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STRATASYS INC  
Form 10-K  
March 25, 2002

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U.S. SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
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FORM 10-K

ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2001

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 1-13400

STRATASYS, INC.  
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE  
(STATE OR OTHER JURISDICTION OF  
INCORPORATION OR ORGANIZATION)

36-3658792  
(I.R.S. EMPLOYER  
IDENTIFICATION NO.)

14950 MARTIN DRIVE, EDEN PRAIRIE, MINNESOTA  
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

55344  
(ZIP CODE)

(952) 937-3000  
(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)

SECURITIES REGISTERED UNDER SECTION 12(B) OF THE ACT:

TITLE OF EACH CLASS -----	NAME OF EACH EXCHANGE ON WHICH EACH CLASS IS REGISTERED -----
COMMON STOCK, \$.01 PAR VALUE	THE PACIFIC EXCHANGE INC.

SECURITIES REGISTERED UNDER SECTION 12(G) OF THE ACT: NONE

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act 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 past 90 days. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

The aggregate market value of the Registrant's Common Stock held by non-affiliates of the Registrant as of March 15, 2002 was approximately

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\$35,061,881. On such date, the closing price of the Registrant's Common Stock, as quoted on the Nasdaq National Market, was \$8.60.

### DOCUMENTS INCORPORATED BY REFERENCE

Part III of the Annual Report on Form 10-K is herein incorporated by reference from the Registrant's Definitive Proxy Statement to be filed with the Securities and Exchange Commission with respect to the Registrant's Meeting of Stockholders scheduled to be held on May 9, 2002.

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#### ITEM 1. DESCRIPTION OF BUSINESS.

##### GENERAL DEVELOPMENT OF BUSINESS

Stratasys manufactures and sells a line of rapid prototyping ("RP") devices that create physical models from computerized designs. We were incorporated in Delaware in 1989 and our executive offices are located in Eden Prairie, Minnesota. Our rapid prototyping systems are based on our core patented fused deposition modeling ("FDM/(R)/") technology or on our patented Genisys/(R)/ technology. We sold our first product, the 3-D Modeler/(R)/, commercially in April 1992 and introduced our second product, the Benchtop, in June 1993. Other significant developments in our business are set forth below:

- In 1996 and 1997, we introduced several enhanced versions of our FDM system. In 1997, we also introduced our Genisys system, which we developed from technology that we acquired from IBM in 1995.
- In January 1998, we introduced the FDM Quantum/(R)/, which offers large modeling capabilities (the largest commercial build envelope in the industry) combined with significant speed and performance enhancements as compared with the FDM 2000. The FDM Quantum incorporates MagnaDrive technology that allows the extrusion heads to move on a bed of air while controlled by electro-magnetic homing devices.
- In December 1998, we acquired RP technology that we subsequently used to develop our Prodigy(TM) and Dimension(TM) systems.
- In April 1999, we introduced the GenisysXs. This system offered enhanced performance and speed improvements over the original Genisys.
- In August 1999, we introduced the FDM 3000 system based on our core FDM technology. The FDM 3000 features a build envelope 60% larger than our Benchtop systems. In conjunction with the FDM 3000, we introduced WaterWorks(TM). The patented WaterWorks process allows for the easy removal of supports from a completed prototype model by simple immersion into a water-based solution.
- In July 2000, we introduced Prodigy. Prodigy is a low-cost rapid prototyping system that produces ABS parts for functional testing of prototype designs. Prodigy offers office modeling, speed, ease of use, and networking capabilities at a competitive price.
- In November 2000, we introduced the Maxum(TM). Maxum offers significant speed enhancements over our previously released Quantum system. Maxum features WaterWorks and Insight(TM), our preprocessing software that increases build speed and improves the design engineer's control and efficiency over the entire build process. Insight was separately introduced in February 2001 as a replacement for our QuickSlice software.

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- In May 2001, we introduced the FDM Titan(TM). Titan is based on our core FDM technology and offers users the capability to model in polycarbonate, a durable engineering thermoplastic material that offers strength and superior heat and chemical resistance. The capability of modeling in ABS was added to Titan in December 2001.
- In February 2002, we introduced the Dimension. Dimension offers ABS modeling capabilities on a 3-D Printer platform. We believe that Dimension, introduced at \$29,900, is the lowest priced system in the rapid prototyping market.
- In March 2002, we introduced the Prodigy Plus(TM). This system incorporates our WaterWorks soluble support system on the Prodigy platform, and is further enhanced by the addition of our Insight software. Commercial shipments are expected to commence in May 2002.

### DESCRIPTION OF BUSINESS

We are a leader in the three dimensional ("3-D") imaging business, which is referred to as "rapid prototyping". We develop, manufacture and market a family of rapid prototyping devices that enable engineers and designers to create physical models, tooling and prototypes out of plastic and other materials directly from a computer aided design ("CAD") workstation. In many industries, the models and prototypes required in product development are produced laboriously by hand-sculpting or machining, a traditional process that can take days or weeks. Our computerized modeling systems use our proprietary technology to make models and prototypes more directly from a designer's three-dimensional CAD in a matter of hours.

We believe that the RP systems using our FDM technology and Genisys technology are the only rapid prototyping systems commercially available that can produce parts from plastic without relying on lasers. This affords our products a number of significant advantages over other commercially available three-dimensional rapid prototyping technologies, which rely primarily on lasers to create models. Such benefits include:

- the ability to use the device in an office environment due to the absence of hazardous emissions
- ease of use
- the need for relatively little set up of the system for a particular project
- the availability of a variety of modeling materials
- the lack of any need for costly replacement lasers and laser parts

Our systems can also run virtually unattended, producing models while designers perform other tasks.

The process involved in the development of a three-dimensional model using our FDM systems begins with the creation of a conceptual geometric model on a CAD workstation. The model is then imported into our proprietary software programs, which mathematically slice the conceptual model into horizontal layers that are downloaded into the system. These rapid prototyping machines basically draw cross-sections of the model one layer at a time to create a three-dimensional "blueprint." A spool of thin thermoplastic modeling material feeds into a moving FDM extruding head, which heats the material to a semi-liquid state. This semi-liquid material is then extruded and deposited in

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ultra-thin flat layers on a base (the "X-Y Stage") in the modeling chamber. As the material is directed into place by the computer-controlled head, layer upon layer, the material solidifies, creating a precise and strong laminated model.

The Genisys modeling process is similar. Genisys uses our proprietary AutoGen/(R)/ software to slice the conceptual model created on a CAD workstation into horizontal layers that are downloaded into Genisys. Genisys then uses wafers of polyester modeling material, rather than spools of filament, to feed the extrusion head. The extrusion head heats these wafers and, using a precision hydraulic pump, deposits a continuous layer of plastic polymer roads onto the X-Y Stage to create a three-dimensional model by building up layers. In comparison to the FDM systems, due to its size, Genisys allows the prototype to be created on a desktop, directly from a workstation, like a 3-D printer. The Company's GenisysXs uses a modeling process similar to the original Genisys system.

### PRODUCTS

Modeling Equipment. We have been developing and improving our line of rapid prototyping products since our inception in 1989. Since we began selling the 3-D Modeler, our first product, commercially in 1992, we have enhanced and expanded our product line. We have improved both the speed and accuracy of our FDM systems, we have expanded their build envelope, we have introduced a number of new modeling materials, and we have developed and introduced a low-cost 3-D printer based on technology that we acquired from IBM. We have also enhanced and upgraded the software that our systems use to read CAD files and build prototypes. Although we have discontinued the manufacture of the 3-D Modeler and the other systems that we introduced between 1992 and 1998, we continue to support and maintain systems that are still in the field and to make and sell the modeling materials

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that they use. Our current product line ranges from our Dimension, a low-cost 3-D printer to our Maxum, which can be used to build large functional prototypes and replacement parts.

GenisysXs offers enhanced performance and speed improvements over the original Genisys. It is useful for the production of conceptual models employed in the early stages of the design cycle, as it enables a designer to produce concept iterations at his desk directly from a workstation in a simple push-button fashion. We introduced GenisysXs in April 1999 and began shipping it in May 1999. With the introduction of Dimension, we expect to phase out the GenisysXs in 2002.

Prodigy is our low-cost rapid prototyping system that produces ABS parts for functional testing of prototype designs. Prodigy operates in the office, offering speed, ease of use, and networking capabilities at a competitive price. It is based on technology we purchased in December 1998 and further developed throughout 1999 and the first half of 2000. We introduced it and began commercial shipments in July 2000.

The FDM 2000 is an enhanced version of our FDM Benchtop system, but features a 30% to 40% throughput improvement over its predecessor, the FDM 1650. Upgraded hardware and software accounts for the improved performance features. We introduced and began shipment of the FDM 2000 in March 1997.

The FDM 3000 system is based on our core patented FDM technology. It features a build envelope 60% larger than our other Benchtop systems. In conjunction with the FDM 3000, we introduced WaterWorks. The patented WaterWorks process allows for the easy removal of supports from a completed prototype model

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by simple immersion into a water-based solution. The support material is dissolved, resulting in a cleaned prototype that eliminates most post-processing requirements. We offered WaterWorks to users of our FDM 2000 systems in the fourth quarter of 1999. We introduced the FDM 3000 in August 1999 and began shipments in the fourth quarter of that year.

The FDM Maxum offers significant speed enhancements over our previously released Quantum system. It incorporates MagnaDrive technology, which allows the extrusion head to float on a bed of air while being controlled through electromagnetic devices. This offers significant speed and performance enhancements as compared with our benchtop systems. Maxum also features WaterWorks and Insight, our preprocessing software that increases build speed and improves the design engineers' control and efficiency over the entire build process. Insight was separately introduced in February 2001 as a replacement for our QuickSlice software, which has been standard on all FDM systems since 1993. We introduced Maxum in November 2000, and commercial shipments commenced in December 2000.

The FDM Titan offers a unique set of features that addresses demanding customer requirements. Titan offers users the capability to model in polycarbonate, a durable engineering thermoplastic material that offers strength and superior heat and chemical resistance. This will allow our customers to improve their functional testing capabilities. Titan also utilizes new technology based on "look ahead" motion profiles as well as automatic material loading and supply changeover. The capability to model in ABS was added to Titan in December 2001. We expect to offer additional materials on the Titan platform that will offer improved thermal and chemical performance properties over those materials currently available.

The Dimension is a 3-D printer that allows users to create parts in ABS, which offers the part strength required of true form, fit and function testing. Dimension features our Catalyst(TM) software, which allows for push-button ease of use by automating most required build procedures. We introduced Dimension in February 2002, although commercial shipments to selected resellers commenced in December 2001. We believe that Dimension, at a list price of \$29,900, is the lowest priced system in the rapid prototyping market.

The Prodigy Plus incorporates our WaterWorks soluble support system on the Prodigy platform, and is further enhanced by the addition of our Insight software. Prodigy Plus, announced in March 2002, is expected to commercially ship in May 2002.

Our family of rapid prototyping systems offers product designers and developers the ability to create prototypes throughout all stages of the development cycle as well as a wide range of prices from which to choose. The domestic

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list prices of our systems range from \$29,900 for a Dimension and reach \$250,000 for the FDM Maxum. We also offer special pricing for trade-in systems and upgrades.

We have also adapted our FDM Benchtop technology for medical use. Our MedModeler(TM) creates anatomical parts from computed tomography ("CT") and magnetic resonance imaging ("MRI") devices. The U.S. Food and Drug Administration granted us a 510(k) pre-market clearance in 1997 to sell the MedModeler as a medical device.

