STRATASYS INC
Form 10-Q
August 09, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2012

OR

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

For the transition period from ______________ to ________________

Commission File Number: 1-13400

STRATASYS, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	36-3658792 (I.R.S. Employer Identification No.)
7665 Commerce Way, Eden Prairie, Minnesota (Address of principal executive offices)	55344 (Zip Code)

(952) 937-3000
(Registrant s telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes [ü] No [ ]

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

Large accelerated filer [ ] Accelerated filer [ü]

Non-accelerated filer [ ]
(Do not check if a smaller reporting company)

Smaller reporting company [ ]

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

As of August 1, 2012 the Registrant had 21,336,451 shares of common stock, $.01 par value, issued and outstanding.

Stratasys, Inc.

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STRATASYS, INC. AND SUBSIDIARIES
CONSOLIDATED FINANCIAL STATEMENTS

PART I - FINANCIAL INFORMATION
Item 1. Financial Statements.

Consolidated Balance Sheets

	June 30, 2012 (unaudited)	December 31, 2011
ASSETS		
Current assets		
Cash and cash equivalents	$ 26,968,072	$ 20,092,200
Short-term investments - held to maturity	24,191,472	14,602,408
Accounts receivable, less allowance for doubtful accounts of $1,145,000 at June 30, 2012 and $1,089,000 at December 31, 2011	33,484,094	26,230,289
Inventories	22,524,798	22,771,460
Net investment in sales-type leases, less allowance for doubtful accounts of $214,000 at June 30, 2012 and $230,000 at December 31, 2011	4,747,067	3,295,039
Prepaid expenses and other current assets	2,118,213	3,259,012
Deferred income taxes	2,973,000	2,973,000
Total current assets	117,006,716	93,223,408
Property and equipment, net	44,986,430	39,669,433
Other assets		
Goodwill	25,375,310	25,393,967
Other intangible assets, net	24,618,244	25,295,032
Net investment in sales-type leases	5,265,356	5,494,753
Long-term investments - held to maturity	22,257,058	32,581,472
Other non-current assets	288,049	112,300
Total other assets	77,804,017	88,877,524
Total assets	$ 239,797,163	$ 221,770,365
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable and other current liabilities	$ 26,592,399	$ 19,368,197
Unearned revenues	9,762,390	9,768,610
Total current liabilities	36,354,789	29,136,807
Non-current liabilities		
Deferred tax liabilities	6,760,000	6,760,000
Unearned revenues - long-term	2,656,403	2,562,195
Total liabilities	45,771,192	38,459,002
Commitments and contingencies		
Stockholders' equity		
Common stock, $.01 par value, authorized 30,000,000 shares; 27,025,441 and 26,933,301 shares issued at June 30, 2012 and December 31, 2011, respectively	270,254	269,333
Additional paid-in capital	121,330,824	118,134,006
Retained earnings	111,551,819	104,011,848
Accumulated other comprehensive (loss)	(122,501)	(99,399)
Treasury stock at cost, 5,687,631 shares at June 30, 2012 and December 31, 2011	(39,004,425)	(39,004,425)
Total stockholders' equity	194,025,971	183,311,363
Total liabilities and stockholders' equity	$ 239,797,163	$ 221,770,365

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STRATASYS, INC. AND SUBSIDIARIES
CONSOLIDATED FINANCIAL STATEMENTS

Consolidated Statements of Operations and Comprehensive Income (Unaudited)

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Net sales				
Products	$ 41,443,572	$ 30,664,384	$ 78,987,247	$ 58,760,588
Services	7,961,855	7,126,422	15,382,282	13,608,346
	49,405,427	37,790,806	94,369,529	72,368,934
Cost of sales				
Products	18,650,930	14,982,787	36,286,970	28,468,051
Services	4,595,285	3,072,613	8,967,050	5,915,025
	23,246,215	18,055,400	45,254,020	34,383,076
Gross profit	26,159,212	19,735,406	49,115,509	37,985,858
Operating expenses				
Research and development	4,157,088	3,725,817	8,509,248	7,073,910
Selling, general and administrative	16,209,680	9,918,643	27,584,472	18,654,882
	20,366,768	13,644,460	36,093,720	25,728,792
Operating income	5,792,444	6,090,946	13,021,789	12,257,066
Other income (expense)				
Interest income, net	192,622	216,599	443,048	422,380
Foreign currency transaction losses, net	(140,218)	(80,868)	(192,555)	(211,983)
Other	6,630	112,671	102,901	1,509,285
	59,034	248,402	353,394	1,719,682
Income before income taxes	5,851,478	6,339,348	13,375,183	13,976,748
Income taxes	2,833,852	2,345,699	5,835,222	4,993,604
Net income	$ 3,017,626	$ 3,993,649	$ 7,539,961	$ 8,983,144
Net income per common share				
Basic	$ 0.14	$ 0.19	$ 0.35	$ 0.43
Diluted	0.14	0.18	0.35	0.41
Weighted average common shares outstanding				
Basic	21,312,471	21,145,458	21,289,002	21,078,045
Diluted	21,834,318	21,789,520	21,799,629	21,718,985
Comprehensive Income				
Net income	$ 3,017,626	$ 3,993,649	$ 7,539,961	$ 8,983,144
Other comprehensive income (loss):				
Foreign currency translation adjustment	(135,073)	(112,715)	(23,102)	108,926
Comprehensive income	**$ 2,882,553**	**$ 3,880,934**	**$ 7,516,859**	**$ 9,092,070**

See accompanying notes to consolidated financial statements.

STRATASYS, INC. AND SUBSIDIARIES
CONSOLIDATED FINANCIAL STATEMENTS

Consolidated Statements of Cash Flows (Unaudited)

	Six Months Ended June 30, 2012	2011
Cash flows from operating activities		
Net income	$ 7,539,961	$ 8,983,144
Adjustments to reconcile net income to net cash provided by operating activities:		
Deferred income taxes	-	(210,410)
Depreciation	3,261,940	2,826,542
Amortization	2,256,717	1,920,518
Stock-based compensation	1,113,074	647,196
Excess tax benefit from stock options	(578,416)	(2,530,930)
Gain on disposal of property and equipment	-	(156,273)
Gain on sale of investment	-	(1,204,408)
Increase (decrease) in cash attributable to changes in operating and liabilities:		
Accounts receivable, net	(7,253,805)	(3,012,521)
Inventories	(1,807,977)	(3,572,730)
Net investment in sales-type leases	(1,222,631)	(849,948)
Prepaid expenses	1,140,799	955,385
Other assets	(175,749)	127,638
Accounts payable and other current liabilities	7,577,035	2,448,413
Unearned revenues	87,988	653,782
Net cash provided by operating activities	11,938,936	7,025,398
Cash flows from investing activities		
Proceeds from the maturity of investments	4,012,096	23,080,977
Proceeds from the sale of investments	4,802,917	-
Purchase of investments	(8,406,660)	(4,227,007)
Acquisition of property and equipment	(6,305,593)	(6,961,420)
Acquisition of intangible and other assets	(1,234,276)	(3,104,407)
Acquisition of Solidscape, Inc., net of cash acquired	-	(38,559,085)
Net cash used in investing activities	(7,131,516)	(29,770,942)
Cash flows from financing activities		
Proceeds from exercise of stock options	1,506,249	5,005,710
Excess tax benefit from stock options	578,416	2,530,930
Net cash provided by financing activities	2,084,665	7,536,640
Effect of exchange rate changes on cash	(16,213)	97,741
Net increase (decrease) in cash and cash equivalents	6,875,872	(15,111,163)
Cash and cash equivalents, beginning of period	20,092,200	27,554,411
Cash and cash equivalents, end of period	$ 26,968,072	$ 12,443,248
Supplemental disclosures of cash flow information:		
Cash paid for taxes	$ 6,050,982	$ 2,806,246
Transfer of fixed assets to inventory	278,050	64,669
Transfer of inventory to fixed assets	2,332,690	1,877,436

See accompanying notes to consolidated financial statements.

