

Proto Labs Inc  
Form 10-Q  
August 06, 2015  
. H

---

---

**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 June 30, 2015**

or

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number: 001-35435**

**Proto Labs, Inc.**

(Exact name of registrant as specified in its charter)

**Minnesota**

(State or other jurisdiction of  
incorporation or organization)

**41-1939628**

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

**5540 Pioneer Creek Drive**

**Maple Plain, Minnesota**

(Address of principal executive offices)

**55359**

(Zip Code)





**Proto Labs, Inc.**

**TABLE OF CONTENTS**

| <b>Item Description</b>  | <b>Page</b> |
|--|-------------|
| <b><u>PART I</u></b>   |             |
| 1. Financial Statements  | 3           |
| 2. Management's Discussion and Analysis of Financial Condition and Results of Operations | 14          |
| 3. Quantitative and Qualitative Disclosures about Market Risk                            | 22          |
| 4. Controls and Procedures   | 23          |
| <b><u>PART II</u></b>  |             |
| 1. Legal Proceedings   | 24          |
| 1A. Risk Factors   | 24          |
| 6. Exhibits  | 24          |

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

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

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

Edgar Filing: Proto Labs Inc - Form 10-Q

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

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

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

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

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

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

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

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





## **Note 1 – Basis of Presentation**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

**Note 6 – Marketable Securities**

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

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

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

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



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

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

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

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

#### **Note 7 – Inventory**

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

The Company's inventory consists of the following:

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