STRATASYS INC
Form 10-K/A
March 25, 2005

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K/A
(Amendment No. 1)

x Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2004 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	36-3658792
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

14950 Martin Drive, Eden Prairie, Minnesota 55344
(Address of Principal Executive Offices)

(952) 937-3000
(Registrant's Telephone Number, Including Area Code)

Securities Registered Under Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common stock, $.01 par value	The Pacific Exchange Inc.

Securities Registered Under Section 12(g) of the Act: None

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act 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 past 90 days. Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

Indicate by check mark whether the registrant is an accelerated filer (as defined in rule 12b-2 of the Act). Yes x No ¨

The aggregate market value of the Registrant's Common Stock held by non-affiliates of the Registrant as of June 30, 2004, the last business day of the Registrant's most recently completed second quarter, was approximately $235,989,838.00. On such date, the closing price of the Registrant's Common Stock, as quoted on the Nasdaq National Market was $28.60.

The Registrant had 10,465,490 shares of common stock outstanding as of March 4, 2005.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Definitive Proxy Statement to be filed with the Securities and Exchange Commission with respect to the Registrant's Annual Meeting of Stockholders scheduled to be held on May 5, 2005, are incorporated by reference into Part II, Item 5 and Part III of this Annual Report.

EXPANATORY NOTE

We are filing this Amendment No. 1 on Form 10-K/A ("Form 10-K/A") to our Annual Report on Form 10-K for the fiscal year ended December 31, 2004 (the "Original Filing"), which was filed with the Securities and Exchange Commission on March 16, 2005. The purposes of the Amendment are:

- to revise Item 9A of Part II of the Original Filing to make reference to the report of Rothstein, Kass & Company, P.C. ("Rothstein Kass"), our independent registered public accounting firm, with respect to our internal controls over financial reporting;

- to include management's report on internal control over financial reporting;

- to include the revised report of Rothstein Kass relating to the audit of our financial statements, which includes a reference to their audit of the effectiveness of our internal control over financial reporting;

- to include the attestation report on management's assessment of the effectiveness of our internal control over financial reporting issued by Rothstein Kass; and

- as a result of the revisions above, to amend and restate the Consent of Rothstein Kass to the incorporation by reference to their reports into certain of our registration statements.

As a result of these amendments, the certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"), filed as an exhibit to the Original Filing, have been revised. These certifications, in addition to the certifications pursuant to Section 906 of Sarbanes-Oxley, have been re-executed and re-filed as of the date of this Form 10-K/A.

Except for the amendments described above, this Form 10-K/A does not modify or update any other disclosures in, or exhibits to, the Original Filing. For the convenience of the reader, this Form 10-K/A also includes the remainder of the Original Filing in its entirety.

PART I

Item 1. Business.

General Development of Business

We develop, manufacture, and sell a family of rapid prototyping ("RP") devices, which includes a line of three dimensional ("3D") printing devices, all of which create physical models from computerized designs. We were incorporated in Delaware in 1989 and our executive offices are located in Eden Prairie, Minnesota. Our RP systems are based on our core patented fused deposition modeling ("FDM") technology or on our patented Genisys technology, which we purchased from IBM in 1994. We sold our first product, the 3D Modeler, commercially in April 1992 and introduced our second product, the Benchtop, in June 1993. Other recent significant developments in our business are set forth below:

- In February 2002, we introduced Dimension®. Dimension offers ABS modeling capabilities on a desktop 3D printer platform. We believe that Dimension, when introduced at $29,900, was the lowest priced system in the RP and 3D printing markets.

- In March 2002, we introduced Prodigy Plus. This system incorporates our WaterWorks soluble support system on the Prodigy platform, and is further enhanced by the addition of our InSight software. Commercial shipments commenced in May 2002.

- In July 2003 we introduced FDM Vantage. Vantage utilizes proven FDM technology to build prototypes in either polycarbonate ("PC") or ABS, an engineering thermo plastic material named for its three initial monomers - acrylonitrile, butadiene and styrene. It is an extension of the FDM Titan design platform.

