

STRATASYS LTD.

FORM 6-K (Report of Foreign Issuer)

Filed 05/09/14 for the Period Ending 05/09/14

| | |
|-------------|--|
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| CIK | 0001517396 |
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| Sector | Technology |
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 6-K

**REPORT OF FOREIGN PRIVATE ISSUER PURSUANT TO RULE 13a-16 OR 15d-16 UNDER THE
SECURITIES EXCHANGE ACT OF 1934**

For the month of May 2014

Commission File Number 001-35751

STRATASYS LTD.

(Translation of registrant's name into English)

**c/o Stratasys, Inc.
7665 Commerce Way
Eden Prairie, Minnesota 55344**

**2 Holtzman Street, Science Park
P.O. Box 2496
Rehovot, Israel 76124**

(Address of principal executive office)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F. Form 20-F Form 40-F

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1): _____

Note : Regulation S-T Rule 101(b)(1) only permits the submission in paper of a Form 6-K if submitted solely to provide an attached annual report to security holders.

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7): _____

The contents of this Report of Foreign Private Issuer on Form 6-K (this “**Form 6-K**”), including Exhibits 99.1, 99.2 and 101 annexed hereto, are incorporated by reference into the Registrant’s registration statements on Form S-8, SEC file numbers 333-185240 and 333-190963, filed by the Registrant with the SEC on December 3, 2012 and September 3, 2013, respectively, and the Registrant’s registration statement on Form F-3, SEC file number 333-190965, filed by the Registrant on September 3, 2013 (as supplemented by any prospectus supplements filed on or prior to the date of this Form 6-K), and shall be a part thereof from the date on which this Form 6-K is furnished, to the extent not superseded by documents or reports subsequently filed or furnished .

CONTENTS

On May 9, 2014, Stratasys Ltd., or Stratasys, released its financial results for the three months ended March 31, 2014.

Attached hereto as Exhibit 99.1 are the unaudited, condensed consolidated financial statements of Stratasys for the three months ended March 31, 2014 and 2013 (including the notes thereto) (the “Q1 2014 Financial Statements”).

Attached hereto as Exhibit 99.2 is Stratasys’ review of its results of operations and financial condition for the three months ended March 31, 2014 and 2013, including the following:

- (i) Operating and Financial Review and Prospects
- (ii) Quantitative and Qualitative Disclosures About Market Risk
- (iii) Legal Proceedings Update

Attached hereto as Exhibit 101 are the Q1 2014 Financial Statements, formatted in XBRL (eXtensible Business Reporting Language), consisting of the following sub-exhibits:

Exhibit

| Number | Document Description |
|------------|--|
| EX-101.INS | XBRL Taxonomy Instance Document |
| EX-101.SCH | XBRL Taxonomy Extension Schema Document |
| EX-101.CAL | XBRL Taxonomy Calculation Linkbase Document |
| EX-101.DEF | XBRL Taxonomy Extension Definition Linkbase Document |
| EX-101.LAB | XBRL Taxonomy Label Linkbase Document |
| EX-101.PRE | XBRL Taxonomy Presentation Linkbase Document |

The XBRL related information in Exhibit 101 to this Form 6-K shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability under 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.

Dated: May 9, 2014

STRATASYS LTD.

By: /s/ Erez Simha

Name: Erez Simha

Title: Chief Financial Officer and
Chief Operating Officer

STRATASYS LTD.
CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED
MARCH 31, 2014
(UNAUDITED)

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED MARCH 31, 2014
(UNAUDITED)**

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STRATASYS LTD.
CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Consolidated Balance Sheets

| <i>in thousands</i> | March 31, 2014 | December 31, 2013 |
|---|-----------------------|--------------------------|
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$ 407,168 | \$ 414,088 |
| Short-term bank deposits | 200,370 | 200,370 |
| Accounts receivable, net | 106,042 | 99,200 |
| Inventories | 99,783 | 88,406 |
| Investment in sales-type leases, net | 7,008 | 6,696 |
| Prepaid expenses | 6,444 | 5,470 |
| Deferred income taxes | 19,351 | 16,501 |
| Other current assets | 25,342 | 21,398 |
| Total current assets | <u>871,508</u> | <u>852,129</u> |
| Non-current assets | | |
| Goodwill | 1,196,227 | 1,195,891 |
| Other intangible assets, net | 604,814 | 622,330 |
| Investment in sales-type leases | 11,797 | 11,219 |
| Amounts funded in respect of employee rights upon retirement | 3,279 | 3,166 |
| Property, plant and equipment, net | 99,146 | 91,005 |
| Other non-current assets | 4,807 | 6,481 |
| Total non-current assets | <u>1,920,070</u> | <u>1,930,092</u> |
| Total assets | <u>\$ 2,791,578</u> | <u>\$ 2,782,221</u> |
| LIABILITIES AND EQUITY | | |
| Current liabilities | | |
| Accounts payable | \$ 35,056 | \$ 35,375 |
| Accrued expenses and other current liabilities | 34,348 | 32,849 |
| Accrued compensation and related benefits | 28,326 | 21,441 |
| Earn-out obligation | 21,530 | 12,027 |
| Unearned revenues | 39,458 | 36,033 |
| Total current liabilities | <u>158,718</u> | <u>137,725</u> |
| Non-current liabilities | | |
| Employee rights upon retirement | 4,811 | 4,683 |
| Earn-out obligation - long term | - | 16,998 |
| Deferred tax liabilities | 102,463 | 105,901 |
| Unearned revenues - long term | 3,219 | 3,315 |
| Other non-current liabilities | 10,838 | 13,812 |
| Total liabilities | <u>280,049</u> | <u>282,434</u> |
| Contingencies, see note 9 | | |
| Equity | | |
| Ordinary shares, NIS 0.01 nominal value, authorized 180,000 shares; 49,328 and 49,211 shares issued and outstanding at March 31, 2014 and December 31, 2013, respectively | 133 | 133 |
| Additional paid-in capital | 2,420,211 | 2,412,197 |
| Retained earnings | 89,636 | 85,549 |
| Accumulated other comprehensive income | 1,549 | 1,908 |

| | | |
|-------------------------------------|---------------------|---------------------|
| Total equity | 2,511,529 | 2,499,787 |
| Total liabilities and equity | \$ 2,791,578 | \$ 2,782,221 |

See accompanying notes to condensed consolidated financial statements.

STRATASYS LTD.
CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Consolidated Statements of Operations and Comprehensive Income

| <i>in thousands, except per share data</i> | Three Months Ended March 31, | |
|---|-------------------------------------|--------------------|
| | 2014 | 2013 |
| Net sales | | |
| Products | \$ 129,252 | \$ 81,810 |
| Services | 21,689 | 15,397 |
| | <u>150,941</u> | <u>97,207</u> |
| Cost of sales | | |
| Products | 61,022 | 49,043 |
| Services | 12,191 | 10,790 |
| | <u>73,213</u> | <u>59,833</u> |
| Gross profit | <u>77,728</u> | <u>37,374</u> |
| Operating expenses | | |
| Research and development, net | 16,771 | 10,789 |
| Selling, general and administrative | 67,617 | 43,325 |
| Change in fair value of earn-out obligation | (7,495) | - |
| | <u>76,893</u> | <u>54,114</u> |
| Operating income (loss) | <u>835</u> | <u>(16,740)</u> |
| Other income (expense) | <u>(1,336)</u> | <u>514</u> |
| Loss before income taxes | <u>(501)</u> | <u>(16,226)</u> |
| Income taxes | (4,588) | (743) |
| Net income (loss) | <u>\$ 4,087</u> | <u>\$ (15,483)</u> |
| Net income attributable to non-controlling interest | - | 53 |
| Net income (loss) attributable to Stratasy Ltd. | <u>\$ 4,087</u> | <u>\$ (15,536)</u> |
| Net income (loss) per ordinary share attributable to Stratasy Ltd. | | |
| Basic | \$ 0.08 | \$ (0.40) |
| Diluted | \$ 0.08 | \$ (0.40) |
| Weighted average ordinary shares outstanding | | |
| Basic | 49,273 | 38,494 |
| Diluted | 51,240 | 38,494 |
| Comprehensive Income (loss) | | |
| Net income (loss) | \$ 4,087 | \$ (15,483) |
| Other comprehensive income (loss), net of tax: | | |
| Losses on securities reclassified into earnings | 168 | - |
| Foreign currency translation adjustments | (398) | (368) |
| Fair value adjustments on derivatives designated as cash flow hedges | (129) | - |

| | | |
|---|-----------------|--------------------|
| Other comprehensive loss, net of tax | (359) | (368) |
| Comprehensive income (loss) | 3,728 | (15,851) |
| Less: comprehensive income attributable to non-controlling interest | - | 115 |
| Comprehensive income (loss) attributable to Stratasys Ltd. | \$ 3,728 | \$ (15,966) |

See accompanying notes to condensed consolidated financial statements.