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STRATASYS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Basis of Presentation and Consolidation

The consolidated interim financial statements include the accounts of Stratasys, Inc. and its wholly-owned subsidiaries (collectively, the Company). All intercompany accounts and transactions have been eliminated in consolidation. The consolidated interim financial information herein is unaudited; however, such information reflects all adjustments (consisting of normal, recurring adjustments), which are, in the opinion of management, necessary for a fair statement of results for the interim period. Certain reclassifications have been made to the prior year s financial statements to conform to the current year presentation. These reclassifications had no net effect on previously reported results of operations. The results of operations for the three and six months ended June 30, 2012 are not necessarily indicative of the results to be expected for the full year. Certain financial information and footnote disclosures normally included in the annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been condensed or omitted. The reader is referred to the audited consolidated financial statements and notes thereto for the year ended December 31, 2011, filed as part of the Company s Annual Report on Form 10-K for such year.

On April 16, 2012, the Company and privately held Objet Ltd., a leading manufacturer of 3D printers for rapid prototyping, announced that the boards of directors of both companies have unanimously approved a definitive merger agreement (the Merger Agreement) under which the companies would combine in an all-stock transaction. The Company believes that the Objet technology is complementary to its technology and will create synergies in the respective sales channels. The transaction is expected to position the combined company as a leader within the high-growth 3D printing and direct digital manufacturing industry.

Under the terms of the merger agreement, Stratasys will merge with a subsidiary of Objet, and Stratasys shareholders will receive one Objet ordinary share for each share of Stratasys common stock they own. The receipt of this merger consideration generally will be taxable to Stratasys stockholders for U.S. federal income tax purposes. Upon closing of the transaction, Stratasys shareholders are expected to own approximately 55 percent and Objet shareholders are expected to own approximately 45 percent of the combined company on a fully diluted basis using the treasury stock method.

Under certain circumstances the Company would be required to pay a termination fee to Objet of $28.0 million (in the case of a change of the boards recommendation upon receipt of a superior acquisition offer) or $48.0 million (in the case of any other change in the boards recommendation) and to reimburse Objet for certain expenses incurred by Objet in connection with the merger.

The merger is subject to customary closing conditions. These closing conditions include, among others, the receipt of required approvals of the Companys stockholders, the effectiveness of the registration statement on Form F-4 filed by Objet regarding the proposed merger, and the expiration or termination of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (the HSR Act), which occurred in June 2012.

Note 2. Business Combinations

On May 3, 2011, the Company entered into an Agreement and Plan of Merger (the Merger Agreement) with Solidscape, Inc., a Delaware corporation (Solidscape); Granite Acquisition Corporation, a Delaware corporation and the Company s wholly-owned subsidiary (Merger Sub); and the Controlling Stockholders identified in the Merger Agreement, pursuant to which the Company acquired all the outstanding shares of capital stock of Solidscape in a cash-for-stock transaction where all the outstanding shares of capital stock and all in-the-money options to purchase shares of common stock of Solidscape were exchanged for an aggregate purchase price of $39.1 million. Under the terms of the Merger Agreement, Merger Sub merged with and into Solidscape, with Solidscape surviving as the Company s wholly-owned subsidiary (the Merger). The Merger Agreement was unanimously approved by the Company s board of directors.

The acquisition has been accounted for under the acquisition method of accounting in accordance with ASC Topic 805, *Business Combinations.* The final allocation of the purchase price to assets acquired and liabilities assumed is as follows:

	Allocation of Purchase Price

Cash and cash equivalents	$	540,489
Accounts receivable		439,284
Inventories		1,577,970
Other current assets		771,441
Deferred income taxes		383,000
Property and equipment, net		364,443
Goodwill		24,615,757
Intangible assets		19,500,000
Accounts payable & other liabilities		(1,041,681)
Unearned revenue		(154,031)
Deferred tax liabilities		(7,897,098)
Total purchase price	$	39,099,574

STRATASYS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The allocation of the purchase price to the net assets acquired and liabilities assumed resulted in the recognition of the following intangible assets:

	Amount	Weighted Average Life - Years
Developed technology	$ 11,750,000	6.7
Customer base	5,100,000	15
Trademarks	1,150,000	15
In-process R&D	1,150,000	Indefinite
Non-compete agreement	350,000	3
Total intangible assets	$ 19,500,000	

The fair values of the identified intangible assets were estimated using an income approach. Under the income approach, an intangible asset s fair value is equal to the present value of future economic benefits to be derived from ownership of the asset. Indications of value are developed by discounting future net cash flows to their present value at market-based rates of return. The goodwill recognized as a result of the Solidscape acquisition is primarily attributable to the value of the workforce and corporate synergies. None of the goodwill recognized is expected to be deductible for income tax purposes. The useful life of the intangible assets for amortization purposes was determined with the help of outside consultants considering the period of expected cash flows used to measure the fair value of the intangible assets adjusted as appropriate for the entity-specific factors including legal, regulatory, contractual, competitive, economic or other factors that may limit the useful life of intangible assets.

The actual Solidscape net sales and net income included in the Company s Consolidated Statements of Operations for the three and six months ended June 30, 2012 and the supplemental unaudited pro forma net sales and net income of the combined entity had the acquisition been completed on the first day of the earliest period presented are as follows:

(Unaudited)	Net Sales	Net Income (Loss)	Net Income (Loss) Per Common Share - Diluted
Actual for the three months ended June 30, 2012	$ 3,455,318	$ 282,167	$ 0.01
Actual for the six months ended June 30, 2012	6,846,031	433,930	0.02
Actual for the three and six months ended June 30, 2011	2,095,548	(248,702)	(0.01)
Supplemental pro forma combined results of operations:			
Three months ended June 30, 2011	$ 38,753,403	$ 4,870,157	$ 0.22
Six months ended June 30, 2011	76,359,747	10,138,279	0.47

Adjustments to the supplemental pro forma combined results of operations for the three and six months ended June 30, 2011 are as follows:

(Unaudited)

	Three Months	Six Months
Non-recurring expense related to fair market value adjustment to acquisition-date inventory	$ 561,094	$ 561,094
Net impact of the change in amortization of intangibles	26,162	104,650
Add interest on loans and preferred stock no longer incurred post-merger	111,167	384,860
Add management fees no longer incurred post-merger	17,391	71,450
Remove expenses related to business combination (deal fees, bonus & option payments)	3,127,980	3,127,980
Adjust taxes to the blended rate after business combination	(1,283,427)	(2,235,415)

	$ 2,560,367	$ 2,014,619

STRATASYS, INC. AND SUBSIDIARIES
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These unaudited pro forma condensed consolidated financial results have been prepared for illustrative purposes only and do not purport to be indicative of the results of operations that actually would have resulted had the acquisition occurred on the first day of the earliest period presented, or of future results of the consolidated entities. The unaudited pro forma condensed consolidated financial information does not reflect any operating efficiencies and cost savings that may be realized from the integration of the acquisition.

Note 3. Investments

Classification of investments as current or non-current is dependent upon management s intended holding period, the investment s maturity date and liquidity considerations based on market conditions. These investments are then evaluated and classified as available-for-sale or held-to-maturity in accordance with the provisions of ASC 320, *Investments - Debt and Equity Securities*. This evaluation takes into consideration the Company s past history of holding investments until maturity, projected cash flow estimates, future capital requirements, the existence of credit deterioration of the issuer and the Company s overall investment strategy as established by management and approved by the Company s Board of Directors.

If management has the positive intent and ability to hold its debt securities until maturity, they are classified as held-to-maturity and accounted for using the amortized-cost method. All other securities are classified as available-for-sale and accounted for at fair value with the unrealized gain or loss, net of tax, reported in other comprehensive income. While the Company does not generally hold any investments for trading purposes, the Company did liquidate certain investments during the six months ended June 30, 2012. The Company believes that the liquidation of these investments was an isolated event that is unusual and nonrecurring in nature and was not reasonably anticipated. The net carrying value of liquidated investments was $4.5 million and the sale resulted in a gain of approximately $67,000. The Company does not currently hold any investments for trading purposes and had no unrecognized gains or losses related to held-to-maturity investments at June 30, 2011 or December 31, 2011, as the fair value of those investments approximated cost.

