Proto Labs Inc
Form 10-Q
November 04, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2014

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from__________ to__________

Commission File Number: 001-35435

Proto Labs, Inc.

(Exact name of registrant as specified in its charter)

Minnesota	**41-1939628**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
5540 Pioneer Creek Drive	
Maple Plain, Minnesota	**55359**
(Address of principal executive offices)	(Zip Code)

(763) 479-3680

(Registrant’s telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date: 25,821,479 shares of Common Stock, par value $0.001 per share, were outstanding at October 31, 2014.

Proto Labs, Inc.

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Proto Labs, Inc.

Consolidated Balance Sheets

(In thousands, except share and per share amounts)

	September 30, 2014 (Unaudited)	December 31, 2013
Assets		
Current assets		
Cash and cash equivalents	$ 34,268	$ 43,039
Short-term marketable securities	24,212	36,339
Accounts receivable, net of allowance for doubtful accounts of $105 and $90 as of September 30, 2014 and December 31, 2013, respectively	25,460	18,320
Inventory	5,705	5,166
Prepaid expenses and other current assets	4,278	3,569
Income taxes receivable	3,223	2,907
Deferred tax assets	452	455
Total current assets	97,598	109,795
Property and equipment, net	87,962	56,101
Goodwill	28,916	-
Other intangible assets, net	4,269	-
Long-term marketable securities	60,449	64,023
Other long-term assets	232	256
Total assets	$ 279,426	$ 230,175
Liabilities and shareholders' equity		
Current liabilities		
Accounts payable	$ 7,973	$ 6,455
Accrued compensation	8,154	6,196
Accrued liabilities and other	3,804	808
Current portion of long-term debt obligations	164	204
Total current liabilities	20,095	13,663
Long-term deferred tax liabilities	4,112	3,682
Long-term debt obligations	42	159
Other long-term liabilities	854	1,028

Total liabilities	25,103	18,532
Shareholders' equity		
Preferred stock, $0.001 par value, authorized 10,000,000 shares; issued and outstanding 0 shares as of each of September 30, 2014 and December 31, 2013	-	-
Common stock, $0.001 par value, authorized 150,000,000 shares; issued and outstanding 25,816,096 and 25,546,107 shares as of September 30, 2014 and December 31, 2013, respectively	26	26
Additional paid-in capital	178,767	166,861
Retained earnings	77,290	45,847
Accumulated other comprehensive income (loss)	(1,760)	(1,091)
Total shareholders' equity	254,323	211,643
Total liabilities and shareholders' equity	$ 279,426	$ 230,175

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

Proto Labs, Inc.

Consolidated Statements of Comprehensive Income

(In thousands, except share and per share amounts)

(Unaudited)

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2014	**2013**	**2014**	**2013**
Statements of Operations:				
Revenue	$54,574	$42,008	$153,514	$119,070
Cost of revenue	21,492	16,053	58,725	44,983
Gross profit	33,082	25,955	94,789	74,087
Operating expenses				
Marketing and sales	7,351	5,409	21,029	16,222
Research and development	4,555	3,026	11,925	8,405
General and administrative	5,733	4,118	15,970	12,035
Total operating expenses	17,639	12,553	48,924	36,662
Income from operations	15,443	13,402	45,865	37,425
Other income (expense), net	(56)	31	(19)	149
Income before income taxes	15,387	13,433	45,846	37,574
Provision for income taxes	5,003	4,561	14,404	11,804
Net income	$10,384	$8,872	$31,442	$25,770
Net income per share:				
Basic	$0.40	$0.35	$1.23	$1.03
Diluted	$0.40	$0.34	$1.20	$1.00
Shares used to compute net income per share:				
Basic	25,757,593	25,384,940	25,651,156	25,121,941
Diluted	26,200,741	26,002,240	26,109,539	25,794,950
Comprehensive Income (net of tax)				
Comprehensive income	$9,011	$9,678	$30,773	$25,471

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

Proto Labs, Inc.

Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Nine Months Ended September 30, 2014	2013
Operating activities		
Net income	$31,442	$25,770
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,696	5,528
Stock-based compensation expense	3,561	2,595
Deferred taxes	487	(61)
Excess tax benefit from stock-based compensation	(4,383)	(8,198)
Loss on disposal of property and equipment	-	111
Amortization of held-to-maturity securities	1,194	1,007
Changes in operating assets and liabilities:		
Accounts receivable	(6,302)	(2,242)
Inventories	(339)	(380)
Prepaid expenses and other	(706)	1,545
Income taxes	4,032	6,099
Accounts payable	1,414	1,564
Accrued liabilities and other	1,908	1,562
Net cash provided by operating activities	40,004	34,900
Investing activities		
Purchases of property and equipment	(35,928)	(12,976)
Acquisitions, net of cash acquired	(33,864)	-
Purchases of marketable securities	(47,338)	(82,657)
Proceeds from sales and maturities of marketable securities	61,896	50,663
Net cash used in investing activities	(55,234)	(44,970)
Financing activities		
Payments on debt	(1,005)	(211)
Acquisition-related contingent consideration	(800)	-
Proceeds from exercises of stock options and other	3,962	4,635
Excess tax benefit from stock-based compensation	4,383	8,198
Net cash provided by financing activities	6,540	12,622
Effect of exchange rate changes on cash and cash equivalents	(81)	71
Net increase (decrease) in cash and cash equivalents	(8,771)	2,623

Cash and cash equivalents, beginning of period	43,039	36,759
Cash and cash equivalents, end of period	$34,268	$39,382

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

Note 1 – Basis of Presentation

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

The preparation of the financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses, and the related disclosures at the date of the financial statements and during the reporting period. Actual results could materially differ from these estimates. For further information, refer to the audited consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013 as filed with the Securities and Exchange Commission (SEC) on February 28, 2014.

