 | $ 0.70 | $ 1.10 |

**Liquidity and Capital Resources**

During the third quarter of 2006, Zebra settled the outstanding litigation with Paxar Americas, Inc., with a payment of $63,750,000. Cash, cash equivalents, investments and marketable securities balances as of September 30, 2006 were $547,623,000, compared with $544,239,000 at December 31, 2005. Other factors affecting cash and investment balances during the first nine months of 2006 include the following (note that changes discussed below include the impact of foreign currency):

Operations provided cash in the amount of $40,755,000, primarily from net income, which includes $53,392,000 of pre-tax expense related to the Paxar settlement.

Inventories increased $16,746,000. Inventory turns decreased to 4.8 from 5.6 at the end of 2005.

Intangibles increased $18,091,000 due to payments for licenses to use patents, including $10,358,000 of Paxar intangibles.

Purchases of property and equipment totaled $14,640,000.

Income taxes payable decreased $6,149,000 due to the quarterly loss resulting from the Paxar settlement.

Net purchases of investments and marketable securities totaled $1,067,000.

Purchases of treasury shares totaled $4,069,000. Zebra made open market repurchases of our shares under an authorization of the Board of Directors dated October 4, 2005.

Stock option exercises and purchases under the stock purchase plan contributed $9,050,000.

At the end of September, inventory levels are high in comparison to historical balances due to RoHs transition issues and other operational issues. Zebra believes that the inventory balances need to be reduced significantly and is implementing plans to do so within the next year. An insufficient reduction in these inventory balances could result in increased inventory obsolescence expenses.

We believe that existing capital resources and funds generated from operations are sufficient to finance anticipated capital requirements. It is our intention to actively pursue opportunities to acquire other businesses.

**Critical Accounting Policies and Estimates**

Management prepared the consolidated financial statements of Zebra Technologies Corporation under accounting principles generally accepted in the United States of America. These principles require the use of estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions used are reasonable, based upon the information available.

Our estimates and assumptions affect the reported amounts in our financial statements. The following accounting policies comprise those that we believe are the most critical in understanding and evaluating Zebra s reported financial results.

*Revenue Recognition*

Product revenue is recognized once four criteria are met: (1) we have persuasive evidence that an arrangement exists; (2) delivery has occurred and title has passed to the customer, which happens at the point of shipment provided that no significant obligations remain; (3) the price is fixed and determinable; and (4) collectibility is reasonably assured. Other items that affect our revenue recognition include:

Customer returns

Customers have the right to return products that do not function properly within a limited time after delivery. We monitor and track product returns and record a provision for the estimated future returns based on historical experience and any notification received of pending returns. Returns have historically been within expectations and the provisions established, but Zebra cannot guarantee that it will continue to experience return rates consistent with historical patterns. Historically, our product returns have not been significant. However, if a significant issue should arise, it could have a material impact on our financial statements.

Growth Rebates

Some of our channel program partners are offered incentive rebates based on the attainment of specific growth targets related to products they purchase from us over a quarter or year. These rebates are recorded as a reduction to revenue. Each quarter, we estimate the amount of outstanding growth rebates and establish a reserve for them based on shipment history. Historically, actual growth rebates have been in line with our estimates.

Price Protection

Some of our customers are offered price protection by Zebra as an incentive to carry inventory of our product. These price protection plans provide that if we lower prices, we will credit them for the price decrease on inventory they hold. We estimate future payments under price protection programs quarterly and establish a reserve, which is charged against revenue. Our customers typically carry limited amounts of inventory, and Zebra infrequently lowers prices on current products. As a result, the amounts paid under these plans have been minimal.

Software Revenue

We sell three types of software and record revenue as follows:

Our printers contain *embedded firmware,* which is part of the hardware purchase. We consider the sale of this firmware to be incidental to the sale of the printer and do not attribute any revenue to it.