- In September 2003 we entered into an agreement with Objet Geometries Ltd. to exclusively distribute their Eden333 RP system in North America, including Mexico and Canada. The Eden333 uses inkjet technology to jet ultra-fine layers of UV-cured resin to build RP models.

- In December 2003 we announced significant throughput enhancements for Titan, offering users a 50% improvement in build speed over the previous generation of Titan.

- In February 2004 we introduced Dimension SST and renamed our original Dimension system Dimension BST. Dimension SST incorporates all the functionality of Dimension with an enhanced soluble support removal system. This system gives users greater convenience in the design process while allowing for the creation of models and prototypes that involve more complex design geometries. Dimension SST's list price was $34,900 when introduced, and was reduced to $29,900 in March 2005. Concurrently with this introduction, we reduced the price of Dimension to $24,900.

- In March 2004 we introduced Triplets, which offers three variations of our FDM Vantage RP system. Prices range from $99,000 for the base model Vantage to $195,000 for the fully equipped Vantage SE. The models are differentiated by the speed at which they build prototypes, by the size of the build envelope, by additional canister bays, which allow for longer build cycles, and by price. We commenced shipment of Triplets in the second quarter of 2004.

- In February 2005 we announced that we will distribute another Objet System in North America, Eden260. It also incorporates inkjet technology, but is smaller and priced lower than Eden333.

Description of Business

We are a leader in the office prototyping market, since our high performance RP devices and 3D printers can be used in office environments without expensive facility modification. We develop, manufacture, market, and service a family of 3D printers and other RP systems that enable engineers and designers to create physical models, tooling and prototypes out of plastic and other materials directly from a computer-aided design ("CAD") workstation. In many industries, the models and prototypes required in product development are produced laboriously by hand-sculpting or machining, a traditional process that can take days or weeks. Our computerized modeling systems use our proprietary technology to make models and prototypes directly from a designer's three-dimensional CAD in a matter of hours.

We believe that the high performance RP and 3D printing systems using our FDM technology are the only RP systems commercially available that can produce prototypes and models from plastic without relying on lasers. This affords our products a number of significant advantages over other commercially available three-dimensional rapid prototyping technologies, which rely primarily on lasers to create models. Such benefits include:

- the ability to use the device in an office environment due to the absence of hazardous emissions
- little or no post-processing
- ease of use
- the need for relatively little set up of the system for a particular project
- the availability of a variety of modeling materials
- modeling in production-grade plastics for functional testing
- no need for costly replacement lasers and laser parts

Our systems can also run virtually unattended, producing models while designers perform other tasks.

The process involved in the development of a three-dimensional model using our FDM systems begins with the creation of a 3D geometric model on a CAD workstation. The model is then imported into our proprietary software program, which mathematically slices the CAD model into horizontal layers that are downloaded into the system. A spool of thin thermoplastic modeling material feeds into a moving FDM extruding head, which heats the material to a semi-liquid state. This semi-liquid material is extruded and deposited, one ultra-thin layer at a time, on a base (the "X-Y Stage") in a thermally-controlled modeling chamber. As the material is directed into place by the computer-controlled head, layer upon layer, the material solidifies, creating a precise and strong laminated model.

We also believe that Eden333 and Eden260 (the "Eden systems") provide us with an additional RP technology that complements our core FDM technology. The Eden systems offer faster prototype build times, with superior surface finish and resolution. Like the FDM technology, Eden systems:

- can be used in the office environment
- create models with a one-step process
- are easy to use
- have a low acquisition price

Applications For Rapid Prototyping and 3D Printing

Both high-end RP systems and 3D printers allow for the physical modeling of a design using a special class of machine technology. These systems take data created from CAD data, CT and MRI scan data or 3D digitized data to quickly produce models, using an additive approach. Traditionally, RP and 3D printing have been used by organizations to accelerate product development. Many companies use RP and 3D printing models to test form, fit and function to help improve the time to market.

Frequently, users report rapid pay-back times by using RP and 3D printing, as they accelerate their product development cycle and reduce post-design flaws through more extensive design verification and testing.