The Company invests in certificates of deposit, corporate bonds, tax-free government bonds, and auction rate securities (ARS), all of which are insured Level 1 investments. The following is a summary of amounts recorded on the Consolidated Balance Sheet for marketable securities (current and non-current) at June 30, 2012 and December 31, 2011.

	June 30, 2012 (unaudited)	December 31, 2011
Bonds	$ 24,191,472	$ 14,602,408
Short-term investments - held to maturity	24,191,472	14,602,408
Auction rate securities	2,000,000	2,000,000
Bonds	20,257,058	30,581,472
Long-term investments - held to maturity	22,257,058	32,581,472
Total investments	$ 46,448,530	$ 47,183,880

At June 30, 2012, the Company s investments included:

- approximately $44.4 million in bonds maturing between July 2012 and September 2016, all of which have ratings between AAA and A3 at June 30, 2012; and
- approximately $2.0 million of a tax-free ARS, which re-prices approximately every 35 days. The ARS had a rating of A1 at June 30, 2012.

STRATASYS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 4. Inventories

Inventories consisted of the following at June 30, 2012 and December 31, 2011, respectively:

	2012	2011
Finished goods	$ 7,459,812	$ 9,805,319
Raw materials	15,064,986	12,966,141
Total Inventory	$ 22,524,798	$ 22,771,460

Note 5. Material Commitments

The Company estimates that as of June 30, 2012 and December 31, 2011, it had approximately $14.3 million and $23.8 million, respectively, of purchase commitments for inventory from vendors. In addition to purchase commitments for inventory, the Company also has future commitments for leased facilities of approximately $2.0 million. The Company intends to finance its purchase commitments from existing cash and investments or from cash flows from operations.

Note 6. Earnings per Common Share

The Company complies with ASC 260, *Earnings Per Share*, which requires dual presentation of basic and diluted income per common share for all periods presented. Basic net income per share excludes dilution and is computed by dividing net income by the weighted average number of shares outstanding for the periods that have net income. Diluted net income per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then share in the income of the Company. The difference between the number of common shares used to compute basic net income per share and diluted net income per share relates to additional common shares that would be issued upon the assumed exercise of stock options and warrants, net of the common shares that would hypothetically be repurchased using the proceeds received from the original exercise.

The additional common shares amounted to 521,847 and 644,062 for the three months ended June 30, 2012 and 2011, respectively, and 510,627 and 640,940 for the six months ended June 30, 2012 and 2011, respectively. There were 338,750 shares excluded from the dilution calculation for the three and six months ended June 30, 2012 since their inclusion would have an anti-dilutive effect. There were no options excluded from the dilution calculation for the three and six months ended June 30, 2011, since the market price of the Company s common stock at June 30, 2011, exceeded the exercise price of all outstanding options.

The following table provides information relative to stock options that were exercised in the respective periods:

	Periods Ended June 30, Three Months		Six Months	
	2012	2011	2012	2011
Proceeds from exercise of stock options	$ 691,601	$ 398,967	$ 1,506,249	$ 5,005,710
Number of options exercised	46,745	29,776	92,140	339,283
Weighted average exercise price	$ 14.80	$ 13.40	$ 16.35	$ 14.75
Tax benefit recognized in stockholders' equity from stock option exercises	$ (387,549)	$ (190,752)	$ (578,416)	$ (2,530,930)

STRATASYS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 7. Stock-Based Compensation

Stock-based compensation expense, the associated estimated deferred income tax benefit on nonqualified stock options and the current income tax benefit resulting from disqualifying dispositions of incentive stock options were as follows for the respective periods:

	Periods Ended June 30, Three Months		Six Months	
	2012	**2011**	**2012**	**2011**
Stock-based compensation expense	$ 632,435	$ 323,598	$ 1,113,074	$ 647,196
Income tax benefit	(236,348)	(111,438)	(419,596)	(287,896)
	$ 396,087	$ 212,160	$ 693,478	$ 359,300

There were 338,750 options granted in the six months ended June 30, 2012 and no options were granted in the six months ended June 30, 2011.

Note 8. Income Taxes

The Company uses a two-step approach to recognizing and measuring uncertain tax positions (tax contingencies) in accordance with ASC 740, *Income Taxes*. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. The Company reevaluates these tax positions quarterly and makes adjustments as required. The Company had unrecognized tax benefits of $1.7 and $1.6 million at June 30, 2012 and December 31, 2011, respectively.

The effective tax rate of 48.4% for the quarter ended June 30, 2012 was higher as compared to the 37.0% effective rate for the same prior-year period. The increase is primarily due to non-deductible expenses related to the Company s current efforts to combine with Objet Ltd. In addition, the federal research credit expired December 31, 2011 and, therefore, was not considered in computing the effective rate for the quarter ended June 30, 2012. The effective tax rate of 43.6% for the six months ended June 30, 2012 was higher as compared to the 35.7% effective rate for the same prior-year period for the same reasons.

Note 9. Fair Value Measurements

Fair value is defined as the exit price, or the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants as of the measurement date. A hierarchy has been established for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available.

Observable inputs are inputs market participants would use in valuing the asset or liability developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company s assumptions about the factors market participants would use in valuing the asset or liability developed based upon the best information available under the circumstances. The hierarchy is broken down into three levels. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, and inputs (other than quoted prices) that are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs for the asset or liability. Categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

STRATASYS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

During the quarter ended June 30, 2012, the Company had no significant measurements of assets or liabilities at fair value on a recurring or nonrecurring basis subsequent to their initial recognition.

Note 10. Foreign Currency Hedge

The Company invoices sales to certain European distributors in Euros and such receivable balances are subject to fluctuations in the exchange rates of that currency in relation to the United States dollar. The Company s strategy is to hedge most of its Euro-denominated accounts receivable positions by entering into 30-day foreign currency forward contracts on a month-to-month basis to reduce the risk that its earnings will be adversely affected by changes in currency exchange rates. The Company does not use derivative financial instruments for speculative or trading purposes. The Company enters into 30-day foreign currency forward contracts on the last day of each month and therefore the notional value of the contract equals the fair value at the end of each reporting period. As such, there is no related asset or liability or unrealized gain or loss recorded on the Balance Sheet as of the end of the period. All realized gains and losses related to hedging activities are recorded in current period earnings under the Consolidated Statements of Operations and Comprehensive Income caption Foreign currency transaction gains (losses), net .

The Company hedged between €6.0 million and €7.0 million for the three months ended June 30, 2012 and between €5.5 million and €9.8 million for the six months ended June 30, 2012 of accounts receivable and cash that was denominated in Euros. The foreign currency forward contracts resulted in a currency translation gain of approximately $473,000 and a currency translation loss of approximately $101,000 for the three months ended June 30, 2012 and June 30, 2011, respectively. The foreign currency forward contracts resulted in a currency translation gain of approximately $125,000 and a currency translation loss of approximately $576,000 for the six months ended June 30, 2012 and June 30, 2011, respectively. The resulting gain or loss from foreign currency forward contracts only partially offset the total foreign currency transactions gains or losses that the Company recorded.

The Company will continue to monitor exposure to currency fluctuations. Instruments that may be used to hedge future risks may include foreign currency forward, swap, and option contracts. These instruments may be used to selectively manage risks, but there can be no assurance that the Company will be fully protected against material foreign currency fluctuations.

Note 11. Accounting for Collaborative Arrangements

In 2008, the Company fulfilled its responsibilities under a three-year, $3.6 million agreement with a Fortune 500 global manufacturing company to jointly advance its proprietary FDM (Fused Deposition Modeling) technology for rapid manufacturing applications. This agreement entitled the Company to receive reimbursement payments as it achieved specific milestones stated in the agreement. This effort was focused around the Company s high-performance systems and resulted in the commercial release of the Fortus 900mc. Because receipt of these payments represented reimbursements of costs actually incurred under this joint development project, all payments received were recorded as offsets to the research and development expenditures and are therefore not recognized as revenue.