The accompanying Consolidated Balance Sheet as of December 31, 2013 was derived from the audited Consolidated Financial Statements but does not include all disclosures required by U.S. GAAP for a full set of financial statements. This Form 10-Q should be read in conjunction with the Company’s Consolidated Financial Statements and Notes included in the Annual Report on Form 10-K filed on February 28, 2014 as referenced above.

Note 2 – Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers*. This ASU is a comprehensive new revenue recognition model that requires a company to recognize revenue from the transfer of goods or services to customers in an amount that reflects the consideration that the entity expects to receive in exchange for those goods or services. The Company is required to adopt the new pronouncement on January 1, 2017 using one of two retrospective application methods. The Company is evaluating the application method and the impact of this new standard on our financial statements.

In August 2014, the FASB issued ASU No. 2014-15*, Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern*, to provide guidance on management’s responsibility in evaluating whether there is substantial doubt about a company’s ability to continue as a going concern and to provide related footnote disclosures. The Company is required to adopt the new pronouncement for the annual period ending after December 15, 2016, with early adoption permitted. We believe the impact of ASU 2014-15 will not affect the Company.

There are no other new accounting pronouncements that are expected to have a significant impact on the Company's consolidated financial statements.

Note 3 – Business Combinations

On April 23, 2014, the Company acquired 100% of the outstanding shares of FineLine Prototyping, Inc. ("FineLine") for $33.9 million net cash consideration, which was funded with cash available in the United States and the sale of $15.5 million of held-to-maturity securities. The shares of FineLine acquired through the Stock Purchase Agreement ("Agreement") were initially issued in a private transaction exempt from the registration under the Securities Act of 1933 and the operations of FineLine will be integrated into the operations of the Company. Under the terms of the Agreement, the Company is obligated to make an additional cash payment of up to $3.0 million, contingent upon both the achievement of 2014 revenue goals and certain milestones relating to the integration of FineLine's operations with the Company.

FineLine is based in Raleigh, North Carolina and is a leading producer of parts using additive manufacturing technologies, often times referred to as 3D printing. FineLine produces high-quality parts using stereolithography (SLA), selective laser sintering (SLS) and direct metal laser sintering (DMLS) technologies to customers in a wide variety of industries, including medical, aerospace, computer/electronics, consumer products and industrial machinery, among others. Along with Protomold and Firstcut, the Company will offer these technologies to its customers under the Fineline product name.

Consistent with the provisions of Accounting Standards Codification (ASC) 805, *Business Combinations* (ASC 805), the Company accrued the contingent payment on the date of acquisition after determining its fair value of $3.0 million in arriving at $36.9 million of total consideration, net of cash acquired. The contingent consideration liability is reflected in *accrued liabilities and other* as of September 30, 2014 and continues to be remeasured to fair value at each reporting period with changes in fair value reflected in the *Consolidated Statements of Comprehensive Income*. To date as of September 30, 2014, the Company has made payments of $0.8 million related to the attainment of milestones and as of September 30, 2014, the contingent consideration balance totaled $2.2 million.

The fair value of the consideration paid for this acquisition was allocated to the assets purchased and liabilities assumed based on their estimated fair values as of the acquisition date, with any excess recorded as goodwill. The goodwill associated with the acquisition is deductible for tax purposes and represents the strategic and growth opportunities from strengthening the Company’s portfolio of rapid prototyping product offerings. The addition of additive manufacturing expands Proto Labs’ products to address a wider spectrum of need for the product developer. From concept models, to form and fit testing, to functional testing and short-run production, the acquisition of FineLine allows the Company to offer a broader range of quick-turn custom parts with speed, reliability and consistency.

The results of FineLine since the date of acquisition and pro forma disclosures of the consolidated results of the Company with the full year effects of FineLine have not been separately presented since the impact to the Company's results of operations was not material.

The acquisition has been accounted for under the acquisition method of accounting in accordance with ASC 805. As of September 30, 2014, this allocation for FineLine remains preliminary as it relates to the valuation of certain working capital accounts, intangible assets and taxes. The preliminary allocation of the purchase price to assets acquired and liabilities assumed is as follows:

(in thousands)	
Assets acquired:	
Current assets	$1,248
Intangible assets	4,580
Goodwill	28,916
Other long-term assets	3,849
Total assets acquired	38,593
Liabilities assumed:	
Current liabilities	1,729
Total liabilities assumed	1,729
Net assets acquired	36,864
Cash paid	34,468
Cash acquired	(604)
Net cash consideration	33,864
Contingent consideration	3,000
Total purchase consideration	$36,864

Note 4 – Goodwill and Other Intangible Assets

The changes in the carrying amount of Goodwill for the nine months ended September 30, 2014 were as follows:

(in thousands)	**Nine Months Ended September 30, 2014**
Balance as of the beginning of the period	$ -
Goodwill acquired during the period	28,916
Balance as of the end of the period	$ 28,916

Intangible assets other than Goodwill at September 30, 2014 and December 31, 2013 were as follows:

	September 30, 2014			December 31, 2013				
(in thousands)	**Gross**	**Accumulated Amortization**	**Net**	**Gross**	**Accumulated Amortization**	**Net**	**Useful Life (in years)**	**Weighted Average Useful Life Remaining (in years)**
Intangible Assets with finite lives:								
Marketing assets	$930	$ (39)	$891	$ -	$ -	$ -	10.0	9.6
Non-compete agreement	190	(40)	150	-	-	-	2.0	1.6
Trade secrets	250	(21)	229	-	-	-	5.0	4.6
Internally developed software	680	(94)	586	-	-	-	3.0	2.6
Customer relationships	2,530	(117)	2,413	-	-	-	9.0	8.6
Total intangible assets	$4,580	$ (311)	$4,269	$ -	$ -	$ -		

Amortization expense for intangible assets for the three and nine months ended September 30, 2014 was $0.2 million and $0.3 million, respectively. There was no amortization expense in the same periods of the prior year.