RP also represents opportunities for rapid manufacturing ("RM"). RM involves the use of prototypes fabricated directly from the RP system that are subsequently incorporated into the user's end product or process. RM 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 appropriate due to small volumes. Our FDM Titan, Vantage, and Maxum products are well suited for these types of applications.

An emerging market segment for RP systems is Rapid Tooling ("RT"). Although not clearly defined today, RT is driven by RP systems and allows for the production of molds and fixtures directly from CAD data or indirectly by producing custom mold inserts.

During the past three years, the largest growth segment of the RP market has been 3D printing products. 3D printers are low-cost RP systems (typically under $40,000) that reside in the design/engineering office environment, allowing product development organizations quick access to a modeling system. Based upon data and estimates furnished in the 2004 Wohlers Report, through 2003 we shipped approximately 27% of all RP systems since the industry's inception in 1987, an improvement over the 24% realized through 2002.

We have shipped over 4,000 systems since our inception. A wide variety of design and manufacturing organizations use our systems. Current markets include:

- Aerospace
- Automotive
- Consumer Products
- Business Machines
- Educational Institutions
- Electronics
- Medical Systems
- Medical Analysis
- Mold Making
- Tooling

Additional future applications include:

- Architectural design
- Rapid manufacturing of custom parts
- Free-form graphic design
- Secondary tooling and mold-making

Among potential medical applications, rapid prototyping is being used to produce accurate models of internal organs, bones or skulls for pre-operative evaluations or modeling of prostheses. In such uses, our RP systems serve as a peripheral device for CT and MRI devices.

Products

Modeling Equipment

We have been developing and improving our line of RP products since our inception in 1989. Since our first commercial product was introduced in 1992, we have enhanced and expanded our product line. We have improved both the speed and accuracy of our FDM systems, expanded their build envelopes, introduced a number of new modeling materials and developed and introduced a low-cost 3D printer. We have also enhanced and upgraded the software that our systems use to read CAD files and build the prototypes.

Each of our products is based upon our patented FDM process or technology acquired from IBM and is sold as an integrated system. The system consists of an RP machine, the software to convert the CAD designs into a machine compatible format, and modeling materials. Each of our products is compatible with an office environment and does not require an operator to be present while it is running.

Our family of high performance RP and 3D printing systems affords a customer's product development team, including engineers, designers and managers, the ability to create prototypes through all stages of the development cycle. Our products meet the needs of a very demanding and diverse industrial base by offering a wide range of capability and price from which to choose. The domestic list prices of our systems range from $24,900 for Dimension BST to $250,000 for our high performance FDM Maxum. We also offer special pricing for trade-in systems and upgrades.

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Dimension BST is a 3D printer that allows a user to create parts in ABS plastic. ABS offers the part strength required for true form, fit and function testing. Dimension BST operates in the office, offering speed, ease of use and networking capabilities at a competitive price. Dimension features our Catalyst® software, which offers a single push-button operation by automating all of the required build procedures. We introduced Dimension BST in February 2002, although commercial shipments to selected resellers commenced in December 2001. We believe that Dimension BST, at a list price of $24,900, is among the lowest-priced systems in the 3D printing market. Dimension SST is our newest 3D printing system, which offers users the benefits of our WaterWorks soluble support system on the Dimension platform. Introduced in February 2004, it is priced at $29,900.

The Prodigy Plus is our lowest price FDM System that incorporates our WaterWorks soluble support system and InSight Software. The patented WaterWorks process allows for the easy removal of supports from a completed prototype model by simple immersion into a water-based solution. The support material is dissolved, resulting in a cleaned prototype that eliminates most post-processing requirements. Prodigy Plus is further enhanced by the addition of our InSight software. InSight offers the customer a more flexible array of features allowing for a range of fully automatic operation to individual and customized functions for each step of the build process. With the combination of ABS, WaterWorks and InSight software, the Prodigy Plus offers the customer “hands free” operation of the entire prototype building process. The Prodigy Plus was introduced in March 2002, and we have sold it to customers in a number of industries since that time.