STRATASYS LTD.
CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Consolidated Statements of Cash Flows

| <i>in thousands</i> | Three Months Ended March 31, | |
|--|-------------------------------------|------------------|
| | 2014 | 2013 |
| Cash flows from operating activities | | |
| Net income (loss) | \$ 4,087 | \$ (15,483) |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 23,367 | 29,328 |
| Stock-based compensation | 6,736 | 5,490 |
| Deferred income taxes | (5,871) | (3,875) |
| Excess tax benefit from stock options | (238) | (986) |
| Change in fair value of earn-out obligations | (7,495) | - |
| Other non-cash items | 22 | (79) |
| Change in cash attributable to changes in operating assets and liabilities, net of the impact of acquisitions: | | |
| Accounts receivable, net | (10,417) | (9,723) |
| Inventories | (13,216) | (7,146) |
| Net investment in sales-type leases | (891) | (67) |
| Prepaid expenses | (1,100) | 1,176 |
| Other non-current assets | (379) | (543) |
| Accounts payable and other current liabilities | 10,121 | (13,768) |
| Unearned revenues | 3,048 | 2,996 |
| Other non-current liabilities | (2,914) | 428 |
| Net cash provided by (used in) operating activities | 4,860 | (12,252) |
| Cash flows from investing activities | | |
| Change in short-term bank deposits, net | - | (55,307) |
| Purchase of property and equipment | (10,872) | (5,046) |
| Acquisition of intangible and other assets | (1,706) | (252) |
| Proceeds from sale of investment | 1,634 | - |
| Other investing activities | 41 | 12 |
| Net cash used in investing activities | (10,903) | (60,593) |
| Cash flows from financing activities | | |
| Acquisition of non-controlling interest | (2,171) | - |
| Proceeds from exercise of stock options | 1,040 | 3,607 |
| Excess tax benefit from stock options | 238 | 986 |
| Net cash (used in) provided by financing activities | (893) | 4,593 |
| Effect of exchange rate changes on cash and cash equivalents | 16 | (69) |
| Net change in cash and cash equivalents | (6,920) | (68,321) |
| Cash and cash equivalents, beginning of period | 414,088 | 133,826 |
| Cash and cash equivalents, end of period | \$ 407,168 | \$ 65,505 |

Supplemental disclosures of cash flow information:

| | | |
|---------------------------------------|-------|-----|
| Transfer of fixed assets to inventory | 60 | 83 |
| Transfer of inventory to fixed assets | 1,643 | 589 |

See accompanying notes to condensed consolidated financial statements.

STRATASYS LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1. Basis of Presentation and Consolidation

Stratasys Ltd. and subsidiaries (collectively the “Company”) is a leading global provider of additive manufacturing (“AM”) solutions for the creation of parts used in the processes of designing and manufacturing products and for the direct manufacture of end parts. The Company’s systems include desktop 3D printers for idea and design development, various systems for rapid prototyping (“RP”) and large production systems for direct digital manufacturing (“DDM”). The Company also develops, manufactures and sells materials for use with its systems and provides various services to its customers.

The Company is the result of the 2012 merger of two AM companies, Stratasys, Inc. and Objet Ltd. (“Objet”). On December 1, 2012 (the “merger date”), the two companies completed an all-stock merger (the “Stratasys-Objet merger” or “the merger”), pursuant to which Stratasys, Inc. became an indirect, wholly-owned subsidiary of Objet, and Objet changed its name to Stratasys Ltd.

The condensed consolidated interim financial statements include the accounts of Stratasys Ltd. and its subsidiaries. All intercompany accounts and transactions, including profits from intercompany sales not yet realized outside the Company, 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. The results of operations for the three months ended March 31, 2014 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, 2013, filed as part of the Company’s Annual Report on Form 20-F for such year.

Recently adopted and issued accounting pronouncements:

In July 2013, the Financial Accounting Standards Board (FASB), issued an accounting standard update, under which an entity must present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, in the absence of certain conditions. This accounting standard update was effective for the Company in the three months ended March 31, 2014. The adoption of this standard did not have a material impact on the Company’s consolidated financial statements.

STRATASYS LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 2. Acquisitions

MakerBot transaction

On August 15, 2013 (“MakerBot transaction date”) the Company acquired privately held Cooperation Technology Corporation (“MakerBot”) for an aggregate purchase price of \$493.7 million (“MakerBot transaction”), which was calculated based on the Company’s share price of \$97.46 as of the MakerBot transaction date.

The acquisition consideration was attributed to net assets on the basis of the fair value of assets acquired and liabilities assumed based on an appraisal performed by management, which included a number of factors, including the assistance of independent appraisers. The estimated fair values are based on the information that was available as of March 31, 2014 and may be subject to changes.

MakerBot stockholders also could qualify for two earn-out payments. The first is for the six-month period ended December 31, 2013, which amounted to \$10.8 million and which was paid in cash during April 2014. The second earn-out period is for the year ended December 31, 2014, for which MakerBot stockholders could qualify for aggregate payment of up to 0.8 million shares depending on the level of achievement of financial metrics for the period. The second earn-out payment, if earned, will be made in the Company’s shares or cash, or a combination thereof, at the Company’s discretion.

The fair value of the earn-out obligations was determined to be approximately \$28.3 million at the MakerBot transaction date. The estimated fair value of the obligations is based on management’s assessment of whether, and at what level, the financial metrics will be achieved, and the present value factors associated with the timing of the payments. Management re-measures the fair value of the earn-out obligations at the end of each reporting period, with any changes in fair value being recorded in that period’s statement of operations. The fair value was estimated based on a Monte Carlo simulation, under which many scenarios are computed to measure possible outcomes of the financial metrics and the likelihood of occurrence. The resultant probability-weighted financial metrics are then applied to the earn-out formula to determine the cash flows under the earn-out. Those cash flows were then discounted using rates of the yields for U.S. treasury bonds with similar terms to maturity. This fair value measurement is based on significant inputs not observable in the market and thus represents a Level 3 measurement within the fair value hierarchy. Based on the results for the six months ended December 31, 2013, the Company determined that the payment for the first earn-out period was \$10.8 million, and estimates the earn-out obligation for the second earn-out period to be \$10.7 million, as of March 31, 2014.

Certain MakerBot employees participate in a performance bonus plan in connection with the MakerBot transaction. Participating employees are entitled, contingent on certain continuing employment conditions, to bonus payments of compensation that in the aggregate will equal, dollar-for-dollar, the actual amounts determined in the earn-out calculation.

Other transactions

In October 2013, the Company acquired all non-controlling interests of its investment in Stratasys Japan Co. Ltd., for a total purchase price of approximately \$2 million which was paid during the first quarter of 2014. Prior to the acquisition, the Company owned 51% of the Japanese company. The excess of the purchase price over the carrying value of the non-controlling interests was credited to additional paid-in capital. This acquisition enabled the Company to expand its Japanese operations.

In January 2014, the Company purchased certain assets, including customer service contracts and inventory, from its local channel partner in South Korea, Sysopt Engineering Co. Ltd. The acquisition enables the Company to expand its South Korean operations.