Modeling Material. FDM technology allows the use of a greater variety of modeling materials and colors than other technologies. We continue to develop

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filament modeling materials that meet the customer's needs for increased speed, strength, accuracy, surface resolution, chemical and heat resistance, and color. These materials are processed into our patented filament form, which is then fed into the FDM systems. Our spool-based system has proven to be a significant advantage for our products over Ultra Violet ("UV") polymer systems, because our system allows the user to quickly change material by simply mounting the spool and threading the desired material into the FDM devices. Spools weigh from one pound to ten pounds, and the creation of a model may require from 0.1 pound to more than one pound of filament. The spool-based system also compares favorably with UV polymer system, because the spool-based system allows the customer to use the system in an office environment and to purchase a single spool, as compared to an entire vat of UV polymer, thereby reducing the customer's up-front costs. Our newer systems feature automatic loading capabilities in the form of a cartridge or canister.

Currently, we have seven modeling materials commercially available for use with our FDM technology:

- an elastomer material for applications requiring strength, durability and flexibility, as used in seals or tubing
- polycarbonate, an engineering thermoplastic material, which is used commercially for demanding applications in a number of industries; polycarbonate offers superior impact strength coupled with resistance to heat and corrosive agents
- the hard polymer material ABS (named for its three initial monomers, acrylonitrile, butadiene and styrene and which is also known as an engineering thermoplastic material), which is used commercially to make products such as cell phones, computer cases and toys
- a highergrade ABS (ABSi), which features greater impact strength than ABS and can also be used in medical applications
- a release material, which is used for support and removed from the final model
- a water-soluble material, which is used for support during the build process and which is later dissolved from the finished prototype
- an investment casting wax

Each material has specific characteristics that make it appropriate for various applications. The ability to use different materials allows the user to match the material to the end use application of the prototype, whether it is a pattern for tooling, a concept model, or a functional prototype.

Genisys Xs uses only one type of modeling material, a polyester, which is manufactured in the form of wafers. A total of 50 wafers are held in a cassette, which allows the wafers to be fed into the machine and rapidly extruded in layers. Additional cassettes are easily loaded into the system. Each cassette contains a memory chip that instructs the system as to the parameters and melt temperature of the material lot, which optimizes the automatic build process of the Genisys system. Polyester provides a unique blend of properties of cost, durability, and easy handling for concept models.

The modeling filament and wafers are consumable products that provide us additional revenue.

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### OPERATING SOFTWARE

Prior to 2001, we offered two proprietary software products: QuickSlice and AutoGen. QuickSlice processes three-dimensional computer models to generate operating data for our FDM 1650, 2000, 3000, 8000, and Quantum products. AutoGen performs the same function for Genisys and GenesysXs 3-D Printers. We have retained copyrights and all other ownership rights for AutoGen and QuickSlice.

QuickSlice is an interactive software product giving users choices ranging from semi-automatic operations to a feature-rich array of options and controls.

In 1994, we developed SupportWorks/(R)/, which is used in conjunction with QuickSlice to automatically generate support structures, thereby eliminating a time-consuming manual step in the modeling process. In 1995, we integrated SupportWorks into QuickSlice.

In July 2000, we introduced Catalyst on our Prodigy System. It offers automatic processing along with a greatly simplified user interface.

In January 2001, we introduced Insight as a replacement for our QuickSlice software, which had been standard on all FDM systems since 1993. Insight is our preprocessing software that increases build speed and the design engineer's control and efficiency over the entire build process. Insight is offered to users as an upgrade under our maintenance program.

AutoGen gives users semi-automatic operation for our Genisys and GenesysXs 3-D Printers. AutoGen is able to choose most options and settings for the user, saving significant operator labor time. AutoGen is included in the Genisys sales price.

### APPLICATIONS FOR RAPID PROTOTYPING

Rapid prototyping (RP) is the physical modeling of a design using a special class of machine technology. Using an additive approach, RP systems take data created from 3-D computer aided design (CAD data), CT and MRI scan data or 3-D digitized data to quickly produce models. Traditionally, RP has been used by organizations to accelerate product development. Many companies use RP to test form, fit and function to help improve the time to market. An emerging market segment for Rapid Prototyping systems is Rapid Tooling (RT). Although not clearly defined today, RT is driven by RP systems and allows for the production of molds directly from CAD data or indirectly by producing custom mold inserts.

During the past two years the largest growth segment of the RP market has been 3-D printing products. 3-D printers are low cost RP systems (typically under \$70,000) that reside in the design/engineering environment allowing the product development organizations quick access to an RP system. Systems in this market segment have shown a 100% growth rate during the past 24 months, according to Wholers Associates, Inc.

We have shipped over 1900 systems. A wide variety of design and manufacturing organizations use our systems. Current applications include:

- Automotive
- Consumer Products
- Business Machines
- Educational Institutions
- Electronics
- Medical Systems
- Medical Analysis
- Mold Making
- Tooling

Additional future applications include:

- architectural design
- rapid manufacturing of small-volume custom parts
- free-form graphic design
- secondary tooling and mold-making

Among potential medical applications, rapid prototyping is being used to produce accurate models of internal organs, bones or skulls for pre-operative evaluations or modeling of prostheses. In such uses, our MedModeler is serving as a peripheral device for CT and MRI devices.

#### MARKETING, DISTRIBUTION AND CUSTOMERS

The focus of our marketing begins with the identification of customer needs. We feature a broad array of products that allow us to meet the precise needs of engineers, designers, educators, marketers and manufacturers. Our broad range of products begins with what we believe is the industry's lowest priced system, the Dimension at \$29,900, and moves to the high performance FDM Maxum priced at \$250,000. We currently have five other products between these price points, meeting a variety of material, size and performance criteria.

We have sold systems to the following representative customers:

General Motors Corporation	Harley Davidson
Intel	Georgia Tech
Boeing	Xerox
University of Wisconsin - Madison	InFocus
Callaway Golf	Lockheed Martin
Lego	Lever
Honda	Ford Motor Company
St. Jude Medical	NASA

We have also sold systems to service bureaus, universities and distributors in the United States and abroad. We sell complete rapid prototyping systems as well as supplies and services.

We use a variety of tactical marketing methods to reach potential customers:

- Web-based marketing
- trade magazine articles
- brochures
- telemarketing programs
- videos
- press releases
- advertisements
- direct mailings
- trade show demonstrations
- Web sites
- [www.Stratasys.com](http://www.Stratasys.com)
- [www.Dimensionprinting.com](http://www.Dimensionprinting.com)

In addition, we have developed domestic and international on-site demonstration capabilities.



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Domestically, we sell directly to our customers. In 1997, we organized our domestic FDM sales force into three regions. Salespersons and management reside in the regions they service. In addition, Dimension resellers have been assigned to managers within this regional framework. We market internationally through a network of distributors and sales representatives. During the years ended December 31, 2001, 2000, and 1999, export sales amounted to approximately \$19,283,900, \$18,606,700 and \$19,753,300 respectively.

No customer accounted for more than 10% of sales in 2001, 2000, or 1999.

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### WARRANTY AND SERVICE

We provide a 90-day warranty on our systems sold domestically and a one-year warranty on those sold internationally. In addition, we offer annual service and maintenance contracts for our systems. The service contracts include updates of our software systems. Annual service contracts for our systems are priced from \$2,500 to \$50,000.

### MANUFACTURING

Our manufacturing process consists of the assembly of purchased components. We obtain all parts used in the manufacturing process either from distributors of standard electrical or mechanical parts or from custom fabricators of our proprietary designs. We currently operate on a build-to-forecast basis.

We purchase the major component parts for our FDM and office modeling equipment from various outside vendors, subcontractors and other sources and assemble them at our Minnesota facility. Our production floor has been organized using demand-flow techniques in order to maximize efficiency and quality. Computer-based Material Requirements Planning ("MRP") is used in the ordering of parts to be delivered on-time to meet forecasted needs. At the completion of assembly, we perform complete power up and final quality tests to ensure the quality of our products before shipment to customers.

We maintain an inventory of most of our necessary supplies, which facilitates the assembly of products required for production. Our sole current supplier of the X-Y tables for the FDM 2000, FDM 3000 and FDM 8000 systems is Asymtek; and our sole current supplier of the FDM head motors is MircoMo Electronics, Inc. We also have sole suppliers for two key components of our FDM Maxum system. We consider all of these suppliers to be reliable. Nevertheless, we maintain an inventory of such components to support continued supply. Furthermore, we believe that the supplier of the X-Y Stage could be replaced by in-house design and production of the part within a three-month period, if necessary; and we could employ FDM head motors from other suppliers by modifications to the design of the FDM systems. In-house development to replace the vendors of the Maxum components would take four to eighteen months to accomplish. In regard to other parts and materials, we use multiple sources of supply and do not believe that we are dependent on any single supplier. Although we believe that we maintain adequate inventories of vendor-specific materials, the loss of a supplier of such vendor-specific materials or compounds could result in a delay in the manufacture and delivery of those materials and compounds resulting from the need to retest and recertify products supplied by one or more new vendors. We consider our relationships with our suppliers to be good.

### RESEARCH AND DEVELOPMENT

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We believe that ongoing research and development efforts are essential to our continued success. Accordingly, our engineering development efforts will continue to focus on improvements to the FDM technology and development of new modeling processes, materials, software and products. We have devoted significant time and resources to the development of a universally compatible and user-friendly software system. To date, much of our activity has been focused on research and development. For the years ended December 31, 2001, 2000 and 1999, our research and development expenses were approximately \$4,915,000, \$6,367,000, and \$6,583,000, respectively.

Our filament development and production operation is located at our facility in Eden Prairie, Minnesota. We regard the filament formulation and manufacturing process as a trade secret, and we hold patent claims on filament usage in our products.

### INTELLECTUAL PROPERTY

We consider our proprietary technology to be material to the development, manufacture, and sale of our products and seek to protect our technology through a combination of patents and confidentiality agreements with our employees and others. Scott Crump, our President and CEO, was granted two U.S. patents that cover many claims relating to various aspects of our products, FDM technology and the associated modeling process. The term of one patent lasts until June 9, 2009, and the term of the other lasts until August 23, 2011. The patents have been assigned to us. In addition, other employees have assigned us patents and patent applications for other rapid prototyping

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processes and apparatuses associated with the FDM process. As part of our purchase of rapid prototyping technology assets from IBM, we were also assigned the rights and title to three patents developed by IBM, which cover the Genisys system and which we believe will further augment several of our other product lines. We recorded these patents domestically and are in the process of recording them in certain foreign countries. The terms of these patents extend until June 7, 2005, April 12, 2011, and May 17, 2011. In total, we currently own 22 primary U.S. patents. Corresponding patent applications covering the same claims that are contained in our issued patents have been initiated in various foreign countries. Other foreign patent applications have also been filed, including the patent applications assigned to us by IBM.

Our registered trademarks include:

### REGISTERED TRADEMARKS

- |                   |               |
|-------------------|---------------|
| - Stratasys, Inc. | - AutoGen     |
| - 3D Modeler      | - FDMM        |
| - QuickSlice      | - FDC         |
| - 3D Plotter      | - BMD         |
| - 3D Visualizer   | - FDM Quantum |
| - FDM             | - Genisys     |

Other trademarks include:

- |             |              |
|-------------|--------------|
| - FDM Maxum | - 3D Printer |
| - BASS      | - Prodigy    |

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- Catalyst
- Insight
- Prodigy Plus
- WaterWorks
- SupportWorks
- Dimension

Each of the registered trademarks has a duration of 10 years and may be renewed every 10 years while it is in use. Trademark applications have also been filed in Japan and the European Community.