We sell a limited amount of *prepackaged,* or *off-the-shelf, software* for the creation of bar code labels using our printers. There is no customization required to use this software, and we have no post-shipment obligations on the software. Revenue is recognized at the time this prepackaged software is shipped.

We sometimes provide *custom software* as part of a printer installation project. We bill custom software development services separate from the related hardware. Revenue related to custom software is recognized once the custom software development services have been completed and accepted by the customer.

Shipping and Handling

We charge our customers for shipping and handling services based upon our internal price list for these items. The amounts billed to customers are recorded as revenue when the product ships. Any costs incurred related to these services are included in cost of sales.

From time to time, Zebra will enter into sales transactions that include more than one product type. This bundle of products might include printers, current or future supplies, and services. When this type of transaction occurs, we allocate the purchase price to each product type based on the fair value of the individual products. The revenue for each individual product is then recognized when the recognition criteria for that product is fully met.

*Investments and Marketable Securities*

Investments and marketable securities at September 30, 2006, consisted of U.S. government securities (7.8%), state and municipal bonds (83.0%), corporate bonds (1.6%) and partnership interests (7.6%). We classify our debt and marketable equity securities in one of three categories: trading, available-for-sale or held-to-maturity. Trading securities are bought and held principally for the purpose of selling them in the near term. Held-to-maturity securities are those securities that Zebra has the ability and intent to hold until maturity. All securities not included in trading or held-to-maturity are classified as available-for-sale.

Trading and available-for-sale securities are recorded at fair value. Held-to-maturity securities are recorded at amortized cost, adjusted for the amortization or accretion of discounts or premiums. Unrealized holding gains and losses on trading securities are included in earnings. Unrealized holding gains and losses, net of the related tax effect, on available-for-sale securities are excluded from earnings and are reported as a separate component of stockholders equity until realized. As of September 30, 2006, the majority of Zebra s investments and marketable debt securities are classified as available-for-sale. In addition, as of September 30, 2006, all of our investments and marketable debt securities with maturities greater than one year are classified as long-term in the balance sheet due to our ability and intent to hold them until maturity.

*Accounts Receivable*

We have standardized credit granting and review policies and procedures for all customer accounts, including:

- Credit reviews of all new customer accounts,
- Ongoing credit evaluations of current customers,

Credit limits and payment terms based on available credit information,

Adjustments to credit limits based upon payment history and the customer s current credit worthiness, and

An active collection effort by regional credit functions, reporting directly to the corporate financial officers.

We reserve for estimated credit losses based upon historical experience and specific customer collection issues. Over the last three years, accounts receivable reserves varied from 0.6% to 2.1% of total accounts receivable. Accounts receivable reserves as of September 30, 2006, were $930,000, or 0.8% of the balance due. We feel this reserve level is appropriate considering the quality of the portfolio as of September 30, 2006. While credit losses have historically been within expectations and the provisions established, we cannot guarantee that our credit loss experience will continue to be consistent with historical experience.

On July 3, 2006, a Zebra reseller filed for bankruptcy protection. At the time of the filing, the reseller owed various Zebra subsidiaries a total of $12,065,000. The entire balance due to Zebra is guaranteed by a U.K. insurance company. Zebra has initiated a suit in the U.K. courts to enforce the guarantee. We believe full recovery is probable; therefore, no reserve has been recorded against the balance due.

*Inventories*

We value our inventories at the lower of the actual cost to purchase or manufacture using the first-in, first-out (FIFO) method, or the current estimated market value. We review inventory quantities on hand and record a provision for excess and obsolete inventory based on forecasts of product demand and production requirements for the subsequent twelve months.

Over the last three years, our reserves for excess and obsolete inventories have ranged from 10.0% to 13.1% of gross inventory. As of September 30, 2006, reserves for excess and obsolete inventories were $9,171,000, or 10.0% of gross inventory. We feel this reserve level is appropriate considering the quantities and quality of the inventories as of September 30, 2006.