STRATASYS LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Subsequent transactions

In April 2014, the Company announced the signing of a definitive agreement to acquire Solid Concepts Inc. (“Solid Concepts”), an independent additive manufacturing service bureau. Under the terms of the definitive agreement with Solid Concepts, the Company will acquire 100% of Solid Concepts’ outstanding shares for total consideration of up to \$217 million, including a payment on closing of \$157 million (or, if settled in cash, part on closing and part six months after closing) and deferred payments of \$60 million. Certain of Solid Concepts’ employees may also qualify for retention-related and other payments of up to \$78 million. Subject to certain requirements for cash payments, the Company retains the discretion to settle any of the amounts payable under the definitive agreement and the retention plan in its shares, cash or any combination of the two.

In April 2014, the Company announced the signing of a definitive agreement to acquire Harvest Technologies Inc (“Harvest”), a specialty additive manufacturing service bureau. Under the terms of the definitive agreement with Harvest, the Company will acquire 100% of Harvest’s outstanding shares for cash, shares, or a combination of the two , at the discretion of the Company. Certain of Harvest’s employees may also qualify for certain retention-related payments.

These two transactions are expected to enable the Company to expand its existing digital manufacturing service business , to create a leading strategic platform to meet a broad range of customers' additive manufacturing needs and provide opportunities to leverage manufacturing services capabilities.

In April 2014, the Company acquired certain assets of Interfacial Solutions LLC (“Interfacial Solutions”), a privately held provider of thermoplastics research and development and production services. This transaction is designed to strengthen the Company’s materials research and development skills and enable it to become vertically integrated in material development and manufacturing and also increase materials production space and capacity.

STRATASYS LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 3. Inventories

Inventories consisted of the following (in thousands):

| | March 31, 2014 | December 31, 2013 |
|-----------------|---------------------------|------------------------------|
| Finished goods | \$ 63,215 | \$ 42,251 |
| Work-in-process | 3,327 | 164 |
| Raw materials | 33,241 | 45,991 |
| | <u>\$ 99,783</u> | <u>\$ 88,406</u> |

Note 4. Intangible Assets

The intangible assets consisted of the following (in thousands):

| | <u>March 31, 2014</u> | | <u>December 31, 2013</u> | |
|---|--------------------------------------|-------------------------------------|--------------------------------------|-------------------------------------|
| | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization |
| Developed technology | \$ 462,289 | \$ 67,107 | \$ 447,842 | \$ 54,029 |
| Patents | 14,209 | 6,922 | 14,065 | 6,523 |
| Trademarks and trade names | 59,034 | 5,226 | 59,019 | 3,817 |
| Customer relationships | 101,566 | 14,081 | 100,679 | 10,793 |
| Non-compete agreement | 10,354 | 1,903 | 10,354 | 1,249 |
| Capitalized software development costs | 16,889 | 13,963 | 16,612 | 13,828 |
| In process research and development | 49,675 | - | 63,998 | - |
| | <u>714,016</u> | <u>\$ 109,202</u> | <u>712,569</u> | <u>\$ 90,239</u> |
| Accumulated amortization | 109,202 | | 90,239 | |
| Net book value of amortizable intangible assets | <u>\$ 604,814</u> | | <u>\$ 622,330</u> | |

In process research and development with a gross carrying value of \$14.4 million at December 31, 2013 was launched during the three months ended March 31, 2014 and is now classified as developed technology with a six-year life for amortization.

Amortization expense for intangible assets for the three-month periods ended March 31, 2014 and 2013 was approximately \$19.0 million and \$13.1 million, respectively.

As of March 31, 2014, estimated amortization expense relating to intangible assets currently subject to amortization for each of the next five years and thereafter was as follows (in thousands)

| Year ending December 31, | |
|---------------------------------|-----------|
| Remaining 9 months of 2014 | \$ 57,537 |
| 2015 | 74,916 |
| 2016 | 74,810 |
| 2017 | 73,514 |
| 2018 | 67,601 |
| Thereafter | 206,761 |

STRATASYS LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 5. Earnings (Loss) Per Share

The Company complies with ASC 260, *Earnings Per Share*, which requires dual presentation of basic and diluted income (loss) per ordinary share attributable to Stratasys Ltd. for all periods presented. Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of shares, outstanding for the reporting periods. Diluted net income per share is computed using the weighted-average number of common shares and the potential dilutive common shares outstanding during the period. Diluted shares outstanding include the dilutive effect of in-the-money options and restricted stock units (“RSUs”) using the treasury stock method, as well as, shares held back from issuance in connection with the MakerBot acquisition.

The following table presents a reconciliation of the numerator and denominator of the basic and diluted income (loss) per share computations for the three months ended March 31, 2014 and 2013:

| (in thousands, except per share amounts) | Three months ended March 31, | |
|--|------------------------------|-------------|
| Numerator: | 2014 | 2013 |
| Net income (loss) attributable to Stratasys Ltd.– for the computation of basic and diluted net income (loss) per share | \$ 4,087 | \$ (15,536) |
| Denominator: | | |
| Weighted average shares – denominator for basic net income (loss) per share | 49,273 | 38,494 |
| Add: Effect of dilutive securities | | |
| Additional shares from the assumed exercise of employee stock options and unvested RSUs | 1,312 | - |
| Held back issuable shares in connection with MakerBot acquisition | 655 | - |
| Denominator for diluted income (loss) per share | 51,240 | 38,494 |
| Net income (loss) per share attributable to Stratasys Ltd. | | |
| Basic | \$ 0.08 | \$ (0.40) |
| Diluted | \$ 0.08 | \$ (0.40) |

The computation of diluted net income (loss) per share excluded stock options to purchase 0.16 million and 3.05 million thousands shares for the three months ended March 31, 2014 and 2013, respectively, because their inclusion would have had an anti-dilutive effect on the diluted net income (loss) per share.

STRATASYS LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 6. Income Taxes

The Company's effective tax rate for the three months ended March 31, 2014 and 2013 was 915.8% and 4.6%, respectively, on the loss before income taxes in those periods. The Company's effective tax rate has varied significantly since the December 1, 2012 Stratasys-Objet merger due to the lower tax rate in Israel, and changes in the mix of income (loss) between the U.S. and Israel, as well as the impact of the tax benefit as a result of the realization of the deferred tax liability associated with the amortization of the intangible assets. The income of \$7.5 million attributable to the change in fair value of the Company's earn-out obligations in the three months ended March 31, 2014 is non-taxable, and therefore had a significant impact on the effective tax rate.

Note 7. 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 LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The following table presents the Company's assets and liabilities that are measured at fair value on a recurring basis, segregated by classes (in thousands):

| | March 31, 2014 | | |
|--|-------------------|--------------------|--------------------|
| | Level 2 | Level 3 | Total |
| Assets: | | | |
| Foreign exchange forward contracts not designated as hedging instruments | \$ 38 | \$ - | \$ 38 |
| Foreign exchange forward contracts designated as hedging instruments | 24 | - | 24 |
| Liabilities: | | | |
| Foreign exchange forward contracts not designated as hedging instruments | (1,539) | - | (1,539) |
| Earn-out obligation | - | (21,530) | (21,530) |
| | <u>\$ (1,477)</u> | <u>\$ (21,530)</u> | <u>\$ (23,007)</u> |
| | | | |
| | December 31, 2013 | | |
| | Level 2 | Level 3 | Total |
| Assets: | | | |
| Long term investment | \$ 1,634 | \$ - | \$ 1,634 |
| Foreign exchange forward contracts not designated as hedging instruments | 301 | - | 301 |
| Foreign exchange forward contracts designated as hedging instruments | 153 | - | 153 |
| Liabilities: | | | |
| Foreign exchange forward contracts not designated as hedging instruments | (1,543) | - | (1,543) |
| Earn-out obligations | - | (29,025) | (29,025) |
| | <u>\$ 545</u> | <u>\$ (29,025)</u> | <u>\$ (28,480)</u> |

Foreign exchange forward contracts are presented as other current assets and other current liabilities and are valued primarily based on observable inputs, including interest rate curves and both forward and spot prices for currencies (Level 2 inputs). At March 31, 2014, the Company had foreign exchange forward contracts in effect for the conversion of \$90.0 million into €663 million and \$40.3 million into NIS 140.8 million out of which the Company designated \$13.8 million as cash flow hedge for accounting purposes. The Company uses short-term cash flow hedge contracts to reduce its exposure to variability in expected future cash flows resulting mainly from payroll costs denominated in New Israeli Shekels. The change in fair value of those contracts of \$0.1 million is included in accumulated other comprehensive income at March 31, 2014. These contracts mature through September 30, 2014.