We have also registered the following Internet domain names:

- prototype.com
- webprototypes.com
- 3DPrinter.com
- Dimension printing.com
- webmodeling.com
- 3D-fax.com
- Stratasys.com

### WORKING CAPITAL PRACTICES

We do not engage in unusual practices regarding inventories, receivables or other items of working capital.

### BACKLOG

Our total backlog of system orders at December 31, 2001 was less than \$500,000, as compared with approximately \$7.0 million at December 31, 2000. We estimate that most of our backlog will ship in 2002.

### COMPETITION

We compete in a marketplace that is still dominated by conventional methods of model-making and prototype development. Machinists and engineers working from blueprints or CAD files and using machining or by-hand methods generally perform the prototype development and fabrication. We believe that there is currently no other commercial producer of 3-D modeling devices that uses a single-step, non-toxic technology similar to our FDM and Genisys technologies. Most other rapid prototyping or 3-D printing systems involve an additional post-processing step, such as curing the part after construction of the model or prototype. Our FDM and Genisys technologies do not

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rely on the laser or light technology used by many other commercial manufacturers in the rapid prototyping industry.

Our competitors employ a number of different technologies in their rapid prototyping devices. 3D Systems, D-MEC, Mitsui and Teijin Seiki Co. use stereolithography in their products. 3D Systems introduced the first rapid prototyping product. We believe that 3D Systems has accounted for approximately 29% of rapid prototyping units sold to date. DTM Corporation, purchased by 3D Systems in 2001, and EOS produce machines that use lasers to sinter or harden powdered material. Z Corp. uses inkjet technology to sinter powdered materials. Sanders Prototype, Inc. and 3D Systems have developed prototyping systems that use inkjet technology to deposit wax material layer by layer, which can be used in an office environment. A smoothing or milling process is required between each deposited layer to maintain accuracy in these processes. We believe that our FDM and Genisys technologies have important advantages over our competitors' products. These advantages include:

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- the ability to be used in an office environment
- the availability of multiple strong modeling materials
- a one-step modeling process
- ease of use
- automated support removal

Certain of our competitors have greater financial and marketing resources than we have. We believe that in 2001 we were the second largest in the industry in terms of both unit shipments and revenues.

### EMPLOYEES

As of March 11, 2002, we had 186 full-time employees and four subcontractors or temporary employees. While we have separate internal departments, such as manufacturing, marketing, engineering and sales, many employees perform overlapping functions within the organization. No employee is represented by a union, and we have not experienced a work stoppage. We believe our employee relations are good.

### GOVERNMENTAL REGULATION

#### GENERAL

We are subject to various local, state and federal laws, regulations and agencies that affect businesses generally. These include:

- regulations promulgated by federal and state environmental and health agencies
- the federal Occupational Safety and Health Administration
- laws pertaining to the hiring, treatment, safety and discharge of employees

#### FDA REGULATION

The FDA has the authority to regulate the preclinical and clinical testing, manufacture, labeling, distribution, and promotion of our MedModeler FDM system as a Class II medical device under the Federal Food, Drug, and Cosmetic Act of 1976. In November 1997, we announced that the FDA had granted the MedModeler FDM system 510(k) clearance. We have subsequently made modifications to the MedModeler, which we believe do not require the submission of a new 510(k) notification. There can be no assurance, however, that the FDA would agree with our determination not to submit, or would not require us to submit, a new 510(k) notification for any of these changes.

The MedModeler is subject to pervasive and continuing regulation by the FDA. Our medical sector manufacturing facility will be subject to inspection by the FDA to assure compliance with its Quality System Regulation ("QSR"), which imposes testing, control, documentation and other quality assurance procedures. In addition, we will be subject to other regulatory requirements that usually apply to medical devices marketed in the United States, including:

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- labeling regulations
- Medical Device Reporting ("MDR") regulations which require that a manufacturer report to the FDA certain types of adverse events involving its products
- the FDA's prohibitions against promoting products for unapproved or "off-label" uses

In addition, Class II devices can be subject to additional special controls that do not apply to Class I devices, such as performance standards, postmarket surveillance, patient registries, and FDA guidelines.

The MedModeler FDM system may be subject in certain instances to regulation by foreign regulatory authorities to the extent that we seek to market it outside the United States.

### FINANCIAL INFORMATION ABOUT OPERATIONS IN THE UNITED STATES AND OTHER COUNTRIES

The information required by this item is incorporated by reference to our Financial Statements included elsewhere in this report. (See Part IV, Item 14, Note 13.)

#### ITEM 2. PROPERTIES.

Our executive offices and production facilities presently comprise approximately 89,856 square feet in two adjacent buildings in Eden Prairie, Minnesota, near Minneapolis. We occupy a 27,756 square foot facility under a lease that was to expire July 31, 2002. In 2001 we extended this lease until July 31, 2004. Currently monthly base rent on this facility is \$15,100, which will increase in August 2002 to \$15,680 per month. This facility used for R&D, administrative, marketing, and sales activities.

On August 1, 2001, we purchased our manufacturing facility and land for approximately \$2,990,000. We had previously leased this facility since October 1996, and prior to 2002 had subleased approximately 25% of this facility. The facility consists of 62,100 square feet, and is used for machine assembly, filament production, inventory storage, operations, sales support, and administration. The facility is subject to a mortgage agreement with a bank that provided a loan of \$2,287,500. Monthly payments on this loan are \$18,396, and the loan is collateralized by the property.

We opened two regional sales offices in 1997. We occupy 2,889 square feet of space in Southfield, Michigan, a suburb of Detroit. We renewed this lease in June 2001 for a three-year term that expires on June 14, 2004. Base monthly rent under this lease is \$5,056, which increased to \$5,176 per month for a one-year period commencing in June 2002. We occupy 2,504 square feet of space in Ontario, California. We renewed this lease on September 1, 2000 for a two year period expiring on August 31, 2002. Monthly base rent on this facility was \$3,180 through August 2001, and increased to \$3,310 per month for the remainder of the lease. We are also responsible for real estate taxes, insurance, utilities, trash removal, and maintenance expenses at these facilities.

In November 1997, our German subsidiary entered into a lease to occupy 4,360 square feet of space in Frankfurt, Germany. The lease expires in November 2002, with base monthly rent of approximately \$6,400.

#### ITEM 3. LEGAL PROCEEDINGS.

We are not a party to any pending legal or administrative proceeding, and our property is not subject to any such proceeding, other than actions arising in the ordinary course of our business, which we believe are not material.

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## ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF STOCKHOLDERS.

No matter was submitted to a vote of stockholders, through the solicitation of proxies or otherwise, during the fourth quarter of the fiscal year ended December 31, 2001.

## PART II

## ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

### MARKET INFORMATION

Our common stock is quoted on the National Association of Securities Dealers, Inc. Automated Quotation System National Market ("Nasdaq") under the symbol SSYS and is traded on The Pacific Exchange Inc. under the symbol SAS.

The following table sets forth the high and low closing bid prices of the Company's common stock for each quarter from January 1, 2000 through the fiscal year ended December 31, 2001.

	HIGH	LOW
	----	---
	BID PRICES \$	
	-----	-----
Fiscal Year Ended December 31, 2001		
January 1, 2001 - March 31, 2001	3.531	2.25
April 1, 2001 - June 30, 2001	3.71	2.50
July 1, 2001 - September 30, 2001	4.71	2.82
October 1, 2001 - December 31, 2001	7.84	2.96
Fiscal Year Ended December 31, 2000		
January 1, 2000-- March 31, 2000.....	12.75	7.375
April 1, 2000-- June 30, 2000.....	9.500	5.688
July 1, 2000-- September 30, 2000.....	7.625	5.375
October 1, 2000-- December 31, 2000.....	6.000	2.063

There were approximately 169 stockholders of record of our common stock as of March 15, 2002.

### DIVIDENDS

We have not paid or declared any cash dividends to date and do not anticipate paying any in the foreseeable future. We intend to retain earnings, if any, to support the growth of our business.

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## ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA.

The selected consolidated financial data as of and for the five-year period

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ended December 31, 2001, should be read in conjunction with the Consolidated Financial Statements and related Notes for the year ended December 31, 2001, and the Management's Discussion and Analysis of Financial Condition and Results of Operations.

	YEARS ENDED DECEMBER 31,				
	-----				
	(IN THOUSANDS, EXCEPT PER SHARE				
	AMOUNTS)				
	2001	2000	1999	1998	1997
	-----	-----	-----	-----	-----
Statement of Operations Data:					
Sales.....	37,572	35,611	37,587	32,437	29,636
Gross Profit.....	23,001	21,948	24,675	21,347	19,940
Selling, general and administrative expenses.....	14,598	15,233	15,611	15,320	14,676
Research and development.....	4,915	6,367	6,583	5,944	5,055
Purchased in-process research and development.....	--	--	--	6,513	--
Operating income (loss).....	3,488	349	2,481	(6,429)	209
Net income (loss).....	2,513	988	2,144	(3,318)	515
Net income (loss) per basic share..	0.46	0.18	0.37	(0.55)	0.09
Weighted average basic shares outstanding.....	5,462	5,527	5,776	6,072	5,726
Net income (loss) per diluted share	0.46	0.17	0.37	(0.55)	0.09
Weighted average diluted shares outstanding.....	5,493	5,684	5,779	6,072	6,016
	2001	2000	1999	1998	1997
	-----	-----	-----	-----	-----
	(IN THOUSANDS)				
Balance Sheet Data					
Working Capital.....	21,594	20,014	19,567	18,655	26,357
Total Assets.....	41,951	37,582	37,113	41,190	38,984
Long term debt (less current portion).....	2,216	130	318	193	136
Stockholders' equity.....	31,303	29,226	28,783	28,103	33,087

### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

#### GENERAL

We develop, manufacture, and market a family of rapid prototyping devices that enable engineers and designers to create physical models, tooling and prototypes out of plastic and other materials directly from a computer aided design ("CAD") workstation. Historically, our growth has come from sales to a number of industries, including automotive, consumer products, electronics, medical, and aerospace. Universities, other educational institutions, and service bureaus have also been significant markets for us. Our current and future growth is largely dependent upon our ability to penetrate new markets, and develop and market new rapid prototyping devices and applications that meet the needs of its current and prospective customers. New product developments will focus on various rapid prototyping devices, modeling materials, and software enhancements. We anticipate that in 2002 our primary business strategy will focus on expanding international and domestic sales of our existing family of rapid prototyping devices, while maintaining on-going development of new

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rapid prototyping equipment, modeling materials, and software.

In May 2001 we introduced the FDM Titan and began commercial shipments in June 2001. Titan is a rapid prototyping system that produces parts in polycarbonate. In January 2002, we announced that Titan would also have the capabilities to model in ABS. We expect to introduce other materials on the Titan platform in the future. Parts made of polycarbonate offer superior strength, temperature, and chemical resistance, and thus are ideal for demanding functional testing in extreme environments.

We introduced the Dimension in February 2002. Dimension offers ABS modeling capabilities in a 3-D Printer platform. The part output from 3-D printers offered by our competitors has tended to be extremely fragile. Dimension allows users to create parts from ABS, which offers parts having the strength required for true

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form, fit and function testing. We believe that Dimension, introduced at \$29,900, is the lowest priced system in the rapid prototyping market.