The FDM Titan was introduced in 2001 and provides a unique set of features that addresses demanding customer requirements. Titan offers users the capability to model with a wide range of engineering thermoplastic materials including polycarbonate (“PC”), ABS, polyphenylsulfone (“PPSF”) and other thermoplastic materials that we expect to release, and also offers WaterWorks. These modeling materials provide superior strength coupled with heat and chemical resistance. This combination of properties allows engineers and designers a variety of options to meet demanding industrial prototyping and design requirements. Titan has a large build envelope and uses new technology based on “look ahead” motion profiles that provide faster build speeds. The Titan also incorporates enhanced ease of use features, such as the InSight software, automatic material loading and supply changeover.

In December 2003 we announced a throughput enhancement for Titan users. This new feature enables Titan users a 50% improvement in build speed over the previous generation of Titans.

In July 2003 we introduced Vantage. Vantage, which is an extension of the Titan design platform, offers modeling capabilities in PC and ABS, and is priced lower than Titan. In March 2004 we introduced three variations of Vantage called Triplets. Prices range from $99,000 for the base model Vantage to $195,000 for the Vantage SE. Model build speed, envelope size, and variety of materials account for the price range.

The FDM Maxum™ was released in late 2000. It incorporates MagnaDrive technology, which allows the extrusion head to float on a bed of air while being controlled through electromagnet devices. Its build envelope is among the largest in the industry, allowing users to build large prototypes. The Maxum also delivers a fine feature detail capability allowing customers to make prototypes of very small parts. This feature was developed in conjunction with Fuji Film Corp. of Japan. Features as small as .005” x .010” may be built, allowing for increased prototyping capabilities for the telecommunications, electrical connector and camera and photography industries.

In September 2003 we entered into an agreement with Objet Geometries Ltd. to distribute their Eden333 RP system in North American, including Mexico and Canada. Eden333 uses inkjet technology to jet ultra-fine layers of UV-cured resin to build RP prototypes. We added Eden260 in the first quarter of 2005. Eden systems build prototypes rapidly with excellent surface resolution.

We periodically discontinue manufacturing older products. We discontinued sales of the GenisysXs, FDM 8000 and Prodigy systems at various times in 2002. We discontinued sales of the FDM 2000 in 2003 and the FDM 3000 in

2004. However, we continue to support these products in the field.

Modeling Material

FDM technology allows the use of a greater variety of production grade plastic modeling materials than other RP technologies. We continue to develop filament modeling materials that meet the customer's needs for increased speed, strength, accuracy, surface resolution, chemical and heat resistance, and color. These materials are processed into our patented filament form, which is then fed into the FDM systems. Our spool-based system has proven to be a significant advantage for our products over ultraviolet ("UV") polymer systems, because our system allows the user to quickly change material by simply mounting the spool and feeding the desired filament into the FDM devices. Spools weigh from one pound to ten pounds, and the creation of a model may require from 0.1 pound to more than one pound of filament. The spool-based system also compares favorably with the UV polymer systems, because the spool-based system allows the customer to use it in an office environment and to purchase a single spool, as compared to an entire vat of UV polymer, thereby reducing the customer's up-front costs. The material delivery systems on our newer RP devices use cartridges or canisters and feature automatic loading capabilities and transition between multiple canisters or cartridges.

Currently, we have seven modeling materials commercially available for use with our FDM technology:

- ABS is an engineering thermoplastic material (named for its three initial monomers, acrylonitrile, butadiene, and styrene), which offers a balance of strength, toughness and thermal resistance and is used commercially to make products such as cell phones, computer cases and toys.

- Polycarbonate ("PC") is an engineering thermoplastic material, which is used commercially for demanding applications in a number of industries; PC offers superior impact strength coupled with resistance to heat and corrosive agents.

- PC-ISO, a derivative of PC that is translucent, expands the usage of polycarbonate models and prototypes in various medical applications.

- Polyphenylsufone ("PPSF") is a specialty thermoplastic material, which offers excellent mechanical properties while being subjected to demanding thermal and chemical environments. PPSF is used to prototype parts for numerous industries, including automotive, fluid and chemical handling, aerospace, and medical sterilization.