Foreign exchange forward contracts in effect as of December 31, 2013 were for the conversion of \$54.0 million into €40.3 million and \$18.3 million into NIS 65.0 million.

The earn-out obligations are described in note 2 and are classified within level 3 because fair value is measured based on the probability-weighted present value of the consideration expected to be transferred. A decrease in the earn-out obligations fair value of \$7.5 million and an increase of \$0.8 million were recorded in the three months ended March 31, 2014 and in the twelve months ended December 31, 2013 respectively.

Long term investment consists of an investment in debt securities classified as available-for-sale and are recorded at fair value. The fair value is based on the sale of similar securities in the market, as well as last sales of these securities in the market (Level 2 inputs). The debt securities were sold during the three months ended March 31, 2014.

Other financial instruments consist mainly of cash and cash equivalents, short-term bank deposits, current and non-current receivables,

accounts payable and accruals. The fair value of these financial instruments approximates their carrying values.

STRATASYS LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 8. Stock-Based Compensation Plan

Stock-based compensation expense for stock options and restricted stock units (“RSUs”) was allocated as follows (in thousands):

| | Three Months Ended | |
|---|---------------------------|-----------------|
| | March 31, | |
| | 2014 | 2013 |
| Cost of sales | \$ 912 | \$ 634 |
| Research and development, net | 938 | 900 |
| Selling, general and administrative | 4,886 | 3,956 |
| Total stock-based compensation expenses | <u>\$ 6,736</u> | <u>\$ 5,490</u> |

A summary of stock option activity for the three months ended March 31, 2014 is as follows:

| | Number of Options | Weighted Average |
|---|--------------------------|-------------------------|
| | Outstanding | Exercise Price |
| Shares under option at January 1, 2014 | 2,007,433 | \$ 29.66 |
| Granted | 4,633 | 115.12 |
| Exercised | (116,609) | 8.61 |
| Forfeited | (11,690) | 42.17 |
| Shares under option at March 31, 2014 | <u>1,883,767</u> | <u>\$ 31.10</u> |
| Shares exercisable under option at March 31, 2014 | <u>959,555</u> | <u>\$ 11.83</u> |

The outstanding options generally have a term of ten years from the grant date. Options granted become exercisable over the vesting period, which is normally a four-year period beginning on the grant date, subject to the employee’s continuing service to the Company.

The fair value of stock options is determined using the Black-Scholes model. The weighted-average grant date fair value of options that were granted during the three months ended March 31, 2014 was \$42.85.

During the three months ended March 31, 2014 and 2013, the Company issued 116,609 and 292,808 shares, respectively, upon the exercise of stock options. This resulted in an increase in equity of \$1 million and \$3.6 million for the three months ended March 31, 2014 and 2013, respectively.

As of March 31, 2014, the unrecognized compensation cost related to all unvested stock options of \$37.1 million is expected to be recognized as expense over a weighted-average period of 1.8 years.

During the three months ended March 31, 2014, the Company granted 6,247 RSUs. The fair value of RSUs is determined based on the quoted price of the Company’s common stock on the date of the grant.

As of March 31, 2014, the unrecognized compensation cost related to all unvested RSUs of \$18.2 million is expected to be recognized as expense on a straight-line basis over a weighted-average period of 3.4 years.

STRATASYS LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 9. Contingencies

Claims and Proceedings

In December 2008, an employee, whose employment with the Company was subsequently terminated, filed a claim against the Company demanding that, based on an alleged undertaking the Company had made, the Company issue to him an option that would allow him to maintain an equity interest of 1.45% in the Company, as well as reimburse salary reductions he had suffered in an aggregate sum of NIS 552,000 (\$159,000). In July 2009, the Company filed its statement of defense, rejecting the claims raised by the former employee. Together with the former employee, the Company initiated mediation of the dispute, but did not reach a settlement. The former employee later amended his initial pleading to seek an additional NIS 441,000 (\$127,000) on account of alleged wrongful termination by the Company. The claim was dismissed in November 2013 by the Israeli labor court, also awarding the Company legal expenses of NIS 55,000. The plaintiff has appealed the decisions and the appeal is currently ongoing at the national Israeli labor court.

On March 4, 2013, four current or former minority shareholders (two of whom were former directors) of the Company filed two lawsuits against the Company in an Israeli district court. The lawsuits demand that the Company amend its capitalization table such that certain share issuances prior to the Stratasys-Objet merger to certain of Objet's shareholders named as defendants would be cancelled, with a consequent issuance of additional shares to the plaintiffs to account for the subsequent dilution to which they have been subject. The lawsuits also name as defendants Elchanan Jaglom, Chairman of the Executive Committee of the Company's board of directors, David Reis, Chief Executive Officer, various shareholders of the Company who were also shareholders of Objet, and, in one of the lawsuits, Ilan Levin, a director. The lawsuits allege in particular that a series of investments in Objet during 2002 and - 2007 was effected at a price per share that was below fair market value, thereby illegally diluting those shareholders that did not participate in the investments. The plaintiffs also allege that a portion of the amount invested in those transactions was actually invested by an investor who was already a shareholder of Objet and allegedly acting in concert with Mr. Jaglom, and that the interest of these two shareholders in these transactions was not properly disclosed to the minority shareholders at the time. The lawsuits furthermore claim that the Company effectively engaged in backdating the issuance of certain shares, in that shares that Objet reported as having been issued in 2006 and 2007 were actually issued at a subsequent date—as late as 2009. The Company filed its statements of defense in May 2013 denying the plaintiffs' claims. Also, the Company filed motion to dismiss the claims on grounds of statute of limitations, laches and lack of cause. On April 1, 2014, the court held a hearing on the motion and a decision will be issued after the parties will submit summation briefs. The Company also filed an appeal to make the plaintiffs pay full court fees, which was held on May 8, 2014.

The Company believes that these claims are all entirely baseless and that the transactions in question were conducted in accordance with applicable law. Management does not believe that these lawsuits will have a material adverse effect on the Company's operations or financial condition, and the Company intends to vigorously defend these lawsuits.

The Company is a party to various other legal proceedings, the outcome of which, in the opinion of management, will not have a material adverse effect on the financial position, results of operations or cash flows of the Company.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and the related notes included as Exhibit 99.1 to the Report of Foreign Private Issuer on Form 6-K to which this Operating and Financial Review and Prospects is attached, or the Form 6-K. The discussion below contains forward-looking statements (within the meaning of the United States federal securities laws) that are based upon our current expectations and are subject to uncertainty and changes in circumstances. Actual results may differ materially from these expectations due to inaccurate assumptions and known or unknown risks and uncertainties, including those identified in “Forward-looking Statements and Factors that May Affect Future Results of Operations”, below, as well “Risk Factors” in Item 3.D of our Annual Report on Form 20-F for the year ended December 31, 2013.

Overview of Business and Trend Information

We are a leading global provider of additive manufacturing, or AM, solutions for the creation of parts used in the processes of designing and manufacturing products and for the direct manufacture of end parts. Our solutions are sold under eight brands, with products ranging from entry-level desktop 3D printers to systems for rapid prototyping, or RP, and large production systems for direct digital manufacturing, or DDM, and related service offerings. We also develop, manufacture and sell materials for use with our systems. We believe that the range of more than 130 3D printing consumable materials that we offer is the widest in the industry. Our service offerings include professional services as well as paid parts. We conduct our business globally, and our main operational facilities are located in the United States, Israel, Germany, Hong Kong, Japan and Brazil. We have more than 1,900 employees and hold more than 550 granted or pending additive manufacturing patents globally.

