Proto Labs Inc
Form 10-Q
May 04, 2012
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2012

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)**

(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 x 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). x 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	x (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 x No

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 23,916,908 shares of Common Stock, par value $0.001 per share, were outstanding at May 01, 2012.

Table of Contents

Proto Labs, Inc.

TABLE OF CONTENTS

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

Proto Labs, Inc.

Consolidated Balance Sheets

(In thousands, except share and per share amounts)

	March 31, 2012 (Unaudited)	December 31, 2011
Assets		
Current assets		
Cash	$ 79,679	$ 8,135
Short-term marketable securities		250
Accounts receivable, net of allowance for doubtful accounts of $115 and $97 as of March 31, 2012 and December 31, 2011, respectively	14,782	11,533
Inventory	3,905	3,797
Prepaid expenses and other current assets	3,378	3,430
Deferred tax assets	932	932
Total current assets	102,676	28,077
Property and equipment, net	41,099	34,249
Total assets	$ 143,775	$ 62,326
Liabilities, redeemable convertible preferred stock, redeemable common stock and shareholders equity (deficit)		
Current liabilities		
Accounts payable	$ 5,788	$ 4,431
Accrued compensation	3,464	4,767
Accrued liabilities and other	2,025	318
Income taxes payable	2,028	33
Current portion of long-term debt obligations	389	390
Total current liabilities	13,694	9,939
Deferred tax liability	4,252	4,252
Long-term debt obligations	526	613
Other	856	871
Redeemable convertible stock		
Redeemable convertible preferred stock, $0.001 par value, authorized, issued and outstanding 0 and 427,985 shares as of March 31, 2012 and December 31, 2011, respectively		66,075
Redeemable common stock, $0.001 par value, issued and outstanding 0 and 3,189,648 shares as of March 31, 2012 and December 31, 2011, respectively		819
Shareholders equity (deficit)		
Preferred stock, $0.001 par value, authorized 10,000,000 and 0 shares; issued and outstanding 0 shares as of March 31, 2012 and December 31, 2011, respectively		
Common stock, $0.001 par value, authorized 150,000,000 shares; issued and outstanding 23,916,908 and 9,706,270 shares as of March 31, 2012 and December 31, 2011, respectively	24	10
Additional paid in capital	133,376	8,229
Accumulated equity (deficit)	(8,673)	(27,744)
Accumulated other comprehensive income (loss)	(280)	(738)

Total shareholders equity (deficit)	124,447	(20,243)
Total liabilities, redeemable convertible preferred stock, redeemable common stock and shareholders equity (deficit)	$ 143,775	$ 62,326

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

Table of Contents

Proto Labs, Inc.

Consolidated Statements of Comprehensive Income

(In thousands, except share and per share amounts)

(Unaudited)

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
Statements of Operations:		
Revenue	$ 29,970	$ 22,335
Cost of revenue	12,243	8,429
Gross profit	17,727	13,906
Operating expenses		
Marketing and sales	4,441	3,215
Research and development	1,660	1,112
General and administrative	3,988	2,506
Total operating expenses	10,089	6,833
Income from operations	7,638	7,073
Other expense, net	577	81
Income before income taxes	7,061	6,992
Provision for income taxes	2,279	2,269
Net income	4,782	4,723
Less: dividends on redeemable preferred stock		(1,031)
Less: undistributed earnings allocated to preferred shareholders		(1,259)
Net income attributable to common shareholders	$ 4,782	$ 2,433
Net income per share:		
Basic	$ 0.23	$ 0.21
Diluted	$ 0.22	$ 0.19
Shares used to compute net income per share:		
Basic	20,934,948	11,581,430
Diluted	22,226,356	12,868,254
Comprehensive income	$ 5,240	$ 4,865

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

Table of Contents

Proto Labs, Inc.

Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
Operating activities		
Net income	$ 4,782	$ 4,723
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,328	893
Stock-based compensation expense	850	198
Loss on disposal of property and equipment	5	
Provision for doubtful accounts	23	8
Provision for excess inventory	27	
Changes in operating assets and liabilities:		
Accounts receivable	(3,208)	(2,324)
Inventories	(127)	(160)
Prepaid expenses and other	29	94
Income taxes	1,991	1,146
Accounts payable	1,344	710
Accrued liabilities and other	367	708
Net cash provided by operating activities	7,411	5,996
Investing activities		
Purchases of property and equipment	(8,264)	(2,262)
Proceeds from sale of marketable securities	250	250
Net cash used in investing activities	(8,014)	(2,012)
Financing activities		
Proceeds from initial public offering, net of offering costs	71,675	
Proceeds from issuance of debt		637
Payments on debt	(94)	(1,284)
Proceeds from exercises of warrants and stock options	30	222
Net cash provided by (used in) financing activities	71,611	(425)
Effect of exchange rate changes on cash	536	27
Net increase in cash	71,544	3,586
Cash, beginning of period	8,135	6,101
Cash, end of period	$ 79,679	$ 9,687

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

5

Table of Contents

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.

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 prospectus filed on February 27, 2012 with the SEC pursuant to Rule 424(b)(4) of the Securities Act of 1933.

The accompanying Consolidated Balance Sheet as of December 31, 2011 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 prospectus filed on February 27, 2012 as referenced above.

On February 21, 2012, the Company executed a 14-for-1 forward stock split of the Company s common stock. The consolidated financial statements as of March 31, 2012 and December 31, 2011 give retroactive effect to the stock split.

Note 2 Recent Accounting Pronouncements

On April 5, 2012, President Obama signed into law the Jumpstart Our Business Startups Act (JOBS Act), which establishes a new category of issuer called an emerging growth company (EGC). Under the JOBS Act, an EGC is defined as an issuer with total annual gross revenues less than $1 billion during its most recently completed fiscal year. An issuer continues to be eligible for EGC status until the earliest of (1) the last day of the fiscal year during which it had total annual gross revenues of $1 billion or more (as indexed for inflation in the manner set forth in the JOBS Act), (2) the last day of the fiscal year of the issuer following the fifth anniversary of the date of its initial public offering (IPO), (3) the date on which it issued more than $1 billion in non-convertible debt in the previous three-year period, or (4) the date on which it became a large accelerated filer as defined in Rule 12b-2 of the Securities Exchange Act of 1934.

Among other requirements, the JOBS Act exempts an EGC from the requirements to adopt new or revised accounting standards that are effective for public companies. Instead, the effective dates for private companies for such standards will apply to an EGC. Section 107(b) of the JOBS Act permits an EGC to opt out of the accounting standard exemption and apply new or revised accounting standards on the same basis as a public company.

Under the JOBS Act, the Company meets the definition of an EGC. During the period it continues to be eligible for EGC status, the Company will apply new or revised accounting standards following the effective dates for private companies.

In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS* (ASU 2011-04). This accounting update generally aligns the principles for fair value measurements and the related disclosure requirements under U.S. GAAP and International Financial Reporting Standards. From a U.S. GAAP perspective, the amendments are largely clarifications, but some could have a significant effect on certain companies. A number of new disclosures also are required. Except for certain disclosures, the guidance applies to public and nonpublic companies and is to be applied prospectively. For public and nonpublic companies, the amendments are effective during interim and annual periods beginning after December 15, 2011. The Company adopted this accounting guidance effective January 1, 2012. The adoption of ASU 2011-04 did not result in a material impact to the Company s financial statements.