- ABSi is a higher grade translucent ABS, which features greater impact strength than ABS. It can also be used in medical applications, including gamma-ray sterilization.

- A proprietary water-soluble material is used for support during the build process, which is later dissolved from the finished prototype in products that employ our WaterWorks system.

    - Other proprietary release materials are used for support and removed from the final model.

We introduced a new modeling material blend, PC-ABS, in December 2004, with commercial release expected in the second quarter of 2005.

Each material has specific characteristics that make it appropriate for various applications. The ability to use different materials allows the user to match the material to the end use application of the prototype, whether it is a pattern for tooling, a concept model, or a functional prototype. ABS is also offered in numerous colors, including black, red, blue, yellow and green. We offer a program to create custom colors for unique customer needs.

The modeling filament used in our material delivery systems is a consumable product that provides us additional recurring revenue.

Operating Software

In addition to the prototyping machines and materials, we offer two software products that convert the three-dimensional CAD databases into the appropriate two-dimensional data formats for our family of prototyping machines. The software products also provide a wide range of features, including automatic support generation, part scaling, positioning and nesting, as well as geometric editing capabilities. The software is not sold as a stand-alone product.

Catalyst is our entry-level software product that enables users to build prototype parts at the push of a button. It was introduced in 2000 and is used on Dimension BST and Dimension SST.

InSight is used on the remainder of our FDM products - Prodigy Plus, Vantage, Titan and Maxum. InSight is our preprocessing software that increases build speed and improves the design engineer's control and efficiency over the entire build process. InSight was separately introduced in February 2001 as a replacement for our QuickSlice software. It has a broad set of features that facilitate the demanding applications ranging from a single "push button" for automatic pre-processing to individual editing and manipulation tools for each process step.

We continuously improve both products to meet the demands of our sophisticated customers. Throughput enhancements, advanced build algorithms and features keep pace with the complex industrial geometric designs while saving valuable operator time.

Services

We also provide a number of services both to our customers and to others in relation to our rapid prototyping business. We provide maintenance to our customers under our standard warranties and separate maintenance contracts. We also lease or rent systems under operating agreements to customers that do not desire to purchase them or enter into sales-type leases. Our paid parts service offers both customers and potential customers the ability to purchase models and prototypes that we make for them from CAD files that they provide to us. We offer training to our customers, particularly on our high-performance RP systems. Finally, from time to time we offer contract engineering services to third parties in connection with the development of systems and services incorporating our proprietary technology.

Marketing, Distribution and Customers

Marketing and Customers

The focus of our marketing begins with the identification of customer needs. We feature a broad array of products that allow us to meet the precise needs of engineers, designers, educators, marketers and manufacturers. Our products range from Dimension BST, priced at $24,900, to a high-performance FDM Maxum, priced at $250,000. We currently offer seven other products between these price points, meeting a variety of material, size and performance criteria.

We have sold systems to the following representative customers:

- General Motors Corporation
- Intel
- The Boeing Company
- University of Wisconsin - Madison
- Callaway Golf
- Lego
- Honda
- St. Jude Medical
- Harley Davidson
- Georgia Tech
- Xerox
- InFocus
- Lockheed Martin
- Lever
- Ford Motor Company
- NASA
- Toyota
- Nike
- Mitsubishi Electronics
- Pioneer Speaker
- Cornell University
- Toro
- Graco
- Medtronic-Sofamar Danek

We have also sold systems to service bureaus, universities and distributors in the United States and abroad. We sell complete RP and 3D printing systems as well as supplies and services.

No customer accounted for more than 10% of sales in 2004, 2003, or 2002.

We use a variety of tactical marketing methods to reach potential customers:

- Web-based marketing
- Trade magazine articles
- Brochures
- Telemarketing programs
- CD's
- Press releases
- Print advertisements
- Direct mailings
- Trade show demonstrations
- Web sites
- Broadcast e-mail
- Webinars

In addition, we have developed domestic and international on-site demonstration capabilities.

