

Proto Labs Inc
Form 10-Q
November 03, 2015

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, 2015

or

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

For the transition period from _____ to _____

Commission File Number: 001-35435

Proto Labs, Inc.

(Exact name of registrant as specified in its charter)

Minnesota

(State or other jurisdiction of
incorporation or organization)

41-1939628

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

**5540 Pioneer Creek Drive
Maple Plain, Minnesota**

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: 26,163,402 shares of Common Stock, par value \$0.001 per share, were outstanding at October 28, 2015.

Proto Labs, Inc.

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PART I. FINANCIAL INFORMATION**Item 1. Financial Statements****Proto Labs, Inc.****Consolidated Balance Sheets****(In thousands, except share and per share amounts)**

	September 30, 2015 (Unaudited)	December 31, 2014
Assets		
Current assets		
Cash and cash equivalents	\$ 64,131	\$ 43,329
Short-term marketable securities	28,062	30,706
Accounts receivable, net of allowance for doubtful accounts of \$222 and \$198 as of September 30, 2015 and December 31, 2014, respectively	32,897	24,226
Inventory	7,228	6,194
Prepaid expenses and other current assets	5,733	3,406
Income taxes receivable	4,029	-
Deferred tax assets	460	483
Total current assets	142,540	108,344
Property and equipment, net	108,626	91,626
Goodwill	28,916	28,916
Other intangible assets, net	3,523	4,083
Long-term marketable securities	57,801	54,318
Other long-term assets	520	227
Total assets	\$ 341,926	\$ 287,514
Liabilities and shareholders' equity		
Current liabilities		
Accounts payable	\$ 11,552	\$ 7,882
Accrued compensation	10,519	6,067
Accrued liabilities and other	2,424	2,718
Income taxes payable	-	1,953
Current portion of long-term debt obligations	39	139
Total current liabilities	24,534	18,759
Long-term deferred tax liabilities	1,488	1,846
Long-term debt obligations	-	10

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Other long-term liabilities	1,716	1,360
Total liabilities	27,738	21,975
Shareholders' equity		
Preferred stock, \$0.001 par value, authorized 10,000,000 shares; issued and outstanding 0 shares as of each of September 30, 2015 and December 31, 2014	-	-
Common stock, \$0.001 par value, authorized 150,000,000 shares; issued and outstanding 26,159,735 and 25,838,110 shares as of September 30, 2015 and December 31, 2014, respectively	26	26
Additional paid-in capital	195,856	180,960
Retained earnings	122,002	87,482
Accumulated other comprehensive loss	(3,696)	(2,929)
Total shareholders' equity	314,188	265,539
Total liabilities and shareholders' equity	\$ 341,926	\$ 287,514

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

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Statements of Operations:				
Revenue	\$67,842	\$54,574	\$190,347	\$153,514
Cost of revenue	27,517	21,492	77,218	58,725
Gross profit	40,325	33,082	113,129	94,789
Operating expenses				
Marketing and sales	10,027	7,351	28,383	21,029
Research and development	4,760	4,555	13,471	11,925
General and administrative	8,134	5,733	20,683	15,970
Total operating expenses	22,921	17,639	62,537	48,924
Income from operations	17,404	15,443	50,592	45,865
Other income (expense), net	593	(56)	) 100	(19)
Income before income taxes	17,997	15,387	50,692	45,846
Provision for income taxes	5,615	5,003	16,171	14,404
Net income	\$12,382	\$10,384	\$34,521	\$31,442
Net income per share:				
Basic	\$0.47	\$0.40	\$1.33	\$1.23
Diluted	\$0.47	\$0.40	\$1.31	\$1.20
Shares used to compute net income per share:				
Basic	26,083,405	25,757,593	25,952,451	25,651,156
Diluted	26,381,313	26,200,741	26,290,758	26,109,539
Comprehensive Income (net of tax)				
Comprehensive income	\$11,416	\$9,011	\$33,754	\$30,773