In June 2011, the FASB issued ASU 2011-05, *Presentation of Comprehensive Income* (ASU 2011-05). This accounting update requires entities to present items of net income and other comprehensive income either in a single continuous statement, or in separate, but consecutive, statements of net income and other comprehensive income. The new requirements do not change which components of comprehensive income are recognized in net income or other comprehensive income, or when an item of other comprehensive income must be reclassified to net income. However, the current option under existing standards to report other comprehensive income and its components in the statement of changes in equity is eliminated. In December 2011, the FASB issued ASU 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05* (ASU 2011-12). The updated guidance defers the requirement in ASU 2011-05 to present on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income. The amendments apply to public and nonpublic companies and are to be applied retrospectively. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. For nonpublic entities, the amendments are effective for fiscal years ending after December 15, 2012, and interim and annual periods thereafter. Early adoption of the amendments is permitted. As disclosed above, the Company will apply new or revised accounting standards following the effective dates for nonpublic companies. Since early adoption of the amendments is permitted, the Company has elected to early adopt this accounting guidance effective January 1, 2012 and has presented the items of net income and other comprehensive income in a single continuous statement in this report. The adoption of ASU 2011-05 and ASU 2011-12 did not result in a material impact to the Company s financial statements.

Table of Contents

Proto Labs, Inc.

Notes to Consolidated Financial Statements

(Unaudited)

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 the potentially dilutive common shares been issued and reduced by the number of shares the Company could have repurchased from the proceeds from issuance of the potentially dilutive shares. Potentially dilutive shares of common stock include stock options and other stock-based 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:

	Three Months Ended March 31,	
	2012	2011
	(in thousands, except share and per share amounts)	
Net Income	$ 4,782	$ 4,723
Less: dividends on redeemable convertible preferred stock		(1,031)
Less: undistributed earnings allocated to preferred shareholders		(1,259)
Net income attributable to common shareholders	$ 4,782	$ 2,433
Basic weighted-average shares outstanding:	20,934,948	11,581,430
Effect of dilutive securities:		
Employee stock options and warrants	1,248,737	1,286,824
Employee stock purchase plan	42,671	
Diluted weighted-average shares outstanding:	22,226,356	12,868,254
Net income per share attributable to common shareholders:		
Basic	$ 0.23	$ 0.21
Diluted	$ 0.22	$ 0.19

Weighted average diluted shares for the three months ended March 31, 2011 excludes redeemable convertible preferred stock as it was anti-dilutive for the period.

7

Table of Contents

Proto Labs, Inc.

Notes to Consolidated Financial Statements

(Unaudited)

The following table sets forth the calculation of unaudited pro forma net income per basic and diluted share which gives effect to the conversion of all outstanding shares of redeemable convertible preferred stock as if the conversion had occurred on January 1, 2011:

	Three Months Ended March 31,	
	2012	2011
	(in thousands, except share and per share amounts)	
Net income attributable to common shareholders, as reported	$ 4,782	$ 2,433
Dividends on redeemable convertible preferred stock		1,031
Undistributed earnings allocated to preferred shareholders		1,259
Pro forma net income	$ 4,782	$ 4,723
Basic weighted-average shares outstanding, as reported	20,934,948	11,581,430
Add: common shares from conversion of redeemable convertible preferred shares		5,991,790
Pro forma basic weighted average shares outstanding	20,934,948	17,573,220
Effect of dilutive securities:		
Employee stock options and warrants	1,248,737	1,286,824
Employee stock purchase plan	42,671	
Pro forma diluted weighted-average shares outstanding:	22,226,356	18,860,044
Pro forma net income per share attributable to common shareholders:		
Basic	$ 0.23	$ 0.27
Diluted	$ 0.22	$ 0.25

Note 4 Fair Value Measurements

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

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

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

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

The Company s cash consists of bank deposits. The Company s short-term marketable securities consist of domestic certificates of deposits at various banks and treasury notes. The Company determines the fair value of all investments using Level I inputs.

As of March 31, 2012, financial instruments measured at fair value included cash, accounts receivable and accounts payable, the fair values of which approximated carrying values due to the short-term nature of these instruments.

Table of Contents

Proto Labs, Inc.