In March 2002 we introduced the Prodigy Plus. This system incorporates our WaterWorks soluble support system on the Prodigy platform, and is further enhanced by the addition of our Insight software, which offers speed and performance improvements over those of our Benchtop systems. Commercial shipments are expected to commence in May 2002.

Net revenue in 2001 derived from our rapid prototyping devices, modeling materials, and maintenance increased by \$1,961,035, or 5.5%, over the revenue reported in the prior year. However, gross unit shipments declined to 277 from 297 gross unit shipments in 2000, as we shipped considerably more high-end systems such as Titan in 2001. Our gross profit declined slightly to 61.2% of sales in 2001 from 61.6% in 2000, as the average selling price of many of our older product lines declined as compared with 2000 and our manufacturing overhead expenses increased. The mix shift to sales of our high-end systems was not sufficient to offset these other trends. In any given period, our gross profit can be significantly impacted by shifts in our product mix and sales volume.

We had a layoff in January 2001 that reduced our headcount of employees and contractors by approximately 8%. The goal of this downsizing was to position our company for greater profitability as we improved our top line growth. This downsizing, accompanied by other expense cuts, resulted in reduced levels of spending on both research and development ("R&D") and on our selling, general and administrative ("SG&A") expenses in 2001. R&D expenditures amounted to \$4,915,098 in 2001 as compared with \$6,366,800 in 2000, and as a percentage of sales declined to 13.1% of revenue in 2001 from 17.9% of revenue in 2000. SG&A expenses declined to \$14,597,862 in 2001 from \$15,232,662 in 2000, and as a percentage of sales declined to 38.9% of revenue in 2001 from 42.8% of revenue in 2000. On revenue growth of \$1,961,035 in 2001 as compared with 2000, our operating profit improved by \$3,138,805, or almost 900%, as compared with the operating profit reported in 2000.

Our strategy in 2002 is to expand our position in the 3-D printing market and our other core businesses. We anticipate that we will continue to control our expenses while we expand our revenue growth. We believe that the 3-D printing market represents a significant growth area. With the introduction of Dimension, we believe that this product will have a significant positive impact on our 2002 results. However, since the market for this product is unproven, we may not be able to achieve the anticipated benefits from the introduction of



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the Dimension. We remain fully committed to the continued growth of our historic core business, which is represented by our Maxum, Titan, Prodigy Plus, and FDM 3000 systems. We also believe that our service, consumable, and maintenance revenues derived from all our systems will also improve over the results attained in 2001. However, we continue to be concerned about the pace of the economic recovery from the capital goods recession that we and other capital equipment manufacturers have experienced for the past year. Our ability to implement our strategy is subject to numerous uncertainties, many of which are described in this Management's Discussion and Analysis and in the "Forward Looking Statements and Factors That May Affect Future Results of Operations Risks" of this Form 10-K. We cannot ensure you that our efforts will be successful.

In addition to the uncertainty of future revenues from new or existing products, expenses associated with the new product launch of Dimension should cause some increase to SG&A expenses in 2002 over the run rates recorded over the past several quarters. Many of these expenses will be incurred in the first half of 2002, before we recognize any significant revenue from the Dimension. Therefore, we expect that our operating margins will be negatively impacted in the first half, and possibly the full year, of 2002 as compared with 2001. Additionally, depending upon product mix, there could be a negative impact on gross margins throughout the year, since gross margins are not consistent across all product lines.

Our operating results could be adversely affected if the downturn in general economic conditions experienced by most capital equipment manufacturers in 2001 were to continue in 2002. Our expense levels are based in part on our expectations of future revenues. Our planning assumes that the economic conditions affecting capital equipment manufacturers will not decline from the levels of 2001, and will slowly improve by mid-2002. If general economic conditions should worsen or the recovery takes longer than we expect, the revenues we recognize could be severely impacted. Additionally, our backlog is limited and will have a minimal effect on our 2002 results. These factors may lead to operating losses in certain quarters, and reduced operating and gross profits as compared with the results

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reported in 2001. While we have adjusted, and will continue to adjust, our expense levels based on revenues, fluctuations in revenues in a particular period could adversely impact our operating results.

We believe that the rapid prototyping industry is growing at approximately 5-10% per year and that 3-D printers and office modelers account for more than 30% of the total units of rapid prototyping systems shipped. Furthermore, we believe the 3-D Printing segment of this market is the fastest growing component of the market, and that our Dimension system, based upon price and performance, is positioned to capture an increased share of this market. We believe that there is a long-term trend toward lower priced rapid prototyping systems capable of producing functional prototypes. This pricing trend should lead to growth in the more traditional functional prototyping marketplace as companies continue to address in-house rapid prototyping and concept-modeling needs. Certain market segments in the industry have not demonstrated significant pricing sensitivity. These segments are more interested in modeling envelope size, modeling material, throughput, part quality, part durability, and rapid tooling, which should allow growth to continue for higher priced rapid prototyping systems that address these needs, such as our Maxum and Titan systems.

RESULTS OF OPERATIONS

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YEAR ENDED DECEMBER 31, 2001 COMPARED WITH YEAR ENDED DECEMBER 31, 2000

The following table sets forth certain statement of operations data as a percentage of net sales for the periods indicated. All items are included in or derived from our statement of operations.

	For the years ended December 31,	
	2001	2000
Net sales	100.0%	100.0%
Cost of sales	38.8%	38.4%
Gross margin	61.2%	61.6%
Selling, general, and administrative expenses	38.9%	42.8%
Research & development expense	13.1%	17.9%
Operating income	9.3%	1.0%
Other income	.1%	1.6%
Income before taxes	9.4%	2.6%
Income taxes (benefit)	2.7%	(.2%)
Net income	6.7%	2.8%

### Net Sales

Net sales for the year ended December 31, 2001 were \$37,571,582, compared with sales of \$35,610,547 for the year ended December 31, 2000. This represents an increase of \$1,961,035, or 5.5%. Sales of our Benchtop systems were strong in 2001, and constituted our largest product line. However, sales of these systems declined when compared with the prior year. Maxum, Titan and Prodigy system sales also contributed significantly to our 2001 results, with Prodigy showing the strongest year over year growth of any of our systems that were available in 2000. Revenues from consumable and maintenance also increased in the twelve months ended December 31, 2001 as compared with the same 2000 period. Maintenance and materials revenues were enhanced by the larger installed base of systems, customer satisfaction with ABS, WaterWorks, polycarbonate, and other material selections, and continued emphasis on the sale of maintenance contracts.

Our gross shipments of systems amounted to 277 systems in 2001 compared with 297 systems in 2000. System sales in 2001 included gross shipments of all systems, including trade-in and upgrades. The average selling price of our systems increased in 2001 as compared with 2000, and was significantly influenced by sales of our Titan and Prodigy systems. Product mix can dramatically affect the average selling price in any period. We ended 2001 with an order backlog under \$500,000 compared with an order backlog of approximately \$7,000,000 at December 31,

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2000. However, not all the 2000 backlog shipped in 2001, and a number of customers cancelled orders due to declining business conditions.

Domestic sales accounted for approximately 51% of total revenue in 2001, down from the 52% recorded in 2000. In the United States, the eastern and central regions recorded the highest revenue. Europe accounted for

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approximately 21% of total revenue in 2001, an improvement from 19% of revenue recorded in 2000. Our combined Asia-Pacific region, which comprises Japan, China, the Far East and India, accounted for approximately 24% of total revenue, comparable to the 24% attained in 2000. The Asia-Pacific region benefited from an approximately \$1 million order for multiple Maxum systems that shipped at the end of the year. This was the largest order in the history of our Company. We believe that 2002 sales into our Asia Pacific and European regions will remain strong, and that United States market will improve by the third quarter of the year. However, our future sales and profitability could be adversely impacted by declining economic conditions in any of these regions.

### Gross Profit

Gross profit increased to \$23,000,767, or 61.2% of sales, in the year ended December 31, 2001, compared with \$21,948,464, or 61.6% of sales, in the year ended December 31, 2000. This represents an improvement of \$1,052,303, or 4.8%. Gross profit improved due to a shift in our product mix to higher-priced systems that have better margins. This would include systems such as our Maxum and Titan, the sales of which were especially strong in the fourth quarter of the year. Increased overhead expenses and write-offs of approximately \$660,000 of inventory for obsolescence and scrap negatively impacted margins in 2001.

### Operating Expenses

SG&A expenses decreased to \$14,597,862 for the year ended December 31, 2001, from \$15,232,662 for the year ended December 31, 2000. This represents a decrease of \$634,800, or 4.2%. Reductions to salaries and wages, travel, and general office expenses accounted for much of the decrease in 2001 as compared with 2000.

R&D expenses declined to \$4,915,098 for the year ended December 31, 2001 from \$6,366,800 for the year ended December 31, 2000. The decrease in 2001 from 2000 amounted to \$1,451,702, or 22.8%. Decreases for salaries, wages, benefits, and contract labor accounted for most of the reductions, a direct result of our January 2001 layoff where we reduced our staff by approximately 8%.

Our operating income for the year ended December 31, 2001 amounted to \$3,487,807, or 9.3% of sales, compared with operating income of \$349,002, or 1.0% of sales, for the year ended December 31, 2000.

### Other Income

Other income and expense netted to \$35,250 in 2001 compared with \$576,886 in 2000. Interest income amounted to \$306,068 in 2001 compared with \$551,841 in 2000. The reduction in interest income was primarily due to the reduction to interest rates that occurred throughout 2001. Interest expense increased to \$103,732 in 2001 from \$69,545 in 2000, primarily due to interest on the mortgage for the acquisition of our manufacturing facility.

### Net Income

For the reasons cited above, net income for 2001 amounted to \$2,513,185, or 6.7% of sales, compared with net income of \$988,301, or 2.8% of sales in 2000. This resulted in 2001 income per diluted common and common share equivalent of \$.46 compared income per diluted common and common equivalent share of \$. 17 for the period ended December 31, 2000.

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The following table sets forth certain statement of operations data as a percentage of net sales for the periods indicated. All items are included in or derived from our statement of operations.

	FOR THE YEARS ENDED DECEMBER 31,	
	2000	1999
Net sales.....	100.0%	100.0%
Cost of sales.....	38.4%	34.4%
Gross margin.....	61.6%	65.6%
Selling, general, and administrative expenses...	42.5%	41.5%
Research & development expense.....	17.9%	17.5%
Operating income.....	1.2%	6.6%
Other income.....	1.4%	1.1%
Income before taxes.....	2.6%	7.7%
Income taxes (benefit).....	(.2)%	2.0%
Net income.....	2.8%	5.7%

### Net Sales

Net sales for the year ended December 31, 2000 were \$35,610,547, compared with sales of \$37,586,938 for the year ended December 31, 1999. This represents a decrease of \$1,976,391, or 5.3%. Sales of our Benchtop systems were particularly strong in 2000, and constituted our strongest product line. Prodigy system sales also contributed significantly to our 2000 results following its July 2000 introduction. Consumable and maintenance revenues also increased in the twelve months ended December 31, 2000 as compared with 1999. Maintenance and materials revenues were enhanced by the larger installed base of systems, customer satisfaction with ABS, WaterWorks, and other material selections, and continued emphasis on the sale of maintenance contracts.

Our gross shipments amounted to 297 systems in 2000 compared with 293 systems in 1999. System sales in 2000 included gross shipments of all systems, including trade-in and upgrade systems. The average selling price of our systems declined in 2000 as compared with 1999, which was significantly influenced by product mix shifts. Product mix can dramatically affect the average selling price in any period. We ended 2000 with an order backlog in excess of \$7,000,000 compared with an order backlog of approximately \$3,900,000 at December 31, 1999. The 2000 year-end backlog is the highest in our history.