*Valuation of Long-Lived and Intangible Assets and Goodwill.*

We test the impairment of goodwill each year or whenever events or changes in circumstances indicate that the carrying value may not be recoverable. We completed our last assessment during June 2006. At that time, no adjustment to goodwill was necessary due to impairment.

We evaluate the impairment of identifiable intangibles and other long-lived assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

Factors considered that may trigger an impairment review consist of:

Significant underperformance relative to expected historical or projected future operating results,

Significant changes in the manner of use of the acquired assets or the strategy for the overall business,

Significant negative industry or economic trends,

Significant decline in Zebra s stock price for a sustained period, and

Significant decline in market capitalization relative to net book value.

If we believe that one or more of the above indicators of impairment have occurred, we measure impairment based on projected discounted cash flows using a discount rate that incorporates the risk inherent in the cash flows. Net intangible assets, long-lived assets and goodwill amounted to $158,901,000 as of September 30, 2006.

*Contingencies*

We record estimated liabilities related to contingencies based on our estimates of the probable outcomes. Quarterly, we assess the potential liability related to pending litigation, tax audits and other contingencies and confirm or revise estimates and reserves as appropriate.

For a discussion of the Paxar and Printherm litigation matters, see Note 11 to the Consolidated Financial Statements.

*Stock-based Compensation*

As of September 30, 2006, we had two stock-based compensation plans available for future grants. Prior to January 1, 2006, we accounted for these plans using the intrinsic value method in accordance with the recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees,* and related interpretations, as permitted by SFAS No. 123, *Accounting for Stock Based Compensation*. Accordingly, we recognized no compensation cost as all options granted under these plans had grant prices equal to the market value of the underlying common stock on the date of grant and the number of shares was fixed.

Effective January 1, 2006, Zebra adopted SFAS No. 123(R), *Share-Based Payments,* utilizing the modified retrospective approach, which requires the prior period financial statements to be restated to recognize compensation costs in the amounts previously reported in the pro forma footnote disclosures. See Note 2 to the Consolidated Financial Statements for further information on the adoption and impact of SFAS No. 123(R).

*New Accounting Pronouncement*

In June 2006, the FASB issued Emerging Issues Task Force Issue No. 06-3 (EITF 06-3), *How Sales Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross Versus Net Presentation),* which discusses taxes imposed on, and imposed concurrent with, a specific revenue-producing transaction between a seller and its customer. It requires entities to disclose, if significant, on an interim and annual basis for all periods presented: (a) the accounting policy elected for these taxes and (b) the amounts of the taxes reflected gross (as revenue) in the income statement. This Issue will become effective for Zebra during the first quarter of 2007. We do not expect it to have a material impact on our financial condition or results of operations.

In June 2006, the FASB issued FIN 48, *Accounting for Uncertainty in Income Taxes  an interpretation of FASB Statement No. 109,* which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. This Interpretation will become effective for Zebra during the first quarter of 2007. We are still evaluating the impact of this Interpretation but do not expect it to have a material impact on our financial condition or results of operations.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements. It does not require any new fair value measurements. This Statement will become effective for Zebra during the first quarter of 2007. We do not expect it to have a material impact on our financial condition or results of operations.

**Significant Customer**

ScanSource, Inc. is our most significant customer. Our net sales to ScanSource, an international distributor of Zebra product, as a percentage of total net sales were as follows:

| | **September 30, 2006** | **October 1, 2005** |
|---|---|---|
| For the three months ended | 17.0% | 15.9% |
| For the nine months ended | 16.5% | 15.6% |

No other customer accounted for 10% or more of total net sales during these periods.

**Expectations**

As stated on our quarterly conference call on November 1, 2006, we estimate net sales, gross profit margins, operating expenses, and earnings for the fourth quarter of 2006 as follows (in thousands, except per share amounts and percentages):

| | **Fourth Quarter 2006** |
|---|---|
| Net sales | $190,000 to $200,000 |
| Gross profit margins | 47.5% to 48.5% |
| Operating expenses | $54,000 to $56,500 |
| Diluted earnings per share | $0.38 to $0.42 |

The effective tax rate is expected to be 34.5% of income before income taxes for the fourth quarter of 2006.