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, 2015 2014	
Operating activities		
Net income	\$34,521	\$31,442
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	10,422	7,696
Stock-based compensation expense	4,515	3,561
Deferred taxes	(310)	487
Excess tax benefit from stock-based compensation	(5,212)	(4,383)
Amortization of held-to-maturity securities	936	1,194
Changes in operating assets and liabilities:		
Accounts receivable	(8,827)	(6,302)
Inventories	(1,117)	(339)
Prepaid expenses and other	(2,596)	(706)
Income taxes	(546)	4,032
Accounts payable	3,744	1,414
Accrued liabilities and other	5,754	1,908
Net cash provided by operating activities	41,284	40,004
Investing activities		
Purchases of property and equipment	(27,259)	(35,928)
Acquisitions, net of cash acquired	-	(33,864)
Purchases of marketable securities	(42,674)	(47,338)
Proceeds from sales and maturities of marketable securities	40,899	61,896
Net cash used in investing activities	(29,034)	(55,234)
Financing activities		
Payments on debt	(107)	(1,005)
Acquisition-related contingent consideration	(1,400)	(800)
Proceeds from exercises of stock options and other	5,165	3,962
Excess tax benefit from stock-based compensation	5,212	4,383
Net cash provided by financing activities	8,870	6,540
Effect of exchange rate changes on cash and cash equivalents	(318)	(81)

Net increase (decrease) in cash and cash equivalents	20,802	(8,771)
Cash and cash equivalents, beginning of period	43,329	43,039
Cash and cash equivalents, end of period	\$64,131	\$34,268

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

Proto Labs, Inc.

Notes to Consolidated Financial Statements

(Unaudited)

Note 1 – Basis of Presentation

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

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

During the three months ended September 30, 2015, the Company adjusted the useful lives of its primary production equipment based on experience and condition of current equipment. This change in accounting estimate is accounted for prospectively, and therefore had no effect on property and equipment, net as previously reported. This change was not material.

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

The accompanying Consolidated Balance Sheet as of December 31, 2014 was derived from the audited Consolidated Financial Statements but does not include all disclosures required by U.S. GAAP for a full set of financial statements.

This Form 10-Q should be read in conjunction with the Company's Consolidated Financial Statements and Notes included in the Annual Report on Form 10-K filed on February 27, 2015 as referenced above.

Note 2 – Recent Accounting Pronouncements

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

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

Note 3 – Net Income per Common Share

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

Proto Labs, Inc.**Notes to Consolidated Financial Statements****(Unaudited)**

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,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net income	\$12,382	\$10,384	\$34,521	\$31,442
Basic - weighted-average shares outstanding:	26,083,405	25,757,593	25,952,451	25,651,156
Effect of dilutive securities:				
Employee stock options and other	297,908	443,148	338,307	458,383
Diluted - weighted-average shares outstanding:	26,381,313	26,200,741	26,290,758	26,109,539
Net income per share:				
Basic	\$0.47	\$0.40	\$1.33	\$1.23
Diluted	\$0.47	\$0.40	\$1.31	\$1.20

Note 4 – Goodwill and Other Intangible Assets

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

(in thousands)	Nine Months Ended September 30, 2015
Balance as of the beginning of the period	\$ 28,916

Goodwill acquired during the period	-
Balance as of the end of the period	\$ 28,916

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

(in thousands)	September 30, 2015			December 31, 2014			Useful Life (in years)	Weighted Average Useful Life Remaining (in years)
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net		
Intangible Assets with finite lives:								
Marketing assets	\$930	\$ (132)	\$798	\$930	\$ (62)	\$868	10.0	8.6
Non-compete agreement	190	(135)	55	190	(63)	127	2.0	0.6
Trade secrets	250	(71)	179	250	(33)	217	5.0	3.6
Internally developed software	680	(321)	359	680	(151)	529	3.0	1.6
Customer relationships	2,530	(398)	2,132	2,530	(188)	2,342	9.0	7.6
Total intangible assets	\$4,580	\$ (1,057)	\$3,523	\$4,580	\$ (497)	\$4,083		

Amortization expense for intangible assets for the three and nine months ended September 30, 2015 was \$0.2 million and \$0.6 million, respectively. Amortization expense for intangible assets, which were acquired in the purchase of FineLine in April 2014, was \$0.2 million and \$0.3 million for the three and nine months ended September 30, 2014, respectively.