Domestic sales accounted for approximately 52% of total revenue in 2000, comparable to the 52% recorded in 1999. In the United States, the central region recorded the highest revenue. Europe accounted for approximately 19% of total revenue in 2000, an improvement from 18% of revenue recorded in 1999. Our combined Asia-Pacific region, which comprises Japan, China, the Far East and India, accounted for approximately 23% of total revenue, down from the 29% attained in 1999. We believe that year 2001 sales into our Asia Pacific and European regions will remain strong. No assurances, however, can be given that future sales and profitability will not be adversely impacted by the economic conditions of these regions.

### Gross Profit

Gross profit decreased to \$21,948,464, or 61.6% of sales, in the year ended December 31, 2000, compared with \$24,675,038, or 65.6% of sales, in the year ended December 31, 1999. This represents a deterioration of \$2,726,574, or 11.0%. Gross profit decreased due to a shift in our product mix to lower-priced systems, increased overhead expenses, and write-offs of approximately \$600,000 of inventory for obsolescence and scrap.

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### Operating Expenses

SG&A expenses decreased to \$15,138,072 for the year ended December 31, 2000, from \$15,611,257 for the year ended December 31, 1999. This represents a decrease of \$473,185, or 3.0%. Reductions to commissions, amortization, and warranty expenses accounted for much of the decrease in 2000 as compared with 1999.

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R&D expenses declined to \$6,366,800 for the year ended December 31, 2000 from \$6,583,120 for the year ended December 31, 1999. The decrease in 2000 from 1999 amounted to \$216,320, or 3.3%. Increases to personnel expenses were more than offset by reductions to contract labor and materials in 2000. In early January 2001, we announced a layoff in which approximately 8% of our headcount, some of whom were contractors, were terminated. These cuts were concentrated in the R&D and selling departments. Future expense savings should amount to approximately \$2,000,000. A provision for severance and outplacement expenses was taken in the fourth quarter and is reflected in our operating expenses of the period.

Our operating income for the year ended December 31, 2000 amounted to \$443,592, or 1.2% of sales, compared with operating income of \$2,480,661, or 6.6% of sales, for the year ended December 31, 1999.

### Other Income

Other income and expense netted to \$482,296 in 2000 compared with \$408,988 in 1999. Interest income amounted to \$551,841 in 2000 compared with \$452,855 in 1999. Interest expense increased \$69,545 in 2000 from \$43,867, representing the financing effect of higher capitalized lease balances.

### Net Income

For the reasons cited above, net income for 2000 amounted to \$988,301, or 2.8% of sales, compared with net income of \$2,143,649, or 5.7% of sales in 1999. This resulted in 2000 income per diluted common and common equivalent share of \$.17 compared with income per diluted common and common equivalent share of \$.37 for the period ended December 31, 1999.

### LIQUIDITY AND CAPITAL RESOURCES

Operating activities during 2001 provided cash of \$6,244,376, primarily reflecting our net income of \$2,513,185, a decrease in inventories of \$1,464,046, and an increase to unearned maintenance revenues of \$192,416. Unearned maintenance revenues increased as a result of continued selling emphasis and larger installed base of customers. An increase to accounts receivable used cash of \$636,223 in 2001. The increase to accounts receivable was due to a significant number of shipments late in the fourth quarter, coupled with heavier international sales throughout the year. International sales generally take longer to collect than domestic ones. Operating activities during 2000 provided cash of \$663,286, primarily reflecting our 2000 net income of \$988,301, an increase to unearned maintenance contracts of \$391,752, and a decrease in accounts receivable of \$259,742. An increase to inventory balances used cash of \$2,455,553 in 2000.

Our investing activities used cash of \$4,429,215 in 2001, reflecting the acquisition of property and equipment of \$3,928,177 and the payments for intangible assets, including patents, of \$501,038. We purchased our

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manufacturing facility and surrounding land for approximately \$3,100,000 in 2001. Our investing activities provided cash of \$4,445,221 in 2000, including net proceeds of \$6,000,620 from the sale of marketable securities. In 2000 we used cash to acquire property and equipment and for payments of intangible assets of \$978,359 and \$577,040, respectively

In 2001 our financing activities provided cash of \$1,670,346, which included proceeds from a mortgage payable of \$2,287,500. We used cash for the purchase of treasury stock and for payments of obligations under capital leases of \$449,439 and \$187,692, respectively. In 2000, our financing activities used net cash of \$878,915, which included \$731,135 for the purchase of treasury stock under our stock buyback program and \$230,229 for payments of obligations under capital leases.

The net increase in cash in 2001, for the reasons cited above, amounted to \$3,474,092. In 2000, the net increase in cash amounted to \$4,204,907. Our ending cash and cash equivalents balance as of December 31, 2001 and 2000 was \$10,211,398 and \$6,737,306, respectively.

In 2002 our cash will be used for working capital purposes; for improvements to our manufacturing facility; for new product development and sustaining engineering; for the acquisition of equipment, including production

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equipment, tooling, and computers; for the purchase of intangible assets, including patents; for increased selling and marketing activities, especially as they relate to the Dimension product launch and market development; and for our common stock buyback program. We purchased 88,400 shares of our common stock for an aggregate cost of \$449,439 in 2001. In February 2002 we announced a new buyback program for up to \$1,000,000 of our stock, and increased that to \$2,000,000 in March 2002. Through March 15, 2002, we have purchased approximately \$1,900,000 of our common stock under the \$2,000,000 authorization. While we believe that the primary source of liquidity in 2001 will be derived from current cash balances and cash flows from operations, we have maintained a line of credit for the lesser of \$4,000,000 or a defined borrowing base. To date, we have not borrowed against this credit facility.

As of December 31, 2001, we had gross accounts receivable of \$12,695,626, less an allowance of \$562,888 for returns and doubtful accounts. Historically, our bad debt expense has been minimal. However, at December 31, 2001, large balances were concentrated with certain international distributors. Default by one or more of these distributors would result in a significant charge against our current reported earnings. While we can give no assurances, we believe that most, if not all, of the accounts receivable balances will ultimately be collected.

Our total current assets amounted to \$30,026,597 at December 31, 2001, the majority of which consisted of cash, cash equivalents, inventories and accounts receivable. Total current liabilities amounted to \$8,432,349. Our debt is minimal, consisting of a mortgage payable of \$2,270,977 and principal payments due under a capital lease of \$130,320. We will pay off the capital lease by the end of 2002. We estimate that we will spend approximately \$1,300,000 in 2002 for facility improvements, production and R&D equipment, computers and integrated software, and tooling. As of December 31, 2001, material commitments for inventory purchases from selected vendors for the ensuing twelve-month period ending December 31, 2002 should amount to approximately \$2,200,000. We intend to finance these purchases from existing funds or from cash flows from operations.

INFLATION

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We believe that inflation has not had a material effect on our operations or on our financial condition during the three most recent fiscal years.

### FOREIGN CURRENCY TRANSACTIONS

Prior to 2001, substantially all of our recognized revenues from foreign sales were invoiced in United States dollars. Therefore, our exposure to foreign currency exchange rates was immaterial. Commencing in late 2000 and continuing throughout 2001, we began to invoice sales in certain regions to euros. Our reported results have been subject to fluctuations based upon changes in the exchange rates of these currencies in relation to the United States dollar. We have hedged using forward foreign exchange contracts in both the second and third quarters of 2001, although both involved relatively small positions. We will continue to monitor our exposure to currency fluctuations, and, when appropriate, may use financial hedging techniques in the future. Instruments to hedge our risks may include foreign currency forward, swap, and option contracts. These instruments will be used to selectively manage risk but there can be no assurances that we will be fully protected against material foreign currency fluctuations. Translation exposure to our balance sheet with respect to foreign operations is not hedged. We expect to continue to derive most of our revenue from regions where the transactions are negotiated, invoiced, and paid in US dollars. Fluctuations in the currency exchange rates in these other countries may therefore reduce the demand for our products by increasing the price of our products in the currency of countries in which the local currency has declined in value.

### FORWARD-LOOKING STATEMENTS AND FACTORS THAT MAY AFFECT FUTURE RESULTS OF OPERATIONS

All statements herein that are not historical facts or that include such words as expect, anticipate, project, estimates or believes or other similar words are forward-looking statements deemed by us to be covered by and to qualify for the safe harbor protection covered by the safe harbor protection provided by the Private Securities Litigation Reform Act of 1995 (the "1995 Act"). Investors and prospective investors in our Company should understand that several factors govern whether any forward-looking statement herein will be or can be achieved. Any one of these factors could cause actual results to differ materially from those projected herein. These forward-looking statements include the expected increases in net sales of rapid prototyping systems, services and

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consumables, our ability to maintain our gross margins on these sales, and our plans and objectives to introduce new products, control expenses, improve the quality and reliability of our systems, and improve profitability. The forward-looking statements included herein are based on current expectations that involve a number of risks and uncertainties. These forward-looking statements are based on assumptions, among others, that we (1) will be able to continue to introduce new rapid prototyping systems acceptable to the market and improve our existing technology and software in our current product offerings, (2) will be able to successfully launch the new Dimension product, and that the market will accept this product, (3) will be able to maintain our gross margins on our present products, (4) will be able to control our operating expenses, and (5) will be able to retain and recruit employees with the necessary skills to produce, develop, market, and sell our products. Assumptions relating to the foregoing involve judgments with respect to, among other things, future economic, competitive, market and technology conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. Although we believe that the assumptions

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underlying the forward-looking statements contained herein are reasonable, any of those assumptions could prove inaccurate, and therefore there is and can be no assurance that the results contemplated in any such forward-looking statement will be realized. The impact of actual experience and business developments may cause us to alter our marketing plans, our capital expenditure budgets, or our engineering, selling, manufacturing or other budgets, which may in turn affect our results of operations or the success of our new product development and introduction. Due to the factors noted above and elsewhere in the Management's Discussion and Analysis of Financial Condition and Results of Operations, our future earnings and stock price may be subject to significant volatility, particularly on a quarterly basis. Additionally, we may not learn of revenue or earnings shortfalls until late in a fiscal quarter, since we frequently receive the majority of our orders very late in a quarter. This could result in an immediate and adverse effect on the trading price of our common stock. Past financial performance should not be considered a reliable indicator of future performance, and investors should not use historical trends to anticipate results or trends in future periods.

### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

The information that appears following Item 14 of this report and is incorporated herein by reference.

### ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

The Company did not have any changes in or disagreements with its accountants on accounting and financial disclosure.

## PART III

### ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.

Incorporated herein by reference to the Company's Definitive Proxy Statement with respect to the Company's Annual Meeting of Stockholders scheduled to be held May 9, 2002.

### ITEM 11. EXECUTIVE COMPENSATION.

Incorporated herein by reference to the Company's Definitive Proxy Statement with respect to the Company's Annual Meeting of Stockholders scheduled to be held May 9, 2002.

### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

Incorporated herein by reference to the Company's Definitive Proxy Statement with respect to the Company's Annual Meeting of Stockholders scheduled to be held May 9, 2002.

### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

Incorporated herein by reference to the Company's Definitive Proxy Statement with respect to the Company's Annual Meeting of Stockholders scheduled to be held May 9, 2002.

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### ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K.