FDM Sales Organization

In early 2003, we consolidated our FDM sales organization by structuring sales, service, and marketing into one group. The focus of this new organization is on our high-performance RP systems that feature engineering modeling materials, high quality surface finish, high accuracy and feature detail, and excellent throughput. This group markets, sells and services our Maxum, Titan, Vantage, Prodigy Plus and Eden Systems.

The FDM sales organization operates worldwide. In 2003, we increased the efficiency of our dedicated direct sales force in North America by reducing the number of regions from three to two. Both sales management and support were consolidated. Regional sales and service offices continue to be located in Southfield, Michigan and Ontario, California. We further consolidated our North American territory in 2004 by creating a single region managed by a National Sales Manager. This organization is also responsible for the sale, installation and service of the Eden Systems under our exclusive distribution agreement with Object Geometries Ltd.

Internationally, our third-party distributors continue to sell and service our FDM products. In 2003, new distributor relationships were established in Taiwan, China, and Latin America. Sales management and technical support were increased to support the growth of our international business. International sales and service centers continue to be located in Frankfurt, Germany, and Bangalore, India.

We have continued to expand our FDM paid parts business by operating a dedicated FDM system center at our corporate headquarters. An essential objective of this operation is to increase the number of high quality FDM parts in the marketplace, which we believe will support the expansion of our system sales. Various distribution agreements have been established to accomplish the goals of this business.

In 2004, we increased emphasis on the marketing of FDM technology through an integrated sales and marketing program. Our new FDM sales organization rolled out marketing programs throughout 2004, with the expectation that we will create a solid base for expanding our FDM business in the future.

3D Printing Sales Organization

In conjunction with the consolidation of our FDM sales organization, we also consolidated our 3D printing sales organization in 2003. A worldwide Director of Sales manages four channel managers in North America as well as our international regional managers for sales of our 3D printers.

We use a worldwide reseller network to market, sell, and service our 3D printers. Many of our reseller outlets have Dimension BST and Dimension SST systems that are available for tradeshows, product demonstration, and other

promotional activities. As of early 2005, we had approximately 145 reseller locations worldwide. Most resellers enjoy a long-term presence in their respective territories. In addition to Dimension, most resellers sell and service a 3D solid CAD software package. Most of our North American territories contain a reseller devoted to commercial accounts as well as a different reseller devoted to the education market.

Dimension can be found at many leading companies. Based on estimates from the 2004 Wohlers Report, we believe that 3D printers represented approximately 60% of all RP systems sold in 2004, and that Dimension accounted for about 55% of all 3D printer systems shipped in 2004.

Customer Support

Our Customer Support department provides on-site system installation and maintenance services and remote technical support to users of our products. We offer services on a time and material basis as well as through a number of post-warranty maintenance contracts with varying levels of support and pricing. Our help desk provides technical support via phone, fax, and e-mail to international customers, distributors, and resellers, and our field service personnel. We supply a toll-free telephone number that our domestic customers can utilize to request technical assistance, schedule service visits, order parts and supplies, or directly contact a manager within the Customer Support department.

We employ a field service organization that performs system installation, basic operation and maintenance training, and a full range of maintenance and repair services at customer sites. Field representatives have been trained and certified to service all of our products. Representatives are strategically located in regional offices across North America and are equipped with cellular phones and laptop computers. They have remote access to a customer service database containing service history and technical documentation to aid in troubleshooting and repairing systems.

Customer Support is represented on all cross-functional product development teams within Stratasys to ensure that products are designed for serviceability and to provide our internal design and engineering departments with feedback on field issues. Failure analysis, corrective action, and continuation engineering efforts are driven by data collected in the field. Ongoing customer support initiatives include development of advanced diagnostic and troubleshooting techniques and comprehensive preventative maintenance programs, an expanded training and certification program for technical personnel, and improved communication between the field and the factory.

Warranty and Service

We provide a 90-day warranty on our commercial systems sold domestically and a one-year warranty on domestic educational sales and systems sold internationally. In addition, we offer annual service and maintenance contracts for our systems. Annual service contracts for our systems are priced from $3,000 to $36,000.

