

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-K

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2019**

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)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, Par Value \$0.001 Per Share	PRLB	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of June 30, 2019 (the last business day of the Registrant’s most recently completed second fiscal quarter), the aggregate market value of voting stock held by non-affiliates of the Registrant was approximately \$3.1 billion.

As of February 14, 2020, there were 26,787,910 shares of the Registrant’s common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant’s Proxy Statement for its 2020 Annual Meeting of Shareholders are incorporated by reference to Part III of this Annual Report on Form 10-K.

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Special Note Regarding Forward Looking Statements

Statements contained in this Annual Report on Form 10-K 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,” “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. In particular, some of the risks associated with our business include:

- the level of competition in our industry and our ability to compete;
- our ability to respond to changes in our industry;
- our ability to effectively grow our business and manage our growth;
- our ability to continue to sell to existing and new customers;
- our ability to meet product developers’ and engineers’ needs and expectations regarding quick turnaround time, price and specifications for quality;
- the adoption rate of e-commerce and 3D CAD software by product developers and engineers;
- our ability to process a large volume of designs and identify significant opportunities in our business;
- our ability to maintain and enhance our brand;
- our ability to successfully identify, complete and integrate acquisitions or other strategic transactions;
- our ability to complete and successfully launch updates to our systems;
- the loss of key personnel or failure to attract and retain additional personnel;
- system interruptions at our operating facilities;
- possible unauthorized access to customers’ confidential information stored in our systems; and
- our ability to protect our intellectual property and not infringe on others’ intellectual property.

Certain of these factors and others are described in the discussion on risk factors that appear in Part I, Item 1A. “Risk Factors” of this Annual Report on Form 10-K and uncertainties are detailed in this and other reports and filings with the Securities and Exchange Commission (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.

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PART I

Item 1. Business

Overview

Proto Labs, Inc. was incorporated in Minnesota in 1999. The terms “Proto Labs,” the “Company,” “we,” “us,” and “our” as used herein refer to the business and operations of Proto Labs, Inc. and its subsidiaries. We are the world’s largest and fastest digital manufacturer of custom prototypes and on-demand production parts. Our mission is to help companies accelerate product development, reduce risk, and optimize supply chains by providing quality prototyping and on-demand manufacturing services at unprecedented speeds. Our automated quoting and manufacturing systems allow us to produce commercial-grade plastic, metal, and liquid silicone rubber parts within days. We manufacture prototype and low volume production parts for companies 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, 3D printing and sheet metal fabrication to manufacture custom parts for our customers. 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. We have established our operations in the United States, Europe and Japan, which we believe are three of the largest geographic markets where these product developers and engineers are located. We believe our use of advanced technology enables us to offer significant advantages at competitive prices to many customers and is the primary reason we have become a leading supplier of custom parts.

We believe prototype and low volume 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 customers typically order short run custom parts for a variety of reasons, including:

- they need a prototype to confirm the form, fit and function of one or more components of a product under development;
- they need an initial supply of parts to support pilot production for testing of a product;
- they need an initial supply of parts to support production while their high-volume production mold is being prepared;
- they need to meet their customers' variable demand for custom parts in a competitive timeframe;
- their product will only be released in a limited quantity; or
- they need to support end-of-life production in a cost-effective manner.

In each of these instances, we believe our solution provides product developers, engineers, and supply chains with an exceptional combination of speed, quality, competitive pricing, ease of use and reliability that they typically cannot find among conventional custom parts manufacturers. Our technology enables us to ship parts as soon as the same day after receipt of a customer’s design submission.

Our primary manufacturing product lines currently include Injection Molding, CNC Machining, 3D Printing and Sheet Metal. We continually seek to expand the range of size and geometric complexity of the parts we can make with these 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.

We have experienced significant growth since our inception in 1999. We have grown our total revenue from \$264.1 million in 2015 to \$458.7 million in 2019. We have grown our net income from \$46.5 million in 2015 to \$63.7 million in 2019.

Our increases in revenue and income from operations can be attributed to expanding our customer base, broadening our parts envelope, and launching new manufacturing technologies. We were founded in 1999 with plastic injection molding, and have expanded our product lines over the years by the introduction of:

- CNC machining in 2007;
- liquid silicon rubber (LSR) and lathe manufacturing processes that expanded the breadth and scope of our injection molding and CNC machining product lines in 2014;
- 3D printing, including stereolithography (SL), selective laser sintering (SLS), and direct metal laser sintering (DMLS), through our acquisition of FineLine Prototyping, Inc. (FineLine) in 2014 and expanded through our acquisition of certain assets of Alphaform AG (Alphaform) in 2015;
- rapid overmolding technology in 2016 and insert molding technology in 2017, both of which expanded the breadth of our manufacturing capabilities in our Injection Molding product line;
- PolyJet and Multi Jet Fusion (MJF) in 2017, which expanded the processes with which we produce 3D printed parts;

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- injection molding commercial offerings tailored to on-demand manufacturing customers in 2017;
- sheet metal fabrication capability through our acquisition of RAPID Manufacturing Group, LLC (RAPID) in 2017;
- expanded CNC machining capabilities for larger and more complex parts through our acquisition of RAPID in 2017;
- Carbon Digital Light Synthesis(TM) (DLS) in 2019, which further expanded the processes with which we produce 3D printed parts; and
- during 2018 and 2019, we have been working on enhancements to our e-commerce customer interface and back-end operations software. These

enhancements are expected to launch in 2020 and are designed to add value for our customers and support the growth of the business in the future.

Industry Overview

Our Industry

We serve product developers and engineers worldwide who bring new ideas to market in the form of products containing one or more custom parts. Many of these product developers and engineers use 3D CAD software to create digital models representing their custom part designs that are then used to create physical parts for concept modeling, prototyping, functional testing, market evaluation or production. Custom prototype parts play a critical role in the product development process, as they provide product developers and engineers with the ability to test and confirm their intended performance requirements and explore design alternatives.

Early in the product development process, 3D printing processes such as SL and PolyJet can be used to quickly produce an approximate physical representation of a part, but these representations may not meet product developers' and engineers' requirements for material properties. As an alternative, injection molding, CNC machining, sheet metal, and 3D printing processes such as SLS, DMLS, and MJF can be used to produce low volumes of high-quality custom parts in either metal or plastic. For follow-on functional testing, market evaluation and production runs, parts are typically manufactured using injection molding, CNC machining and sheet metal fabrication.

Our Solution

We have developed proprietary software and advanced manufacturing processes that automate much of the skilled labor conventionally required in quoting, production engineering and manufacturing of custom parts. We believe our interactive web-based interface and highly automated processes address the desires of many product developers and engineers for a fast, efficient and cost-effective means to obtain custom parts, and are the primary reasons we have become a leading supplier of custom parts.

Key elements of our solution include:

Sophisticated Technology that Reduces Turnaround Time and Provides Consistency in Lead Time

Our digital model is centered on our web-based interface and proprietary software, which automate many of the manual and time-consuming processes typically required to obtain custom parts from conventional suppliers. Our platform automates many aspects of the entire process from design submission through manufacturability analysis and feedback, quotation, order submission, mold design, tool path generation, mold or part manufacture and digital inspection. To utilize our platform, a prospective customer uploads a 3D CAD file of their required part through our website. Often within minutes of design submission, our software analyzes the design, assesses the manufacturability of the design and our ability to make the part, and returns a firm price quotation with any recommendations for design modifications. Many of our customers find this analysis particularly helpful, as it diagnoses and prevents potential problems prior to manufacturing. We can also provide a flow analysis to identify design flaws that limit the ability to manufacture a quality part.

Our quoting system is highly interactive, enabling our prospective customers to change the material, finish, quantity or shipping schedule of orders, and to instantly receive an updated quotation. Once an order is received, our software automates much of the manual engineering and skilled labor that is normally required to manufacture parts. As a result, in many cases we are able to quote orders in minutes and ship parts as soon as the same day ordered.

Scale to Process Large Numbers of Unique Part Designs

Our proprietary, highly scalable quoting technology addresses the manual processes conventionally involved in submitting a design, analyzing its manufacturability, making design revision recommendations and generating price quotations. This enables us to quickly analyze high volumes of 3D CAD part design submissions and provide feedback to our prospective product developer and engineer customers. In 2019 alone, we generated quotations for over 1,000,000 design submissions. Our proprietary manufacturing automation technology is also highly scalable, enabling us to process large numbers of unique designs and, combined with our manufacturing processes, efficiently and effectively manufacture high volumes of parts to meet the needs of product developers and engineers.

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Enhanced Customer Experience

Our web-based customer interface provides a straightforward means of submitting 3D CAD part designs. Our proprietary manufacturability analysis then quickly analyzes whether a part design falls within our manufacturing capabilities. In many cases, our software provides suggested design modifications to enhance manufacturability, which is presented to the product developer or engineer in an interactive quotation containing a color-coded 3D representation of the part. This allows product developers and engineers to quickly determine the manufacturability of their parts, understand the cost and when they can be shipped. Our interactive quotations provide instant visibility into the impact of changing an order's various parameters such as material, finish, quantity or shipping schedule. As a result, we provide product developers and engineers with an easy-to-use and consistent means to obtain custom parts.

Attractive Custom Pricing

Based on internal market research, we believe we generally have competitive pricing on custom orders. We believe this, combined with speed, is a direct result of our technology and the efficiency of our operations, both of which were designed specifically for lower volume runs of custom parts production. By limiting these costs, we can typically offer attractive pricing not normally possible in the low volume, high mix custom parts market, and as a result, we can typically offer product developers and engineers competitive prices on custom manufactured parts.

Our Product Lines

Our Injection Molding, CNC Machining, 3D Printing and Sheet Metal product lines offer many product developers and engineers the ability to quickly and efficiently outsource their quick-turn custom parts manufacturing. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" for the historical revenue generated by each of Injection Molding, CNC Machining, 3D Printing and Sheet Metal.

Injection Molding

Our Injection Molding product line uses our 3D CAD-to-CNC machining technology for the automated design and manufacture of molds, which are then used to produce custom plastic and liquid silicone rubber injection-molded parts and over-molded and insert-molded injection-molded parts on commercially available equipment. Our Injection Molding product line works best for on-demand production, bridge tooling, pilot runs and functional prototyping. Our affordable aluminum molds and quick turnaround times help reduce design risk and limit overall production costs for product developers and engineers. 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 Proto Labs' Injection Molding product line for additional quantities. They do so to support pilot production for product testing, 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 requires limited annual quantity or because they need end-of-life production support. In 2017, we launched an on-demand manufacturing injection molding service. This service utilizes our existing processes, but is designed to fulfill the needs of customers with on-going production needs, typically in annual volumes of less than 10,000 parts.

CNC Machining

Our CNC Machining product line uses commercially available CNC machines to offer milling and turning. CNC milling is a manufacturing process that cuts plastic and metal blocks into one or more custom parts based on the 3D CAD model uploaded by the product developer or engineer. CNC turning with live tooling combines both lathe and mill capabilities to machine parts with cylindrical features from metal rod stock. Our efficiencies derive from the automation of the programming of these machines and a proprietary fixturing process. Quick-turn CNC machining works best for prototyping, form and fit testing, jigs and fixtures and functional components for end-use applications. We offer competitive pricing at higher quantities, in addition to First Article Inspection (FAI) reporting, material certifications and additional in-house and outsourced finishing options, like anodizing and chromate plating. The CNC Machining product line is well suited to produce small quantities, typically in the range of 15 to 1,000 parts.

3D Printing

Our 3D Printing product line includes SL, SLS, DMLS, MJF, PolyJet and Carbon DLS processes, which offers customers a wide-variety of high-quality, precision rapid prototyping and low volume production. These processes create parts with a high level of accuracy, detail, strength and durability. Industrial 3D Printing is best suited for functional prototypes, complex designs and end-use applications. 3D Printing is well suited to produce small quantities, typically in the range of one to several hundred parts.

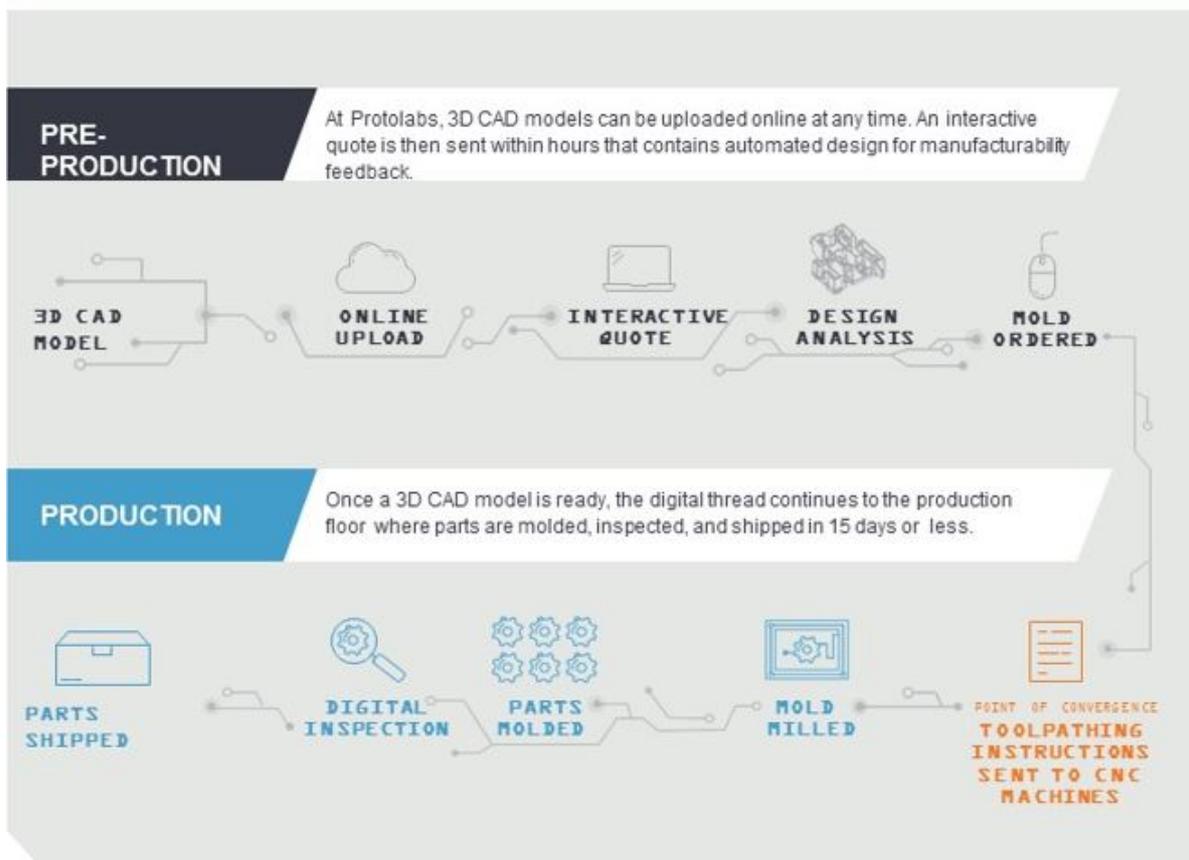
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Sheet Metal

Our Sheet Metal product line includes quick-turn and e-commerce-enabled custom sheet metal parts, providing customers with prototype and low-volume production parts. The rapid prototype sheet metal process is most often used when form, fit and function are all a priority. Our manufacturing process uses customer 3D CAD models uploaded by the product developer or engineer to fabricate rapid prototyping sheet metal or end-use production parts and assemblies. The Sheet Metal product line is well suited to produce quantities in the range of one to 500 parts.

Our Process

Digital Differentiation



The process for Injection Molding begins when the product developer or engineer uploads one or more 3D CAD models representing the desired part geometry through our website. Our proprietary software uses complex algorithms to analyze the 3D CAD geometry, analyze its manufacturability and support the creation of an interactive, web-based quotation containing pricing and manufacturability information. A link to the quotation is then e-mailed to the product developer or engineer, who can access the quotation, change a variety of order parameters and instantly see the effect on price before finalizing the order. Our proprietary software supports the creation of the mold design and the tool paths required to manufacture the mold components, which are then routed to our CNC machining centers for execution. Once the mold is assembled, it is placed in one of our injection molding presses to create the required parts. Parts are shipped in as little as one business day from design submission. We ship our parts via small parcel common carriers on standard terms and conditions. Our other services have similar processes, but differ mainly due to the nature of the manufacturing processes on which each service is based.

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Our Growth Strategy

The principal elements of our growth strategy are to:

Expand the Customer Base

We plan to expand our customer base to serve more product developers and engineers within the companies that have already used our product lines. Individual product developers and engineers typically make or influence the choice of vendor when sourcing custom parts. We believe a significant opportunity exists for us to leverage highly satisfied product developers and engineers to encourage others within the same organization to utilize our product lines. We have historically gained a significant number of new customers through word-of-mouth referrals from other product developers and engineers, and combine these referrals with the efforts of our marketing and sales force to identify and market our product lines to the colleagues of our existing customers.

We also plan to use our marketing and sales capabilities to continue to pursue product developers and engineers within companies who have not yet used our products. Our presence in geographic regions that have high populations of 3D CAD users provides us with a broad universe of potential new customer companies on which to focus our marketing and sales efforts.

We believe there may be opportunities to grow by identifying and expanding into select additional geographic markets. We currently operate in the United States, Europe and Japan, where we believe a substantial portion of the world's product developers and engineers are located. We entered the European market in 2005 and launched operations in Japan in 2009. For 2019, revenue earned in these markets represents approximately 22.0% of our total revenue. While we currently do not have specific plans to expand our manufacturing into any particular geographic markets, we believe opportunities exist to serve the needs of product developers and engineers in select new geographic regions and we will continue to evaluate such opportunities if and when they arise.

We plan to further enhance the functionality and ease of use of our platform and expand the capabilities of our customer-facing and back-end systems in order to further increase automation and meet the evolving needs of product developers and engineers worldwide. We believe product developers and engineers have come to expect advanced web-based tools and a fully integrated Internet platform from their vendors. We will continue to use the Internet to

provide product developers and engineers with a standardized interface through which they can upload their 3D CAD models and obtain firm, interactive quotations quickly and efficiently.

Launch New Manufacturing Technology

We seek to identify additional manufacturing processes to which we can apply our digital technology and expertise to meet a greater range of product developers' and engineers' needs. Introducing new manufacturing processes can both attract new customers and provide us with a significant opportunity to cross-sell our existing product lines to our existing customer base. We regularly evaluate new manufacturing processes to offer product developers and engineers and introduce such new processes when we are confident that a sufficient market demand exists and that we can offer the same advantages our customers have come to expect from us.

We were founded with Injection Molding which represents 47.4% of our total revenue for the year ended December 31, 2019. Examples of new manufacturing services we have added include CNC Machining, 3D Printing and Sheet Metal. Our CNC Machining product line was first introduced in the United States and Europe in 2007, expanded to Japan in 2009, and further expanded in the United States through our acquisition of RAPID in November 2017. CNC Machining represents 33.9% of our total revenue for the year ended December 31, 2019. 3D printing technologies were introduced through our acquisition of FineLine in April 2014. We further expanded our 3D printing capabilities in October 2015 through our acquisition of Alphaform. Our 3D product line represents 13.4% of our total revenue for the year ended December 31, 2019. Our Sheet Metal product line was introduced through our acquisition of RAPID in November 2017 and represents 4.6% of total revenue for the year ended December 31, 2019.

We continue to expand our core product lines through product line extensions including liquid silicone rubber injection molding, lathe-turned parts, rapid overmolding, insert molding, PolyJet, MJF and Carbon DLS. We introduced liquid silicone rubber injection molding during 2014. In 2015, we introduced lathe-turned products to expand our CNC product line. In 2016, we expanded the breadth of our manufacturing capabilities by adding rapid overmolding technology. In 2017, we added insert molding to our Injection Molding product line and PolyJet and MJF to our 3D Printing product line. In addition, we launched on-demand manufacturing to address the needs of the low-volume, high-mix product segment. We also opened our first metrology lab in 2017 for enhanced inspection reporting on end-use production parts, including First Article Inspection Reports and digital inspection reports. In 2019, we added Carbon DLS to provide a cost-effective production solution for geometric complexities that cannot be molded or otherwise fabricated.

Enhance Customer Experience

We serve nearly all our customers over the internet using our e-commerce, digital model. The majority of customers upload CAD files through our secure e-commerce platform to receive a quote, and ultimately, place an order. The order is then processed through our digital model that is connected by our systems. Having an industry leading customer experience is important to our overall growth strategy. In 2019, and as we look to 2020, the Company is focused on Protolabs 2.0, an internal project focused on our business systems designed to evolve the way we engage and serve our customers. Through development of our customer-facing and back-end systems, Protolabs 2.0 will allow us to capitalize on the market opportunity and properly serve the long-term needs of our customers. We expect the long-term benefits of the project to be an improved customer experience, speed and scalability of the business, internal business insights and internal productivity.

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Broaden the Parts Envelope

We regularly analyze the universe of customer design submissions that we are currently unable to manufacture and focus a portion of our research and development efforts to expand the range of parts that we can produce. Since we first introduced our Injection Molding product line in 1999, we have steadily expanded the size and geometric complexity of the injection-molded parts we are able to manufacture, and we continue to extend the diversity of materials we are able to support. Similarly, since first introducing our CNC Machining product line in 2007, we have expanded the range of part sizes, design geometries and materials we can support. In 2017, we launched PolyJet and MJF, which expanded our 3D Printing processes to support a broader range of our customers needs. Through our acquisition of RAPID in November 2017, we added quick-turn and e-commerce-enabled Sheet Metal services to our portfolio and expanded our CNC Machining capabilities to support larger and more complex projects. In 2019, we added Carbon DLS to our 3D Printing processes, introduced precision color matching on Injection Molding parts and launched production capabilities for metal 3D Printing. As we continue to expand the range of our existing process capabilities, we believe we will meet the needs of a broader set of product developers and engineers and consequently convert a higher number of quotation requests into orders.

Marketing

As a customer centric organization, we continue to evolve our go-to-market strategy. Our global marketing effort generates prospects for our sales teams and seeks to strengthen our reputation as an industry leader in digital manufacturing services for custom prototyping and low-volume manufacturing. Since we are an agile, technology-based company, much of our marketing activities occur online. We use marketing automation software to enhance the productivity of our marketing and sales teams and continuously track the results of every campaign to ensure our return on investment.

We maintain top-of-mind brand awareness with product developers and engineers through regular publication of technical information including design guidelines and helpful tips, engineering white papers, educational webinars, quick videos, and a quarterly journal focused on important industry topics. We also provide complimentary physical design aids to designers and engineers — as well as teachers and students — that highlight technical aspects of injection molding to help create efficient, well-designed parts. We believe these educational materials are key aspects of our lead generation efforts.

Marketing represents the face of Proto Labs, so it is our goal to actively and intelligently engage designers and engineers across multiple mediums — whether print, online, social media or in person. By doing this, we gain new customers, drive sales and build brand equity.

Sales and Customer Service

We maintain an internal sales team trained in the basics of part design and the capabilities of our manufacturing product lines, as well as the key advantages of our processes over alternate methods of custom parts manufacturing. We organize our sales team into complementary roles: business development, account management and strategic account management, with the former focused on selling to new customer companies within targeted market segments and the latter two focused on expanding sales within existing customer companies.

We believe our sales staff is adept at researching customer companies and networking to find additional product developers and engineers who may have a need for our products. We also have a team of customer service engineers who can support highly technical engineering discussions with product developers and engineers as required during the sales process. Our revenue is generated from a diverse customer base, with no single customer company representing more than 2% of our total revenue in 2019.

Competition

The market for custom parts manufacturing is fragmented, highly competitive and subject to rapid and significant technological change. Our potential competitors include:

- *Other custom parts manufacturers.* There are thousands of alternative manufacturing machine shops, injection molding suppliers, sheet metal fabricators, and 3D printing service bureaus and vendors worldwide. The size and scale of these businesses range from very small specialty shops to large, high-volume production manufacturers.
- *Captive in-house product manufacturing.* Many larger companies undertaking product development have established additive rapid prototyping (3D printing), CNC machining, injection molding or sheet metal capabilities internally to support prototyping or manufacturing requirements of their product developers and engineers.
- *Brokers.* There are an increasing number of digital brokers that provide product developers with a network of manufacturers, generally a subset of the other custom parts manufacturers described above, that can offer a diverse range of capabilities, capacity, competitive pricing and desired lead times to meet customer demand.

We believe that the key competitive factors in our industry include:

- Quality: dimensional accuracy, surface finish, material properties, color and cleanliness;
- Speed: turnaround time for quotations and parts;

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- Reliability: greater than 97% on-time delivery with predictable lead times;
- Service: overall customer experience, from web interface to post-sales support;
- Capability: range of part sizes and dimensional complexities supported, variety of manufacturing processes offered, materials supported and post-processing provided;
- Scale: ability to support thousands of part designs in parallel;
- Capacity: ability to manage peaks in demand with very short lead times and no minimum order quantities; and
- Price: mold and part pricing, including total cost of ownership.

We believe that our digital end-to-end manufacturing capability positions us favorably and has enabled us to become a leader in our markets. We also believe that substantially all of our current direct competitors are relatively small in terms of size of operations, revenue, number of customers and volume of parts sold, and generally lack our technological capabilities. However, our industry is evolving rapidly and other companies, including potentially larger and more established companies with developed technological capabilities, may begin to focus on low volume, high mix custom parts manufacturing. These companies could more directly compete with us, along with our existing competitors, and could also launch new products and product lines that we do not offer that may quickly gain market acceptance. Any of the foregoing could adversely affect our ability to attract customers.

Intellectual Property

We regard our patents, trademarks, service marks, trade dress, trade secrets, copyrights, domain names and other intellectual property as valuable to our business and rely on patent, trademark and copyright law, trade secret protection and confidentiality and/or license agreements with our employees, customers, vendors and others to protect our proprietary rights. We register our patents, trademarks and service marks in the United States and other jurisdictions as we deem appropriate. As of December 31, 2019, we owned and had applications pending for patents relating to various aspects of our quoting and manufacturing processes as follows:

Jurisdiction	Issued Patents	Applications Pending
United States	18	11
United Kingdom	2	0
Germany	0	2

Our patents have expiration dates ranging from 2022 to 2032. We also owned approximately 20 registered and 3 pending United States trademarks or service marks as of December 31, 2019, with corresponding registered protection in Europe and Japan for the most important of these marks such as PROTO LABS, PROTOMOLD, FIRSTCUT, PROTOQUOTE, FIRSTQUOTE, PROTOFLOW and FINELINE, corresponding approved protection in Canada for PROTO LABS, FIRSTCUT and FINELINE, and corresponding registered protection in Australia, Canada and Mexico for PROTOMOLD. There can be no

assurance that the steps we take to protect our proprietary rights will be adequate or that third parties will not infringe or misappropriate such rights. We have been subject to claims and expect to be subject to legal proceedings and claims from time to time in the ordinary course of our business. In particular, we may face claims from third parties that we have infringed their patents, trademarks or other intellectual property rights. Such claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources. Any unauthorized disclosure or use of our intellectual property could make it more expensive to do business and harm our operating results.

Employees

As of December 31, 2019 we had 2,535 full-time employees. We also regularly use independent contractors and other temporary employees across the organization to augment our regular staff. We believe that our future success will depend in part on our continued ability to attract, hire and retain qualified personnel.

Available Information

Our principal executive offices are located at 5540 Pioneer Creek Drive, Maple Plain, Minnesota 55359 and our telephone number is (763) 479-3680. Our website address is www.protolabs.com. Information on our website does not constitute part of this Annual Report on Form 10-K or any other report we file or furnish with the SEC. We provide free access to various reports that we file with or furnish to the SEC through our website as soon as reasonably practicable after they have been filed or furnished. These reports include, but are not limited to, our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments to these reports. Our SEC reports can be accessed through the investor relations section of our website.

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The SEC maintains a website that contains reports, proxy and information statements, and other information regarding issuers that file information electronically with the SEC. The SEC's website is www.sec.gov.

Executive Officers of the Registrant

Set forth below are the names of our current executive officers, their ages, titles, the year first appointed as an executive officer, and employment for the past five years:

Victoria M. Holt	62	President, Chief Executive Officer and Director
Robert Bodor	47	Vice President/General Manager – Americas
John A. Way	47	Chief Financial Officer and Executive Vice President of Development
Arthur R. Baker III	52	Chief Technology Officer
Bjoern Klaas	50	Vice President/General Manager and Managing Director – Europe, Middle East and Africa

Executive officers of the Company are elected at the discretion of the board of directors with no fixed terms. There are no family relationships between or among any of the executive officers or directors of the Company.

Victoria M. Holt. Ms. Holt has been our President and Chief Executive Officer since February 2014. Prior to joining Proto Labs, Ms. Holt served as President and Chief Executive Officer of Spartech Corporation, a leading producer of plastic sheet, compounds and packaging products, from September 2010 until Spartech was purchased by PolyOne Corporation in March 2013. Ms. Holt also is a member of the Board of Directors of Waste Management, Inc. and Piper Sandler Companies.

Robert Bodor. Dr. Bodor has served as our Vice President/General Manager - Americas since January 2015. From July 2013 to January 2015, Dr. Bodor served as our Chief Technology Officer. From December 2012 to June 2013, Dr. Bodor served as our Director of Business Development. Prior to joining Proto Labs, from January 2011 to December 2012, Dr. Bodor held several roles at Honeywell, most recently leading SaaS business offerings for Honeywell's Life Safety Division.

John A. Way. Mr. Way has served as our Chief Financial Officer and Executive Vice President of Development since December 2014. From September 2012 to September 2014, Mr. Way served as Chief Financial Officer for portfolio companies of two Private Equity Firms. From October 2002 to September 2012, Mr. Way worked in senior financial positions at several divisions within UnitedHealth Group, including Chief Financial Officer of Optum Care, Medicare Advantage and OptumHealth.

Arthur R. Baker III. Dr. Baker has been our Chief Technology Officer since May 2016. Prior to joining Proto Labs, Dr. Baker served as Chief Technology Officer of PaR Systems, a robotics and specialty machine tool builder. From 2005 to 2014, Dr. Baker held multiple positions at MTS Systems, including General Manager of the Test Division, Chief Technology Officer, and Vice President of Engineering and Operations. MTS Systems was a leader in mechanical testing and simulation systems for automotive, aerospace, medical, civil-seismic and general research.

Bjoern Klaas. Mr. Klaas has led our company's business in Europe, Middle East and Africa as the Vice President and Managing Director since December 2017. Prior to joining Proto Labs, Mr. Klaas held key positions with global polymer supplier PolyOne from 2012 to 2017, most recently as its Vice President and General Manager for its ColorMatrix Group headquartered in the United States. From 2008 to 2012, Mr. Klaas worked at Colorant-Chromatics, a global leader for high temperature polymer formulations, as the General Manager for the global business.

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Item 1A. Risk Factors

The following are the significant factors that could materially adversely affect our business, financial condition, or operating results, as well as adversely affect the value of an investment in our common stock.

Risks Relating to Our Business

We face significant competition and expect to face increasing competition in many aspects of our business, which could cause our operating results to suffer.

The market for custom parts manufacturing is fragmented and highly competitive. We compete for customers with a wide variety of custom parts manufacturers and methods. Some of our current and potential competitors include captive in-house product lines, other custom parts manufacturers, brokers of custom parts and alternative manufacturing vendors such as those utilizing 3D printing processes. Moreover, some of our existing and potential competitors are researching, designing, developing and marketing other types of products and product lines. We also expect that future competition may arise from the development of allied or related techniques for custom parts manufacturing that are not encompassed by our patents, from the issuance of patents to other companies that may inhibit our ability to develop certain products and from improvements to existing technologies. Furthermore, our competitors may attempt to adopt and improve upon key aspects of our business model, such as development of technology that automates much of the manual labor conventionally required to quote and manufacture custom parts, implementation of interactive web-based and automated user interface and quoting systems and/or building scalable operating models specifically designed for efficient custom production. Third-party CAD software companies may develop software that mold-makers, injection molders and CNC machine shops could use to compete with our business model. Additive manufacturers may develop stronger, higher temperature resins or introduce other improvements that could more effectively compete with us on part quality. We may also, from time to time, establish alliances or relationships with other competitors or potential competitors. To the extent companies terminate such relationships and establish alliances and relationships with our competitors, our business could be harmed.

Existing and potential competitors may have substantially greater financial, technical, marketing and sales, manufacturing, distribution and other resources and name recognition than us, as well as experience and expertise in intellectual property rights and operating within certain international locations, any of which may enable them to compete effectively against us.

Though we plan to continue to expend resources to develop new technologies, processes and product lines, we cannot assure you that we will be able to maintain our current position or continue to compete successfully against current and future sources of competition. Our challenge in developing new products is finding product lines for which our automated quotation and manufacturing processes offer an attractive value proposition, and we may not be able to find any new product lines with potential economies of scale similar to our existing product lines. If we do not keep pace with technological change and introduce new technologies, processes and product lines, the demand for our products and product lines may decline and our operating results may suffer.

Our success depends on our ability to deliver products and product lines that meet the needs of product developers and engineers and to effectively respond to changes in our industry.

We derive almost all of our revenue from the manufacture and sale to product developers and engineers of quick-turn low volumes of custom parts for prototyping, support of internal manufacturing and limited quantity product release. Our business has been, and, we believe, will continue to be, affected by changes in product developer and engineering requirements and preferences, rapid technological change, new product and product line introductions and the emergence of new standards and practices, any of which could render our technology, products and product lines less attractive, uneconomical or obsolete. To the extent that our customers' need for quick-turn parts decreases significantly for any reason, it would likely have a material adverse effect on our business and operating results and harm our competitive position. In addition, CAD simulation and other technologies may reduce the demand for physical prototype parts. Therefore, we believe that to remain competitive, we must continually expend resources to enhance and improve our technology, product offerings and product lines.

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In particular, we plan to increase our research and development efforts and to continue to focus a significant portion of those efforts to further develop our technology in areas such as our interactive user interface and manufacturing processes, potentially introduce new manufacturing processes within the research and development initiative we refer to as Protoworks, and broaden the range of parts that we are able to manufacture. We believe successful execution of this part of our business plan is critical for our ability to compete in our industry and grow our business, and there are no guarantees we will be able to do so in a timely fashion, or at all. Broadening the range of parts we offer is of particular importance since limitations in manufacturability are the primary reason we are not able to fulfill many quotation requests. There are no guarantees that the resources devoted to executing on this aspect of our business plan will improve our business and operating results or result in increased demand for our products and product lines. Failures in this area could adversely impact our operating results and harm our reputation and brand. Even if we are successful in executing in these areas, our industry is subject to rapid and significant technological change, and our competitors may develop new technologies, processes and product lines that are superior to ours. Our research and development costs were approximately \$32.7 million, \$28.7 million and \$23.6 million for the years ended December 31, 2019, 2018 and 2017, respectively, and there is no guarantee that these costs will enable us to maintain or grow our revenue profitability. Refer to Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Annual Report on Form 10-K for additional discussion related to research and development costs.

Any failure to properly meet the needs of product developers and engineers or respond to changes in our industry on a cost-effective and timely basis, or at all, would likely have a material adverse effect on our business and operating results and harm our competitive position.

Our failure to meet our customers' expectations regarding quick turnaround time would adversely affect our business and results of operations.

We believe many product developers and engineers are facing increased pressure from global competitors to be first to market with their finished products, often resulting in a need for quick turnaround of custom parts. We believe our ability to quickly quote, manufacture and ship custom parts has been an important factor in our results to date. There are no guarantees we will be able to meet product developers' and engineers' increasing expectations regarding quick turnaround time, especially as we increase the scope of our operations. If we fail to meet our customers' expectations regarding turnaround time in any given period, our business and results of operations will likely suffer.

Our failure to meet our customers' price expectations would adversely affect our business and results of operations.

Demand for our product lines is sensitive to price. We believe our competitive pricing has been an important factor in our results to date. Therefore, changes in our pricing strategies can have a significant impact on our business and ability to generate revenue. Many factors, including our production and personnel costs and our competitors' pricing and marketing strategies, can significantly impact our pricing strategies. If we fail to meet our customers' price

expectations in any given period, demand for our products and product lines could be negatively impacted and our business and results of operations could suffer.

Our failure to meet our customers' quality specifications would adversely affect our business and results of operations.

We believe many product developers and engineers have a need for specific quality of quick-turn, on-demand custom parts. We believe our ability to create parts with the specifications of the product developers and engineers is an important factor in our results to date. If we fail to meet our customers' specifications in any given period, demand for our products and product lines could be negatively impacted and our business and results of operations could suffer.

The strength of our brand is important to our business, and any failure to maintain and enhance our brand would hurt our ability to retain and expand our customer base as well as further penetrate existing customers.

Since our products and product lines are sold primarily through our websites, the success of our business depends upon our ability to attract new and repeat customers to our websites in order to increase business and grow our revenue. Customer awareness and the perceived value of our brand will depend largely on the success of our marketing efforts, as well as our ability to consistently provide quality custom parts within the required timeframes and positive customer experiences, which we may not do successfully. A primary component of our business strategy is the continued promotion and strengthening of our brand, and we have incurred and plan to continue to incur substantial expense related to advertising and other marketing efforts directed toward enhancing our brand. We have initiated marketing efforts through social media, but this method of marketing may not be successful and subjects us to a greater risk of inconsistent messaging and bad publicity. We may choose to increase our branding expense materially, but we cannot be sure that this investment will be profitable. If we are unable to successfully maintain and enhance our brand, this could have a negative impact on our business and ability to generate revenue.

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Our business depends in part on our ability to process a large volume of new part designs from a diverse group of product developers and engineers and successfully identify significant opportunities for our business based on those submissions.

We believe the volume of new part designs we process and the size and diversity of our customer base give us valuable insight into the needs of our prospective customers. We utilize this industry knowledge to determine where we should focus our development resources. If the number of new part designs we process or the size and diversity of our customer base decrease, our ability to successfully identify significant opportunities for our business and meet the needs of product developers and engineers could be negatively impacted. In addition, even if we do continue to process a large number of new part designs and work with a significant and diverse customer base, there are no guarantees that any industry knowledge we extract from those interactions will be successfully utilized to help us identify significant business opportunities or better understand the needs of product developers and engineers.

The loss of one or more key members of our management team or personnel, or our failure to attract, integrate and retain additional personnel in the future, could harm our business and negatively affect our ability to successfully grow our business.

We are highly dependent upon the continued service and performance of the key members of our management team and other personnel. The loss of any of these individuals, each of whom is "at will" and may terminate his or her employment relationship with us at any time, could disrupt our operations and significantly delay or prevent the achievement of our business objectives. We believe that our future success will also depend in part on our continued ability to identify, hire, train and motivate qualified personnel. A possible shortage of qualified individuals in the regions where we operate might require us to pay increased compensation to attract and retain key employees, thereby increasing our costs. In addition, we face intense competition for qualified individuals from numerous companies, many of whom have substantially greater financial and other resources and name recognition than us. We may be unable to attract and retain suitably qualified individuals who are capable of meeting our growing operational, managerial and other requirements, or we may be required to pay increased compensation in order to do so. Our failure to attract, hire, integrate and retain qualified personnel could impair our ability to achieve our business objectives.

If we fail to grow our business as anticipated, our net sales, gross margin and operating margin will be adversely affected.

We are attempting to grow our business substantially. To this end, we have made and expect to continue to make significant investments in our business, including investments in our infrastructure, technology, and marketing and sales efforts. These investments include dedicated facilities expansion and increased staffing, both domestic and international. If our business does not generate the level of revenue required to support our investment, our net sales and profitability will be adversely affected.

If we are unable to manage our growth and expand our operations successfully, our reputation and brand may be damaged, and our business and results of operations may be harmed.

Over the past several years, we have experienced rapid growth. For example, we have grown from 1,549 full-time employees as of January 1, 2016 to 2,535 full-time employees as of December 31, 2019. We have expanded internationally, including establishing manufacturing operations in Europe in 2005 and Japan in 2009. In 2014, we expanded our product lines with 3D Printing through our acquisition of FineLine. In 2015, we expanded our manufacturing operations and our 3D Printing product lines in Europe through our acquisition of Alphaform. In 2017, we expanded our product lines to include Sheet Metal through our acquisition of RAPID. We expect this growth to continue and the number of countries and facilities from which we operate to increase in the future. Our ability to effectively manage our anticipated growth and expansion of our operations will require us to do, among other things, the following:

- enhance our operational, financial and management controls and infrastructure, human resource policies, and reporting systems and procedures, in particular as we continue to operate as a global organization;
- effectively scale our operations, including accurately predicting the need for floor space, equipment, and additional staffing;
- successfully identify, recruit, hire, train, develop, maintain, motivate and integrate additional employees; and
- expand our international resources.

These enhancements and improvements will require significant capital expenditures and allocation of valuable management and employee resources. Furthermore, our growth, combined with the geographical dispersion of our operations, has placed, and will continue to place, a strain on our operational, financial and management infrastructure. Our future financial performance and our ability to execute on our business plan will depend, in part, on our ability to effectively manage any future growth and expansion. There are no guarantees we will be able to do so in an efficient or timely manner, or at all. Our failure to effectively manage growth and expansion could have a material adverse effect on our business, results of operations, financial condition, prospects, and reputation and brand, including impairing our ability to perform to our customers' expectations.

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We may not timely and effectively scale and adapt our existing technology, processes and infrastructure to meet the needs of our business.

A key element to our continued growth is the ability to quickly and efficiently quote an increasing number of product developer and engineer submissions across geographic regions and to manufacture the related parts. This will require us to timely and effectively scale and adapt our existing technology, processes and infrastructure to meet the needs of our business. With respect to our websites and quoting technology, it may become increasingly difficult to maintain and improve their performance, especially during periods of heavy usage and as our solutions become more complex and our user traffic increases across geographic regions. Similarly, our manufacturing automation technology may not enable us to process the large numbers of unique designs and efficiently manufacture the related parts in a timely fashion to meet the needs of product developers and engineers as our business continues to grow. Any failure in our ability to timely and effectively scale and adapt our existing technology, processes and infrastructure could negatively impact our ability to retain existing customers and attract new customers, damage our reputation and brand, result in lost revenue, and otherwise substantially harm our business and results of operations.

We may experience difficulties implementing our new e-commerce system and updates to our back-end systems.

We are engaged in implementing a new e-commerce system. The e-commerce system is designed to improve our customer experience which will allow us to capitalize on the market opportunity and properly serve the long-term needs of our customers. We are updating back-end systems with standard software packages augmented by internally developed software to ensure the scalability of our architecture moving forward. These activities have required, and will continue to require, the investment of significant personnel and financial resources. We may not be able to successfully implement the e-commerce system without experiencing delays, increased costs and other difficulties. If we are unable to successfully design and implement the new e-commerce system and supporting architecture as planned, our financial positions, results of operations and cash flows could be negatively impacted. Additionally, if we do not effectively implement the new e-commerce system as planned or the back-end systems do not operate as intended, our ability to process orders, manufacture and ship parts, send invoices and track payments, fulfill contractual obligations or otherwise operate our business could be adversely affected. While we have invested significant resources in planning, project management, and training, additional and significant implementation issues may arise.

Numerous factors may cause us not to maintain the revenue growth that we have historically experienced.

Although our revenue has grown over the past five years from \$264.1 million for the year ended December 31, 2015 to \$458.7 million for the year ended December 31, 2019, we may not be able to maintain our historical rate of revenue growth. We believe that our continued revenue growth will depend on many factors, a number of which are out of our control, including among others, our ability to:

- retain and further penetrate existing customer companies, as well as attract new customer companies;
- consistently execute on custom part orders in a manner that satisfies product developers' and engineers' needs and provides them with a superior experience;
- develop new technologies or manufacturing processes and broaden the range of parts we offer;
- successfully execute on our international strategy and expand into new geographic markets;
- capitalize on product developer and engineer expectations for access to comprehensive, user-friendly e-commerce capabilities 24 hours per day, 7 days per week;
- increase the strength and awareness of our brand across geographic regions;
- respond to changes in product developer and engineer needs, technology and our industry;
- react to challenges from existing and new competitors; and
- respond to an economic recession which negatively impacts manufacturers' ability to innovate and bring new products to market.

We cannot assure you that we will be successful in addressing the factors above and continuing to grow our business and revenue.

Our operating results and financial condition may fluctuate on a quarterly and annual basis.

Our operating results and financial condition may fluctuate from quarter to quarter and year to year, and are likely to continue to vary due to a number of factors, some of which are outside of our control. In addition, our actual or projected operating results may fail to match our past performance. These events could in turn cause the market price of our common stock to fluctuate. If our operating results do not meet the expectations of securities analysts or investors, who may derive their expectations by extrapolating data from recent historical operating results, the market price of our common stock will likely decline.

Our operating results and financial condition may fluctuate due to a number of factors, including those listed below and those identified throughout this "Risk Factors" section:

- the development of new competitive systems or processes by others;
- the entry of new competitors into our market, whether by established companies or by new companies;

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- changes in the size and complexity of our organization, including our international operations;
- levels of sales of our products and product lines to new and existing customers;
- the geographic distribution of our sales;
- changes in product developer and engineer preferences or needs;
- changes in the amount that we invest to develop, acquire or license new technologies and processes, which we anticipate will generally increase and may fluctuate in the future;
- delays between our expenditures to develop, acquire or license new technologies and processes, and the generation of sales related thereto;
- our ability to timely and effectively scale our business during periods of sequential quarterly or annual growth;
- limitations or delays in our ability to reduce our expenses during periods of declining sequential quarterly or annual revenue;
- changes in our pricing policies or those of our competitors, including our responses to price competition;
- changes in the amount we spend in our marketing and other efforts;
- unexpected increases in expenses as compared to our related accounting accruals or operating plan;
- the volatile global economy;
- general economic and industry conditions that affect customer demand and product development trends;
- interruptions to or other problems with our website and interactive user interface, information technology systems, manufacturing processes or other operations;
- changes in accounting rules and tax and other laws; and
- plant shutdowns due to a health pandemic or weather conditions.

Due to all of the foregoing factors and the other risks discussed in this “Risk Factors” section, you should not rely on quarter-to-quarter or year-to-year comparisons of our operating results as an indicator of future performance.

Interruptions to or other problems with our website and interactive user interface, information technology systems, manufacturing processes or other operations could damage our reputation and brand and substantially harm our business and results of operations.

The satisfactory performance, reliability, consistency, security and availability of our websites and interactive user interface, information technology systems, manufacturing processes and other operations are critical to our reputation and brand, and to our ability to effectively service product developers and engineers. Any interruptions or other problems that cause any of our websites, interactive user interface or information technology systems to malfunction or be unavailable, or negatively impact our manufacturing processes or other operations, may damage our reputation and brand, result in lost revenue, cause us to incur significant costs seeking to remedy the problem and otherwise substantially harm our business and results of operations.

A number of factors or events could cause such interruptions or problems, including among others: human and software errors, design faults, challenges associated with upgrades, changes or new facets of our business, power loss, telecommunication failures, fire, flood, extreme weather, political instability, acts of terrorism, war, break-ins and security breaches, contract disputes, labor strikes and other workforce-related issues, capacity constraints due to an unusually large number of product developers and engineers accessing our websites or ordering parts at the same time, and other similar events. These risks are augmented by the fact that our customers come to us largely for our quick-turn manufacturing capabilities and that accessibility and turnaround speed are often of critical importance to these product developers and engineers. We are dependent upon our facilities through which we satisfy all of our production demands and in which we house all of the computer hardware necessary to operate our websites and systems as well as managerial, customer service, sales, marketing and other similar functions, and we have not identified alternatives to these facilities or established fully redundant systems in multiple locations. However, we have back-up computing systems for each of our United States, European and Japanese operations. In addition, we are dependent in part on third parties for the implementation and maintenance of certain aspects of our communications and production systems, and therefore preventing, identifying and rectifying problems with these aspects of our systems is to a large extent outside of our control.

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Moreover, the business interruption insurance that we carry may not be sufficient to compensate us for the potentially significant losses, including the potential harm to the future growth of our business that may result from interruptions in our product lines as a result of system failures.

We store confidential customer information in our systems that, if breached or otherwise subjected to unauthorized access, may harm our reputation or brand or expose us to liability.

Our system stores, processes and transmits our customers' confidential information, including the intellectual property in their part designs and other sensitive data. We rely on encryption, authentication and other technologies licensed from third parties, as well as administrative and physical safeguards, to secure such confidential information. Any compromise of our information security could damage our reputation and brand and expose us to a risk of loss, costly litigation and liability that would substantially harm our business and operating results. We may not have adequately assessed the internal and external risks posed to the security of our company's systems and information and may not have implemented adequate preventative safeguards or take adequate reactionary measures in the event of a security incident. In addition, most states have enacted laws requiring companies to notify individuals and often state authorities of data security breaches involving their personal data. These mandatory disclosures regarding a security breach often lead to widespread negative publicity, which may cause our existing and prospective customers to lose confidence in the effectiveness of our data security measures. Any security breach, whether successful or not, would harm our reputation and brand and could cause the loss of customers.

Aspects of our business are subject to privacy, data use and data security regulations, which may impact the way we use data to target customers.

Privacy and security laws and regulations may limit the use and disclosure of certain information and require us to adopt certain cybersecurity and data handling practices that may affect our ability to effectively market our services to current, past or prospective customers. In many jurisdictions consumers must be notified in the event of a data security breach, and such notification requirements continue to increase in scope and cost. The changing privacy laws in the United States, Europe and elsewhere—including the General Data Protection Regulation (GDPR) in the European Union, which became effective May 25, 2018, and the California Consumer Privacy Act of 2018, which was enacted on June 28, 2018 and became effective on January 1, 2020—create new individual privacy rights and impose increased obligations, including disclosure obligations, on companies handling personal data. The impact of these continuously evolving laws and regulations could have a material adverse effect on the way we use data to digitally market and pursue our customers.

Global economic conditions may harm our ability to do business, increase our costs and negatively affect our stock price.

The prospects for economic growth in the United States and other countries remain uncertain and could worsen. Economic concerns and other issues such as reduced access to capital for businesses may cause product developers and engineers to further delay or reduce the product development projects that our business supports. Given the continued uncertainty concerning the global economy, we face risks that may arise from financial difficulties experienced by our suppliers, product developers and engineers and other related risks to our business.

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Political and economic uncertainty arising from the outcome of the United Kingdom's referendum on its membership in the European Union could adversely affect our business and results of operations.

On June 23, 2016, the United Kingdom (UK) held a referendum in which voters approved a withdrawal from the European Union (EU), commonly referred to as "Brexit." The UK's withdrawal became effective on January 31, 2020. A transition period will apply until the end of 2020 while the UK and EU negotiate rules that will apply to their future relationship. It is possible that the level of economic activity in this region will be adversely impacted and that there will be increased regulatory and legal complexities, including those relating to tax, trade, security and employees. In addition, Brexit could lead to economic uncertainty, including significant volatility in global stock markets and currency exchange rates, which may adversely impact our business. To mitigate the potential impact of Brexit on the import and export of goods to and from the UK, the Company is establishing business processes with shipping entities, including obtaining Authorized Economic Operator certification. In addition, the Company is increasing inventory in the UK and EU in an effort to maintain inventory required to meet customer demand in the event of disruption in shipments. Although the specific terms and the timeframe of the negotiations are unknown, it is possible that these changes could adversely affect our business and results of operations.

We operate a global business that exposes us to additional risks.

We have established our operations in the United States, Europe and Japan and are seeking to further expand our international operations. As of December 31, 2019, we had sold products into approximately 60 countries. In addition to English, our website is available in British English, French, German, Italian, Japanese and Spanish. Our international revenue accounted for approximately 22%, 21% and 24% of our total revenue in the years ended December 31, 2019, 2018 and 2017, respectively. The future growth and profitability of our international business is subject to a variety of risks and uncertainties. Many of the following factors have adversely affected our international operations and sales to customers located outside of the United States and may again in the future:

- difficulties in staffing and managing foreign operations, particularly in new geographic locations;
- challenges in providing solutions across a significant distance, in different languages and among different cultures;
- rapid changes in government, economic and political policies and conditions, political or civil unrest or instability, terrorism or epidemics, and other similar outbreaks or events;
- economic uncertainty, including significant volatility in global stock markets and currency exchange rates, resulting from Brexit;
- fluctuations in foreign currency exchange rates;
- differences in product developer and engineer preferences and means of procuring parts;
- compliance with and changes in foreign laws and regulations, as well as U.S. laws affecting the activities of U.S. companies abroad, including those associated with export controls, tariffs and embargoes, other trade restrictions and antitrust and data privacy concerns;
- different, complex and changing laws governing intellectual property rights, sometimes affording companies lesser protection in certain areas;

- differing levels of use of the Internet or 3D CAD software;
- seasonal reductions in business activity in certain parts of the world, particularly during the summer months in Europe and holiday season;
- higher costs of doing business internationally;
- interruptions resulting from any events affecting raw material supply or manufacturing capabilities abroad;
- protectionist laws and business practices that favor local producers and service providers;
- taxation;
- energy costs;
- restrictions imposed by local labor practices and laws on our business and operations;
- workforce uncertainty in countries where labor unrest is more common than in the United States;
- transportation delays; and
- increased payment risk and higher levels of payment fraud.

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Our business depends on product developers' and engineers' demand for our product lines, the general economic health of current and prospective customers, and companies' desire or ability to make investments in new products. A deterioration of global, regional or local political, economic or social conditions could affect potential customers in ways that reduce demand for our product lines, disrupt our manufacturing and sales plans and efforts or otherwise negatively impact our business. Acts of terrorism, wars, public health issues and increased energy costs could disrupt commerce in ways that could impair our ability to get products to our customers and increase our manufacturing and delivery costs. We have not undertaken hedging transactions to cover our foreign currency exposure, and changes in foreign currency exchange rates may negatively impact reported revenue and expenses. In addition, our sales are often made on unsecured credit terms, and a deterioration of political, economic or social conditions in a given country or region could reduce or eliminate our ability to collect accounts receivable in that country or region. In any of these events, our results of operations could be materially and adversely affected.

If a natural or man-made disaster strikes any of our manufacturing facilities, we will be unable to manufacture our products for a substantial amount of time and our sales will decline.

We manufacture all of our products in 12 manufacturing facilities, located in Maple Plain, Minnesota; Rosemount, Minnesota; Plymouth, Minnesota; Brooklyn Park, Minnesota; Cary, North Carolina; Nashua, New Hampshire (3 facilities); Telford, United Kingdom; Feldkirchen, Germany; Eschenlohe, Germany; and Zama, Kanagawa, Japan. These facilities and the manufacturing equipment we use would be costly to replace and could require substantial lead time to repair or replace. Our facilities may be harmed by natural or man-made disasters, including, without limitation, earthquakes, floods, tornadoes, fires, hurricanes, tsunamis and nuclear disasters.

In the event any of our facilities are affected by a disaster, we may:

- be unable to meet the shipping deadlines of our customers;
- experience disruptions in our ability to process submissions and generate quotations, manufacture and ship parts, provide marketing and sales support and customer service, and otherwise operate our business, any of which could negatively impact our business;
- be forced to rely on third-party manufacturers;
- need to expend significant capital and other resources to address any damage caused by the disaster; and
- lose customers and be unable to regain those customers.

Although we possess insurance for damage to our property and the disruption of our business from casualties, this insurance may not be sufficient to cover all of our potential losses and may not continue to be available to us on acceptable terms, or at all.

If our present single or limited source suppliers become unavailable or inadequate, our customer relationships, results of operations and financial condition may be adversely affected.

We acquire substantially all of the manufacturing equipment and certain of our materials that are critical to the ongoing operation and future growth of our business from several third parties. We do not have long-term supply contracts with any of our suppliers and operate on a purchase-order basis. While most manufacturing equipment and materials for our products are available from multiple suppliers, certain of those items are only available from single or limited sources. Should any of our present single or limited source suppliers for manufacturing equipment or materials become unavailable or inadequate, or impose terms unacceptable to us such as increased pricing terms, we could be required to spend a significant amount of time and expense to develop alternate sources of supply, and we may not be successful in doing so on terms acceptable to us, or at all. Natural disasters, such as hurricanes, may affect our supply of materials, particularly resins, from time to time, and we may purchase larger amounts of certain materials in anticipation of future shortages or increases in pricing. In addition, if we were unable to find a suitable supplier for a particular type of manufacturing equipment or material, we could be required to modify

our existing business processes and offerings to accommodate the situation. As a result, the loss of a single or limited source supplier could adversely affect our relationship with our customers and our results of operations and financial condition.

We may not be able to adequately protect or enforce our intellectual property rights, which could impair our competitive position.

Our success and future revenue growth will depend, in part, on our ability to protect our intellectual property. We rely primarily on patents, licenses, trademarks and trade secrets, as well as non-disclosure agreements and other methods, to protect our proprietary technologies and processes globally. Despite our efforts to protect our proprietary technologies and processes, it is possible that competitors or other unauthorized third parties may obtain, copy, use or disclose our technologies and processes. We cannot assure you that any of our existing or future patents will not be challenged, invalidated or circumvented. As such, any rights granted under these patents may not provide us with meaningful protection. We may not be able to obtain foreign patents corresponding to our United States patents. Even if foreign patents are granted, effective enforcement in foreign countries may not be available. If our patents and other intellectual property do not adequately protect our technology, our competitors may be able to offer product lines similar to ours. Our competitors may also be able to develop similar technology independently or design around our patents. Any of the foregoing events would lead to increased competition and lower revenue or gross margin, which would adversely affect our net income.

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We may be subject to infringement claims.

We may be subject to intellectual property infringement claims from individuals, vendors and other companies who have acquired or developed patents in the fields of injection molding, CNC machining, 3D printing, sheet metal fabrication or part production for purposes of developing competing products or for the sole purpose of asserting claims against us. Any claims that our products or processes infringe the intellectual property rights of others, regardless of the merit or resolution of such claims, could cause us to incur significant costs in responding to, defending and resolving such claims, and may prohibit or otherwise impair our ability to commercialize new or existing products. If we are unable to effectively defend our processes, our market share, sales and profitability could be adversely impacted.

Our failure to expand our intellectual property portfolio could adversely affect the growth of our business and results of operations.

Expansion of our intellectual property portfolio is one of the available methods of growing our revenue and our profits. This involves a complex and costly set of activities with uncertain outcomes. Our ability to obtain patents and other intellectual property can be adversely affected by insufficient inventiveness of our employees, by changes in intellectual property laws, treaties, and regulations, and by judicial and administrative interpretations of those laws, treaties and regulations. Our ability to expand our intellectual property portfolio could also be adversely affected by the lack of valuable intellectual property for sale or license at affordable prices. There is no assurance that we will be able to obtain valuable intellectual property in the jurisdictions where we and our competitors operate or that we will be able to use or license that intellectual property.

We may be subject to product liability claims, which could result in material expense, diversion of management time and attention and damage to our business and reputation and brand.

The prototype parts we manufacture and the parts we manufacture in low volumes may contain undetected defects or errors that are not discovered until after the products have been installed and used by customers. This could result in claims from customers or others, damage to our business and reputation and brand, or significant costs to correct the defect or error.

We attempt to include provisions in our agreements with customers that are designed to limit our exposure to potential liability for damages arising from defects or errors in our products. However, it is possible that these limitations may not be effective as a result of unfavorable judicial decisions or laws enacted in the future.

The sale and support of our products entails the risk of product liability claims. Any product liability claim brought against us, regardless of its merit, could result in material expense, diversion of management time and attention, damage to our business and reputation and brand, and cause us to fail to retain existing customers or to fail to attract new customers.

Government regulation of the Internet and e-commerce is evolving, and unfavorable changes or failure by us to comply with these regulations could substantially harm our business and results of operations.

We are subject to general business regulations and laws as well as regulations and laws specifically governing the Internet and e-commerce. Existing and future laws and regulations may impede the growth of the Internet or other online services. These regulations and laws may cover taxation, restrictions on imports and exports, customs, tariffs, user privacy, data protection, pricing, content, copyrights, distribution, electronic contracts and other communications, consumer protection, the provision of online payment services, broadband residential Internet access and the characteristics and quality of products and product lines. It is not clear how existing laws governing issues such as property use and ownership, sales and other taxes, fraud, libel and personal privacy apply to the Internet and e-commerce, especially where these laws were adopted prior to the advent of the Internet and do not contemplate or address the unique issues raised by the Internet or e-commerce. Those laws that do reference the Internet are being interpreted by the courts and their applicability and reach are therefore uncertain. The costs of compliance with these regulations may increase in the future as a result of changes in the regulations or the interpretation of them. Further, any failures on our part to comply with these regulations may subject us to significant liabilities. Those current and future laws and regulations or unfavorable resolution of these issues may substantially harm our business and results of operations.

Changes in, or interpretation of, tax rules and regulations may impact our effective tax rate and future profitability.

We are a multinational company based in the United States and subject to tax in multiple tax jurisdictions, both domestic and abroad. Our future effective tax rates could be adversely affected by changes in statutory tax rates or interpretation of tax rules, including those set forth in the Tax Cuts and Jobs Act enacted in 2017, and regulations in jurisdictions in which we do business, changes in the amount of revenue or earnings in the countries with varying statutory tax rates, or by changes in the valuation of deferred tax assets and liabilities.

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In addition, we are subject to audits and examinations of previously filed income tax returns by the Internal Revenue Service, or IRS, and other domestic and foreign tax authorities. We regularly assess the potential impact of such examinations to determine the adequacy of our provision for income taxes and have reserved for potential adjustments that may result from the current examinations. We believe such estimates to be reasonable; however, there is no assurance that the final determination of any examination will not have an adverse effect on our operating results and financial position.

We may require additional capital to support business growth, and this capital might not be available on acceptable terms, if at all.

We intend to continue to make investments to support our business growth and may require additional funds to respond to business challenges, including the need to complement our growth strategy, increase market share in our current markets or expand into other markets, or broaden our technology, intellectual property or product line capabilities. Accordingly, we may need to engage in equity or debt financings to secure additional funds. If we raise additional funds through future issuances of equity or convertible debt securities, our existing shareholders could suffer significant dilution, and any new equity securities we issue could have rights, preferences and privileges superior to those of holders of our common stock. Any debt financing we secure in the future could involve restrictive covenants relating to our capital raising activities and other financial and operational matters, which may make it more difficult for us to obtain additional capital and to pursue business opportunities, including potential acquisitions. We may not be able to obtain additional financing on terms favorable to us, if at all. If we are unable to obtain adequate financing or financing on terms satisfactory to us when we require it, our ability to continue to support our business growth and to respond to business challenges could be significantly impaired, and our business may be harmed.

Any acquisition, strategic relationship, joint venture or investment could disrupt our business and harm our operating results and financial condition.

Our business and our customer base have been built primarily through organic growth. However, from time to time, we may selectively pursue acquisitions, strategic relationships, joint ventures or investments that we believe may allow us to complement our growth strategy, increase market share in our current markets or expand into other markets, or broaden our technology, intellectual property or product line capabilities. For example, in April 2014, we acquired FineLine to enable us to offer our customers 3D printing manufacturing processes; in October 2015, we acquired Alphaform to enable us to expand our 3D printing capabilities in Europe, and in November 2017, we acquired RAPID to enable us to offer our customers Sheet Metal and expand our CNC Machining processes. We cannot forecast the number, timing or size of any future acquisitions or other similar strategic transactions, or the effect that any such transactions might have on our operating or financial results. We have limited experience engaging in these types of transactions. Such transactions may be complex, time consuming and expensive, and may present numerous challenges and risks including:

- an acquired company, asset or technology not furthering our business strategy as anticipated;
- difficulties entering and competing in new product or geographic markets and increased competition, including price competition;
- integration challenges;
- challenges in working with strategic partners and resolving any related disagreements or disputes;
- high valuation for a company, asset or technology, or changes in the economic or market conditions or assumptions underlying our decision to make an acquisition;
- significant problems or liabilities, including increased intellectual property and employment related litigation exposure, associated with acquired businesses, assets or technologies;
- acquisition of a significant amount of goodwill, which could result in future impairment charges that would reduce our earnings; and
- requirements to record substantial charges and amortization expense related to certain purchased intangible assets, deferred stock compensation and other items, as well as other charges or expenses.

Any one of these challenges or risks could impair our ability to realize any benefit from our acquisitions, strategic relationships, joint ventures or investments after we have expended resources on them, as well as divert our management's attention. Any failure to successfully address these challenges or risks could disrupt our business and harm our operating results and financial condition. Moreover, any such transaction may not be viewed favorably by investors or stakeholders.

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In addition, from time to time we may enter into negotiations for acquisitions, relationships, joint ventures or investments that are not ultimately consummated. These negotiations could result in significant diversion of management time, as well as substantial out-of-pocket costs.

Our business involves the use of hazardous materials, and we and our suppliers must comply with environmental laws and regulations, which can be expensive and restrict how we do business.

Our business involves the controlled storage, use and disposal of hazardous materials. We and our suppliers are subject to federal, state and local as well as foreign laws and regulations governing the use, manufacture, storage, handling and disposal of these hazardous materials. Although we believe that the safety procedures utilized by us and our suppliers for handling and disposing of these materials comply with the standards prescribed by these laws and regulations, we cannot eliminate the risk of accidental contamination or injury from these materials. In the event of an accident, state, federal or foreign authorities may curtail the use of these materials and interrupt our business operations. We do not currently maintain hazardous materials insurance coverage. If we are subject to any liability as a result of activities involving hazardous materials, our business and financial condition may be adversely affected and our reputation and brand may be harmed.

If we are unable to meet quality standards applicable to our manufacturing and quality processes for the parts we manufacture, our business, financial condition or operating results could be harmed.

As a manufacturer of CNC-machined and injection-molded custom parts, we conform to certain international standards, including International Organization for Standardization, or ISO, 9001:2015 for our injection molding facilities and the AS9001D standard for our CNC-machined facilities in Minnesota. In North Carolina, we conform to the ISO 9001:2015 standard for our plastics manufacturing and the AS9100D standard for our metals manufacturing. In New Hampshire, we conform to the ISO 9001:2015 and the AS9100D standards for our CNC-machined and sheet metal custom parts. We also conform to international standard ISO 9001:2008 at our manufacturing facilities in Feldkirchen, Germany and Eschenlohe, Germany. Additionally, we conform to international standard ISO 13485 at our manufacturing facility in Eschenlohe, Germany and international standard ISO 14001 at our manufacturing facility in Feldkirchen, Germany. Lastly, we conform to international standards ISO 9001, ISO 14001 and ISO 27001 at our facilities in Japan. If any system inspection reveals that we are not in compliance with applicable standards, registrars may take action against us, including issuing a corrective action request or discontinuing our certifications. If any of these actions were to occur, it could harm our reputation as well as our business, financial condition and operating results.

We are subject to payment-related risks.

We accept payments using a variety of methods, including credit card, customer invoicing, physical bank check and payment upon delivery. As we offer new payment options to our customers, we may be subject to additional regulations, compliance requirements and fraud risk. For certain payment methods, including credit and debit cards, we pay interchange and other fees, which may increase over time and raise our operating costs and lower profitability. We rely on third parties to provide payment processing services, including the processing of credit cards, debit cards or electronic checks, and it could disrupt our business if these companies become unwilling or unable to provide these services to us. We are also subject to payment card association operating rules, certification requirements and rules governing electronic funds transfers, which could change or be reinterpreted to make it difficult or impossible for us to comply. If we fail to comply with these rules or requirements, we may be subject to fines and higher transaction fees and lose our ability to accept credit and debit card payments from our customers, process electronic funds transfers, or facilitate other types of online payments, and our business and operating results could be adversely affected.

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Risks Relating to Ownership of Our Common Stock

Our stock price has been and may continue to be volatile.

In the year ended December 31, 2019, our common stock traded as high as \$130.60 and as low as \$88.75. The market for our common stock may become less active, liquid or orderly, which could depress the trading price of our common stock. Some of the factors, many of which are outside of our control, that may cause the market price of our common stock to fluctuate include:

- fluctuations in our financial condition and operating results;
- our ability to retain and attract customers and increase net sales;
- pricing pressures due to competition or otherwise and changes in gross margins;
- changes in general economic and market conditions, economic uncertainty and changes in product development activity levels;
- announcements by us or our competitors of technological innovations or new product or product lines offerings or significant acquisitions;
- timing, effectiveness, and costs of expansion and upgrades of our offerings, systems and infrastructure;
- changes in key personnel;
- success in entry into new markets and expansion efforts;
- the public's response to press releases or other public announcements by us or third parties, including our filings with the Securities and Exchange Commission and announcements relating to litigation;
- the projections we may provide to the public, any changes in these projections or our failure to meet these projections;
- the issuance of new or updated research or reports by any securities or industry analysts who follow our common stock, changes in analysts' financial estimates or ratings, and failure of securities analysts to initiate or maintain coverage of our common stock;
- changes in the market valuations of similar companies;
- significant lawsuits, including patent or shareholder litigation;
- changes in laws or regulations applicable to us;
- changes in accounting principles;
- the sustainability of an active trading market for our common stock;
- future sales of our common stock by us or our shareholders, including sales by our officers, directors and significant shareholders;
- share price and volume fluctuations attributable to inconsistent trading levels of our shares; and

- other events or factors, including those resulting from war, acts of terrorism, natural disasters or responses to these events.

In addition, the stock markets have experienced extreme price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many companies. In the past, shareholders have instituted securities class action litigation following periods of market volatility. If we were to become involved in securities litigation, we could incur substantial costs and our resources and the attention of management could be diverted from our business.

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If securities or industry analysts publish inaccurate or unfavorable research or reports about our business, our stock price and trading volume could decline.

The trading market for our common stock depends, in part, on the research and reports that securities or industry analysts publish about us or our business. We do not have any control over these analysts. If one or more of the analysts who covers us downgrades our common stock, changes their opinion of our shares or publishes inaccurate or unfavorable research about our business, our stock price would likely decline. If one or more of these analysts ceases coverage of us or fails to publish reports on us regularly, demand for our common stock could decrease and we could lose visibility in the financial markets, which could cause our stock price and trading volume to decline.

Our failure to maintain proper and effective internal controls over financial reporting and otherwise comply with Section 404 of the Sarbanes-Oxley Act or prevent or detect misstatements in our financial statements in the future could harm our business and cause a decrease in our stock price.

Ensuring that we have internal financial and accounting controls and procedures adequate to produce accurate financial statements on a timely basis is a costly and time-consuming effort that needs to be re-evaluated frequently. The Sarbanes-Oxley Act requires, among other things, that we maintain effective internal control over financial reporting and disclosure controls and procedures. In particular, we are required to perform annual system and process evaluation and testing of our internal control over financial reporting to allow management and our independent registered public accounting firm to report on the effectiveness of our internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act. If we are not able to comply with the requirements of Section 404 in the future, or if we fail to prevent or detect misstatements in the financial statements we include in our reports filed with the SEC, our business could be harmed and the market price of our common stock could decline.

Anti-takeover provisions in our charter documents and Minnesota law might discourage or delay acquisition attempts for us that you might consider favorable.

Our Third Amended and Restated Articles of Incorporation, as amended, and Amended and Restated By-Laws contain provisions that may make the acquisition of our company more difficult without the approval of our board of directors. These provisions:

- permit our board of directors to issue up to 10,000,000 shares of preferred stock, with any rights, preferences and privileges as our board may designate, including the right to approve an acquisition or other change in our control;
- provide that the authorized number of directors may be changed by resolution of the board of directors;
- provide that all vacancies, including newly created directorships, may, except as otherwise required by law, be filled by the affirmative vote of a majority of directors then in office, even if less than a quorum;
- provide that shareholders seeking to present proposals before a meeting of shareholders or to nominate candidates for election as directors at a meeting of shareholders must provide notice in writing in a timely manner, and also specify requirements as to the form and content of a shareholder's notice; and
- do not provide for cumulative voting rights.

We are subject to the provisions of Section 302A.673 of the Minnesota Statutes, which regulates business combinations. Section 302A.673 generally prohibits any business combination by an issuing public corporation, or any of its subsidiaries, with an interested shareholder, which means any shareholder that purchases 10% or more of the corporation's voting shares within four years following the date the person became an interested shareholder, unless the business combination is approved by a committee composed solely of one or more disinterested members of the corporation's board of directors before the date the person became an interested shareholder.

These anti-takeover provisions could discourage, delay or prevent a transaction involving a change in control of our company, even if doing so would benefit our shareholders. These provisions could also discourage proxy contests and make it more difficult for you and other shareholders to elect directors of your choosing and to cause us to take other corporate actions you desire.

We do not expect to pay any cash dividends for the foreseeable future.

We have never declared or paid any cash dividends on our common stock, and we do not anticipate that we will pay any such cash dividends for the foreseeable future. We anticipate that we will retain all of our future earnings for use in the business and for general corporate purposes. Any determination to pay dividends in the future will be at the discretion of our board of directors and will depend upon results of operations, financial condition, contractual restrictions, restrictions imposed by applicable law and other factors our board of directors deems relevant.

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Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We believe that our facilities are well maintained and of sufficient capacity to support our current operations. We have facilities in the following regions:

United States

Our corporate headquarters are located in Maple Plain, Minnesota in a facility we own encompassing approximately 95,000 square feet of office space. We also own a nearby facility encompassing approximately 35,000 square feet of manufacturing space. We own a facility in Rosemount, Minnesota that encompasses approximately 130,000 square feet of manufacturing and office space. We also own a facility in Plymouth, Minnesota that encompasses approximately 170,000 square feet of manufacturing and office space. In 2018, we purchased a facility in Brooklyn Park, Minnesota that encompasses approximately 215,000 square feet of manufacturing and office space.

We own a facility in Cary, North Carolina that encompasses approximately 77,000 square feet of manufacturing and office space.

In November 2017, we purchased RAPID and assumed the leases of three facilities in Nashua, New Hampshire. The three facilities we lease total approximately 146,000 square feet of manufacturing and office space. The leases expire at various times from 2020 to 2022.

Europe

Our European operations are headquartered in Telford, United Kingdom in a facility we own encompassing approximately 178,000 square feet of office and manufacturing space.

We also lease office space in the United Kingdom; Mosbach, Germany; Le Bourget du Lac, France; Novara, Italy and Nacka, Sweden, for sales, customer service and technical support staff. The leases expire at various times from 2021 to 2025. In October 2015, we purchased Alphaform, headquartered in Feldkirchen (Munich), Germany. As a result of the acquisition, we lease manufacturing and office facilities encompassing approximately 60,000 square feet in Feldkirchen, Germany and approximately 22,000 square feet in Eschenlohe, Germany. The leases expire at various times from 2021 to 2028.

Japan

Our Japan operations are headquartered in Zama, Kanagawa, Japan (southwest of Tokyo). In 2016, we moved into a new leased facility encompassing approximately 96,000 square feet of office and manufacturing space. The lease expires in April 2023.

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Item 3. 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 this Annual Report on Form 10-K, 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 4. Mine Safety Disclosures

Not applicable.

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PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock has traded on the New York Stock Exchange (NYSE) under the symbol "PRLB" since February 24, 2012. Prior to that date, there was no public market for our common stock.

As of February 14, 2020, we had 10 holders of record of our common stock. The actual number of shareholders is greater than this number of record holders, and includes shareholders who are beneficial owners, but whose shares are held in street name by brokers and other nominees.

We have never declared or paid any cash dividends on our capital stock and we do not intend to pay cash dividends on our common stock for the foreseeable future. Any future determination related to our dividend policy will be made at the discretion of our board of directors and will depend on then-existing conditions, including our financial condition, operating results, contractual restrictions, capital requirements, business prospects and other factors our board of directors may deem relevant.

Outstanding Equity Awards

The following table summarizes, as of December 31, 2019, information about shares of our common stock that may be issued under equity compensation plans approved by shareholders and plans not approved by shareholders:

Plan Category	Number of shares to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of shares remaining available for future issuance under equity compensation plans (excluding shares in first column)
Equity compensation plans approved by shareholders(1)	656,011	\$72.38	6,160,817(2)
Equity compensation plans not approved by shareholders	None	N/A	None

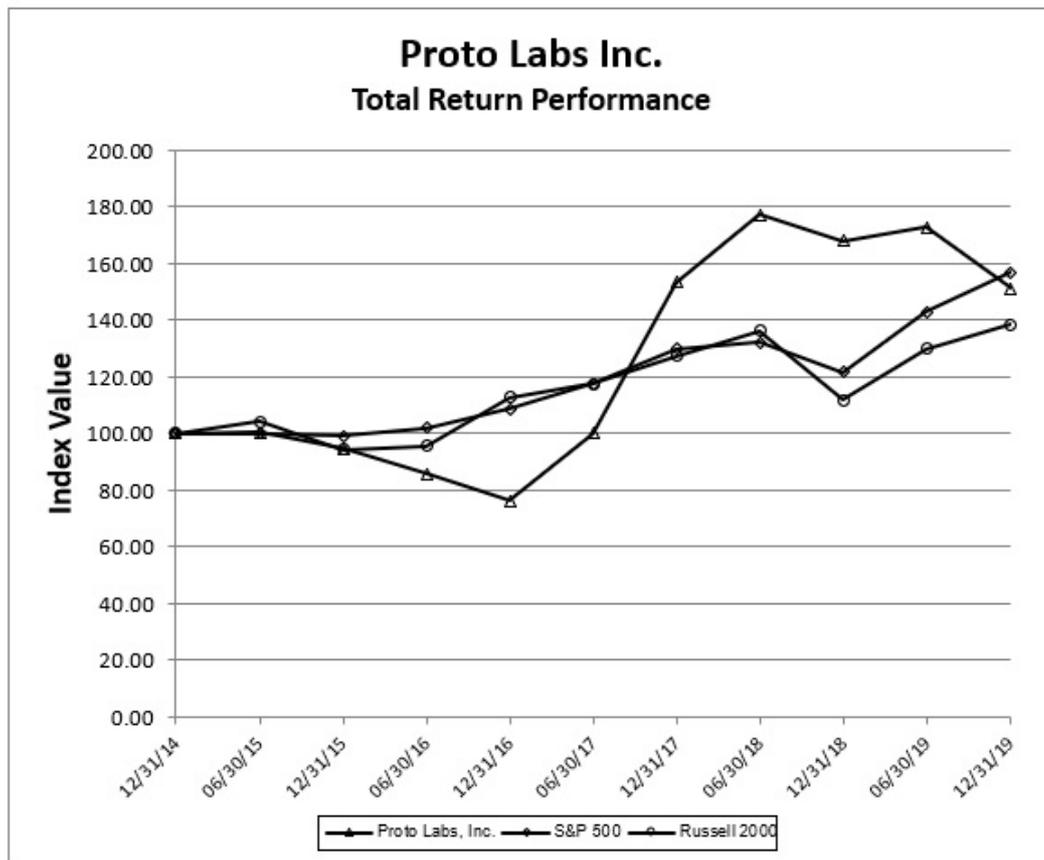
(1) Includes the 2000 Stock Option Plan, the 2012 Long-Term Incentive Plan and our Employee Stock Purchase Plan.

(2) Includes 1,168,830 shares remaining available for issuance as of December 31, 2019 under our Employee Stock Purchase Plan.

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Performance Graph

The following graph shows a comparison from December 31, 2014 through December 31, 2019 of the cumulative total return for our common stock, the S&P 500 Index and the Russell 2000 Index. We have selected the Russell 2000 Index because the Russell 2000 Index measures the performance of the small market capitalization segment of U.S. equity instruments and we are a member company included in the Russell 2000 Index. Such returns are based on historical results and are not intended to suggest future performance. Data for the S&P 500 Index and the Russell 2000 Index assume reinvestment of dividends.



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Unregistered Sales of Equity Securities and Issuer Purchases of Equity Securities

On May 15, 2019 the Board of Directors authorized the repurchase of shares of the Company's common stock from time to time on the open market or in privately negotiated purchases, at an aggregate purchase price of up to \$100 million. The timing and amount of any share repurchases will be determined by our management based on market conditions and other factors. The term of the program runs through December 31, 2023.

The Company had no repurchases in the fourth quarter of 2019. During the year ended December 31, 2019, we repurchased 326,462 shares at an average price of \$102.65 per share for an aggregate purchase price of \$33.5 million. We have \$49.9 million remaining under this authorization.

Item 6. Selected Financial Data

The following tables set forth selected consolidated financial data for the periods and at the dates indicated. The selected consolidated statements of comprehensive income data for the years ended December 31, 2019, 2018 and 2017 and selected consolidated balance sheets data as of December 31, 2019 and 2018 are derived from our audited consolidated financial statements included in Item 8. "Financial Statements and Supplementary Data" of this Annual Report on Form 10-K. The selected consolidated statements of comprehensive income data for the years ended December 31, 2016 and 2015 and selected consolidated balance sheet data as of December 31, 2017, 2016 and 2015 are derived from our audited consolidated financial statements not included in this report.

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The historical results presented below are not necessarily indicative of the results to be expected for any future period. You should read this selected consolidated financial data in conjunction with Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations," and the consolidated financial statements and related notes appearing in Item 8. "Financial Statements and Supplementary Data" of this Annual Report on Form 10-K.

(in thousands, except share and per share amounts)	Year Ended December 31,				
	2019	2018	2017	2016	2015
Consolidated Statements of Comprehensive Income Data					
Revenue	\$ 458,728	\$ 445,596	\$ 344,490	\$ 298,055	\$ 264,106
Cost of revenue	223,438	206,917	150,648	131,118	109,703
Gross profit	235,290	238,679	193,842	166,937	154,403
Operating expenses:					
Marketing and sales	72,976	68,533	56,856	46,131	39,188
Research and development	32,692	28,735	23,560	22,388	18,350
General and administrative	49,766	52,513	41,200	36,651	29,716
Total operating expenses	155,434	149,781	121,616	105,170	87,254
Income from operations	79,856	88,898	72,226	61,767	67,149
Other income, net	1,337	2,757	2,209	2,454	712
Income before income taxes	81,193	91,655	74,435	64,221	67,861
Provision for income taxes	17,538	15,067	22,657	21,514	21,347
Net income	\$ 63,655	\$ 76,588	\$ 51,778	\$ 42,707	\$ 46,514
Net income per share(1)					
Basic	\$ 2.37	\$ 2.84	\$ 1.94	\$ 1.62	\$ 1.79
Diluted	\$ 2.35	\$ 2.81	\$ 1.93	\$ 1.61	\$ 1.77
Weighted average shares outstanding(1)					
Basic	26,866,985	26,982,614	26,647,610	26,365,173	26,005,858
Diluted	27,049,423	27,278,816	26,845,071	26,564,639	26,320,284
Other comprehensive income (loss) (net of tax)					
Foreign currency translation adjustments	\$ 1,474	\$ (3,258)	\$ 5,519	\$ (5,541)	\$ (2,283)
Comprehensive income	\$ 65,129	\$ 73,330	\$ 57,297	\$ 37,166	\$ 44,231

(1)See Note 3 of notes to Consolidated Financial Statements for an explanation of the method used to calculate net income per basic and diluted share attributable to common shareholders and weighted average shares outstanding of the years ended December 31, 2019, 2018, and 2017 respectively.

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

(in thousands)	Year Ended December 31,				
	2019	2018	2017	2016	2015
Stock options and grants	\$ 9,591	\$ 10,113	\$ 7,954	\$ 6,177	\$ 5,580
Employee stock purchase plan	1,190	815	604	598	502
Total stock-based compensation expense	\$ 10,781	\$ 10,928	\$ 8,558	\$ 6,775	\$ 6,082
Cost of revenue	\$ 2,056	\$ 1,543	\$ 970	\$ 691	\$ 513
Operating expenses:					
Marketing and sales	2,632	1,942	1,429	977	1,074
Research and development	1,851	1,517	1,091	1,396	1,285
General and administrative	4,242	5,926	5,068	3,711	3,210
Total stock-based compensation expense	\$ 10,781	\$ 10,928	\$ 8,558	\$ 6,775	\$ 6,082

(in thousands)	Year Ended December 31,				
	2019	2018	2017	2016	2015
Consolidated Balance Sheets Data					
Cash and cash equivalents	\$ 125,225	\$ 85,046	\$ 36,707	\$ 68,795	\$ 47,653

Working capital	188,838	162,628	121,249	134,357	111,740
Total assets	673,667	618,985	518,738	414,241	361,036
Total liabilities	87,877	77,488	57,523	34,408	33,391
Total shareholders' equity	\$ 585,790	\$ 541,497	\$ 461,215	\$ 379,833	\$ 327,645

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Item 7. 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 the consolidated financial statements and related notes included elsewhere in this Annual Report on Form 10-K. This discussion and analysis contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth under "Risk Factors" and elsewhere in this Annual Report on Form 10-K.

Overview

We are an e-commerce driven digital manufacturer of quick-turn, on-demand injection-molded, CNC-machined, 3D-printed and sheet metal-fabricated custom parts for prototyping and short-run production. We provide custom parts to product developers and engineers worldwide, who are under increasing pressure to bring their finished products to market faster than their competition. 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 in low volumes, and our customers conduct nearly all of their business with us over the Internet. We target our product lines to the millions of product developers and engineers who use 3D CAD software to design products across a diverse range of end markets. Our primary manufacturing product lines currently include Injection Molding, CNC Machining, 3D Printing and Sheet Metal.

We have experienced significant growth since our inception. Since we first introduced our Injection Molding product line in 1999, we have steadily expanded the size and geometric complexity of the injection-molded parts we are able to manufacture, and we continue to extend the diversity of materials we are able to support. Similarly, since first introducing our CNC Machining product line in 2007, we have expanded the range of part sizes, design geometries and materials we can support. In 2014, we acquired FineLine Prototyping, Inc. (FineLine) to expand the number of process types we offer to include stereolithography (SL), selective laser sintering (SLS) and direct metal laser sintering (DMLS). In 2017, we acquired RAPID to expand the number of process types we offer to include sheet metal fabrication and expand our CNC machining capability. In 2019, we added Carbon DLS to our 3D printing processes, introduced precision color matching on Injection Molding parts and launched production capabilities for metal 3D printing. We also continually seek to enhance other aspects of our technology and manufacturing processes, including our interactive web-based and automated user interface and quoting system. We intend to continue to invest significantly to enhance our technology and manufacturing processes and expand the range of our existing capabilities with the aim of meeting the needs of a broader set of customers. As a result of the factors described above, many of our customers tend to return to Proto Labs to meet their ongoing needs, with approximately 92%, 91% and 89% of our revenue in 2019, 2018 and 2017, respectively, derived from existing customers.

We have established our operations in the United States, Europe and Japan, which we believe are three of the largest geographic markets where product developers and engineers are located. We entered the European market in 2005, launched operations in Japan in late 2009. Our operations were further expanded in Europe through our acquisition of Alphaform in 2015 and the United States through our acquisition of RAPID in November 2017. As of December 31, 2019, we had sold products into approximately 60 countries. Our revenue outside of the United States accounted for approximately 22%, 21% and 24% of our consolidated revenue in the years ended December 31, 2019, 2018 and 2017, respectively. We intend to continue to expand our international sales efforts and believe opportunities exist to serve the needs of product developers and engineers in select new geographic regions.

We have grown our total revenue from \$264.1 million in 2015 to \$458.7 million in 2019. During this period, our operating expenses increased from \$87.3 million in 2015 to \$155.4 million in 2019. We have grown our income from operations from \$67.1 million in 2015 to \$79.9 million in 2019. Our recent growth in revenue and income from operations has been accompanied by increased cost of revenues and operating expenses. We expect to increase investment in our operations to support anticipated future growth as discussed more fully below.

In addition, we believe that a number of trends affecting our industry have affected our results of operations and may continue to do so. For example, we believe that many of our target product developer and engineer customers are facing three mega trends, which are disrupting long-term product growth models. We believe our customers are facing increased pressure to shorten product life-cycles, to embed products with connectivity driven by the internet of things technology, and to deliver products that are personalized and customized to unique customer specifications. We believe we continue to be well positioned to benefit from these trends, given our proprietary technology that enables us to automate and integrate the majority of activities involved in procuring custom parts. While our business may be positively affected by these trends, our results may also be favorably or unfavorably impacted by other trends that affect product developer and engineer orders for custom parts in low volumes, including, among others, economic conditions, changes in product developer and engineer preferences or needs, developments in our industry and among our competitors, and developments in our customers' industries. For a more complete discussion of the risks facing our business, see Part I, Item 1A. "Risk Factors" of this Annual Report on Form 10-K.

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Key Financial Measures and Trends
Revenue

Our operations are comprised of three geographic operating segments in the United States, Europe and Japan. Revenue is derived from our Injection Molding, CNC Machining, 3D Printing and Sheet Metal product lines. Injection Molding revenue consists of sales of custom injection molds and injection-molded parts. CNC Machining revenue consists of sales of CNC-machined custom parts. 3D Printing revenue consists of sales of custom 3D-printed parts. Sheet Metal revenue consists of sales of fabricated sheet metal custom parts. Our revenue is generated from a diverse customer base, with no single customer

company representing more than 2% of our total revenue in 2019. 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, including:

- the introduction of our 3D Printing product line through our acquisition of FineLine in 2014;
- expanding 3D printing to Europe through our acquisition of Alphaform in October 2015;
- the introduction of our Sheet Metal product line through our acquisition of RAPID in 2017;
- continuously improving the usability of our product lines such as our web-centric applications; and
- expanding the breadth and scope of our products by adding more sizes and materials to our offerings.

During 2019, we served 47,774 unique product developers and engineers who purchased our products through our web-based customer interface, an increase of 3.9% over the same period in 2018.

During 2018, we served 45,968 unique product developers and engineers who purchased our products through our web-based customer interface, an increase of 22.5% over the same period in 2017.

During 2017, we served 37,538 unique product developers and engineers who purchased our products through our web-based customer interface, an increase of 19.3% over the same period in 2016.

Cost of Revenue, Gross Profit and Gross Margin

Cost of revenue consists primarily of raw materials, equipment depreciation, employee compensation including benefits and stock-based compensation, facilities costs and overhead allocations associated with the manufacturing process for molds and custom parts. We expect our personnel-related costs to increase in order to retain and attract top talent and remain competitive in the market. Overall, we expect cost of revenue to increase in absolute dollars, but remain relatively constant as a percentage of total revenue.

Our business model requires that we invest in our capacity well in advance of demand to ensure we can fulfill the expectations for quick delivery of our products to our customers. Therefore, during each of 2019, 2018 and 2017 we made significant investments in additional factory space, equipment, and infrastructure in the United States. We also made significant investments in infrastructure in Europe in 2017 and significant investments in additional factory space in Japan in 2019 and 2016. We expect to continue to grow in future periods, which will result in the need for additional investments in factory space and equipment. We expect that these additional costs for factory and equipment expansion can be absorbed by revenue growth, and allow gross margins by product line to remain relatively consistent over time.

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 mix of revenue by product line, pricing, sales volume, manufacturing costs, the costs associated with increasing production capacity, the mix between domestic and foreign revenue sources and foreign exchange rates.

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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 in each of these 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 injection-molded, CNC-machined, CNC-turned, 3D-printed and sheet metal custom parts for prototyping and low-volume production. In order 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 electronic, print and pay-per-click advertising, trade shows 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 and grow revenue.

Research and development. Research and development expense consists primarily of personnel and outside service costs related to the development of new processes and product lines, enhancement of existing product lines, software developed for internal use, maintenance of internally developed software, quality assurance and testing. Costs for internal use software are evaluated by project and capitalized where appropriate under Accounting Standards Codification (ASC) 350-40, *Intangibles — Goodwill and Other, Internal-Use Software*. We expect research and development expense to increase in the future as we seek to enhance our e-commerce interface technology, internal software and supporting business systems, and continue to expand our product lines.

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, Net

Other income, net primarily consists of foreign currency-related gains and losses and interest income on cash balances and investments. 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.

Provision for Income Taxes

Provision for income taxes is comprised of federal, state, local and foreign taxes based on pre-tax income. On December 22, 2017, the Tax Cuts and Jobs Act was signed into law in the United States. As a result, many provisions will affect our tax rate in future years. Some provisions, such as the reduction to the U.S. corporate tax rate from 35% to 21%, which began in 2018, reduced our effective tax rate in 2018 and subsequent years. Overall, our effective tax rate for 2018 and beyond will remain consistent based on the current tax laws.

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Results of Operations

The following table summarizes 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)	Year Ended December 31,				Change		Year Ended December 31,				Change	
	2019		2018		\$	%	2018		2017		\$	%
Revenue	\$ 458,728	100.0%	\$ 445,596	100.0%	\$ 13,132	2.9%	\$ 445,596	100.0%	\$ 344,490	100.0%	\$ 101,106	29.3
Cost of revenue	223,438	48.7	206,917	46.4	16,521	8.0	206,917	46.4	150,648	43.7	56,269	37.4
Gross profit	235,290	51.3	238,679	53.6	(3,389)	(1.4)	238,679	53.6	193,842	56.3	44,837	23.1
Operating expenses:												
Marketing and sales	72,976	15.9	68,533	15.4	4,443	6.5	68,533	15.4	56,856	16.5	11,677	20.5
Research and development	32,692	7.1	28,735	6.4	3,957	13.8	28,735	6.4	23,560	6.8	5,175	22.0
General and administrative	49,766	10.9	52,513	11.8	(2,747)	(5.2)	52,513	11.8	41,200	12.0	11,313	27.5
Total operating expenses	155,434	33.9	149,781	33.6	5,653	3.8	149,781	33.6	121,616	35.3	28,165	23.2
Income from operations	79,856	17.4	88,898	20.0	(9,042)	(10.2)	88,898	20.0	72,226	21.0	16,672	23.1
Other income, net	1,337	0.3	2,757	0.6	(1,420)	(51.5)	2,757	0.6	2,209	0.6	548	24.8
Income before income taxes	81,193	17.7	91,655	20.6	(10,462)	(11.4)	91,655	20.6	74,435	21.6	17,220	23.1
Provision for income taxes	17,538	3.8	15,067	3.4	2,471	16.4	15,067	3.4	22,657	6.6	(7,590)	(33.5)
Net income	\$ 63,655	13.9%	\$ 76,588	17.2%	\$ (12,933)	(16.9%)	\$ 76,588	17.2%	\$ 51,778	15.0%	\$ 24,810	47.9%

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

(dollars in thousands)	Year Ended December 31,		
	2019	2018	2017
Stock options and grants	\$ 9,591	\$ 10,113	\$ 7,954
Employee stock purchase plan	1,190	815	604
Total stock-based compensation expense	\$ 10,781	\$ 10,928	\$ 8,558
Cost of revenue	\$ 2,056	\$ 1,543	\$ 970
Operating expenses:			
Marketing and sales	2,632	1,942	1,429
Research and development	1,851	1,517	1,091
General and administrative	4,242	5,926	5,068
Total stock-based compensation expense	\$ 10,781	\$ 10,928	\$ 8,558

Comparison of Years Ended December 31, 2019 and 2018

Revenue

Revenue by reportable segment and the related changes for 2019 and 2018 is summarized as follows:

(dollars in thousands)	Year Ended December 31,		Change	
	2019	2018	\$	%
	\$	% of Total	\$	% of Total

	Revenue		Revenue			
Revenue						
United States	\$	360,205	78.5%	\$	350,535	78.7%
Europe		82,805	18.1		80,889	18.2
Japan		15,718	3.4		14,172	3.1
Total revenue	\$	458,728	100.0%	\$	445,596	100.0%
					\$	13,132
						2.9%

Our revenue increased \$13.1 million, or 2.9%, for 2019 compared with 2018. By reportable segment, revenue in the United States increased \$9.7 million, or 2.8%, for 2019 compared with 2018. Revenue in Europe increased \$1.9 million, or 2.4%, for 2019 compared with 2018. Revenue in Japan increased \$1.5 million, or 10.9%, for 2019 compared with 2018.

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Our revenue growth in 2019 was primarily driven by an increased volume of the product developers and engineers we served. During 2019, we served 47,774 unique product developers and engineers, an increase of 3.9% over 2018. Our growth in product developers and engineers served increased at a greater rate than our revenue growth, resulting in a decrease of 1.0% in the average revenue per product developer and engineer during 2019 as compared to 2018. The decrease in average spend per product developer and engineer was driven by a change in the mix of products, with 3D Printing and CNC Machining generally producing lower average order revenue than our other products.

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 of existing customer accounts. Our marketing personnel focus on marketing activities that have proven to generate the greatest number of customer leads to support sales activity. International revenue was negatively impacted by \$4.2 million in 2019 compared to 2018 as a result of foreign currency movements, primarily the weakening of the Euro relative to the United States dollar.

Revenue by product line and the related changes for 2019 and 2018 is summarized as follows:

(dollars in thousands)	Year Ended December 31,				Change	
	2019		2018		\$	%
	\$	% of Total Revenue	\$	% of Total Revenue		
Revenue						
Injection Molding	\$	217,415	47.4%	\$	210,523	47.2%
CNC Machining		155,473	33.9		153,521	34.5
3D Printing		61,352	13.4		53,342	12.0
Sheet Metal		21,000	4.6		24,998	5.6
Other Revenue		3,488	0.7		3,212	0.7
Total revenue	\$	458,728	100.0%	\$	445,596	100.0%
					\$	13,132
						2.9%

By product line, our revenue growth was driven by a 3.3% increase in Injection Molding revenue, a 1.3% increase in CNC Machining revenue, a 15.0% increase in 3D Printing revenue, as well as a \$0.3 million increase in Other Revenue, which was partially offset by a 16.0% decrease in Sheet Metal revenue, in each case for 2019 compared with 2018. The decrease in Sheet Metal revenue was driven by a decision to move away from certain business which was not scalable and did not fit into the envelope of our revised Sheet Metal product offerings.

Cost of Revenue, Gross Profit and Gross Margin

Cost of Revenue. Cost of revenue increased \$16.5 million, or 8.0%, for 2019 compared to 2018, which was faster than the rate of revenue increase of 2.9% for 2019 compared to 2018. The increase in cost of revenue resulted from the growth of the business and investments to support future growth. Specifically, the increases were driven by raw material and production cost increases of \$2.6 million, an increase in direct labor headcount and wage inflation resulting in personnel and related cost increases of \$7.8 million and equipment and facility-related cost increases of \$6.1 million to support increased sales volumes and future growth of the business.

Gross Profit and Gross Margin. Gross profit decreased from \$238.7 million in 2018 to \$235.3 million in 2019 primarily due to an increase in expenses associated with the cost of revenue. Gross margin decreased from 53.6% of revenue in 2018 to 51.3% of revenue in 2019 due to investments in facilities and personnel to support future growth and the timing and mix of revenue, with the lower volumes in Sheet Metal and certain CNC operations related to the RAPID acquisition being the primary driver of the mix related impact.

Income from Operations

Income from operations decreased \$9.0 million, or 10.2%, for 2019 compared with 2018. By reportable segment, income from operations for the United States and Europe decreased 6.1% and 10.0%, respectively, and Corporate Unallocated and Japan increased 0.6% for 2019 compared with 2018.

Operating Expenses

Marketing and Sales. Marketing and sales expense increased \$4.4 million, or 6.5%, for 2019 compared to 2018 due to an increase in headcount resulting in personnel and related cost increases of \$3.3 million and marketing program cost increases of \$1.1 million. The increase in marketing program

costs is the result of our focus on funding those programs that have proven to be the most effective in growing our business.

Research and Development. Our research and development expense increased \$4.0 million, or 13.8%, for 2019 compared to 2018 due to an increase in headcount resulting in personnel and related cost increases of \$3.5 million, as well as an increase in administrative and depreciation cost increases of \$0.5 million.

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General and Administrative. Our general and administrative expense decreased \$2.7 million, or 5.2%, for 2019 compared to 2018 due to stock-based compensation cost decreases of \$1.7 million driven by lower performance-related compensation, amortization cost decreases of \$1.0 million driven by allocations to other expense categories to appropriately reflect the nature of our intangible assets and professional service decreases of \$0.4 million, which were partially offset by administrative cost increases of \$0.4 million.

Other Income, Net and Provision for Income Taxes

Other Income, Net. We recognized other income, net of \$1.3 million in 2019, a decrease of \$1.5 million compared to other income, net of \$2.8 million for 2018. Other income, net for 2019 primarily consisted of \$2.1 million in interest income on investments, which was partially offset by a \$0.8 million loss on foreign currency. Other income, net for 2018 primarily consisted of \$1.7 million in interest income on investments, a \$0.7 million gain on our sale of RAPID Wire & Cable, LLC and a \$0.4 million gain on foreign currency.

Provision for Income Taxes. Our income tax provision increased by \$2.4 million for 2019 compared to 2018. The increase in the provision is primarily due to a decrease in tax benefits from the vesting of restricted stock and exercise of stock options. This increase was coupled with an increase in the state tax provision and an increase in valuation allowances. Our effective tax rate of 21.6% for 2019 increased 5.2% compared to 16.4% for the same period in 2018.

Comparison of Years Ended December 31, 2018 and 2017

Revenue

Revenue by reportable segment and the related changes for 2018 and 2017 is summarized as follows:

(dollars in thousands)	Year Ended December 31,				Change	
	2018		2017		\$	%
	\$	% of Total Revenue	\$	% of Total Revenue		
Revenue						
United States	\$ 350,535	78.7%	\$ 263,086	76.4%	\$ 87,449	33.2%
Europe	80,889	18.2	70,154	20.4	10,735	15.3
Japan	14,172	3.1	11,250	3.2	2,922	26.0
Total revenue	<u>\$ 445,596</u>	<u>100.0%</u>	<u>\$ 344,490</u>	<u>100.0%</u>	<u>\$ 101,106</u>	<u>29.3%</u>

Our revenue increased \$101.1 million, or 29.3%, for 2018 compared with 2017. By reportable segment, revenue in the United States increased \$87.4 million, or 33.2%, for 2018 compared with 2017. Revenue growth in the United States was partially attributable to the acquisition of RAPID in November 2017. Revenue in Europe increased \$10.7 million, or 15.3%, for 2018 compared with 2017. Revenue in Japan increased \$2.9 million, or 26.0%, for 2018 compared with 2017.

Our revenue growth in 2018 was primarily driven by an increased volume of the product developers and engineers we served. During 2018, we served 45,968 unique product developers and engineers, an increase of 22.5% over 2017. Average revenue per product developer or engineer increased 6% during 2018 as compared to 2017 due to changes in the mix of products purchased by our customers.

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 of existing customer accounts. Our marketing personnel focus on marketing activities that have proven to generate the greatest number of customer leads to support sales activity. International revenue increased by \$3.5 million in 2018 compared to 2017 as a result of foreign currency movements, primarily the strengthening of the Euro relative to the United States dollar.

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Revenue by product line and the related changes for 2018 and 2017 is summarized as follows:

(dollars in thousands)	Year Ended December 31,				Change	
	2018		2017		\$	%
	\$	% of Total Revenue	\$	% of Total Revenue		
Revenue						

Injection Molding	\$	210,523	47.2%	\$	194,432	56.4%	\$	16,091	8.3%
CNC Machining		153,521	34.5		103,739	30.1		49,782	48.0
3D Printing		53,342	12.0		43,329	12.6		10,013	23.1
Sheet Metal		24,998	5.6		1,767	0.5		23,231	*
Other Revenue		3,212	0.7		1,223	0.4		1,989	*
Total revenue	\$	445,596	100.0%	\$	344,490	100.0%	\$	101,106	29.3%

* Percentage change not meaningful

By product line, our revenue growth was driven by an 8.3% increase in Injection Molding revenue, a 48.0% increase in CNC Machining revenue and a 23.1% increase in 3D Printing revenue, as well as a \$23.2 million increase in Sheet Metal revenue and a \$2.0 million increase in Other Revenue, in each case for 2018 compared with 2017. Our November 2017 acquisition of RAPID added the Sheet Metal product line, expanded our CNC Machining product line and contributed to Other Revenue.

Cost of Revenue, Gross Profit and Gross Margin

Cost of Revenue. Cost of revenue increased \$56.3 million, or 37.4%, for 2018 compared to 2017, which was faster than the rate of revenue increase of 29.3% for 2018 compared to 2017. The increase in cost of revenue resulted from the growth of the business, including via the RAPID acquisition, and was due to raw material and production cost increases of \$16.6 million to support increased sales volumes, an increase in direct labor headcount resulting in personnel and related cost increases of \$30.8 million and equipment and facility-related cost increases of \$8.9 million.

Gross Profit and Gross Margin. Gross profit increased from \$193.8 million in 2017 to \$238.7 million in 2018 primarily due to an increase in revenue. Gross margin decreased from 56.3% of revenue in 2017 to 53.6% of revenue in 2018 primarily due to the timing and mix of revenue, with the RAPID acquisition and CNC facility relocation in the United States being the primary drivers of the reduction in gross margin.

Income from Operations

Income from operations increased \$16.7 million, or 23.1%, for 2018 compared with 2017. By reportable segment, income from operations for the United States, Europe and Corporate Unallocated and Japan increased 17.0%, 30.8% and 10.9%, respectively, as a percentage of revenue for 2018 compared with 2017.

Operating Expenses

Marketing and Sales. Marketing and sales expense increased \$11.7 million, or 20.5%, for 2018 compared to 2017 due to an increase in headcount resulting in personnel and related cost increases of \$10.0 million and marketing program cost increases of \$1.7 million. The increase in marketing program costs is the result of our focus on funding those programs that have proven to be the most effective in growing our business.

Research and Development. Our research and development expense increased \$5.2 million, or 22.0%, for 2018 compared to 2017 due to an increase in headcount resulting in personnel and related cost increases of \$4.9 million and professional services cost increases of \$0.6 million, which were partially offset by a decrease in operating cost of \$0.3 million.

General and Administrative. Our general and administrative expense increased \$11.3 million, or 27.5%, for 2018 compared to 2017 due to an increase in headcount resulting in personnel and related cost increases of \$2.4 million, stock-based compensation cost increases of \$0.9 million, administrative cost increases of \$5.3 million and amortization cost increases of \$2.7 million.

Other Income, Net and Provision for Income Taxes

Other Income, Net. We recognized other income, net of \$2.8 million in 2018, an increase of \$0.6 million compared to other income, net of \$2.2 million for 2017. Other income, net for 2018 primarily consisted of \$1.7 million in interest income on investments, a \$0.7 million gain on our sale of RAPID Wire & Cable, LLC and a \$0.4 million gain on foreign currency. Other income, net for 2017 primarily consisted of \$1.5 million in interest income on investments, a \$0.4 million favorable legal settlement and a \$0.3 million gain on foreign currency.

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Provision for Income Taxes. Our income tax provision decreased by \$7.6 million for 2018 compared to 2017. The decrease in the provision is primarily due to the Tax Cuts and Jobs Act that went into effect in 2018 and benefits from the vesting of restricted stock and the exercise of stock options. Our effective tax rate of 16.4% for 2018 decreased 14.0% compared to 30.4% for the same period in 2017.

Selected Quarterly Results of Operations Data

The following tables set forth selected unaudited quarterly results of operations data for 2019 and 2018. This unaudited quarterly information has been prepared on the same basis as our annual audited consolidated financial statements appearing elsewhere in this Annual Report on Form 10-K and includes all adjustments, consisting only of normal recurring adjustments, that we consider necessary to present fairly the financial information for the fiscal quarters presented. The quarterly data should be read in conjunction with our selected financial data and consolidated financial statements and the related notes appearing elsewhere in this Annual Report on Form 10-K. Operating results for any quarter are not necessarily indicative of results for a full-year period, and the historical results presented below are not necessarily indicative of the results to be expected in any future period.

(in thousands, except share and per share amounts)	Three Months Ended							
	Dec. 31, 2019	Sep. 30, 2019	Jun. 30, 2019	Mar. 31, 2019	Dec. 31, 2018	Sep. 30, 2018	Jun. 30, 2018	Mar. 31, 2018

**Consolidated Statements of
Comprehensive Income Data:**

Revenue	\$ 111,889	\$ 117,455	\$ 115,932	\$ 113,452	\$ 112,769	\$ 115,430	\$ 109,652	\$ 107,745
Cost of revenue	55,311	57,839	55,696	54,592	53,614	53,027	50,439	49,837
Gross profit	56,578	59,616	60,236	58,860	59,155	62,403	59,213	57,908
Operating expenses:								
Marketing and sales	17,510	17,604	19,285	18,577	17,586	16,818	17,557	16,572
Research and development	8,151	8,359	8,169	8,013	7,580	7,458	7,032	6,665
General and administrative	11,355	12,380	13,209	12,822	13,834	13,096	12,640	12,943
Total operating expenses	37,016	38,343	40,663	39,412	39,000	37,372	37,229	36,180
Income from operations	19,562	21,273	19,573	19,448	20,155	25,031	21,984	21,728
Other income (expense), net	(229)	228	1,125	213	1,381	390	808	178
Income before income taxes	19,333	21,501	20,698	19,661	21,536	25,421	22,792	21,906
Provision for income taxes	4,147	4,709	4,532	4,150	2,250	4,484	4,478	3,855
Net income	\$ 15,186	\$ 16,792	\$ 16,166	\$ 15,511	\$ 19,286	\$ 20,937	\$ 18,314	\$ 18,051

Net income per share:

Basic	\$ 0.57	\$ 0.63	\$ 0.60	\$ 0.58	\$ 0.71	\$ 0.77	\$ 0.68	\$ 0.67
Diluted	\$ 0.56	\$ 0.62	\$ 0.60	\$ 0.57	\$ 0.71	\$ 0.77	\$ 0.67	\$ 0.66

Shares used to compute net income
per share:

Basic	26,777,536	26,846,030	26,875,153	26,963,366	27,040,207	27,038,585	26,972,990	26,879,388
Diluted	26,945,927	27,005,341	27,041,422	27,177,039	27,311,988	27,337,886	27,274,882	27,197,099

[Table of Contents](#)**Liquidity and Capital Resources***Cash Flows*

The following table summarizes our cash flows for the years ended December 31, 2019, 2018 and 2017:

(dollars in thousands)	Year Ended December 31,		
	2019	2018	2017
Net cash provided by operating activities	\$ 116,052	\$ 122,929	\$ 81,748
Net cash used in investing activities	(44,303)	(63,281)	(123,975)
Net cash (used in) provided by financing activities	(31,617)	(10,438)	9,192
Effect of exchange rates on cash and cash equivalents	47	(871)	947
Net increase (decrease) in cash and cash equivalents	\$ 40,179	\$ 48,339	\$ (32,088)

Sources of Liquidity

We finance our operations and capital expenditures through cash flow from operations. We had cash and cash equivalents of \$125.2 million as of December 31, 2019, an increase of \$40.2 million from December 31, 2018. The increase in our cash was due primarily to cash generated through operations, partially offset by investing activity and repurchases of common stock. We had cash and cash equivalents of \$85.0 million as of December 31, 2018, an increase of \$48.3 million from December 31, 2017. The increase in our cash was due primarily to cash generated through operations. We had cash and cash equivalents of \$36.7 million as of December 31, 2017, a decrease of \$32.1 million from December 31, 2016. The decrease in our cash was due primarily to the acquisition of RAPID in November 2017.

As of December 31, 2019, the amount of cash and cash equivalents held by foreign subsidiaries was \$21.6 million. Our intent is to continue to permanently reinvest these funds outside the U.S. and our current plans do not demonstrate a need to repatriate them to fund our domestic operations. We believe that our existing cash and cash equivalents together with cash generated from operations will be sufficient to meet our working capital expenditure requirements for at least the next 12 months.

Cash Flows from Operating Activities

Cash flow from operating activities of \$116.1 million during 2019 primarily consisted of net income of \$63.7 million, adjusted for certain non-cash items, including depreciation and amortization of \$30.9 million, stock-based compensation expense of \$10.8 million and deferred taxes of \$6.1 million and changes in operating assets and liabilities and other items totaling \$4.3 million. The cash flow from operating activities during 2019 compared to 2018 decreased \$6.8 million due to decreases in net income of \$12.9 million and deferred taxes of \$5.8 million, which were partially offset by increases in depreciation and amortization of \$4.1 million driven by an increase in capital investments and changes in operating assets and liabilities and other items of \$7.8 million.

Cash flow from operating activities of \$122.9 million during 2018 primarily consisted of net income of \$76.6 million, adjusted for certain non-cash items, including depreciation and amortization of \$26.8 million, stock-based compensation expense of \$10.9 million and deferred taxes of \$11.9 million, which were partially offset by changes in operating assets and liabilities and other items totaling \$3.3 million. The cash flow from operating activities during 2018 compared to 2017 increased \$41.2 million due to increases in net income of \$24.8 million, increases in stock-based compensation expense of \$2.4 million driven by an increased level of equity grants to employees, increases in depreciation and amortization of \$8.3 million driven by an increase in capital investments and increases in deferred taxes of \$10.8 million. These increases were partially offset by changes in operating assets and liabilities and other items of \$5.1 million.

Cash flow from operating activities of \$81.8 million during 2017 primarily consisted of net income of \$51.8 million, adjusted for certain non-cash items, including depreciation and amortization of \$18.5 million, stock-based compensation expense of \$8.6 million and changes in operating assets and liabilities and other items totaling \$2.9 million. The cash flow from operating activities during 2017 compared to 2016 increased \$4.2 million due to increases in net income of \$9.0 million, increases in stock-based compensation expense of \$1.8 million driven by an increased level of equity grants to employees and increases in depreciation and amortization of \$1.0 million driven by an increase in capital investments. These increases were partially offset by decreases to deferred taxes of \$1.6 million, amortization of held-to-maturity securities of \$0.1 million and changes in operating assets and liabilities of \$5.9 million.

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Cash Flows from Investing Activities

Cash used in investing activities was \$44.3 million for the year ended December 31, 2019, consisting of \$62.2 million for the purchase of property, equipment and other capital assets, \$46.4 million for the purchase of marketable securities and \$4.0 million in other investing activities, which were partially offset by \$68.3 million in proceeds from maturities of marketable securities.

Cash used in investing activities was \$63.3 million for the year ended December 31, 2018, consisting of \$87.1 million for the purchase of property, equipment and other capital assets primarily to expand our production capacity and \$41.4 million for the purchase of marketable securities, which were partially offset by \$65.1 million in proceeds from maturities of marketable securities and \$0.1 million in other investing activities.

Cash used in investing activities was \$123.9 million for the year ended December 31, 2017, consisting of \$110.5 million for the purchase of RAPID, \$32.6 million for the purchase of property, equipment and other capital assets primarily to expand our production capacity, \$20.0 million for the purchase of marketable securities and \$8.8 million for the purchases of other assets and investments, which were partially offset by \$48.0 million in proceeds from maturities and call redemption of marketable securities.

Cash Flows from Financing Activities

Cash used in financing activities was \$31.6 million for the year ended December 31, 2019, consisting of \$33.5 million in repurchases of common stock, and \$2.5 million in purchases of shares withheld for tax obligations associated with equity transactions, partially offset by \$4.4 million in proceeds from exercises of stock options.

Cash used in financing activities was \$10.4 million for the year ended December 31, 2018, consisting of \$12.2 million in repurchases of common stock, payments on short-term debt obligations of \$5.0 million, and \$2.1 million in purchases of shares withheld for tax obligations associated with equity transactions, partially offset by \$8.9 million in proceeds from exercises of stock options.

Cash provided by financing activities was \$9.2 million for the year ended December 31, 2017, consisting of \$5.0 million in short-term debt obligations and \$8.6 million in proceeds from the exercise of stock options, partially offset by \$4.4 million for repurchases of common stock.

Operating and Capital Expenditure Requirements

We believe, based on our current operating plan, that our cash balances and cash generated through operations and interest income will be sufficient to meet our anticipated cash requirements through at least the next 12 months. From time to time we may seek to sell equity or convertible debt securities or enter into credit facilities. The sale of equity and convertible debt securities may result in dilution to our shareholders. If we raise additional funds through the issuance of convertible debt securities or enter into credit facilities, these securities and debt holders could have rights senior to those of our common stock, and this debt could contain covenants that would restrict our operations. We may require additional capital beyond our currently forecasted amounts. Any such required additional capital may not be available on terms acceptable to us, or at all.

Our future capital requirements will depend on many factors, including the following:

- the revenue growth in Injection Molding, CNC Machining, 3D Printing and Sheet Metal product lines;
- costs of operations, including costs relating to expansion and growth;
- the emergence of competing or complementary technological developments;
- the costs of filing, prosecuting, defending and enforcing any patent claims and other intellectual product rights, or participating in litigation-related activities; and
- the acquisition of businesses, products and technologies, although we currently have no commitments or agreements relating to any of these types of transactions.

Our recent annual capital expenditures have varied between 10% and 20% of annual revenue. We believe future growth capital expenditures, excluding any expenditures for buildings and maintenance capital we might purchase for our operations, are likely to vary between approximately 8% and 12% of annual revenue.

Contractual Obligations

As of December 31, 2019, our contractual obligations and the effect such obligations are expected to have on our liquidity and cash flows in future periods were as follows:

(in thousands)	Total	Payment Due by Period			
		Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Operating leases	\$ 12,678	\$ 4,034	\$ 6,533	\$ 1,406	\$ 705
Total	\$ 12,678	\$ 4,034	\$ 6,533	\$ 1,406	\$ 705

The table above reflects only payment obligations that are fixed and determinable. Our commitments for operating leases relate to three of our United States manufacturing facilities; our European sales, customer service and technical support offices; manufacturing and office facilities located in Germany; and our Japan facility.

Financing Arrangements

We had no financing arrangements as of December 31, 2019 and 2018.

Inflation

We experience normal inflation and changing prices, primarily on our production materials and labor. In 2019 and 2018, wage inflation contributed to our lower gross margin. In 2017, we do not believe inflation and changing prices had a material effect on our financial condition.

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

The discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates, judgments and assumptions that affect the reported amount of assets, liabilities, revenue, expenses and related disclosures. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, goodwill, other intangible assets, stock-based compensation, and income taxes. We base our estimates of the carrying value of certain assets and liabilities on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. In many cases, we could reasonably have used different accounting policies and estimates. In some cases, changes in the accounting estimates are reasonably likely to occur from period to period. Management has discussed the development, selection and disclosure of these estimates with the audit committee of our board of directors. Our actual results may differ significantly from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect our more significant judgments used in the preparation of our consolidated financial statements. See the Notes to Consolidated Financial Statements included in Item 8. "Financial Statements and Supplementary Data" in this Annual Report on Form 10-K for additional information about these critical accounting policies, as well as a description of our other accounting policies.

Revenue Recognition

On January 1, 2018, we adopted ASC 606, *Revenue from Contracts with Customers*, using the modified retrospective approach. We manufacture custom parts to specific customer orders that have no alternative use to us, and we believe there is a legally enforceable right to payment for performance completed to date on these manufactured parts. For manufactured parts that meet these two criteria, we will recognize revenue over time.

Prior to 2018, we recognized revenue in accordance with ASC 605, *Revenue Recognition*, which states that revenue is realized or realizable and earned when all of the following criteria are met: (1) persuasive evidence of an arrangement exists, (2) delivery has occurred or services have been rendered, (3) the price to the buyer is fixed or determinable, and (4) collectability is reasonably assured. Revenue was recognized upon transfer of title and risk of loss, which was generally upon the shipment of parts in our Injection Molding, CNC Machining, 3D Printing, Sheet Metal and Other product lines.

Goodwill

We recognize goodwill in accordance with ASC 350, *Intangibles—Goodwill and Other*. Goodwill is the excess of cost of an acquired entity over the amounts assigned to assets acquired and liabilities assumed in a business combination. Goodwill is not amortized. Goodwill is tested for impairment annually in the fourth quarter of each year, and is tested for impairment between annual tests if an event occurs or circumstances change that would indicate the carrying amount may be impaired. An impairment charge for goodwill is recognized only when the estimated fair value of a reporting unit, including goodwill, is less than its carrying amount. As of December 31, 2019 no impairment charges for goodwill have been recognized.

Other Intangible Assets

We recognize other intangibles assets in accordance with ASC 350, *Intangibles—Goodwill and Other*. Other intangible assets include software technology, customer relationships and other intangible assets acquired from independent parties. Other intangible assets with a definite life are amortized over a period ranging from two to 10 years on a straight line basis, and are tested for impairment whenever events or circumstances indicate that the carrying amount of an asset (asset group) may not be recoverable. An impairment loss is recognized when the carrying amount of an asset exceeds the estimated undiscounted cash flows generated by the asset. As of December 31, 2019 no impairment charges for intangible assets have been recognized.

Stock-Based Compensation

We determine our stock-based compensation in accordance with ASC 718, *Compensation—Stock Compensation* (ASC 718), which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and non-employee directors based on the grant date fair value of the award.

Determining the appropriate fair value model and calculating the fair value of stock option grants requires the input of subjective assumptions. We use the Black-Scholes option pricing model to value our stock option awards. Stock-based compensation expense is significant to our consolidated financial statements and is calculated using our best estimates, which involve inherent uncertainties and the application of management's judgment. Significant estimates include our expected term and stock price volatility. If different estimates and assumptions had been used, our common stock valuations could be significantly different and related stock-based compensation expense may be materially impacted.

The Black-Scholes option pricing model requires inputs such as the risk-free interest rate, expected term, expected volatility and expected dividend yield. We base the risk-free interest rate that we use in the Black-Scholes option pricing model on zero coupon U.S. Treasury instruments with maturities similar to the expected term of the award being valued. The expected term of stock options is estimated from the vesting period of the award and represents the weighted average period that our stock options are expected to be outstanding. We estimated the volatility of our stock price based on the historic volatility of our common stock. We have never paid and do not anticipate paying any cash dividends in the foreseeable future and, therefore, we use an expected dividend yield of zero in the option pricing model. We account for forfeitures as they occur.

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The fair value of each new employee option awarded was estimated on the date of grant for the periods below using the Black-Scholes option pricing model with the following assumptions:

	Year Ended December 31,		
	2019	2018	2017
Risk-free interest rate	2.35 - 2.58%	2.52 - 3.07%	2.24 - 2.36%
Expected life (years)	6.25	6.25	6.50
Expected volatility	42.52 - 42.74%	41.68 - 42.22%	42.68 - 44.68%
Expected dividend yield	0%	0%	0%
Weighted average grant date fair value	\$47.84	\$50.08	\$32.26

Our 2012 Employee Stock Purchase Plan (ESPP) allows eligible employees to purchase a variable number of shares of our common stock during each offering period at a discount through payroll deductions of up to 15% of their eligible compensation, subject to plan limitations. The ESPP provides for six-month offering periods with a single purchase period. At the end of each offering period, employees are able to purchase shares at 85% of the lower of the fair market value of our common stock on the first trading day of the offering period or on the last trading day of the offering period. We determine the fair value stock-based compensation related to our ESPP in accordance with ASC 718 using the component measurement approach and the Black-Scholes standard option pricing model.

The fair value of each offering period was estimated using the Black-Scholes option pricing model with the following assumptions:

	Year Ended December 31,		
	2019	2018	2017
Risk-free interest rate	1.59 - 2.35%	2.06 - 2.33%	0.97 - 1.48%
Expected life (months)	6.00	6.00	6.00
Expected volatility	42.63 - 53.57%	31.50 - 37.36%	24.49 - 34.51%
Expected dividend yield	0%	0%	0%

There are significant differences among option valuation models, and this may result in a lack of comparability with other companies that use different models, methods and assumptions. If factors change and we employ different assumptions in the application of ASC 718 in future periods, or if we decide to use a different valuation model, such as a lattice model, the stock-based compensation expense that we record in the future under ASC 718 may differ significantly from what we have recorded using the Black-Scholes option pricing model and could materially affect our operating results.

We recognize stock-based compensation expense on a straight-line basis over the requisite service period. We recorded stock-based compensation expense relating to stock options, restricted stock awards, performance stock units and our ESPP of \$10.8 million, \$10.9 million and \$8.6 million during the

years ended December 31, 2019, 2018 and 2017, respectively. As of December 31, 2019, we had \$3.6 million of unrecognized stock-based compensation costs related to unvested stock options that are expected to be recognized over a weighted average period of 2.6 years. We issued options to purchase 53,708, 36,600 and 60,100 shares of our common stock in 2019, 2018 and 2017, respectively. As of December 31, 2019, we had \$21.1 million of unrecognized stock-based compensation costs related to non-vested restricted stock, which is expected to be recognized over a weighted average period of 2.6 years. We issued restricted stock awards of 115,471, 106,855 and 210,744 shares of our common stock in 2019, 2018 and 2017, respectively. As of December 31, 2019, we had \$0.1 million of unrecognized stock-based compensation costs related to non-vested performance stock, which is expected to be recognized over a weighted average period of 0.1 years. The decrease in unrecognized stock-based compensation costs related to non-vested performance stock in 2019 when compared to 2018 is driven by a decrease in the number of shares expected to vest at the end of future performance periods. We issued performance stock awards of 21,434, 20,006 and 25,707 shares of our common stock in 2019, 2018 and 2017, respectively.

In future periods, our stock-based compensation expense is expected to increase due to our existing unrecognized stock-based compensation and the issuance of additional stock-based awards to continue to attract and retain employees and non-employee directors.

Income Taxes

We account for income taxes in accordance with ASC 740, *Income Taxes* (ASC 740). Under this method, we determine tax assets and liabilities based upon the differences between the financial statement carrying amounts and the tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to affect taxable income. The tax consequences of most events recognized in the current year's financial statements are included in determining income taxes currently payable. However, because tax laws and financial accounting standards differ in their recognition and measurement of assets, liabilities and equity, revenues, expenses, gains and losses, differences arise between the amount of taxable income and pretax financial income for a year and between the tax basis of assets or liabilities and their reported amounts in the financial statements. Because we assume that the reported amounts of assets and liabilities will be recovered and settled, respectively, a difference between the tax basis of an asset or liability and its reported amount in the balance sheet will result in a taxable or a deductible amount in some future years when the related liabilities are settled or the reported amounts of the assets are recovered, giving rise to a deferred tax asset or liability. We establish a valuation allowance for any portion of our deferred tax assets that we believe will not be recognized.

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ASC 740 also clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements by defining a criterion that an individual tax position must meet for any part of the benefit of that position to be recognized in an enterprise's financial statements. Additionally, ASC 740 provides guidance on measurement, de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. Including interest and penalties, we have established a liability for uncertain tax positions of \$5.4 million as of December 31, 2019.

The effective tax rate increased by 5.2% for the year ended December 31, 2019 when compared to 2018 primarily due to a decrease in tax benefits from the vesting of restricted stock and exercise of stock options, an increase in the state tax provision, and an increase to valuation allowances for unrealizable deferred tax assets.

The Tax Cuts and Jobs Act (the "Act") was enacted on December 22, 2017. The Act reduced the U.S. federal corporate tax rate from 35% to 21%, required companies to pay a transition tax on earnings of certain foreign subsidiaries that were previously tax deferred and creates new taxes on certain foreign sourced earnings. No additional income taxes have been provided for any remaining undistributed foreign earnings not subject to the transition tax or any additional outside basis difference inherent in these entities as these amounts continue to be indefinitely reinvested in foreign operations.

Recently adopted accounting pronouncements

During the fourth quarter of 2019, we early adopted the Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2017-04, *Intangibles – Goodwill and Other*, which is intended to simplify the subsequent measurement of goodwill. The adoption of this guidance had no material impact on our consolidated financial statements.

During the first quarter of 2019, we adopted the FASB ASU 2016-02, *Leases* (ASC 842), which introduces the balance sheet recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous guidance. We have adopted the new lease standard using the new transition option issued under the amendments in ASU 2018-11, *Leases*, which allowed us to continue to apply the legacy guidance in Accounting Standards Codification (ASC) 840, *Leases*, in the comparative periods presented in the year of adoption. We elected the package of practical expedients permitted under the transition guidance within the new standard, which among other things, allowed us to carry forward the historical lease classification. We made an accounting policy election to keep leases with an initial term of 12 months or less off of the balance sheet. We will recognize those lease payments in the Consolidated Statements of Comprehensive Income on a straight-line basis over the lease term. The impact of the adoption was an increase to our operating lease assets and liabilities on January 1, 2019 of \$13.1 million.

During the first quarter of 2018, we adopted the FASB ASU 2014-09, *Revenue from Contracts with Customers* (ASC 606). 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. We adopted the new revenue standard using the modified retrospective approach. We manufacture custom parts to specific customer orders that have no alternative use to us, and we believe there is a legally enforceable right to payment for performance completed to date on these manufactured parts. For manufactured parts that meet these two criteria, we will recognize revenue over time. The transition adjustment recorded was an increase of \$1.5 million to our retained earnings balance as of January 1, 2018.

During the first quarter of 2018, we adopted ASU 2017-09, *Compensation – Stock Compensation*, which is intended to provide clarity and reduce diversity in practice as well as cost and complexity when applying the guidance to a change to the terms or conditions of a share-based payment award. The adoption of this guidance did not have a material impact on our consolidated financial statements.

Recently issued accounting pronouncements

In December 2019, the FASB issued ASU 2019-12, *Income Taxes*, which is intended to simplify the accounting for income taxes. This guidance will be effective for fiscal years beginning after December 15, 2020 and interim periods within those fiscal years with early adoption permitted. We are evaluating the impact of future adoption of this guidance on our consolidated financial statements, but we do not expect the impact to be material.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses*, which is intended to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments held by a reporting entity at each reporting date. This guidance will be effective for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years with early adoption permitted. The impact of this guidance will not have a material impact on our consolidated financial statements.

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Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Quantitative and Qualitative Disclosure of Market Risks

Our exposure to market risk is confined to our cash and cash equivalent balances and investments. The primary goals of our investment policy are preservation of capital, fulfillment of liquidity needs and fiduciary control of cash and cash equivalent balances. We also seek to maximize income from our investments without assuming significant risk. To achieve our goals, we maintain a portfolio of debt securities with various maturities ranging from one to three years. Due to the nature of our investment portfolio, we are subject to interest rate risks, which we mitigate by holding our investments to maturity. In future periods, we will continue to evaluate our investment policy in order to continue our overall goals.

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 and incur production costs and operating expenses in British Pound, 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 assessed 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 losses of \$0.8 million for the year ended December 31, 2019 and foreign currency gains of \$0.3 million and \$0.4 million for the years ended December 31, 2018 and 2017, respectively.

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Item 8. Financial Statements and Supplementary Data

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Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of Proto Labs, Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Proto Labs, Inc. (the Company) as of December 31, 2019 and 2018, the related consolidated statements of comprehensive income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2019, and the related notes (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2019 and 2018, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2019, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2019, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated February 26, 2020 expressed an unqualified opinion thereon.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical Audit Matters

The critical audit matters communicated below are matters arising from the current period audit of the consolidated financial statements that were communicated or required to be communicated to the audit committee and that: (1) relate to accounts or disclosures that are material to the consolidated financial statements and (2) involved our especially challenging, subjective or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

Revenue Recognition – Revenue Recognized Over Time

Description of the Matter As discussed in Notes 2 and 3 to the consolidated financial statements, the Company provides quality, quick-turn prototyping and on-demand manufacturing services. The majority of revenue recognized in a reporting period is based on completed, invoiced contracts. The Company manufactures parts that have no alternative use to the Company since the parts are custom made to specific customer orders and the Company believes that there is a legally enforceable right to payment for performance completed to date on these manufactured parts. Revenue is recognized over time for manufactured parts which meet these two criteria. For revenue recognized over time, management uses the input method to measure progress toward the complete satisfaction of performance obligations, based on production time incurred to date as a percentage of total estimated production time.

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Auditing revenue recognized over time was challenging because the relevant accounting standard requires the Company to estimate the progress towards satisfaction of performance obligations, applying a single appropriate method to measure progress. The input method requires an analysis of the incurred time in production and an estimate of the total time necessary to complete the total parts per the customer's order. The Company also estimates a reasonable profit margin. These estimates are based on management's assessment of the current status of production as well as historical results.

How We Addressed the Matter in Our Audit We obtained an understanding, evaluated the design and tested the operating effectiveness of controls over the Company's process for recognizing revenue over time. This included testing controls over management's evaluation of contract terms, the estimation of production time incurred to date and total production time used in the input method, estimation of a reasonable profit margin and the completeness and accuracy of the data used in the input method.

To test the Company's revenue recognition over time, we performed audit procedures that included, among others, inspecting a sample of contracts to evaluate the existence of an enforceable right to payment for performance completed to date, evaluating the progress towards completion of orders in process through examination of a sample of product shipments subsequent to the end of the reporting period, evaluating the reasonableness of management's estimate of profit margins based on a comparison to historical margins, testing the appropriateness of the timing and amount of revenue recognized over time based on the underlying inputs, and performing an independent sensitivity analysis to evaluate the impact on revenues of changes in significant assumptions.

Capitalized Software Costs

Description of the Matter As discussed in Note 2 to the consolidated financial statements, the Company follows ASC 350-40, Internal-Use Software, in accounting for internally developed software. The Company capitalized \$16.1 million of internal-use software costs during the year ended December 31, 2019.

Auditing capitalized internal-use software development costs was challenging due to the degree of subjectivity involved in management's assessment of what development activities and related costs met the capitalization criteria, as only those costs incurred in certain stages of software development and certain types of costs qualify for capitalization in accordance with the applicable accounting standard.

How We Addressed the Matter in Our Audit We obtained an understanding, evaluated the design and tested the operating effectiveness of controls over the Company's internal-use software costs process. This included testing controls over management's determination of which costs qualify for capitalization in accordance with the applicable accounting standard and Company policy.

To test the Company's capitalization of internal-use software costs, we performed audit procedures that included, among others, inspecting underlying documentation to evaluate whether the costs were capitalizable in accordance with the Company's capitalization policy and the applicable accounting standard. We also assessed the Company's determination of costs that qualified for capitalization through inspection of a sample of vendor contracts and invoices, inquiries of project personnel to assess the nature of the costs and review of payroll data to evaluate the internal payroll costs capitalized.

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Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of Proto Labs, Inc.

Opinion on Internal Control over Financial Reporting

We have audited Proto Labs, Inc.'s internal control over financial reporting as of December 31, 2019, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). In our opinion, Proto Labs, Inc. (the Company) maintained, in all material respects, effective internal control over financial reporting as of December 31, 2019, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of Proto Labs, Inc. as of December 31, 2019 and 2018, the related consolidated statements of comprehensive income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2019, and the related notes and our report dated February 26, 2020 expressed an unqualified opinion thereon.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects.

Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Ernst & Young LLP

Minneapolis, Minnesota
February 26, 2020

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

	December 31,	
	2019	2018
Assets		
Current assets		
Cash and cash equivalents	\$ 125,225	\$ 85,046
Short-term marketable securities	35,437	46,750
Accounts receivable, net of allowance for doubtful accounts of \$952 and \$919 as of December 31, 2019	57,450	59,155

and December 31, 2018, respectively		
Inventory	10,075	10,087
Prepaid expenses and other current assets	8,232	8,567
Income taxes receivable	-	5,757
Total current assets	236,419	215,362
Property and equipment, net	263,712	228,001
Goodwill	128,752	128,752
Other intangible assets, net	17,369	19,850
Long-term marketable securities	12,960	23,579
Operating lease assets	11,425	-
Other long-term assets	3,030	3,441
Total assets	<u>\$ 673,667</u>	<u>\$ 618,985</u>

Liabilities and shareholders' equity

Current liabilities		
Accounts payable	\$ 16,804	\$ 17,411
Accrued compensation	15,058	18,130
Accrued liabilities and other	11,057	16,702
Current operating lease liabilities	3,340	-
Income taxes payable	1,322	491
Total current liabilities	47,581	52,734
Long-term operating lease liabilities	8,565	-
Long-term deferred tax liabilities	26,283	20,162
Other long-term liabilities	5,448	4,592
Total liabilities	87,877	77,488

Shareholders' equity

Preferred stock, \$0.001 par value, authorized 10,000,000 shares; issued and outstanding 0 shares as of December 31, 2019 and December 31, 2018, respectively	-	-
Common stock, \$0.001 par value, authorized 150,000,000 shares; issued and outstanding 26,786,459 and 26,984,747 shares as of December 31, 2019 and December 31, 2018, respectively	27	27
Additional paid-in capital	268,059	258,502
Retained earnings	324,722	291,460
Accumulated other comprehensive loss	(7,018)	(8,492)
Total shareholders' equity	585,790	541,497
Total liabilities and shareholders' equity	<u>\$ 673,667</u>	<u>\$ 618,985</u>

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

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

	Year Ended December 31,		
	2019	2018	2017
Statements of Operations:			
Revenue	\$ 458,728	\$ 445,596	\$ 344,490
Cost of revenue	223,438	206,917	150,648
Gross profit	235,290	238,679	193,842
Operating expenses			
Marketing and sales	72,976	68,533	56,856
Research and development	32,692	28,735	23,560
General and administrative	49,766	52,513	41,200
Total operating expenses	155,434	149,781	121,616
Income from operations	79,856	88,898	72,226
Other income, net	1,337	2,757	2,209
Income before income taxes	81,193	91,655	74,435
Provision for income taxes	17,538	15,067	22,657
Net income	<u>\$ 63,655</u>	<u>\$ 76,588</u>	<u>\$ 51,778</u>
Net income per share:			
Basic	<u>\$ 2.37</u>	<u>\$ 2.84</u>	<u>\$ 1.94</u>
Diluted	<u>\$ 2.35</u>	<u>\$ 2.81</u>	<u>\$ 1.93</u>

Shares used to compute net income per share:

Basic	26,866,985	26,982,614	26,647,610
Diluted	27,049,423	27,278,816	26,845,071

Other Comprehensive (Loss) Income, net of tax

Foreign currency translation adjustments	\$ 1,474	\$ (3,258)	\$ 5,519
Comprehensive income	\$ 65,129	\$ 73,330	\$ 57,297

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

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Proto Labs, Inc.
Consolidated Statements of Shareholders' Equity
(In thousands, except share amounts)

	Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
	Shares	Amount				
Balance at January 1, 2017	26,504,868	26	213,857	176,703	(10,753)	379,833
Common shares issued on exercise of options and other	283,449	1	8,603	-	-	8,604
Common shares issued for RAPID acquisition	118,140	1	11,335	-	-	11,336
Stock-based compensation expense	-	-	8,558	-	-	8,558
Repurchases of Common Stock	(77,806)	(1)	(628)	(3,784)	-	(4,413)
Net income	-	-	-	51,778	-	51,778
<i>Other comprehensive income</i>						
Foreign currency translation adjustment	-	-	-	-	5,519	5,519
Comprehensive income						57,297
Balance at December 31, 2017	<u>26,828,651</u>	<u>\$ 27</u>	<u>\$ 241,725</u>	<u>\$ 224,697</u>	<u>\$ (5,234)</u>	<u>\$ 461,215</u>
Common shares issued on exercise of options and other	260,694	-	6,791	-	-	6,791
Stock-based compensation expense	-	-	10,928	-	-	10,928
Repurchases of Common Stock	(104,598)	-	(942)	(11,287)	-	(12,229)
Revenue recognition transition adjustment	-	-	-	1,462	-	1,462
Net income	-	-	-	76,588	-	76,588
<i>Other comprehensive income</i>						
Foreign currency translation adjustment	-	-	-	-	(3,258)	(3,258)
Comprehensive income						73,330
Balance at December 31, 2018	<u>26,984,747</u>	<u>\$ 27</u>	<u>\$ 258,502</u>	<u>\$ 291,460</u>	<u>\$ (8,492)</u>	<u>\$ 541,497</u>
Common shares issued on exercise of options and other	128,174	-	1,904	-	-	1,904
Stock-based compensation expense	-	-	10,781	-	-	10,781
Repurchases of Common Stock	(326,462)	-	(3,128)	(30,393)	-	(33,521)
Net income	-	-	-	63,655	-	63,655
<i>Other comprehensive income</i>						
Foreign currency translation adjustment	-	-	-	-	1,474	1,474
Comprehensive income						65,129
Balance at December 31, 2019	<u>26,786,459</u>	<u>\$ 27</u>	<u>\$ 268,059</u>	<u>\$ 324,722</u>	<u>\$ (7,018)</u>	<u>\$ 585,790</u>

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

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

	Year Ended December 31,		
	2019	2018	2017
Operating activities			
Net income	\$ 63,655	\$ 76,588	\$ 51,778

Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	30,864	26,754	18,474
Stock-based compensation expense	10,781	10,928	8,558
Deferred taxes	6,106	11,936	1,174
Loss on impairment of assets	-	-	513
Gain on sale of businesses	-	(671)	-
Amortization of held-to-maturity securities	5	374	1,063
Other	391	(619)	(153)
Changes in operating assets and liabilities, net of acquisitions:			
Accounts receivable	1,848	(6,098)	(9,933)
Inventories	60	(189)	(985)
Prepaid expenses and other	545	(2,098)	(691)
Income taxes	6,555	(6,652)	1,646
Accounts payable	(719)	1,942	3,176
Accrued liabilities and other	(4,039)	10,734	7,128
Net cash provided by operating activities	116,052	122,929	81,748
Investing activities			
Purchases of property, equipment and other capital assets	(62,230)	(87,104)	(32,635)
Cash used for acquisitions, net of cash acquired	-	(90)	(110,533)
Proceeds from sale of businesses	-	284	-
Purchases of other assets and investments	(4,000)	(126)	(8,742)
Purchases of marketable securities	(46,403)	(41,384)	(20,037)
Proceeds from maturities of marketable securities	68,330	65,139	47,972
Net cash used in investing activities	(44,303)	(63,281)	(123,975)
Financing activities			
Payments on debt	-	(5,000)	-
Proceeds from issuance of debt	-	-	5,000
Proceeds from exercises of stock options	4,391	8,935	8,602
Purchases of shares withheld for tax obligations	(2,487)	(2,144)	-
Repurchases of common stock	(33,521)	(12,229)	(4,410)
Net cash used in financing activities	(31,617)	(10,438)	9,192
Effect of exchange rate changes on cash and cash equivalents	47	(871)	947
Net increase (decrease) in cash and cash equivalents	40,179	48,339	(32,088)
Cash and cash equivalents, beginning of period	85,046	36,707	68,795
Cash and cash equivalents, end of period	\$ 125,225	\$ 85,046	\$ 36,707
Supplemental cash flow disclosure			
Cash paid for interest	\$ 14	\$ 39	\$ 19
Cash paid for taxes	\$ 4,002	\$ 9,966	\$ 19,113

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

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Proto Labs, Inc.
Notes to Consolidated Financial Statements

Note 1 — Nature of Business

Organization and business

Proto Labs, Inc. and its subsidiaries (Proto Labs, the Company, we, us, or our) is an e-commerce driven digital manufacturer of quick-turn, on-demand injection-molded, computer numerical control (CNC) machined, 3D-printed and sheet metal-fabricated custom parts for prototyping and short-run production. The Company's customers are product developers and engineers throughout the world who require a faster and less expensive way to obtain low volumes of parts. The Company's proprietary technology eliminates most of the time-consuming and expensive skilled labor conventionally required to quote and manufacture parts in low volumes, and its customers conduct nearly all of their business with the Company over the Internet. The Company targets its product lines to the millions of product developers and engineers who use three-dimensional (3D) computer-aided design (CAD) software to design products across a diverse range of end-markets. The Company has established operations in the United States, Europe and Japan, which the Company believes are among the largest geographic markets where these product developers and engineers are located. The Company's primary manufacturing product lines currently include Injection Molding, CNC Machining, 3D Printing and Sheet Metal. Proto Labs, Inc. is headquartered in Maple Plain, Minnesota. The Company's subsidiaries are:

Name	Location
PL-US International LLC	United States
Rapid Management Group LLC	United States

Rapid Sheet Metal LLC (RSM)	United States
Rapid Manufacturing LLC (RM)	United States
Proto Labs Ltd.	United Kingdom
PL International Holdings, UK, Ltd.	United Kingdom
PL Euro Services Limited	United Kingdom
Proto Labs GmbH	Germany
Proto Labs Tooling GmbH	Germany
Proto Labs, G.K.	Japan

Note 2 — Summary of Significant Accounting Policies

Principles of consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, as listed within “Organization and business” above. All intercompany accounts and transactions have been eliminated in consolidation.

Comprehensive income

Components of comprehensive income include net income and foreign currency translation adjustments. Comprehensive income is disclosed in the accompanying consolidated statements of comprehensive income and consolidated statements of shareholders’ equity.

Proto Labs, Inc.
Notes to Consolidated Financial Statements

Accounting estimates

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

Cash and cash equivalents

Cash and cash equivalents include cash and other investments, including marketable securities, with maturities of three months or less at the date of purchase. The Company maintains its cash in bank deposit accounts, which, at times, may exceed federally insured limits. The Company has not experienced any losses on such accounts.

Marketable securities

Marketable securities include held-to-maturity debt securities recorded at amortized cost. Management determines the appropriate classification of debt securities at the time of purchase and reevaluates such designation as of each balance sheet date. Debt securities are classified as held-to-maturity when the Company has the positive intent and ability to hold the securities to maturity. Held-to-maturity securities are stated at amortized cost, adjusted for amortization of premiums and accretion of discounts to maturity computed under the effective interest method. Such amortization is included in other income, net. Interest on securities classified as held to maturity is included in other income, net. The classification of marketable securities as current or non-current is dependent upon the security's maturity date. Securities with maturities of three months or less at the time of purchase are categorized as cash equivalents as described above. The Company reviews impairments associated with its marketable securities in accordance with the measurement guidance provided by ASC 320, *Investments – Debt and Equity Securities*, when determining the classification of impairment as “temporary” or “other-than-temporary.” The factors used to differentiate between temporary and other-than-temporary include assessment of the quality of the security, credit ratings actions and management's intent to hold the security to maturity as well as other factors.

Accounts receivable and allowance for doubtful accounts

Accounts receivable are reported at the invoiced amount less an allowance for doubtful accounts. As of each balance sheet date, the Company evaluates its accounts receivable and establishes an allowance for doubtful accounts based on a combination of specific customer circumstances and credit conditions taking into account the history of write-offs and collections. A receivable is considered past due if payment has not been received within the period agreed upon in the invoice. Accounts receivable are written off after all collection efforts have been exhausted. Recoveries of trade receivables previously written off are recorded when received.

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.

Property, equipment and leasehold improvements

Property, equipment and leasehold improvements are stated at cost. Major improvements that substantially extend an asset's useful life are capitalized. Repairs, maintenance and minor improvements are charged to operations as incurred. Depreciation, including amortization of leasehold improvements and assets recorded under capital leases, is calculated using the straight-line method over the estimated useful lives of the individual assets and ranges from 3 to 39 years. Manufacturing equipment is depreciated over 3 to 15 years, office furniture and equipment are depreciated over 3 to 7 years, computer hardware and software are depreciated over 3 to 5 years, building costs are depreciated over 39 years, leasehold improvements are depreciated over the estimated lives of the related assets or the life of the lease, whichever is shorter, and building and land improvements are depreciated over 10 to 39 years. Assets not in service are not depreciated until the asset is put into use.

The Company follows ASC 350-40, *Internal-Use Software*, in accounting for internally developed software. As of December 31, 2019 and 2018, respectively, \$32.7 million and \$16.6 million of software development costs were capitalized. Capitalized software development costs for the year ended December 31, 2019 were \$16.1 million.

Proto Labs, Inc.
Notes to Consolidated Financial Statements

Goodwill

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

Other Intangible Assets

Other intangible assets include software technology, customer relationships and other intangible assets acquired from other independent parties. Other intangible assets with a definite life are amortized over a period ranging from two to 10 years on a straight line basis, and are tested for impairment whenever events or circumstances indicate that the carrying amount of an asset (asset group) may not be recoverable. An impairment loss is recognized when the carrying amount of an asset exceeds the estimated undiscounted cash flows generated by the asset. The amount of the impairment loss recorded is calculated by the excess of the asset's carrying value over its fair value.

Accounting for long-lived assets

The Company periodically reviews the carrying amount of its property, equipment and leasehold improvements to determine if circumstances exist indicating an impairment or if depreciation periods should be modified. If facts or circumstances indicate that an impairment may exist, the Company will prepare a projection of the undiscounted future cash flows of the specific assets to determine if the assets are recoverable. If impairment exists based on these projections, an adjustment will be made to reduce the carrying amount of the specific assets to fair value.

Revenue recognition

On January 1, 2018, the Company adopted ASC 606, *Revenue from Contracts with Customers*, using the modified retrospective approach. The Company manufactures custom parts to specific customer orders that have no alternative use to the Company, and the Company believes there is a legally enforceable right to payment for performance completed to date on these manufactured parts. For manufactured parts that meet these two criteria, the Company will recognize revenue over time. Revenue is recognized over time using the input method based on time in production as a percentage of total estimated production time to measure progress toward satisfying performance obligations.

Prior to 2018, the Company recognized revenue when it was realized or realizable and earned when all of the following criteria were met: persuasive evidence of an arrangement existed, delivery had occurred or services had been rendered, the price to the buyer was fixed or determinable and collectability was reasonably assured. Revenue was recognized upon transfer of title and risk of loss, which was generally upon the shipment of parts in the Company's Injection Molding, CNC Machining, 3D Printing and Sheet Metal product lines.

Leases

On January 1, 2019, the Company adopted ASC 842, *Leases*, which introduced the balance sheet recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous guidance. The Company determines if an arrangement is a lease at inception. Operating leases are included in operating lease assets, current operating lease liabilities and long-term operating lease liabilities in the Consolidated Balance Sheets and are recognized based on the present value of lease payments over the lease term at commencement date.

Proto Labs, Inc.
Notes to Consolidated Financial Statements

Income taxes

The Company accounts for income taxes in accordance with ASC 740, *Income Taxes* (ASC 740). Under this method, the Company determines tax assets and liabilities based upon the differences between the financial statement carrying amounts and the tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to affect taxable income. The tax consequences of most events recognized in the financial statements are included in determining income taxes currently payable. However, because tax laws and financial accounting standards differ in their recognition and measurement of assets, liabilities and equity, revenues, expenses, gains and losses, differences arise between the amount of taxable income and pretax financial income for a year and between the tax basis of assets or liabilities and their reported amounts in the financial statements. Because the Company assumes that the reported amounts of assets and liabilities will be recovered and settled, respectively, a difference between the tax basis of an asset or liability and its reported amount in the balance sheet will result in a taxable or a deductible amount in some future years when the related liabilities are settled or the reported amounts of the assets are recovered, giving rise to a deferred tax asset or liability. The Company establishes a valuation allowance for any portion of its deferred tax assets that the Company believes may not be recognized.

ASC 740 also clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements by requiring that individual tax positions are recorded only when they meet a more-likely-than-not criterion. Additionally, ASC 740 provides guidance on measurement, de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

Stock-based compensation

The Company accounts for stock-based compensation in accordance with ASC 718, *Compensation—Stock Compensation* (ASC 718). Under the fair value recognition provisions of ASC 718, the Company measures stock-based compensation cost at the grant date fair value and recognizes the compensation expense over the requisite service period, which is the vesting period, using a straight-line attribution method. The amount of stock-based compensation expense recognized during a period is based on the portion of the awards that are ultimately expected to vest. The Company accounts for forfeitures as they occur. Ultimately, the total expense recognized over the vesting period will only be for those awards that vest. The Company's awards are not eligible to vest early in the event of retirement, however, the awards vest early in the event of a change in control.

In determining the compensation cost of the options granted, the fair value of options granted has been estimated on the date of grant using the Black-Scholes option-pricing model.

Advertising costs

Advertising is expensed as incurred and was approximately \$13.0 million, \$11.8 million and \$10.7 million for the years ended December 31, 2019, 2018 and 2017, respectively.

Research and development

Research and development expenses consist primarily of personnel and outside service costs related to the development of new processes and product lines, enhancements of existing product lines, development of software for internal use, maintenance of internally developed software, quality assurance and testing. Costs for internal use software are evaluated by project and capitalized where appropriate under ASC 350-40, *Intangibles - Goodwill and Other, Internal-Use Software*. Research and development costs were approximately \$32.7 million, \$28.7 million and \$23.6 million for the years ended December 31, 2019, 2018 and 2017, respectively.

Foreign currency translation/transactions

The Company translated the balance sheets of its foreign subsidiaries at period-end exchange rates and the income statement at the average exchange rates in effect throughout the period. The Company has recorded the translation adjustment as a separate component of consolidated shareholders' equity. Foreign currency transaction gains and losses are recognized in the consolidated statements of comprehensive income.

Business combinations

The Company accounts for business combinations in accordance with ASC 805, *Business Combinations* (ASC 805). On November 30, 2017, the Company acquired RAPID Manufacturing Group, LLC (RAPID) for \$122.0 million, consisting of \$110.6 million in cash and \$11.3 million in the Company's common stock.

Proto Labs, Inc.
Notes to Consolidated Financial Statements

Recently adopted accounting pronouncements

During the fourth quarter of 2019, the Company early adopted the Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2017-04, *Intangibles – Goodwill and Other*, which is intended to simplify the subsequent measurement of goodwill. The adoption of this guidance had no material impact on the Company's consolidated financial statements.

During the first quarter of 2019, the Company adopted the FASB ASU 2016-02, *Leases* (ASC 842), which introduces the balance sheet recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous guidance. The Company has adopted the new lease standard using the new transition option issued under the amendments in ASU 2018-11, *Leases*, which allowed the Company to continue to apply the legacy guidance in Accounting Standards Codification (ASC) 840, *Leases*, in the comparative periods presented in the year of adoption. The Company elected the package of practical expedients permitted under the transition guidance within the new standard, which among other things, allowed the Company to carry forward the historical lease classification. The Company made an accounting policy election to keep leases with an initial term of 12 months or less off of the balance sheet. The Company will recognize those lease payments in the Consolidated Statements of Comprehensive Income on a straight-line basis over the lease term. The impact of the adoption was an increase to the Company's operating lease assets and liabilities on January 1, 2019 of \$13.1 million.

During the first quarter of 2018, the Company adopted the FASB ASU 2014-09, *Revenue from Contracts with Customers* (ASC 606). 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 adopted the new revenue standard using the modified retrospective approach. The Company manufactures custom parts to specific customer orders that have no alternative use to the Company, and the Company believes there is a legally enforceable right to payment for performance completed to date on these manufactured parts. For manufactured parts that meet these two criteria, the Company will recognize revenue over time. The transition adjustment recorded was an increase of \$1.5 million to the Company's retained earnings balance as of January 1, 2018.

During the first quarter of 2018, the Company adopted ASU 2017-09, *Compensation – Stock Compensation*, which is intended to provide clarity and reduce diversity in practice as well as cost and complexity when applying the guidance to a change to the terms or conditions of a share-based payment award. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

Recently issued accounting pronouncements

In December 2019, the FASB issued ASU 2019-12, *Income Taxes*, which is intended to simplify the accounting for income taxes. This guidance will be effective for fiscal years beginning after December 15, 2020 and interim periods within those fiscal years with early adoption permitted. The Company is evaluating the impact of future adoption of this guidance on its consolidated financial statements, but does not expect the impact to be material.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses*, which is intended to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments held by a reporting entity at each reporting date. This guidance will be effective for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years with early adoption permitted. The impact of this guidance will not have a material impact on the Company's consolidated financial statements.

Proto Labs, Inc.
Notes to Consolidated Financial Statements

Note 3 – Revenue

The Company provides quality, quick-turn prototyping and on-demand manufacturing services. As a result, the majority of revenue recognized in a reporting period is based on completed, invoiced contracts. The Company accounts for revenue in accordance with ASC 606, which the Company adopted on January 1, 2018, using the modified retrospective method. Results for reporting periods beginning after January 1, 2018 are presented under ASC 606, while prior period amounts are not adjusted and continue to be reported in accordance with the Company's historic accounting under ASC 605. The Company recorded a net increase of \$1.5 million to its retained earnings balance on January 1, 2018 due to the cumulative impact of adopting ASC 606. The impact of adopting ASC 606 was to increase revenue by \$0.3 million and increase cost of revenue by \$0.2 million for the year ended December 31, 2018, and to increase accounts receivable by \$2.9 million and decrease inventory by \$1.3 million as of December 31, 2018, which includes the transition adjustment of \$1.5 million noted above.

A performance obligation is a promise in a contract to transfer a distinct good or service to the customer, and is the unit of account in ASC 606. The majority of the Company's CNC machining, 3D printing, and sheet metal contracts have a single performance obligation. The majority of the Company's injection molding contracts have multiple performance obligations including one obligation to produce the mold and a second obligation to produce parts. For injection molding contracts with multiple performance obligations, we allocate revenue to each performance obligation based on its relative standalone selling price. We generally determine standalone selling price based on the price charged to customers.

The Company manufactures parts that have no alternative use to the Company since the parts are custom made to specific customer orders, and the Company believes there is a legally enforceable right to payment for performance completed to date on these manufactured parts. For manufactured parts that meet these two criteria, the Company will recognize revenue over time. Revenue is recognized over time using the input method based on time in production as a percentage of total estimated production time to measure progress toward satisfying performance obligations.

Revenue by geographic region for the years ended December 31, 2019, 2018 and 2017 was as follows:

(in thousands)	Year Ended December 31,		
	2019	2018	2017
Revenue:			
United States	\$ 360,205	\$ 350,535	\$ 263,086
Europe	82,805	80,889	70,154
Japan	15,718	14,172	11,250
Total revenue	\$ 458,728	\$ 445,596	\$ 344,490

Revenue by product line for the years ended December 31, 2019, 2018 and 2017 was as follows:

(in thousands)	Year Ended December 31,		
	2019	2018	2017
Revenue:			
Injection Molding	\$ 217,415	\$ 210,523	\$ 194,432
CNC Machining	155,473	153,521	103,739
3D Printing	61,352	53,342	43,329
Sheet Metal	21,000	24,998	1,767
Other Revenue	3,488	3,212	1,223
Total revenue	\$ 458,728	\$ 445,596	\$ 344,490

The Company generally expenses sales commissions when incurred because the amortization period would have been one year or less. These costs are recorded within marketing and sales expenses. The value of unsatisfied performance obligations for contracts with an original expected length of one year or less is not material.

Proto Labs, Inc.
Notes to Consolidated Financial Statements

Note 4 – 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 following table presents the calculation of net income per basic and diluted share attributable to common shareholders:

(in thousands, except share and per share amounts)	Year Ended December 31,		
	2019	2018	2017
Net Income	\$ 63,655	\$ 76,588	\$ 51,778
Basic - weighted-average shares outstanding:	26,866,985	26,982,614	26,647,610
Effect of dilutive securities:			
Employee stock options and other	182,438	296,202	197,461
Diluted - weighted-average shares outstanding:	27,049,423	27,278,816	26,845,071
Net income per share attributable to common shareholders:			
Basic	\$ 2.37	\$ 2.84	\$ 1.94
Diluted	\$ 2.35	\$ 2.81	\$ 1.93

Note 5 – Business Combinations

On November 30, 2017, the Company acquired RAPID for \$122.0 million, consisting of \$110.6 million in cash (net of cash acquired) and \$11.3 million in the Company's common stock. The operations of RAPID are integrated into the operations of the Company.

RAPID is a New Hampshire-based custom parts supplier specializing in quick-turn sheet metal fabrication and CNC machining. With the acquisition, the Company offers its customers another quick-turn manufacturing service while expanding its CNC machining capabilities.

The acquisition has been accounted for under the acquisition method of accounting in accordance with ASC 805. The fair value of the consideration paid exceeded the fair value of the assets acquired and liabilities assumed, which resulted in goodwill of \$99.8 million. The goodwill primarily relates to synergies resulting from the acquisition and is deductible for tax purposes over a 15-year period.

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The RAPID amortizable intangible assets were valued as of the acquisition date and were deemed to have a weighted-average useful life of 5.5 years. The customer relationships were valued at \$7.5 million based on the Multi-Period Excess Earnings Method and are amortized over 6.0 years. The trade names were valued at \$1.1 million based on the Relief-from-Royalty Method and are amortized over 2.0 years. The non-competition agreement was valued at \$0.1 million based on the Discounted Cash Flow method and will be amortized over 5 years. The allocation of the purchase price to assets acquired and liabilities assumed is as follows:

(in thousands)	
Assets acquired:	
Current assets	\$ 6,720
Goodwill	99,836
Other intangible assets	8,700
Other long-term assets	8,855
Total assets acquired	124,111
Liabilities assumed:	
Current liabilities	2,067
Other long-term liabilities	85
Total liabilities assumed	2,152
Net assets acquired	\$ 121,959
Cash paid	\$ 115,378
Cash acquired	(4,755)
Net cash consideration	110,623
Equity portion of purchase price	11,336
Total purchase consideration	\$ 121,959

The following unaudited pro forma information represents the Company's results of operations as if the fiscal 2017 acquisition of RAPID had occurred at the beginning of fiscal 2016. These performance results may not be indicative of the actual results that would have occurred under the ownership and management of the Company.

(in thousands)	Year Ended December 31,	
	2017	2016
	(unaudited)	
Revenue	\$ 386,677	\$ 336,634
Net income	55,070	41,805

The unaudited pro forma net income for the year ended December 31, 2017 excludes transaction costs of approximately \$1.9 million and includes the increase in estimated depreciation expense of approximately \$0.9 million and the increase in estimated amortization expense of approximately \$3.0 million. The unaudited pro forma net income for the year ended December 31, 2016 includes the impact of new stock options and restricted stock units granted to employees of approximately \$0.2 million in connection with the acquisition, an increase in estimated depreciation expense of approximately \$0.6 million and the increase in estimated amortization expense of approximately \$3.1 million. The pro forma net income for the years ended December 31, 2017 and 2016 include the related tax effects of the adjustments. The pro forma information has been prepared for comparative purposes only and includes certain adjustments, as noted above. The adjustments are estimates and actual amounts may differ materially from these estimates. They do not reflect the effect of costs or synergies that would have been expected to result from the integration of the RAPID acquisition. The pro forma information does not purport to be indicative of the results of operations that actually would have resulted had the RAPID acquisition occurred on January 1, 2016. The Company's 2017 Consolidated Statements of Comprehensive Income include \$3.6 million of revenue and \$0.7 million of net loss related to RAPID. The net loss was primarily driven by \$1.1 million of bonus payments to RAPID employees as a result of the acquisition.

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Note 6 – Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill for the years ended December 31, 2019 and 2018 were as follows:

(in thousands)	Goodwill acquired during 2018		Goodwill acquired during 2019	
	Dec. 31, 2017	Dec. 31, 2018	Dec. 31, 2018	Dec. 31, 2019
United States	\$ 123,635	\$ 248	\$ 123,883	\$ -
Europe	4,239	-	4,239	-
Japan	630	-	630	-
Total goodwill	<u>\$ 128,504</u>	<u>\$ 248</u>	<u>\$ 128,752</u>	<u>\$ -</u>

As described in Note 5 – Business Combinations, the Company acquired RAPID in November 2017. The fair value of the consideration paid exceeded the fair value of the assets acquired and liabilities assumed, which resulted in goodwill in the United States of \$99.6 million for the year ended December 31, 2017 and a related working capital adjustment of \$0.2 million for the year ended December 31, 2018.

Intangible assets other than goodwill for the years ended December 31, 2019 and 2018 were as follows:

(in thousands)	Year Ended December 31, 2019			Year Ended December 31, 2018			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	\$ (527)	\$ 403	\$ 930	\$ (434)	\$ 496	10.0	4.3
Non-compete agreement	270	(222)	48	270	(206)	64	2.0 - 5.0	3.0
Trade secrets	250	(250)	-	250	(233)	17	5.0	0.0
Trade names	1,080	(1,080)	-	1,080	(540)	540	2.0	0.0
Software technology	13,229	(2,275)	10,954	12,229	(997)	11,232	10.0	8.0
Customer relationships	10,070	(4,106)	5,964	10,070	(2,569)	7,501	6.0 - 9.0	3.8
Total intangible assets	<u>\$ 25,829</u>	<u>\$ (8,460)</u>	<u>\$ 17,369</u>	<u>\$ 24,829</u>	<u>\$ (4,979)</u>	<u>\$ 19,850</u>		

Amortization expense for intangible assets for the years ended December 31, 2019, 2018 and 2017 was \$3.5 million, \$3.2 million and \$0.5 million, respectively.

The Company acquired a software company in December 2017, which was accounted for as an asset acquisition and resulted in an \$8.2 million software technology intangible asset for the year ended December 31, 2017. The acquisition did not meet the definition of a business under ASC 805. The asset acquisition included an additional \$5.0 million in contingent consideration to be recognized and paid upon completion of certain milestones over a 24-month period. The completion of each milestone resulted in additional value to the software technology intangible asset. We recognized \$1.0 million of the contingent consideration for the year ended December 31, 2019. We recognized \$4.0 million of the contingent consideration for the year ended December 31, 2018.

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

(in thousands)	Estimated Amortization Expense
2020	\$ 3,016
2021	3,016
2022	3,016
2023	2,813
2024	1,400
Thereafter	4,108
Total estimated amortization expense	<u>\$ 17,369</u>

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Notes to Consolidated Financial Statements

Note 7 – 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 equivalents measured at fair value as of December 31, 2019 and 2018, respectively, consist of money market mutual funds. The Company determines the fair value of these financial assets using Level 1 inputs.

The following tables summarize financial assets as of December 31, 2019 and 2018 measured at fair value on a recurring basis:

(in thousands)	December 31, 2019			December 31, 2018		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Financial Assets:						
Cash and cash equivalents						
Money market mutual funds	\$ 68,962	\$ -	\$ -	\$ 8,943	\$ -	\$ -
Total	<u>\$ 68,962</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 8,943</u>	<u>\$ -</u>	<u>\$ -</u>

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Notes to Consolidated Financial Statements

Note 8 – 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 December 31, 2019 and 2018 is as follows:

(in thousands)	December 31, 2019			Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
U.S. government agency securities	\$ 6,274	\$ 1	\$ (7)	\$ 6,268
Corporate debt securities	26,944	80	(12)	27,012
U.S. municipal securities	10,204	9	(3)	10,210
Commercial paper	3,491	-	-	3,491
Certificates of deposit/time deposits	1,484	22	-	1,506
Total marketable securities	\$ 48,397	\$ 112	\$ (22)	\$ 48,487

(in thousands)	December 31, 2018			Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
U.S. government agency securities	\$ 16,843	\$ -	\$ (88)	\$ 16,755
Corporate debt securities	31,769	-	(96)	31,673
U.S. municipal securities	17,509	1	(33)	17,477
Certificates of deposit/time deposits	4,208	-	(25)	4,183
Total marketable securities	\$ 70,329	\$ 1	\$ (242)	\$ 70,088

Fair values for the U.S. government agency securities and corporate debt securities are primarily determined based on quoted market prices (Level 1). Fair values for the U.S. municipal securities, commercial paper 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 to be temporary in nature. The investment policy adopted by the Company dictates that only investments in quality, highly rated debt securities are permitted. Those unrealized losses displayed above are the result of macroeconomic factors and are indicative of neither the quality of the underlying security nor the issuer's ability to pay its debt. The Company intends, and has the ability, 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.

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The December 31, 2019 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)	December 31, 2019
Due in one year or less	\$ 35,437
Due after one year through five years	12,960
Total marketable securities	\$ 48,397

Note 9 – Property and Equipment

Property and equipment consists of the following:

(in thousands)	December 31,	
	2019	2018
Land	\$ 14,098	\$ 10,566
Buildings and improvements	75,843	72,819
Machinery and equipment	208,954	185,416
Computer hardware and software	24,953	22,323
Leasehold improvements	7,341	7,330
Construction in progress	54,313	25,279
Total	385,502	323,733
Accumulated depreciation and amortization	(121,790)	(95,732)
Property and equipment, net	\$ 263,712	\$ 228,001

Depreciation expense for the years ended December 31, 2019, 2018 and 2017 was \$27.4 million, \$23.5 million and \$18.0 million, respectively.

Note 10 – Inventory

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

The Company's inventory consists of the following:

(in thousands)	December 31,	
	2019	2018
Raw materials	\$ 9,818	\$ 9,560
Work in process	501	792
Total inventory	10,319	10,352
Allowance for obsolescence	(244)	(265)
Inventory, net of allowance	\$ 10,075	\$ 10,087

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Notes to Consolidated Financial Statements

Note 11 – Financing Obligations

The Company had no financing obligations as of December 31, 2019 and 2018.

Note 12 – Employee Benefit Plans

The Company maintains a 401(k) retirement plan that covers employees in the United States. Under the plan, a full-time or regular part-time (over 20 hours/week) employee becomes a participant after completing three months of employment. Employees may elect to contribute up to 50 percent of regular gross pay, subject to federal law limits on the dollar amount that participants may contribute to the plan, each calendar year. The Company matches part of the employee contributions and may make a discretionary contribution to the plan. Total employer contributions were approximately \$3.1 million, \$2.7 million and \$1.9 million for the years ended December 31, 2019, 2018 and 2017, respectively.

The Company also sponsors a defined contribution retirement plan that covers the employees in the United Kingdom. Total employer contributions were approximately \$0.3 million in each of the years ended December 31, 2019, 2018 and 2017.

Note 13 – Stock-Based Compensation

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 on February 21, 2012, all shares that were reserved but not issued under the 2000 Plan were assumed by the 2012 Plan. No additional awards 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, performance 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 of the board of directors 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. Restricted stock is valued at fair market value on the date of grant.

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The Company's 2012 Employee Stock Purchase Plan (ESPP) allows eligible employees to purchase a variable number of 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 with a single purchase period, 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. The Company determines the fair value stock-based compensation related to its ESPP in accordance with ASC 718 using the component measurement approach and the Black-Scholes standard option pricing model.

Employees purchased 41,615 and 33,562 shares of common stock under the ESPP at an average exercise price of \$86.70 and \$85.61 during 2019 and 2018, respectively. As of December 31, 2019, 1,168,830 shares remained available for future issuance under the ESPP.

The Company determines its stock-based compensation in accordance with ASC 718, which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and non-employee directors based on fair value.

Determining the appropriate fair value model and calculating the fair value of stock option grants requires the input of subjective assumptions. The Company uses the Black-Scholes option pricing model to value its stock option awards. Stock-based compensation expense is calculated using the Company's best estimates, which involve inherent uncertainties and the application of management's judgment. Significant estimates include its expected term and stock price volatility.

The expected term of stock options is estimated from the vesting period of the award and represents the weighted average period that the Company's stock options are expected to be outstanding. The Company estimates the volatility of its stock price based on the historic volatility of its common stock. The Company bases the risk-free interest rate that it uses in the Black-Scholes option pricing model on U.S. Treasury instruments with maturities similar to the expected term of the award being valued. The Company has never paid and does not anticipate paying, any cash dividends in the foreseeable future and, therefore, the Company uses an expected dividend yield of zero in the option pricing model. The Company accounts for forfeitures as they occur. The Company allocates stock-based compensation expense on a straight-line basis over the requisite service period.

The following table summarizes stock-based compensation expense for the years ended December 31, 2019, 2018 and 2017, respectively:

(in thousands)	Year Ended December 31,		
	2019	2018	2017
Stock options and other	\$ 9,591	\$ 10,113	\$ 7,954
Employee stock purchase plan	1,190	815	604
Total stock-based compensation expense	<u>\$ 10,781</u>	<u>\$ 10,928</u>	<u>\$ 8,558</u>
Cost of revenue	\$ 2,056	\$ 1,543	\$ 970
Operating expenses:			
Marketing and sales	2,632	1,942	1,429
Research and development	1,851	1,517	1,091
General and administrative	4,242	5,926	5,068
Total stock-based compensation expense	<u>\$ 10,781</u>	<u>\$ 10,928</u>	<u>\$ 8,558</u>

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Notes to Consolidated Financial Statements

Stock Options

The following table provides the assumptions used in the Black-Scholes option pricing model for the years ended December 31, 2019, 2018 and 2017:

	Year Ended December 31,		
	2019	2018	2017
Risk-free interest rate	2.35 - 2.58%	2.52 - 3.07%	2.24 - 2.36%
Expected life (years)	6.25	6.25	6.5
Expected volatility	42.52 - 42.74%	41.68 - 42.22%	42.68 - 44.68%
Expected dividend yield	0%	0%	0%
Weighted average grant date fair value	\$47.84	\$50.08	\$32.26

The following table summarizes stock option activity and the weighted average exercise price for the years ended December 31, 2019, 2018 and 2017:

	Stock Options	Weighted-Average Exercise Price
Options outstanding at January 1, 2017	569,639	\$ 45.00
Granted	60,100	69.06
Exercised	(187,313)	35.93
Cancelled	(43,371)	61.02
Options outstanding at December 31, 2017	399,055	51.13
Granted	36,600	110.59
Exercised	(155,765)	38.92
Cancelled	(27,274)	74.35
Options outstanding at December 31, 2018	252,616	64.71
Granted	53,708	105.81
Exercised	(16,079)	48.67
Cancelled	(13,979)	89.50
Options outstanding at December 31, 2019	276,266	\$ 72.38
Exercisable at December 31, 2019	152,423	\$ 59.26

The outstanding options have a term of 10 years. For employees, options that have been granted become exercisable ratably over the vesting period, which is generally a four- or 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 total intrinsic value of options exercised during the years ended December 31, 2019, 2018 and 2017, was \$0.9 million, \$13.0 million and \$7.0 million, respectively. The aggregate intrinsic value represents the cumulative difference between the fair market value of the underlying common stock and the option exercise prices.

For options outstanding at December 31, 2019, the weighted-average remaining contractual term was 5.5 years and the aggregate intrinsic value was \$8.6 million. For options exercisable at December 31, 2019, the weighted-average remaining contractual term was 3.6 years and the aggregate intrinsic value was \$6.5 million. Refer to the table below for additional information.

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The following table summarizes information about stock options outstanding at December 31, 2019:

<u>Range of Exercise Prices</u>	<u>Options Outstanding, Vested and Expected to Vest</u>			<u>Options Exercisable</u>	
	<u>Number Outstanding</u>	<u>Weighted Average Remaining Contractual Life</u>	<u>Weighted Average Exercise Price (\$)</u>	<u>Number Exercisable</u>	<u>Weighted Average Exercise Price (\$)</u>
7.76 to 31.43	23,883	1.98	25.04	23,883	25.04
31.44 to 66.87	125,022	4.42	58.67	85,656	58.81
66.88 to 96.20	45,255	4.49	70.98	33,445	70.41
96.21 to 123.10	82,106	8.68	107.79	9,439	110.36

The fair value of share-based payment transactions is recognized in the consolidated statements of comprehensive income. As of December 31, 2019, there was \$3.6 million of total unrecognized compensation cost related to unvested stock options, which is expected to be recognized over a weighted average period of 2.6 years. The total fair value of options vested was \$1.5 million, \$1.5 million and \$2.8 million for the years ended December 31, 2019, 2018 and 2017, respectively.

Restricted Stock

The 2012 Plan provides for the award of restricted stock or restricted stock units. Restricted stock awards are share settled and restrictions lapse ratably over the vesting period, which is generally a four- or 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.

The following table summarizes restricted stock activity for the years ended December 31, 2019, 2018 and 2017:

	<u>Restricted Stock Awards</u>	<u>Weighted-Average Grant Date Fair Value Per Share</u>
Restricted stock at January 1, 2017	215,105	\$ 62.78
Granted	210,744	63.70
Restrictions lapsed	(60,102)	63.60
Forfeited	(30,916)	61.99
Restricted stock at December 31, 2017	334,831	63.29
Granted	106,855	115.41
Restrictions lapsed	(86,191)	63.64
Forfeited	(31,574)	68.67
Restricted stock at December 31, 2018	323,921	79.85
Granted	115,471	106.35
Restrictions lapsed	(92,597)	77.25
Forfeited	(31,822)	87.58
Restricted stock at December 31, 2019	314,973	\$ 89.55

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As of December 31, 2019, there was \$21.1 million of unrecognized compensation expense related to non-vested restricted stock, which is expected to be recognized over a weighted-average period of 2.6 years.

Performance Stock

Performance Stock Units (PSUs) are expressed in terms of a target number of PSUs, with anywhere between 0 percent and 150 percent of that target number capable of being earned and vesting at the end of a three-year performance period depending on the Company's performance in the final year of the performance period and the award recipient's continued employment.

The following table summarizes performance stock activity for the years ended December 31, 2019, 2018 and 2017:

	Performance Stock Awards	Weighted- Average Grant Date Fair Value Per Share
Performance stock at January 1, 2017	-	\$ -
Granted	25,707	58.35
Restrictions lapsed	-	-
Forfeited	-	-
Performance stock at December 31, 2017	25,707	58.35
Granted	20,006	105.75
Restrictions lapsed	-	-
Performance change	6,427	58.35
Forfeited	-	-
Performance stock at December 31, 2018	52,140	76.54
Granted	21,434	104.99
Restrictions lapsed	-	-
Performance change	(61,816)	88.06
Forfeited	(2,375)	105.37
Performance stock at December 31, 2019	9,383	\$ 58.35

As of December 31, 2019, there was \$0.1 million of unrecognized compensation expense related to non-vested performance stock, which is expected to be recognized over a weighted-average period of 0.1 years. The decrease in unrecognized stock-based compensation costs related to non-vested performance stock in 2019 when compared to 2018 is driven by a decrease in the number of shares expected to vest at the end of future performance periods.

Employee Stock Purchase Plan

The following table presents the assumptions used to estimate the fair value of the ESPP during the years ended December 31, 2019, 2018 and 2017:

	Year Ended December 31,		
	2019	2018	2017
Risk-free interest rate	1.59 - 2.35%	2.06 - 2.33%	0.97 - 1.48%
Expected life (months)	6.00	6.00	6.00
Expected volatility	42.63 - 53.57%	31.50 - 37.36%	24.49 - 34.51%
Expected dividend yield	0%	0%	0%

Note 14 – Leases

The Company's significant accounting policies are disclosed in Note 2 to the Consolidated Financial Statements included in its Annual Report on Form 10-K for the year ended December 31, 2019. Significant changes to the Company's accounting policies as a result of adopting ASC 842 are discussed below.

The Company accounts for leases in accordance with ASC 842. The Company adopted the standard as of January 1, 2019, using the alternative transition method provided under ASC 842, which allowed the Company to initially apply the new lease standard at the adoption date (the "effective date method"). Under the effective date method, comparative periods are presented in accordance with ASC 840 and do not include any retrospective adjustments to reflect the adoption of ASC 842. The Company elected the package of practical expedients permitted under the transition guidance within the new standard. The Company did not elect the hindsight practical expedient. The Company recorded a net increase of \$13.1 million to its operating lease assets and liabilities on January 1, 2019. The adoption did not result in a cumulative-effect adjustment to the opening balance of retained earnings. The adoption of ASC 842 did not have a material impact on the Company's consolidated statements of comprehensive income, shareholders' equity or cash flows as of the adoption date.

The Company has operating leases for office space, manufacturing facilities and certain company vehicles and equipment. The leases have remaining lease terms of one year to 10 years. Leases with an initial term of 12 months or less are not recorded on the balance sheet; we recognize lease expense for these leases on a straight-line basis over the lease term. For purposes of calculating operating lease liabilities, lease terms may be deemed to include options to extend or terminate the lease when it is reasonably certain that the Company will exercise that option. As of December 31, 2019, the operating lease liability does not include any options to extend or terminate leases. The Company currently has no finance leases.

The Company determines if an arrangement is a lease at inception. Operating leases are included in operating lease assets, current operating lease liabilities and long-term operating lease liabilities in the Consolidated Balance Sheets and are recognized based on the present value of lease payments over the lease term at commencement date. The majority of the Company's leases do not provide an implicit rate of return, therefore, the Company uses its incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. Lease agreements that contain non-lease components, with the exception of certain real estate leases, are accounted for as a single lease component.

Supplemental balance sheet information related to leases was as follows:

(in thousands)	December 31, 2019
Operating lease assets	\$ 11,425
Current operating lease liabilities	\$ 3,340
Long-term operating lease liabilities	8,565
Total operating lease liabilities	<u>\$ 11,905</u>

Lease expense is recognized on a straight-line basis over the lease term, with variable payments recognized in the period those payments are incurred. The components of lease expense for the periods reported were as follows:

(in thousands)	Three Months Ended December 31, 2019	Twelve Months Ended December 31, 2019
Operating lease cost	\$ 976	\$ 3,960
Variable lease cost	228	1,039
Total lease cost	<u>\$ 1,204</u>	<u>\$ 4,999</u>

Maturities of operating lease liabilities as of December 31, 2019 (in accordance with ASC 842) were as follows:

(in thousands)	<u>Operating Leases</u>
Year Ending December 31,	
2020	\$ 4,034
2021	2,835
2022	2,634
2023	1,064
2024	498
After 2024	1,613
Total future minimum lease payments	<u>12,678</u>
Less interest	<u>(773)</u>
Present value of lease liabilities	<u>\$ 11,905</u>

As of December 31, 2019, we have no operating leases that have not yet commenced.

Weighted average remaining lease term and discount rate was as follows:

	<u>December 31, 2019</u>
Weighted Average Remaining Lease Term (Years)	4.8
Weighted Average Discount Rate	2.6%

Supplemental cash flow information related to leases was as follows:

(in thousands)	<u>Twelve Months Ended December 31, 2019</u>
Cash paid for amounts included in the measurement of operating lease liabilities:	
Operating cash flows from operating leases	\$ 5,020
Lease assets obtained in exchange for new operating lease liabilities	1,921

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Note 15 – Accumulated Other Comprehensive Loss

Other comprehensive loss is comprised entirely of foreign currency translation adjustments. The following table presents the changes in accumulated other comprehensive loss balances for the years ending December 31, 2019, 2018 and 2017, respectively:

(in thousands)	Year Ended December 31,		
	2019	2018	2017
Foreign currency translation adjustments			
Balance at beginning of period	\$ (8,492)	\$ (5,234)	\$ (10,753)
Other comprehensive (loss) income before reclassifications	1,474	(3,258)	5,519
Amounts reclassified from accumulated other comprehensive income (loss)	-	-	-
Net current-period other comprehensive (loss) income	1,474	(3,258)	5,519
Balance at end of period	\$ (7,018)	\$ (8,492)	\$ (5,234)

Note 16 – 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 years ended December 31, 2019, 2018 and 2017, the Company recorded an income tax provision of \$17.5 million, \$15.1 million and \$22.7 million, respectively. The effective income tax rate for the years ended December 31, 2019, 2018 and 2017 was 21.6 percent, 16.4 percent and 30.4 percent, respectively.

Proto Labs, Inc.
Notes to Consolidated Financial Statements

The effective tax rate increased by 5.2% for the year ended December 31, 2019 when compared to 2018 primarily due to a decrease in tax benefits from the vesting of restricted stock and exercise of stock options, an increase in the state tax provision, and an increase to valuation allowances for unrealizable deferred tax assets.

The Tax Cuts and Jobs Act (the “Act”) was enacted on December 22, 2017. The Act reduced the U.S. federal corporate tax rate from 35% to 21%, required companies to pay a transition tax on earnings of certain foreign subsidiaries that were previously tax deferred and creates new taxes on certain foreign sourced earnings. No additional income taxes have been provided for any remaining undistributed foreign earnings not subject to the transition tax, or any additional outside basis difference inherent in these entities, as these amounts continue to be indefinitely reinvested in foreign operations.

The provision for income taxes is based on income before income taxes reported for financial statement purposes. The components of income before income taxes are as follows:

(in thousands)	Year Ended December 31,		
	2019	2018	2017
Domestic	\$ 74,841	\$ 81,893	\$ 69,929
Foreign	6,352	9,762	4,506
Total	<u>\$ 81,193</u>	<u>\$ 91,655</u>	<u>\$ 74,435</u>

Significant components of the provision for income taxes for the following periods are as follows:

(in thousands)	Year Ended December 31,		
	2019	2018	2017
Current:			
Federal	\$ 6,991	\$ (782)	\$ 17,808
State	2,882	2,078	1,367
Foreign	1,544	1,810	2,215
Deferred			
Federal	5,121	11,325	865
State	269	538	193
Foreign	(809)	(430)	(1,918)
Valuation Allowance	1,540	528	2,127
Total	<u>\$ 17,538</u>	<u>\$ 15,067</u>	<u>\$ 22,657</u>

A reconciliation of the federal statutory income tax rate to the effective tax rate is as follows:

	Year Ended December 31,		
	2019	2018	2017
Federal tax statutory rate	21.0%	21.0%	35.0%
State tax (net of federal benefit)	2.1	2.0	1.7
Share based compensation	(0.5)	(2.8)	(0.8)
Valuation allowance against deferred tax assets	1.4	0.7	2.9
Research and development credit	(2.8)	(2.5)	(2.2)
Foreign rate differential	(0.3)	(0.1)	(1.9)
Tax reserves	1.1	(0.1)	0.9
Domestic manufacturing deduction	-	-	(2.5)
Miscellaneous	(0.4)	(0.5)	(0.2)
Transition tax	-	(0.8)	3.2
Revaluation of deferred tax liability	-	(0.5)	(5.7)
Total	21.6%	16.4%	30.4%

Significant components of deferred tax assets and liabilities are as follows:

(in thousands)	December 31,	
	2019	2018
Deferred tax assets:		
Accrued expenses	\$ 1,362	\$ 931
Leases	3,337	-
Warrants and stock options	3,325	2,908
Intangible assets	1,171	748
Inventories	169	154
Other assets	1,765	666
Net operating loss	6,513	6,605
Less valuation allowance	(8,248)	(6,900)
Total deferred tax assets	9,394	5,112
Deferred tax liabilities:		
Depreciation	(26,750)	(21,788)
Goodwill	(5,590)	(3,486)
Leases	(3,337)	-
Total deferred tax liabilities	(35,677)	(25,274)
Net deferred tax liability	\$ (26,283)	\$ (20,162)

The Company has recorded no U.S. deferred taxes related to the undistributed earnings of its non-U.S. subsidiaries as of December 31, 2019. Such amounts are intended to be reinvested outside of the United States indefinitely. It is not practicable to estimate the amount of additional tax that might be payable on the foreign earnings. As of December 31, 2019, the Company had accumulated undistributed earnings in non-U.S. subsidiaries of \$9.3 million.

As of December 31, 2019, the Company had estimated net operating loss carry forwards of \$6.5 million for tax purposes. The net operating losses relate to operations in Japan and Germany. Japan losses can be carried forward for up to ten years. The remaining Japan net operating losses begin to expire at various dates between 2020 and 2026. The Company's Japan operations are taxed both by local authorities and in the U.S. Germany net operating losses may be carried forward without any time limitations but are limited to €1 million, plus 60 percent of taxable income exceeding €1 million.

Proto Labs, Inc.
Notes to Consolidated Financial Statements

The Company establishes valuation allowances for deferred tax assets when, after consideration of all positive and negative evidence, it is considered more-likely-than-not that a portion of the deferred tax assets will not be realized. The Company's valuation allowances of \$8.2 million and \$6.9 million at December 31, 2019 and 2018, respectively, reduce the carrying value of deferred tax assets associated with certain net operating loss carry forwards and other assets with insufficient positive evidence for recognition. The increase in the valuation allowance is primarily attributable to fluctuations in foreign currency and the net operating losses incurred in Germany in 2019.

The Company files a U.S. federal income tax return and income tax returns in various states and foreign jurisdictions. With a few exceptions, the Company is no longer subject to U.S. federal, state, or foreign income tax examinations by tax authorities for years before 2016.

The Company has liabilities related to unrecognized tax benefits totaling \$4.6 million and \$4.1 million at December 31, 2019 and 2018, respectively, that if recognized would result in a reduction of the Company's effective tax rate. The liabilities are classified as other long-term liabilities in the accompanying consolidated balance sheets. 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. Interest and penalties were immaterial for each of the years ended December 31, 2019, 2018 and 2017.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	December 31,	
	2019	2018
Balance at beginning of period	\$ 4,096	\$ 4,233
Additions for tax positions of current year	592	593
Additions for tax positions of prior years	-	309
Decrease related to expiration of statutes of limitations	(90)	(1,039)
Balance at period end	<u>\$ 4,598</u>	<u>\$ 4,096</u>

Note 17 – Litigation

From time to time, the Company may be subject to various legal proceedings and claims that arise in the ordinary course of its business. Although the results of litigation and claims cannot be predicted with certainty, the Company does not believe it is a party to any litigation the outcome of which, if determined adversely, would individually or in the aggregate be reasonably expected to have a material adverse effect on its business.

Note 18 – Segment Reporting

The Company's reportable segments are based on the internal reporting used by the Company's CEO, who is the chief operating decision maker (CODM), to assess operating performance and make decisions about the allocation of resources. The Company's reportable segments are based upon geographic region, consisting of the United States and Europe. The Corporate Unallocated and Japan category includes non-reportable segments, as well as research and development and general and administrative costs that are global in nature and that the Company does not allocate directly to its operating segments.

Revenue in the United States is derived from Injection Molding, CNC Machining, 3D Printing and Sheet Metal product lines. Revenue in Europe is derived from Injection Molding, CNC Machining, and 3D Printing product lines. Revenue in Japan is derived from Injection Molding and CNC Machining product lines. Injection Molding revenue consists of sales of custom injection molds and injection-molded parts. CNC Machining revenue consists of sales of CNC-machined and lathe-turned customer parts. 3D Printing revenue consists of sales of 3D-printed parts. Sheet Metal revenue consists of sales of fabricated sheet metal parts.

Proto Labs, Inc.
Notes to Consolidated Financial Statements

The accounting policies of the reportable segments are the same as those described in Note 2 – Summary of Significant Accounting Policies. Intercompany transactions primarily relate to intercontinental activity and have been eliminated and are excluded from the reported amounts. The difference between income from operations and pre-tax income relates to foreign currency-related gains and losses and interest income on cash balances and investments, which are not allocated to business segments.

Beginning in 2019, the Company's CODM made a decision to view certain research and development costs by geographic region. As a result, costs previously included in the Corporate Unallocated and Japan category have been included in the respective geographic regions. All periods presented have been restated to reflect this change.

Revenue and income from operations by reportable segment are as follows:

(in thousands)	Year Ended December 31,		
	2019	2018	2017
Revenue:			
United States	\$ 360,205	\$ 350,535	\$ 263,086
Europe	82,805	80,889	70,154
Japan	15,718	14,172	11,250
Total revenue	<u>\$ 458,728</u>	<u>\$ 445,596</u>	<u>\$ 344,490</u>

(in thousands)	Year Ended December 31,		
	2019	2018	2017
Income from Operations:			
United States	\$ 108,594	\$ 115,710	\$ 99,561
Europe	15,077	16,747	12,796
Corporate Unallocated and Japan	(43,815)	(43,557)	(40,131)
Total income from operations	<u>\$ 79,856</u>	<u>\$ 88,898</u>	<u>\$ 72,226</u>

Total long-lived assets, expenditures for additions to long-lived assets and depreciation and amortization expense are as follows:

(in thousands)	December 31,	December 31,	December 31,
	2019	2018	2017
Long-lived assets:			
United States	\$ 210,171	\$ 185,979	\$ 125,308
Europe	45,019	34,577	33,691
Japan	8,522	7,445	7,441
Total long-lived assets	<u>\$ 263,712</u>	<u>\$ 228,001</u>	<u>\$ 166,440</u>

(in thousands)	Year Ended December 31,		
	2019	2018	2017
Expenditures for additions to long-lived assets:			
United States	\$ 45,123	\$ 78,762	\$ 20,370
Europe	14,743	7,576	11,704
Japan	2,364	766	561
Total expenditures for additions to long-lived assets	<u>\$ 62,230</u>	<u>\$ 87,104</u>	<u>\$ 32,635</u>

Proto Labs, Inc.
Notes to Consolidated Financial Statements

(in thousands)	Year Ended December 31,		
	2019	2018	2017
Depreciation and Amortization:			
United States	\$ 24,767	\$ 21,117	\$ 13,267
Europe	4,746	4,679	4,174
Japan	1,351	958	1,033
Total depreciation and amortization	<u>\$ 30,864</u>	<u>\$ 26,754</u>	<u>\$ 18,474</u>

Note 19 – Subsequent Events

None.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable.

Item 9A. 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 Annual Report on Form 10-K, our disclosure controls and procedures were effective and provided 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 timeframes 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.

Management's Annual Report on Internal Control Over Financial Reporting

The Company's management is responsible for establishing and maintaining an adequate system of internal control over financial reporting, as defined in the Exchange Act Rule 13a-15(f). Management conducted an assessment of the Company's internal control over financial reporting based on the framework established by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control – Integrated Framework* (2013 framework). Based on the assessment, management concluded that, as of December 31, 2019, the Company's internal control over financial reporting is effective. The Company's registered public accounting firm's attestation report on the Company's internal control over financial reporting is provided in Part II, Item 8 of this Annual Report on Form 10-K.

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.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The information required by this item with respect to Item 401 relating to executive officers is contained in Item 1 of this Annual Report on Form 10-K under the heading "Executive Officers of the Registrant" and with respect to other information relating to our directors will be set forth in our 2020 Proxy Statement under the caption "Proposal 1 — Election of Directors," which will be filed no later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K, and is incorporated herein by reference.

The information required by this item under Item 405 of Regulation S-K is incorporated herein by reference to the section titled "Corporate Governance — Section 16(a) Beneficial Ownership Reporting Compliance" of our 2020 Proxy Statement, which will be filed no later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K. The information required by this item under Items 407 (c)(3), (d)(4) and (d)(5) of Regulation S-K is incorporated herein by reference to the section titled "Corporate Governance" of our 2015 Proxy Statement, which will be filed no later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

We have adopted a Code of Ethics and Business Conduct that applies to all of our directors, officers and employees, including our principal executive officer and principal financial officer. The Code of Ethics and Business Conduct is available on our website at www.protolabs.com under the Investors Relations section. We plan to post to our website at the address described above any future amendments or waivers of our Code of Ethics and Business Conduct.

Item 11. Executive Compensation

Information related to this item is incorporated herein by reference to the sections titled "Compensation Discussion and Analysis," "Corporate Governance — Compensation Committee Interlocks and Insider Participation," and "Compensation Committee Report" of our 2020 Proxy Statement, which will be filed no later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

Item 12. Security Ownership of Certain Beneficial Owners and Management

Information related to security ownership required by this item is incorporated herein by reference to the section titled "Security Ownership of Certain Beneficial Owners and Management" of our 2020 Proxy Statement, which will be filed no later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K. Information related to our equity compensation plans required by this item is incorporated herein by reference to the section titled "Compensation Discussion and Analysis – Information Regarding Equity-Based Compensation Plans" of our 2020 Proxy Statement, which will be filed no later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

Item 13. Certain Relationships and Related Transactions, and Director Independence

Information required by this item is incorporated herein by reference to the sections titled “Corporate Governance — Certain Relationships and Related Party Transactions,” and “Corporate Governance — Director Independence” of our 2020 Proxy Statement, which will be filed no later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

Item 14. Principal Accountant Fees and Services

Information required by this item is incorporated herein by reference to the section titled “Fees Paid to Independent Registered Public Accounting Firm” of our 2020 Proxy Statement, which will be filed no later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

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PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) The following documents are filed as part of this report:

1. Consolidated Financial Statements

See Index to Consolidated Financial Statement at Item 8 herein.

2. Financial Statement Schedules

Schedules not listed above have been omitted because the information required to be set forth therein is not applicable or is shown in the financial statement or notes herein.

3. Exhibits

See the Exhibit Index immediately following the signature page of this Annual Report on Form 10-K.

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Exhibit Number	Description of Exhibit
2.1(29)	Membership Interest Purchase Agreement, dated November 16, 2017, by and among Proto Labs, Inc., Rapid Manufacturing Group, LLC and the members listed therein. (Certain schedules and exhibits have been omitted in accordance with Item 601(b)(2) of Regulation S-K. A copy of any omitted schedule and/or exhibit will be furnished to the Securities and Exchange Commission upon request.)
3.1(1)	Third Amended and Restated Articles of Incorporation of Proto Labs, Inc.
3.2(27)	Articles of Amendment to Third Amended and Restated Articles of Incorporation of Proto Labs, Inc. dated May 20, 2015
3.3(2)	Second Amended and Restated By-Laws of Proto Labs, Inc, as amended through November 8, 2016.
4.1(3)	Form of certificate representing common shares of Proto Labs, Inc.
4.2(31)	Description of Securities of Registrant
10.1(4)#	2012 Long-Term Incentive Plan, as amended as of August 5, 2015
10.2(5)#	Form of Incentive Stock Option Agreement under 2012 Long-Term Incentive Plan
10.3(6)#	Form of Non-Statutory Stock Option Agreement (Directors) under 2012 Long-Term Incentive Plan
10.4(7)#	Form of Non-Statutory Stock Option Agreement (U.S. Employees) under 2012 Long-Term Incentive Plan
10.5(8)#	Form of Non-Statutory Stock Option Agreement (U.K. Employees) under 2012 Long-Term Incentive Plan
10.6(9)#	Employee Stock Purchase Plan
10.7(10)	Stock Subscription Warrant issued to John B. Tumelty
10.8(11)#	2000 Stock Option Plan, as amended
10.9(12)#	Form of Incentive Stock Option Agreement under 2000 Stock Option Plan
10.10(13)#	Form of Non-Statutory Stock Option Agreement (Directors) under 2000 Stock Option Plan
10.11(14)#	Form of Non-Statutory Stock Option Agreement (U.S. Employees) under 2000 Stock Option Plan
10.12(15)#	Form of Non-Statutory Stock Option Agreement (U.S. Employees) under 2000 Stock Option Plan
10.13(16)#	Form of Non-Statutory Stock Option Agreement (U.K. Employees) under 2000 Stock Option Plan
10.14(17)#	Amended and Restated Credit Agreement, dated as of September 30, 2011, between Proto Labs, Inc. and Wells Fargo Bank, N.A.
10.15(18)#	Credit Agreement, dated November 27, 2017, by and among Proto Labs and Wells Fargo Bank, National Association
10.16(19)#	Form of U.S. Severance Agreement
10.17(20)#	Form of UK Severance Agreement
10.18(21)#	Amended and Restated Executive Employment Agreement, dated August 1, 2019, by and between Proto Labs, Inc. and Victoria M. Holt
10.19(22)#	Form of Restricted Stock Agreement under 2012 Long-Term Incentive Plan for the initial grant to Victoria M. Holt
10.20(23)#	Form of Restricted Stock Unit Agreement under 2012 Long-Term Incentive Plan (U.S. Employees)
10.21(24)#	Form of Restricted Stock Unit Agreement under 2012 Long-Term Incentive Plan (U.K. Employees)
10.22(25)#	Form of Restricted Stock Unit Agreement under 2012 Long-Term Incentive Plan (Directors)
10.23(26)#	Amended and Restated Severance Agreement, dated August 1, 2019, by and between Proto Labs, Inc. and John A. Way
10.24(28)#	Form of Performance Stock Unit Agreement under 2012 Long-Term Incentive Plan
10.25(30)#	Form of Deferred Stock Unit Agreement under 2012 Long-Term Incentive Plan
10.26(32)#	Transition and Separation Agreement, dated May 8, 2019 by and between Proto Labs, Inc. and David M. Fein
10.27(33)#	Form of Executive Severance Agreement
21.1	Subsidiaries of Proto Labs, Inc.
23.1	Consent of Ernst & Young LLP

24.1	Powers of Attorney
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- the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.
101.SCH**	Inline XBRL Taxonomy Extension Schema Document
101.CAL**	Inline XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF**	Inline XBRL Taxonomy Extension Definition Linkbase Document
101.LAB**	Inline XBRL Taxonomy Extension Label Linkbase Document
101.PRE**	Inline XBRL Taxonomy Extension Presentation Linkbase Document
104	Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101)

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- (1) Incorporated by reference to 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.
- (2) Incorporated by reference to Exhibit 3.1 to the Company's Form 8-K, filed with the Commission on November 8, 2016.
- (3) Incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-1/A (File No. 333-175745), filed with the Commission on February 13, 2012.
- (4) Incorporated by reference to Exhibit 10.1 to the Company's Form 10-Q, filed with the Commission on November 3, 2015.
- (5) Incorporated by reference to Exhibit 10.14 to the Company's Registration Statement on Form S-1/A (File No. 333-175745), filed with the Commission on February 13, 2012.
- (6) Incorporated by reference to Exhibit 10.15 to the Company's Registration Statement on Form S-1/A (File No. 333-175745), filed with the Commission on February 13, 2012.
- (7) Incorporated by reference to Exhibit 10.16 to the Company's Registration Statement on Form S-1/A (File No. 333-175745), filed with the Commission on February 13, 2012.
- (8) Incorporated by reference to Exhibit 10.17 to the Company's Registration Statement on Form S-1/A (File No. 333-175745), filed with the Commission on February 13, 2012.
- (9) Incorporated by reference to Exhibit 10.18 to the Company's Registration Statement on Form S-1/A (File No. 333-175745), filed with the Commission on February 13, 2012.
- (10) Incorporated by reference to Exhibit 99.7 to the Company's Registration Statement on Form S-8 (File No. 333-179651), filed with the Commission on February 23, 2012.
- (11) Incorporated by reference to Exhibit 10.7 to the Company's Registration Statement on Form S-1 (File No. 333-175745), filed with the Commission on July 25, 2011.
- (12) Incorporated by reference to Exhibit 10.8 to the Company's Registration Statement on Form S-1 (File No. 333-175745), filed with the Commission on July 25, 2011.
- (13) Incorporated by reference to Exhibit 10.9 to the Company's Registration Statement on Form S-1 (File No. 333-175745), filed with the Commission on July 25, 2011.
- (14) Incorporated by reference to Exhibit 10.10 to the Company's Registration Statement on Form S-1 (File No. 333-175745), filed with the Commission on July 25, 2011.
- (15) Incorporated by reference to Exhibit 10.11 to the Company's Registration Statement on Form S-1 (File No. 333-175745), filed with the Commission on July 25, 2011.
- (16) Incorporated by reference to Exhibit 10.12 to the Company's Registration Statement on Form S-1 (File No. 333-175745), filed with the Commission on July 25, 2011.
- (17) Incorporated by reference to Exhibit 10.19 to the Company's Registration Statement on Form S-1/A (File No. 333-175745), filed with the Commission on October 26, 2011.
- (18) Incorporated by reference to Exhibit 10.1 to the Company's Form 8-K, filed with the Commission on December 1, 2017.
- (19) Incorporated by reference to Exhibit 99.1 to the Company's Form 8-K, filed with the Commission on March 1, 2013.
- (20) Incorporated by reference to Exhibit 10.2 to the Company's Form 10-Q, filed with the Commission on May 8, 2013.
- (21) Incorporated by reference to Exhibit 10.1 to the Company's Form 8-K, filed with the Commission on August 2, 2019.
- (22) Incorporated by reference to Exhibit 10.2 to the Company's Form 8-K, filed with the Commission on February 6, 2014.
- (23) Incorporated by reference to Exhibit 10.1 to the Company's Form 8-K, filed with the Commission on February 12, 2014.
- (24) Incorporated by reference to Exhibit 10.2 to the Company's Form 8-K, filed with the Commission on February 12, 2014.
- (25) Incorporated by reference to Exhibit 99.6 to the Company's Registration Statement on Form S-8 (file No. 333-194272), filed with the Commission on March 3, 2014.
- (26) Incorporated by reference to Exhibit 10.2 to the Company's Form 8-K, filed with the Commission on August 2, 2019.
- (27) Incorporated by reference to Exhibit 3.1 to the Company's Form 8-K, filed with the Commission on May 21, 2015.
- (28) Incorporated by reference to Exhibit 10.1 to the Company's Form 8-K, filed with the Commission on February 17, 2017.
- (29) Incorporated by reference to Exhibit 2.1 to the Company's Form 8-K, filed with the Commission on November 21, 2017.
- (30) Incorporated by reference to Exhibit 10.1 to the Company's Form 10-Q, filed with the Commission on August 1, 2018.
- (31) Filed herewith.
- (32) Incorporated by reference to Exhibit 10.1 to the Company's Form 8-K, filed with the Commission on May 14, 2019.
- (33) Incorporated by reference to Exhibit 99.2 to the Company's Form 8-K, filed with the Commission on August 2, 2019.

#Indicates management contract or compensatory plan or arrangement.

*The certifications furnished in Exhibit 32.1 hereto are deemed to accompany this Annual Report on Form 10-K and will not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended. Such certifications will not be deemed to be incorporated by reference into any filings under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, except to the extent that the registrant specifically incorporates it by reference.

**Users of this data are advised that, pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934 and

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SIGNATURE

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

Proto Labs, Inc.

Date: February 26, 2020

/s/ Victoria M. Holt

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

Date: February 26, 2020

/s/ John A. Way

John A. Way
Chief Financial Officer
(Principal Financial and Accounting Officer)

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

Date: February 26, 2020

/s/ Victoria M. Holt

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

Date: February 26, 2020

/s/ John A. Way

John A Way
Chief Financial Officer
(Principal Financial and Accounting Officer)

Chairman of the Board of Directors:

Sven A. Wehrwein*

Directors:

Archie C. Black*
Sujeet Chand*
Moonhie Chin*
Rainer Gawlick*
John B. Goodman*
Donald G. Krantz*

*Victoria M. Holt, by signing her name hereto, does hereby sign this document on behalf of each of the above named officers and directors of the registrant pursuant to powers of attorney duly executed by such persons and filed as an exhibit hereto.

Date: February 26, 2020

/s/ Victoria M. Holt

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

DESCRIPTION OF THE REGISTRANT'S SECURITIES
REGISTERED PURSUANT TO SECTION 12 OF THE
SECURITIES EXCHANGE ACT OF 1934

As of December 31, 2019, Proto Labs, Inc. (the "Company") had common stock registered under Section 12(b) of the Securities Exchange Act of 1934 and listed on The New York Stock Exchange.

Description of Capital Stock

General

The summary of the general terms and provisions of the capital stock of the Company set forth below does not purport to be complete and is subject to and qualified by reference to the Company's Third Amended and Restated Articles of Incorporation (the "Articles") and Second Amended and Restated By-Laws (the "By-laws," and together with the Articles, the "Charter Documents"), each of which is incorporated herein by reference and attached as an exhibit to the Company's most recent Annual Report on Form 10-K filed with the Securities and Exchange Commission. For additional information, please read the Company's Charter Documents and the applicable provisions of the Minnesota Business Corporation Act.

Common Stock

The aggregate number of shares that the Company has authority to issue is 160,000,000. The shares are classified in two classes, consisting of 10,000,000 shares of preferred stock, par value \$0.001 per share, and 150,000,000 shares of common stock, par value \$0.001 per share. The Board of Directors is authorized to establish one or more series of preferred stock, setting forth the designation of each such series, and fixing the relative rights and preferences of each such series.

Voting Rights

Each share of common stock entitles the holder to one vote with respect to each matter presented to the Company's shareholders on which the holders of common stock are entitled to vote.

No Cumulative Voting

No holder of common stock, or of any class or classes or of a series or series thereof, is entitled to cumulate votes for the election of directors of the Company.

No Preemptive Rights

Holders of common stock do not have any preemptive right to become subscribers or purchasers of additional shares of any class of the Company's capital stock.

Dividend Rights

Subject to preferences that may be applicable to any outstanding series of preferred stock, the holders of the Company's common stock will receive ratably any dividends declared by the board of directors out of funds legally available for the payment of dividends. The board of directors may, at its discretion, modify or repeal the dividend policy.

Liquidation Rights

In the event of the Company's liquidation, dissolution or winding-up, the holders of common stock are entitled to share ratably in all assets remaining after payment of liabilities, subject to prior distribution rights of preferred stock, if any, then outstanding.

Preferred Stock

As of December 31, 2019, there were no shares of preferred stock outstanding. The board has broad discretionary authority with respect to the rights of any new series of preferred stock and may establish the following with respect to the shares to be included in each series, without any vote or action of the shareholders:

- the number of shares;
 - the designations, preferences and relative rights, including voting rights, dividend rights, conversion rights, redemption privileges and liquidation preferences; and
 - any qualifications, limitations or restrictions.
-

We believe that the ability of the board to issue one or more series of preferred stock will provide us with flexibility in structuring possible future financings and acquisitions, and in meeting other corporate needs that may arise.

The board may authorize, without shareholder approval, the issuance of preferred stock with voting and conversion rights that could adversely affect the voting power and other rights of holders of common stock.

Potential Anti-takeover Effects of Minnesota Law and the Company's Charter Documents

Certain provisions of Charter Documents may make it less likely that someone would acquire voting control of the Company without the board's consent. These provisions may delay, deter or prevent tender offers or takeover attempts that shareholders may believe are in their best interests, including tender offers or attempts that might allow shareholders to receive premiums over the market price of their common stock. Among other things, the Company's Charter Documents:

- allow the board of directors to, at any time, and without shareholder approval, issue one or more new series of preferred stock;
- provide that any action required or permitted to be taken by the shareholders of the company may be effected only at a meeting of shareholders and prohibits shareholder action by less than unanimous written consent in lieu of a meeting; and
- specify procedures for director nominations by shareholders and submission of other proposals for consideration at stockholder meetings.

Several provisions of Minnesota law may deter potential changes in control of us that some shareholders may view as beneficial or that may provide a premium on the Company's stock price. Under Section 302A.673 of the Minnesota Business Corporation Act, a shareholder that beneficially owns 10% or more of the voting power of the outstanding shares (an interested shareholder) generally cannot consummate a business combination with the Company, or any subsidiary of the Company, within four years following the time the interested shareholder crosses the 10% stock ownership threshold, unless the business combination is approved by a committee of disinterested members of the board before the time the interested shareholder crosses the 10% stock ownership threshold.

Section 302A.675 of the Minnesota Business Corporation Act generally prohibits an offeror from acquiring the Company's shares within two years following the offeror's last purchase of the Company's shares pursuant to a takeover offer with respect to that class, unless the Company's shareholders may sell their shares to the offeror upon substantially equivalent terms as those provided in the earlier takeover offer. This provision does not apply if the share acquisition is approved by a committee of disinterested members of the board before the purchase of any shares by the offeror pursuant to the earlier takeover offer.

Transfer Agent and Registrar

The transfer agent and registrar for the Company's common stock is Broadridge Corporate Issuer Solutions.

New York Stock Exchange Listing

The Company's common stock is quoted on The New York Stock Exchange under the symbol "PRLB."

Exhibit 21.1**SUBSIDIARIES OF THE REGISTRANT**

All of the Company's subsidiaries listed below are wholly owned.

<u>Name</u>	<u>Jurisdiction of Incorporation or Organization</u>
PL-US International LLC	United States
Rapid Management Group LLC	United States
Rapid Sheet Metal LLC (RSM)	United States
Rapid Manufacturing LLC (RM)	United States
Proto Labs, Ltd.	United Kingdom
PL International Holdings UK Ltd	United Kingdom
PL Euro Services Limited	United Kingdom
Proto Labs GmbH	Germany
Proto Labs Tooling GmbH	Germany
Proto Labs, G.K.	Japan

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in the Registration Statements (Form S-8 Nos. 333-179651, 333-194272 and 333-202486) pertaining to the 2012 Long-Term Incentive Plan, Employee Stock Purchase Plan, 2000 Stock Option Plan, and Stock Subscription Warrant of Proto Labs, Inc. of our reports dated February 26, 2020, with respect to the consolidated financial statements of Proto Labs, Inc., and the effectiveness of internal control over financial reporting of Proto Labs, Inc., included in this Annual Report (Form 10-K) for the year ended December 31, 2019.

/s/ Ernst & Young LLP

Minneapolis, Minnesota
February 26, 2020

PROTO LABS, INC.
POWER OF ATTORNEY OF DIRECTOR AND/OR OFFICER

Each of the undersigned directors and/or officers of Proto Labs, Inc., a Minnesota corporation (the "Company"), does hereby make, constitute and appoint Victoria M. Holt and John A. Way, and each of them, either of whom may act without the joinder of the other, the undersigned's true and lawful attorney-in-fact and agent, with full power of substitution, for the undersigned and in the undersigned's name, place and stead, to sign on his or her behalf, individually and in the capacities stated below, the Annual Report on Form 10-K for the year ended December 31, 2019 under the Securities Exchange Act of 1934, as amended, with any amendment or amendments thereto, with all exhibits thereto and other supporting documents, with the U.S. Securities and Exchange Commission, granting unto said attorneys-in-fact, and each of them, full power and authority to do and perform any and all acts necessary or incidental to the performance and execution of the powers herein expressly granted.

IN WITNESS WHEREOF, each of the undersigned directors and/or officers of Proto Labs, Inc. has hereunto set his or her hand this 26th day of February, 2020.

<u>/s/ Sven Wehrwein</u> Sven A. Wehrwein	Chairman
<u>/s/ Victoria M. Holt</u> Victoria M. Holt	President, Chief Executive Officer and Director
<u>/s/ John A. Way</u> John A. Way	Chief Financial Officer
<u>/s/ Archie C. Black</u> Archie C. Black	Director
<u>/s/ Rainer Gawlick</u> Rainer Gawlick	Director
<u>/s/ John B. Goodman</u> John B. Goodman	Director
<u>/s/ Donald G. Krantz</u> Donald G. Krantz	Director
<u>/s/ Sujeet Chand</u> Sujeet Chand	Director
<u>/s/ Moonhie Chin</u> Moonhie Chin	Director

**CERTIFICATION PURSUANT TO RULE 13a-14(a) OR 15d-14(a) OF
THE SECURITIES EXCHANGE ACT OF 1934,
AS ADOPTED PURSUANT TO SECTION 302 OF
THE SARBANES-OXLEY ACT OF 2002**

I, Victoria M. Holt, certify that:

1. I have reviewed this Annual Report on Form 10-K of Proto Labs, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

- a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
- b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
- c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
- d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

- a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
- b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 26, 2020

By: /s/ Victoria M. Holt

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

**CERTIFICATION PURSUANT TO RULE 13a-14(a) OR 15d-14(a) OF
THE SECURITIES EXCHANGE ACT OF 1934,
AS ADOPTED PURSUANT TO SECTION 302 OF
THE SARBANES-OXLEY ACT OF 2002**

I, John A. Way, certify that:

1. I have reviewed this Annual Report on Form 10-K of Proto Labs, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

- a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
- b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
- c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
- d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

- a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
- b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 26, 2020

By: /s/ John A. Way

John A. Way
Chief Financial Officer
(Principal Financial Officer)

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER
PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, Victoria M. Holt, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Annual Report of Proto Labs, Inc. on Form 10-K for the fiscal year ended December 31, 2019 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Annual Report on Form 10-K fairly presents in all material respects the financial condition and results of operations of Proto Labs, Inc.

Date: February 26, 2020

By: /s/ Victoria M. Holt
Name: Victoria M. Holt
Title: President and Chief Executive Officer

I, John A. Way, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Annual Report of Proto Labs, Inc. on Form 10-K for the fiscal year ended December 31, 2019 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Annual Report on Form 10-K fairly presents in all material respects the financial condition and results of operations of Proto Labs, Inc.

Date: February 26, 2020

By: /s/ John A. Way
Name: John A. Way
Title: Chief Financial Officer