(a) DOCUMENTS



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1. Financial Statements --

Independent Auditors Report.....  
Consolidated Balance Sheets December 31, 2001 and 2000.....  
Consolidated Statements of Operations Years ended December 31, 2001, 2000 and 1999.....  
Consolidated Statements of Stockholders' Equity Years ended December 31, 2001, 2000 and 1999.....  
Consolidated Statements of Cash Flows Years ended December 31, 2001, 2000 and 1999.....  
Notes to Consolidated Financial Statements.....

2. Financial Statement Schedule --

Schedule II-- Valuation and Qualifying Accounts.....

Notes

All other schedules called for under Regulation S-X are not submitted because they are not applicable or not required, or because the required information is included in the financial statements or notes thereto.

Separate financial statements of the Registrant have been omitted because the Registrant is primarily an operating company. All subsidiaries included in the consolidated financial statements are majority owned, and none of the subsidiaries have indebtedness which is not guaranteed by the Registrant.

3. Exhibits

EXHIBIT NO. -----	DESCRIPTION -----
3.1	Restated Certificate of incorporation of the Company.(3)
3.2	Amendment to Certificate of Incorporation of the Company.(6)
3.3	By-Laws of the Company.(1)
10.1	Non-Competition Agreement between the Company and S. Scott Crump, dated October 15, 1990.(1)
10.2	Non-Competition Agreement between the Company and S. Lisa Crump, dated October 15, 1990.(1)
10.3	Employee Confidentiality Agreement between the Company and S. Scott Crump, dated October 15, 1990.(1)
10.4	Employee Confidentiality Agreement between the Company and Lisa Crump, dated October 15, 1990.(1)
10.5	Stratasys, Inc. Employee Stock Option Plan #1.(1)
10.6	Amended and Restated Stratasys, Inc. 1994 Stock Plan.(3)
10.7	Second Amended and Restated Stratasys, Inc. 1994-2 Stock Plan.(8)
10.8	Stratasys, Inc. 1998 Incentive Stock Option Plan.(10)
10.9	Asset Purchase Agreement between the Company and IBM dated January 1, 1995.(4)
10.10	Stratasys, Inc. 2000 Incentive Stock Option Plan.(13)
10.11	Equipment Lease Agreement between the Company and IBM dated January 1, 1995.(4)
10.12	Assignment, dated October 23, 1989, from S. Scott Crump to the Company with respect to a patent application for an apparatus and method for creating three-dimensional objects.(7)
10.13	Assignment, dated June 5, 1992, from S. Scott Crump to the Company

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- with respect to a patent application for a modeling apparatus for three dimensional objects.(7)
- 10.14 Assignment, dated June 1, 1994, from S. Scott Crump, James W. Comb, William R. Priedeman, Jr., and Robert Zinniel to the Company with respect to a patent application for a process and apparatus of support

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- removal for three-dimensional modeling.(7)
- 10.15 Lease between the Company and Welsh Edenvale Partners '86, dated October 9, 1992.(1)
- 10.16 Amendment #4 to Lease between the Company and Welsh Edenvale Partners '86, dated October 9, 1992, between the Company and Carpenter Land Company LLP, dated July 27, 1998.(14)
- 10.17 Warrant Purchase Agreement by and among the Company and certain holder's of the Company's Warrants dated September 30, 1998.(11)
- 10.18 Technology Sale and Assignment Agreement, between the Company and SEK Technologies LLC, dated as of December 21, 1998.(12)
- 10.19 User Agreement, between the Company and SEK Technologies LLC, dated as of August 21, 1997.(12)
- 10.20 Option Agreement, between the Company and SEK Technologies LLC, dated August 21, 1997.(12)
- 10.21 Form of Registration Rights Agreement, between the Company and holders of Investment Units in SEK Technologies LLC, dated as of January 4, 1999.(12)
- 21.1 Subsidiaries of the Company.(14)
- 23.1 Consent of Rothstein, Kass & Company, P.C.

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- (1) Incorporated by reference from the Company's Registration Statement on Form SB-2 (File No. 33-83638-C) filed September 2, 1994.
- (2) Incorporated by reference from the Company's Form 8-K, dated August 24, 1995.
- (3) Incorporated by reference from the Company's Form 10-KSB for the year ended December 31, 1994.
- (4) Incorporated by reference from the Company's Form 8-K, Amendment No. 2, dated January 1, 1995.
- (5) Incorporated by reference from the Company's Registration Statement on Form SB-2 (File No. 33-99108) filed November 8, 1995.
- (6) Incorporated by reference from the Company's Form 10-QSB for the nine months ended September 30, 1995.
- (7) Incorporated by reference from Amendment No. 1 to the Company's Registration Statement on Form SB-2 (File No. 33-99108) filed December 20, 1995.
- (8) Incorporated by reference from the Company's definitive Proxy Statement on Schedule 14A with respect to the Company's 1997 Annual Meeting of

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Stockholders.

- (9) Incorporated by reference from the Company's Form 10-KSB for the year ended December 31, 1996.
- (10) Incorporated by reference from the Company's definitive Proxy Statement on Schedule 14A with respect to the Company's 1998 Annual Meeting of Stockholders.
- (11) Incorporated by reference from the Company's Form 8-K filed on October 16, 1998.
- (12) Incorporated by reference from the Company's Form 8-K filed January 15, 1999.
- (13) Incorporated by reference from the Company's Registration Statement on Form S-8 (File No. 333-32782) filed March 17, 2000.
- (14) Incorporated by reference from the Company's Form 10-K for the year ended December 31, 1999.

(b) REPORTS ON FORM 8-K

None.

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STRATASYS, INC. AND SUBSIDIARIES  
CONSOLIDATED FINANCIAL STATEMENTS  
AND  
INDEPENDENT AUDITORS' REPORT  
DECEMBER 31, 2001 AND 2000

STRATASYS, INC. AND SUBSIDIARIES

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INDEPENDENT AUDITORS' REPORT

Board of Directors  
Stratasys, Inc.

We have audited the accompanying consolidated balance sheets of Stratasys, Inc. and Subsidiaries (the "Company") as of December 31, 2001 and 2000, and the related consolidated statements of operations, stockholders' equity, and cash flows and financial statement schedule for each of the three years in the period ended December 31, 2001. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Stratasys, Inc. and Subsidiaries as of December 31, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion the financial statement schedule referred to above, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information required to be included therein.

/S/ ROTHSTEIN, KASS & COMPANY

Roseland, New Jersey  
February 1, 2002

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STRATASYS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

DECEMBER 31,	2001	2000
ASSETS		
Current assets		
Cash and cash equivalents	\$ 10,211,398	\$ 6,737,306
Accounts receivable, less allowance for returns and doubtful accounts of \$562,888 in 2001 and \$458,359 in 2000	12,132,738	11,496,515

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Inventories	6,877,582	9,102,818
Prepaid expenses	558,879	673,230
Deferred income taxes	246,000	229,000
	-----	-----
Total current assets	30,026,597	28,238,869
	-----	-----
Property and equipment, net	6,006,529	2,905,620
	-----	-----
OTHER ASSETS		
Intangible assets, net	3,288,222	3,521,561
Deferred income taxes	2,363,000	2,687,000
Other	266,997	228,681
	-----	-----
	5,918,219	6,437,242
	-----	-----
\$ 41,951,345	\$ 37,581,731	
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Obligations under capital leases, current portion	\$ 130,320	\$ 187,692
Mortgage payable, current portion	54,994	
Accounts payable and other current liabilities	3,736,284	3,719,309
Unearned maintenance revenues	4,510,751	4,318,335
	-----	-----
Total current liabilities	8,432,349	8,225,336
	-----	-----
Long-term liabilities		
Obligations under capital leases, less current portion		130,320
Mortgage payable, less current portion	2,215,983	
	-----	-----
	2,215,983	130,320
	-----	-----
COMMITMENTS		
Stockholders' equity		
Common stock, \$.01 par value, authorized 15,000,000 shares; issued 6,133,294 shares in 2001 and 6,125,994 shares in 2000	61,333	61,260
Capital in excess of par value	32,943,974	32,907,547
Retained earnings (deficit)	1,797,606	(715,579)
Accumulated other comprehensive loss	(72,084)	(48,776)
Less cost of treasury stock, 740,400 shares in 2001 and 652,000 shares in 2000	(3,427,816)	(2,978,377)
	-----	-----
Total stockholders' equity	31,303,013	29,226,075
	-----	-----
\$ 41,951,345	\$ 37,581,731	
	=====	=====

See accompanying notes to consolidated financial statements.

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STRATASYS, INC. AND SUBSIDIARIES

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### CONSOLIDATED STATEMENTS OF OPERATIONS

YEARS ENDED DECEMBER 31,	2001	2000	1999
SALES	\$ 37,571,582	\$ 35,610,547	\$ 37,586,
Cost of sales	14,570,815	13,662,083	12,911,
Gross profit	23,000,767	21,948,464	24,675,
COSTS AND EXPENSES			
Research and development	4,915,098	6,366,800	6,583,
Selling, general and administrative	4,597,862	15,138,072	15,611,
	19,512,960	21,504,872	22,194,
OPERATING INCOME	3,487,807	443,592	2,480,
OTHER INCOME (EXPENSE)			
Interest and other income	306,068	551,841	452,
Interest and other expense	(270,818)	(69,545)	(43,
	35,250	482,296	408,
Income before income taxes (benefit)	3,523,057	925,888	,889,
Income taxes (benefit)	1,009,872	(62,413)	746,
NET INCOME	\$ 2,513,185	\$ 988,301	\$ 2,143,
Income per common and common equivalent share			
Basic	\$ 0.46	\$ 0.18	\$ 0
Dilluted	\$ 0.46	\$ 0.17	\$ 0
Weighted average number of common and common equivalent shares outstanding			
Basic	5,461,989	5,527,144	5,775,
Diluted	5,492,852	5,684,318	5,779,

See accompanying notes to consolidated financial statements.

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STRATASYS, INC. AND SUBSIDIARIES

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CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

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YEARS ENDED DECEMBER 31, 2001, 2000, AND 1999

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	COMMON STOCK SHARES	COMMON STOCK AMOUNT	CAPITAL IN EXCESS OF PAR VALUE	RETAINED EARNINGS (DEFICIT)
Balances, January 1, 1999	6,100,524	\$ 61,005	\$ 32,710,484	\$ (3,847,529)
Exercise of stock options	1,437	15	2,271	
Net income				2,143,649
Other comprehensive loss Cumulative translation adjustment				
Total comprehensive income				
Purchase of 405,300 shares of treasury stock				
Balances, December 31, 1999	6,101,961	61,020	32,712,755	(1,703,880)
Exercise of stock options and warrants	24,033	240	82,209	
Warrants issued for services			112,583	
Net income				988,301
Other comprehensive loss Cumulative translation adjustment				(9,168)
Total comprehensive income				
Purchase of 109,400 shares of treasury stock				
Balances, December 31, 2000	6,125,994	61,260	32,907,547	(715,579)
Exercise of stock options	7,300	73	36,427	
Net income				2,513,185
Other comprehensive loss Cumulative translation adjustment				
Total comprehensive income				
Purchase of 88,400 shares of treasury stock				
Balances, December 31, 2001	6,133,294	\$ 61,333	\$ 32,943,974	\$1,797,606

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	ACCUMULATED OTHER COMPREHENSIVE LOSS	TREASURY STOCK	TOTAL	CO
Balances, January 1, 1999	\$ (38,956)	\$ (781,927)	\$ 28,103,077	
Exercise of stock options			2,286	
Net income			2,143,649	
Other comprehensive loss				
Cumulative translation adjustment	(652)		(652)	
Total comprehensive income				
Purchase of 405,300 shares of treasury stock		(1,465,315)	(1,465,315)	
-----				
Balances, December 31, 1999	(39,608)	(2,247,242)	28,783,045	
Exercise of stock options and warrants			82,449	
Warrants issued for services			112,583	
Net income			998,301	
Other comprehensive loss				
Cumulative translation adjustm	(9,168)		(9,168)	
Total comprehensive income				
Purchase of 109,400 shares of treasury stock		(731,135)	(731,135)	
-----				
Balances, December 31, 2000	(48,776)	(2,978,377)	29,226,075	
Exercise of stock options			36,500	
Net income			2,513,185	
Other comprehensive loss				
Cumulative translation adjustment	(23,308)		(23,308)	
		(449,439)	(449,439)	
-----				
	\$ (72,084)	\$ (3,427,816)	\$ 31,303,013	
=====				

See accompanying notes to consolidated financial statements

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STRATASYS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS



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YEARS ENDED DECEMBER 31,	2001	2000	19
Cash flows from operating activities			
Net income	\$ 2,513,185	\$ 988,301	\$ 2
Adjustments to reconcile net income to net cash provided by operating activities:			
Deferred income taxes	307,000	(195,000)	
Depreciation	1,545,198	1,302,893	1
Amortization	734,377	465,187	
Warrants issued for services		112,583	
Loss on disposal of property and equipment	41,720	4,686	
Increase (decrease) in cash attributable to changes in assets and liabilities			
Accounts receivable	(636,223)	259,742	(1
Inventories	1,464,046	(2,455,553)	(1
Prepaid expenses	114,032	(246,352)	
Other assets	(38,796)	154,613	
Accounts payable and other current liabilities	7,421	(119,566)	
Unearned maintenance revenues	192,416	391,752	1
Net cash provided by operating activities	6,244,376	663,286	2
Cash flows from investing activities			
Proceeds from sale of marketable securities		13,500,000	23
Acquisition of marketable securities		(7,499,380)	(24
Acquisition of property and equipment	(3,928,177)	(978,359)	
Proceeds from sale of property and equipment			(6
Purchased in-process research and development			(1
Payments for intangible assets	(501,038)	(577,040)	
Net cash provided by (used in) investing activities	(4,429,215)	4,445,221	(9
Cash flows from financing activities			
Proceeds from mortgage payable	2,287,500		
Payments of obligations under capital leases	(187,692)	(230,229)	
Payments of mortgage payable	(16,523)		
Exercise of stock options and warrants	36,500	82,449	
Purchase of treasury stock	(449,439)	(731,135)	(1
Net cash provided by (used in) financing activities	1,670,346	(878,915)	(1
Effect of exchange rate changes on cash	(11,415)	(24,645)	
Net increase (decrease) in cash and cash equivalents	3,474,092	4,204,947	(8
Cash and cash equivalents, beginning of year	6,737,306	2,532,359	11
Cash and cash equivalents, end of year	\$ 10,211,398	\$ 6,737,306	\$ 2

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See accompanying notes to consolidated financial statements

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STRATASYS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31,	2001	2000	1999
Supplemental disclosures of cash flow information, cash paid during the year for:			
Interest	\$ 89,298	\$ 69,545	\$ 43,867
Income taxes	\$ 138,692	\$ 253,265	\$
Supplemental schedules of noncash investing and financing activities:			
Machinery and equipment acquired under capital lease obligations	\$	\$	\$ 369,997
Machinery and equipment transferred from inventory	\$ 761,190	\$	\$

See accompanying notes to consolidated financial statements.

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STRATASYS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Stratasys, Inc. and Subsidiaries (collectively the "Company") develops, manufactures and markets a family of rapid prototyping systems ("RPS") and devices that permit engineers and designers to create physical models and prototypes, made of various materials, utilizing three dimensional Computer Aided Design ("3D CAD") files at a CAD workstation. The Company sells these devices and the related consumable materials and maintenance worldwide.

Principles of Consolidation

The consolidated financial statements include the accounts of Stratasys, Inc. and its wholly owned subsidiaries. All intercompany accounts and transactions

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have been eliminated in consolidation.

### Fair Value of Financial Instruments

The fair value of the Company's assets and liabilities, which qualify as financial instruments under Statement of Financial Accounting Standards (SFAS) No. 107, "Disclosures About Fair Value of Financial Instruments", approximate the carrying amounts presented in the consolidated balance sheets.

### Cash Equivalents

The Company considers all highly-liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents.

### Inventories

Inventories are stated on the first-in, first-out method, at the lower of cost, or market. Inventory costs are comprised of material, direct labor and overhead.

### Impairment of Long-Lived Assets

The Company periodically assesses the recoverability of the carrying amounts of long-lived assets, including intangible assets. A loss is recognized when expected undiscounted future cash flows are less than the carrying amount of the asset. The impairment loss is the difference by which the carrying amount of the asset exceeds its fair value.

### Property and Equipment

Property and equipment is stated at cost less accumulated depreciation and amortization. Depreciation and amortization is computed using the straight-line method over the estimated useful lives of the assets ranging from 3-30 years.

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## STRATASYS, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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#### 1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

##### Intangible Assets

Intangible assets are being amortized over their estimated useful or economic lives using the straight-line method as follows:

RPS Technology	11 years
Capitalized software development costs	3 years
Purchased software	3 years
Patents	10 years

The costs of software development, including significant product enhancements, incurred subsequent to establishing technological feasibility have been capitalized in accordance with SFAS No. 86, "Accounting for the Costs of

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Computer Software to be Sold, Leased or Otherwise Marketed." Costs incurred prior to establishment of technological feasibility are charged to research and development expense.

### Unearned Maintenance Revenues

Maintenance revenues are amortized over the term of the related maintenance contracts, which are typically one to two years.

### Revenue Recognition

The Company recognizes revenues from the sale of RPS machines when shipped. The Company establishes allowances for estimated returns at the time of shipment. Service revenues, excluding maintenance contracts, are recognized at the time the services are performed.

### Advertising

Advertising costs are charged to operations as incurred and were approximately \$584,000, \$704,000, and \$652,000 for 2001, 2000 and 1999, respectively.

### Research and Development Costs

Expenditures for research, development and engineering of products and manufacturing processes are expensed as incurred.

### Income Taxes

The Company complies with SFAS No. 109, "Accounting for Income Taxes," which requires an asset and liability approach to financial reporting of income taxes. Deferred income tax assets and liabilities are computed for differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future, based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce the deferred income tax assets to the amount expected to be realized.

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## STRATASYS, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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#### 1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

##### Income Per Common Share

The Company complies with SFAS No. 128, "Earnings Per Share". SFAS No. 128 requires dual presentation of basic and diluted income per share for all periods presented. Basic income per share excludes dilution and is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted income per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then share in the income of the Company. The difference between the number of shares used to compute basic income per share and diluted income per share relates to additional shares to be issued upon the

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assumed exercise of stock options and warrants, net of shares hypothetically repurchased at the average market price with the proceeds of exercise of 30,863 in 2001, 157,174 in 2000, and 3,395 in 1999.

### Stock-Based Compensation

The Company follows SFAS No. 123 "Accounting for Stock-Based Compensation." The provisions of SFAS No. 123 allow companies to either expense the estimated fair value of stock options or to continue to follow the intrinsic value method set forth in APB Opinion 25, "Accounting for Stock Issued to Employees" ("APB 25") but disclose the pro forma effect on net income (loss) had the fair value of the options been expensed. The Company has elected to continue to apply APB 25 in accounting for its stock option incentive plans.

### Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### Comprehensive Income

The Company complies with SFAS No. 130, "Reporting Comprehensive Income." SFAS No. 130 establishes rules for the reporting and display of comprehensive income and its components; however, the compliance with this Statement has no impact on the Company's net income or stockholders' equity. SFAS No. 130 requires the Company's change in the foreign currency translation adjustment to be included in other comprehensive income.

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## STRATASYS, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### 2. ACCOUNTS RECEIVABLE

At December 31, 2001 and 2000, accounts receivable included balances due from foreign entities of approximately \$8,096,000 and \$6,714,000, respectively.

#### 3. INVENTORIES

Inventories consist of the following at December 31:

	2001	2000
Finished goods	\$4,539,943	\$3,597,770
Raw materials	2,337,639	5,505,048
	-----	-----
	\$6,877,582	\$9,102,818
	=====	=====

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### 4. PROPERTY AND EQUIPMENT

Property and equipment consists of the following at December 31:

	2001	2000
Machinery and equipment	\$ 4,096,073	\$ 2,496,029
Building	2,330,953	
Land	694,876	
Computer equipment and software	3,249,933	3,123,065
Office equipment	809,666	783,451
Leasehold improvements	1,292,437	1,257,595
Equipment under capital leases	362,402	643,851
	-----	-----
	12,836,340	8,303,991
	-----	-----
Accumulated depreciation and amortization (including \$119,619 in 2001 and \$247,726 in 2000 under capital leases)	6,829,811	5,398,371
	-----	-----
	\$ 6,006,529	\$ 2,905,620
	=====	=====

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STRATASYS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### 5. INTANGIBLE ASSETS

Intangible assets consist of the following at December 31:

	2001	2000
RPS technology	\$2,558,532	\$2,558,532
Capitalized software development costs	3,329,699	3,055,663
Purchased software	300,000	300,000
Patents	1,538,933	1,311,931
Other	16,344	16,344
	-----	-----
	7,743,508	7,242,470
Accumulated amortization	4,455,286	3,720,909
	-----	-----
	\$3,288,222	\$3,521,561
	=====	=====

For the years ended December 31, 2001, 2000 and 1999, amortization of capitalized software development costs charged to operations was \$334,590, \$97,611 and \$305,263, respectively.

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Included in research and development expense for the years ended December 31, 2001, 2000 and 1999 are computer software development expenditures of \$1,027,647, \$1,364,175 and \$1,463,692, respectively.

### 6. CREDIT LINE

The Company has an available line of credit from a financial institution for the lesser of \$4,000,000 or a defined borrowing base. The credit line bears interest at defined rates based upon two different indexes and expires in June 2002. No amounts were outstanding at December 31, 2001 and 2000.

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STRATASYS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### 7. ACCOUNTS PAYABLE AND OTHER CURRENT LIABILITIES

Accounts payable and other current liabilities consist of the following at December 31:

	2001	2000
Trade	\$ 697,608	\$ 1,456,502
Compensation and related benefits	2,063,501	1,621,025
Reserve for warranty expenses	134,529	160,000
Other	840,646	481,782
	-----	-----
	\$ 3,736,284	\$ 3,719,309
	=====	=====

### 8. MORTGAGE PAYABLE

In August 2001, the Company entered into a mortgage agreement with a bank providing a loan of \$2,287,500 which was used for the purchase of land and building used in the Company's manufacturing operations which was previously leased. The loan is payable in monthly installments of \$18,396, including interest of 7.38% per annum, with a final payment in July 2006. The loan is collateralized by the property.