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

(in thousands)	**Estimated Amortization Expense**
Remaining 2014	$ 186
2015	746
2016	682
2017	500
2018	424
Thereafter	1,731
Total estimated amortization expense	$ 4,269

Note 5 – Net Income per Common Share

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

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

(in thousands, except share and per share amounts)	Three Months Ended September 30, 2014	2013	Nine Months Ended September 30, 2014	2013
Net income	$10,384	$8,872	$31,442	$25,770
Basic - weighted-average shares outstanding:	25,757,593	25,384,940	25,651,156	25,121,941
Effect of dilutive securities:				
Employee stock options and other	443,148	617,300	458,383	673,009
Diluted - weighted-average shares outstanding:	26,200,741	26,002,240	26,109,539	25,794,950
Net income per share:				
Basic	$0.40	$0.35	$1.23	$1.03
Diluted	$0.40	$0.34	$1.20	$1.00

Note 6 – Fair Value Measurements

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

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

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

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

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

A summary of financial assets as of September 30, 2014 and December 31, 2013 measured at fair value on a recurring basis follows:

	September 30, 2014			**December 31, 2013**		
(in thousands)	**Level 1**	**Level 2**	**Level 3**	**Level 1**	**Level 2**	**Level 3**
Financial Assets:						
Cash and cash equivalents						
Money market mutual fund	$4,917	$ -	$ -	$5,524	$ -	$ -
Total	$4,917	$ -	$ -	$5,524	$ -	$ -

9

Note 7 – Marketable Securities

The Company invests in short-term and long-term agency, municipal, corporate, commercial paper and other debt securities. The securities are categorized as held-to-maturity and are recorded at amortized cost. Categorization as held-to-maturity is based on the Company's ability and intent to hold these securities to maturity. Information regarding the Company's short-term and long-term marketable securities as of September 30, 2014 and December 31, 2013 is as follows:

(in thousands)	September 30, 2014 Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government agency securities	$ 20,533	$ -	$ (48)	$20,485
Corporate debt securities	28,452	9	(61)	28,400
Commercial paper	1,999	-	-	1,999
U.S. municipal securities	28,268	54	(2)	28,320
Certificates of deposit/time deposits	5,409	6	(12)	5,403
Total marketable securities	$ 84,661	$ 69	$ (123)	$84,607

(in thousands)	December 31, 2013 Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government agency securities	$ 21,713	$ 2	$ (22)	$21,693
Corporate debt securities	29,480	30	(20)	29,490
U.S. municipal securities	44,474	49	(22)	44,501
Certificates of deposit/time deposits	4,695	5	(8)	4,692
Total marketable securities	$ 100,362	$ 86	$ (72)	$100,376

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

The Company tests for other than temporary losses on a quarterly basis and has considered the unrealized losses indicated above to be temporary in nature. The Company intends to hold the investments to maturity and recover the full principal.

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

The September 30, 2014 balance of held-to-maturity debt securities by contractual maturity is shown in the following table at amortized cost. Actual maturities may differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties.

(in thousands)	**September 30, 2014**
Due in one year or less	$ 24,212
Due after one year through five years	60,449
Total marketable securities	$ 84,661

Note 8 – Inventory

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

The Company's inventory consists of the following:

(in thousands)	**September 30, 2014**	**December 31, 2013**
Raw materials	$ 5,384	$ 4,875
Work in process	505	410
Total inventory	5,889	5,285
Allowance for obsolescence	(184)	(119)
Inventory, net of allowance	$ 5,705	$ 5,166

Note 9 – Stock-Based Compensation

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

Employee Stock Purchase Plan

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

Stock-Based Compensation Expense

Stock-based compensation expense was $1.4 million and $0.9 million for the three months ended September 30, 2014 and 2013, respectively, and $3.6 and $2.6 million for the nine months ended September 30, 2014 and 2013, respectively.

Stock Options

A summary of stock option activity for the nine months ended September 30, 2014 is as follows:

	Stock Options	Weighted-Average Exercise Price
Options outstanding at December 31, 2013	1,143,250	$ 19.03
Granted	109,530	72.72
Exercised	(247,127)	13.74
Forfeited	(6,619)	26.13
Options outstanding at September 30, 2014	999,034	$ 26.18
Exercisable at September 30, 2014	394,085	$ 15.46

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

The weighted-average grant date fair value of options that were granted during the nine months ended September 30, 2014 was $32.76.

The following table provides the assumptions used in the Black-Scholes pricing model valuation of options during the nine months ended September 30, 2014 and 2013, respectively:

	Nine Months Ended September 30,	
	2014	**2013**
Risk-free interest rate	0.43 - 2.14%	1.03 - 1.98%
Expected life (years)	2.00 - 6.50	5.50 - 6.50
Expected volatility	47.82 - 49.30%	49.36 - 53.54%
Expected dividend yield	0%	0%

As of September 30, 2014, there was $8.1 million of unrecognized compensation expense related to unvested stock options, which is expected to be recognized over a weighted-average period of 3.2 years.

Restricted Stock

Restricted stock includes non-vested shares issued pursuant to grants of restricted stock awards (RSA) and grants of restricted stock units (RSU). During the nine months ended September 30, 2014, the Company granted both RSA and RSU.

Non-vested restricted stock as of September 30, 2014 and changes during the nine months ended September 30, 2014 were as follows:

	Restricted	**Weighted-Average Grant Date Fair Value Per Share**

	Stock Awards		
Nonvested restricted stock at December 31, 2013	-	$	-
Granted	74,467		69.45
Vested	(798)		62.68
Forfeited	-		-
Nonvested restricted stock at September 30, 2014	73,669	$	69.52

As of September 30, 2014, there was $4.4 million of unrecognized compensation expense related to non-vested restricted stock, which is expected to be recognized over a weighted-average period of 3.8 years.

Employee Stock Purchase Plan

The following table presents the assumptions used to estimate the fair value of the ESPP during the nine months ended September 30, 2014 and 2013, respectively:

	Nine Months Ended September 30,	
	2014	2013
Risk-free interest rate	0.01 - 0.11%	0.11 - 0.13%
Expected life (months)	6.00	6.00
Expected volatility	39.16 - 39.80%	53.14% - 53.32%
Expected dividend yield	0%	0%

Note 10 – Accumulated Other Comprehensive Income

Other comprehensive income (loss) is comprised entirely of foreign currency translation adjustments. The following table presents the changes in accumulated other comprehensive income balances during the three and nine months ended September 30, 2014 and 2013, respectively:

(in thousands)	**Three Months Ended September 30, 2014**	**2013**	**Nine Months Ended September 30, 2014**	**2013**
Foreign currency translation adjustment, net of tax				
Balance at beginning of period	$(387)	$(2,033)	$(1,091)	$(928)
Other comprehensive income before reclassifications	(1,373)	806	(669)	(299)
Amounts reclassified from accumulated other comprehensive income	-	-	-	-
Net current-period other comprehensive income	(1,373)	806	(669)	(299)
Balance at end of period	$(1,760)	$(1,227)	$(1,760)	$(1,227)

Note 11 – Income Taxes

The Company is subject to income tax in multiple jurisdictions and the use of estimates is required to determine the provision for income taxes. For the three months ended September 30, 2014 and 2013 the Company recorded an income tax provision of $5.0 million and $4.6 million, respectively. For the nine months ended September 30, 2014 and 2013 the Company recorded an income tax provision of $14.4 million and $11.8 million, respectively. The income tax provision is based on the estimated annual effective tax rate for the year applied to pre-tax income. The effective income tax rate for the three months ended September 30, 2014 was 32.5 percent compared with 34.0 percent in the same period of the prior year. The effective income tax rate for each of the nine months ended September 30, 2014 and 2013 was 31.4 percent.

The effective income tax rate for the three and nine months ended September 30, 2014 differs from the U.S. federal statutory rate of 35 percent due primarily to the mix of revenue earned in domestic and foreign tax jurisdictions and deductions for which the Company qualifies.

The Company had liabilities related to unrecognized tax benefits totaling $0.9 million at September 30, 2014 and $0.7 million December 31, 2013, all of which, if recognized, would affect the Company’s effective tax rate. The Company recognizes interest and penalties related to income tax matters in income tax expense, and reports the liability in current or long-term income taxes payable as appropriate.

During the quarter ended September 30, 2014, the Company decreased its prior year uncertain tax positions by $0.4 million due to the expiration of the statutes of limitations on the Company's 2010 federal income tax return. Also, during the quarter ended September 30, 2014, the Company increased its prior year and current year uncertain tax positions by $0.4 million and $0.5 million, respectively. The increase was due to certain tax positions not meeting the more-like-than-not standard for accounting for uncertain tax positions under the Company's current facts and circumstances.

Based upon the information available as of September 30, 2014, the Company anticipates the amount of uncertain tax positions will change in the next twelve months; however, the change cannot be estimated.

Note 12 – Revenue and Geographic Information

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

(in thousands)	Three Months Ended September 30, 2014	2013	Nine Months Ended September 30, 2014	2013
Revenue:				
Protomold	$35,655	$29,534	$104,604	$84,338
Firstcut	15,549	12,474	43,407	34,732
Fineline	3,370	-	5,503	-
Total revenue	$54,574	$42,008	$153,514	$119,070

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

(in thousands)	Three Months Ended September 30, 2014	2013	Nine Months Ended September 30, 2014	2013
Revenue:				
United States	$40,822	$30,561	$113,810	$88,816
International	13,752	11,447	39,704	30,254
Total revenue	$54,574	$42,008	$153,514	$119,070

(in thousands)	September 30, 2014	December 31, 2013
Long-lived assets:		
United States	$ 73,082	$ 48,381
International	14,880	7,720

Total long-lived assets	$ 87,962	$ 56,101

14

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our unaudited consolidated financial statements and related notes appearing elsewhere in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K for the year ended December 31, 2013.

Forward-Looking Statements

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

Overview

We are a leading online and technology-enabled manufacturer of quick-turn additive-manufactured (3D printed), CNC-machined and molded custom parts for prototyping and short-run production. We provide “Real Parts, Really Fast” to product developers worldwide, who are under increasing pressure to bring their finished products to market faster than their competition. We believe low-volume manufacturing has historically been an underserved market due to the inefficiencies inherent in the quotation, equipment set-up and non-recurring engineering processes required to produce custom parts. Our proprietary technology eliminates most of the time-consuming and expensive skilled labor conventionally required to quote and manufacture parts in low volumes, and our customers conduct nearly all of their business with us over the Internet. We target our services to the millions of product developers who use three-dimensional computer-aided design (3D CAD) software to design products across a diverse range of end-markets. Our primary manufacturing products currently include Fineline, which is our additive-manufacturing (3D printing) product line, Firstcut, which is our CNC machining product line, and Protomold, which is our molding product line.

Key Financial Measures and Trends

Revenue

The Company's operations are comprised of three geographic business units in the United States, Europe and Japan. Revenue within each of our business units is derived from our Fineline, Firstcut and Protomold product lines. Fineline revenue consists of sales of additive-manufactured custom parts, often referred to as 3D printed parts. Firstcut revenue consists of sales of CNC-machined custom parts. Protomold revenue consists of sales of custom molds and molded parts. Our historical and current efforts to increase revenue have been directed at gaining new customers and selling to our existing customer base by:

- increasing marketing and selling activities;
- offering additional services such as the acquisition in April 2014 of FineLine Prototyping, Inc. leading to the offering of Fineline additive manufacturing technologies, often times referred to as 3D printing;
- introducing our Firstcut product line in 2007;
- expanding internationally such as the opening of our Japanese plant in 2009;
- improving the usability of our services such as our web-centric applications; and
- expanding the breadth and scope of our products such as by adding more sizes and materials to our offerings such as liquid silicon rubber (LSR) and metal injection molding (MIM).

Excluding product developers we gained through the acquisition of FineLine, during the three months ended September 30, 2014, we served approximately 8,700 unique product developers, an increase of 19% over the same period in 2013. Excluding product developers we gained through the acquisition of FineLine, during the nine months ended September 30, 2014, we served approximately 15,900 unique product developers, an increase of 19% over the same period in 2013.

Cost of Revenue, Gross Profit and Gross Margin

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

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

Operating Expenses

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

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

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

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

General and administrative. General and administrative expense consists primarily of employee compensation, benefits, stock-based compensation, professional service fees related to accounting, tax and legal services, amortization of intangibles and other related overhead. We expect general and administrative expense to increase on an absolute basis as we continue to grow and expand our operations.

Other Income (Expense), Net

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

Provision for Income Taxes

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

Results of Operations

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

(dollars in thousands)	**Three Months Ended September 30,**				**Change**		**Nine Months Ended September 30,**				**Change**
	2014		**2013**		**$**	**%**	**2014**		**2013**		**$**
Revenue	$54,574	100.0%	$42,008	100.0%	$12,566	29.9%	$153,514	100.0%	$119,070	100.0%	$34,444
Cost of revenue	21,492	39.4	16,053	38.2	5,439	33.9	58,725	38.3	44,983	37.8	13,742
Gross profit	33,082	60.6	25,955	61.8	7,127	27.5	94,789	61.7	74,087	62.2	20,702
Operating expenses:											
Marketing and sales	7,351	13.5	5,409	12.9	1,942	35.9	21,029	13.7	16,222	13.6	4,807
Research and development	4,555	8.3	3,026	7.2	1,529	50.5	11,925	7.8	8,405	7.1	3,520
General and administrative	5,733	10.5	4,118	9.8	1,615	39.2	15,970	10.4	12,035	10.1	3,935
Total operating expenses	17,639	32.3	12,553	29.9	5,086	40.5	48,924	31.9	36,662	30.8	12,262
Income from operations	15,443	28.3	13,402	31.9	2,041	15.2	45,865	29.9	37,425	31.4	8,440
Other income (expense), net	(56)	(0.1)	31	0.1	(87)	*	(19)	-	149	0.1	(168
Income before income taxes	15,387	28.2	13,433	32.0	1,954	14.5	45,846	29.9	37,574	31.5	8,272
Provision for income taxes	5,003	9.2	4,561	10.9	442	9.7	14,404	9.4	11,804	9.9	2,600
Net income	$10,384	19.0 %	$8,872	21.1 %	$1,512	17.0%	$31,442	20.5 %	$25,770	21.6 %	$5,672

* Percentage change not meaningful

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

(dollars in thousands)	Three Months Ended September 30, 2014	2013	Nine Months Ended September 30, 2014	2013
Stock options and restricted stock	$1,192	$756	$3,252	$2,310
Employee stock purchase plan	121	103	309	285
Total stock-based compensation expense	$1,313	$859	$3,561	$2,595
Cost of revenue	$103	$89	$282	$233
Operating expenses:				
Marketing and sales	250	154	685	455
Research and development	287	201	770	555
General and administrative	673	415	1,824	1,352
Total stock-based compensation expense	$1,313	$859	$3,561	$2,595

Comparison of Three Months Ended September 30, 2014 and 2013

Revenue

Revenue by product line and the related changes for the three months ended September 30, 2014 and 2013 were as follows:

	Three Months Ended September 30,								
	2014			**2013**			**Change**		
(dollars in thousands)	**$**	**% of Total Revenue**		**$**	**% of Total Revenue**		**$**	**%**	
Revenue									
Protomold	$35,655	65.3	%	$29,534	70.3	%	$6,121	20.7	%
Firstcut	15,549	28.5		12,474	29.7		3,075	24.7	
Fineline	3,370	6.2		-	-		3,370	100.0	
Total revenue	$54,574	100.0	%	$42,008	100.0	%	$12,566	29.9	%

Revenue by geographic region, based on the billing location of the end customer, is summarized as follows:

	Three Months Ended September 30,								
	2014			**2013**			**Change**		
(dollars in thousands)	**$**	**% of Total Revenue**		**$**	**% of Total Revenue**		**$**	**%**	
Revenue									
United States	$40,822	74.8	%	$30,561	72.8	%	$10,261	33.6	%
International	13,752	25.2		11,447	27.2		2,305	20.1	
Total revenue	$54,574	100.0	%	$42,008	100.0	%	$12,566	29.9	%

Our revenue increased $12.6 million, or 29.9%, for the three months ended September 30, 2014 compared with the same period in 2013. This revenue growth was driven by a 33.6% increase in United States revenue, 20.1% increase in international revenue, 20.7% increase in Protomold revenue, 24.7% increase in Firstcut revenue and $3.4 million increase in revenue from the FineLine acquisition, in all cases for the three months ended September 30, 2014 compared with the same period in 2013.

Within our legacy Firstcut and Protomold product lines, our revenue growth in the three months ended September 30, 2014 was the result of increased number and spending of the product developers we served. During the three months ended September 30, 2014, excluding product developers who purchased Fineline products, we served approximately 8,700 unique product developers, an increase of 18.8% over the same period in 2013. Average revenue per product developer, excluding product developers who only purchased Fineline products, also increased 2.6% during the three months ended September 30, 2014 compared to the same period in 2013.

Excluding revenue gained through the acquisition of FineLine, our revenue increases were primarily driven by increases in sales personnel and marketing activities. Our sales personnel focus on gaining new customer accounts and expanding the depth and breadth into existing customer accounts. Our marketing personnel focus on trade show and marketing activities that have proven to result in the greatest number of customer leads to support sales activity. International revenue was favorably impacted by $0.6 million in the three months ended September 30, 2014 compared to the same period in 2013 due to weakening of the United States dollar relative to certain foreign currencies, particularly the British Pound. The effect of pricing changes on revenue was immaterial for the three months ended September 30, 2014 compared to the same period in 2013.

Cost of Revenue, Gross Profit and Gross Margin

Cost of Revenue. Cost of revenue increased $5.4 million, or 33.9%, for the three months ended September 30, 2014 compared to the same period in 2013, which was faster than the rate of revenue increase of 29.9% for the three months ended September 30, 2014 compared to the same period in 2013. The increase in cost of revenue was due to raw material and production cost increases of $1.5 million to support increased sales volumes, equipment and facility-related cost increases of $0.9 million and an increase in direct labor headcount resulting in personnel and related cost increases of $3.0 million.

Gross Profit and Gross Margin. Gross profit increased to $33.1 million, or 60.6% of revenues, for the three months ended September 30, 2014 from $26.0 million, or 61.8% of revenues, for the three months ended September 30, 2013 due to increases in revenue offset by the cost of revenue as discussed above. Gross margin decreased primarily as a result of our Fineline product line having a lower gross margin than our legacy Firstcut and Protomold product lines.

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

Marketing and Sales. Marketing and sales expense increased $1.9 million, or 35.9%, for the three months ended September 30, 2014 compared to the same period in 2013 due primarily to an increase in headcount resulting in personnel and related cost increases of $1.3 million and marketing program cost increases of $0.6 million. The increase in marketing program costs is the result of our focus and concentration on funding those programs which have proven to be the most effective in growing our business.

Research and Development. Our research and development expense increased $1.5 million, or 50.5%, for the three months ended September 30, 2014 compared to the same period in 2013 due to an increase in headcount resulting in personnel and related cost increases of $1.3 million and operating cost increases of $0.2 million.

General and Administrative. Our general and administrative expense increased $1.6 million, or 39.2%, for the three months ended September 30, 2014 compared to the same period in 2013 due to an increase in headcount resulting in personnel and related cost increases of $0.7 million, stock-based compensation costs increases of $0.3 million, administrative cost increases of $0.2 million, intangible amortization expense cost increases of $0.2 and professional services cost increases of $0.2 million.

Other Income (Expense), net. Other income, net decreased $0.1 million for the three months ended September 30, 2014 compared to the same period in 2013 due to changes in foreign currency rates.

Provision for Income Taxes. Our effective tax rate of 32.5% for the three months ended September 30, 2014 decreased 1.5% when compared to 34.0% for the same period in 2013. The decrease in the effective tax rate is primarily due to our foreign rate differential and an increase in tax benefit from the domestic manufacturing deduction projected for the tax year ending December 31, 2014. As a result of increased income attributable to the fluctuations described above, our income tax provision increased by $0.4 million to $5.0 million for the three months ended September 30, 2014 compared to our income tax provision of $4.6 million for the three months ended September 30, 2013.

Comparison of Nine Months Ended September 30, 2014 and 2013

Revenue

Revenue by product line and the related changes for the nine months ended September 30, 2014 and 2013 were as follows:

	Nine Months Ended September 30,								
	2014			**2013**			**Change**		
(dollars in thousands)	**$**	**% of Total Revenue**		**$**	**% of Total Revenue**		**$**	**%**	
Revenue									
Protomold	$104,604	68.1	%	$84,338	70.8	%	$20,266	24.0	%
Firstcut	43,407	28.3		34,732	29.2		8,675	25.0	
Fineline	5,503	3.6		-	-		5,503	100.0	
Total revenue	$153,514	100.0	%	$119,070	100.0	%	$34,444	28.9	%

Revenue by geographic region, based on the billing location of the end customer, is summarized as follows:

	Nine Months Ended September 30,					
	2014		2013		Change	
(dollars in thousands)	$	% of Total Revenue	$	% of Total Revenue	$	%
Revenue						
United States	$113,810	74.1 %	$88,816	74.6 %	$24,994	28.1%
International	39,704	25.9	30,254	25.4	9,450	31.2
Total revenue	$153,514	100.0 %	$119,070	100.0 %	$34,444	28.9%

Our revenue increased $34.4 million, or 28.9%, for the nine months ended September 30, 2014 compared with the same period in 2013. This revenue growth was driven by a 28.1% increase in United States revenue, 31.2% increase in international revenue, 24.0% increase in Protomold revenue, 25.0% increase in Firstcut revenue and $5.5 million in revenue from the FineLine acquisition, in each case for the nine months ended September 30, 2014 compared with the same period in 2013.

Within our legacy Firstcut and Protomold product lines, our revenue growth in the nine months ended September 30, 2014 was the result of increased number and spending of the product developers we served. During the nine months ended September 30, 2014, excluding product developers who purchased Fineline products, we served approximately 15,900 unique product developers, an increase of 18.8% over the same period in 2013. Average revenue per product developer, excluding product developers who only purchased Fineline products, also increased 4.6% during the nine months ended September 30, 2014 compared to the same period in 2013.

Excluding revenue gained through the acquisition of FineLine, our revenue increases were primarily driven by increases in sales personnel and marketing activities. Our sales personnel focus on gaining new customer accounts and expanding the depth and breadth into existing customer accounts. Our marketing personnel focus on trade show and marketing activities that have proven to result in the greatest number of customer leads to support sales activity. International revenue was favorably impacted by $1.7 million in the nine months ended September 30, 2014 compared to the same period in 2013 due to the weakening of United States dollar relative to certain foreign currency, particularly the British Pound. The effect of pricing changes on revenue was immaterial for the nine months ended September 30, 2014 compared to the same period in 2013.

Cost of Revenue, Gross Profit and Gross Margin

Cost of Revenue. Cost of revenue increased $13.7 million, or 30.5%, for the nine months ended September 30, 2014 compared to the same period in 2013, which was higher than the rate of revenue increase of 28.9% for the nine months ended September 30, 2014. The increase in cost of revenue was due to raw material and production cost increases of $3.8 million to support increased sales volumes, equipment and facility-related cost increases of $2.3 million and an increase in direct labor headcount resulting in personnel and related cost increases of $7.6 million.

Gross Profit and Gross Margin. Gross profit increased to $94.8 million, or 61.7% of revenues, for the nine months ended September 30, 2014 from $74.1 million, or 62.2% of revenues, for the nine months ended September 30, 2013 due to increases in revenue offset by the cost of revenue as discussed above. Gross margin decreased primarily as a result of our Fineline product line having a lower gross margin than our legacy Firstcut and Protomold product lines and the move to our new facility in Plymouth, Minnesota.

Operating Expenses, Other Income (Expenses), Net and Provision for Income Taxes

Marketing and Sales. Marketing and sales expense increased $4.8 million, or 29.6%, for the nine months ended September 30, 2014 compared to the same period in 2013 due primarily to an increase in headcount resulting in personnel and related cost increases of $3.5 million and marketing program cost increases of $1.3 million. The increase in marketing program costs is the result of our focus and concentration on funding those programs which have proven to be the most effective in growing our business.

Research and Development. Our research and development expense increased $3.5 million, or 41.9%, for the nine months ended September 30, 2014 compared to the same period in 2013 due to an increase in headcount resulting in personnel and related cost increases of $2.9 million and operating cost increases of $0.6 million.

General and Administrative. Our general and administrative expense increased $3.9 million, or 32.7%, for the nine months ended September 30, 2014 compared to the same period in 2013 due to an increase in headcount resulting in personnel and related cost increases of $1.5 million, professional services cost increases of $1.1 million, stock-based compensation costs increases of $0.5 million, administrative cost increases of $0.5 million, and intangible amortization expense cost increases of $0.3 million.

Other Income (Expense), Net. Our other income, net decreased $0.2 million for the nine months ended September 30, 2014 compared to the same period in 2013 due to foreign currency change decreases of $0.3 million, which were partially offset by investment interest income increases of $0.1 million.

Provision for Income Taxes. Our effective tax rate of 31.4% for the nine months ended September 30, 2014 was unchanged from our effective tax rate of 31.4% for the same period in 2013. Refer to Note 11 for additional information. As a result of the increased income attributable to the fluctuations described above, our income tax provision increased by $2.6 million to $14.4 million for the nine months ended September 30, 2014 compared to our income tax provision of $11.8 million for the nine months ended September 30, 2013.

Liquidity and Capital Resources

Cash Flows

The following table summarizes our cash flows for the nine months ended September, 2014 and 2013:

(dollars in thousands)	Nine Months Ended September 30, 2014	2013
Net cash provided by operating activities	$40,004	$34,900
Net cash used in investing activities	(55,234)	(44,970)
Net cash provided by financing activities	6,540	12,622
Effect of exchange rates on cash and cash equivalents	(81)	71
Net increase (decrease) in cash and cash equivalents	$(8,771)	$2,623

Sources of Liquidity

Historically we have financed our operations and capital expenditures primarily through cash flow from operations and, to a lesser extent, lease financing. We had cash and cash equivalents of $34.3 million as of September 30, 2014, a decrease of $8.8 million from December 31, 2013. The decrease in our cash was primarily due to the purchase of FineLine Prototyping, Inc. as discussed in Note 3 to the consolidated financial statements appearing in Part I, Item 1 in this Quarterly Report on Form 10-Q.

Cash Flows from Operating Activities

Cash provided by operating activities was $40.0 million for the nine months ended September 30, 2014. We had net income of $31.4 million, which included non-cash charges consisting of $7.7 million in depreciation and amortization, $3.6 million in stock-based compensation, $1.2 million in amortization of held-to-maturity securities and $0.5 million in deferred taxes, partially offset by $4.4 million of excess tax benefit on stock-based compensation. Other uses of cash in operating activities had no net impact on cash provided by operating activities, which included an increase in accounts receivable of $6.3 million, increase in inventory of $0.3 million and increase in prepaid expenses and other of $0.7 million, which were fully offset by an increase in accrued liabilities and other of $1.9 million, increase in accounts payable of $1.4 million and income taxes-related activity of $4.0 million resulting from the excess tax benefit described above partially offset by the increase in income taxes receivable. These operating cash increases in accounts receivable, accounts payable, inventories and other reflect increases in revenue and the growth of our business.

Cash provided by operating activities was $34.9 million for the nine months ended September 30, 2013. We had net income of $25.8 million, which included non-cash charges consisting of $5.5 million in depreciation, $2.6 million in stock-based compensation, $1.0 million in amortization of held-to-maturity securities and $0.1 million in loss on the disposal of property and equipment, offset by $8.2 million of excess tax benefit on stock-based compensation and $0.1 million of deferred taxes. Other sources of cash in operating activities totaled $8.2 million, which included an increase in income taxes payable of $6.1 million, increase in prepaid expenses and other of $1.5 million, increase in accounts payable of $1.6 million and increase in accrued liabilities and other of $1.6 million, which were partially offset by an increase in accounts receivable of $2.2 million and increase in inventories of $0.4 million. These operating cash increases in accounts receivable, accounts payable, inventories and other reflect increases in revenue and the growth of our business.

Cash Flows from Investing Activities

Cash used in investing activities was $55.2 million for the nine months ended September 30, 2014, consisting of $35.9 million for the purchase of property and equipment, $33.9 million for the payments on business acquisitions and $47.3 million for the purchase of marketable securities, which were partially offset by $61.9 million in proceeds from the maturities, sales and call redemptions of marketable securities.

Cash used in investing activities was $45.0 million for the nine months ended September 30, 2013, consisting of $13.0 million for the purchase of property and equipment and $82.7 million for the purchase of marketable securities, which were partially offset by $50.7 million in proceeds from the maturities and call redemptions of marketable securities.

Cash Flows from Financing Activities

Cash provided by financing activities was $6.5 million for the nine months ended September 30, 2014, consisting of proceeds from exercises of stock options of $3.9 million and $4.4 million in excess tax benefit on stock-based compensation, which were partially offset by $1.0 million for payments of debt and $0.8 million for payments of acquisition-related contingent consideration.

Cash provided by financing activities was $12.6 million for the nine months ended September 30, 2013, consisting of excess tax benefit on stock-based compensation of $8.2 million and $4.6 million in proceeds from exercises of stock options, partially offset by $0.2 million for payments of debt.

Off-Balance Sheet Arrangements

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

Critical Accounting Policies and Use of Estimates

We have adopted various accounting policies to prepare the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). Our significant accounting policies are disclosed in Note 2 to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2013. There were no material changes in our significant accounting policies, with the following change made to goodwill and intangible assets during the nine months ended September 30, 2014.

Goodwill

We recognize goodwill in accordance with ASC 350, *Intangibles - Goodwill and Other* (ASC 350). Goodwill is the excess of cost of an acquired entity over the amounts assigned to assets acquired and liabilities assumed in a business combination. Goodwill is not amortized. Goodwill is tested for impairment annually in the fourth quarter of each year, and is tested for impairment between annual tests if an event occurs or circumstances change that would indicate the carrying amount may be impaired. An impairment charge for goodwill is recognized only when the estimated fair value of a reporting unit, including goodwill, is less than its carrying amount.

Other Intangible Assets

We recognize other intangibles assets in accordance with ASC 350, *Intangibles - Goodwill and Other* (ASC 350). Other intangible assets include internally developed software, customer relationships and other intangible assets acquired from an independent party. Other intangible assets with a definite life are amortized over a period ranging from two to 10 years on a straight line basis. Other intangible assets with a definite life are tested for impairment whenever events or circumstances indicate that the carrying amount of an asset (asset group) may not be recoverable. An impairment loss is recognized when the carrying amount of an asset exceeds the estimated undiscounted cash flows used in determining the fair value of the asset. The amount of the impairment loss recorded is calculated by the excess of the asset's carrying value over its fair value.

Recent Accounting Pronouncements

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

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Foreign Currency Risk

As a result of our foreign operations, we have revenue and expenses, assets and liabilities that are denominated in foreign currencies. A number of our employees are located in Europe and Japan. Therefore, a portion of our payrolls and operating expenses are paid and incurred in the British Pound, Euro and Yen. Our operating results and cash flows are adversely impacted when the U.S. dollar depreciates relative to other foreign currencies. We have not used any forward contracts or currency borrowings to hedge our exposure to foreign currency exchange risk. Foreign currency risk can be quantified by estimating the change in cash flows resulting from a hypothetical 10% adverse change in foreign exchange rates. We believe such a change would not have a material impact on our results of operations.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Control over Financial Reporting

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

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

The risk factor discussed below updates the risk factors we previously disclosed in Part I, Item 1A. "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2013.

Our acquisition of FineLine Prototyping, Inc. presents risks to our business and could harm our operating results and financial condition.

On April 23, 2014, we entered into a stock purchase agreement for the purchase of all of the outstanding shares of capital stock of FineLine Prototyping, Inc. At the closing, we paid cash consideration of $34.5 million to the sellers, which amount is subject to adjustment based on FineLine's indebtedness and net working capital as of the closing date and FineLine's expenses in connection with the transactions contemplated by the stock purchase agreement. The stock purchase agreement also provides that we will pay the sellers up to an additional $3 million if FineLine's revenue for 2014 exceeds certain amounts and if certain milestones relating to the integration of FineLine's and our businesses are achieved. FineLine provides additive manufacturing (3D printing) services. Our acquisition of FineLine subjects us to certain risks, including:

- We have not previously provided additive manufacturing services and the complexity of our operations therefore has increased, and we may not be able to maintain or grow the newly acquired portion of our business as quickly or significantly as anticipated, or at all;
- Integrating FineLine's operations with our historic operations could divert management's attention and cause our results of operations to suffer;
- We may be unable to integrate successfully FineLine's business and realize the anticipated benefits of the acquisition;

Our acquisition of FineLine includes significant goodwill, which could result in future impairment charges that would reduce our earnings;
Our acquisition of FineLine and the integration of its business may involve unexpected costs, unexpected liabilities or unexpected delays; and
Our acquisition of FineLine may harm relationships with FineLine's customers, suppliers and employees.

Any failure to successfully address these challenges or risks could disrupt our business and harm our operating results and financial condition.

Item 6. Exhibits

The following documents are filed as part of this report:

Exhibit Number	**Description of Exhibit**
3.1[1]	Third Amended and Restated Articles of Incorporation of Proto Labs, Inc.
3.2[2]	Amended and Restated By-Laws of Proto Labs, Inc.
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act
32.1	Certification of the Chief Executive Officer and the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

(1) Previously filed as Exhibit 3.2 to the Company's Registration Statement on Form S-1/A (File No. 333-175745), filed with the Commission on February 13, 2012, and incorporated by reference herein.

(2) Previously filed as Exhibit 3.4 to the Company's Registration Statement on Form S-1/A (File No. 333-175745), filed with the Commission on February 13, 2012, and incorporated by reference herein.

SIGNATURE

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

Proto Labs, Inc.

Date: November 4, 2014

/s/ Victoria M. Holt
Victoria M. Holt
President and Chief Executive Officer
(Principal Executive Officer)

Date: November 4, 2014

/s/ John R. Judd
John R. Judd
Chief Financial Officer
(Principal Financial Officer)