Proto Labs, Inc.**Notes to Consolidated Financial Statements****(Unaudited)**

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

(in thousands)	Estimated Amortization Expense
Remaining 2015	\$ 186
2016	682
2017	500
2018	424
2019	391
Thereafter	1,340
Total estimated amortization expense	\$ 3,523

Note 5 – Fair Value Measurements

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

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

Level 2—Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices

in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

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

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

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

(in thousands)	September 30, 2015			December 31, 2014		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Financial Assets:						
Cash and cash equivalents						
Money market mutual fund	\$ 15,698	\$ -	\$ -	\$ 6,129	\$ -	\$ -
Total	\$ 15,698	\$ -	\$ -	\$ 6,129	\$ -	\$ -

Proto Labs, Inc.**Notes to Consolidated Financial Statements****(Unaudited)****Note 6 – Marketable Securities**

The Company invests in short-term and long-term agency, municipal, corporate 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, 2015 and December 31, 2014 is as follows:

(in thousands)	September 30, 2015			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. municipal securities	\$34,343	\$ 32	\$ (8)	) \$34,367
Corporate debt securities	26,995	16	(19)	) 26,992
U.S. government agency securities	18,866	11	(17)	) 18,860
Certificates of deposit/time deposits	5,659	8	-	) 5,667
Total marketable securities	\$85,863	\$ 67	\$ (44)	) \$85,886

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

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

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

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

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

(in thousands)	September 30, 2015
Due in one year or less	\$ 28,062
Due after one year through five years	57,801
Total marketable securities	\$ 85,863

Note 7 – Inventory

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

Proto Labs, Inc.**Notes to Consolidated Financial Statements****(Unaudited)**

The Company's inventory consisted of the following as of the dates indicated:

	September	December
	30,	31,
(in thousands)	2015	2014
Raw materials	\$ 6,528	\$ 5,728
Work in process	905	653
Total inventory	7,433	6,381
Allowance for obsolescence	(205)	(187)
Inventory, net of allowance	\$ 7,228	\$ 6,194

Note 8 – Stock-Based Compensation

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

Employee Stock Purchase Plan

The Company's 2012 Employee Stock Purchase Plan (ESPP) allows eligible employees to purchase shares of the Company's common stock at a discount through payroll deductions of up to 15 percent of their eligible compensation,

subject to plan limitations. The ESPP provides for six-month offering periods ending May 15 and November 15, respectively. At the end of each offering period, employees are able to purchase shares at 85 percent of the lower of the fair market value of the Company's common stock on the first trading day of the offering period or on the last trading day of the offering period.

Stock-Based Compensation Expense

Stock-based compensation expense was \$1.6 million and \$1.3 million for the three months ended September 30, 2015 and 2014, respectively, and \$4.5 million and \$3.6 million for the nine months ended September 30, 2015 and 2014, respectively.

Stock Options

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

	Stock Options	Weighted- Average Exercise Price
Options outstanding at December 31, 2014	998,987	\$ 26.49
Granted	110,335	67.36
Exercised	(292,590)	14.76
Forfeited	(25,915)	52.22
Options outstanding at September 30, 2015	790,817	\$ 35.69
Exercisable at September 30, 2015	310,568	\$ 22.45

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,

2015 was \$32.42.

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Proto Labs, Inc.**Notes to Consolidated Financial Statements****(Unaudited)**

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

	Nine Months Ended September 30,			
	2015		2014	
Risk-free interest rate	1.69 -	1.77%	0.43 -	2.14%
Expected life (years)	5.50 -	6.50	2.00 -	6.50
Expected volatility	46.80-	47.23%	47.82-	49.30%
Expected dividend yield		0%		0%

As of September 30, 2015, there was \$7.9 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 awards are share settled awards and restrictions lapse ratably over the vesting period, which is generally a five-year period, beginning on the first anniversary of the grant date, subject to the employee's continuing service to the Company. For directors, restrictions generally lapse in full on the first anniversary of the grant date.