Future principal payments in each of the five years subsequent to December 31, 2001 are as follows:

Year ending December 31,		
2002	\$	54,994
2003		59,163
2004		63,712
2005		68,576
2006		2,024,532
		-----

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\$ 2,270,977

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STRATASYS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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9. INCOME TAXES

The components of the Company's deferred tax assets (liabilities) at December 31, 2001 and 2000 are as follows:

	2001	2000
Net operating loss carryforwards	\$ 80,000	\$ 221,000
Depreciation	198,000	68,000
Amortization	(32,000)	(41,000)
Allowance for doubtful accounts	118,000	98,000
Reserve for warranty expenses	50,000	59,000
Reserve for sales returns, net	90,000	72,000
Unrealized gain on foreign currency	(12,000)	(35,000)
Federal minimum tax credit carryforwards	162,000	162,000
Research and development tax credit carryforwards	1,955,000	2,312,000
	-----	-----
	\$ 2,609,000	\$ 2,916,000
	=====	=====

At December 31, 2001, the Company had research and development tax credit carryforwards of approximately \$1,955,000, which can be utilized against future federal income tax and expire in various years through 2020.

Income before income taxes (benefit) consists of the following:

	2001	2000	1999
United States	\$ 3,446,884	\$ 822,354	\$ 2,682,310
Foreign	76,173	103,534	207,339
	-----	-----	-----
	\$ 3,523,057	\$ 925,888	\$ 2,889,649
	=====	=====	=====

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STRATASYS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS



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9. INCOME TAXES (CONTINUED)

The components of income taxes (benefit) for the years ended December 31, 2001, 2000 and 1999 are as follows:

	2001	2000	1999
Current			
Federal	\$ 620,803	\$ 51,831	\$ 80,000
State	46,714	42,765	
Foreign	35,355	37,991	72,000
	-----	-----	-----
	702,872	132,587	152,000
	-----	-----	-----
Deferred			
Federal	383,000	(231,000)	463,000
State	(76,000)	36,000	131,000
	-----	-----	-----
	307,000	(195,000)	594,000
	-----	-----	-----
	\$ 1,009,872	\$ (62,413)	\$ 746,000
	=====	=====	=====

A reconciliation of the statutory federal income tax rate and the effective tax rate follows:

	2001	2000	1999
Federal statutory rate	34.0%	34.0%	34.0%
Foreign sales corporation exclusion	(3.1)	(3.0)	
Earnings of subsidiaries taxed at other than U.S. statutory rate	0.1	(1.5)	
State income taxes, net of federal effect	(0.8)	8.5	2.9
Permanent differences and other	6.0	4.2	1.0
Utilization of research and development tax credit	(7.5)	(48.9)	(12.1)
	-----	-----	-----
Effective income tax rate	28.7%	(6.7)%	25.8%
	=====	=====	=====

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STRATASYS, INC. AND SUBSIDIARIES

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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10. COMMITMENTS

The Company leases certain of its facilities under leases which expire through 2004.

Aggregate future minimum annual rental payments in the years subsequent to December 31, 2001 are as follows:

Year ending December 31,	
2002	\$ 244,100
2003	246,065
2004	113,827
	-----
	\$ 603,992
	=====

Rent expense for the years ended December 31, 2001, 2000 and 1999 was approximately \$654,000, \$666,000 and \$712,000, respectively.

The Company leases property and equipment under a capital lease which expires in 2002. Total minimum lease payments for 2002 amount to \$139,898 of which \$9,578 represents interest and \$130,320 represents principal.

11. STOCK OPTIONS AND WARRANTS

The Company has five employee stock option plans which have been approved by the stockholders: Stratasy, Inc. Employee Incentive Stock Option Plan #1 (Plan 1), Stratasy, Inc. 1994 Incentive Stock Option Plan (Plan 2), Stratasy, Inc. 1994 - 2 Incentive Stock Option Plan (Plan 3), Stratasy, Inc. 1998 Incentive Stock Option Plan (Plan 4), and Stratasy, Inc. Incentive Stock Option Plan (Plan 5). The five plans provide for the granting of options to qualified employees of the Company, independent contractors, consultants and other persons to purchase up to 2,050,000 shares of common stock.

All of the 100,034 options under Plan 1 have been granted and the plan expired April 19, 2001. Under Plans 2, 3, 4, and 5, options to purchase 165,822 shares, 999,128 shares, 420,020 shares, 248,200 shares, respectively, of common stock have been granted. All options under the above plans are granted at a price not less than the fair market value of the Company's common stock at the dates of grant and are principally exercisable over five years. All grants are net of terminations and expirations.

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STRATASYS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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11. STOCK OPTIONS AND WARRANTS (CONTINUED)

The following summarizes the information relating to outstanding stock options and the activity during 2001, 2000 and 1999:

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	NUMBER OF SHARES	PER SHARE OPTION PRICE			WEIGHTED AVERAGE OPTION PRICE
Shares under option at January 1, 1999	998,216	\$ 1.59	-	\$ 23.56	\$ 12.68
Granted in 1999	503,100	4.53	-	9.13	5.03
Exercised in 1999	(1,437)	1.59	-	1.59	1.59
Forfeited in 1999	(91,340)	5.00	-	9.81	6.34
-----					
Shares under option at December 31, 1999	1,408,539	1.59	-	23.56	7.09
Granted in 2000	104,232	2.34	-	11.31	7.23
Exercised in 2000	(19,048)	1.59	-	7.13	3.09
Expired in 2000	(17,000)	5.38	-	5.38	5.38
Forfeited in 2000	(152,096)	4.44	-	23.56	18.45
-----					
Shares under option at December 31, 2000	1,324,627	1.59	-	21.81	7.12
Granted in 2001	283,650	2.76	-	6.24	3.08
Exercised in 2001	(7,300)	5.00	-	5.00	5.00
Expired in 2001	(100,300)	5.25	-	17.50	10.55
Forfeited in 2001	(42,100)	2.34	-	9.13	5.82
-----					
Shares under option at December 31, 2001	1,458,577	\$ 1.59	-	\$ 21.81	\$ 6.73
=====					
Options exercisable at December 31, 2001	1,097,847	\$ 1.59	-	\$ 21.81	\$ 7.34
=====					

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STRATASYS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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11. STOCK OPTIONS AND WARRANTS (CONTINUED)

The Company, as part of sales of common stock and other agreements, has issued warrants to purchase the Company's common stock. The following summarizes the information relating to outstanding warrants and the activity during 2001, 2000 and 1999:

	NUMBER OF SHARES	PER SHARE WARRANT PRICE	WEIGHTED AVERAGE WARRANT PRICE
Shares under warrants at January 1, 1999			

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and 2000	236,355	\$	5.00	-	\$ 15.44	\$	12.48
Granted in 2000	121,000		3.60	-	7.00		5.58
Exercised in 2000	(13,000)		5.00	-	5.00		5.00
Expired in 2000	(69,355)		14.00	-	15.44		14.10
Forfeited in 2000	(60,000)		7.00	-	7.00		7.00
-----							
Shares under warrants at December 31, 2000 and 2001	215,000	\$	3.60	-	\$ 13.88	\$	10.06
=====							

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STRATASYS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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11. STOCK OPTIONS AND WARRANTS (CONTINUED)

Had compensation cost for the Company's five stock option plans and stock purchase warrants been determined based on the fair value at the grant date of awards in 2001, 2000 and 1999, consistent with the provisions of SFAS 123, the Company's net income and income per share would have been reduced to the pro forma amounts indicated below:

	2001	2000	1999
Net income, as reported	\$ 2,513,185	\$ 988,301	\$ 2,143,649
Net income, pro forma	\$ 1,987,185	\$ 536,501	\$ 1,721,787
Basic income per share - as reported	\$ 0.46	\$ 0.18	\$ 0.37
Diluted income per share - as reported	\$ 0.46	\$ 0.17	\$ 0.37
Basic income per share - pro forma	\$ 0.36	\$ 0.10	\$ 0.30
Diluted income per share - pro forma	\$ 0.36	\$ 0.09	\$ 0.30

The Company used the Black-Scholes option pricing model to determine the fair value of grants made in 2001, 2000 and 1999. The following assumptions were applied in determining the pro forma compensation cost:

	2001	2000	1999
Risk-free interest rate	5.00	5.94	5.57
Expected option term	4 years	4 years	3-4 years
Expected price volatility	83%	62%	67%
Dividend yield	-	-	-

12. EXPORT SALES

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Export sales were as follows for the years ended December 31:

	2001	2000	1999
Europe	\$ 8,017,111	\$ 6,657,860	\$ 6,348,845
Asia Pacific	9,916,468	8,642,917	11,070,532
Other	1,350,352	3,305,884	2,333,956
	-----	-----	-----
	\$ 19,283,931	\$ 18,606,661	\$ 19,753,333
	=====	=====	=====

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STRATASYS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### 13. QUARTERLY RESULTS (UNAUDITED)

	FIRST QUARTER	SECOND QUARTER	THIRD QUARTER	FOURTH QUARTER
2001				
Net sales	\$ 8,687,689	\$ 9,223,715	\$ 9,703,008	\$ 9,957,170
Gross profit	5,098,476	5,532,138	5,931,270	6,438,883
Net income	197,818	416,309	979,667	919,391
Income per common and common equivalent share:				
Basic	0.04	0.08	0.18	0.16
Diluted	0.04	0.08	0.18	0.16
2000				
Net sales	\$ 9,298,007	\$ 9,023,247	\$ 9,001,518	\$ 8,287,775
Gross profit	5,905,715	5,951,616	5,421,570	4,669,563
Net income	375,764	326,894	171,481	114,162
Income per common and common equivalent share:				
Basic	0.07	0.06	0.03	0.02
Diluted	0.06	0.06	0.03	0.02

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STRATASYS, INC. AND SUBSIDIARIES

SCHEDULE II  
VALUATION AND QUALIFYING ACCOUNTS

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COLUMN A	COLUMN B	COLUMN C	COLUMN D
DESCRIPTION	BALANCE AT BEGINNING OF PERIOD	ADDITIONS - CHARGED TO INCOME	DEDUCTIONS FROM RESERVES
2001			
Reserve for bad debts and allowances	\$ 264,260	\$ 60,000	\$ 6,305
Reserve for sales returns and other allowances	\$ 194,099	\$ 390,880	\$ 340,046
2000			
Reserve for bad debts and allowances	\$ 300,000	\$ 1,489	\$ 37,229
Reserve for sales returns and other allowances	\$ 120,833	\$ 1,766,397	\$ 1,693,131
1999			
Reserve for bad debts and allowances	\$ 279,508	\$ 29,920	\$ 9,428
Reserve for sales returns and other allowances	\$ 129,833	\$ 100,000	\$ 109,000

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SIGNATURES

In accordance with Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

STRATASYS, INC.

By: /s/ S. Scott Crump

-----  
S. Scott Crump  
President

Dated: March 25, 2002

In accordance with the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

/s/ S. Scott Crump

-----  
S. Scott Crump

Chairman of the Board of Directors,  
President, Chief Executive Officer,  
Treasurer, (Principal Executive  
Officer)

March 25, 2002

/s/ Thomas W. Stenoien

-----  
Thomas W. Stenoien

Chief Financial Officer (Principal  
Financial and Accounting Officer)

March 25, 2002

/s/ Ralph E. Crump

-----

Director

March 25, 2002

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Ralph E. Crump		
/s/ Clifford H. Schwieter		
-----	Director	March 25, 2002
Clifford H. Schwieter		
/s/ Arnold J. Wasserman		
-----	Director	March 25, 2002
Arnold J. Wasserman		
/s/ Gregory L. Wilson		
-----	Director	March 25, 2002
Gregory L. Wilson		
/s/ Cameron Truesdell		
-----	Director	March 25, 2002
Cameron Truesdell		
/s/ Edward J. Fierko		
-----	Director	March 25, 2002
Edward J. Fierko		