**Safe Harbor**

Forward-looking statements contained in this filing are subject to the safe harbor created by the Private Securities Litigation Reform Act of 1995 and are highly dependent upon a variety of important factors which could cause actual results to differ materially from those reflected in such forward looking statements. These factors include market acceptance of Zebra s printer and software products and competitors product offerings and the potential effects of technological changes. They also include the effect of market conditions in North America and other geographic regions on our financial results. Profits will be affected by our ability to control manufacturing and operating costs. Because of a large investment portfolio, interest rate and financial market conditions will also have an impact on results. Foreign exchange rates will have an effect on financial results, because of the large percentage of our international sales. The outcome of litigation in which Zebra is involved, and particularly litigation or claims related to infringement of third party intellectual property rights, is another factor. Also, Zebra faces new regulations in the European Union that restrict the use of certain hazardous substances in electrical and electronic equipment. When used in this document and documents referenced herein, the words anticipate, believe, estimate, will and expect and similar expressions as they relate to Zebra or its management are intended to identify such forward-looking statements. We encourage readers of this report to review the Risk Factors portion of Zebra s Form 10-K for the year ended December 31, 2005, and of this Form 10-Q for a further discussion of issues that could affect Zebra s future results. Zebra undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, changed circumstances or any other reason after the date of this report.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

There were no material changes, except as discussed below, in Zebra s market risk during the quarter ended September 30, 2006. For additional information on market risk, refer to the  Quantitative and Qualitative Disclosures About Market Risk  section of our Form 10-K for the year ended December 31, 2005.

In the normal course of business, portions of Zebra s operations are subject to fluctuations in currency values. We manage these risks using derivative financial instruments.

**Item 4. Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures**

We conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act )) as of the end of the period covered by this Form 10-Q. The controls evaluation was conducted under the supervision of our Disclosure Committee, and with the participation of management, including our Chief Executive Officer and Chief Financial Officer. Based on that evaluation, our Chief Executive Office and Chief Financial Officer, have concluded that our disclosure controls and procedures were effective to provide reasonable assurance that (i) the information required to be disclosed by us in this report on Form 10-Q was recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and (ii) information required to be disclosed by us in our reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

**Changes in Internal Control over Financial Reporting**

There were no changes in our internal controls over financial reporting during the quarter ended September 30, 2006, that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

**Inherent Limitations on the Effectiveness of Controls**

Our management, including our Chief Executive Office and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal controls will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within Zebra have been detected.

These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

**PART II - OTHER INFORMATION**

**Item 1. Legal Proceedings**

See Note 11 to the Consolidated Financial Statements included in this Form 10-Q.

**Item 1A. Risk Factors**

In addition to the other information included in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2005, and the factors identified under Safe Harbor at the end of Item 2 of Part I of this Quarterly Report on Form 10-Q, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing Zebra. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition, and/or operating results.

In addition, the following updates the Risk Factors in our Form 10-K and should be read in conjunction with those Risk Factors:

*Zebra s equipment is subject to US and foreign regulations that pertain to electrical and electronic equipment, which may materially adversely affect Zebra s business.*

These regulations influence the design, components or operation of such products. New regulations and changes to current regulations are always possible and, in some jurisdictions, regulations may be introduced with little or no time to bring related products into compliance with these regulations. Zebra s failure to comply with these regulations may prevent Zebra from selling our products in a certain country. In addition, these regulations may increase our cost of supplying the products by forcing us to redesign existing products or to use more expensive designs or components. In these cases, Zebra may experience unexpected disruptions in our ability to supply customers with products, or we may incur unexpected costs or operational complexities to bring products into compliance. This could have an adverse effect on Zebra s revenues, gross profit margins and results of operations and increase the volatility of our financial results.