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

Weighted-

	Restricted Stock	Average Grant Date Fair Value Per Share
Restricted stock at December 31, 2014	76,574	\$ 69.27
Granted	68,580	68.89
Restrictions lapsed	(16,227)	69.50
Forfeited	(1,858)	78.59
Restricted stock at September 30, 2015	127,069	\$ 68.90

As of September 30, 2015, there was \$7.3 million of unrecognized compensation expense related to non-vested restricted stock, which is expected to be recognized over a weighted-average period of 3.9 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, 2015 and 2014, respectively:

	Nine Months Ended September 30,					
	2015			2014		
Risk-free interest rate	0.08	-	0.10%	0.01	-	0.11%
Expected life (months)		6.00			6.00	
Expected volatility	33.68	-	37.64%	39.16	-	39.80%
Expected dividend yield		0%			0%	

Proto Labs, Inc.**Notes to Consolidated Financial Statements****(Unaudited)****Note 9 – Accumulated Other Comprehensive Income (Loss)**

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

(in thousands)	Three Months Ended September 30, 2015		Nine Months Ended September 30, 2015	
Foreign currency translation adjustments				
Balance at beginning of period	\$(2,730)	\$(387)	\$(2,929)	\$(1,091)
Other comprehensive loss before reclassifications	(966)	(1,373)	(767)	(669)
Amounts reclassified from accumulated other comprehensive income (loss)	-	-	-	-
Net current-period other comprehensive loss	(966)	(1,373)	(767)	(669)
Balance at end of period	\$(3,696)	\$(1,760)	\$(3,696)	\$(1,760)

Note 10 – Income Taxes

The Company is subject to income tax in multiple jurisdictions and the use of estimates is required to determine the provision for income taxes. For the three months ended September 30, 2015 and 2014, the Company recorded an income tax provision of \$5.6 million and \$5.0 million, respectively. For the nine months ended September 30, 2015 and 2014, the Company recorded an income tax provision of \$16.2 million and \$14.4 million, respectively. The income tax provision is based on the estimated annual effective tax rate for the year applied to pre-tax income. The effective income tax rate for the three months ended September 30, 2015 was 31.2 percent compared to 32.5 percent

in the same period of the prior year. The effective income tax rate for the nine months ended September 30, 2015 was 31.9 percent compared to 31.4 percent in the same period of the prior year.

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

The Company had liabilities related to unrecognized tax benefits totaling \$1.7 million at September 30, 2015 and \$1.3 million at December 31, 2014, all of which, if recognized, would affect the Company's effective tax rate. The Company recognizes interest and penalties related to income tax matters in income tax expense, and reports the liability in current or long-term income taxes payable as appropriate.

During the nine months ended September 30, 2015, the Company increased its current year uncertain tax positions by \$0.4 million. Based upon the information available as of September 30, 2015, the Company anticipates the amount of uncertain tax positions will change in the next twelve months; however, the change is not expected to be material.

Note 11 – Revenue and Geographic Information

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2015	2014	2015	2014
Revenue:				
Protomold	\$41,971	\$35,655	\$119,521	\$104,604
Firstcut	19,833	15,549	54,788	43,407
Fineline	6,038	3,370	16,038	5,503
Total revenue	\$67,842	\$54,574	\$190,347	\$153,514

Proto Labs, Inc.**Notes to Consolidated Financial Statements****(Unaudited)**

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2015	2014	2015	2014
Revenue:				
United States	\$50,214	\$40,822	\$144,357	\$113,810
International	17,628	13,752	45,990	39,704
Total revenue	\$67,842	\$54,574	\$190,347	\$153,514

	September 30, 2015	December 31, 2014
(in thousands)		
Long-lived assets:		
United States	\$ 90,683	\$ 76,923
International	17,943	14,703
Total long-lived assets	\$ 108,626	\$ 91,626

Note 12 – Subsequent Events

In October 2015, the Company acquired certain assets and shares of Alphaform AG, a provider of additive manufacturing, injection molding and other services. Total consideration paid for this acquisition was \$5.5 million.

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

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

Forward-Looking Statements

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

Overview

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

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

(3D CAD) software to design products across a diverse range of end-markets.

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

Protomold

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

Firstcut

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

Fineline

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

Key Financial Measures and Trends

Revenue

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

- increasing marketing and selling activities;

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

- introducing our Firstcut product line in 2007;

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

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

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

During the three months ended September 30, 2015, we served approximately 12,500 unique product developers and engineers, an increase of 24% over the same period in 2014. During the nine months ended September 30, 2015, we served approximately 22,600 unique product developers and engineers, an increase of 29% over the same period in 2014. These product developers and engineers are served under all our product lines, including Fineline, which we added via our acquisition of FineLine Prototyping, Inc. in April 2014.

Cost of Revenue, Gross Profit and Gross Margin

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

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

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

Operating Expenses

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

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

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

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

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

Other Income (Expense), Net

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

Provision for Income Taxes

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

Results of Operations

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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	
	2015		2014		\$	%	2015		2014		\$	%
Revenue	\$67,842	100.0%	\$54,574	100.0%	\$13,268	24.3%	\$190,347	100.0%	\$153,514	100.0%	\$36,833	
Cost of revenue	27,517	40.6	21,492	39.4	6,025	28.0	77,218	40.6	58,725	38.3	18,493	
Gross profit	40,325	59.4	33,082	60.6	7,243	21.9	113,129	59.4	94,789	61.7	18,340	
Operating expenses:												
Marketing and sales	10,027	14.7	7,351	13.5	2,676	36.4	28,383	14.9	21,029	13.7	7,354	
Research and development	4,760	7.0	4,555	8.3	205	4.5	13,471	7.1	11,925	7.8	1,546	
General and administrative	8,134	12.0	5,733	10.5	2,401	41.9	20,683	10.9	15,970	10.4	4,713	
Total operating expenses	22,921	33.7	17,639	32.3	5,282	29.9	62,537	32.9	48,924	31.9	13,613	
Income from operations	17,404	25.7	15,443	28.3	1,961	12.7	50,592	26.6	45,865	29.9	4,727	
Other income (expense), net	593	0.9	(56)	(0.1)	649	*	100	0.1	(19)	(0.0)	119	
Income before income taxes	17,997	26.6	15,387	28.2	2,610	17.0	50,692	26.7	45,846	29.9	4,846	
Provision for income taxes	5,615	8.3	5,003	9.2	612	12.2	16,171	8.5	14,404	9.4	1,767	
Net income	\$12,382	18.3 %	\$10,384	19.0 %	\$1,998	19.2%	\$34,521	18.1 %	\$31,442	20.5 %	\$3,079	

* Percentage change not meaningful

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
(dollars in thousands)	2015	2014	2015	2014
Stock options and restricted stock	\$1,483	\$1,192	\$4,138	\$3,252
Employee stock purchase plan	123	121	377	309
Total stock-based compensation expense	\$1,606	\$1,313	\$4,515	\$3,561
Cost of revenue	\$136	\$103	\$378	\$282
Operating expenses:				
Marketing and sales	288	250	796	685
Research and development	335	287	964	770
General and administrative	847	673	2,377	1,824
Total stock-based compensation expense	\$1,606	\$1,313	\$4,515	\$3,561

Comparison of Three Months Ended September 30, 2015 and 2014

Revenue

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

	Three Months Ended September 30,		Change	
	2015	2014	\$	%
(dollars in thousands) \$	% of Total Revenue	\$	% of Total Revenue	
Revenue				

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Protomold	\$41,971	61.9	% \$35,655	65.3	% \$6,316	17.7%
Firstcut	19,833	29.2	15,549	28.5	4,284	27.6
Fineline	6,038	8.9	3,370	6.2	2,668	79.2
Total revenue	\$67,842	100.0	% \$54,574	100.0	% \$13,268	24.3%

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

(dollars in thousands)	Three Months Ended September 30, 2015		2014		Change	
	\$	% of Total Revenue	\$	% of Total Revenue	\$	%
Revenue						
United States	\$50,214	74.0	% \$40,822	74.8	% \$9,392	23.0%
International	17,628	26.0	13,752	25.2	3,876	28.2
Total revenue	\$67,842	100.0	% \$54,574	100.0	% \$13,268	24.3%

Our revenue increased \$13.3 million, or 24.3%, for the three months ended September 30, 2015 compared to the same period in 2014. By geographic region, this revenue growth was driven by a 23.0% increase in United States revenue and a 28.2% increase in international revenue. By product line, this revenue growth was driven by a 17.7% increase in Protomold revenue, 27.6% increase in Firstcut revenue and 79.2% increase in Fineline revenue in each case for the three months ended September 30, 2015 compared to the same period in 2014.

Our revenue growth during the three months ended September 30, 2015 was the result of increased volume of the product developers and engineers we served. During the three months ended September 30, 2015, we served approximately 12,500 unique product developers and engineers, an increase of 24% over the same period in 2014. Average revenue per product developer or engineer was consistent during the three months ended September 30, 2015 when compared to the same period in 2014.

