

Proto Labs Inc  
Form 10-Q  
August 06, 2015  
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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

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**FORM 10-Q**

(Mark One)

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

**For the quarterly period ended June 30, 2015**

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: 001-35435**

**Proto Labs, Inc.**

(Exact name of registrant as specified in its charter)

**Minnesota**

(State or other jurisdiction of  
incorporation or organization)

**41-1939628**

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

**5540 Pioneer Creek Drive**

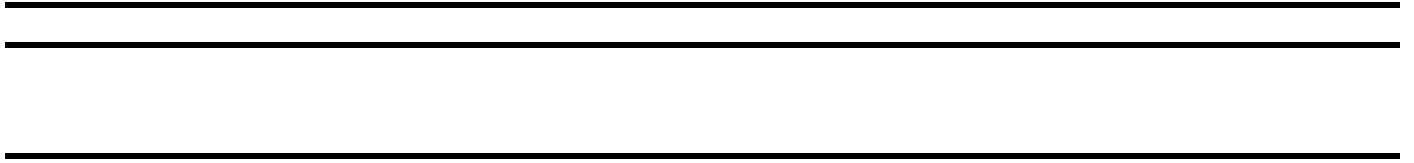
**Maple Plain, Minnesota**

(Address of principal executive offices)

**55359**

(Zip Code)





**Proto Labs, Inc.**

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**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements**

**Proto Labs, Inc.**  
**Consolidated Balance Sheets**  
(In thousands, except share and per share amounts)

|  | <b>June 30,<br/>2015<br/>(Unaudited)</b> | <b>December<br/>31,<br/>2014</b> |
|--|--|----------------------------------|
| <b>Assets</b>  |  |                                  |
| Current assets   |  |                                  |
| Cash and cash equivalents  | \$ 56,324                                | \$ 43,329                        |
| Short-term marketable securities   | 31,190                                   | 30,706                           |
| Accounts receivable, net of allowance for doubtful accounts of \$150 and \$198 as of June 30, 2015 and December 31, 2014, respectively | 29,493                                   | 24,226                           |
| Inventory  | 6,828                                    | 6,194                            |
| Prepaid expenses and other current assets  | 3,935                                    | 3,406                            |
| Income taxes receivable  | 2,931                                    | -                                |
| Deferred tax assets  | 464                                      | 483                              |
| Total current assets   | 131,165                                  | 108,344                          |
| Property and equipment, net  | 100,921                                  | 91,626                           |
| Goodwill   | 28,916                                   | 28,916                           |
| Other intangible assets, net   | 3,710                                    | 4,083                            |
| Long-term marketable securities  | 54,482                                   | 54,318                           |
| Other long-term assets   | 197                                      | 227                              |
| Total assets   | \$ 319,391                               | \$ 287,514                       |
| <b>Liabilities and shareholders' equity</b>  |  |                                  |
| Current liabilities  |  |                                  |
| Accounts payable   | \$ 11,334                                | \$ 7,882                         |
| Accrued compensation   | 8,264                                    | 6,067                            |
| Accrued liabilities and other  | 1,779                                    | 2,718                            |
| Income taxes payable   | -  | 1,953                            |
| Current portion of long-term debt obligations  | 71                                       | 139                              |
| Total current liabilities  | 21,448                                   | 18,759                           |
| Long-term deferred tax liabilities   | 2,423                                    | 1,846                            |
| Long-term debt obligations   | -  | 10                               |
| Other long-term liabilities  | 1,533                                    | 1,360                            |

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|   |            |            |
|---|------------|------------|
| Total liabilities   | 25,404     | 21,975     |
| Shareholders' equity  |            |            |
| Preferred stock, \$0.001 par value, authorized 10,000,000 shares; issued and outstanding 0 shares as of each of June 30, 2015 and December 31, 2014                             | -          | -          |
| Common stock, \$0.001 par value, authorized 150,000,000 shares; issued and outstanding 25,953,735 and 25,838,110 shares as of June 30, 2015 and December 31, 2014, respectively | 26         | 26         |
| Additional paid-in capital  | 187,070    | 180,960    |
| Retained earnings   | 109,621    | 87,482     |
| Accumulated other comprehensive loss  | (2,730 )   | (2,929 )   |
| Total shareholders' equity  | 293,987    | 265,539    |
| Total liabilities and shareholders' equity  | \$ 319,391 | \$ 287,514 |

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

**Proto Labs, Inc.**  
**Consolidated Statements of Comprehensive Income**  
(In thousands, except share and per share amounts)  
(Unaudited)

|  | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|--|---------------------------|-------------|-------------------------|-------------|
|  | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|  | <b>2015</b>               | <b>2014</b> | <b>2015</b>             | <b>2014</b> |
| <b>Statements of Operations:</b>             |                           |             |                         |             |
| Revenue                                      | \$63,969                  | \$52,866    | \$122,505               | \$98,940    |
| Cost of revenue                              | 26,419                    | 20,183      | 49,701                  | 37,233      |
| Gross profit                                 | 37,550                    | 32,683      | 72,804                  | 61,707      |
| Operating expenses                           |                           |             |                         |             |
| Marketing and sales                          | 9,502                     | 7,261       | 18,356                  | 13,678      |
| Research and development                     | 4,397                     | 3,914       | 8,711                   | 7,370       |
| General and administrative                   | 6,304                     | 5,534       | 12,549                  | 10,237      |
| Total operating expenses                     | 20,203                    | 16,709      | 39,616                  | 31,285      |
| Income from operations                       | 17,347                    | 15,974      | 33,188                  | 30,422      |
| Other income (expense), net                  | (36)                      | (66)        | (493)                   | 37          |
| Income before income taxes                   | 17,311                    | 15,908      | 32,695                  | 30,459      |
| Provision for income taxes                   | 5,625                     | 4,952       | 10,556                  | 9,401       |
| Net income                                   | \$11,686                  | \$10,956    | \$22,139                | \$21,058    |
| Net income per share:                        |                           |             |                         |             |
| Basic  | \$0.45                    | \$0.43      | \$0.86                  | \$0.82      |
| Diluted                                      | \$0.44                    | \$0.42      | \$0.84                  | \$0.81      |
| Shares used to compute net income per share: |                           |             |                         |             |
| Basic  | 25,921,111                | 25,620,005  | 25,885,888              | 25,597,055  |
| Diluted                                      | 26,277,503                | 26,146,848  | 26,245,135              | 26,132,265  |
| <b>Comprehensive Income (net of tax)</b>     |                           |             |                         |             |
| Comprehensive income                         | \$12,960                  | \$11,488    | \$22,338                | \$21,762    |

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

**Proto Labs, Inc.**  
**Consolidated Statements of Cash Flows**  
(In thousands)  
(Unaudited)

|   | <b>Six Months Ended</b> |                 |
|---|-------------------------|-----------------|
|   | <b>June 30,</b>         |                 |
|   | <b>2015</b>             | <b>2014</b>     |
| <b>Operating activities</b>   |                         |                 |
| Net income  | \$22,139                | \$21,058        |
| Adjustments to reconcile net income to net cash provided by operating activities: |                         |                 |
| Depreciation and amortization   | 6,940                   | 4,683           |
| Stock-based compensation expense  | 2,909                   | 2,248           |
| Deferred taxes  | 620                     | 107             |
| Excess tax benefit from stock-based compensation                                  | (989 )                  | (1,623 )        |
| Amortization of held-to-maturity securities                                       | 632                     | 854             |
| Changes in operating assets and liabilities:                                      |                         |                 |
| Accounts receivable   | (5,219 )                | (5,742 )        |
| Inventories   | (663 )                  | (306 )          |
| Prepaid expenses and other  | (469 )                  | (372 )          |
| Income taxes  | (3,687 )                | 2,431           |
| Accounts payable  | 3,377                   | 5,143           |
| Accrued liabilities and other   | 2,243                   | (2,464 )        |
| Net cash provided by operating activities   | 27,833                  | 26,017          |
| <b>Investing activities</b>   |                         |                 |
| Purchases of property and equipment   | (15,717)                | (31,625)        |
| Acquisitions, net of cash acquired  | -                       | (33,864)        |
| Purchases of marketable securities  | (25,389)                | (38,463)        |
| Proceeds from sales and maturities of marketable securities                       | 24,109                  | 55,441          |
| Net cash used in investing activities   | (16,997)                | (48,511)        |
| <b>Financing activities</b>   |                         |                 |
| Payments on debt  | (77 )                   | (954 )          |
| Acquisition-related contingent consideration                                      | (1,000 )                | (400 )          |
| Proceeds from exercises of stock options and other                                | 2,207                   | 1,806           |
| Excess tax benefit from stock-based compensation                                  | 989                     | 1,623           |
| Net cash provided by financing activities   | 2,119                   | 2,075           |
| Effect of exchange rate changes on cash and cash equivalents                      | 40                      | 234             |
| <b>Net increase (decrease) in cash and cash equivalents</b>                       | <b>12,995</b>           | <b>(20,185)</b> |
| <b>Cash and cash equivalents, beginning of period</b>                             | <b>43,329</b>           | <b>43,039</b>   |
| <b>Cash and cash equivalents, end of period</b>                                   | <b>\$56,324</b>         | <b>\$22,854</b> |

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





## **Note 1 – Basis of Presentation**

The unaudited interim Consolidated Financial Statements of Proto Labs, Inc. (Proto Labs, the Company, we, us or our) have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. These statements are unaudited but, in the opinion of management, reflect all adjustments necessary for a fair presentation of the Company's statement of financial position, results of operations and cash flows for the periods presented. Except as otherwise disclosed herein, these adjustments consist of normal, recurring items. Operating results for interim periods are not necessarily indicative of results that may be expected for the fiscal year as a whole.

On April 23, 2014, the Company completed the acquisition of FineLine Prototyping, Inc. (FineLine). The operations of FineLine have been integrated into the operations of the Company and operating results beginning April 23, 2014 are included in the consolidated results under the Fineline product line.

The preparation of the financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses, and the related disclosures at the date of the financial statements and during the reporting period. Actual results could materially differ from these estimates. For further information, refer to the audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014 as filed with the Securities and Exchange Commission (SEC) on February 27, 2015.

The accompanying Consolidated Balance Sheet as of December 31, 2014 was derived from the audited Consolidated Financial Statements but does not include all disclosures required by U.S. GAAP for a full set of financial statements. This Form 10-Q should be read in conjunction with the Company's Consolidated Financial Statements and Notes included in the Annual Report on Form 10-K filed on February 27, 2015 as referenced above.

## **Note 2 – Recent Accounting Pronouncements**

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers. This ASU is a comprehensive new revenue recognition model that requires a company to recognize revenue from the transfer of goods or services to customers in an amount that reflects the consideration that the entity expects to receive in exchange for those goods or services. The Company is required to adopt the new pronouncement using one of two retrospective application methods.

On July 9, 2015, the FASB voted to approve a one-year deferral of the effective date of ASU 2014-09 by one year to December 15, 2017 for annual reporting periods beginning after that date. The Company is evaluating the application method and the impact of this new standard on our financial statements, but does not expect the impact to be material.

**Note 3 – Net Income per Common Share**

Basic net income per share is computed based on the weighted-average number of common shares outstanding. Diluted net income per share is computed based on the weighted-average number of common shares outstanding, increased by the number of additional shares that would have been outstanding had potentially dilutive common shares been issued and reduced by the number of shares the Company could have repurchased from the proceeds from issuance of the potentially dilutive shares. Potentially dilutive shares of common stock include stock options, restricted stock units and restricted stock awards granted under stock-based compensation plans and shares committed to be purchased under the employee stock purchase plan.

The table below sets forth the computation of basic and diluted net income per share:

| (in thousands, except share and per share amounts) | <b>Three Months Ended<br/>June 30,</b> |             | <b>Six Months Ended<br/>June 30,</b> |             |
|--|--|-------------|--------------------------------------|-------------|
|  | <b>2015</b>                            | <b>2014</b> | <b>2015</b>                          | <b>2014</b> |
| Net income   | \$11,686                               | \$10,956    | \$22,139                             | \$21,058    |
| Basic - weighted-average shares outstanding:       | 25,921,111                             | 25,620,005  | 25,885,888                           | 25,597,055  |
| Effect of dilutive securities:                     |  |             |                                      |             |
| Employee stock options and other                   | 356,392                                | 526,843     | 359,247                              | 535,210     |
| Diluted - weighted-average shares outstanding:     | 26,277,503                             | 26,146,848  | 26,245,135                           | 26,132,265  |
| Net income per share:                              |  |             |                                      |             |
| Basic  | \$0.45                                 | \$0.43      | \$0.86                               | \$0.82      |
| Diluted  | \$0.44                                 | \$0.42      | \$0.84                               | \$0.81      |

#### Note 4 – Goodwill and Other Intangible Assets

The changes in the carrying amount of Goodwill during the six months ended June 30, 2015 were as follows:

| (in thousands)                            | <b>Six<br/>Months<br/>Ended<br/>June 30,<br/>2015</b> |
|---|---|
| Balance as of the beginning of the period | \$28,916  |
| Goodwill acquired during the period       | -   |
| Balance as of the end of the period       | \$28,916  |

Intangible assets other than Goodwill at June 30, 2015 and December 31, 2014 were as follows:

| (in thousands) | <b>June 30, 2015</b> |  | <b>December 31, 2014</b> |  | <b>Useful<br/>Life</b> | <b>Weighted<br/>Average<br/>Useful Life</b> |
|----------------|----------------------|--|--------------------------|--|------------------------|---|
|                | <b>Gross</b>         | <b>Accumulated<br/>AmortizationNet</b> | <b>Gross</b>             | <b>Accumulated<br/>AmortizationNet</b> |                        |   |

|   |         |           |         |         |           |         | (in<br>years) | Remaining (in<br>years) |
|---|---------|-----------|---------|---------|-----------|---------|---------------|-------------------------|
| Intangible Assets with finite<br>lives: |         |           |         |         |           |         |               |                         |
| Marketing assets                        | \$930   | \$ (109 ) | \$821   | \$930   | \$ (62 )  | \$868   | 10.0          | 8.8                     |
| Non-compete agreement                   | 190     | (111 )    | 79      | 190     | (63 )     | 127     | 2.0           | 0.8                     |
| Trade secrets                           | 250     | (58 )     | 192     | 250     | (33 )     | 217     | 5.0           | 3.8                     |
| Internally developed<br>software        | 680     | (264 )    | 416     | 680     | (151 )    | 529     | 3.0           | 1.8                     |
| Customer relationships                  | 2,530   | (328 )    | 2,202   | 2,530   | (188 )    | 2,342   | 9.0           | 7.8                     |
| Total intangible assets                 | \$4,580 | \$ (870 ) | \$3,710 | \$4,580 | \$ (497 ) | \$4,083 |               |                         |

Amortization expense for intangible assets for the three and six months ended June 30, 2015 was \$0.2 million and \$0.4 million, respectively. Amortization expense for intangible assets, which were acquired in the purchase of FineLine in April 2014, was \$0.1 million for each of the three and six months ended June 30, 2014.

Estimated aggregated amortization expense based on the current carrying value of the amortizable intangible assets is as follows:

| (in thousands)                       | <b>Estimated<br/>Amortization<br/>Expense</b> |
|--------------------------------------|---|
| Remaining 2015                       | \$ 373  |
| 2016                                 | 682   |
| 2017                                 | 500   |
| 2018                                 | 424   |
| 2019                                 | 391   |
| Thereafter                           | 1,340   |
| Total estimated amortization expense | \$ 3,710                                      |

#### **Note 5 – Fair Value Measurements**

ASC 820, *Fair Value Measurement* (ASC 820), defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC 820 also establishes a fair value hierarchy which requires classification based on observable and unobservable inputs when measuring fair value. There are three levels of inputs that may be used to measure fair value:

*Level 1*—Quoted prices in active markets for identical assets or liabilities.

*Level 2*—Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

*Level 3*—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The Company's cash consists of bank deposits. The Company's cash equivalents measured at fair value consist of money market mutual funds. The Company determines the fair value of these investments using Level 1 inputs.

A summary of financial assets as of June 30, 2015 and December 31, 2014 measured at fair value on a recurring basis follows:

| (in thousands)            | June 30, 2015 |         |         | December 31, 2014 |         |         |
|---------------------------|---------------|---------|---------|-------------------|---------|---------|
|                           | Level 1       | Level 2 | Level 3 | Level 1           | Level 2 | Level 3 |
| <b>Financial Assets:</b>  |               |         |         |                   |         |         |
| Cash and cash equivalents |               |         |         |                   |         |         |
| Money market mutual fund  | \$ 15,761     | \$ -    | \$ -    | \$ 6,129          | \$ -    | \$ -    |
| Total                     | \$ 15,761     | \$ -    | \$ -    | \$ 6,129          | \$ -    | \$ -    |

**Note 6 – Marketable Securities**

The Company invests in short-term and long-term agency, municipal, corporate, commercial paper and other debt securities. The securities are categorized as held-to-maturity and are recorded at amortized cost. Categorization as held-to-maturity is based on the Company's ability and intent to hold these securities to maturity. Information regarding the Company's short-term and long-term marketable securities as of June 30, 2015 and December 31, 2014 is as follows:

| (in thousands)                        | <b>June 30, 2015</b>  |                         |                          |                   |
|---------------------------------------|-----------------------|-------------------------|--------------------------|-------------------|
|                                       | <b>Amortized Cost</b> | <b>Unrealized Gains</b> | <b>Unrealized Losses</b> | <b>Fair Value</b> |
| U.S. municipal securities             | \$32,661              | \$ 20                   | \$ (49 )                 | \$32,632          |
| Corporate debt securities             | 25,932                | 5                       | (31 )                    | 25,906            |
| U.S. government agency securities     | 19,857                | 9                       | (23 )                    | 19,843            |
| Certificates of deposit/time deposits | 5,656                 | 12                      | -                        | 5,668             |
| Commercial paper                      | 1,566                 | -                       | (1 )                     | 1,565             |
| Total marketable securities           | \$85,672              | \$ 46                   | \$ (104 )                | \$85,614          |

| (in thousands)                        | <b>December 31, 2014</b> |                         |                          |                   |
|---------------------------------------|--------------------------|-------------------------|--------------------------|-------------------|
|                                       | <b>Amortized Cost</b>    | <b>Unrealized Gains</b> | <b>Unrealized Losses</b> | <b>Fair Value</b> |
| U.S. municipal securities             | \$30,004                 | \$ 32                   | \$ (18 )                 | \$30,018          |
| Corporate debt securities             | 29,316                   | 7                       | (79 )                    | 29,244            |
| U.S. government agency securities     | 20,048                   | -                       | (71 )                    | 19,977            |
| Certificates of deposit/time deposits | 5,656                    | 5                       | (15 )                    | 5,646             |
| Total marketable securities           | \$85,024                 | \$ 44                   | \$ (183 )                | \$84,885          |

Fair values for the corporate debt securities are primarily determined based on quoted market prices (Level 1). Fair values for the U.S. municipal securities, U.S. government agency securities, certificates of deposit and commercial paper are primarily determined using dealer quotes or quoted market prices for similar securities (Level 2).



The Company tests for other-than-temporary losses on a quarterly basis and has considered the unrealized losses indicated above, which are the result of changes in interest rates, to be temporary in nature. In reaching this conclusion, the Company considered the credit quality of the issuers of the debt securities as well as the Company's intent to hold the investments to maturity and recover the full principal.

Classification of marketable securities as current or non-current is based upon the security's maturity date as of the date of these financial statements.

The June 30, 2015 balance of held-to-maturity debt securities by contractual maturity is shown in the following table at amortized cost. Actual maturities may differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties.

|                                       | <b>June<br/>30,<br/>2015</b> |
|---------------------------------------|------------------------------|
| (in thousands)                        |                              |
| Due in one year or less               | \$31,190                     |
| Due after one year through five years | 54,482                       |
| Total marketable securities           | \$85,672                     |

#### **Note 7 – Inventory**

Inventory consists primarily of raw materials, which are recorded at the lower of cost or market using the average-cost method, which approximates first-in, first-out (FIFO) cost. The Company periodically reviews its inventory for slow-moving, damaged and discontinued items and provides allowances to reduce such items identified to their recoverable amounts.

The Company's inventory consists of the following:

|                             | <b>June</b> | <b>December</b> |
|-----------------------------|-------------|-----------------|
|                             | <b>30,</b>  | <b>31,</b>      |
| (in thousands)              | <b>2015</b> | <b>2014</b>     |
| Raw materials               | \$6,108     | \$ 5,728        |
| Work in process             | 922         | 653             |
| Total inventory             | 7,030       | 6,381           |
| Allowance for obsolescence  | (202 )      | (187 )          |
| Inventory, net of allowance | \$6,828     | \$ 6,194        |

#### **Note 8 – Stock-Based Compensation**

Under the 2012 Long-Term Incentive Plan (2012 Plan), the Company has the ability to grant stock options, stock appreciation rights (SARs), restricted stock, stock units, other stock-based awards and cash incentive awards. Awards under the 2012 Plan will have a maximum term of ten years from the date of grant. The compensation committee may provide that the vesting or payment of any award will be subject to the attainment of specified performance measures in addition to the satisfaction of any continued service requirements and the compensation committee will determine whether such measures have been achieved. The per share exercise price of stock options and SARs granted under the 2012 Plan generally may not be less than the fair market value of a share of our common stock on the date of the grant.

#### **Employee Stock Purchase Plan**

The Company's 2012 Employee Stock Purchase Plan (ESPP) allows eligible employees to purchase shares of the Company's common stock at a discount through payroll deductions of up to 15 percent of their eligible compensation, subject to plan limitations. The ESPP provides for six-month offering periods ending May 15 and November 15, respectively. At the end of each offering period, employees are able to purchase shares at 85 percent of the lower of the fair market value of the Company's common stock on the first trading day of the offering period or on the last trading day of the offering period.

#### **Stock-Based Compensation Expense**

Stock-based compensation expense was \$1.6 million and \$1.2 million for the three months ended June 30, 2015 and 2014, respectively, and \$2.9 million and \$2.2 million for the six months ended June 30, 2015 and 2014, respectively.

## Stock Options

A summary of stock option activity during the six months ended June 30, 2015 is as follows:

|  | <b>Stock<br/>Options</b> | <b>Weighted-<br/>Average<br/>Exercise<br/>Price</b> |
|--|--------------------------|---|
| Options outstanding at December 31, 2014 | 998,987                  | \$ 26.49  |
| Granted                                  | 110,335                  | 67.36   |
| Exercised                                | (86,656 )                | 15.72   |
| Forfeited                                | (25,713 )                | 52.39   |
| Options outstanding at June 30, 2015     | 996,953                  | \$ 31.28  |
| Exercisable at June 30, 2015             | 515,568                  | \$ 19.12  |

The outstanding options generally have a term of ten years. For employees, options granted become exercisable ratably over the vesting period, which is generally a five-year period beginning on the first anniversary of the grant date, subject to the employee's continuing service to the Company. For directors, options generally become exercisable in full on the first anniversary of the grant date.

The weighted-average grant date fair value of options that were granted during the six months ended June 30, 2015 was \$32.42.

The following table provides the assumptions used in the Black-Scholes pricing model valuation of options during the six months ended June 30, 2015 and 2014, respectively:

|                         | <b>Six Months Ended June 30,</b> |        |             |        |
|-------------------------|----------------------------------|--------|-------------|--------|
|                         | <b>2015</b>                      |        | <b>2014</b> |        |
| Risk-free interest rate | 1.69 -                           | 1.77%  | 0.43 -      | 2.14%  |
| Expected life (years)   | 5.50 -                           | 6.50   | 2.00 -      | 6.50   |
| Expected volatility     | 46.80-                           | 47.23% | 48.87-      | 49.30% |
| Expected dividend yield | 0%                               |        | 0%          |        |

As of June 30, 2015, there was \$8.8 million of unrecognized compensation expense related to unvested stock options, which is expected to be recognized over a weighted-average period of 3.3 years.

### **Restricted Stock**

The 2012 Plan provides for the award of restricted stock or restricted stock units. Restricted stock awards are share settled awards and restrictions lapse ratably over the vesting period, which is generally a five-year period, beginning on the first anniversary of the grant date, subject to the employee's continuing service to the Company. For directors, restricted stock awards generally vest in full on the first anniversary of the grant date.

A summary of restricted stock activity during the six months ended June 30, 2015 is as follows:

|   | <b>Restricted<br/>Stock</b> | <b>Weighted-<br/>Average<br/>Grant<br/>Date<br/>Fair<br/>Value<br/>Per Share</b> |
|---|-----------------------------|--|
| Nonvested restricted stock at December 31, 2014 | 76,574                      | \$ 69.27   |
| Granted   | 68,580                      | 68.89  |
| Vested  | (16,161 )                   | 69.47  |
| Forfeited                                       | (1,858 )                    | 78.59  |
| Nonvested restricted stock at June 30, 2015     | 127,135                     | \$ 68.90   |

As of June 30, 2015, there was \$7.9 million of unrecognized compensation expense related to non-vested restricted stock, which is expected to be recognized over a weighted-average period of 4.1 years.

### Employee Stock Purchase Plan

The following table presents the assumptions used to estimate the fair value of the ESPP during the six months ended June 30, 2015 and 2014, respectively:

|                         | <b>Six Months Ended June 30,</b> |        |             |        |
|-------------------------|----------------------------------|--------|-------------|--------|
|                         | <b>2015</b>                      |        | <b>2014</b> |        |
| Risk-free interest rate | 0.08 -                           | 0.10%  | 0.01 -      | 0.11%  |
| Expected life (months)  | 6.00                             |        | 6.00        |        |
| Expected volatility     | 33.68-                           | 37.64% | 39.16-      | 39.80% |
| Expected dividend yield | 0%                               |        | 0%          |        |

**Note 9 – Accumulated Other Comprehensive Income (Loss)**

Other comprehensive income (loss) is comprised entirely of foreign currency translation adjustments. The following table presents the changes in accumulated other comprehensive income (loss) balances during the three and six months ended June 30, 2015 and 2014, respectively:

| (in thousands)  | <b>Three Months<br/>Ended<br/>June 30,</b> |             | <b>Six Months<br/>Ended<br/>June 30,</b> |             |
|---|--|-------------|--|-------------|
|   | <b>2015</b>                                | <b>2014</b> | <b>2015</b>                              | <b>2014</b> |
| Foreign currency translation adjustments                                |  |             |  |             |
| Balance at beginning of period  | \$ (4,004)                                 | \$ (919)    | \$ (2,929)                               | \$ (1,091)  |
| Other comprehensive income before reclassifications                     | 1,274                                      | 532         | 199                                      | 704         |
| Amounts reclassified from accumulated other comprehensive income (loss) | -  | -           | -  | -           |
| Net current-period other comprehensive income                           | 1,274                                      | 532         | 199                                      | 704         |
| Balance at end of period  | \$ (2,730)                                 | \$ (387)    | \$ (2,730)                               | \$ (387)    |

**Note 10 – Income Taxes**

The Company is subject to income tax in multiple jurisdictions and the use of estimates is required to determine the provision for income taxes. For the three months ended June 30, 2015 and 2014, the Company recorded an income tax provision of \$5.6 million and \$5.0 million, respectively. For the six months ended June 30, 2015 and 2014, the Company recorded an income tax provision of \$10.6 million and \$9.4 million, respectively. The income tax provision is based on the estimated annual effective tax rate for the year applied to pre-tax income. The effective income tax rate for the three months ended June 30, 2015 was 32.5 percent compared with 31.1 percent in the same period of the prior year. The effective income tax rate for the six months ended June 30, 2015 was 32.3 percent compared with 30.9 percent in the same period of the prior year.

The effective income tax rate for the three and six months ended June 30, 2015 differs from the U.S. federal statutory rate of 35 percent due primarily to the mix of income earned in domestic and foreign tax jurisdictions and deductions for which the Company qualifies.

The Company had liabilities related to unrecognized tax benefits totaling \$1.5 million at June 30, 2015 and \$1.3 million at December 31, 2014, all of which, if recognized, would affect the Company's effective tax rate. The Company recognizes interest and penalties related to income tax matters in income tax expense, and reports the

liability in current or long-term income taxes payable as appropriate.

During the six months ended June 30, 2015, the Company increased its current year uncertain tax positions by \$0.2 million. The increase was due to certain tax positions not meeting the more-likely-than-not standard for accounting for uncertain tax positions under the Company's current facts and circumstances.

Based upon the information available as of June 30, 2015, the Company anticipates the amount of uncertain tax positions will change in the next twelve months; however, the change is not expected to be material.

### Note 11 – Revenue and Geographic Information

The Company's revenue is derived from its Protomold injection molding, Firstcut computer numerical control (CNC) machining and Fineline additive manufacturing (3D printing) product lines. Total revenue by product line is as follows:

|                 | <b>Three Months<br/>Ended June 30,</b> |             | <b>Six Months Ended<br/>June 30,</b> |             |
|-----------------|--|-------------|--------------------------------------|-------------|
| (in thousands)  | <b>2015</b>                            | <b>2014</b> | <b>2015</b>                          | <b>2014</b> |
| <b>Revenue:</b> |  |             |                                      |             |
| Protomold       | \$39,932                               | \$36,255    | \$77,550                             | \$68,949    |
| Firstcut        | 18,585                                 | 14,478      | 34,955                               | 27,858      |
| Fineline        | 5,452                                  | 2,133       | 10,000                               | 2,133       |
| Total revenue   | \$63,969                               | \$52,866    | \$122,505                            | \$98,940    |

Revenue to external customers based on the billing location of the end user customer and long-lived assets by geographic region are as follows:

| (in thousands)  | <b>Three Months<br/>Ended June 30,</b> |             | <b>Six Months Ended<br/>June 30,</b> |             |
|-----------------|--|-------------|--------------------------------------|-------------|
|                 | <b>2015</b>                            | <b>2014</b> | <b>2015</b>                          | <b>2014</b> |
| <b>Revenue:</b> |  |             |                                      |             |
| United States   | \$49,298                               | \$39,966    | \$94,143                             | \$72,988    |
| International   | 14,671                                 | 12,900      | 28,362                               | 25,952      |
| Total revenue   | \$63,969                               | \$52,866    | \$122,505                            | \$98,940    |

| (in thousands)            | <b>June 30,</b> | <b>December</b>     |
|---------------------------|-----------------|---------------------|
|                           | <b>2015</b>     | <b>31,<br/>2014</b> |
| <b>Long-lived assets:</b> |                 |                     |
| United States             | \$84,014        | \$76,923            |
| International             | 16,907          | 14,703              |
| Total long-lived assets   | \$100,921       | \$91,626            |



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

*The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our unaudited consolidated financial statements and related notes appearing elsewhere in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K for the year ended December 31, 2014.*

### **Forward-Looking Statements**

Statements contained in this report regarding matters that are not historical or current facts are “forward-looking statements” within the meaning of The Private Securities Litigation Reform Act of 1995. In some cases, you can identify forward-looking statements by the following words: “may,” “will,” “could,” “would,” “should,” “expect,” “intend,” “p,” “anticipate,” “believe,” “estimate,” “predict,” “project,” “potential,” “continue,” “ongoing” or the negative of these terms or other comparable terminology, although not all forward-looking statements contain these words. These statements involve known and unknown risks, uncertainties and other factors which may cause our results to be materially different than those expressed or implied in such statements. Certain of these risk factors and others are described in Item 1A. “Risk Factors” of our Annual Report on Form 10-K as filed with the SEC. Other unknown or unpredictable factors also could have material adverse effects on our future results. We cannot guarantee future results, levels of activity, performance or achievements. Accordingly, you should not place undue reliance on these forward-looking statements. Finally, we expressly disclaim any intent or obligation to update any forward-looking statements to reflect subsequent events or circumstances.

### **Overview**

We are a leading online and technology-enabled, quick-turn, on-demand manufacturer of custom parts for prototyping and short-run production. We manufacture parts for product developers and engineers worldwide who are under increasing pressure to bring their finished products to market faster than their competition. We utilize injection molding, computer numerical control (CNC) machining and additive manufacturing to manufacture custom parts for our customers.

We believe custom parts manufacturing has historically been an underserved market due to the inefficiencies inherent in the quotation, equipment set-up and non-recurring engineering processes required to produce custom parts. Our proprietary technology eliminates most of the time-consuming and expensive skilled labor conventionally required to quote and manufacture parts. Our customers conduct nearly all of their business with us over the Internet. We target our products to the millions of product developers and engineers who use three-dimensional computer-aided design (3D CAD) software to design products across a diverse range of end-markets.

Our primary manufacturing product lines currently include Protomold, which is our injection molding product line, Firstcut, which is our CNC machining product line, and Fineline, which is our additive-manufactured (3D printing) product line. We continually seek to expand the range of size and geometric complexity of the parts we can make with these manufacturing processes, to extend the variety of materials we are able to support and to identify additional manufacturing processes to which we can apply our technology in order to better serve the evolving preferences and needs of product developers and engineers.

### ***Protomold***

Our Protomold product line uses our 3D CAD-to-CNC machining technology for the automated design and manufacture of thermoplastic, metal, or liquid silicone injection molds, which are then used to produce custom injection-molded parts on commercially available equipment. Our Protomold product line is used for prototype, on-demand and short-run production. Prototype quantities typically range from 25 to 100 parts. Because we retain possession of the molds, customers who need short-run production often come back to Protomold for additional quantities typically ranging up to 100,000 parts or more. They do so to support pilot production while their tooling for high-volume production is being prepared, because they need on-demand manufacturing due to disruptions in their manufacturing process, because their product will only be released in a limited quantity, or because they need end-of-life production support. These additional part orders typically occur on approximately half of the molds that we make, typically accounting for approximately half of our total Protomold revenue.

### ***Firstcut***

Our Firstcut product line uses commercially available CNC machines to cut plastic or metal bars and blocks into one or more custom parts based on the 3D CAD model uploaded by the product developer or engineer. Our efficiencies derive from the automation of the programming of these machines and a proprietary fixturing process. The Firstcut product line is well suited to produce small quantities, typically in the range of one to 200 parts.

## ***Fineline***

Our Fineline additive manufacturing product line, often referred to as 3D printing, includes stereolithography (SL), selective laser sintering (SLS) and direct metal laser sintering (DMLS) processes, which offer customers a wide-variety of high-quality, precision rapid prototyping. These processes create parts with a high level of accuracy, detail, strength and durability. The Fineline product line is well suited to produce small quantities, typically in the range of one to 50 parts.

## **Key Financial Measures and Trends**

### ***Revenue***

The Company's operations are comprised of three geographic business units in the United States, Europe and Japan, which we believe are three of the largest geographic markets where product developers and engineers are located. Revenue within each of our United States and Europe business units is derived from our Protomold, Firstcut and Fineline product lines. Revenue within our Japan business unit is derived from our Protomold and Firstcut product lines. Our historical and current efforts to increase revenue have been directed at gaining new customers and selling to our existing customer base by:

- increasing marketing and selling activities;

- offering additional product lines such as our Fineline additive manufacturing technologies, often times referred to as 3D printing, which we added via the acquisition of FineLine Prototyping, Inc. (FineLine) in April 2014;

- introducing our Firstcut product line in 2007;

- expanding internationally, including the opening of our Japanese plant in 2009;

- improving the usability of our product lines such as our web-centric applications; and

- expanding the breadth and scope of our products, for example by adding more sizes and materials to our offerings such as liquid silicone rubber (LSR) and metal injection molding (MIM).

During the three months ended June 30, 2015, we served approximately 11,800 unique product developers and engineers, an increase of 28% over the same period in 2014. During the six months ended June 30, 2015, we served approximately 17,200 unique product developers and engineers, an increase of 31% over the same period in 2014. These product developers and engineers are served under all our product lines, including Fineline, which we added via our acquisition of FineLine Prototyping, Inc. in April 2014.

***Cost of Revenue, Gross Profit and Gross Margin***

Cost of revenue consists primarily of raw materials, equipment depreciation, employee compensation, benefits, stock-based compensation, facilities costs and overhead allocations associated with the manufacturing process for molds and custom parts. We expect cost of revenue to increase in absolute dollars, but remain relatively constant as a percentage of total revenue.

We define gross profit as our revenue less our cost of revenue, and we define gross margin as gross profit expressed as a percentage of revenue. Our gross profit and gross margin are affected by many factors, including our pricing, sales volume and manufacturing costs, the costs associated with increasing production capacity, the mix between sales by product line, the mix between domestic and foreign revenue sources and foreign exchange rates.

Our gross margins vary between geographic markets due primarily to the costs associated with starting new factories, available capacity and our operating maturity in these markets. We believe that over time and with growth and maturity of our international business, gross margins will be generally consistent through all our markets.

***Operating Expenses***

Operating expenses consist of marketing and sales, research and development and general and administrative expenses. Personnel-related costs are the most significant component of the marketing and sales, research and development and general and administrative expense categories.

Our recent growth in operating expenses is mainly due to higher headcounts to support our growth and expansion, and we expect that trend to continue. Our business strategy is to continue to be a leading online and technology-enabled manufacturer of quick-turn, on-demand additive-manufactured (3D printing), CNC-machined, CNC-turned and injection-molded custom parts for prototyping and short-run production. For us to achieve our goals, we anticipate continued substantial investments in technology and personnel, resulting in increased operating expenses.

*Marketing and sales.* Marketing and sales expense consists primarily of employee compensation, benefits, commissions, stock-based compensation, marketing programs such as print and pay-per-click advertising, trade shows, direct mail and other related overhead. We expect sales and marketing expense to increase in the future as we increase the number of marketing and sales professionals and marketing programs targeted to increase our customer base.

*Research and development.* Research and development expense consists primarily of employee compensation, benefits, stock-based compensation, depreciation on equipment, outside services and other related overhead. All of our research and development costs have been expensed as incurred. We expect research and development expense to increase in the future as we seek to enhance and expand our product line offerings.

*General and administrative.* General and administrative expense consists primarily of employee compensation, benefits, stock-based compensation, professional service fees related to accounting, tax and legal and other related overhead. We expect general and administrative expense to increase in the future as we continue to grow and expand as a global organization.

#### ***Other Income (Expense), Net***

Other income (expense), net primarily consists of foreign currency-related gains and losses, interest income on cash balances and investments, and interest expense on borrowings. Our foreign currency-related gains and losses will vary depending upon movements in underlying exchange rates. Our interest income will vary each reporting period depending on our average cash balances during the period, composition of our marketable security portfolio and the current level of interest rates. Our interest expense will vary based on borrowings and interest rates.

#### ***Provision for Income Taxes***

Provision for income taxes is comprised of federal, state, local and foreign taxes based on pre-tax income. We expect income taxes to increase as our taxable income increases and our effective tax rate to remain relatively constant.

## Results of Operations

The following table sets forth a summary of our results of operations and the related changes for the periods indicated. The results below are not necessarily indicative of the results for future periods.

| (dollars in thousands)      | Three Months Ended June 30, |        |          |        | Change   |        | Six Months Ended June 30, |        |          |        | Change   |   |
|-----------------------------|-----------------------------|--------|----------|--------|----------|--------|---------------------------|--------|----------|--------|----------|---|
|                             | 2015                        |        | 2014     |        | \$       | %      | 2015                      |        | 2014     |        | \$       | % |
| Revenue                     | \$63,969                    | 100.0% | \$52,866 | 100.0% | \$11,103 | 21.0%  | \$122,505                 | 100.0% | \$98,940 | 100.0% | \$23,565 |   |
| Cost of revenue             | 26,419                      | 41.3   | 20,183   | 38.2   | 6,236    | 30.9   | 49,701                    | 40.6   | 37,233   | 37.6   | 12,468   |   |
| Gross profit                | 37,550                      | 58.7   | 32,683   | 61.8   | 4,867    | 14.9   | 72,804                    | 59.4   | 61,707   | 62.4   | 11,097   |   |
| Operating expenses:         |                             |        |          |        |          |        |                           |        |          |        |          |   |
| Marketing and sales         | 9,502                       | 14.8   | 7,261    | 13.7   | 2,241    | 30.9   | 18,356                    | 15.0   | 13,678   | 13.8   | 4,678    |   |
| Research and development    | 4,397                       | 6.9    | 3,914    | 7.4    | 483      | 12.3   | 8,711                     | 7.1    | 7,370    | 7.4    | 1,341    |   |
| General and administrative  | 6,304                       | 9.9    | 5,534    | 10.5   | 770      | 13.9   | 12,549                    | 10.2   | 10,237   | 10.4   | 2,312    |   |
| Total operating expenses    | 20,203                      | 31.6   | 16,709   | 31.6   | 3,494    | 20.9   | 39,616                    | 32.3   | 31,285   | 31.6   | 8,331    |   |
| Income from operations      | 17,347                      | 27.1   | 15,974   | 30.2   | 1,373    | 8.6    | 33,188                    | 27.1   | 30,422   | 30.8   | 2,766    |   |
| Other income (expense), net | (36 )                       | -      | (66 )    | (0.1 ) | 30       | (45.5) | (493 )                    | (0.4 ) | 37       | -      | (530 )   |   |
| Income before income taxes  | 17,311                      | 27.1   | 15,908   | 30.1   | 1,403    | 8.8    | 32,695                    | 26.7   | 30,459   | 30.8   | 2,236    |   |
| Provision for income taxes  | 5,625                       | 8.8    | 4,952    | 9.4    | 673      | 13.6   | 10,556                    | 8.6    | 9,401    | 9.5    | 1,155    |   |
| Net income                  | \$11,686                    | 18.3 % | \$10,956 | 20.7 % | \$730    | 6.7 %  | \$22,139                  | 18.1 % | \$21,058 | 21.3 % | \$1,081  |   |

\* Percentage change not meaningful

Stock-based compensation expense included in the statements of operations data above is as follows:

|  | <b>Three Months<br/>Ended June<br/>30,</b> |             | <b>Six Months<br/>Ended June<br/>30,</b> |             |
|--|--|-------------|--|-------------|
|  | <b>2015</b>                                | <b>2014</b> | <b>2015</b>                              | <b>2014</b> |
| (dollars in thousands)                 |  |             |  |             |
| Stock options and restricted stock     | \$1,436                                    | \$1,147     | \$2,655                                  | \$2,060     |
| Employee stock purchase plan           | 131  | 103         | 254                                      | 188         |
| Total stock-based compensation expense | \$1,567                                    | \$1,250     | \$2,909                                  | \$2,248     |
| Cost of revenue                        | \$132                                      | \$97        | \$243                                    | \$179       |
| Operating expenses:                    |  |             |  |             |
| Marketing and sales                    | 271  | 240         | 507                                      | 435         |
| Research and development               | 336  | 268         | 630                                      | 483         |
| General and administrative             | 828  | 645         | 1,529                                    | 1,151       |
| Total stock-based compensation expense | \$1,567                                    | \$1,250     | \$2,909                                  | \$2,248     |

*Comparison of Three Months Ended June 30, 2015 and 2014*

*Revenue*

Revenue by product line and the related changes for the three months ended June 30, 2015 and 2014 were as follows:

|                        | <b>Three Months Ended June 30,</b> |                                   |             |                                   | <b>Change</b> |          |
|------------------------|------------------------------------|-----------------------------------|-------------|-----------------------------------|---------------|----------|
|                        | <b>2015</b>                        | <b>% of<br/>Total<br/>Revenue</b> | <b>2014</b> | <b>% of<br/>Total<br/>Revenue</b> | <b>\$</b>     | <b>%</b> |
| (dollars in thousands) | <b>\$</b>                          |                                   | <b>\$</b>   |                                   |               |          |
| Revenue                |                                    |                                   |             |                                   |               |          |
| Protomold              | \$39,932                           | 62.4 %                            | \$36,255    | 68.6 %                            | \$3,677       | 10.1 %   |
| Firstcut               | 18,585                             | 29.1 %                            | 14,478      | 27.4 %                            | 4,107         | 28.4 %   |
| Fineline               | 5,452                              | 8.5 %                             | 2,133       | 4.0 %                             | 3,319         | 155.6 %  |
| Total revenue          | \$63,969                           | 100.0 %                           | \$52,866    | 100.0 %                           | \$11,103      | 21.0 %   |

Revenue by geographic region, based on the billing location of the end customer, for the three months ended June 30, 2015 and 2014 is summarized as follows:

|                        | <b>Three Months Ended June 30,</b> |                | <b>2014</b> |                | <b>Change</b> |          |
|------------------------|------------------------------------|----------------|-------------|----------------|---------------|----------|
|                        | <b>2015</b>                        | <b>% of</b>    | <b>\$</b>   | <b>% of</b>    | <b>\$</b>     | <b>%</b> |
| (dollars in thousands) | <b>\$</b>                          | <b>Total</b>   | <b>\$</b>   | <b>Total</b>   | <b>\$</b>     | <b>%</b> |
|                        |                                    | <b>Revenue</b> |             | <b>Revenue</b> |               |          |
| Revenue                |                                    |                |             |                |               |          |
| United States          | \$49,298                           | 77.1 %         | \$39,966    | 75.6 %         | \$9,332       | 23.3 %   |
| International          | 14,671                             | 22.9 %         | 12,900      | 24.4 %         | 1,771         | 13.7 %   |
| Total revenue          | \$63,969                           | 100.0 %        | \$52,866    | 100.0 %        | \$11,103      | 21.0 %   |

Our revenue increased \$11.1 million, or 21.0%, for the three months ended June 30, 2015 compared to the same period in 2014. By geographic region, this revenue growth was driven by a 23.3% increase in United States revenue and a 13.7% increase in international revenue. By product line, this revenue growth was driven by a 10.1% increase in Protomold revenue, 28.4% increase in Firstcut revenue and 155.6% increase in Fineline revenue in each case for the three months ended June 30, 2015 compared to the same period in 2014. Fineline revenue for the three months ended June 30, 2014 commenced upon the completion of our acquisition of FineLine Prototyping, Inc. on April 23, 2014.

Our revenue growth during the three months ended June 30, 2015 was the result of increased volume of the product developers and engineers we served. During the three months ended June 30, 2015, we served approximately 11,800 unique product developers and engineers, an increase of 28% over the same period in 2014. Average revenue per product developer or engineer decreased 6% during the three months ended June 30, 2015 when compared to the same period in 2014.



Our revenue increases were primarily driven by increases in sales personnel and marketing activities. Our sales personnel focus on gaining new customer accounts and expanding the depth and breadth into existing customer accounts. Our marketing personnel focus on marketing activities that have proven to result in the greatest number of customer prospects to support sales activity.

International revenue was negatively impacted by \$2.2 million for the three months ended June 30, 2015 compared to the same period in 2014 due to the strengthening of the United States dollar relative to the British Pound and Japanese Yen, as well as the strengthening of the British Pound relative to the Euro. The effect of pricing changes on revenue was immaterial for the three months ended June 30, 2015 compared to the same period in 2014.

#### *Cost of Revenue, Gross Profit and Gross Margin*

*Cost of Revenue.* Cost of revenue increased \$6.2 million, or 30.9%, for the three months ended June 30, 2015 compared to the same period in 2014, which was faster than the rate of revenue increase of 21.0% for the three months ended June 30, 2015 compared to the same period in 2014. The increase in cost of revenue was due to raw material and production cost increases of \$2.3 million to support increased sales volumes, an increase in direct labor headcount resulting in personnel and related cost increases of \$3.0 million and equipment and facility-related cost increases of \$0.9 million.

*Gross Profit and Gross Margin.* Gross profit increased from \$32.7 million, or 61.8% of revenues, in the three months ended June 30, 2014 to \$37.6 million, or 58.7% of revenue, in the three months ended June 30, 2015 primarily due to increases in revenue offset by the cost of revenue as discussed above. Gross margin decreased primarily as a result of our Finline product line having a lower gross margin than our legacy Firstcut and Protomold product lines and the impact of fluctuations in foreign currency exchange rates.

#### *Operating Expenses, Other Income (Expense), net and Provision for Income Taxes*

*Marketing and Sales.* Marketing and sales expenses increased \$2.2 million, or 30.9%, during the three months ended June 30, 2015 compared to the same period in 2014 due primarily to an increase in headcount resulting in personnel and related cost increases of \$1.8 million and marketing program cost increases of \$0.4 million. The increase in marketing program costs is the result of our focus and concentration on funding those programs which have proven to be the most effective in growing our business.

*Research and Development.* Our research and development expenses increased \$0.5 million, or 12.3%, during the three months ended June 30, 2015 compared to the same period in 2014 due to an increase in headcount resulting in personnel and related cost increases of \$0.8 million and operating cost increases of \$0.2 million, which were partially offset by professional services cost decreases of \$0.5 million.

*General and Administrative.* Our general and administrative expenses increased \$0.8 million, or 13.9%, during the three months ended June 30, 2015 compared to the same period in 2014 due to an increase in headcount resulting in personnel and related cost increases of \$0.8 million, stock-based compensation costs increases of \$0.2 million and intangible amortization expense increases of \$0.1 million, which were partially offset by professional services cost decreases of \$0.3 million.

*Other Income (Expense), net.* Other expense, net did not materially change during the three months ended June 30, 2015 compared to the same period in 2014.

*Provision for Income Taxes.* Our effective tax rate of 32.5% for the three months ended June 30, 2015 increased 1.4% when compared to 31.1% for the same period in 2014. The increase in the effective tax rate is primarily due to changes in the mix of projected income earned in domestic and foreign tax jurisdictions for the tax year ending December 31, 2015. As a result of the increase in our effective tax rate combined with increased income attributable to the fluctuations described above, our income tax provision increased by \$0.6 million to \$5.6 million for the three months ended June 30, 2015 compared to our income tax provision of \$5.0 million for the three months ended June 30, 2014.

*Comparison of Six Months Ended June 30, 2015 and 2014**Revenue*

Revenue by product line and the related changes for the six months ended June 30, 2015 and 2014 were as follows:

| (dollars in thousands) | <b>Six Months Ended June 30,</b> |                |             |                | <b>Change</b> |          |
|------------------------|----------------------------------|----------------|-------------|----------------|---------------|----------|
|                        | <b>2015</b>                      | <b>% of</b>    | <b>2014</b> | <b>% of</b>    | <b>\$</b>     | <b>%</b> |
|                        | <b>\$</b>                        | <b>Total</b>   | <b>\$</b>   | <b>Total</b>   |               |          |
|                        |                                  | <b>Revenue</b> |             | <b>Revenue</b> |               |          |
| Revenue                |                                  |                |             |                |               |          |
| Protomold              | \$77,550                         | 63.3           | % \$68,949  | 69.7           | % \$8,601     | 12.5%    |
| Firstcut               | 34,955                           | 28.5           | 27,858      | 28.2           | 7,097         | 25.5     |
| Fineline               | 10,000                           | 8.2            | 2,133       | 2.1            | 7,867         | *        |
| Total revenue          | \$122,505                        | 100.0          | % \$98,940  | 100.0          | % \$23,565    | 23.8%    |

\*

Percentage  
change not  
meaningful

Revenue by geographic region, based on the billing location of the end customer, for the six months ended June 30, 2015 and 2014 is summarized as follows:

| (dollars in thousands) | <b>Six Months Ended June 30,</b> |                |             |                | <b>Change</b> |          |
|------------------------|----------------------------------|----------------|-------------|----------------|---------------|----------|
|                        | <b>2015</b>                      | <b>% of</b>    | <b>2014</b> | <b>% of</b>    | <b>\$</b>     | <b>%</b> |
|                        | <b>\$</b>                        | <b>Total</b>   | <b>\$</b>   | <b>Total</b>   |               |          |
|                        |                                  | <b>Revenue</b> |             | <b>Revenue</b> |               |          |
| Revenue                |                                  |                |             |                |               |          |
| United States          | \$94,143                         | 76.8           | % \$72,988  | 73.8           | % \$21,155    | 29.0%    |
| International          | 28,362                           | 23.2           | 25,952      | 26.2           | 2,410         | 9.3      |
| Total revenue          | \$122,505                        | 100.0          | % \$98,940  | 100.0          | % \$23,565    | 23.8%    |

Our revenue increased \$23.6 million, or 23.8%, for the six months ended June 30, 2015 compared to the same period in 2014. By geographic region, this revenue growth was driven by a 29.0% increase in United States revenue and a 9.3% increase in international revenue. By product line, this revenue growth was driven by a 12.5% increase in Protomold revenue and a 25.5% increase in Firstcut revenue, in each case for the six months ended June 30, 2015 compared to the same period in 2014, as well as \$7.9 million in Fineline revenue related to the FineLine acquisition completed in the second quarter of 2014.

Our revenue growth during the six months ended June 30, 2015 was the result of increased volume of the product developers and engineers we served. During the six months ended June 30, 2015, we served approximately 17,200 unique product developers and engineers, an increase of 31% over the same period in 2014. Average revenue per product developer or engineer decreased 6% during the six months ended June 30, 2015 when compared to the same period in 2014.

In addition to revenue gained through the acquisition of FineLine, our revenue increases were primarily driven by increases in sales personnel and marketing activities. Our sales personnel focus on gaining new customer accounts and expanding the depth and breadth into existing customer accounts. Our marketing personnel focus on marketing activities that have proven to result in the greatest number of customer prospects to support sales activity.

International revenue was negatively impacted by \$4.0 million for the six months ended June 30, 2015 compared to the same period in 2014 due to the strengthening of the United States dollar relative to the British Pound and Japanese Yen, as well as the strengthening of the British Pound relative to the Euro. The effect of pricing changes on revenue was immaterial for the six months ended June 30, 2015 compared to the same period in 2014.

#### *Cost of Revenue, Gross Profit and Gross Margin*

*Cost of Revenue.* Cost of revenue increased \$12.5 million, or 33.5%, for the six months ended June 30, 2015 compared to the same period in 2014, which was faster than the rate of revenue increase of 23.8% for the six months ended June 30, 2015 compared to the same period in 2014. The increase in cost of revenue was due to raw material and production cost increases of \$4.4 million to support increased sales volumes, an increase in direct labor headcount resulting in personnel and related cost increases of \$6.3 million and equipment and facility-related cost increases of \$1.8 million.

*Gross Profit and Gross Margin.* Gross profit increased from \$61.7 million, or 62.4% of revenues, in the six months ended June 30, 2014 to \$72.8 million, or 59.4% of revenue, in the six months ended June 30, 2015 primarily due to increases in revenue offset by the cost of revenue as discussed above. Gross margin decreased primarily as a result of our Finline product line having a lower gross margin than our legacy Firstcut and Protomold product lines, expenses attributable to recent capacity expansion, primarily in the United States, and the impact of fluctuations in foreign currency exchange rates.

*Operating Expenses, Other Income (Expense), net and Provision for Income Taxes*

*Marketing and Sales.* Marketing and sales expenses increased \$4.7 million, or 34.2%, during the six months ended June 30, 2015 compared to the same period in 2014 due primarily to an increase in headcount resulting in personnel and related cost increases of \$3.7 million and marketing program cost increases of \$1.0 million. The increase in marketing program costs is the result of our focus and concentration on funding those programs which have proven to be the most effective in growing our business.

*Research and Development.* Our research and development expenses increased \$1.3 million, or 18.2%, during the six months ended June 30, 2015 compared to the same period in 2014 due to an increase in headcount resulting in personnel and related cost increases of \$2.0 million and operating cost increases of \$0.3 million, which were partially offset by professional services cost decreases of \$1.0 million.

*General and Administrative.* Our general and administrative expenses increased \$2.3 million, or 22.6%, during the six months ended June 30, 2015 compared to the same period in 2014 due to an increase in headcount resulting in personnel and related cost increases of \$2.0 million, stock-based compensation costs increases of \$0.4 million, intangible amortization expense increases of \$0.2 million and administrative cost increases of \$0.1 million, which were partially offset by professional services cost decreases of \$0.4 million. Amortization expenses relate to intangible assets acquired in the purchase of FineLine in April 2014.

*Other Income (Expense), net.* Other expense, net increased \$0.5 million during the six months ended June 30, 2015 compared to the same period in 2014 due to changes in foreign currency rates.

*Provision for Income Taxes.* Our effective tax rate of 32.3% for the six months ended June 30, 2015 increased 1.4% when compared to 30.9% for the same period in 2014. The increase in the effective tax rate is primarily due to changes in the mix of projected income earned in domestic and foreign tax jurisdictions for the tax year ending December 31, 2015. As a result of the increase in our effective tax rate combined with increased income attributable to the fluctuations described above, our income tax provision increased by \$1.2 million to \$10.6 million for the six months ended June 30, 2015 compared to our income tax provision of \$9.4 million for the six months ended June 30,

2014.

*Liquidity and Capital Resources**Cash Flows*

The following table summarizes our cash flows during the six months ended June 30, 2015 and 2014:

| (dollars in thousands)                                | <b>Six Months Ended</b> |             |
|---|-------------------------|-------------|
|   | <b>June 30,</b>         |             |
|   | <b>2015</b>             | <b>2014</b> |
| Net cash provided by operating activities             | \$27,833                | \$26,017    |
| Net cash used in investing activities                 | (16,997)                | (48,511)    |
| Net cash provided by financing activities             | 2,119                   | 2,075       |
| Effect of exchange rates on cash and cash equivalents | 40                      | 234         |
| Net increase (decrease) in cash and cash equivalents  | \$12,995                | \$(20,185)  |

*Sources of Liquidity*

Historically we have financed our operations and capital expenditures primarily through cash flow from operations and, to a lesser extent, lease financing. We had cash and cash equivalents of \$56.3 million as of June 30, 2015, an increase of \$13.0 million from December 31, 2014. The increase in our cash was primarily due to cash generated through operations and – to a lesser extent – proceeds from exercises of stock options and purchases through our employee stock purchase plan, which were partially offset by investing activity.

*Cash Flows from Operating Activities*

Cash flows from operating activities of \$27.8 million during the six months ended June 30, 2015 primarily consisted of net income of \$22.1 million, adjusted for certain non-cash items, including depreciation and amortization of \$6.9 million, stock-based compensation expense of \$2.9 million, deferred taxes of \$0.6 million and amortization of held-to-maturity securities of \$0.6 million, which were partially offset by excess tax benefit from stock-based compensation expense of \$1.0 million. Cash flows from operating activities increased \$1.8 million during the six months ended June 30, 2015 compared to the same period in 2014 due to increases in net income of \$1.0 million, depreciation and amortization of \$2.3 million, stock-based compensation expense of \$0.7 million, deferred taxes of \$0.5 million and a decrease in excess tax benefits of \$0.6 million, which were partially offset by a decrease in amortization of held-to-maturity securities of \$0.2 million and changes in operating assets and liabilities of \$3.1 million.

Cash flows from operating activities of \$26.0 million during the six months ended June 30, 2014 consisted of net income of \$21.1 million, adjusted for certain non-cash items, including depreciation and amortization of \$4.7 million, stock-based compensation expense of \$2.2 million, amortization of held-to-maturity securities of \$0.8 million and deferred taxes of \$0.1 million, which were partially offset by changes in operating assets and liabilities of \$1.3 million and excess tax benefit from stock-based compensation expense of \$1.6 million.

*Cash Flows from Investing Activities*

Cash used in investing activities was \$17.0 million during the six months ended June 30, 2015, consisting of \$15.7 million for the purchases of property and equipment and \$25.4 million for the purchases of marketable securities, which were partially offset by \$24.1 million in proceeds from maturities and call redemptions of marketable securities.

Cash used in investing activities was \$48.5 million during the six months ended June 30, 2014, consisting of \$31.6 million for the purchases of property and equipment, \$33.9 million for the payments on business acquisitions and \$38.5 million for the purchases of marketable securities, which were partially offset by \$55.5 million in proceeds from maturities, sales and call redemptions of marketable securities.

*Cash Flows from Financing Activities*

Cash provided by financing activities was \$2.1 million during the six months ended June 30, 2015, consisting of proceeds from exercises of stock options of \$2.2 million and \$1.0 million in excess tax benefit on stock-based compensation, which were partially offset by \$1.0 million for payments of acquisition-related contingent consideration and \$0.1 million for payments of debt.

Cash provided by financing activities was \$2.1 million for the six months ended June 30, 2014, consisting of proceeds from exercises of stock options of \$1.8 million and \$1.6 million in excess tax benefit on stock-based compensation, which were partially offset by \$0.9 million for payments of debt and \$0.4 million for payments of acquisition-related contingent consideration.

### **Off-Balance Sheet Arrangements**

Since our inception, we have not engaged in any off-balance sheet arrangements, including the use of structured finance, special purpose entities or variable interest entities.

### **Critical Accounting Policies and Use of Estimates**

We have adopted various accounting policies to prepare the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). Our significant accounting policies are disclosed in Note 2 to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2014. There were no material changes in our significant accounting policies during the six months ended June 30, 2015.

### **Recent Accounting Pronouncements**

For information on recent accounting pronouncements, see Note 2 to the consolidated financial statements appearing in Part I, Item 1 in this Quarterly Report on Form 10-Q.



### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

#### **Foreign Currency Risk**

As a result of our foreign operations, we have revenue, expenses, assets and liabilities that are denominated in foreign currencies. We generate revenue in British Pounds, Euro and Japanese Yen. Our production costs are incurred in British Pounds and Japanese Yen. A number of our employees are located throughout Europe and in Japan. Therefore, a portion of our payrolls and operating expenses are incurred and paid in British Pounds, Euro and Japanese Yen.

Our operating results and cash flows are adversely impacted when the United States dollar appreciates relative to other foreign currencies. Additionally, our operating results and cash flows are adversely impacted when the British Pound appreciates relative to the Euro. As we expand internationally, our results of operations and cash flows will become increasingly subject to changes in foreign currency exchange rates.

We have not used forward contracts or currency borrowings to hedge our exposure to foreign currency risk. Foreign currency risk can be quantified by estimating the change in results of operations or financial position resulting from a hypothetical 10% adverse change in foreign exchange rates. We believe such a change would generally not have a material impact on our financial position, but could have a material impact on our results of operations. We recognized foreign currency losses of \$0.2 million and \$0.8 million in the three and six months ended June 30, 2015, respectively. We recognized foreign currency losses of \$0.2 million in each of the three and six months ended June 30, 2014.

#### **Item 4. Controls and Procedures**

##### **Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (Exchange Act)) as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this quarterly report, our disclosure controls and procedures are effective and provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported accurately and within the time frames specified in the SEC's rules and forms and accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

##### **Changes in Internal Control over Financial Reporting**

There have been no changes in our internal control over financial reporting (as such term is defined in Rule 13a-15(f) under the Exchange Act) during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **Item 1. Legal Proceedings**

From time to time, we are subject to various legal proceedings and claims that arise in the ordinary course of our business activities. Although the results of litigation and claims cannot be predicted with certainty, as of the date of these financial statements, we do not believe we are party to any litigation the outcome of which, if determined adversely to us, would individually or in the aggregate be reasonably expected to have a material adverse effect on our business.

### **Item 1A. Risk Factors**

There have been no material changes from the risk factors we previously disclosed in Part I, Item 1A. "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2014.

### **Item 6. Exhibits**

The following documents are filed as part of this report:

| <b>Exhibit Number</b> | <b>Description of Exhibit</b>  |
|-----------------------|--|
| 3.1 <sup>(1)</sup>    | Third Amended and Restated Articles of Incorporation of Proto Labs, Inc.   |
| 3.2 <sup>(2)</sup>    | Amended and Restated By-Laws of Proto Labs, Inc.   |
| 3.3 <sup>(3)</sup>    | Articles of Amendment to Third Amended and Restated Articles of Incorporation of Proto Labs, Inc. dated May 20, 2015           |
| 10.1 <sup>(4)</sup>   | Form of Severance Agreement with Executive Officers  |
| 31.1                  | Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act                                 |
| 31.2                  | Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act                                 |
| 32.1                  | Certification of the Chief Executive Officer and the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act |
| 101.INS               | XBRL Instance Document   |
| 101.SCH               | XBRL Taxonomy Extension Schema Document  |
| 101.CAL               | XBRL Taxonomy Extension Calculation Linkbase Document  |
| 101.DEF               | XBRL Taxonomy Extension Definition Linkbase Document   |

101.LAB XBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

- (1) Previously filed as Exhibit 3.2 to the Company's Registration Statement on Form S-1/A (File No. 333-175745), filed with the Commission on February 13, 2012, and incorporated by reference herein.
- (2) Previously filed as Exhibit 3.4 to the Company's Registration Statement on Form S-1/A (File No. 333-175745), filed with the Commission on February 13, 2012, and incorporated by reference herein.
- (3) Previously filed as Exhibit 3.1 to the Company's Form 8-K (File No. 001-35435), filed with the Commission on May 21, 2015, and incorporated by reference herein.
- (4) Previously filed as Exhibit 10.1 to the Company's Form 8-K (File No. 001-35435), filed with the Commission on April 6, 2015, and incorporated by reference herein.

**SIGNATURE**

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

Proto  
Labs, Inc.

/s/

Date: August 6, 2015 Victoria  
M. Holt  
Victoria  
M. Holt  
President  
and Chief  
Executive  
Officer

(Principal  
Executive  
Officer)

Date: August 6, 2015 /s/ John A.  
Way  
John A.  
Way  
Chief  
Financial  
Officer

(Principal  
Financial  
Officer)