Notes to Consolidated Financial Statements

(Unaudited)

A summary of financial assets as of December 31, 2011 measured at fair value on a recurring basis follows:

(in thousands)	December 31, 2011 Level 1	Level 2	Level 3
Financial Assets			
Short-term marketable securities	$ 250	$	$
Total	$ 250	$	$

Note 5 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:

	March 31, 2012 (in thousands)	December 31, 2011
Raw materials	$ 3,651	$ 3,463
Work in process	338	418
Total Inventory	3,989	3,881
Allowance for obsolescence	(84)	(84)
Inventory, net of allowance	$ 3,905	$ 3,797

Note 6 Stockholders Equity

Initial Public Offering

In February 2012, the Company issued 4.9 million shares of common stock (including the exercise of the underwriters over-allotment shares) in conjunction with its initial public offering (IPO). The public offering price of the shares sold in the offering was $16.00 per share. The total gross proceeds from the IPO to the Company were $79.1 million. After deducting underwriting discounts and commissions and offering expenses payable by the Company, the aggregate net proceeds received by the Company totaled approximately $71.6 million. As of March 31, 2012, $0.1 million of offering costs remained unpaid and these costs are expected to be paid during the next fiscal quarter.

In August 2008, the Company entered into an investors rights agreement with Protomold Investment Company, LLC (PIC), which included a put right whereby PIC may require the Company to repurchase its shares of common stock any time after August 2, 2018. Upon completion of the IPO, the put rights of PIC terminated. Also in August 2008, the Company entered into a management rights agreement with North Bridge Growth Equity I, L.P. (North Bridge), which provides North Bridge with certain additional management and information rights. This management agreement terminated upon completion of the IPO.

Table of Contents

Proto Labs, Inc.

Notes to Consolidated Financial Statements

(Unaudited)

Immediately prior to the consummation of the IPO, all outstanding shares of redeemable convertible preferred stock and redeemable common stock were converted into shares of common stock. Shares of redeemable convertible preferred stock were converted into 5,991,790 shares of common stock. All previously accrued dividends on the preferred stock have been released back into retained earnings as of March 31, 2012. Shares of redeemable common stock were converted into 3,189,648 shares of common stock. Refer to the table below for additional information regarding the conversion.

The following tables present the shares authorized and issued and outstanding as of the periods presented, as well as equity transactions related to the IPO (in thousands, except share data):

	March 31, 2012		December 31, 2011	
	Shares Authorized	Shares Issued and Outstanding	Shares Authorized	Shares Issued and Outstanding
Redeemable stock:				
Redeemable convertible preferred stock, $0.001 par value			427,985	427,985
Redeemable common stock, $0.001 par value			3,189,648	3,189,648
Stockholders equity:				
Preferred stock, $0.001 par value	10,000,000			
Common stock, $0.001 par value	150,000,000	23,916,908	150,000,000	9,706,270

	Common Stock				Accumulated Other	
	Shares	Amount	Additional Paid-In Capital	Accumulated Deficit	Comprehensive Income (Loss)	Total
Balance at December 31, 2011	9,706,270	10	8,229	(27,744)	(738)	(20,243)
Common shares issued upon initial public offering	4,945,000	5	71,670			71,675
Common shares issued upon conversion of redeemable convertible preferred stock	5,991,790	6	66,070			66,076
Common shares issued upon conversion of redeemable common stock	3,189,648	3	816			819
Common shares issued on exercise of options and other	84,200		30			30
Preferred stock dividends			(14,289)	14,289		
Stock-based compensation expense			850			850
Net income				4,782		4,782
Other comprehensive income						
Foreign currency translation adjustment					458	458
Comprehensive income						5,240
Balance at March 31, 2012	23,916,908	24	133,376	(8,673)	(280)	124,447

Equity Incentive Plans

The Company has two equity incentive plans: the 2000 Stock Option Plan (2000 Plan) and the 2012 Long-Term Incentive Plan (2012 Plan). Upon the adoption of the 2012 Plan, all shares that were reserved under the 2000 Plan but not issued were assumed by the 2012 Plan. No additional shares will be issued under the 2000 Plan. Under the 2012 Plan, the Company has the ability to grant stock options, stock appreciation rights (SARs), restricted stock, stock units, other stock-based awards and cash incentive awards. Awards under the 2012 Plan will have a maximum term of ten years from the date of grant. The compensation committee may provide that the vesting or payment of any award will be subject to the attainment of specified performance measures in addition to the satisfaction of any continued service requirements, and the compensation committee will determine whether such measures have been achieved. The per share exercise price of stock options and SARs granted under the 2012 Plan generally may not be less than the fair market value of a share of our common stock on the date of the grant.