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

International revenue was negatively impacted by \$2.1 million for the three months ended September 30, 2015 compared to the same period in 2014 due to the strengthening of the United States dollar relative to the British Pound and Japanese Yen, as well as the strengthening of the British Pound relative to the Euro. The effect of pricing changes on revenue was immaterial for the three months ended September 30, 2015 compared to the same period in 2014.

Cost of Revenue, Gross Profit and Gross Margin

Cost of Revenue. Cost of revenue increased \$6.0 million, or 28.0%, for the three months ended September 30, 2015 compared to the same period in 2014, which was faster than the rate of revenue increase of 24.3% for the three months ended September 30, 2015 compared to the same period in 2014. The increase in cost of revenue was due to raw material and production cost increases of \$2.8 million to support increased sales volumes, an increase in direct labor headcount resulting in personnel and related cost increases of \$3.1 million and equipment and facility-related cost increases of \$0.1 million.

Gross Profit and Gross Margin. Gross profit increased from \$33.1 million, or 60.6% of revenues, in the three months ended September 30, 2014 to \$40.3 million, or 59.4% of revenue, in the three months ended September 30, 2015 primarily due to increases in revenue offset by the cost of revenue as discussed above. Gross margin decreased primarily as a result of increases in investments of additional manufacturing capacity and the impact of fluctuations in foreign currency exchange rates.

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

Marketing and Sales. Marketing and sales expenses increased \$2.7 million, or 36.4%, during the three months ended September 30, 2015 compared to the same period in 2014 due primarily to an increase in headcount resulting in personnel and related cost increases of \$2.3 million and marketing program cost increases of \$0.4 million. The increase in marketing program costs is the result of our focus and concentration on funding those programs which have proven to be the most effective in growing our business.

Research and Development. Our research and development expenses increased \$0.2 million, or 4.5%, during the three months ended September 30, 2015 compared to the same period in 2014 due to an increase in headcount resulting in personnel and related cost increases of \$0.7 million, partially offset by professional services cost decreases of \$0.5 million.

General and Administrative. Our general and administrative expenses increased \$2.4 million, or 41.9%, during the three months ended September 30, 2015 compared to the same period in 2014 due to an increase in headcount resulting in personnel and related cost increases of \$0.8 million, stock-based compensation cost increases of \$0.2 million, administrative cost increases of \$0.6 million, professional services cost increases of \$0.2 million and \$0.6 million in costs related to our acquisition of Alphaform.

Other Income (Expense), net. Other expense, net decreased \$0.6 million during the three months ended September 30, 2015 compared to the same period in 2014 due to changes in foreign currency rates.

Provision for Income Taxes. Our effective tax rate of 31.2% for the three months ended September 30, 2015 decreased 1.3% when compared to 32.5% for the same period in 2014. The decrease in the effective tax rate is primarily due to an increased benefit from domestic tax credits realized in the quarter ended September 30, 2015 when compared to the quarter ended September 30, 2014. As a result of an increase in income before income taxes, our income tax provision increased by \$0.6 million to \$5.6 million for the three months ended September 30, 2015 compared to our income tax provision of \$5.0 million for the three months ended September 30, 2014.

*Comparison of Nine Months Ended September 30, 2015 and 2014**Revenue*

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

	Nine Months Ended September 30, 2015		2014		Change	
	(dollars in thousands) \$	% of Total Revenue	\$	% of Total Revenue	\$	%
Revenue						
Protomold	\$ 119,521	62.8	% \$ 104,604	68.1	% \$ 14,917	14.3 %
Firstcut	54,788	28.8	43,407	28.3	11,381	26.2
Fineline	16,038	8.4	5,503	3.6	10,535	*
Total revenue	\$ 190,347	100.0	% \$ 153,514	100.0	% \$ 36,833	24.0 %

* Percentage change not meaningful

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

	Nine Months Ended September 30, 2015		2014		Change	
	(dollars in thousands) \$	% of Total Revenue	\$	% of Total Revenue	\$	%
Revenue						

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United States	\$144,357	75.8	%	\$113,810	74.1	%	\$30,547	26.8%
International	45,990	24.2		39,704	25.9		6,286	15.8
Total revenue	\$190,347	100.0	%	\$153,514	100.0	%	\$36,833	24.0%

Our revenue increased \$36.8 million, or 24.0%, for the nine months ended September 30, 2015 compared to the same period in 2014. By geographic region, this revenue growth was driven by a 26.8% increase in United States revenue and a 15.8% increase in international revenue. By product line, this revenue growth was driven by a 14.3% increase in Protomold revenue and a 26.2% increase in Firstcut revenue, in each case for the nine months ended September 30, 2015 compared to the same period in 2014, as well as \$10.5 million in Fineline revenue related to the FineLine acquisition completed in the second quarter of 2014.

Our revenue growth during the nine months ended September 30, 2015 was the result of increased volume of the product developers and engineers we served. During the nine months ended September 30, 2015, we served approximately 22,600 unique product developers and engineers, an increase of 29% over the same period in 2014. Average revenue per product developer or engineer decreased 4.0% during the nine months ended September 30, 2015 when compared to the same period in 2014.

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

International revenue was negatively impacted by \$6.1 million for the nine months ended September 30, 2015 compared to the same period in 2014 due to the strengthening of the United States dollar relative to the British Pound and Japanese Yen, as well as the strengthening of the British Pound relative to the Euro. The effect of pricing changes on revenue was immaterial for the nine months ended September 30, 2015 compared to the same period in 2014.

Cost of Revenue, Gross Profit and Gross Margin

Cost of Revenue. Cost of revenue increased \$18.5 million, or 31.5%, for the nine months ended September 30, 2015 compared to the same period in 2014, which was faster than the rate of revenue increase of 24.0% for the nine months ended September 30, 2015 compared to the same period in 2014. The increase in cost of revenue was due to raw material and production cost increases of \$7.2 million to support increased sales volumes, an increase in direct labor headcount resulting in personnel and related cost increases of \$9.4 million and equipment and facility-related cost increases of \$1.9 million.

Gross Profit and Gross Margin. Gross profit increased from \$94.8 million, or 61.7% of revenues, in the nine months ended September 30, 2014 to \$113.1 million, or 59.4% of revenue, in the nine months ended September 30, 2015 primarily due to increases in revenue offset by the cost of revenue as discussed above. Gross margin decreased primarily as a result of an increase in expense attributable to recent manufacturing capacity expansion, and the impact of fluctuations in foreign currency exchange rates.

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

Marketing and Sales. Marketing and sales expenses increased \$7.3 million, or 35.0%, during the nine months ended September 30, 2015 compared to the same period in 2014 due primarily to an increase in headcount resulting in personnel and related cost increases of \$6.0 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 expenses increased \$1.5 million, or 13.0%, during the nine months ended September 30, 2015 compared to the same period in 2014 due to an increase in headcount resulting in personnel and related cost increases of \$2.7 million and operating cost increases of \$0.3 million, which were partially offset by professional services cost decreases of \$1.5 million.

General and Administrative. Our general and administrative expenses increased \$4.7 million, or 29.5%, during the nine months ended September 30, 2015 compared to the same period in 2014 due to an increase in headcount resulting in personnel and related cost increases of \$2.8 million, stock-based compensation costs increases of \$0.6 million, intangible amortization expense increases of \$0.2 million, administrative cost increases of \$0.7 million and \$0.6 million in costs related to our acquisition of Alphaform, which were partially offset by a decrease in professional services costs of \$0.2 million. Amortization expenses relate to intangible assets acquired in the purchase of FineLine in April 2014.

Other Income (Expense), net. Other expense, net decreased \$0.1 million during the nine months ended September 30, 2015 compared to the same period in 2014 due to changes in interest income on investments.

Provision for Income Taxes. Our effective tax rate of 31.9% for the nine months ended September 30, 2015 increased 0.5% when compared to 31.4% for the same period in 2014. The increase in the effective tax rate is primarily due to changes in the mix of projected income earned in domestic and foreign tax jurisdictions for the tax year ending December 31, 2015. As a result of the increase in our effective tax rate combined with increased income attributable

to the fluctuations described above, our income tax provision increased by \$1.8 million to \$16.2 million for the nine months ended September 30, 2015 compared to our income tax provision of \$14.4 million for the nine months ended September 30, 2014.