Due to the success of this initial arrangement, the Company has continued this relationship under similar terms and objectives. During the three months ended June 30, 2012 and June 30, 2011, approximately $166,000 and $208,000, respectively, of research and development expenses were offset by payments that were received from that company. During the six months ended June 30, 2012 and June 30, 2011, approximately $317,000 and $339,000, respectively, of research and development expenses were offset by payments that were received from that company.

Note 12. Subsequent Events

On August 1, 2012, the Company announced that Stratasys, Inc. and Hewlett-Packard Company (HP) entered into an agreement on July 31, 2012, to terminate the Master Original Equipment Manufacturer Agreement (the OEM Agreement) between the two companies effective December 31, 2012. Under the terms of the OEM Agreement, signed in January 2010, the Company has developed and manufactured for HP an exclusive line of 3D printers based on patented FDM technology. Later that year, HP began a phased rollout of the 3D printers, which are now being sold exclusively by HP in eight European countries. The Company terminated the OEM Agreement because it no longer believed that it could achieve the financial benefits originally anticipated by entering into the OEM Agreement. Under the termination agreement, HPs exclusivity ends on October 31, 2012, and the Company will begin selling equivalent Stratasys products in the current HP territory after that date. The termination agreement also provides for continuity of consumables and service for end user customers that have purchased systems sold by HP under the OEM Agreement.

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

Overview

Description of Business

We develop, manufacture, and market a family of 3D printing, rapid prototyping (RP) and direct digital manufacturing (DDM) systems, which enable engineers and designers to create physical models, tooling, jigs, fixtures, prototypes, and end use parts out of production grade thermoplastic directly from a computer aided design (CAD) workstation. Our systems and related consumable products are distributed mainly through a world-wide network of value added resellers and agents that sell our products to end users as well as service them. We also operate a service business that uses our systems and other RP systems to print parts from a customer s CAD file, typically in situations where these customers have not yet purchased a system from us or do not have enough capacity on their existing systems.

In May 2011, we acquired Solidscape, Inc. for $39.1 million in cash. Solidscape is a manufacturer of high precision 3D printers and is a proven leader in investment casting applications that require ultra-fine feature detail. This addition provides us with access to markets that we did not previously serve, including the under-penetrated jewelry, dental and precision industrial casting markets. We believe that this acquisition provides the potential to expand our technology platform into new applications and will create synergies, particularly in our respective sales channels, manufacturing, and research and development.

On April 16, 2012, Stratasys and privately held Objet Ltd., a leading manufacturer of 3D printers for rapid prototyping, announced that the boards of directors of both companies have unanimously approved a definitive merger agreement (the Merger Agreement) under which the companies would combine in an all-stock transaction. We believe that the Objet technology is complementary to our technology and will create synergies in the respective sales channels. The transaction is expected to position the combined company as a leader within the high-growth 3D printing and direct digital manufacturing industry.

Summary of Financial Results

For the quarter ended June 30, 2012, we recorded net income of $3.0 million, or $0.14 per diluted share, as compared to net income of $4.0 million, or $0.18 per diluted share, for the quarter ended June 30, 2011. Results for the second quarter of 2011 included two months of operations of Solidscape, which was acquired on May 3, 2011. Net income decreased during the three and six months ended June 30, 2012 as compared to the same prior year periods primarily due to expenses related to the pending Objet Ltd. transaction, a $1.3 million gain on the sale of an equity investment that we maintained in an independent online parts quoting service company in the first quarter of 2011 and a higher effective tax rate.

Our revenues in the second quarter of 2012 increased to $49.4 million as compared to revenues of $37.8 million that were reported in the second quarter of 2011. Gross profit of $26.2 million in the first quarter of 2012 increased as compared to $19.7 million reported in the prior year

Our balance sheet continues to be strong. As of June 30, 2012, our cash and investments balance was approximately $73.4 million, up from $67.3 million at December 31, 2011. We generated approximately $5.1 million of cash from operations during the quarter, primarily driven by our net income adjusted for non-cash charges for depreciation, amortization and stock-based compensation. We also have no debt and believe that we have adequate liquidity to fund our growth strategy throughout 2012.

Our Market Strategy and Description of Current Conditions

It is our belief that we are successfully implementing our overall marketing strategy in the 3D printing, RP and DDM markets through the expansion of our distribution channel and the introduction of new products.

Distribution Channel We use an extensive world-wide reseller network to market and sell our 3D printers, Fortus 3D production systems, and consumable materials, and to provide maintenance service and replacement parts. Most of the reseller outlets have 3D printers available for tradeshows, product demonstrations and other promotional activities. Many of them also enjoy a long-term presence in their respective territories making this distribution model highly effective relative to a direct sales model. In addition to our 3D Printers and 3D production systems, most resellers sell and service a third-party 3D solid CAD software package.

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In addition to our reseller network, we have initiated a program to recruit and train a significant number of new selling agents that will focus exclusively on selling our most affordable products. We have now recruited and trained over 120 sales agents in the U.S. who are focused exclusively on selling our uPrint and Mojo 3D printer lines.

3D Printers We are the unit leader in the commercial 3D printing market and have followed a strategy of moving down the price elasticity curve, evidenced by our introduction of the Mojo, uPrint and uPrint Plus systems. We believe our strategy of offering low-priced 3D printing systems combined with high reliability, ease of use and increased functionality will allow for an increase of 3D printers in the market and continue to make our 3D printers an attractive alternative to our competitors products. In May 2011, we acquired Solidscape whose 3D printers use Drop-on-Demand thermoplastic ink-jetting technology and high-precision milling to produce extremely high resolution parts with precise details and fine surface finish.

We also believe our lower-priced systems and the expansion of our distribution channel will increase awareness of our technology and products. Lower-priced systems will reduce our margins as a percentage of revenue from the levels we have previously achieved, but we intend to compensate for these lower margins by expanding the market and unit volume for our 3D printers (and related proprietary consumables), thereby substantially increasing the number of 3D printers sold and our overall revenues and profits. Although we believe that there is a large market for our 3D printers, there can be no assurance that we will be able to increase our revenues sufficiently to maintain or increase our profitability.

RP and DDM Markets Our strategy in the high-performance market is to expand our installed base of RP and DDM systems by helping customers build stable, strong, accurate and durable parts for functional testing and end-use. We plan to build on our leadership position in this area by offering additional system capabilities and improved material properties. We also have growing opportunities in DDM applications. DDM involves the manufacture of parts fabricated directly from our systems that are subsequently incorporated into the user s end product or production process. DDM is particularly attractive in applications that require short-run or low-volume parts that require rapid turn-around and for which tooling would not be cost effective due to small volumes.

In February 2011, we obtained ISO 9001:2008 certification by maintaining a highly developed quality management system and continually improving its effectiveness in accordance with the ISO requirements. We believe that ISO certification is a key requirement in expanding our products applicability to the RP and DDM markets that we are focusing on, such as aerospace, defense, medical, and automotive. We will use this certification to demonstrate our ability to consistently provide products that meet customer and applicable regulatory requirements and enhance customer satisfaction through its effective application.

We continued to collaborate with a Fortune 500 global manufacturing company to advance our proprietary FDM technology for direct digital manufacturing applications and expect to maintain this collaboration throughout 2012 for the seventh consecutive year.

Recurring Revenues As our installed base of systems has increased, we expect an increasing amount of revenue from the sales of consumables, maintenance contracts, and other services. We have experienced an increase in consumable sales throughout 2011 and into 2012.

RedEye Paid Parts Service Our RedEye paid parts service makes and sells physical models, tooling and prototype parts for RP and DDM applications based on our customers CAD files. We believe that a significant portion of RedEye sales have come from current system users that have had short-term capacity constraints on their own FDM systems. We believe that another part of RedEye sales has come from the rising demand for our technology in DDM applications, because of the production-grade thermoplastics used. To take advantage of the growth we see in our DDM customer base, we are adding staff to our existing sales force that will focus exclusively on large strategic accounts.

Developments in Our Business During the Period

In May 2012, we introduced the Mojo 3D Printer, which comes in a complete system called a 3D Print Pack. The Mojo 3D Print Pack is the market s lowest-priced, professional-grade complete 3D printing system. Priced at $9,900 the Mojo 3D Print Pack contains everything needed to produce models, including material, supplies and a support-removal system. To produce a model, Mojo employs a variation on traditional FDM material extrusion. The ABS material spool and the print head are integrated into a single package, called the QuickPack print engine. To ensure reliability, the print engine is single-use only, and a fresh print head is part of each material change. Modeling operations are controlled with Mojo s preprocessing software, Print Wizard, which helps users manage workflow. Support material removal is also a simple process with the included WaveWash55. It is a self-contained, hands-free support removal system, and it requires no plumbing.

In April 2012, Stratasys and privately held Objet Ltd., a leading manufacturer of 3D printers for rapid prototyping, announced that the boards of directors of both companies had unanimously approved a definitive merger agreement under which the companies would combine in an all-stock transaction. We expect the transaction to position the combined company as a leader within the high-growth 3D printing and direct digital manufacturing industry.

Under the terms of the merger agreement, Stratasys will merge with a subsidiary of Objet, and Stratasys stockholders will receive one Objet ordinary share for each share of Stratasys common stock they own. The receipt of this merger consideration generally will be taxable to Stratasys stockholders for U.S. federal income tax purposes. Upon closing of the transaction, Stratasys stockholders are expected to own approximately 55 percent and Objet shareholders are expected to own approximately 45 percent of the combined company on a fully diluted basis using the treasury stock method.

The combined company, which will operate under the name Stratasys Ltd. and retain the Stratasys ticker symbol, SSYS , will have dual headquarters in Eden Prairie, Minnesota and Rehovot, Israel, the locations of Stratasys' and Objet's current headquarters, respectively, and will be registered in Israel.

In February 2012, RedEye obtained AS9100 certification. AS9100 is the quality management system for the aviation, space, and defense industries. AS9100 fully incorporates ISO 9001:2008 while adding nearly 100 additional requirements specific to quality and safety for aerospace. We believe that AS9100 certification in RedEye will help us expand our services applicability to DDM in the aerospace and defense markets.

On August 1, 2012, we announced that Stratasys and HP have agreed to discontinue their Master Original Equipment Manufacturer Agreement (The OEM Agreement) for 3D printers, effective December 31, 2012. HP s exclusivity under the OEM Agreement will end on October 31, 2012, and we will begin selling equivalent Stratasys systems in the current HP territory after that date. The termination agreement also provides for continuity of consumables and service for end user customers that have purchased systems sold by HP under the OEM Agreement. We terminated the OEM Agreement because we no longer believed that it could achieve the financial benefits originally anticipated. We do not expect the termination of this agreement with HP to have a material impact on our financial results for the current year and intend to work closely with HP to ensure a smooth transition for customers.

Cautionary Note Concerning Factors that May Affect Future Results

Our current and future growth is largely dependent upon our ability to penetrate new markets and develop and market new rapid prototyping and manufacturing systems, materials, applications, and services that meet the needs of our current and prospective customers. Our expense levels are based in part on our expectations of future revenues. While we have adjusted, and will continue to adjust, our expense levels based on both actual and anticipated revenues, fluctuations in revenues in a particular period could adversely impact our operating results. Our ability to continue to implement our strategy in 2012 is subject to numerous uncertainties and risks, many of which are described in this Management s Discussion and Analysis of Financial Condition and Results of Operations, in the section below captioned Forward Looking Statements and Factors That May Affect Future Results of Operations, and in Item 1A, Risk Factors, of our Annual Report on Form 10-K for 2011 and our Quarterly Reports on Form 10-Q and Current Reports on Form 8-K filed with the SEC. We cannot ensure that our efforts will be successful.

Results of Operations
(unaudited)

The following table sets forth certain consolidated statements of operations data as a percentage of net sales for the periods indicated. All items are included in or derived from our consolidated interim statements of operations.

Three- and Six-Month Periods Ended June 30,

	Three Months		Six Months	
	2012	2011	2012	2011
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	47.1%	47.8%	48.0%	47.5%
Gross profit	52.9%	52.2%	52.0%	52.5%
Research and development	8.4%	9.9%	9.0%	9.8%
Selling, general, and administrative	32.8%	26.2%	29.2%	25.8%
Operating income	11.7%	16.1%	13.8%	16.9%
Other income	0.1%	0.7%	0.4%	2.4%
Income before income taxes	11.8%	16.8%	14.2%	19.3%
Income tax expense	5.7%	6.2%	6.2%	6.9%
Net income	6.1%	10.6%	8.0%	12.4%

Net Sales

Our net sales of $49.4 million in the quarter ended June 30, 2012 increased by 30.7% as compared to net sales of $37.8 million in the quarter ended June 30, 2011. Net sales of $94.4 million in the six months ended June 30, 2012 increased by 30.4% as compared to net sales of $72.4 million in the same prior-year period. The following is a breakdown of our revenues by products and services:

Three- and Six Month Periods Ended June 30,

(In Thousands)	Three Months		Period-over-	Six Months		Period-over-
	2012	2011	period change	2012	2011	period change
Products	$ 41,444	$ 30,664	35.2%	$ 78,987	$ 58,761	34.4%
Services	7,962	7,127	11.7%	15,382	13,608	13.0%
	$ 49,406	$ 37,791	30.7%	$ 94,369	$ 72,369	30.4%

Sales derived from products increased $10.8 million, or 35.2%, in the quarter ended June 30, 2012, as compared with the quarter ended June 30, 2011. System revenue grew by 32.7% as a result of strong sales of our higher-priced Fortus 3D production systems. We shipped 776 units in the second quarter of 2012 as compared with 735 units shipped in the second quarter of 2011. The increase in total units shipped as compared to the prior year is primarily due to strong unit sales of our new Fortus 250mc. In addition, we generated strong growth in unit shipments of our 400mc and 900mc production systems driven by the demand for direct digital manufacturing and an upselling trend within the sales channel. Consumable revenue increased 34.0%, primarily driven by acceleration in customer usage and our growing installed base of systems. The increases were also due to the acquisition of Solidscape in May 2011.

For the six months ended June 30, 2012, sales derived from products increased $20.2 million, or 34.4%, as compared with the same prior-year period. System revenue grew by 32.5% as a result of strong sales of our higher-priced Fortus 3D production systems. We shipped 1,598 units in the six months ended June 30, 2012 as compared with 1,302 units shipped in the same prior-year period. The increase in total units shipped as compared to the prior year is primarily due strong unit sales of our Fortus 3D production systems. Consumable revenue increased 31.9%, primarily driven by acceleration in customer usage and our growing installed base of systems.

Sales from our service offerings increased by approximately $0.8 million, or 11.7%, in the quarter ended June 30, 2012 and $1.8 million, or 13.0%, in the six months ended June 30, 2012 as compared to the same prior-year periods. Maintenance revenue increased by 6.3% and 6.6% for the three and six months ended June 30, 2012, respectively, as compared with the same prior-year periods. This increase reflects our growing installed base of systems and strong Fortus system sales, which generally have higher attachment rates for maintenance contracts relative to our 3D printers. Sales from our RedEye paid parts service increased by 13.1% and 18.3% for the three and six months ended June 30, 2012, respectively, as compared to the prior year, primarily resulting from increased new customer business and an increase in average sales price.

Revenues in the Americas region, which includes North and South America, accounted for approximately 53.0% and 51.1% of total revenue for the quarters ended June 30, 2012 and 2011, respectively. Revenues in the Americas region accounted for approximately 51.2% and 52.2% of total revenue for the six months ended June 30, 2012 and 2011, respectively.

Revenues outside the Americas region accounted for approximately 47.0% and 48.9% of total revenue for the quarters ended June 30, 2012 and 2011, respectively. Revenues outside the Americas region accounted for approximately 48.8% and 47.8% of total revenues for the six months ended June 30, 2012 and 2011, respectively.

Gross Profit

Three- and Six-Month Periods Ended June 30,

(In Thousands)	**Three Months**		**Period-over-**	**Six Months**		**Period-over-**
	2012	**2011**	**period change**	**2012**	**2011**	**period change**
Products	$ 22,792	$ 15,681	45.4%	$ 42,700	$ 30,293	41.0%
Services	3,367	4,054	-16.9%	6,416	7,693	-16.6%
Total	$ 26,159	$ 19,735	32.6%	$ 49,116	$ 37,986	29.3%
Gross Profit as a Percentage of Related Sales						
Products	55.0%	51.1%		54.1%	51.6%	
Services	42.3%	56.9%		41.7%	56.5%	
Total	52.9%	52.2%		52.0%	52.5%	

Gross profit increased by $6.4 million, or 32.6%, to $26.2 million in the quarter ended June 30, 2012 as compared with $19.7 million in the same prior-year period. Gross profit increased by $11.1 million, or 29.3%, to $49.1 million in the six months ended June 30, 2012 as compared with $38.0 million in the same prior-year period. The increase is primarily attributable to increased sales of our higher-margin Fortus 3D production systems and consumables.

Product gross profit increased by 45.4% and 40.1% for the three and six months ended June 30, 2012, respectively, as compared to the same prior-year periods. This increase is primarily due to increased volume to cover fixed overhead and a product mix that favored our higher priced Fortus systems, which included the introduction of our new Fortus 250mc 3D production system. The increase in gross profit as a percentage of related sales was primarily due to increased growth in our higher-margin Fortus systems and consumables.

Gross profit from services decreased by 16.9% and 16.6% for the three and six months ended June 30, 2012, respectively, as compared to the same prior-year periods primarily due to lower margin auxiliary RedEye paid parts service sales and higher cost of sales on Fortus 3D production system maintenance contracts.

Operating Expenses

Operating expenses and operating expense as a percentage of sales, as well as the percentage changes in operating expenses were as follows:

Three- and Six-Month Periods Ended June 30,

(In Thousands)	Three Months 2012	2011	Period-over-period change	Six Months 2012	2011	Period-over-period change
Research & development	$ 4,157	$ 3,726	11.6%	$ 8,509	$ 7,074	20.3%
Selling, general & administrative	16,210	9,918	63.4%	27,584	18,655	47.9%
	$ 20,367	$ 13,644	49.3%	$ 36,093	$ 25,729	40.3%
Percentage of sales	41.2%	36.1%		38.2%	35.6%	

Research and development expense increased by 11.6% and 20.3% for the three and six months ended June 30, 2012, respectively, as compared to the same prior-year period. The overall increase was driven primarily by new product initiatives within 3D printing, 3D production systems and Solidscape. Capitalized research and development expenditures for the quarter ended June 30, 2012 relating to internally developed software was approximately $426,000 as compared to $273,000 for the same prior-year period. Capitalized research and development expenditures for the six months ended June 30, 2012 relating to internally developed software was approximately $863,000 as compared to $624,000 for the same prior-year period.

In 2008, we fulfilled our responsibilities under a three-year, $3.6 million agreement with a Fortune 500 global manufacturing company to jointly advance our proprietary FDM technology for rapid manufacturing applications. This agreement entitled us to receive reimbursement payments as we achieved specific milestones stated in the agreement. This effort was focused around our high-performance systems and resulted in the commercial release of the Fortus 900mc. Because receipt of these payments represented reimbursements of costs actually incurred under this joint development project, all payments received were recorded as offsets to the research and development expenditures and are therefore not recognized as revenue.

Due to the success of this initial arrangement, we have continued this relationship under similar terms and objectives. During the three months ended June 30, 2012 and June 30, 2011, approximately $166,000 and $208,000, respectively, of research and development expenses were offset by payments that were received from that company. During the six months ended June 30, 2012 and June 30, 2011, approximately $317,000 and $339,000, respectively, of research and development expenses were offset.

Selling, general and administrative expenses increased by 63.4% and 47.9% for the six months ended June 30, 2012, respectively, as compared to the same prior-year periods. The increase is primarily due to legal, advisory, accounting and integration expenses related to the Objet Ltd. merger. In addition, the six months ended June 30, 2012 included significant expenses surrounding our new Mojo 3D printer launch, which included an international reseller meeting.

Operating Income

Operating income and operating income as a percentage of sales, as well as the percentage change in operating income, were as follows:

Three- and Six-Month Periods Ended June 30,

(In Thousands)	Three Months 2012	2011	Period-over-period change	Six Months 2012	2011	Period-over-period change
Operating income	$ 5,792	$ 6,091	-4.9%	$ 13,022	$ 12,257	6.2%
Percentage of sales	11.7%	16.1%		13.8%	16.9%	

Operating income decreased by $0.3 million, or 4.9%, in the quarter ended June 30, 2012 as compared with the same prior-year period. The overall decrease in operating income was primarily attributable to the increase in expenses related to our current efforts to combine with Objet

Ltd. and expenses surrounding our new Mojo 3D printer launch. Operating income for the six months ended June 30, 2012 increased by $0.8 million, or 6.2%, as compared with the same prior-year period. The overall increase in operating income was primarily attributable to increased product sales led by our higher-margin Fortus systems and consumables, partially offset by expenses related to our current efforts to combine with Objet Ltd. and expenses surrounding our new Mojo 3D printer launch. The increase was also due to the acquisition of Solidscape in May 2011.

Other Income

Other income as a percentage of sales and changes in other income were as follows:

Three- and Six-Month Periods Ended June 30,

(In Thousands)	Three Months 2012	Three Months 2011	Period-over-period change	Six Months 2012	Six Months 2011	Period-over-period change
Interest income	$ 193	$ 216	-10.6%	$ 443	$ 422	5.0%
Foreign currency transaction losses	(140)	(81)	72.8%	(193)	(212)	-9.0%
Other	6	113	-94.7%	103	1,510	-93.2%
	$ 59	$ 248	-76.2%	$ 353	$ 1,720	-79.5%
Percentage of sales	0.1%	0.7%		0.4%	2.4%	

Interest income decreased by 10.6% and increased by 5.2% for the three and six months ended June 30, 2012, respectively, as compared to the same prior-year period. The change is primarily due to varying effective interest rates of our investment portfolio.

We invoice sales to certain European distributors in Euros and reported results are therefore subject to fluctuations in the exchange rates of that currency in relation to the United States dollar. Our strategy is to hedge most of our Euro-denominated accounts receivable positions by entering into 30-day foreign currency forward contracts on a month-to-month basis to reduce the risk that our earnings will be adversely affected by changes in currency exchange rates. We do not use derivative financial instruments for speculative or trading purposes. Instruments to hedge risks may include foreign currency forward, swap, and option contracts. These instruments will be used to selectively manage risks, but there can be no assurance that we will be fully protected against material foreign currency fluctuations.

Other income decreased by $0.2 million and $1.4 million for the three and six months ended June 30, 2012, respectively, as compared to the prior-year period due to a $1.3 million gain on the sale of an equity investment that we maintained in an independent online parts quoting service company in the first quarter of 2011.

Income Tax Expense

Income taxes and income taxes as a percentage of net income before income taxes, as well as the percentage change, were as follows:

Three- and Six-Month Periods Ended June 30,

(In Thousands)	Three Months 2012	Three Months 2011	Period-over-period change	Six Months 2012	Six Months 2011	Period-over-period change
Income tax expense	$ 2,834	$ 2,346	20.8%	$ 5,835	$ 4,994	16.8%
Effective tax rate	48.4%	37.0%		43.6%	35.7%	

The effective tax rate of 48.4% for the quarter ended June 30, 2012 was higher as compared to the 37.0% effective rate for the same prior-year period. The effective tax rate of 43.6% for the six months ended June 30, 2012 was higher as compared to the 35.7% effective rate for the same prior-year period. The increase is primarily due to non-deductible expenses related to our current efforts to combine with Objet Ltd. In addition, the federal research credit expired December 31, 2011 and, therefore, was not considered in computing the effective rate for the three and six months ended June 30, 2012.

Net Income

Net income and net income as a percentage of sales, as well as the percentage change in net income, were as follows:

Three- and Six-Month Periods Ended June 30,

(In Thousands)	**Three Months**		**Period-over-**	**Six Months**		**Period-over-**
	2012	**2011**	**period change**	**2012**	**2011**	**period change**
Net income	$ 3,018	$ 3,994	-24.4%	$ 7,540	$ 8,983	-16.1%
Percentage of sales	6.1%	10.6%		8.0%	12.5%	

Net income decreased during the three and six months ended June 30, 2012 as compared to the same prior year periods primarily due to expenses related to the pending Objet Ltd. transaction, a $1.3 million gain on the sale of an equity investment that we maintained in an independent online parts quoting service company in the first quarter of 2011 and a higher effective tax rate.

Liquidity and Capital Resources
(unaudited)

A summary of our consolidated interim statements of cash flows for the six months ended June 30, 2012 and 2011 are as follows:

(In Thousands)

	2012	**2011**
Net income	$ 7,540	$ 8,983
Depreciation and amortization	5,519	4,748
Stock-based compensation	1,113	647
Gain on disposal of property and equipment	-	(156)
Gain on sale of investment	-	(1,204)
Changes in operating assets and liabilities	(2,233)	(5,993)
Net cash provided by operating activities	11,939	7,025
Net cash used in investing activities	(7,132)	(29,771)
Net cash provided by financing activities	2,085	7,537
Effect of exchange rate changes on cash	(16)	98
Net increase (decrease) in cash and cash equivalents	6,876	(15,111)
Cash and cash equivalents, beginning of period	20,092	27,554
Cash and cash equivalents, end of period	$ 26,968	$ 12,443

Our cash and cash equivalents balance increased by $6.9 million to $27.0 million at June 30, 2012, from $20.1 million at December 31, 2011. The increase is primarily due to cash provided by operations.

In the six months ended June 30, 2012, net cash provided by our operating activities was $11.9 million compared to cash provided by operating activities of $7.0 million during the comparable 2011 period. Our accounts receivable balance increased to $33.5 million at June 30, 2012 from $26.2 million as of December 31, 2011. This increase was principally due to sales growth. At June 30, 2012, our inventory balance decreased modestly to $22.5 million as compared to $22.8 million at December 31, 2011.

Our investing activities used net cash of $7.1 million in first six months of 2012 as compared to $29.8 million in same prior-year period. We received net cash of approximately $0.4 million in connection with the purchase, maturity and sale of investments during the first six months of 2012 as compared to $18.9 million net cash received in 2011. We used cash of approximately $6.3 million for fixed asset additions in the first six months of 2012 as compared to $7.0 million in the same prior-year period. Net cash used for payments for intangible assets and other investments, including patents and capitalized software, was $1.2 million during the first six months of 2012 as compared to $3.1 million for the same prior-year period. During the six months ended June 30, 2011, we used $38.6 in cash for the acquisition of Solidscape.

In the six months ended June 30, 2012 and 2011, net cash provided by financing activities of $2.1 million and $7.5 million resulted from the proceeds from the exercise of stock options and adjustment to income taxes payable for excess tax benefits from the exercise of stock options.

For 2012, we expect to use our cash as follows:

- to finance the expenses of our combination with Objet Ltd.;
- for improvements to our facilities;
- for the continuation of our leasing program;
- for working capital purposes;
- for information systems and infrastructure enhancements;
- for new product and materials development;
- for sustaining engineering;
- for the acquisition of equipment, including production equipment, tooling, and computers;
- for the purchase or development of intangible assets, including patents; and
- for increased selling and marketing activities, especially as they relate to the continued market and channel development.

Our total current assets amounted to approximately $117.0 million at June 30, 2012, most of which consisted of cash and cash equivalents, investments, accounts receivable and inventories. Total current liabilities amounted to approximately $36.4 million and we have no debt. We believe that we have adequate resources to fund our foreseeable future growth.

Inflation

We believe that inflation has not had a material effect on our operations or on our financial condition during the three most recent fiscal years and during the current quarter.

Foreign Currency Transactions

We invoice sales to certain European distributors in Euros, and reported results are therefore subject to fluctuations in the exchange rates of that currency in relation to the United States dollar. Our strategy is to hedge most of our Euro-denominated accounts receivable positions by entering into 30-day foreign currency forward contracts on a month-to-month basis to reduce the risk that our earnings will be adversely affected by changes in currency exchange rates. We do not use derivative financial instruments for speculative or trading purposes. We enter into 30-day foreign currency forward contracts on the last day of each month and therefore the notional value of the contract equals the fair value. As such, there is no related asset or liability or unrealized gains or losses recorded on the Balance Sheet as of the end of the period. All realized gains and losses related to hedging activities are recorded in current period earnings under the Statement of Operations caption Foreign currency transactions gains (losses), net.

We hedged between €6.0 million and €7.0 million for the three months ended June 30, 2012 and between €5.5 million and €9.8 million for the six months ended June 30, 2012 of accounts receivable and cash that was denominated in Euros. The foreign currency forward contracts resulted in a currency translation gain of approximately $473,000 and a currency translation loss of approximately $101,000 for the three months ended June 30, 2012 and June 30, 2011, respectively. The foreign currency forward contracts resulted in a currency translation gain of approximately $125,000 and a currency translation loss of approximately $576,000 for the six months ended June 30, 2012 and June 30, 2011, respectively. The resulting gain or loss from foreign currency forward contracts only partially offset the total foreign currency transactions gains or losses that we recorded.

We will continue to monitor exposure to currency fluctuations. Instruments to hedge risks may include foreign currency forward, swap, and option contracts. These instruments will be used to selectively manage risks, but there can be no assurance that we will be fully protected against material foreign currency fluctuations.

Critical Accounting Policies

We have prepared our consolidated interim financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America. This has required us to make estimates, judgments, and assumptions that affected the amounts we reported.

We have identified several critical accounting policies that required us to make assumptions about matters that were uncertain at the time of our estimates. Had we used different estimates and assumptions, the amounts we recorded could have been significantly different. Additionally, if we had used different assumptions or if different conditions existed, our financial condition or results of operations could have been materially different. Certain critical accounting policies that were affected by the estimates, assumptions, and judgments used in the preparation of our consolidated interim financial statements are described in our Annual Report on Form 10-K for 2011.

Forward-looking Statements and Factors That May Affect Future Results of Operations

All statements herein that are not historical facts or that include such words as expects , anticipates , projects , estimates , vision , planning could , potential , plan , believes , desires , intends , assume or similar words constitute forward-looking statements that we deem to be co and to qualify for the safe harbor protection covered by the Private Securities Litigation Reform Act of 1995 (the 1995 Act). Investors and prospective investors in our Company should understand that several factors govern whether any forward-looking statement herein will be or can be achieved. Any one of these factors could cause actual results to differ materially from those projected herein.

These forward-looking statements include statements regarding projected revenue and income in future quarters; the size of the 3D printing market; our objectives for the marketing and sale of our Dimension, Mojo and uPrint 3D Printers; our support removal systems; and our Fortus 3D production systems, particularly for use in direct digital manufacturing (DDM); the demand for our proprietary consumables; the expansion of our paid parts service; and our beliefs with respect to the growth in the demand for our products. Other risks and uncertainties that may affect our business include our ability to penetrate the 3D printing market; our ability to achieve the growth rates experienced in preceding quarters; our ability to introduce, produce and market consumable materials, and the market acceptance of these materials; the impact of competitive products and pricing; our timely development of new products and materials and market acceptance of those products and materials; the success of our recent R&D initiative to expand the DDM capabilities of our core FDM technology; and the success of our RedEyeOnDemand™ and other paid parts services. They also include statements about future financial and operating results of our company after the acquisition of Solidscape and after closing of the pending combination with Objet Ltd. and anticipated benefits of those transactions. Actual results may differ from those expressed or implied in our forward-looking statements. Such forward-looking statements involve and are subject to certain risks and uncertainties, which may cause our actual results to differ materially from those discussed in a forward-looking statement. Such risk factors include our ability to successfully integrate and market Solidscape products, our ability to attract and retain management and our ability to protect and defend intellectual property. These statements represent beliefs and expectations only as of the date they were made. We may elect to update forward-looking statements, but we expressly disclaim any obligation to do so, even if our beliefs and expectations change. The forward-looking statements included herein are based on current expectations that involve a number of risks and uncertainties, some of which are described in Item 1A, Risk Factors in our Annual Report on Form 10-K for 2011 and in our Quarterly Report on Form 10-Q for the quarter ended March 31, 2012. These forward-looking statements are based on assumptions, among others, that we will be able to:

- successfully close the proposed transaction with Objet Ltd. and successfully integrate the two businesses;
- continue to introduce new high-performance and 3D printing systems and materials acceptable to the market, and to continue to improve our existing technology and software in our current product offerings;
- successfully develop the 3D printing market with our Dimension BST, Dimension SST, Dimension Elite, Mojo and uPrint systems, and that the market will accept these systems;

- successfully develop the DDM market with our Fortus 360mc, 400mc and 900mc, and that the market will accept these systems;
- successfully integrate acquired businesses;
- control our operating expenses;
- expand our manufacturing capabilities to meet the expected demand generated by our Mojo, uPrint, Dimension BST, Dimension SST and Dimension Elite systems, our consumable products and our RedEye paid parts service;
- successfully commercialize new materials and gain market acceptance for these new materials; and
- recruit, retain, and develop employees with the necessary skills to produce, create, commercialize, market, and sell our products.

Assumptions relating to the foregoing involve judgments with respect to, among other things, future economic, geo-political, competitive, market and technological conditions, and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. Although we believe that the assumptions underlying the forward-looking statements contained herein are reasonable, any of those assumptions could prove inaccurate, and therefore there is and can be no assurance that the results contemplated in any such forward-looking statement will be realized. The impact of actual experience and business developments may cause us to alter our marketing plans, our capital expenditure budgets, or our engineering, selling, manufacturing or other budgets, which may in turn affect our results of operations or the success of our new product development and introduction. We may not be able to alter our plans or budgets in a timely manner, resulting in reduced profitability or losses.

Due to the factors noted above and elsewhere in this Management s Discussion and Analysis of Financial Condition and Results of Operations, our future earnings and stock price may be subject to significant volatility, particularly on a quarterly basis. Additionally, we may not learn of revenue or earnings shortfalls until late in a fiscal quarter, since we frequently receive a significant number of orders very late in a quarter. This could result in an immediate and adverse effect on the trading price of our common stock. Past financial performance should not be considered a reliable indicator of future performance, and investors should not use historical trends to anticipate results or trends in future periods.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Interest Rate Risk

Our cash and cash equivalent investments are held exclusively in short-term money market and sweep instruments with maturities of less than 90 days. These are subject to limited interest rate risk. A 10% change in interest rates would not have a material effect on our financial condition or results of operations. Our short- and long-term investments are invested in auction rate securities, corporate and municipal bonds and certificates of deposit that bear interest at rates of 0.2% to 5.5%. An immediate 10% change in interest rates would have no material effect on our financial condition or results of operations.

Foreign Currency Exchange Rate Risk

We have not historically hedged sales from or expenses incurred by our European operations that have a functional currency in Euros. A hypothetical 10% change in the exchange rates between the U.S. dollar and the Euro could increase or decrease our income before taxes by less than $0.6 million for the continued maintenance of our European facility. We hedged between €6.0 million and €7.0 million for the three months ended June 30, 2012 and between €5.5 million and €9.8 million for the six months ended June 30, 2012 of accounts receivable and cash that were denominated in Euros. We believe that a hypothetical 10% change in the exchange rates between the US dollar and the Euro could increase or decrease income before taxes by $5.0 million.

Item 4. Controls and Procedures.

Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report (the Evaluation Date). Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded as of the Evaluation Date that our disclosure controls and procedures were effective. Disclosure controls and procedures require that the information relating to us required to be disclosed in our Securities and Exchange Commission (SEC) reports (i) is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Internal Control over Financial Reporting

An evaluation was also performed under the supervision and with the participation of management, including the CEO and CFO, of any change in our internal controls over financial reporting that occurred during the last fiscal quarter and that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting. That evaluation did not identify any changes in our internal control over financial reporting during our most recently completed fiscal quarter that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934).

PART II OTHER INFORMATION

Item 1. Litigation

On June 29, 2012, a purported class action complaint captioned *Legette v. Crump et al.* was filed in the District Court, Fourth Judicial District, Hennepin County, Minnesota, naming Stratasys, the members of its board of directors, Seurat Holdings Inc. (Holdco), and Oaktree Merger, Inc. (Merger Sub) as defendants. On July 2, 2012, another purported class action complaint captioned *Henning v. Crump et al.* was filed in the Court of Chancery of the State of Delaware, naming the same persons as well as Objet Ltd. as defendants. A third purported class action complaint captioned *Askersrud v. Stratasys et al.* was filed on July 17, 2012, also in the District Court, Fourth Judicial District, Hennepin County, Minnesota, naming the same persons (except for Objet) as defendants. Each of the foregoing complaints has been filed in connection with the proposed merger of Stratasys and Objet. They generally allege that, in connection with approving the merger, the Stratasys directors breached their fiduciary duties owed to Stratasys stockholders and that Stratasys, Objet, Holdco and Merger Sub knowingly aided and abetted the Stratasys directors breaches of their fiduciary duties. The complaints seek, among other things, certification of the case as a class action, an injunction against the consummation of the transaction, a judgment against the defendants for damages, and an award of fees, expenses and costs to plaintiffs and their attorneys.

ITEM 1A. RISK FACTORS

We encourage you to review the discussion of Forward Looking Statements and Factors That May Affect Future Results of Operations appearing in this report at Part I, Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.

In addition to the other information set forth in this Report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our 2011 Annual Report Form 10-K and our Quarterly Report on Form 10-Q for the quarter ended March 31, 2012 (our Q1 2012 Form 10-Q), which could materially affect our business, financial condition or operating results. The risks described in our 2011 Form 10-K and our Q1 2012 Form 10-Q are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition or operating results.

Item 6. Exhibits

(a) Exhibits.

31.1	Certification of the Chief Executive Officer required by Rule 13a-14(a) or Rule 15d-14(a).
31.2	Certification of the Chief Financial Officer required by Rule 13a-14(a) or Rule 15d-14(a).
32.1	Certification of the Chief Executive Officer required by Rule 13a-14(b) or Rule 15d-14(b) and 18 U.S.C. 1350.
32.2	Certification of the Chief Financial Officer required by Rule 13a-14(b) or Rule 15d-14(b) and 18 U.S.C. 1350.
101.INS	XBRL Instance Document*
101.SCH	XBRL Taxonomy Extension Schema Document*
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document*
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document*
101.LAB	XBRL Taxonomy Extension Label Linkbase Document*
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document*

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* The XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability of that section and shall not be incorporated by reference into any filing or other document pursuant to the Securities Act of 1933, as amended, except as shall be expressly set forth by specific reference in such filing or document.

SIGNATURES

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

Date: August 9, 2012	**Stratasys, Inc.**	
	By:	/s/ Robert F. Gallagher Robert F. Gallagher Chief Financial Officer