We are the result of a 2012 merger of two leading additive manufacturing companies, Stratasys, Inc. and Objet Ltd., which we refer to as the Stratasys-Objet merger. Pursuant to the Stratasys-Objet merger, which closed on December 1, 2012, Stratasys, Inc. became an indirect, wholly-owned subsidiary of Objet Ltd., and Objet Ltd. changed its name to Stratasys Ltd.

On August 15, 2013, we completed the acquisition of privately-held Cooperation Technology Corporation, which was the direct parent company of MakerBot Industries, LLC, or MakerBot, a leader in desktop 3D printing, and which owned and operated Thingiverse.com, a website dedicated to the sharing of user-created digital files. The aggregate purchase price was \$493.7 million and the consideration that we paid consisted primarily of ordinary shares that we issued. For additional details regarding the financial terms of this transaction, see Item 18 of our Annual Report on Form 20-F for the year ended December 31, 2013.

We believe that desktop 3D printers are becoming a mainstream tool across many market segments. Desktop 3D printer usage has shown rapid growth, with the introduction and adoption of affordable entry-level 3D printers and increased availability of content. These entry-level desktop printers are driving substantially increased market adoption. We expect that the adoption of 3D printing will continue to increase over the next several years, both in terms of RP applications, on the one hand, and DDM applications, on the other hand. We believe that the expansion of the market will be spurred by increased proliferation of 3D content and 3D authoring tools (3D CAD and other simplified 3D authoring tools). We also believe that increased market adoption of 3D printing will be facilitated by continued improvements in 3D printing technology and greater affordability of entry-level systems.

We believe that the proliferation of 3D content, advancements in additive manufacturing technology platforms and the introduction of improved materials will continue to drive market growth. Accordingly, we will continue to invest in our R&D efforts, which focus on enhancing our 3D printing technologies and developing consumables that offer an even broader array of physical, mechanical and aesthetic properties, thereby broadening user applications. We also intend to invest in the identification of new DDM applications for which our proprietary printing technologies and materials are appropriate and to encourage existing and potential customers to identify new applications in part by increasing awareness of the features of our technology and product offerings.

With the introduction of entry-level systems, we have seen unit volume increase faster than revenues growth, and we expect that trend to continue in the near future. As we have developed appropriate sales channels, unit sales of our more affordable systems have accelerated, resulting in lower overall margins on the sale of our systems. We will also address the continuing increased demand in the market for higher-end systems, through which we believe we will increase our installed base and sales of related consumables, and consequently our overall revenues and profits. However, there can be no assurance that we will be able to increase our revenues sufficiently to maintain or increase our current profitability.

In April 2014, we announced the signing of a definitive agreement to acquire Solid Concepts Inc. (“Solid Concepts”), an independent additive manufacturing service bureau. Under the terms of the definitive agreement with Solid Concepts, we will acquire 100% of Solid Concepts’ outstanding shares for total consideration of up to \$217 million, including a payment on closing of \$157 million (or, if settled in cash, part on closing and part six months after closing) and deferred payments of \$60 million. Solid Concepts’ employees will also qualify for retention-related and other payments of up to \$78 million. Subject to certain requirements for cash payments we retain discretion to settle any of the amounts payable under the definitive agreement and the retention plan in our shares, cash or any combination of the two.

In April 2014, we also announced the signing of a definitive agreement to acquire Harvest Technologies Inc (“Harvest”), a specialty additive manufacturing service bureau. Under the terms of the definitive agreement with Harvest, we will acquire 100% of Harvest’s outstanding shares for cash, our shares or a combination thereof at our discretion. Harvest’s employees will also qualify for certain retention-related payments.

We believe that these two transactions will enable us to expand our existing digital manufacturing service business, create a leading strategic platform to meet a broad range of customers' additive manufacturing needs, provide us opportunities to leverage significant manufacturing services capabilities and create opportunity for cross-selling synergies.

In April, 2014, we entered into a definitive agreement to acquire and completed the acquisition of certain assets of Interfacial Solutions LLC (“Interfacial Solutions”), a privately held provider of thermoplastics research and development and production services. We believe that this transaction will support our objectives of strengthening our materials research and development skills and enables us to become vertically integrated in material development and manufacturing as well as increases materials production space and capacity.

We may make other investments in strategic acquisitions, property and equipment, process improvements, information technology, or IT, and human resource activities that will be required for future growth. Our expense levels are based in part on our expectations of future sales, and we will make adjustments that we consider appropriate. While we have adjusted, and will continue to adjust, our expense levels based on both actual and anticipated sales, fluctuations in sales in a particular period could adversely impact our operating results.

Summary of Financial Results

Our unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United State of America, or GAAP. In the opinion of our management, all adjustments considered necessary for a fair statement of the unaudited interim consolidated financial statements have been included herein and are of a normal recurring nature. The following discussion compares the actual results (on a GAAP basis) for the three months ended March 31, 2014 with the corresponding period in 2013.

Our net sales in the three months ended March 31, 2014 were \$150.9 million as compared to net sales of \$97.2 million in the three months ended March 31, 2013, representing an increase of 55.3%. The increase was mainly a result of strong business performance in our growing market and the inclusion of MakerBot net sales.

For the three months ended March 31, 2014, we recorded net income attributable to Stratasys Ltd. of \$4.1 million, or \$0.08 per diluted share, as compared to net loss of \$15.5 million or \$0.40 per diluted share, for the three months ended March 31, 2013. Net income during the three months ended March 31, 2014 was mainly a result of higher revenues, higher gross margin, lower amortization and other purchase accounting related expenses and a gain due to revaluation of earn out obligations in connection with the MakerBot transaction .

As of March 31, 2014, our cash, cash equivalents and short-term bank deposits were approximately \$607.5 million, down from \$614.5 million at December 31, 2013. We generated cash from operations of approximately \$4.9 million during the three months ended March 31, 2014 and we used cash of \$10.9 million for the acquisition of property and equipment. In addition, we paid \$2.2 million in connection with acquisition of non-controlling interest.

Results of Operations

The following table sets forth certain statement of operations data for the periods indicated:

| | Three Months Ended March 31, | | | |
|--|------------------------------|-------------------|------------------------|-------------------|
| | 2014 | | 2013 | |
| | U.S.\$ in thousands | % of Net sales | U.S.\$ in thousands | % of Net sales |
| Net sales | \$ 150,941 | 100.0% | \$ 97,207 | 100.0% |
| Cost of sales | 73,213 | 48.5% | 59,833 | 61.6% |
| Gross profit | 77,728 | 51.5% | 37,374 | 38.4% |
| Research and development | 16,771 | 11.1% | 10,789 | 11.1% |
| Selling, general and administrative | 67,617 | 44.8% | 43,325 | 44.6% |
| Change in fair value of earn-out obligations | (7,495) | -5.0% | - | 0.0% |
| Operating income (loss) | 835 | 0.6% | (16,740) | -17.2% |
| Other income (expense) | (1,336) | -0.9% | 514 | 0.5% |
| Loss before income taxes | (501) | -0.3% | (16,226) | -16.7% |
| Income taxes | (4,588) | -3.0% | (743) | -0.8% |
| Net income (loss) attributable to Stratasys Ltd. | 4,087 | 2.7% | (15,536) | -16.0% |

Discussion of Results of Operations

Net Sales

Net sales of our products and services, as well as the percentage change, were as follows:

| | Three Months Ended March 31, | | |
|----------|------------------------------|------------------|----------|
| | 2014 | 2013 | % Change |
| | U.S.\$ in thousands | | |
| Products | \$ 129,252 | \$ 81,810 | 58.0% |
| Services | 21,689 | 15,397 | 40.9% |
| | <u>\$ 150,941</u> | <u>\$ 97,207</u> | 55.3% |

Product Revenues

Revenues derived from products (including AM systems, consumable materials and other products) increased by \$47.4 million for the three months ended March 31, 2014, or 58.0%, as compared to the three months ended March 31, 2013.

The number of systems shipped increased to 8,802 units as compared to 1,168 units shipped in the three months ended March 31, 2013. The increase in both revenues and number of units shipped primarily reflects sales growth across all product lines as well as the inclusion of MakerBot revenues and unit sales which were not reflected in the three months ended March 31, 2013. This growth has been driven in part by the continued adoption of our Connex systems for complex prototyping using a wide range of materials with diverse mechanical and physical properties.



Consumables revenues for the three months ended March 31, 2014 increased by 36.0% as compared to consumables revenues for the three months ended March 31, 2013. The increase was driven by acceleration in customer usage and our growing installed base of systems. The strong Production series and high-end Design series system sales in prior periods contributed to strong consumables sales growth given their relatively higher consumable utilization rates. We believe that our growing installed base, and in particular the Production series and high-end Design series systems installed base, are positive indicators of consumables revenues growth in future periods.

Service Revenues

Service revenues (including RedEye paid parts, maintenance and other services) increased by \$6.3 million for the three months ended March 31, 2014, or 40.9%, as compared to the three months ended March 31, 2013. The increase in services revenues was attributable to increased revenues from maintenance contracts and service parts, reflecting our growing base of installed systems.

Revenues by Region

Net sales and the percentage of net sales by region, as well as the percentage change, were as follows:

| | Three Months Ended March 31, | | | | |
|---------------|-------------------------------------|-----------------------|----------------------------|-----------------------|-----------------|
| | 2014 | | 2013 | | % Change |
| | U.S.\$ in thousands | % of Net sales | U.S.\$ in thousands | % of Net sales | |
| North America | 74,663 | 49.5% | \$ 48,850 | 50.3% | 52.8% |
| EMEA | 41,215 | 27.3% | 27,373 | 28.2% | 50.6% |
| Asia Pacific | 33,420 | 22.1% | 19,719 | 20.3% | 69.5% |
| Other | 1,643 | 1.1% | 1,265 | 1.2% | 29.9% |
| | <u>\$ 150,941</u> | <u>100.0%</u> | <u>\$ 97,207</u> | <u>100.0%</u> | <u>55.3%</u> |

Revenues in all regions increased for the three months ended March 31, 2014 as compared to the three months ended March 31, 2013, due to strong demand to our products, as well as the inclusion of MakerBot revenues. MakerBot revenues were generated primarily in North America.

Gross Profit

Gross profit for our products and services, as well as the percentage change, were as follows:

| | Three Months Ended March 31, | | |
|--------------------------------------|-------------------------------------|------------------|-----------------|
| | 2014 | 2013 | % Change |
| Gross profit attributable to: | U.S.\$ in thousands | | |
| Products | \$ 68,230 | \$ 32,767 | 108.2% |
| Services | 9,498 | 4,607 | 106.2% |
| | <u>\$ 77,728</u> | <u>\$ 37,374</u> | <u>108.0%</u> |

Gross profit as a percentage of net sales for our products and services, as well as the percentage change, were as follows:

| Gross profit as a percentage of revenues from: | Three Months Ended March 31, | | |
|---|-------------------------------------|-------------|-----------------|
| | 2014 | 2013 | % Change |
| Products | 52.8% | 40.1% | 31.8% |
| Services | 43.8% | 29.9% | 46.4% |
| Total gross profit | 51.5% | 38.4% | 33.9% |

Gross profit attributable to products sales increased by \$35.5 million, or 108.2%, to \$68.2 million for the three months ended March 31, 2014 as compared to \$32.8 million for the three months ended March 31, 2013. Gross profit from services increased by \$4.9 million, or 106.2%, to \$9.5 million for the three months ended March 31, 2014 as compared with \$4.6 million for the three months ended March 31, 2013.

The increase is mostly a result of an increase in revenues across all product lines, the inclusion of MakerBot results for the three months ended March 31, 2014, and lower amortization and other expenses related to the Stratasys-Objet merger and the MakerBot transaction in a total amount of \$13.2 million for the three months ended March 31, 2014 compared to \$18.9 million for the three months ended March 31, 2013.

Gross profit as a percentage of revenue increased to 51.5% for the three months ended March 31, 2014 compared to 38.4% in three months ended March 31, 2013, mainly due to the product mix sales that favored our higher-margin Production series and high-end Design series systems and strong growth in our high-margin consumables sales, as well as the lower amortization and other merger related expenses.

Operating Expenses

The amount of each type of operating expense, as well as the percentage change and total operating expenses as a percentage of our total net sales, were as follows:

| | Three Months Ended March 31, | | |
|--|-------------------------------------|-------------|-----------------|
| | 2014 | 2013 | % Change |
| | U.S.\$ in thousands | | |
| Research and development, net | \$ 16,771 | \$ 10,789 | 55.4% |
| Selling, general & administrative | 67,617 | 43,325 | 56.1% |
| Change in fair value of earn-out obligations | (7,495) | - | N/A |
| | \$ 76,893 | \$ 54,114 | 42.1% |
| Percentage of net sales | 50.9% | 55.7% | |

Research and development expenses, net for the three months ended March 31, 2014 increased as compared to the three months ended March 31, 2013. The increase was primarily due to the inclusion of MakerBot and an increase in headcount to support new initiatives. The headcount increase reflects our intention to continue to invest in research and development efforts, focusing on enhancing our AM technologies and developing consumables that offer an even broader array of physical, mechanical and aesthetic properties, aimed at broadening user applications.

Research and development expense, net for three months ended March 31, 2014 as a percentage of sales was 11.1%, similar to the three months ended March 31, 2013.

Selling, general and administrative expenses for the three months ended March 31, 2014 amounted to \$67.6 million, compared to \$43.3 million for the three months ended March 31, 2013.

The increase primarily reflects the inclusion of MakerBot's selling, general and administrative expenses as well as changes in few of our products distribution strategy involving independent sales agents, which resulted in increased sales commissions, expenses for strategic and marketing initiatives and an increase in the Company's headcount to support our growth. In addition, we recorded an expense of \$1.8 million for the MakerBot performance bonus plan under selling, general and administrative expenses. Selling, general and administrative expenses for the three months ended March 31, 2014 as percentage of net sales was approximately 45%, similar to the three months ended March 31, 2013.

During the three months ended March 31, 2014 we recorded a gain of \$7.5 million due to the revaluation of earn out obligations in connection with the MakerBot transaction.

Operating Income (Loss)

Operating income (loss) and operating income (loss) as a percentage of our total net sales, as well as the percentage change in operating income (loss), were as follows:

| | Three Months Ended March 31, | | |
|-------------------------|-------------------------------------|-------------|-----------------|
| | 2014 | 2013 | % Change |
| | U.S.\$ in thousands | | |
| Operating income (loss) | \$ 835 | \$ (16,740) | n/a |
| Percentage of net sales | 0.6% | -17.2% | |

Operating income for the three months ended March 31, 2014 amounted to \$0.8 million compared to an operating loss of \$16.7 million for the three months ended March 31, 2013. The increase in operating income was primarily due to higher net sales and gross profit (due to factors that were previously discussed), lower amortization expense and a gain that was recorded due to revaluation of earn out obligations in connection with the MakerBot transaction. The increase was partially offset by the higher selling, general and administrative and research and development expense, which were mainly driven by the inclusion of MakerBot results.

Income Taxes

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

| | Three Months Ended March 31, | | |
|--|-------------------------------------|-------------|-----------------|
| | 2014 | 2013 | % Change |
| | U.S.\$ in thousands | | |
| Income taxes | \$ (4,588) | \$ (743) | 517.5% |
| As a percent of income (loss) before income taxes | 915.8% | 4.6% | |

Our effective tax rate for the three months ended March 31, 2014 and 2013 was 915.8% and 4.6%, respectively, on the loss before income taxes in those periods. Our effective tax rate has varied significantly since the December 1, 2012 Stratasys-Objet merger due to the lower tax rate in Israel, changes in mix of income (loss) between the U.S. and Israel, and the impact of the tax benefit as a result of the realization of the deferred tax liability associated with the amortization of the intangible assets. The income of \$7.5 million attributable to the change in fair value of our earn-out obligations in the three months ended March 31, 2014 is non-taxable, and therefore had a significant impact on the effective tax rate.

Net Income (Loss) and Net Income (Loss) Per Share Attributable to Stratasys Ltd .

Net income (loss) and net income (loss) as a percentage of our total net sales, as well as the percentage change, were as follows:

| | Three Months Ended March 31, | | |
|--|------------------------------|-------------|----------|
| | 2014 | 2013 | % Change |
| | U.S.\$ in thousands | | |
| Net income (loss) attributable to Stratasys Ltd. | \$ 4,087 | \$ (15,536) | n/a |
| Percentage of net sales | 2.7% | -16% | |

This increase of net income attributable to Stratasys Ltd was due to the factors previously discussed, primarily the increase in operating income in the three months ended March 31, 2014, as compared to an operating loss in the three months ended March 31, 2013.

The weighted average fully diluted share count for the three months ended March 31, 2014 was 51,240 thousands, compared to 38,494 thousand for the three months ended March 31, 2013. The increase is primarily due to the public offering of shares and the issuance of shares in connection with the MakerBot transaction during the third quarter of 2013.

Diluted earnings per share was \$0.08 for the three months ended March 31, 2014, compared to diluted loss per share of \$0.40 for the three months ended March 31, 2013.

Supplemental Operating Results on a Non-GAAP Basis

The following non-GAAP data, which exclude the categories of expenses described below, are non-GAAP financial measures. Our management believes that these non-GAAP financial measures are useful information for investors and shareholders of our company in gauging our results of operations (x) on an ongoing basis after the Stratasys-Objet merger, the MakerBot transaction and other acquisition related expense, and (y) excluding non-cash charges for share-based compensation and amortization of intangible assets, which do not reflect actual cash outlays that impact our liquidity or our financial condition, as assessed by management. These non-GAAP financial measures are presented to permit investors to more fully understand how management assesses our performance. The limitations of using these non-GAAP financial measures as performance measures are that they provide a view of our results of operations without including all events during a period, such as the effects of merger-related, non-cash compensation and other charges, and may not provide a comparable view of our performance to other companies in our industry. The presentation of these non-GAAP measures is not meant to be considered in isolation or as an alternative to any measure of financial performance calculated in accordance with GAAP.

Reconciliation of GAAP to Non-GAAP Results of Operations

| | Three Months Ended March 31, | | | | | |
|---|------------------------------|------------------|-----------|-----------|------------------|-----------|
| | 2014 | Non-GAAP | 2014 | 2013 | Non-GAAP | 2013 |
| | | Adjustments | Non-GAAP | | Adjustments | Non-GAAP |
| | In thousands | | | | | |
| Gross profit (1) | \$ 77,728 | \$ 14,396 | \$ 92,124 | \$ 37,374 | \$ 20,535 | \$ 57,909 |
| Operating income (loss) (1,2) | 835 | 21,919 | 22,754 | (16,740) | 37,042 | 20,302 |
| Net income (loss) attributable to Stratasys Ltd. (1,2,3) | 4,087 | 16,511 | 20,598 | (15,536) | 33,116 | 17,580 |
| (1) Acquired intangible assets amortization expense | | 13,225 | | | 18,762 | |
| Deferred revenue purchase price adjustments | | 235 | | | 1,015 | |
| Non-cash stock-based compensation expense | | 912 | | | 634 | |
| Merger and acquisition related expense | | 24 | | | 124 | |
| | | <u>14,396</u> | | | <u>20,535</u> | |
| (2) Acquired intangible assets amortization expense | | 5,364 | | | 5,461 | |
| Non-cash stock-based compensation expense | | 5,824 | | | 4,857 | |
| Change in earn-out obligation fair value and performance bonus expense | | (5,149) | | | - | |
| Merger and acquisition related expense | | 1,484 | | | 6,189 | |
| | | <u>7,523</u> | | | <u>16,507</u> | |
| | | <u>21,919</u> | | | <u>37,042</u> | |
| (3) Tax expense related to adjustments | | (5,408) | | | (3,886) | |
| Depreciation and amortization expense attributable to non-controlling interest | | - | | | (40) | |
| | | <u>\$ 16,511</u> | | | <u>\$ 33,116</u> | |

Liquidity and Capital Resources

A summary of our statement of cash flows is as follows:

| | Three Months Ended March 31, | |
|---|------------------------------|-------------|
| | 2014 | 2013 |
| | In thousands | |
| Net income (loss) | \$ 4,087 | \$ (15,483) |
| Depreciation and amortization | 23,367 | 29,328 |
| Deferred income taxes | (5,871) | (3,875) |
| Stock-based compensation | 6,736 | 5,490 |
| Excess tax benefit from stock options | (238) | (986) |
| Change in earn-out obligation | (7,495) | - |
| Other non-cash items | 22 | (79) |
| Change in working capital and other | (15,749) | (26,647) |
| Net cash provided by (used in) operating and other activities | 4,860 | (12,252) |
| Net cash from used in investing activities | (10,903) | (60,593) |
| Net cash (used in) provided by financing activities | (893) | 4,593 |
| Effect of exchange rate changes on cash and cash equivalents | 16 | (69) |
| Net change in cash and cash equivalents | (6,920) | (68,321) |
| Cash and cash equivalents, beginning of period | 414,088 | 133,826 |
| Cash and cash equivalents, end of period | \$ 407,168 | \$ 65,505 |

Our cash and cash equivalents balance decreased to \$407.2 million at March 31, 2014 from \$414.1 million at December 31, 2013. The decrease was primarily due to cash used in investing activities in an amount of \$10.9 million, offset by cash provided by operating activity of \$4.9 million.

Cash flows from operating activities

We generated cash from operating activities of \$4.9 million during the three months ended March 31, 2014. The net income of \$4.1 million was favorably adjusted due to non-cash charges in depreciation and amortization and stock-based compensation expense offset by the change in the fair value of earn-out obligations. Non-cash charges that unfavorably affected cash from operating activities were mainly the changes in the deferred income taxes of \$5.9 million and the changes in working capital of \$15.7 million. The increase in the working capital consisted mainly of an increase in inventories of \$13.2 million and accounts receivable of \$10.4 million, offset by an increase in accounts payables and other current liabilities of \$10.1 million. The change in working capital is mainly due to strong order flow and anticipation of strong order flow.

During the three months ended March 31, 2013 we used \$12.3 million of cash in operating activities. The net loss of \$15.5 million was favorably adjusted due to non-cash charges of \$29.3 million in depreciation and amortization and a stock-based compensation expense of \$5.5 million. Non-cash charges that unfavorably affected cash from operating activities were a \$3.9 million deferred tax benefit and a \$1.0 million excess tax benefit from stock option exercises. Changes in working capital using cash from operations included primarily a \$9.7 million increase in accounts receivable due to strong order flow and a decrease in accounts payable and other current liabilities primarily driven by an overall increase in operating expenses and timing of payments for merger-related expenses resulted in cash used in operating activities of \$13.8 million.

Cash flows from investing activities

Our investing activities used cash of \$10.9 million and \$60.6 million in the three months ended March 31, 2014 and 2013, respectively.

Property and equipment acquisitions totaled \$10.9 million and \$5.0 million in the three months ended March 31, 2014 and 2013, respectively. Our principal property and equipment acquisitions were for manufacturing or engineering development equipment, tooling, building and leasehold improvements and the acquisition of computer systems and software applications. The decrease in cash used for investing activities the three months ended March 31, 2014 was mainly due to \$55.3 million that was used in the purchasing of bank deposits during the three months ended March 31, 2013.

Cash flows from financing activities

Net cash used in financing activities in the three months ended March 31, 2014 was \$0.9 million compared to \$4.6 million that was

provided in the three months ended March 31, 2013. The decrease was mainly due to lower proceeds from exercise of stock options and a reduction in realized excess tax benefits from stock issued under employee benefit plans as well as cash payment of \$2.2 million in connection with acquisition of non-controlling interest. Exercises of stock options and the related excess tax benefit provided cash of \$1.3 million in the three months ended March 31, 2014 compared to \$4.6 million in the three months ended March 31, 2013.

Capital resources and capital expenditures

Our total current assets amounted to \$871.5 million at March 31, 2014, most of which consisted of cash and cash equivalents, short-term bank deposits, accounts receivable, and inventories. Total current liabilities amounted to \$158.7 million. Cash and cash equivalents are primarily held in banks in Israel, Switzerland and the U.S., with only minor amounts subject to any restrictions on movement of balances within the Company and our subsidiaries.

Revolving credit facility

Pursuant to a credit agreement, dated November 7, 2013, with Bank of America, N.A., or BofA, as administrative agent and swing line lender, and the other lenders party thereto, our company (via Stratasys International Ltd., our wholly-owned subsidiary, which serves as borrower) has in place a five year revolving credit facility in an aggregate principal amount of up to \$250 million. The revolving credit facility permits swing line loans of up to the lesser of: (1) \$25 million and (2) the aggregate commitments of all of the lenders. All of the obligations under the credit agreement are unconditionally guaranteed by our company and by our (and the borrower's) active U.S. and Israeli subsidiaries (excluding, through the end of 2014, MakerBot and its subsidiaries).

The credit agreement contains customary representations and warranties, and affirmative and negative covenants. The negative covenants include, without limitation, restrictions on indebtedness, liens, investments, and certain dispositions. The negative covenants are each subject to a number of specific exceptions, as well as broader exceptions which are a function of our consolidated financial status. These broader exceptions include, among other things, the ability of our company, the borrower, or any of their subsidiaries to make investments, consummate acquisitions (as such terms are defined in the credit agreement), and incur additional unsecured indebtedness in the form of convertible unsecured bonds or similar convertible securities, as long as certain conditions are met. We believe that we were in compliance with the affirmative covenants under the credit agreement as of March 31, 2014.

As of March 31, 2014, we had not drawn upon the revolving credit facility.

For a more complete description of the credit facility, please see "Item 5. Operating and Financial Review and Prospects—B. Liquidity and Capital Resources—Revolving Credit Facility" in our Annual Report on Form 20-F for the year ended December 31, 2013.

We believe that we will have adequate cash and cash generated from operating activities to fund our ongoing operations for the next 12 months. We may make investments in fixed assets, process improvements, information technology, or IT, and human resource development activities that will be required for future growth.

The initial MakerBot merger consideration was in the form of issuance of our ordinary shares. MakerBot shareholders could also qualify for two earn-out payments, the first for the six month period ended December 31, 2013, which amounted to \$10.8 million and which was paid in cash during April 2014, and a second earn-out period for which MakerBot shareholders could qualify for up to 0.8 million shares depending on the level of achievement of financial metrics for the year ended December 31, 2014. The value of any shares earned will be equal to the price of Stratasys ordinary shares on the date the amount of shares is determined. For example, had the maximum of 0.8 million shares been earned for the second earn-out period and based on the Company share price, the value would have been \$85.3 million in aggregate. The earn-out payments would be made in issuance of our shares or in cash, or a combination thereof, at our discretion. Certain MakerBot employees participate in a performance bonus plan in connection with the MakerBot transaction. Participating employees are entitled, contingent on certain continuing employment conditions, to bonus payments that in the aggregate will equal dollar-for-dollar, the actual amounts determined in the earn-out calculation. The \$10.8 million bonus earned for the first earn-out period and any bonus earned in the second earn-out period will be paid upon vesting, with the issuance of our shares or in cash, or a combination thereof, at our discretion.

As discussed in note 2 to the condensed consolidated financial statements, we signed a definitive agreement to acquire Solid Concepts in April 2014. Under the terms of the definitive agreement, we can pay the purchase price in cash, by the issuance of our shares or a combination of the two at our discretion. We believe that our existing cash reserves and our revolving credit facility will be adequate to permit us to make the cash payments if we choose to pay the purchase price in cash. As part of our business strategy, we plan to consider and, as appropriate, make acquisitions of other businesses, products, product rights or technologies. Our cash reserves, revolving credit facility and other liquid assets may be inadequate to consummate such acquisitions and it may be necessary for us to issue shares or raise substantial additional funds in the future to complete future transactions. In addition, as a result of our acquisition efforts, we are likely to experience significant charges to earnings and significant cash outflows for mergers and related expenses (whether or not our efforts are successful) that may include transaction costs, closure costs or costs of restructuring activities.

Critical Accounting Policies

We have prepared our consolidated 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. Actual results may differ from those estimates. To facilitate the understanding of our business activities, certain accounting policies that are important to the presentation of our financial condition and results of operations and that require management's subjective judgments are described in our Annual Report on Form 20-F for the year ended December 31, 2013. We base our judgments on our experience and various assumptions that we believe to be reasonable under the circumstances.

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

Certain information included in or incorporated by reference into the Form 6-K may be deemed to be "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are those that predict or describe future events or trends and that do not relate solely to historical matters. You can generally identify forward-looking statements as statements containing the words "may," "will," "could," "should," "expect," "anticipate," "intend," "estimate," "believe," "project," "plan," "assume" or other similar expressions, or negatives of those expressions, although not all forward-looking statements contain these identifying words.

These forward-looking statements may include, but are not limited to, statements regarding our future strategy, future operations, projected financial position, proposed products, estimated future revenues, projected costs, future prospects, the future of our industry and results that might be obtained by pursuing management's current plans and objectives.

You should not place undue reliance on our forward-looking statements because the matters they describe are subject to certain risks, uncertainties and assumptions that are difficult to predict. Our forward-looking statements are based on the information currently available to us and speak only as of the date of this Form 6-K. Over time, our actual results, performance or achievements may differ from those expressed or implied by our forward-looking statements, and such difference might be significant and materially adverse to our shareholders. We undertake no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

Important factors that could cause actual results, developments and business decisions to differ materially from those anticipated in these forward-looking statements include, among other things:

- our ability to continue efficiently and successfully integrate the operations of Stratasys, Inc. and Objet Ltd. after their merger as well as Makerbot, Solid Concepts and Harvest Technologies after their acquisition and to success fully establish and execute effective post-acquisition integration plans;
- the overall global economic environment;
- the impact of competition and new technologies;
- general market, political and economic conditions in the countries in which we operate;
- projected capital expenditures and liquidity;

- changes in our strategy;
- government regulations and approvals;
- changes in customers' budgeting priorities;
- litigation and regulatory proceedings; and
- those factors referred to in Item 3.D "Key Information - Risk Factors", Item 4 "Information on the Company", and Item 5 "Operating and Financial Review and Prospects" in our Annual Report on Form 20-F for the year ended December 31, 2013, as well as in that annual report generally.

Readers are urged to carefully review and consider the various disclosures made throughout the Form 6-K of which this Operating and Financial Review is a part, our Annual Report on Form 20-F for the year ended December 31, 2013, and in our other reports filed with or furnished to the SEC, which are designed to advise interested parties of the risks and factors that may affect our business, financial condition, results of operations and prospects.

QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT RISK

Reference is made to "Quantitative and Qualitative Disclosures About Market Risk" (Item 11) in our Annual Report on Form 20-F for the year ended December 31, 2013.

LEGAL PROCEEDINGS

We are subject to various litigation and other legal proceedings. For a discussion of certain of these matters that we deem to be material to the Company, see Note 9-"Contingencies" in the notes to our unaudited consolidated financial statements attached as Exhibit 99.1 to the in this Report on Form 6-K.