Liquidity and Capital Resources

Cash Flows

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

(dollars in thousands)	Nine Months Ended September 30,	
	2015	2014
Net cash provided by operating activities	\$41,284	\$40,004
Net cash used in investing activities	(29,034)	(55,234)
Net cash provided by financing activities	8,870	6,540
Effect of exchange rates on cash and cash equivalents	(318)	(81)
Net increase (decrease) in cash and cash equivalents	\$20,802	\$(8,771)

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 \$64.1 million as of September 30, 2015, an increase of \$20.8 million from December 31, 2014. The increase in our cash was primarily due to cash generated through operations and, to a lesser extent, proceeds from exercises of stock options and purchases through our employee stock purchase plan, which were partially offset by investing activity.

Cash Flows from Operating Activities

Cash flows from operating activities of \$41.3 million during the nine months ended September 30, 2015 primarily consisted of net income of \$34.5 million, adjusted for certain non-cash items, including depreciation and amortization of \$10.4 million, stock-based compensation expense of \$4.5 million and amortization of held-to-maturity securities of \$0.9 million, which were partially offset by deferred taxes of \$0.3 million and excess tax benefit from stock-based compensation expense of \$5.2 million. Cash flows from operating activities increased \$1.3 million during the nine months ended September 30, 2015 compared to the same period in 2014 due to increases in net income of \$3.1 million, depreciation and amortization of \$2.7 million and stock-based compensation expense of \$1.0 million, which were partially offset by a decrease in amortization of held-to-maturity securities of \$0.3 million, an increase in excess tax benefits of \$0.8 million, changes in operating assets and liabilities of \$3.6 million and deferred taxes of \$0.8 million.

Cash flows from operating activities of \$40.0 million during the nine months ended September 30, 2014 consisted of net income of \$31.4 million, adjusted for certain non-cash items, including depreciation and amortization of \$7.7 million, stock-based compensation expense of \$3.6 million, amortization of held-to-maturity securities of \$1.2 million and deferred taxes of \$0.5 million, which were partially offset by \$4.4 million of excess tax benefit on stock-based compensation.

Cash Flows from Investing Activities

Cash used in investing activities was \$29.0 million during the nine months ended September 30, 2015, consisting of \$27.2 million for the purchases of property and equipment and \$42.7 million for the purchases of marketable securities, which were partially offset by \$40.9 million in proceeds from maturities and call redemptions of marketable securities.

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

Cash Flows from Financing Activities

Cash provided by financing activities was \$8.9 million during the nine months ended September 30, 2015, consisting of proceeds from exercises of stock options of \$5.2 million and \$5.2 million in excess tax benefit on stock-based compensation, which were partially offset by \$1.4 million for payments of acquisition-related contingent consideration and \$0.1 million for payments of debt.

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.

Off-Balance Sheet Arrangements

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

Critical Accounting Policies and Use of Estimates

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

Recent Accounting Pronouncements

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

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Foreign Currency Risk

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

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

We have not used forward contracts or currency borrowings to hedge our exposure to foreign currency risk. Foreign currency risk can be quantified by estimating the change in results of operations or financial position resulting from a hypothetical 10% adverse change in foreign exchange rates. We believe such a change would generally not have a material impact on our financial position, but could have a material impact on our results of operations. We recognized foreign currency income of \$0.4 million and foreign currency loss of \$0.4 million in the three and nine months ended September 30, 2015, respectively. We recognized foreign currency losses of \$0.2 million and \$0.4 million in the three and nine months ended September 30, 2014, respectively.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Control over Financial Reporting

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

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

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

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

No matters to disclose.

Item 3. Defaults Upon Senior Securities

No matters to disclose.

Item 4. Mine Safety Disclosures

No matters to disclose.

Item 5. Other Information

No matters to disclose.

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.
3.3 ⁽³⁾	Articles of Amendment to Third Amended and Restated Articles of Incorporation of Proto Labs, Inc. dated May 20, 2015
10.1	2012 Long-Term Incentive Plan, as amended August 5, 2015
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act
32.1	Certification of the Chief Executive Officer and the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

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

SIGNATURE

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

Proto
Labs, Inc.

/s/

Date: November 3, 2015 Victoria
M. Holt
Victoria
M. Holt
President
and Chief
Executive
Officer

(Principal
Executive
Officer)

Date: November 3, 2015 /s/ John A. Way
John A. Way
Chief Financial Officer

(Principal Financial Officer)