Table of Contents

Proto Labs, Inc.

Notes to Consolidated Financial Statements

(Unaudited)

Under the fair value recognition provisions of U.S. GAAP for accounting for stock-based compensation, the Company measures stock-based compensation expense at the grant date based on the fair value of the award and recognizes the compensation expense over the requisite service period, which is generally the vesting period.

Employee Stock Purchase Plan

The Company s 2012 Employee Stock Purchase Plan (ESPP) became effective on February 23, 2012. The 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 generally provides for six-month offering periods, and 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. Due to the timing of the IPO, the initial offering period under the ESPP will run eight-and-a-half months from the offering date of February 23, 2012 to November 15, 2012.

Stock-Based Compensation Expense

Stock-based compensation expense was $0.9 million and $0.2 million for the three months ended March 31, 2012 and 2011, respectively.

Stock Options

A summary of stock option activity for the three months ended March 31, 2012 is as follows:

	Stock Options	Weighted-Average Exercise Price
Options outstanding at December 31, 2011	2,099,300	$ 6.18
Granted	42,000	16.00
Exercised	(59,200)	0.51
Cancelled		0.00
Options outstanding March 31, 2012	2,082,100	$ 6.54
Exercisable at March 31, 2012	1,128,700	$ 3.14

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 5-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 for the three months ended March 31, 2012 was $8.17.

Table of Contents

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:

	Three months ended March 31, 2012	2011
Risk-free interest rate	1.16%	3.35%
Expected life (years)	6.25	10
Expected volatility	53.00%	38.05%
Expected dividend yield	0%	0%

The following table presents the weighted-average assumptions used to estimate the fair value of the ESPP during the three months ended March 31, 2012:

	Three months ended March 31, 2012
Risk-free interest rate	0.16%
Expected life (months)	8.5
Expected volatility	53.00%
Expected dividend yield	0%

As of March 31, 2012 there was $4.2 million of total unrecognized compensation expense related to unvested stock options, which is expected to be recognized over a weighted average period of 3.6 years.

Note 7 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 March 31, 2012 and 2011 the Company recorded an income tax provision of $2.3 million and $2.3 million, respectively. The income tax provision is based on the estimated annual effective tax rate for the year applied to net income. The effective income tax rate for the three months ended March 31, 2012 was 32.3 percent compared with 32.5 percent in the same period of the prior year.

The effective income tax rate for the three month period ended March 31, 2012 differs from the U.S. federal statutory rate of 35 percent primarily due to the components of income.

The Company has liabilities related to unrecognized tax benefits totaling $0.4 million at March 31, 2012 and December 31, 2011 that if recognized would result in a reduction of the Company s effective tax rate. There were no material adjustments to the unrecorded tax benefits during the three months ended March 31, 2012, and the Company does not anticipate that total unrecognized tax benefits will materially change in the next twelve months. 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.

Note 8 Segment Information

The Company s operations are comprised of three geographically-based operating segments in the United States, Europe and Japan included in the reportable segments of United States, Europe and Other. Each operating segment generates revenue by providing low-volume custom parts to product developers worldwide. Operations included in the category Other are not considered significant.

Table of Contents

Proto Labs, Inc.

Notes to Consolidated Financial Statements

(Unaudited)

Certain operating expenses and total assets managed by the Company on a global basis are included in the United States segment. As a result, reportable segment income from operations is not representative of the income from operations of the geographies in the reportable segments.

Revenue, income from operations, depreciation and amortization, capital expenditures and total assets by segment are as follows:

	Three months ended March 31, 2012	2011
	(in thousands)	
Revenue:		
United States	$ 23,132	$ 18,200
Europe	5,480	3,796
Other	1,358	339
Consolidated	$ 29,970	$ 22,335
Income from operations:		
United States	$ 7,021	$ 6,875
Europe	1,460	849
Other	(843)	(651)
Consolidated	$ 7,638	$ 7,073
Depreciation and amortization:		
United States	$ 1,004	$ 636
Europe	258	209
Other	66	48
Consolidated	$ 1,328	$ 893
Provision for income taxes:		
United States	$ 2,092	$ 2,090
Europe	187	179
Other		
Consolidated	$ 2,279	$ 2,269
Capital expenditures:		
United States	$ 6,250	$ 1,152
Europe	679	784
Other	1,335	326
Consolidated	$ 8,264	$ 2,262

Table of Contents

Proto Labs, Inc.

Notes to Consolidated Financial Statements

(Unaudited)

	March 31, 2012	December 31, 2011
	(in thousands)	
Total assets:		
United States	$ 127,553	$ 47,710
Europe	11,037	10,719
Other	5,185	3,897
Consolidated	$ 143,775	$ 62,326

The Company s revenue is derived from two product lines, Protomold injection molding and Firstcut computer numerical control (CNC) machining. Total revenue by product line is as follows:

	Three Months Ended March 31, 2012	2011
	(in thousands)	
Revenue		
Protomold	$ 21,793	$ 16,921
First Cut	8,177	5,414
Total revenue	$ 29,970	$ 22,335

Note 9 Geographic Information

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 March 31, 2012	2011
	(in thousands)	
Revenue:		
United States	$ 22,175	$ 17,432
International		
Europe	5,480	3,796
Other	2,315	1,107
Total international	$ 7,795	$ 4,903
Total revenue	$ 29,970	$ 22,335

Table of Contents

Proto Labs, Inc.

Notes to Consolidated Financial Statements

(Unaudited)

	March 31, 2012	December 31, 2011
	(in thousands)	
Long-lived assets:		
United States	$ 34,077	$ 28,831
International		
Europe	3,916	3,377
Other	3,106	2,041
Total international	$ 7,022	$ 5,418
Total long-lived assets	$ 41,099	$ 34,249

Table of Contents

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.

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, plan, anticipate, believe, estimate, predict, project, potential, continue, 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 the Risk Factors section of the final prospectus relating to our IPO dated February 23, 2012, as filed with the SEC, as well as in our subsequent reports filed with the SEC. Other unknown or unpredictable factors also could have material adverse effects on our future results. We cannot guarantee future results, levels of activity, performance or achievements. Accordingly, you should not place undue reliance on these forward-looking statements. Finally, we expressly disclaim any intent or obligation to update any forward-looking statements to reflect subsequent events or circumstances.

Overview

We are a leading online and technology-enabled manufacturer of quick-turn CNC machined and injection molded custom parts for prototyping and short-run production. We provide Real Parts, Really Fast to product developers worldwide, who are under increasing pressure to bring their finished products to market faster than their competition. We believe low-volume

Table of Contents

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

Key Financial Measures and Trends

Revenue

The Company s operations are comprised of three geographically-based operating segments in the United States, Europe and Japan included in the reportable segments of United States, Europe, and Other. Revenue within these segments is derived from our Firstcut and Protomold services. Firstcut revenue consists of sales of CNC machined custom parts. Protomold revenue consists of sales of custom injection molds and injection-molded parts. Our revenue is generated from a diverse customer base, with no single customer company representing more than approximately 1% of our total revenue in the three months ended March 31, 2012. Our historical and current efforts to increase revenue have been directed at gaining new customers and selling to our existing customer base by increasing marketing and selling activities, offering additional services such as the introduction of our Firstcut service in 2007, expanding internationally such as the opening of our Japanese office in 2009, improving the usability of our services such as our web-centric applications, and expanding the breadth and scope of our products such as by adding more sizes and materials to our offerings. During the three months ended March 31, 2012, we sold our services to approximately 2,900 customer companies from our existing customer base, an increase of 36% over the comparable period in 2011, and to approximately 750 new customer companies gained during the three months ended March 31, 2012, an increase of 36% over the comparable period in 2011.

Cost of Revenue, Gross Profit and Gross Margin

Cost of revenue consists primarily of raw materials, employee salaries, bonuses, benefits, stock-based compensation, equipment depreciation 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, our sales volume, our manufacturing costs, the costs associated with increasing production capacity, 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 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. 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 CNC machined 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 salaries, commissions, bonuses, benefits, stock-based compensation, marketing programs such as print and pay-per-click advertising, trade shows and 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 salaries, bonuses, benefits, stock-based compensation, depreciation on equipment and other related overhead. All of our research and development costs have been expensed as incurred. We expect research and development expense to increase in the future as we seek to enhance and expand our service offerings.

17

Table of Contents

General and administrative. General and administrative expense consists primarily of employee salaries, bonuses, 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 on an absolute basis and as a percentage of revenue as we continue to grow and expand our operations and develop the infrastructure necessary to operate as a public company. These expenses will include increased audit and legal fees, costs of compliance with securities and other regulations, implementation costs for compliance with the provisions of the Sarbanes-Oxley Act, investor relations expense and higher insurance premiums.

Other Income (Expense), net

Other income (expense), net primarily consists of foreign currency-related gains and losses, interest income on cash balances 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 and the current level of interest rates. Our interest expense will vary based on borrowings and interest rates.

Provision for Income Taxes

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

Results of Operations

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

	Three Months Ended March 31,				Change	
	2012		2011		$	%
	(dollars in thousands)					
Revenue	$ 29,970	100.0%	$ 22,335	100.0%	$ 7,635	34.2%
Cost of revenue	12,243	40.9	8,429	37.7	3,814	45.2
Gross profit	17,727	59.1	13,906	62.3	3,821	27.5
Operating expenses:						
Marketing and sales	4,441	14.8	3,215	14.4	1,226	38.1
Research and development	1,660	5.5	1,112	5.0	548	49.3
General and administrative	3,988	13.3	2,506	11.2	1,482	59.1
Total operating expenses	10,089	33.6	6,833	30.6	3,256	47.7
Income from operations	7,638	25.5	7,073	31.7	565	8.0
Other expense, net	577	1.9	81	0.4	496	612.3
Income before income taxes	7,061	23.6	6,992	31.3	69	1.0
Provision for income taxes	2,279	7.6	2,269	10.1	10	0.4
Net income	$ 4,782	16.0%	$ 4,723	21.2%	$ 59	1.2%

Table of Contents

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

	Three months ended March 31, 2012	2011
	(dollars in thousands)	
Stock options and grants	$ 797	$ 198
Employee stock purchase plan	53	
Total stock-based compensation expense	$ 850	$ 198
Cost of revenue	$ 45	$ 19
Operating expenses:		
Marketing and sales	73	46
Research and development	78	69
General and administrative	654	64
Total stock-based compensation expense	$ 850	$ 198

Comparison of Three Months Ended March 31, 2012 and 2011

Revenue

Revenue and the related changes for the three months ended March 31, 2012 and 2011 were as follows:

	Three Months Ended March 31, 2012		2011		Change	
	$	% of Total Revenue	$	% of Total Revenue	$	%
	(dollars in thousands)					
Revenue						
Protomold	$ 21,793	72.7%	$ 16,921	75.8%	$ 4,872	28.8%
First Cut	8,177	27.3	5,414	24.2	2,763	51.0
Total revenue	$ 29,970	100.0%	$ 22,335	100.0%	$ 7,635	34.2%

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

	Three Months Ended March 31, 2012		2011		Change	
	$	% of Total Revenue	$	% of Total Revenue	$	%