In January 2003, the European Union, ( EU ), issued two directives relating to chemical substances in electronic products. The Waste Electrical and Electronic Equipment Directive requires producers of electrical goods to pay for specified collection, recycling, treatment and disposal of past and future covered products. EU governments were required to enact and implement legislation that complies with this directive (such legislation together with the directive, the WEEE Legislation ), and certain producers are to be financially responsible under the WEEE Legislation. The EU issued another directive that requires electrical and electronic equipment placed on the EU market after July 1, 2006, to be free of lead, mercury, cadmium, hexavalent chromium (above a threshold limit) and brominated flame retardants. EU governments were required to enact and implement legislation that complies with this directive (such legislation together with this directive, the RoHS Legislation ). If we do not comply with these directives, we may suffer a loss of revenue, be unable to sell in certain markets and/or countries, be subject to penalties and enforced fees, and/or suffer a competitive disadvantage. Also, complying with these directives has presented additional complexities to manufacturing and operations which could result in adverse results. We cannot assure you that the costs to comply with these new laws, or with current and future environmental laws, will not have a material adverse effect on our results of operations, expenses and financial condition.

*Added risks are associated with our international operations which may have a material adverse effect on Zebra s business.*

Zebra has significant overseas operations, notably in the U.K., Middle East and Africa, Latin America and Asia-Pacific, including, in particular, an increasing presence in China, which present added risks that may materially adversely affect the financial results and condition of Zebra. These risks include (in addition to the risks described in Zebra s Annual Report on Form 10-K related to international sales of products and procurement of parts) the following:

- Adverse changes in, or uncertainty of, local business laws or practices;
- Inadequately managing and overseeing operations that are distant and remote from corporate headquarters;
- The inability to hire and retain appropriate employees in highly competitive job markets; and

The failure to implement and maintain adequate internal controls relating to these operations.

If we are not able to effectively manage these risks, they may harm our business and the trading price of our common stock.

*The planned retirement of Zebra s chief executive officer could cause dislocations in management and changes in strategic direction.* During the third quarter of 2006, we announced that Ed Kaplan, Zebra s co-founder, chairman and chief executive officer, plans to retire as CEO following the recruitment of a successor CEO. This current period of transition and future change in leadership could result in changes in other senior and mid-level management personnel. Such changes could have an adverse affect on Zebra s business. In addition, no assurances can be provided as to whether the successor CEO, who has yet to be named, will seek to change Zebra s strategies.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

**Treasury Shares**

During the third quarter of 2006, Zebra purchased 116,800 shares of Zebra common stock. The repurchase was under a purchase authorization approved by the Board of Directors. In September 2005, the Board authorized the purchase of up to 2,500,000 shares of Zebra common stock. The purchase price is at management s discretion, and there is no expiration on the authorization.

| Period | Total number of shares purchased | Average price paid per share | Total number of shares purchased as part of publicly announced program | Maximum number of shares that may yet be purchased under the program |
|---|---|---|---|---|
| September 2006 (August 27 September 30) | 116,800 | $ 34.83 | 116,800 | 2,383,200 |

**Item 6. Exhibits and Reports on Form 8-K**

| | |
|---|---|
| 10.1 | 2006 Management Bonus Plan (management compensation plan) (incorporated by reference to Form 8-K filed on July 18, 2006) |
| 10.2 | Paxar Settlement Agreement (incorporated by reference to Form 8-K filed on September 19, 2006) |
| 31.1 | Rule 13a-14(a)/15d-14(a) Certification |
| 31.2 | Rule 13a-14(a)/15d-14(a) Certification |
| 32.1 | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

**SIGNATURES**

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

| | |
|---|---|
| | **ZEBRA TECHNOLOGIES CORPORATION** |
| Date: November 6, 2006 | By: /s/ Edward L. Kaplan<br>Edward L. Kaplan<br>Chief Executive Officer |
| Date: November 6, 2006 | By: /s/ Charles R. Whitchurch<br>Charles R. Whitchurch<br>Chief Financial Officer |