Manufacturing

Our manufacturing process consists of the assembly of purchased components. We obtain all parts used in the manufacturing process either from distributors of standard electrical or mechanical parts or from custom fabricators of our proprietary designs. Our suppliers are measured by on-time performance and quality. We currently operate on a build-to-forecast basis.

We purchase major component parts for our FDM and 3D printing equipment from various outside suppliers, subcontractors and other sources and assemble them at our Minnesota facility. Our production floor has been organized using demand-flow techniques (“DFT”) in order to maximize efficiency and quality. Using DFT, our production lines are balanced and as capacity constraints arise, we can avoid the requirements of relaying out our production floor. Computer-based Material Requirements Planning (“MRP”) is used for reordering to insure on-time delivery of forecasted parts. All operators and assemblers are certified and trained on up-to-date assembly and test procedures. At the completion of assembly, we perform a complete power up and final quality tests to ensure the quality of our products before shipment to customers. The complete final quality tests must be run error free before the system can be cleared for shipment. We maintain a history folder on all products that show revision level configuration and a complete history during the manufacturing and test process. All issues on the system during the

manufacturing process are logged and tracked and used to make continuous process improvements of our production processes. Other manufacturing strengths that are incorporated into our new designs are the commonality of designs in our different products and the Design For Manufacturability and Assembly (DFMA) principles.

We maintain an inventory of most of our necessary supplies, which facilitates the assembly of products required for production. While most components are available from multiple suppliers, certain components used in our systems are only available from single or limited sources. Should our present sole/single source suppliers become inadequate, we would be required to spend a significant amount of time and money researching alternate sources. We consider these suppliers very reliable. Although we believe we maintain adequate inventories of vendor-specific materials, the loss of a supplier of such vendor-specific materials or compounds could result in the delay in the manufacture and delivery of those materials and compounds. The delay could require us to find an alternate source, which would require us to re-qualify the product supplied by one or more new vendors. We consider our relationships with our suppliers to be good.

Research, Development and Engineering

We believe that ongoing research, development and engineering efforts are essential to our continued success. Accordingly, our engineering development efforts will continue to focus on improvements to the FDM technology and development of new modeling processes, materials, software, user applications and products. We have devoted significant time and resources to the development of a universally compatible and user-friendly software system. We continue to standardize our product platforms, leveraging each new design so that it will result in multiple product offerings that are developed faster and at reduced expense. The FDM Vantage, Prodigy Plus, and Dimension SST products as well as the Catalyst and InSight software products are examples of this successful strategic initiative. For the years ended December 31, 2004, 2003 and 2002, our research, development and engineering expenses were approximately $5.6 million, $5.0 million and $4.7 million, respectively.

Our filament development and production operation is located at our facility in Eden Prairie, MN. We regard the filament formulation and manufacturing process as a trade secret and hold patent claims on filament usage in our products.

Intellectual Property

We consider our proprietary technology to be material to the development, manufacture, and sale of our products and services and seek to protect our technology through a combination of patents and confidentiality agreements with our employees and others. All patents and patent applications for our rapid prototyping processes and apparatuses associated with the FDM process have been assigned to us by their inventors. As part of our purchase of rapid prototyping technology assets from IBM, we were also assigned the rights and title to three patents developed by IBM, which were incorporated in our Genisys system and are used in several of our other product lines. We recorded these patents domestically and are in the process of recording them in certain foreign countries. The terms of these patents extend until June 7, 2005, April 12, 2011, and May 17, 2011. The United States patents covering our proprietary FDM technology expire at various times between 2009 and 2025. In total, we currently own approximately 175 U.S. and international patents and patent applications. Other foreign patent applications have also been filed, including the patent applications assigned to us by IBM.

Our registered trademarks include:

- Stratasys, Inc.
- QuickSlice
- 3D Plotter
- Dimension BST
- FDM
- AutoGen
- FDM Quantum
- Dimension SST
- Catalyst
- Dimension
- Genisys

Other trademarks include: