Bridgeline Digital, Inc.
Form 10-K
December 29, 2014
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

(Mark One)

ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended September 30, 2014

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ______________ to ______________

Commission File Number 333-139298

Bridgeline Digital, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**52-2263942**
State or Other Jurisdiction of Incorporation	IRS Employer Identification No.

80 Blanchard Road	
Burlington, Massachusetts	**01803**
(Address of Principal Executive Offices)	(Zip Code)

(781) 376-5555
(Registrant’s telephone number)

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

Title of each class	Name of exchange on which registered
Common Stock, $0.001 par value per share	The NASDAQ Stock Market, LLC

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

None

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes 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 a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer	Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant was approximately $19,525,963 based on the closing price of $1.01 of the issuer's common stock, par value $.001 per share, as reported by the NASDAQ Stock Market on March 31, 2014.

On December 12, 2014, there were 21,974,529 shares of the registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE: Portions of the definitive proxy statement for our 2014 annual meeting of stockholders, which is to be filed within 120 days after the end of the fiscal year ended September 30, 2014, are incorporated by reference into Part III of this Form 10-K, to the extent described in Part III.

Forward Looking Statement

Statements contained in this Annual Report on Form 10-K that are not based on historical facts are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements may be identified by the use of forward-looking terminology such as "should," "could," "may," "will," "expect," "believe," "estimate," "anticipate," "intends," "continue," or similar terms or variations of those terms or the negative of those terms. These statements appear in a number of places in this Form 10-K and include statements regarding the intent, belief or current expectations of Bridgeline Digital, Inc. Forward-looking statements are merely our current predictions of future events. Investors are cautioned that any such forward-looking statements are inherently uncertain, are not guaranties of future performance and involve risks and uncertainties. Actual results may differ materially from our predictions. Important factors that could cause actual results to differ from our predictions include the impact of the weakness in the U.S. and international economies on our business, our inability to manage our future growth effectively or profitably, fluctuations in our revenue and quarterly results, our license renewal rate, the impact of competition and our ability to maintain margins or market share, the limited market for our common stock, the volatility of the market price of our common stock, the ability to maintain our listing on the NASDAQ Capital Market, the ability to raise capital, the performance of our products, our ability to respond to rapidly evolving technology and customer requirements, our ability to protect our proprietary technology, the security of our software, our dependence on our management team and key personnel, our ability to hire and retain future key personnel, or our ability to maintain an effective system of internal controls. Although we have sought to identify the most significant risks to our business, we cannot predict whether, or to what extent, any of such risks may be realized, nor is there any assurance that we have identified all possible issues which we might face. We assume no obligation to update our forward-looking statements to reflect new information or developments. We urge readers to review carefully the risk factors described herein and in the other documents that we file with the Securities and Exchange Commission. You can read these documents at www.sec.gov.

Where we say "we," "us," "our," "Company" or "Bridgeline" or "Bridgeline Digital" we mean Bridgeline Digital, Inc.

PART I

Item 1. Business.

Overview

Bridgeline Digital, The Digital Engagement Company™, enables its customers to maximize the performance of their mission critical websites, intranets, and online stores. Bridgeline's iAPPS® platform deeply integrates Web Content Management, eCommerce, eMarketing, Social Media management, and Web Analytics to help marketers deliver online experiences that attract, engage and convert their customers across all digital channels. Bridgeline's iAPPS platform combined with its digital services assists customers in maximizing on-line revenue, improving customer service and loyalty, enhancing employee knowledge, and reducing operational costs.

In fiscal 2012, Bridgeline Digital announced the release of iAPPSds (“distributed subscription”), a platform that empowers franchise and multi-unit organizations with state-of-the-art web engagement management while providing superior oversight of corporate branding. iAPPSds deeply integrates content management, eCommerce, eMarketing and web analytics and is a self-service web platform that is offered to each authorized franchise or dealer for a monthly subscription fee. In fiscal 2013, we acquired franchise web developer ElementsLocal, expanding Bridgeline Digital’s presence in the franchise market place.

The iAPPS platform is delivered through a cloud-based SaaS (“Software as a Service”) multi-tenant business model, whose flexible architecture provides customers with state of the art deployment providing maintenance, daily technical operation and support; or via a traditional perpetual licensing business model, in which the iAPPS software resides on a dedicated server in either the customer’s facility or Bridgeline’s co-managed hosting facility.

The iAPPS Platform is an award-winning application recognized around the globe. Our teams of Microsoft Gold© certified developers have won over 100 industry related awards. In recent years, our iAPPS Content Manager and iAPPS Commerce products were selected as finalists for the 2014, 2013, and 2012 CODiE Awards for Best Content Management Solution and Best Electronic Commerce Solution, globally. In 2014 and 2013, Bridgeline Digital won twenty-five Horizon Interactive Awards for outstanding development of web applications and websites. Also in 2013, the Web Marketing Association sponsored Internet Advertising Competition honored Bridgeline Digital with three awards for iAPPS customer websites and B2B Magazine selected Bridgeline Digital as one of the Top Interactive Technology companies in the United States. KMWorld Magazine Editors selected Bridgeline Digital as one of the 100 Companies That Matter in Knowledge Management and also selected iAPPS as a Trend Setting Product in 2013.

Bridgeline Digital was incorporated under the laws of the State of Delaware on August 28, 2000.

Locations

The Company's corporate office is in Burlington, Massachusetts. The Company maintains regional field offices serving the following geographical locations: Atlanta, GA; Baltimore, MD; Boston, MA; Chicago, IL; Dallas, TX; Denver, CO; New York, NY; San Diego, CA; San Luis Obispo, CA; and Tampa, FL. The Company has one wholly-owned subsidiary, Bridgeline Digital Pvt. Ltd. located in Bangalore, India.

Summary of Fiscal 2014

Financial

Total subscription and perpetual license revenue increased 44% to $5.7 million in fiscal 2014 from $4.0 million in fiscal 2013.

Recurring revenue, which reflects amounts that are contractually due to Bridgeline, increased 33% to $6.9 million in fiscal 2014 from $5.2 million in fiscal 2013.

Total iAPPS related revenue increased 8% to $20.3 million in fiscal 2014 from $18.8 million in fiscal 2013.

Non-iAPPS related revenue decreased 40% in fiscal 2014 compared to fiscal 2013.

Products and Services

Products

Subscription and Perpetual Licenses

Revenue from sales of both on-demand SaaS web tools and perpetual licenses is reported as subscription and perpetual licenses in the accompanying consolidated financial statements.

iAPPS Platform

The iAPPS platform provides a unified common set of shared software modules that are critical to today's mission critical websites, on-line stores, intranets, extranets, and portals. The iAPPS platform empowers companies and developers to create websites, web applications and online stores with advanced business logic, state-of-the-art graphical user interfaces, and improved quality.

The iAPPS platform is a Web Engagement Management (WEM) platform that unifies web content management, web Analytics, eCommerce, social media management and eMarketing capabilities deep within the websites, intranets or online stores in which they reside, enabling customers to enhance and optimize the value of their web properties and better engage their website users. The iAPPS platform significantly enhances WEM and Customer Experience Management (CXM) capabilities.

The iAPPSds platform was built specifically to support the needs of multi-unit organizations and franchises, Bridgeline's cloud-based platform allows companies to execute local marketing plans, follow SEO best practices, drive eCommerce initiatives, and measure results with actionable analytics.

The iAPPS suite of products includes:

iAPPS Content Manager allows non-technical users to create, edit, and publish content via a browser-based interface. The advanced, easy-to-use interface allows businesses to keep content and promotions fresh - whether for a public commercial site or a company intranet. iAPPS Content Manager handles the presentation of content based on a sophisticated indexing and security scheme that includes management of front-end access to online applications. The system provides a robust library functionality to manage permissions, versions and organization of different content types, including multimedia files and images. Administrators are able to easily configure a simple or advanced workflow. The system can accommodate the complexity of larger companies with strict regulatory policies. iAPPS Content Manager is uniquely integrated and unified with iAPPS Analyzer, iAPPS Commerce, and iAPPS Marketier; providing our customers with precise information, accurate results, expansion options, and stronger user adoption.

iAPPS Commerce is an online B2B and B2C eCommerce solution that allows users to maximize and manage all aspects of their domestic and international Commerce initiatives. The customizable dashboard provides customers with a real-time overview of the performance of their online stores, including sales trends, demographics, profit margins, inventory levels, inventory alerts, fulfillment deficiencies, average check out times, potential production issues, and delivery times. iAPPS Commerce also provides backend access to payment and shipping gateways. In combining iAPPS Commerce with iAPPS Analyzer and iAPPS Marketier, our customers can take their Commerce initiatives to an advanced level by personalizing their product offerings, improving their marketing effectiveness, providing value-added services and cross selling additional products. iAPPS Commerce is uniquely integrated and unified with iAPPS Analyzer, iAPPS Content Manager, and iAPPS Marketier; providing our customers with precise information, more accurate results, expansion options, and stronger user adoption.

iAPPS Marketier is a marketing lifecycle management solution that includes customer transaction analysis, email management, surveys and polls, event registration and issue tracking to measure campaign return on investment and client satisfaction. Website content and user profiling is leveraged to deliver targeted campaigns and stronger customer relationships. The email management features provide comprehensive reporting capabilities including success rate, and recipient activity such as click-thrus and opt-outs. iAPPS Marketier integrates with leading Customer Relationship Management (CRM's) systems such as Salesforce.com and leading ad banner engines such as Google. iAPPS Marketier is uniquely integrated and unified with iAPPS Analyzer, iAPPS Content Manager, and iAPPS Commerce; providing customers with precise information, accurate results, expansion options, and stronger user adoption.

iAPPS Analyzer provides the ability to manage, measure and optimize web properties by recording detailed events and subsequently mine data within a web application for statistical analysis. Our customers have access to information regarding where their visitors are coming from, what content and products their viewers are most interested in, and how they navigate through a particular web application. Through user-definable web reports, iAPPS Analytics provides deep insight into areas like visitor usage, content access, age of content, actions taken, and event triggers, and reports on both client and server-side events. iAPPS Analyzer's smart recommendation engine uses this data and identifies actionable solutions enabling our customers to optimize site content and reach their digital campaign goals. There are over 20 standard web reports that come with iAPPS Analyzer. iAPPS Analyzer is uniquely integrated and unified with iAPPS Content Manager, iAPPS Commerce, and iAPPS Marketier; providing our customers with precise information, accurate results, expansion options, and stronger user adoption.

iAPPSds is a web content management and eCommerce platform built specifically to support the needs of multi-unit organizations and franchises. iAPPSds deeply integrates content management, eCommerce, eMarketing, and web analytics and is a self-service web platform that is offered to each authorized franchise or multi-unit organization for a monthly subscription fee. iAPPSds acts as a control center for a large organization's distributed websites enabling local content publishing that is managed through a workflow approval process that gives corporate marketing control of the brand and message. iAPPSds also supports responsive design that adapts to specific device screen sizes access a website, driving more positive user experiences and engagement. iAPPSds is a cloud based SaaS solution.

iAPPS Social is a social media management solution that empowers customers to easily set up customized watch lists tailored by social network, topic, or author to monitor relevant conversations happening on social media, popular websites and blogs. Customers can also prioritize and engage in conversations across the web without ever exiting the iAPPS dashboard and leverage the power of publishing content to department, dealer, franchise or other social media accounts.

Services

Revenue from Digital Engagement Services

Revenue from all digital engagement services is reported as *digital engagement services* in the accompanying consolidated financial statements.

Digital Engagement Services

Digital engagement services address specific customer needs such as digital strategy, web design and web development, usability engineering, information architecture, and Search Engine Optimization (SEO) for their mission critical web site, intranet or online store. Application development engagements are often sold as part of a multiple element arrangement that includes our software products, hosting arrangements (i.e. Managed Service Hosting) that provide for the use of certain hardware and infrastructure at one of our co-managed network operating centers, or retained professional services subsequent to completion of the application development.

Digital Strategy Services

Bridgeline helps customers maximize the effectiveness of their online marketing activities to ensure that their web applications can be exposed to the potential customers that use search engines to locate products and services. Bridgeline's SEO services include competitive analysis, website review, keyword generation, proprietary leading page technology, ongoing registration, monthly reports, and monitoring. Bridgeline's web analytics experts offer consulting and assistance in implementing iAPPS Analyzer or any other type of web analytics package.

Usability Design

By integrating usability into traditional development life cycles, we believe our usability experts can significantly enhance a user's experience. Our usability professionals provide the following services: usability audits, information architecture, process analysis and optimization, interface design and user testing. Our systematic and user-centered approach to application development focuses on developing applications that are intuitive, accessible, engaging, and effective. Our goal is to produce a net effect of increased traffic, improved visitor retention, increased user productivity, reduced user error, lower support cost, and reduced long-term development cost.

Information Architecture

Information Architecture is a design methodology focused on structuring information to ensure that users can find the appropriate data and can complete their desired transactions within a website or application. Understanding users and the context in which users will be initiating with a web application is central to information architecture. Information architects try to put themselves in the position of a typical user of an application to better understand a user's characteristics, behaviors, intentions and motivations. At the same time, the information architect develops an understanding of a web application's functionality and data structures. The understanding of these components enables the architect to make customer centric decisions about the end user and then translate those decisions into site maps, wire frames and clickable prototypes.

Information architecture forms the foundation of a web application's usability. The extent to which a web application is user-friendly and is widely adopted by a user base is primarily dependent on the success of the information architecture. Information architecture defines how well users can navigate through a website or application and how easily they can find the desired information or function. As digital engagement becomes more standard and commoditized, information architecture will increase as a differentiator for application developers.

Managed Service Hosting

Revenue from Managed Service Hosting

Revenue from managed service hosting is reported as *managed service hosting* in the accompanying consolidated financial statements.

A large number of our customers engage Bridgeline to host and manage the mission critical web sites and web stores we develop. Through our partnerships with Internap, a Tier 1 secured data center, we offer co-location services in state-of-the-art facilities. We provide 24/7 application monitoring, emergency response, version control, load balancing, managed firewall security, and virus protection services. We provide shared hosting, dedicated hosting, and SaaS hosting for our customers.

Sales and Marketing

Overview

Bridgeline employs a direct sales force to sell enterprise iAPPS engagements and each sale takes on average 180 days to complete. Our direct sales force focuses its efforts selling to mid-sized and large companies. These companies are generally categorized in the following vertical markets: financial services, retail brand names, health services and life sciences, technology (software and hardware), and associations and foundations.

Bridgeline also employs a direct sales force to sell iAPPSds engagements to franchises and multi-unit organizations. Each sale in this vertical market takes on average approximately one year to complete.

We have ten geographic locations in the United States with full-time professional direct sales personnel. Our geographic locations are in the metropolitan Atlanta, Baltimore, Boston, Chicago, Dallas, Denver, New York, San Diego, San Luis Obispo, and Tampa areas.

Strategic Alliances

We have dedicated business development professionals whose mission is to identify and establish strategic alliances for iAPPS and iAPPSds. In June 2012, Bridgeline announced a strategic alliance with UPS Logistics. Bridgeline and UPS Logistics signed a multi-year agreement to offer B2B and B2C eCommerce web stores with an end-to-end eCommerce offering comprised of Bridgeline's eCommerce Fulfilled™ solution and UPS Logistics and fulfillment services. The combined Bridgeline and UPS Logistics offering provides customers with the ability to manage the eCommerce and supply chain fulfillment needs and was designed to benefit mid-market and larger online web stores who seek end to end solutions.

In July of 2012 Bridgeline signed a multi-year agreement with The UPS Stores, a national franchise network of over 4,300 locations who license the iAPPSds platform.

We continue to pursue other significant strategic alliances that will enhance the sales and distribution opportunities of iAPPS related intellectual property.

Engagement Methodology

We use an accountable, strategic engagement process developed specifically for target companies that require a technology based professional approach. We believe it is critical to qualify each opportunity and to assure our skill set and tools match up well with customer’s needs. As an essential part of every engagement, we believe our engagement methodology streamlines our customer qualification process, strengthens our customer relationships, ensures our skill set and tools match the customer’s needs, and results in the submission of targeted proposals.

Organic Growth from Existing Customer Base

We have specific proactive programs that consistently market our iAPPS platform and interactive development capabilities. Our business development professionals seek ongoing business opportunities within our existing customer base and within other operating divisions or subsidiaries of our existing customer base.

New Customer Acquisition

We identify customers within our vertical expertise (financial services, franchise/dealer networks, retail brand names, health services and life sciences, high technology, and associations and foundations). Our business development professionals create an annual territory plan identifying various strategies to engage our target customers. These territory plans are evaluated and updated every 60 days.

Customer Retention Programs

We use digital marketing capabilities when marketing to our customer base. We make available via email and on our website Bridgeline authored Whitepapers, featured case studies, and/or Company related announcements to our customers on a bimonthly basis. We also host educational on-line webinars, face to face seminars and training.

New Lead Generation Programs

We generate targeted leads and new business opportunities by leveraging on-line marketing strategies. We receive leads by maximizing the SEO capabilities of our own website. Through our website, we provide various educational Whitepapers and promote upcoming on-line seminars. In addition, we utlilize banner advertisements on various independent newsletters and paid search advertisements that are linked to our website. We also participate and exhibit at targeted events.

Social Media Programs

We market Bridgeline's upcoming events, Whitepapers, blogs, case studies, digital product tutorials, announcements, and related articles frequently on leading social media platforms such as Twitter, LinkedIn, YouTube and Facebook.

Acquisitions

Bridgeline will continue to evaluate expanding its distribution of iAPPS and its interactive development capabilities through acquisitions.

There were no acquisitions during the fiscal year ended September 30, 2014 and one acquisition during the fiscal year ended September 30, 2013 as described below.

ElementsLocal

On August 1, 2013, we completed the acquisition of ElementsLocal, a California based developer of a SaaS website platform for the franchise marketplace. ElementsLocal has over 3,200 franchises on its web platform. We acquired all of the outstanding capital stock of ElementsLocal for consideration consisting of (i) $463 thousand in cash, (ii) $604 thousand in shares of Bridgeline Digital common stock (valued at $1.15 per share), (iii) assumption of $188 thousand of indebtedness and (iv) contingent consideration of up to $904 thousand in cash and $396 thousand in shares of Bridgeline Digital common stock. The contingent consideration is payable quarterly over the 12 consecutive calendar quarters following the acquisition, contingent upon the acquired business achieving a certain quarterly revenue target during the period. The contingent common stock payable each earnout period is determined by dividing $33 thousand by the greater of: (i) the average closing price for Bridgline Digitial common stock for the 30 day trading period preceding the end of the earnout period, or (ii) $1.17. To the extent that a quarterly revenue target is not met in a particular quarter, the earn-out period will be extended for up to four additional quarters. ElementsLocals operating results are reflected in the condensed consolidated financial statements as of the acquisition date.

Research and Development

We have a strong commitment to research and development activities focusing on creating new products and innovations, product enhancements, and funding future market opportunities. In fiscal 2014 and 2013, research and development expenses were $2.4 million, or 10% of revenues, and $1.4 million, or 6% of revenues, respectively.

Employees

We have 135 employees worldwide as of September 30, 2014. Substantially all of those employees are full time employees.

Customers

We primarily serve the following vertical markets that we believe have a history of investing in information technology enhancements and initiatives as follows:

Financial Services
Franchises/Multi-unit Organizations
Retail Brand Names
Health Services and Life Sciences
Technology (software and hardware)
Associations and Foundations

For the years ended September 30, 2014 and 2013, no customer generated more than 10% of our revenue. We will focus our efforts to engage with customers that are aligned with the Company's core competencies and will continue to proactively end engagements with a number of smaller hosting customers obtained through previous acquisitions.

Competition

The markets for our products and services, including software for web content management, eCommerce platform software, eMarketing software, web analytics software and digital engagement services are highly competitive, fragmented, and rapidly changing. Barriers to entry in such markets remain relatively low. The markets are significantly affected by new product introductions and other market activities of industry participants. With the introduction of new technologies and market entrants, we expect competition to persist and intensify in the future.

We believe we compete adequately with others and we distinguish ourselves from our competitors in a number of ways:

We believe our competitors generally offer their web application software typically as a single point of entry type product (such as content management only, or commerce only) as compared to the deeply integrated approach as provided by the iAPPS platform.

We believe our competitors can generally only deploy their solutions in either a Cloud/SaaS environment or in a dedicated server environment. The iAPPS platform's architecture is flexible and is capable of being deployed in either a Cloud/SaaS or dedicated server environment.

We believe the majority of our competitors do not provide interactive technology development services that complement their software products. Our ability to develop mission critical web sites and online stores on our own deeply integrated iAPPS platform providing a quality end-to-end solution that distinguishes us from our competitors.

We believe the interface of the iAPPS platform has been designed for ease of use without substantial technical skills.

Finally, we believe the iAPPS platform offers a competitive price-to-functionality ratio when compared to our competitors.

Available Information

This Annual Report on Form 10-K, as well as our quarterly reports on Form 10-Q and current reports on Form 8-K, along with any amendments to those reports, are made available upon request, on our website www.bridgeline.com as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission. Copies of the following are also available through our website on the "About Us - Investor Information" page under the caption "Governance" and are available in print to any shareholder who requests it:

Code of Business Ethics

Committee Charters for the following Board Committees:

o Nominating and Corporate Governance Committee

o Audit Committee

o Compensation Committee

The public may read and copy any materials that we file with the SEC at the SEC's Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549. Information regarding the SEC's Public Reference Room can be obtained by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site that contains reports, proxy and information statements, and other information and can be found at http://www.sec.gov.

Item 1A. Risk Factors

This report contains forward-looking statements that involve risks and uncertainties, such as statements of our objectives, expectations and intentions. The cautionary statements made in this report are applicable to all forward-looking statements wherever they appear in this report. Our actual results could differ materially from those discussed herein. In addition to the risks discussed in "Management's Discussion and Analysis of Financial Condition and Results of Operations," our business is subject to the risks set forth below.

We operate in a rapidly changing environment that involves certain risks and uncertainties, some of which are beyond our control. The risks described below are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial may also materially adversely affect our business, financial condition and/or operating results.

If we are unable to manage our future growth efficiently, our business, liquidity, revenues and profitability may suffer.

We anticipate that continued expansion of our core business will require us to address potential market opportunities. For example, we may need to expand the size of our research and development, sales, corporate finance or operations staff. There can be no assurance that our infrastructure will be sufficiently flexible and adaptable to manage our projected growth or that we will have sufficient resources, human or otherwise, to sustain such growth. If we are unable to adequately address these additional demands on our resources, our profitability and growth might suffer. Also, if we continue to expand our operations, management might not be effective in expanding our physical facilities and our systems, procedures or controls might not be adequate to support such expansion. Our inability to manage our growth could harm our business and decrease our revenues.

We may also require additional funding to further expand our business. We currently have a borrowing facility with Bridge Bank from which we can borrow, and this line is subject to financial covenants that must be met. It is not certain that all or part of this line will be available to us in the future; and other sources of financing may not be available to us in a timely basis if at all, or on terms acceptable to us. If we fail to obtain acceptable funding when needed, we may not have sufficient resources to fund our normal operations, and this would have a material adverse effect on our business.

Our revenue and quarterly results may fluctuate, which could adversely affect our stock price.

We have experienced, and may in the future experience, significant fluctuations in our quarterly operating results that may be caused by many factors. These factors include:

- changes in demand for our products;
- introduction, enhancement or announcement of products by us or our competitors;
- market acceptance of our new products;
- the growth rates of certain market segments in which we compete;
- size and timing of significant orders;
- budgeting cycles of customers;
- mix of products and services sold;
- changes in the level of operating expenses;
- completion or announcement of acquisitions; and
- general economic conditions in regions in which we conduct business.

The length of our sales cycle can fluctuate significantly which could result in significant fluctuations in license revenues being recognized from quarter to quarter.

The decision by a customer to purchase our products often involves the development of a complex implementation plan across a customer's business. This process often requires a significant commitment of resources both by prospective customers and us. Given the significant investment and commitment of resources required in order to implement our software, it may take several months, or even several quarters, for marketing opportunities to materialize. If a customer's decision to purchase our products is delayed or if the installation of our products takes longer than originally anticipated, the date on which we may recognize revenues from these sales would be delayed. Such delays and fluctuations could cause our revenues to be lower than expected in a particular period and we may not be able to adjust our costs quickly enough to offset such lower revenue, potentially negatively impacting our results of operations.

Because most of our licenses are renewable on an annual basis, a reduction in our license renewal rate could reduce our revenue.

Our customers have no obligation to renew their annual subscription licenses, and some customers have elected not to do so. Our license renewal rates may decline or fluctuate as a result of a number of factors, including customer dissatisfaction with our products and services, our failure to update our products to maintain their attractiveness in the market, or constraints or changes in budget priorities faced by our customers. A decline in license renewal rates could cause our revenue to decline which would have a material adverse effect on our operations.

We face intense and growing competition, which could result in price reductions, reduced operating margins and loss of market share.

We operate in a highly competitive marketplace and generally encounter intense competition to create and maintain demand for our services and to obtain service contracts. If we are unable to successfully compete for new business and license renewals, our revenue growth and operating margins may decline. The market for our iAPPS platform (Content Manager, Analyzer, eCommerce, Marketier, Social) and web development services are competitive and rapidly changing. Barriers to entry in such markets are relatively low. With the introduction of new technologies and market entrants, we expect competition to intensify in the future. Some of our principal competitors offer their products at a lower price, which may result in pricing pressures. Such pricing pressures and increased competition generally could result in reduced sales, reduced margins or the failure of our product and service offerings to achieve or maintain more widespread market acceptance.

The web development/services market is highly fragmented with a large number of competitors and potential competitors. Our prominent public company competitors are Open Text, Demandware, Digital River, GSI Commerce, and Adobe. We face competition from customers and potential customers who develop their own applications internally. We also face competition from potential competitors that are substantially larger than we are and who have significantly greater financial, technical and marketing resources, and established direct and indirect channels of distribution. As a result, they are able to devote greater resources to the development, promotion and sale of their products than we can.

There may be a limited market for our common stock which may make it more difficult for you to sell your stock and which may reduce the market price of our common stock.

The average shares traded per day in fiscal 2014 was approximately 95,000 shares per day compared to approximately 50,000 for fiscal 2013. If our average trading volume of our common stock were to decrease it may impair the ability of holders of our common stock to sell their shares at the time they wish to sell them or at a price that they consider reasonable. The low trading volume may also reduce the fair market value of the shares of our common stock. Accordingly, there can be no assurance that the price of our common stock will reflect our actual value. There can be no assurance that the daily trading volume of our common stock will increase or improve either now or in the future.

The market price of our common stock is volatile which could adversely affect your investment in our common stock.

The market price of our common stock is volatile and could fluctuate significantly for many reasons, including, without limitation: as a result of the risk factors listed in this annual report on Form 10-K; actual or anticipated fluctuations in our operating results; and general economic and industry conditions. During fiscal 2014, the closing price of our common stock as reported by NASDAQ fluctuated between $0.65 and $1.36.

We will not be able to maintain our listing on the NASDAQ Capital Market if we are unable to satisfy NASDAQ's minimum bid price requirements of $1.00 per share.

We are currently not in compliance with the requirements for listing on the NASDAQ Capital Market. We are required to meet certain financial criteria in order to maintain our listing on the NASDAQ Capital Market. One such requirement is that we maintain a minimum closing bid price of at least $1.00 per share for our common stock. Because our stock traded below $1.00 per share for 30 consecutive business days, on May 28, 2014, The Nasdaq Stock Market ("Nasdaq") notified us that we were not in compliance with Marketplace Rule 5550(a)(2). We were provided 180 calendar days, or until November 24, 2014, to regain compliance with the minimum closing bid price requirement. On December 1, 2014, we were notified by Nasdaq that we are eligible for an additional 180 calendar day period, or until May 26, 2015 to regain compliance. If at any time during this additional time period the closing bid price of our stock price is at least $1.00 per share for a minimum of 10 consecutive business days, then we can regain compliance.

If we are unable to demonstrate compliance by May 26, 2015 then our shares of common stock will be subject to delisting. At that point, the Nasdaq staff will determine whether we meet the NASDAQ Capital Market initial listing criteria, except for the minimum bid price requirement. If NASDAQ determines that we meet the initial listing criteria, the NASDAQ staff will grant us an additional 180 calendar day compliance period. If we are not eligible for an additional compliance period, the NASDAQ staff will provide written notice that our securities will be delisted from the NASDAQ Capital Market.

The delisting of our common stock could have a negative effect on the market price for our shares.

If our common stock is delisted from NASDAQ it may be traded on the OTCQX or the OTC Bulletin Board which may limit the market for our stock and affect our ability to raise capital.

We are currently not in compliance with the requirements for listing on the NASDAQ Capital Market. If our common stock is delisted from NASDAQ, we will apply to have our common stock quoted on the OTCQX, the world's largest interdealer quotation system, which is operated by OTC Market Groups, Inc. Our stock may also be traded on the OTC Bulletin Board.

There may be a limited market for our common stock if it is quoted on the OTCQX or the OTC Bulletin Board. Trading in our stock may become more difficult and our share price could decrease. Specifically, you may not be able to resell your shares of common stock at or above the price you paid.

In addition, the delisting of our common stock from NASDAQ may impair our ability to raise additional capital due to the less liquid nature of the OTCQX and OTC Bulletin Board markets. While we cannot guarantee that we would be able to complete an equity financing on acceptable terms, or at all, we believe that dilution from any equity financing while our shares are quoted on an over-the-counter market would likely be substantially greater than if we were to complete a financing while our common stock is traded on a national securities exchange. Further, if our common stock is not traded on an exchange, we will no longer be eligible to use short-form registration statements on Form S-3 for the registration of our securities, which could impair our ability to raise additional capital as needed.

If our products fail to perform properly due to undetected errors or similar problems, our business could suffer, and we could face product liability exposure.

We develop and sell complex web engagement software which may contain undetected errors, or bugs. Such errors can be detected at any point in a product's life cycle, but are frequently found after introduction of new software or enhancements to existing software. We continually introduce new products and new versions of our products. Despite internal testing and testing by current and potential customers, our current and future products may contain serious defects. If we detect any errors before we ship a product, we might have to delay product shipment for an extended period of time while we address the problem. We might not discover software errors that affect our new or current products or enhancements until after they are deployed, and we may need to provide enhancements to correct such errors. Therefore, it is possible that, despite our testing, errors may occur in our software. These errors could result in the following:

- harm to our reputation;
- lost sales;
- delays in commercial release;
- product liability claims;
- contractual disputes;
- negative publicity;
- delays in or loss of market acceptance of our products;
- license terminations or renegotiations; or
- unexpected expenses and diversion of resources to remedy errors.

Furthermore, our customers may use our software together with products from other companies. As a result, when problems occur, it might be difficult to identify the source of the problem. Even when our software does not cause these problems, the existence of these errors might cause us to incur significant costs, divert the attention of our technical personnel from our product development efforts, impact our reputation, or cause significant customer relations problems.

Technology and customer requirements evolve rapidly in our industry, and if we do not continue to develop new products and enhance our existing products in response to these changes, our business could suffer.

We will need to continue to enhance our products in order to maintain our competitive position. We may not be successful in developing and marketing enhancements to our products on a timely basis, and any enhancements we develop may not adequately address the changing needs of the marketplace. Overlaying the risks associated with our existing products and enhancements are ongoing technological developments and rapid changes in customer requirements. Our future success will depend upon our ability to develop and introduce in a timely manner new products that take advantage of technological advances and respond to new customer requirements. The development of new products is increasingly complex and uncertain, which increases the risk of delays. We may not be successful in developing new products and incorporating new technology on a timely basis, and any new products may not adequately address the changing needs of the marketplace. Failure to develop new products and product enhancements that meet market needs in a timely manner could have a material adverse effect on our business, financial condition and operating results.

If we are unable to protect our proprietary technology and other intellectual property rights, our ability to compete in the marketplace may be substantially reduced.

If we are unable to protect our intellectual property, our competitors could use our intellectual property to market products similar to our products, which could decrease demand for such products, thus decreasing our revenue. We rely on a combination of copyright, trademark and trade secret laws, as well as licensing agreements, third-party non-disclosure agreements and other contractual measures, to protect our intellectual property rights. These protections may not be adequate to prevent our competitors from copying or reverse-engineering our products. Our competitors may independently develop technologies that are substantially similar or superior to our technology. To protect our trade secrets and other proprietary information, we require employees, consultants, advisors and collaborators to enter into confidentiality agreements. These agreements may not provide meaningful protection for our trade secrets, know-how or other proprietary information in the event of any unauthorized use, misappropriation or disclosure of such trade secrets, know-how or other proprietary information. The protective mechanisms we include in our products may not be sufficient to prevent unauthorized copying. Existing copyright laws afford only limited protection for our intellectual property rights and may not protect such rights in the event competitors independently develop similar products. In addition, the laws of some countries in which our products are or may be licensed do not protect our products and intellectual property rights to the same extent as do the laws of the United States.

Policing unauthorized use of our products is difficult, and litigation could become necessary in the future to enforce our intellectual property rights. Any litigation could be time consuming and expensive to prosecute or resolve, result in substantial diversion of management attention and resources, and materially harm our business or financial condition.

If a third party asserts that we infringe upon its proprietary rights, we could be required to redesign our products, pay significant royalties or enter into license agreements.

Claims of infringement are becoming increasingly common as the software industry develops and as related legal protections, including but not limited to patents, are applied to software products. Although we do not believe that our products infringe on the rights of third parties, a third party may assert that our technology or technologies of entities we acquire violates its intellectual property rights. As the number of software products in our markets increases and the functionality of these products further overlap, we believe that infringement claims will become more common. Any claims against us, regardless of their merit, could:

- be expensive and time consuming to defend;
- result in negative publicity;
- force us to stop licensing our products that incorporate the challenged intellectual property;
- require us to redesign our products;
- divert management’s attention and our other resources; and or

require us to enter into royalty or licensing agreements in order to obtain the right to use necessary technologies, which may not be available on terms acceptable to us, if at all.

We believe that any successful challenge to our use of a trademark or domain name could substantially diminish our ability to conduct business in a particular market or jurisdiction and thus decrease our revenue and result in possible losses to our business.

If the security of our software, in particular the hosted Internet solutions products we have developed, is breached, our business and reputation could suffer.

Fundamental to the use of our products is the secure collection, storage and transmission of confidential information. Third parties may attempt to breach our security or that of our customers and their databases. We might be liable to our customers for any breach in such security, and any breach could harm our customers, our business and reputation. Any imposition of liability, particularly liability that is not covered by insurance or is in excess of insurance coverage, could harm our reputation, business and operating results. Computers, including those that utilize our software, are vulnerable to computer viruses, physical or electronic break-ins and similar disruptions, which could lead to interruptions, delays or loss of data. We might be required to expend significant capital and other resources to protect further against security breaches or to rectify problems caused by any security breach, which, in turn could divert funds available for corporate growth and expansion or future acquisitions.

If our co-managed network operations center that houses our iAPPS SaaS environment and managed service hosting were to experience a disruption in service, our business and reputation could suffer.

We host our SaaS and managed hosting customers from our co-managed network operation center (“NOC”), which is operated by a third-party. While we have ownership control and have access to our servers and all of the components of our network operation center, we do not control the operation of the Tier-1 data facility. Our data facility lease expires in 2014 with an automatic renewal of one year. If upon renewal date our third-party provider does not provide commercially reasonable terms, we may be required to transfer our servers to a new data center facility, and we may incur significant costs and possible service interruption in connection with doing so.

Problems faced by our third-party data center location, with the telecommunications network providers with whom we or they contract, or with the systems by which our telecommunications providers allocate capacity among their customers, including us, could adversely affect the experience of our customers. Our third-party data center operator could decide to close their facilities without adequate notice. In addition, any financial difficulties, such as bankruptcy, faced by our third-party data center operators or any of the service providers with whom we or they contract may have negative effects on our business, the nature and extent of which are difficult to predict. Additionally, if our data center is unable to keep up with our growing needs for capacity, this could have an adverse effect on our business. Any changes in third-party service levels at our data centers or any errors, defects, disruptions, or other performance problems with our services could harm our reputation. Interruptions in our services might reduce our revenue, cause us to issue credits or refunds to customers, subject us to potential liability, or harm our renewal rates.

We are dependent upon our management team, and the loss of any of these individuals could harm our business.

We are dependent on the efforts of our key management personnel. The loss of any of our key management personnel, or our inability to recruit and train additional key management and other personnel in a timely manner, could materially and adversely affect our business, operations and future prospects. We do not maintain a key man insurance policy covering any of our employees. In addition, in the event that Thomas Massie, our founder, Chairman and Chief Executive Officer, is terminated by us without cause, he is entitled to receive severance payments equal to three years’ total compensation, including bonus amounts. In the event we are required to pay the severance payments to Mr. Massie, it could have a material adverse effect on our results of operations for the fiscal quarter and year in which such payments are made.

Because competition for highly qualified personnel is intense, we might not be able to attract and retain the employees we need to support our planned growth.

We will need to increase the size and maintain the quality of our sales force, software development staff and professional services organization to execute our growth plans. To meet our objectives, we must attract and retain highly qualified personnel with specialized skill sets. Competition for qualified personnel can be intense, and we might not be successful in attracting and retaining them. Our ability to maintain and expand our sales, product development and professional services teams will depend on our ability to recruit, train and retain top quality people with advanced skills who understand sales to, and the specific needs of, our target customers. For these reasons, we have experienced, and we expect to again experience in the future, challenges in hiring and retaining highly skilled employees with appropriate qualifications for our business. In addition to hiring services personnel to meet our needs, we may also engage additional third-party consultants as contractors, which could have a negative impact on our financial results. If we are unable to hire or retain qualified personnel, or if newly hired personnel fail to develop the necessary skills or reach productivity slower than anticipated, it would be more difficult for us to sell our products and services, and we could experience a shortfall in revenue and not achieve our planned growth.

Future acquisitions may be difficult to integrate into our existing operations, may disrupt our business, dilute stockholder value, divert management's attention, or negatively affect our operating results.

We have acquired multiple businesses since our inception in 2000. A key element of our growth and market share expansion strategy has been the pursuit of additional acquisitions in the fragmented digital engagement industry in the future. These future acquisitions may create risks such as: (i) the need to integrate and manage the businesses and products acquired with our own business and products; (ii) additional demands on our resources, systems, procedures and controls; (iii) disruption of our ongoing business; (iv) unknown liabilities associated with the acquired businesses; and (v) diversion of management's attention from other business concerns. In addition, future acquisitions could involve substantial investment of funds or financings by issuance of debt or equity securities and could result in one-time charges and expenses and have the potential to either dilute the interests of existing shareholders or result in the issuance of or assumption of debt. Any such acquisition may not be successful in generating revenues, income or other returns to us, and the resources committed to such activities will not be available to us for other purposes. Moreover, if we are unable to access capital markets on acceptable terms or at all, we may not be able to consummate acquisitions, or may have to do so based upon less than optimal capital structure. Our inability to take advantage of growth opportunities for our business or to address risks associated with acquisitions or investments in businesses may negatively affect our operating results. Additionally, any impairment of goodwill or other intangible assets acquired in an acquisition or in an investment, or charges to earnings associated with any acquisition or investment activity, may materially reduce our earnings which, in turn, may have an adverse material effect on the price of our common stock.

Increasing government regulation could affect our business and may adversely affect our financial condition.

We are subject not only to regulations applicable to businesses generally, but also to laws and regulations directly applicable to electronic commerce. Although there are currently few such laws and regulations, state, federal and foreign governments may adopt laws and regulations applicable to our business. Any such legislation or regulation could dampen the growth of the Internet and decrease its acceptance. If such a decline occurs, companies may choose in the future not to use our products and services. Any new laws or regulations in the following areas could affect our business:

- user privacy;
- the pricing and taxation of goods and services offered over the Internet;
- the content of websites;
- copyrights;
- consumer protection, including the potential application of “do not call” registry requirements on customers and consumer backlash in general to direct marketing efforts of customers;
- the online distribution of specific material or content over the Internet; or
- the characteristics and quality of products and services offered over the Internet.

We have never paid dividends and we do not anticipate paying dividends in the future.

We have never paid cash dividends and do not believe that we will pay any cash dividends on our common stock in the future. Since we have no plan to pay cash dividends, an investor would only realize income from his investment in our shares if there is a rise in the market price of our common stock, which is uncertain and unpredictable.

Item 1B. Unresolved Staff Comments

Not required.

Item 2. Properties.

The following table lists our offices, all of which are leased:

Geographic Location	Address	Size
Atlanta, Georgia	5555 Triangle Parkway Norcross, Georgia 30092	8,547 square feet, professional office space
Baltimore, Maryland	6711 Columbia Gateway Dr. Baltimore, Maryland 21046	4,925 square feet, Professional office space
Bangalore, India	Inner Ring Road Bangalore 560 052	14,302 square feet professional office space
Boston, Massachusetts	80 Blanchard Road Burlington, Massachusetts 01803	21,136 square feet, professional office space
Chicago, Illinois	30 N. LaSalle Street, 20th Floor Chicago, IL 60602	4,880 square feet, professional office space
Dallas, Texas	4975 Preston Park Boulevard, Suite 550 Plano, TX 75093	5,641 square feet, professional office space
Denver, Colorado	410 17th Street, Suite 600 Denver, CO 80202	5,993 square feet, professional office space
New York, New York	450 7th Avenue New York, NY 10123	5,582 square feet, professional office space
San Diego, California	6240 Cornerstone Suite 110 San Diego, CA 92121	2,560 square feet Professional office space
San Luis Obispo, California	3450 Broad Street San Luis Obispo, CA 93401	3,937 square feet Professional office space
Tampa, Florida	5325 Primrose Lake Circle Tampa, FL 33647	4,264 square feet Professional office space

Item 3. Legal Proceedings.

From time to time we are subject to ordinary routine litigation and claims incidental to our business. We are not currently involved in any legal proceedings that we believe are material beyond those described below.

Bridgeline Digital, Inc vs. e.Magination Network, LLC and its principal owner, Daniel Roche.

In August 2010, Bridgeline initiated a lawsuit against e.Magination network, LLC and its principal owner, Daniel Roche, in the Federal District Court of Massachusetts. On August 6, 2013 the parties entered into a settlement agreement pursuant to which Bridgeline agreed to pay Mr. Roche a total of $468 thousand, as well as the payment of previously earned contingent consideration which was accrued at the date of acquisition. This claim was settled in full during fiscal 2014.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for Common Equity, Related Stockholder Matters and Issuer Purchase of Equity Securities.

The following table sets forth, for the periods indicated, the range of high and low sale prices for our common stock. Our common stock trades on the NASDAQ Capital Market under the symbol BLIN.

Year Ended September 30, 2014	**High**	**Low**
Fourth Quarter	$0.93	$0.65
Third Quarter	$1.02	$0.76
Second Quarter	$1.36	$0.88
First Quarter	$1.16	$0.79
Year Ended September 30, 2013	**High**	**Low**
Fourth Quarter	$1.33	$1.00
Third Quarter	$1.30	$0.99
Second Quarter	$1.80	$1.25
First Quarter	$2.40	$1.20

We have not declared or paid cash dividends on our common stock and do not plan to pay cash dividends to our shareholders in the near future. As of December 5, 2014, our common stock was held of record by approximately 1,486 shareholders. Most of the Company’s stock is held in street name through one or more nominees.

Recent Sales of Unregistered Securities; Use of Proceeds From Registered Securities

The following summarizes all sales of our unregistered securities during the year ended September 30, 2014, other than sales of unregistered securities during the quarter ended March 31, 2014 that were previously disclosed on Form 8-K. The securities in the below-referenced transactions were (i) issued without registration and (ii) were subject to restrictions under the Securities Act and the securities laws of certain states, in reliance on the private offering exemptions contained in Sections 4(2), 4(6) and/or 3(b) of the Securities Act and on Regulation D promulgated there under, and in reliance on similar exemptions under applicable state laws as transactions not involving a public offering. Unless stated otherwise, no placement or underwriting fees were paid in connection with these transactions.

During the year ended September 30, 2014, the Company granted 1,197,500 stock options under its Amended and Restated Stock Incentive Plan at a weighted average exercise price of $1.10 per share.

The securities were issued exclusively to our directors, executive officers and employees. The issuance of options and the shares of common stock issuable upon the exercise of such options as described above were issued pursuant to written compensatory plans or arrangements with our employees, directors and consultants, in reliance on the exemptions from the registration provisions of the Securities Act set forth in Section 4(2) thereof relative to sales by an issuer not involving any public offering, to the extent an exemption from such registration was required.

Item 6. Selected Financial Data.

Not required.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

This section contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of a variety of factors and risks including the impact of the weakness in the U.S. and international economies on our business, our inability to manage our future growth effectively or profitably, fluctuations in our revenue and quarterly results, our license renewal rate, the impact of competition and our ability to maintain margins or market share, the limited market for our common stock, the volatility of the market price of our common stock, the ability to maintain our listing on the NASDAQ Capital Market, the ability to raise capital, the performance of our products, our ability to respond to rapidly evolving technology and customer requirements, our ability to protect our proprietary technology, the security of our software, our dependence on our management team and key personnel, our ability to hire and retain future key personnel, or our ability to maintain an effective system of internal controls. These and other risks are more fully described herein and in our other filings with the Securities and Exchange Commission.

This section should be read in combination with the accompanying audited consolidated financial statements and related notes prepared in accordance with United States generally accepted accounting principles.

Overview

Bridgeline Digital, The Digital Engagement Company™, enables its customers to maximize the performance of their mission critical websites, intranets, and online stores. Bridgeline's iAPPS® platform deeply integrates Web Content Management, eCommerce, eMarketing, Social Media management, and Web Analytics to help marketers deliver online experiences that attract, engage and convert their customers across all digital channels. Bridgeline's iAPPS platform combined with its digital services assists customers in maximizing on-line revenue, improving customer service and loyalty, enhancing employee knowledge, and reducing operational costs.

In fiscal 2012, Bridgeline Digital announced the release of iAPPSds ("distributed subscription"), a platform that empowers franchise and multi-unit organizations with state-of-the-art web engagement management while providing superior oversight of corporate branding. iAPPSds deeply integrates content management, eCommerce, eMarketing and web analytics and is a self-service web platform that is offered to each authorized franchise or dealer for a monthly subscription fee. On August 1, 2013, we acquired franchise web developer ElementsLocal, expanding Bridgeline Digital's presence in the franchise market place.

The iAPPS platform is delivered through a cloud-based SaaS ("Software as a Service") multi-tenant business model, whose flexible architecture provides customers with state of the art deployment providing maintenance, daily technical operation and support; or via a traditional perpetual licensing business model, in which the iAPPS software resides on a dedicated server in either the customer's facility or Bridgeline's co-managed hosting facility.

iAPPS Content Manager and iAPPS Commerce were selected as finalists for the 2014, 2013, and 2012 CODiE Awards for Best Content Management Solution and Best Electronic Commerce Solution, globally. In 2014, Bridgeline Digital won ten Horizon Interactive Awards for outstanding development of web applications and websites and won fifteen Horizon Interactive Awards in 2013. Also in 2013, the Web Marketing Association sponsored Internet Advertising Competition honored Bridgeline Digital with three awards for iAPPS customer websites and B2B Magazine selected Bridgeline Digital as one of the Top Interactive Technology companies in the United States. In 2013, KMWorld Magazine Editors selected Bridgeline Digital as one of the 100 Companies That Matter in Knowledge Management and also selected iAPPS as a Trend Setting Product in 2013.

Bridgeline Digital was incorporated under the laws of the State of Delaware on August 28, 2000.

Locations

The Company’s corporate office is located in Burlington, Massachusetts. The Company maintains regional field offices serving the following geographical locations: Atlanta, Baltimore, Boston, Chicago, Dallas, Denver, New York, San Diego, San Luis Obispo and Tampa. The Company has one wholly-owned subsidiary, Bridgeline Digital Pvt. Ltd. located in Bangalore, India.

Sales and Marketing

Bridgeline employs a direct sales force and each sale takes on average 180 days to complete. Each franchise/multi-unit organization sale takes on average 365 days to complete. Our direct sales force focuses its efforts selling to medium-sized and large companies. These companies are generally categorized in the following vertical markets: (i) financial services; (ii) franchises/multi-unit organizations; (iii) retail brand names; (iv) health services and life sciences; (v) technology (software and hardware); and (vi) associations and foundations. We have ten geographic locations in the United States with full-time professional direct sales personnel.

We have business development professionals dedicated to identifying and establishing strategic alliances for iAPPS and iAPPSds. In 2012, Bridgeline announced a strategic alliance with UPS Logistics. Bridgeline and UPS Logistics signed a multi-year agreement to offer B2B and B2C eCommerce web stores with an end-to-end eCommerce offering comprised of Bridgeline’s eCommerce Fulfilled™ solution and UPS Logistics and fulfillment services. The combined Bridgeline and UPS Logistics offering provides customers with the ability to manage the eCommerce and supply chain fulfillment needs and was designed to benefit mid-market and larger online web stores who seek end to end solutions. Also, in 2012, we signed a multi-year agreement with The UPS Stores, a national franchise network of over 4,300 locations who license the iAPPS ds platform.

In 2013, we signed a multi-year agreement with a national provider of outsourced sales services with over 300 locations. We also added national brand names such as Sport Clips®, Glass Doctor® and Maaco® to our list of franchise customers via the ElementsLocal acquisition. In 2014, we signed two more national multi-unit organizations expanding the iAPPSds footprint to potentially thousands more customers.

We continue to pursue significant strategic alliances that will enhance the sales and distribution opportunities of iAPPS related intellectual property.

Acquisitions

Bridgeline will continue to evaluate expanding its distribution of iAPPS and its interactive development capabilities through acquisitions.

During the fiscal year ended September 30, 2013, we completed one acquisition. On August 1, 2013, we completed the acquisition of ElementsLocal, a California based developer of an online SaaS platform for the franchise marketplace. ElementsLocal had over 3,200 franchises on its platform.

The operating results of ElementsLocal is reflected in the condensed consolidated financial statements as of the acquisition date.

We may make additional acquisitions in the foreseeable future. These potential acquisitions are consistent with our iAPPS platform distribution strategy and growth strategy by providing Bridgeline with new geographical distribution opportunities, an expanded customer base, an expanded sales force and an expanded developer force. In addition, integrating acquired companies into our existing operations allows us to consolidate the finance, human resources, legal, marketing, research and development of the acquired businesses with our own internal resources, hence reducing the aggregate of these expenses for the combined businesses and resulting in improved operating results.

Customer Information

We currently have approximately 2,500 active customers. For the years ended September 30, 2014 and 2013, no one customer represented 10% or more of the Company's total revenue.

Summary of Results of Operations

Total revenue for the fiscal year ended September 30, 2014 ("fiscal 2014") decreased to $23.7 million from $24.5 million for the fiscal year ended September 30, 2013 ("fiscal 2013"). Loss from operations for fiscal 2014 was ($5.2) million compared with loss from operations of ($3.2) million for fiscal 2013. We had a net loss for fiscal 2014 of ($6.2) million compared with a net loss of ($3.6) million for fiscal 2013. Loss per share for fiscal 2014 was ($0.32) compared with loss per share of ($0.23) for fiscal 2013.

Summary of Fiscal 2014

Financial

Total subscription and perpetual license revenue increased 44% to $5.7 million in fiscal 2014 from $4.0 million in fiscal 2013.

Recurring revenue, which reflects amounts that are contractually due to Bridgeline, increased 33% to $6.9 million in fiscal 2014 from $5.2 million in fiscal 2013.

Total iAPPS related revenue increased 8% to $20.3 million in fiscal 2014 from $18.8 million in fiscal 2013.

Non-iAPPS related revenue decreased 40% in fiscal 2014 compared to fiscal 2013.

RESULTS OF OPERATIONS

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Depreciation and amortization	6,970	6,529	5,926	6,956	8,427
Interest expense	1,830	1,645	1,755	2,490	2,990
Capital expenditures(5)	946	10,100	2,516	781	874

(1) We restated our financial statements during 2006 as a result of our identification of errors in the financial statements.

The effect of these restatements on our operating results for the years ended December 31, 2005 and 2004, respectively, was as follows (in thousands, except per share data):

	Year Ended December 31, 2005		
	As Previously Reported	Adjustments	Restated
Consolidated revenue	$ 139,670	$ (592)	$ 139,078
Net income	$ 10,083	$ (677)	$ 9,406
Net income (loss) per share available to common stockholders:			
Basic	$ 0.56	$ (0.04)	$ 0.52
Diluted	$ 0.53	$ (0.05)	$ 0.48

	Year Ended December 31, 2004		
	As Previously Reported	Adjustments	Restated
Consolidated revenue	$ 125,379	$ 231	$ 125,610
Net income	$ 2,561	$ 459	$ 3,020
Net income per share available to common stockholders:			
Basic	$ 0.08	$ 0.03	$ 0.11
Diluted	$ 0.07	$ 0.04	$ 0.11

We corrected an error related to the manner in which we recorded and maintained goodwill related to the acquisition in 2001 of our Swiss subsidiary, 3D Systems S.A. Neither this error nor its correction had any effect on net income (loss) reported for any period on our Consolidated Statements of Operations. As a result of the correction of this error, at December 31, 2006 our Consolidated Balance Sheet reflects an $1,822 cumulative net increase in goodwill and a corresponding cumulative net increase in other comprehensive income (loss), together with appropriate adjustments to stockholders equity, arising from foreign currency translation related to such goodwill in each year ended on or before December 31, 2006. Such net increase in other comprehensive income (loss) consists of a $1,719 increase through December 31, 2003, an additional $574 increase for the year ended December 31, 2004, a $969 decrease for the year ended December 31, 2005 and a $498 increase for the year ended December 31, 2006.

(2) As of December 31, 2003, we changed our method of accounting for legal fees incurred in the defense of our patents, and we changed our method of accounting for amortization of one of our patent licenses. We treated each of these as a change in accounting principle. The cumulative effect in 2003 of the change in our method of accounting for legal fees incurred in the defense of our patents and the change in our method of accounting for amortization of one of our patent licenses was $1.1 million and $5.9 million, respectively. Basic and diluted net loss per share in 2003 included a loss of $0.55 per share arising from the cumulative effect of these changes in accounting principles. Before giving effect to such cumulative effect, basic and diluted net loss per share amounted to $1.55.

(3)

Net income in 2005 included a $2.5 million non-cash benefit arising from the reduction of the valuation allowance that we maintain against our deferred income tax assets. In 2006, however, we recorded a $2.5 million valuation allowance against this deferred income tax asset (before giving effect to the benefit of $748 of foreign net deferred income tax assets that we recognized in 2006) that had the effect of reversing the 2005 reduction of our valuation allowance as a result of our determination that it was more likely than not that we would not be able to utilize this deferred income tax asset to offset anticipated U.S. income. We believe that these entries were prudent and appropriate in accordance with SFAS No. 109, Accounting for Income Taxes. See Notes 2 and 20 to the Consolidated Financial Statements.

(4) On June 8, 2006, all of our then outstanding Series B Convertible Preferred Stock was converted by its holders into 2,639,772 shares of common stock, including 23,256 shares of common stock covering accrued and unpaid dividends to June 8, 2006. As a consequence of the conversion of the Series B Convertible Preferred Stock, commencing with the third quarter of 2006, we ceased recording dividends with respect to the outstanding Series B Convertible Preferred Stock that we paid from its original issuance in May 2003 until its full conversion in June 2006. See Note 13 to the Consolidated Financial Statements.

(5) Excludes capital lease additions.

Item 7. ***Management s Discussion and Analysis of Financial Condition and Results of Operations.***

The following discussion and analysis should be read together with the selected consolidated financial data and our consolidated financial statements set forth in this Annual Report on Form 10-K. Certain statements contained in this discussion may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements involve a number of risks, uncertainties and other factors that could cause actual results to differ materially from those reflected in forward-looking statements, as discussed more fully in this Annual Report on Form 10-K. See Forward-Looking Statements and Cautionary Statements and Risk Factors in Item 1A.

The forward-looking information set forth in this Annual Report on Form 10-K is provided as of the date of this filing, and, except as required by law, we undertake no duty to update that information.

Overview

We design, develop, manufacture, market and service 3-D modeling, rapid prototyping and manufacturing systems and related products and materials that enable complex three-dimensional objects to be produced directly from computer data without tooling, greatly reducing the time and cost required to produce prototypes or customized production parts. Our consolidated revenue is derived primarily from the sale of our systems, the sale of the related materials used by the systems to produce solid objects and the provision of services to our customers.

Growth strategy.

We are continuing to pursue a growth strategy that focuses on seven strategic initiatives:

- Improving our customer s bottom line;
- Developing significant product applications;
- Expanding our range of customer services;
- Accelerating new product development;
- Optimizing cash flow and supply chain;
- Creating a performance-based ethical culture; and
- Developing people and opportunities.

Improving our customer s bottom line. We believe that our success depends on the success of our customers. Understanding our customers objectives and businesses should enable us to quickly incorporate their needs into our product offerings and to offer them effective solutions to their business needs. By offering them effective solutions to their needs, we should be able to provide them with solutions that significantly improve their own profitability.

Developing significant product applications. We believe that our ability to focus on industries that provide significant growth opportunities enables us to accelerate the adoption of our business solutions and to create significant new applications for a continually expanding customer base. By focusing our efforts on two significant addressable opportunities, 3-D Modeling and Rapid Manufacturing, we are working to build a business model that can provide sustained growth. Pursuing these market opportunities also complements our strategy to increase, as a percent of total revenue, the amount of revenue we derive from materials and other consumables. Our materials are used in these systems and provide a recurring revenue stream, which should be less sensitive to cyclical economic behavior.

Expanding our range of customer services. We believe that our desire to improve our customer s bottom line demands the creation of new and innovative services designed to meet specific customer needs. We are working to establish faster, simpler business practices designed to make our customer experience with us easier and friendlier.

Accelerating new product development. We believe that our growth depends on our ability to bring to market new materials, systems and services through quick and targeted development cycles. Technology and innovation are at the heart of this initiative. As an industry leader, we believe that the only sure way to sustain growth is through our commitment to technological leadership.

Optimizing cash flow and supply chain. We believe that our profitability, competitiveness and cash flow should be enhanced by our ability to optimize our overall manufacturing operations and supply chain. Through the implementation of lean order-to-cash operations, coupled with selective strategic outsourcing, we are working to derive tangible operating improvements and to improve our overall return on assets.

Creating a performance-based ethical culture. We believe that the success of our strategic initiatives will depend on our ability to execute them within the framework of a performance-based culture dedicated to meeting the needs of our customers, stockholders and other constituencies, supported by a corporate culture that is committed to strong principles of business ethics and compliance with law. We recognize the need to align our performance with our organizational capabilities and practices and our strategic vision to enable us to grow at the rate we expect, to drive operating improvements at the rate we expect and to make the progress against targets necessary to create the necessary alignment.

Developing people and opportunities. We believe that our success depends heavily on the skill and motivation of our employees and that we must therefore invest in the skills that our employees possess and in those that we need to accomplish our strategic initiatives.

As with any growth strategy, there can be no assurance that we will succeed in accomplishing our strategic initiatives.

Summary of 2007 Financial Results

As discussed in greater detail below, we achieved record revenue for 2007 primarily as a result of higher unit volume of sales of new products, the favorable combined effect of price and mix and the favorable effect of foreign currency translation. Our revenue increased by 16.1% to $156.5 million from $134.8 million for 2006 and from $139.1 million in 2005.

For 2007, our operating loss declined by 80.0% to $5.1 million from $25.7 million in 2006. This operating improvement was primarily due to higher gross profit and a higher gross profit margin, lower total operating expenses and a decline in operating expenses as a percentage of revenue. We believe that our overall improved results demonstrate that the strategic actions that we have taken to reshape our organization, transform our product portfolio and re-engineer our business model are taking effect.

Our operating loss for 2007 included $9.6 million of non-cash expenses, which primarily consisted of depreciation and amortization, stock-based compensation and the net change in deferred taxes, in 2007 compared to $12.6 million of non-cash expenses in 2006. Our higher depreciation and amortization expense in 2007 arose from our higher level of capital expenditures in 2006 for our relocation to Rock Hill, South Carolina and our implementation of a new ERP system. We expect that our depreciation and amortization expense for the full year 2008 will be in the range of $5 million to $7 million.

Our gross profit for 2007 increased by 37.2% to $63.5 million from $46.3 million in 2006. Our higher gross profit for 2007 arose primarily from our higher level of revenue, and the improvements in our gross profit margin reflected the more modest increases in cost of sales that we experienced during the year as well as the absence in 2007 of the disruptions and adverse effects from the implementation of our new ERP system, supply chain-staffing issues, the outsourcing of our spare parts and certain of our finished goods supply activities to a logistics management company and other adverse effects that we incurred primarily during the second and third quarters of 2006.

Our total operating expenses declined by $8.6 million in the second half of 2007 from the previous year, reflecting lower SG&A expenses in that 2007 six-month period and the absence of the restructuring costs that we incurred in 2006 primarily for our relocation to Rock Hill. We believe that our quarterly operating expenses have begun to resume a more normalized run rate, and accordingly we expect our SG&A expenses for 2008 to fall into the range of $44 million to $52 million.

As we have previously disclosed, during the second and third quarters of 2006, we experienced disruptions and adverse effects from the implementation of our new ERP system, supply chain staffing issues, and the outsourcing of our spare parts and certain of our finished goods supply activities to a logistics management company. We also experienced some growing pains as our initial success in late 2005 and early 2006 in placing new Sinterstation® Pro, Viper™ Pro and 3-D Modeling systems stretched our field engineering resources and presented some stability issues with certain installed systems. The absence in 2007 of the effects that we experienced in 2006 related to these matters in 2007 contributed to our more favorable performance.

We also took several actions to strengthen our liquidity and our balance sheet during 2007, including the following:

In June, we sold 1.25 million shares of our common stock, about 6.1% of the shares then outstanding, in a private placement transaction and received $20.4 million in net proceeds, after deducting costs of issuance, which we intend to use primarily for working capital purposes.

Subsequently, we issued a conditional call for redemption of our outstanding 6% convertible subordinated debentures, all of which were converted into 1.5 million shares of common stock on July 20, 2007.

With our strengthened cash position, on July 20, we voluntarily prepaid our outstanding $8.2 million of revolving credit borrowings with Silicon Valley Bank that were outstanding at December 31, 2006. That credit facility expired in accordance with its terms on October 1, 2007, and we intend to replace it with a new credit facility as conditions in the credit markets and our performance improve and we become able to negotiate acceptable terms for such a facility. In the meantime, we do not expect to have a need for bank borrowings given our strengthened cash position.

As a result of these actions, we reduced our outstanding indebtedness by $23.9 million at December 31, 2007 to $12.2 million from $36.1 million at December 31, 2006. At December 31, 2007, these obligations consisted of $3.3 million of indebtedness outstanding under the industrial development bonds related to our Grand Junction facility and $8.8 million of capitalized lease obligations related to our Rock Hill facility.

Our unrestricted cash and cash equivalents increased by $15.4 million to $29.7 million at December 31, 2007 from $14.3 million at December 31, 2006. At December 31, 2006, our cash and cash equivalents included the effect of $8.2 million of borrowings under the Silicon Valley Bank credit facility. See Liquidity and Capital Resources *Working capital* and *Outstanding debt and capitalized lease obligations.*

As discussed below, our working capital increased by $23.6 million from December 31, 2006 to December 31, 2007. See Liquidity and Capital Resources *Working capital* below.

Among our major components of working capital, accounts receivable, net of allowances, declined by $3.4 million from December 31, 2006 to December 31, 2007 as we continued to work to reduce our days sales outstanding toward their historical levels, and inventory at December 31, 2007 was $6.1 million below its level at December 31, 2006, reflecting early success in our efforts to significantly reduce inventory.

On February 28, 2008, we purchased for $5.3 million certain equipment (principally inventory related) from Tangible Express, LLC that was made available following Tangible Express announcements in late January and early February 2008 that it was closing its doors, no longer providing prototyping services and selling certain equipment. In connection with that transaction, Tangible Express paid to us $0.6 million covering outstanding amounts that it owed to us.

In connection with these arrangements, we and Tangible Express entered into a Settlement and Release Agreement in which both parties agreed to a general release of all claims against the other, including such claims as made by Tangible Express against us in a civil action it filed on January 22, 2008 in the United States District Court, District of Utah, Central Division in which Tangible Express sought, among other things, a refund of the purchase costs for equipment and services and related damages.

As discussed below in Item 9A. Controls and Procedures, we continued at December 31, 2007 to have material weaknesses with respect to our internal controls over financial reporting.

Results of Operations for 2007, 2006 and 2005

Table 1 below sets forth revenue and percentage of revenue by class of product and service.

Table 1

	2007		2006 (Dollars in thousands)		2005	
Systems and other products	$ 58,178	37.2%	$ 46,463	34.5%	$ 55,133	39.6%
Materials	61,969	39.6	52,062	38.6	44,648	32.1
Services	36,369	23.2	36,295	26.9	39,297	28.3
Totals	$ 156,516	100.0%	$ 134,820	100.0%	$ 139,078	100.0%

Consolidated revenue

For 2007, our consolidated revenue increased by 16.1% to $156.5 million from $134.8 million in 2006 and $139.1 million in 2005.

The $21.7 million increase in consolidated revenue for 2007 was caused primarily by increased volume in new products, a favorable effect of foreign currency translation, a favorable combined effect of changes in product mix and average selling prices, and the absence of the disruptions experienced in 2006 that are discussed above. Sales of new products and services introduced since the latter part of 2003 increased by $19.2 million to $69.8 million in 2007, representing approximately 44.6% of revenue for the year. New product volume and the combined effect of price and mix were partially offset by lower volume of our core older products in 2007, continuing their downward trend. See *Products and Services* in Item 1 above.

In 2006, consolidated revenue decreased 3.1% from $139.1 million in 2005.

The $4.3 million decrease in consolidated revenue for 2006 was primarily due to the disruptions and challenges discussed above and primarily affected revenue from systems and services. These factors overshadowed changes in new product revenue, mix and average selling prices, which are the factors that normally affect our consolidated revenue. Sales of new products and services introduced since the latter part of 2003 increased by $7.0 million to $49.2 million in 2006, representing approximately 36.5% of revenue for the year, from $42.2 million in 2005.

As used in this Management s Discussion and Analysis, the combined effect of changes in product mix and average selling prices, sometimes referred to as price and mix effects, relates to changes in revenue that are not able to be specifically related to changes in unit volume. Among these changes are changes in the product mix of our materials and our systems as the trend toward smaller, more economical systems that has affected our business for the past several years has continued and the influence of new systems and materials on our operating results has grown. Our reporting systems are not currently configured to produce more quantitative information regarding the effect of price and mix changes on revenue. However, we believe that changes in product mix, rather than changes in average selling prices, are the principal contributor to the price and mix effects that we experienced in 2007, 2006 and 2005.

Systems orders and sales tend to fluctuate on a quarterly basis as a result of a number of factors, including the types of systems ordered by customers, customer acceptance of newly introduced products, the timing of product orders and shipments, global economic conditions and fluctuations in foreign exchange rates. Our customers generally purchase our systems as capital equipment items, and their purchasing decisions may have a long lead-time.

Due to the relatively high list price of certain systems and the overall low unit volume of systems sales in any particular period, the acceleration or delay of orders and shipments of a small number of systems from one period to another can significantly affect revenue reported for our systems sales for the period involved. Revenue reported for systems sales in any particular period is also affected by revenue recognition rules prescribed by generally accepted accounting principles.

Backlog has historically not been a significant factor in our business, reflecting our relatively short production and delivery lead times. We had approximately $3.1 million of booked orders outstanding at December 31, 2007, primarily for systems, all of which we expect to ship in 2008, compared to approximately $5.0 million of booked orders outstanding at December 31, 2006.

Revenue by class of product and service

2007 compared to 2006

Table 2 sets forth our change in revenue by class of product and service for 2007 compared to of 2006:

Table 2

	Systems and Other Products		**Materials**		**Services**		**Totals**	
	(Dollars in thousands)							
2006 Revenue	$ 46,463	34.5%	$ 52,062	38.6%	$ 36,295	26.9%	$ 134,820	100%
Change in revenue:								
Volume:								
Core products and services	(5,211)	(11.2)	1,759	3.4	(4,054)	(11.2)	(7,506)	(5.5)
New products and services	10,609	22.8	5,727	11.0	2,838	7.8	19,174	14.2
Price/Mix	4,299	9.3	168	0.3			4,467	3.3
Foreign currency translation	2,018	4.3	2,253	4.3	1,290	3.6	5,561	4.1
Net change	11,715	25.2	9,907	19.0	74	0.2	21,696	16.1
2007 Revenue	$ 58,178	37.2%	$ 61,969	39.6%	$ 36,369	23.2%	$ 156,516	100%

As discussed above, on a consolidated basis, revenue for 2007 increased by 16.1% to $156.5 million from $134.8 million for 2006. The principal factors leading to this $21.7 million increase in consolidated revenue were higher revenue from systems and materials. Revenue from services was essentially flat in 2007 compared to 2006.

These changes in revenue primarily consisted of increases in unit volume from new products, the combined positive effect of changes in product mix and average selling prices and the favorable effect of foreign currency translation.

The 2007 increase in revenue was partially offset by a decline in revenue from core products and services, consistent with prior trends. The favorable effect of foreign currency translation accounted for 25.6% of the increase in revenue in 2007 while, as shown on Table 3 below, it had a minor effect on consolidated revenue in 2006. The effect of foreign currency translation in each year primarily reflects the effect of changes in the value of the U.S. dollar relative to foreign currencies.

As set forth in Table 1 and Table 2:

Revenue from systems and other products increased by $11.7 million or 25.2% to $58.2 million for 2007 from $46.5 million for 2006 and increased to 37.2% of consolidated revenue in 2007 from 34.5% in 2006.

This increase was derived primarily from a $10.6 million increase in sales of our newer systems, the $4.3 million favorable combined effect of changes in product mix and average selling prices and a $2.0 million positive impact from foreign currency translation. This was partially offset by a $5.2 million decline in legacy system sales.

Revenue from materials continued its double-digit rate of growth and increased by $9.9 million or 19.0% to $62.0 million for 2007 from $52.1 million for 2006. Materials revenue increased to 39.6% of consolidated revenue in 2007 from 38.6% in 2006.

Materials revenue volume from our legacy products and new products increased $1.8 million and $5.7 million, respectively. The combined effect of product mix and average selling prices increased by $0.2 million. Foreign currency translation had a $2.3 million positive impact on materials revenue.

Revenue from services was essentially flat for 2007 compared to 2006 and declined to 23.2% of consolidated revenue in 2007 from 26.9% in 2006 reflecting the effect of the growth in revenue from systems and materials in 2007.

Declines in volume of legacy services in 2007 almost completely offset a $2.8 million increase in new services and the $1.3 million favorable impact of foreign currency translation on service revenue.

2006 compared to 2005

As shown in Table 3, the $4.3 million decrease in consolidated revenue in 2006 compared to 2005 reflects the effect of an $11.7 million decline in systems and service revenue in 2006 that was partially offset by $7.4 million of higher revenue from materials sales. Sales of new products and services introduced since the latter part of 2003 increased by $7.4 million to $49.2 million in 2006. Unit volume of sales of legacy products declined by $10.6 million in 2006, more than offsetting the favorable effect of higher sales of new products and services. Unfavorable price/mix effects decreased revenue by $1.5 million, which was partially offset by $0.5 million of favorable foreign currency translation effects.

The components of the $4.3 million decline in revenue by class of product and service for 2006 are shown in Table 9, together with the corresponding percentage of that change compared with 2005 revenue by class of product or service.

Table 3

	Systems and Other Products		Materials		Services		Total	
			(Dollars in thousands)					
2005 Revenue	$ 55,133	39.6%	$ 44,648	32.1%	$ 39,297	28.3%	$ 139,078	100%
Volume core products and services	(7,722)	(14.0)	568	1.3	(3,464)	(8.8)	(10,618)	(7.6)
Volume new products and services	2,709	4.9	4,267	9.6	390	1.0	7,366	5.3
Price/Mix	(4,017)	(7.3)	2,561	5.7		0.0	(1,456)	(1.1)

Foreign currency translation	360	0.7	18	0.0	72	0.2	450	0.3
Net change	(8,670)	(15.7)	$ 7,414	16.6	(3,002)	(7.6)	(4,258)	(3.1)
2006 Revenue	$ 46,463	34.5%	$ 52,062	38.6%	$ 36,295	26.9%	$ 134,820	100%

As set forth in Table 1 and Table 3:

> Revenue from systems and other products decreased by 15.7% to $46.5 million in 2006 from $55.1 million in 2005. Revenue from systems and other products declined to 34.5% of consolidated revenue for 2006 from and 39.6% of revenue in 2005.

The $8.7 million decrease in revenue from systems and other products reflects $7.7 million of unit volume decreases from our core products and $4.0 million of unfavorable price/mix effects that were only partially offset by $2.7 million of unit volume increases from our newer systems and a favorable $0.4 million foreign currency translation effect.

Revenue from materials increased by 16.6% to $52.1 million for 2006 from $44.6 million for 2005. Revenue from materials increased to 38.6% of consolidated revenue for 2006 from and 32.1% of revenue in 2005.

The $7.4 million increase in revenue from materials was primarily due to $4.3 million of higher unit sales of new products, $0.6 million of higher unit sales of core products and $2.6 million of favorable price and mix effects.

Revenue from services decreased by 7.6% to $36.3 million for 2006 from $39.3 million for 2005. Revenue from services declined to 26.9% of consolidated revenue for 2006 from 28.3% of revenue for 2005.

The decrease in revenue from services was principally due to a $3.5 million decline in support services provided for our legacy systems as customers transitioned to newer systems.

Revenue by geographic region

2007 compared to 2006

The United States and Europe contributed to our higher level of revenue in 2007. Asia-Pacific revenue declined by less than $0.1 million compared to 2006.

Table 4 sets forth the change in revenue by geographic area for 2007 compared to 2006 (dollars in thousands):

Table 4

	U.S.		Europe		Asia-Pacific		Total	
2006 Revenue	$ 58,646	43.5%	$ 53,884	40.0%	$ 22,290	16.5%	$ 134,820	100.0%
Change in revenue:								
Volume	4,048	6.9	8,731	16.2	(1,111)	(5.0)	11,668	8.7
Price/Mix	2,808	4.8	584	1.1	1,075	4.8	4,467	3.3
Foreign currency translation			5,621	10.4	(60)	(0.2)	5,561	4.1
Net change	6,856	11.7	14,936	27.7	(96)	(0.4)	21,696	16.1
2007 Revenue	$ 65,502	41.8%	$ 68,820	44.0%	$ 22,194	14.2%	$ 156,516	100.0%

As shown in Table 4:

Revenue from U.S. operations increased by $6.9 million or 11.7% in 2007 to $65.5 million from $58.6 million in 2006.

This increase was due primarily to higher volume and, to a lesser extent, the favorable combined effect of price and mix and reversed the decline in revenue from U.S. operations that we experienced in 2006 shown in Table 5.

> Revenue from operations outside the U.S. increased by $14.8 million or 19.4% to $91.0 million in 2007 from $76.2 million in 2006 and comprised 58.1% of consolidated revenue in 2007 compared to 56.5% in 2006. This increase reflected the effect of the $14.9 million increase in European revenue in 2007, partially offset by a $0.1 million decrease in Asia-Pacific revenue, continuing a trend that we also experienced in 2006.

Foreign currency translation, particularly in our European operations, contributed significantly to our revenue increase in 2007. Excluding the $5.6 million favorable effect of foreign currency translation, revenue from operations outside the U.S. would have increased 12.2% for 2007 compared to 2006 and would have been 56.7% of consolidated revenue for 2007.

Revenue from European operations increased by $14.9 million or 27.7% to $68.8 million in 2007 from $53.9 million in 2006. This increase was due to higher volume, positive price/mix variances and the $5.6 million favorable effect of foreign currency translation. Foreign currency translation accounted for 37.6% of the European revenue increase in 2007.

Revenue from Asia-Pacific operations decreased by $0.1 million or 0.4% to $22.2 million in 2007 from $22.3 million in 2006. This decrease was caused primarily by a $1.1 million decline in volume and a $0.1 million of unfavorable foreign currency translation that more than offset the $1.1 million favorable effect of price and mix in the Asia-Pacific region and reflected a similar trend that we experienced in 2006.

2006 compared to 2005

The components of our $4.3 million decrease in revenue by geographic region for 2006 are shown in Table 5, together with the corresponding percentage of that change compared to the level of revenue for the corresponding period of 2005 for that geographic area.

On a consolidated basis, this $4.3 million decrease resulted from $6.6 million of lower unit volume contributed by the U.S. and the Asia-Pacific region, partially offset by a $3.3 million increase in unit volume in Europe, $1.5 million of unfavorable price/mix effect and the $0.5 million favorable effect of foreign currency translation, reflecting partially offsetting currency translation effects in Europe and the Asia-Pacific regions.

Table 5

	U.S.		Europe		Asia-Pacific		Net Change in Consolidated Revenue	
	(Dollars in thousands)							
2005 Revenue	$ 65,428	47.0%	$ 50,654	36.4%	$ 22,996	16.6%	$ 139,078	100%
Volume	(6,364)	(9.8)	3,299	6.5	(187)	(0.8)	(3,252)	(2.3)
Price/Mix	(418)	(0.6)	(1,263)	(2.5)	225	1.0	(1,456)	(1.1)
Foreign currency translation			1,194	2.4	(744)	(3.3)	450	0.3
Net change revenue	(6,782)	(10.4)	3,230	6.4	(706)	(3.1)	$ (4,258)	(3.1)
2006 Revenue	$ 58,646	43.5%	$ 53,884	40.0%	$ 22,290	16.5%	$ 134,820	100%

As set forth in Table 5:

Revenue from U.S. operations in 2006 decreased by $6.8 million to $58.6 million from $65.4 million in 2005 as a $6.4 million decline in unit volume was combined with a $0.4 million negative combined effect of price and mix. Revenue from U.S. operations represented 43.5% and 47.0% of consolidated revenue for 2006 and 2005, respectively.

Revenue from operations outside the U.S. increased by $2.5 million or 3.4% to $76.2 million for 2006 from $73.7 million for 2005 and increased to 56.5% of consolidated revenue for 2006 from 53.0% of consolidated revenue for 2005 reflecting the effect of the $3.2 million increase in European revenue in 2006, partially offset by a $0.7 million decrease in Asia-Pacific revenue. Excluding the $0.5 million favorable effect of foreign currency translation, revenue from operations outside the U.S. would have increased 2.8% for 2006 compared to 2005 and would have been 56.4% of consolidated revenue for 2006.

Revenue from European operations increased by $3.2 million or 6.4% to $53.9 million for 2006 from $50.7 million for 2005. This increase was primarily due to $3.3 million of higher unit volume and the favorable $1.2 million effect of foreign currency translation, partially offset by the $1.3 million unfavorable effect of price and mix. European revenue represented 40.0% and 36.4% of consolidated revenue for 2006 and 2005, respectively.

Revenue from Asia-Pacific operations decreased by $0.7 million to $22.3 million in 2006 compared to $23.0 million 2005. This decrease in revenue was due primarily to a $0.7 million unfavorable effect of foreign currency translation as the unfavorable effect of lower unit volume and the favorable effect of price and mix substantially offset each other. Asia-Pacific revenue represented 16.5% and 16.6% of consolidated revenue for each of 2006 and 2005, respectively.

Costs and margins

Our gross profit and gross profit margin increased in 2007 after having declined in 2006 compared with 2005.

Table 6 sets forth gross profit, both in dollars and as a percentage of revenue, for 2007 compared to 2006 and 2005 (dollars in thousands):

Table 6

	Year Ended December 31,					
	2007		2006		2005	
	Gross Profit	% Revenue	Gross Profit	% Revenue	Gross Profit	% Revenue
			(Dollars in thousands)			
Products	$ 54,514	45.4%	$ 39,296	39.9%	$ 49,449	49.6%
Services	8,946	24.6	6,961	19.2	12,713	32.4
Total	$ 63,460	40.5%	$ 46,257	34.3%	$ 62,162	44.7%

On a consolidated basis, gross profit for 2007 increased by $17.2 million to $63.5 million from $46.3 million for 2006. Consolidated gross profit margin in 2007 increased by 6.2 percentage points to 40.5% of revenue from 34.3% of revenue for the 2006 period. In addition to our higher revenue, the increase in our gross profit margin in 2007 reflected the relatively lower increase in cost of sales, the absence in 2007 of the 2006 business disruptions and challenges discussed above. Foreign currency transactions did not have a material effect on cost of sales in 2007.

Gross profit decreased by 25.6% to $46.3 million in 2006 from $62.2 million in 2005. Our gross profit margin decreased by 10.4 percentage points to 34.3% of consolidated revenue in 2006 compared to 2005.

The $15.9 million decrease in gross profit in 2006, and the related decline in gross profit margin, were due primarily to the combined effects of:

our lower revenue;

our ERP system, supply chain and logistics disruptions that we encountered primarily in the second and third quarters of 2006; and special accommodations that we extended to certain customers whose orders for our products or services or for repairs to systems were delayed by the disruptions we encountered with our ERP system and our logistics activities or who encountered stability issues with their equipment installations that we were not able to quickly address as a result of resource constraints on our service organization.

The decline in gross profit margin also included a $0.4 million difference in inventory value that was included in cost of sales for 2006 and the recording of credit memoranda for the benefit of customers for product return and pricing issues in 2006.

Cost of sales, which is the principal influence on our gross profit, increased by 5.1% to $93.1 million in 2007, a percentage increase substantially less than the 2007 rate of increase in revenue. As a percentage of consolidated revenue, cost of sales decreased to 59.5% of revenue in 2007 from 65.7% in 2006 and 55.3% in 2005. Cost of sales increased by 15.1% to $88.6 million in 2006 from $76.9 million in 2005.

The increase in cost of sales in 2007 was due primarily to our higher volume and the absence in 2007 of the 2006 business disruptions and challenges described above. The increase in cost of sales in 2006 was due primarily to those disruptions and challenges mentioned above.

The $6.4 million increase in cost of sales for products in 2007 was primarily the result of the increase in volume. The $1.9 million decrease in cost of sales for services in 2007 primarily resulted from the absence of disruptions and challenges that occurred in 2006 as discussed above.

The $8.9 million increase in cost of sales for products in 2006 included $3.6 million of inventory reductions for shrinkage, obsolescence and scrap, $2.1 million of higher manufacturing costs, and $1.3 million of unfavorable purchase price variances, partially offset by $0.7 million of favorable foreign exchange transaction gains and $0.5 million of lower license amortization expense. The $2.8 million increase in cost of sales for services in 2006 resulted from increased installation costs of newer systems and the disruptions and special accommodations discussed above.

Primarily reflecting the factors discussed above, gross profit margin for products:

increased by 5.5 percentage points to 45.4% of consolidated product revenue in 2007 from 39.9% of 2006 consolidated product revenue; and

for 2006, decreased to 39.9% of consolidated product revenue from 49.6% of revenue in 2005.

While revenue from services was essentially flat in 2007 compared to 2006, gross profit margin on services increased to 24.6% of consolidated service revenue for 2007 from 19.2% of 2006 consolidated service revenue after having decreased in 2006 from 32.4% of 2005 consolidated service revenue. The improvement in service margins in 2007 was primarily due to the absence of the disruptions and challenges that occurred in 2006 as discussed above. Service margins in 2006 were adversely affected by disruptions in product availability, reduced sales volume of systems and increased installation costs.

Operating expenses

As shown in Table 7, total operating expenses decreased by $3.4 million or 4.7% to $68.6 million for 2007 from $71.9 million for 2006 after having increased from $53.7 million or 38.6% of revenue in 2005. The decrease in 2007 was primarily due to:

the absence in 2007 of the $6.6 million of restructuring and related costs that we incurred in 2006 primarily in connection with our relocation to Rock Hill;

that were partially offset by

$3.0 million of higher selling, general and administrative costs; and

$0.3 million of higher research and development costs.

These higher annual research and development expenses reflected our continuing high level of work on selected new product developments, including our new V-Flash^{tm} Desktop 3-D Modeler.

As one of our business objectives, we are working to manage our operating expenses to be in the range of 30% to 35% of revenue as our business grows. However, there can be no assurance that we will achieve this objective. In 2005, our operating expenses declined to approach the top of this range, but our SG&A expenses in particular rose disproportionately in 2006 due to the business disruptions and challenges that we experienced in 2006 following the start-up of our new ERP system and costs associated with the restatement of our financial statements and the remediation of previously disclosed material weaknesses, and these expenses continued through part of 2007.

We believe that our quarterly operating expenses have begun to resume a more normalized run-rate, and we expect our SG&A expenses in 2008 to fall into the range of $44 million to $52 million. We began to see a trend that supports this expectation develop in 2007 as SG&A expenses averaged $14.9 million in each of the first two quarters of 2007 and averaged $12.2 million in the final two quarters of 2007.

Table 7

	Year Ended December 31,					
	2007		2006		2005	
	Amount	% Revenue	Amount	% Revenue	Amount	% Revenue
	(Dollars in thousands)					
SG&A	$ 54,159	34.6%	$ 51,204	38.0%	$ 40,344	29.0%
R&D	14,430	9.2	14,098	10.5	12,176	8.7
Restructuring and related costs			6,646	4.9	1,227	0.9
Total	$ 68,589	43.8%	$ 71,948	53.4%	$ 53,747	38.6%

Selling, general, and administrative costs

Selling, general and administrative expenses increased by $3.0 million or 5.8% to $54.2 million in 2007 from $51.2 million in 2006 and increased by $10.9 million in 2006 compared to $40.3 million in 2005. As a percentage of revenue, selling, general and administrative expenses were 34.6%, 38.0% and 29.0% of consolidated revenue in 2007, 2006 and 2005, respectively.

The $3.0 million increase in selling, general and administrative expenses in 2007 compared to 2006 resulted from $8.8 million of higher SG&A costs that we incurred on a period-to-period basis through June 30, 2007, which were partially offset by a $5.8 million period-to-period decline in SG&A expenses in the third and fourth quarters of 2007. As noted above, we believe that our operating expenses began to resume a more normalized run-rate during the second half of 2007.

The $3.0 million increase in selling, general and administrative expenses in 2007 was primarily due to:

- $2.8 million of higher expenses related to sales commissions and bonuses;
- $1.4 million of higher audit fees;
- $0.8 million of higher severance unrelated to our relocation; and
- $0.9 million of higher depreciation expense related to the significant capital expenditures that we made in 2006 related to our relocation to Rock Hill.

which were partially offset by:

- $1.5 million of lower bad debt expenses;
- $1.2 million of lower travel expenses; and
- $1.0 million of lower contract labor expense.
- $0.5 million reduction in employee benefits related to a change in our vacation policy

The $10.9 million increase in selling, general and administrative expenses in 2006 was primarily due to:

- $5.7 million of higher consulting expenses that were incurred primarily in connection with our ERP implementation and the restatement of our financial statements;
- $1.5 million of higher bad debt expense;
- $1.3 million of higher stock-based compensation expense arising from our adoption on January 1, 2006 of SFAS No. 123(R), Share-Based Payment, amounting to $0.7 million and an additional $0.5 million of fourth quarter 2006 expense related to prior years option grants;
- $1.2 million of higher travel expenses related primarily to field service; and
- $0.6 million of higher depreciation and amortization expense.

Research and development expenses.

Research and development expenses increased by 2.4% to $14.4 million in 2007 and by 15.8% to $14.1 million in 2006 from $12.2 million in 2005. In 2007 and 2006, these expenses included, among other projects, costs associated with the development of our V-Flash^{tm} 3-D Desktop Modeler and a materials research and development project that we entered into with Symyx Corporation. In addition to the R&D expenses that we incurred with respect to our V-Flash^{tm} modeler, we had capitalized $1.7 million of assets at December 31, 2007 related to this product, consisting of $0.6 million of capitalized software, $0.4 million of capitalized equipment and $0.7 million of inventory. We continue to work on a variety of new product developments, and we expect to incur approximately $13 million to $14 million of research and development expenses for 2008.

Restructuring and related costs.

Restructuring and related costs in 2006 and 2005 primarily included personnel, relocation and recruiting costs incurred in connection with our relocation to Rock Hill, South Carolina. These costs amounted to $6.6 million in 2006 and $1.2 million in 2005. At December 31, 2006 and 2005, we maintained less than $0.1 million and $0.4 million in restructuring reserves, respectively, for unexpended restructuring costs. We maintained no such reserves at December 31, 2007. See Note 10 to the Consolidated Financial Statements.

These restructuring and relocation costs do not include the capitalized lease value of the lease for the Rock Hill facility at December 31, 2007 or 2006, nor do they include the $3.7 million of capitalized tenant improvement and related costs that we incurred in 2006 to complete the Rock Hill facility. See Liquidity and Capital Resources below.

Our severance and other restructuring costs in 2005 related primarily to costs incurred in the fourth quarter of 2005 in connection with our relocation to Rock Hill. These costs included $0.7 million of personnel, relocation and recruiting costs and approximately $0.5 million of non-cash charges associated with accelerated amortization and asset impairments.

Income (loss) from operations

As a result of our higher revenue and gross profit and our lower level of total operating expenses in 2007 that are discussed above, our operating loss declined by 80.0% to $5.1 million in 2007 from $25.7 million in 2006. We reported $8.4 million of operating income for 2005. The 2007 reduction in operating loss included $7.0 million of operating losses incurred in the first six months of 2007 that were partially offset by $1.9 million of operating income in the last six months of 2007 as our operating results continued to improve.

On a geographic basis:

Our operating loss from our U.S. operations declined to $9.8 million in 2007 from $28.9 million in 2006. We reported $3.2 million of operating income in the U.S. in 2005.

Our operating income from operations in Europe declined to $1.4 million in 2007 from $3.2 million in 2006. We reported $3.4 million of operating income in our European operations in 2005.

Operating income from our Asia-Pacific operations increased to $2.1 million in 2007 from $1.8 million in 2006. We reported $2.9 million of operating income in our Asia-Pacific operations in 2005.

The following table sets forth operating income (loss) from operations by geographic area for 2007, 2006 and 2005 (dollars in thousands):

Table 8

	2007	2006	2005
Income (loss) from operations:			
United States	$ (9,924)	$ (28,888)	$ 3,211
Germany	430	1,608	(1,104)
Other Europe	1,110	1,621	4,517
Asia-Pacific	2,127	1,770	2,900
Subtotal	(6,257)	(23,889)	9,524
Inter-segment elimination	1,128	(1,802)	(1,109)
Total	$ (5,129)	$ (25,691)	$ 8,415

With respect to the U.S., in 2007 and 2006, the changes in operating loss by geographic area reflected the same factors relating to our consolidated operating loss that are discussed above. As most of our operations outside of the U.S. are conducted through sales and marketing subsidiaries, the changes in operating income (loss) in our operations outside of the U.S. in each of 2007, 2006 and 2005 resulted primarily from changes in transfer pricing and in foreign currency translation.

Depreciation and amortization increased to $7.0 million in 2007 and $6.5 million in 2006 from $5.9 million in 2005. The increase in depreciation and amortization in 2007 and 2006 was primarily due to the investments that we made in our facilities, infrastructure, the opening of our rapid manufacturing center and product development capabilities in earlier periods. The increase in depreciation and amortization in 2006 was primarily the result of increased depreciation associated with additions to fixed assets, primarily resulting from our new facility in Rock Hill.

Interest and other expense, net

Interest and other expense, net, which consists primarily of interest income and interest expense, amounted to $1.1 million of net expense for 2007, $1.4 million of net expense for 2006 and $0.7 million of net expense for 2005. The 2007 decrease included interest expense on our bank borrowings and 6% convertible subordinated debentures while they were outstanding during 2007, which was only partially offset by interest income during 2007. The increase in 2006 compared with 2005 resulted from lower gains on the sale of fixed assets and higher other expenses arising from miscellaneous items.

We do not currently expect to incur additional borrowings during 2008 given our improved cash position. With the repayment of our bank borrowings and the conversion of our 6% convertible subordinated debentures during the third quarter of 2007, our quarterly interest expense was less than the income we recorded on our invested cash and cash equivalents during the remainder of 2007. We expect that interest and other expense, net will not be a material factor in our operating results during 2008.

Provisions for (benefit from) income taxes

We recorded $0.5 million and $2.2 million provisions for income taxes in 2007 and 2006, respectively, and a $1.7 million benefit from income taxes in 2005.

Our $0.5 million provision for income taxes in 2007 primarily reflects $0.9 million of tax expense associated with income taxes in foreign jurisdictions partially offset by a $0.4 million reduction at December 31, 2007 in the valuation allowance maintained with respect to our deferred tax assets for various foreign subsidiaries. See Note 20 of the Consolidated Financial Statements.

Our $2.2 million provision for income taxes in 2006 primarily reflects tax expense associated with the recording of a net $1.8 million increase in the valuation allowance maintained against our deferred income tax assets in 2006. This adjustment in our valuation allowance consisted of a $2.5 million increase in the valuation allowance recorded against our U.S. deferred income tax assets, partially offset by a $0.7 million reduction at December 31, 2006 in the valuation allowance maintained for various foreign subsidiaries. See Note 20 to the Consolidated Financial Statements. The remaining $0.4 million provision for tax expense in 2006 arose primarily from income taxes attributable to foreign jurisdictions.

A substantial portion of our deferred income tax assets results from available net operating loss carryforwards in the jurisdictions in which we operate. Certain of these net operating loss carryforwards for U.S. state income tax purposes began to expire in 2006, and certain of them will begin to expire in later years for foreign and U.S. Federal income tax purposes. See Note 20 to the Consolidated Financial Statements. While we were profitable in 2005, our level of U.S. losses for the years ended December 31, 2007 and 2006 may be viewed as evidence that we will not be able to utilize all of these net operating loss carryforwards before they expire.

Our 2005 tax benefit arose from the $2.5 million reduction in the valuation allowance maintained with respect to our U.S. deferred income tax assets discussed above that more than offset a $0.8 million provision for income taxes in 2005, arising primarily from foreign taxes. This reduction in the valuation allowance maintained with respect to our U.S. deferred income tax assets in 2005 was subsequently reversed in 2006 as described above.

Net income(loss); net income (loss) available to common stockholders

Our net loss declined by 77.0% in 2007 to $6.7 million from $29.3 million for 2006. We recorded $9.4 million of net income in 2005.

The principal reasons for our lower net loss in 2007 were:

The $20.6 million reduction in our operating loss;

The $1.7 million reduction in our income tax provisions discussed above, which included in 2006 a $1.8 million net increase in our valuation allowance arising from the reversal in 2006 of the $2.5 million deferred tax asset that we recorded at December 31, 2005 discussed above; and

The $0.3 million reduction of interest and other expense, net.

The principal reasons for our $29.3 million net loss for 2006 compared to our $9.4 million of net income for 2005 were:

A $34.1 million increase in operating loss, which more than offset our 2006 operating income;

A $3.9 million increase in our provisions for income taxes, which included the reversal of the $2.5 million deferred tax asset that we recorded at December 31, 2005 discussed above; and

A $0.7 million increase in interest and other expense, net.

Net income (loss) available to common stockholders differs from net income (loss) discussed above in that it includes the effect of preferred stock dividends that we paid on our Series B Convertible Preferred Stock while it was outstanding.

Net loss available to common stockholders for 2007 was $6.7 million. There was no difference between net loss and net loss available to the common stockholders in 2007 since we had no preferred stock outstanding and paid no preferred stock dividends during that period. On a per share basis, our net loss per share available to the common stockholders declined to $0.33 per share in 2007 on both a basic and fully diluted basis from $1.77 per share in 2006. See Note 17 to the Consolidated Financial Statements.

In 2006, net loss available to common stockholders was $30.7 million. This included $1.4 million of preferred stock dividends, of which $0.9 million was non-cash cost associated with the write-off of the initial offering costs that remained unaccreted and dividends accrued to June 8, 2006, related to our Series B Convertible Preferred Stock, all of which was converted into common stock as of that date.

Net income available to common stockholders for 2005 was $7.7 million after deducting accrued preferred stock dividends and accretion of preferred stock issuance costs with respect to our then outstanding Series B Convertible Preferred Stock. On a per share basis, we recorded $0.52 of basic income per share available to the common stockholders in 2005. After taking into account the dilutive effect of outstanding stock options, diluted income per share available to the common stockholders was $0.48 in 2005.

The dilutive effects of our outstanding convertible securities were excluded from the calculation of diluted income per share in 2007 and 2006 as they would have been anti-dilutive, that is, they would have increased net income per share or reduced net loss per share. See Note 17 to the Consolidated Financial Statements.

Liquidity and Capital Resources

During 2007, our primary sources of liquidity were the Silicon Valley Bank credit facility, discussed below, under which we borrowed $8.2 million in 2006 that we repaid on July 20, 2007 and the $20.4 million in net proceeds that we received on June 19, 2007 from the private placement of 1.25 million shares of common stock. We also generated $2.6 million of cash from operating activities in 2007. See *Cash flow* and *Outstanding debt and capitalized lease obligations* below.

Working capital

Our net working capital increased by $23.6 million to $40.9 million at December 31, 2007 from $17.3 million at December 31, 2006. Table 9 provides a summary of the net changes in working capital items from December 31, 2006 to December 31, 2007.

Table 9

	Increase (Decrease) (In thousands, except par value)
Working capital at December 31, 2006	$ 17,335
Changes in current assets:	
Cash and cash equivalents	15,358
Accounts receivable, net of allowances	(3,398)
Inventories, net of reserves	(6,073)
Prepaid expenses and other current assets	(1,839)
Deferred income tax assets	(55)
Total current assets	3,993
Changes in current liabilities:	
Bank credit facility	(8,200)
Current portion of long-term debt	(220)
Current portion of capitalized lease obligation	13
Accounts payable	(6,118)
Accrued liabilities	(329)
Customer deposits	(4,973)
Deferred revenue	249

Total current liabilities		(19,578)
Net change in working capital		23,571
Working capital at December 31, 2007	$	40,906

Our unrestricted cash and cash equivalents increased by $15.4 million to $29.7 million at December 31, 2007 from $14.3 million at December 31, 2006. This increase resulted from $14.7 million of cash provided by financing activities, $2.6 million of cash provided by operating activities and the favorable $0.3 million effect of exchange rate changes on cash that were partially offset by $2.2 million of cash used in investing activities. Cash provided by financing activities included the $20.4 million of net proceeds from our private placement of common stock in June 2007 and net proceeds from stock option exercises and equity compensation, which were partially reduced by our repayment of $8.2 million of bank borrowings in July 2007.

Accounts receivable, net decreased by $3.4 million to $31.1 million at December 31, 2007 from $34.5 million at December 31, 2006. This decline was primarily attributable to the timing of collections, which resulted in a reduction of days sales outstanding to 64 days at December 31, 2007 from 74 days at December 31, 2006. Accounts receivable more than 90 days past due declined to 5.5% of gross receivables at December 31, 2007 compared to 9.9% of gross receivables at December 31, 2006 primarily due to our focus on resolving past due accounts.

Bad debt expense was $0.1 million for 2007, $1.6 million for 2006 and nominal for 2005. Our allowance for doubtful accounts declined to $2.1 million at December 31, 2007 from $2.4 million at December 31, 2006. This decline resulted primarily from the write down of uncollectible receivables and a reduction in the percentage of receivables over 90 days past due.

Components of inventories were as follows:

Table 10

	2007	2006
Raw materials	$ 835	$ 531
Inventory held by assemblers	197	1,048
Work in process	126	
Finished goods and parts inventory	21,189	26,888
Total cost	22,347	28,467
Less: reserves	(2,306)	(2,353)
Inventories, net	$ 20,041	$ 26,114

Inventories decreased by $6.1 million to $20.0 million at December 31, 2007 from $26.1 million at December 31, 2006. This decrease resulted from a $5.7 million decrease in finished goods inventory, primarily due to a reduction in systems held as finished goods, and a $0.9 million decrease in inventory held by assemblers that was partially offset by a $0.3 million increase in raw materials inventory and a $0.1 million increase in work-in-process inventory.

We outsource substantially all of our equipment assembly and refurbishment activities. Most of our inventory consists of finished goods, including primarily systems, materials and service parts, as our third-party assemblers have taken over supply-chain responsibility for the assembly and refurbishment of systems. As part of our working capital management efforts, we worked throughout 2007 to effect inventory reductions in order to reduce our investment in working capital. We expect to continue this program during 2008.

We generally no longer hold in inventory most parts for systems production or refurbishment. In calculating inventory reserves, which were $2.3 million at December 31, 2007 and $2.4 million at December 31, 2006, we direct our attention to spare parts that we hold in inventory and that we expect to be used over the expected life cycles of the related systems, to inventory related to the blending of our engineered materials and composites and to our ability to sell items that are recorded in finished goods inventory, a large portion of which are new systems.

In connection with our outsourcing activities with our third-party assemblers, we sell to them components from time to time of our raw materials inventory related to systems that they assemble. We record those sales in our financial statements as a product financing arrangement under SFAS No. 49, Accounting for Product Financing Arrangements. At December 31, 2007, SFAS No. 49 inventory that we had sold to assemblers had declined to $0.2 million from $1.0 million of such inventory at December 31, 2006, and we had a corresponding accrued liability representing our non-contractual obligation to repurchase assembled systems and refurbished parts produced from such inventory. See Notes 3 and 4 to the Consolidated Financial Statements.

The components of prepaid expenses and other current assets were:

Table 11

	December 31, 2007		December 31, 2006	
	(Dollars in thousands)			
Value added tax (VAT) and sales tax refunds	$	670	$	393
Progress payments to assemblers		866		698
Non-trade receivables		1,076		2,429
Other		1,817		2,748
Total	$	4,429	$	6,268

Our prepaid expenses and other current assets declined by $1.8 million to $4.4 million at December 31, 2007 from $6.3 million at December 31, 2006. The non-trade receivables shown in Table 11, the inventory held by assemblers shown in Table 10 and a related accrued liability in an amount that corresponds to the book value of inventory held by assemblers included in accrued liabilities on our Consolidated Balance Sheet relate to the accounting for our outsourcing arrangements pursuant to SFAS No. 49. The non-trade receivables shown in Table 11 declined by $1.4 million from December 31, 2006 to $1.1 million at December 31, 2007 as a result of a reduction in semi-finished systems and parts that our third-party assemblers purchased from us to complete the assembly of systems for which we had not received payment from them at period end. Progress payments to assemblers increased by $0.2 million to $0.9 million from $0.7 million in 2006. VAT and sales tax refunds increased by $0.3 million to $0.7 million at December 31, 2007. The increase was due primarily to an increase in VAT for which we expect to receive a refund after December 31, 2007.

As discussed elsewhere in this Form 10-K, we closed the Grand Junction facility late in April 2006 and subsequently listed it for sale, with $3.5 million of net assets related to that facility recorded on our Consolidated Balance Sheet as assets held for sale. Also, at December 31, 2007 and December 31, 2006 we have reflected $3.3 million and $3.5 million, respectively, as a current liability consisting of the outstanding principal amount of the industrial development bonds that financed that facility, in anticipation of the sale of the facility. See Notes 5 and 12 to the Consolidated Financial Statements.

Accounts payable declined by $6.1 million to $20.7 million at December 31, 2007 from $26.8 million at December 31, 2006. The decrease primarily related to lower payables associated with inventory and the absence of costs associated with our relocation and ERP implementation at December 31, 2007 compared to December 31, 2006.

Customer deposits decreased by $5.0 million from $6.5 million to $1.5 million as a result of our reduction of backlog from December 31, 2006 to December 31, 2007.

Deferred revenue increased by $0.2 million to $11.7 million at December 31, 2007 from $11.5 million at December 31, 2006 primarily due to a net increase in maintenance contracts and installation, training and warranty revenue from 2007 shipments.

The changes in 2007 that comprise the other components of working capital not discussed above arose in the ordinary course of business.

Differences not discussed above between the amounts of working capital item changes in the cash flow statement and the amounts of balance sheet changes for those items are primarily the result of foreign currency translation adjustments.

Cash flow

Table 12 summarizes the cash provided by or used in operating activities, investing activities and financing activities, as well as the effect of changes in foreign currency exchange rates on cash, for 2007, 2006, and 2005 (dollars in thousands).

Table 12

	2007	2006	2005
Cash provided by (used in) operating activities	$ 2,625	$ (8,551)	$ (5,760)
Cash used in investing activities	(2,205)	(11,016)	(2,669)
Cash provided by financing activities	14,669	9,964	5,506
Effect of exchange rate changes on cash	269	(394)	746
Net increase (decrease) in cash and cash equivalents	$ 15,358	$ (9,997)	$ (2,177)

Cash flow from operations

For the year ended December 31, 2007, we generated $2.6 million of net cash from operating activities. This cash flow from operations consisted of $9.5 million of non-cash items included in our net loss that was partially offset by our $6.7 million net loss and $0.3 million of cash used by net changes in operating accounts.

The principal changes in non-cash items that favorably affected operating cash flow included $7.0 million of depreciation and amortization expense and $2.7 million of stock-based compensation expense.

The principal changes in operating accounts included:

$5.0 million of cash provided from our lower accounts receivable; and

$6.1 million of cash provided from our lower inventories;

$2.0 million of cash provided by our lower prepaid expenses and other current assets;

that were partially offset by

$7.1 million of cash used in the reduction of accounts payable; and

$5.0 million of cash used with respect to customer deposits.

Our operations used $8.6 million of net cash in 2006. This use of cash was generated primarily by our $29.3 million net loss for the period, partially offset by $12.6 million of non-cash items and $7.2 million of net cash provided by changes in operating accounts. These changes are discussed below:

The $12.6 million of non-cash items included in the net loss for 2006 consisted primarily of (i) the provision for $1.8 million of valuation allowances that we placed during 2006 on our deferred income tax assets, (ii) $6.5 million of depreciation and amortization, (iii) $2.7 million of stock-based compensation expense and

(iv) $1.6 million of adjustments of provision for bad debts;

The $7.2 million of net cash provided by changes in operating accounts primarily included

- a $15.0 million increase in accounts payable arising from the timing of payments and costs associated with our ERP implementation, relocation and severance, and build up of inventory;
- a $4.5 million increase in customer deposits related primarily to payment terms we adopted that require deposits with system orders; and
- a $3.0 million decrease in prepaid expenses and other current assets reflecting primarily changes in supply arrangements with certain of our outsource assemblers,

partially offset by

an $10.3 million increase in inventories, primarily reflecting an increase in finished goods inventory and SFAS No. 49 inventory held by assemblers;

a $2.7 million decrease in deferred revenue reflecting the recognition of maintenance and warranty revenue during 2006; and

a $1.9 million increase in accounts receivable, primarily due to higher receivable balances in Europe arising from customer delays in payment for systems while system performance issues were being resolved, most of those delayed payments having been collected during the first quarter of 2007.

In addition to the reasons for these 2006 changes that are discussed above, our operating results and our cash flow from operations were adversely affected in 2006 by the disruptions discussed above from the launch of our ERP system, supply chain activities and outsourcing of our spare parts warehousing and logistics activities that led, among other things, to shortages of parts and delays in both shipping finished products and invoicing our customers. At the same time, we purchased and paid for a large portion of the products that we had planned to sell to our customers, which reduced our available working capital.

Net cash used in operating activities in 2005 was $5.8 million. We generated $13.5 million of cash from our $9.4 million of net income in that year and $4.1 million of non-cash expense for depreciation and amortization that was more than offset by:

$1.9 million of reconciling items, including the $2.5 million reduction in our valuation allowance for our deferred income tax assets, a $0.3 million of gains on the disposition of property and equipment, partially offset by $0.9 million of stock-based compensation expense; and

$19.2 million of cash used in changes in operating accounts.

The principal changes in operating accounts in 2005 were:

$12.6 million of cash used for additions to accounts receivable;

$9.5 million of cash used for additions to inventories; and

$4.2 million of cash used for additions to prepaid expenses and other current assets,

partially offset by

a $4.9 million increase in accounts payable; and

$2.1 million of customer deposits and deferred revenue.

Cash flow from investing activities

Net cash used in investing activities in 2007 declined to $2.2 million from $11.0 million in 2006. This decrease was primarily due to our lower level of capital expenditures in 2007, reflecting the completion in 2006 of the capital projects associated with our Rock Hill facility and our lower level of capital expenditures in 2007.

We used $11.0 million of net cash for investing activities in 2006 compared to $2.7 million in 2005. This included $10.1 million of capital expenditures in 2006, of which $6.5 million primarily related to our new ERP system and the

Rock Hill facility and $3.7 million related to certain tenant improvements in excess of the initial allowance for tenant improvements and change-order costs necessary to complete our new Rock Hill facility. Cash used in investing activities in 2006 also included $0.7 million of software development costs and $0.5 million for additions to patent and license rights. In 2006, we also recognized $0.2 million of cash from the proceeds of sales of property and equipment, primarily related to our Grand Junction facility that were no longer needed for our operations.

Investing activities in 2005 consisted principally of costs of acquiring and implementing our new enterprise-wide software system and computer hardware upgrades, other purchases of property and equipment, additions to licenses and patents and software development costs, partially offset by $0.7 million of proceeds from the disposition of property.

Capital expenditures were $0.9 million in 2007, $10.1 million in 2006 and $2.5 million in 2005. We expect our capital expenditures in 2008 to be in the range of $3 million to $5 million.

Cash flow from financing activities

Net cash provided by financing activities increased to $14.7 million in 2007 from $10.0 million for 2006 and $5.5 million for 2005. This 2007 increase resulted primarily from $20.4 million of net proceeds, after deducting issuance costs, of our private placement of common stock in June 2007 and $2.9 million of net proceeds from stock option exercises and equity compensation awards, and it was partially offset by our payment of $8.2 million of Silicon Valley Bank revolving credit borrowings in July 2007 and $0.4 million of repayments of industrial development bonds related to our Grand Junction facility during the year. The reduction in cash provided by stock option exercise proceeds and equity compensation awards in 2007 and 2006 as compared to 2005 is a trend that we expect to continue since we discontinued granting stock options in 2004, and there are now a lower number of stock options currently outstanding for future exercise.

Net cash provided by financing activities in 2006 increased to $10.0 million from $5.5 million in 2005. In 2006, cash was provided primarily from $8.2 million of bank borrowings under our Silicon Valley Bank credit facility discussed below and $2.8 million of net proceeds from stock option exercises and equity compensation awards. This amount was partially offset by scheduled payments of principal on our outstanding industrial development bonds and payments of preferred stock dividends.

The principal source of cash from financing activities in 2005 was $8.1 million received primarily from the exercise of stock options. Cash was used to pay preferred stock dividends, to make the semi-annual repayments required to be made under our industrial development bonds and to pay certain other obligations that came due during the year.

Outstanding debt and capitalized lease obligations

At December 31, 2007, total debt and capitalized lease obligations decreased to $12.2 million from $36.1 million at December 31, 2006 primarily due to the conversion of all of our outstanding 6% convertible subordinated debentures into common stock during 2007, our voluntary repayment of all outstanding borrowings under the Silicon Valley Bank credit facility, and scheduled payments of principal on our outstanding industrial development bonds. Our fixed-rate debt and capitalized lease obligations were $8.8 million at December 31, 2007 and $24.4 million at December 31, 2006. In June 2007, we issued a conditional call for redemption of our outstanding 6% convertible subordinated debentures, and all of them were converted into 1.5 million shares of common stock on July 20, 2007. In addition, on July 20, we repaid our $8.2 million of outstanding revolving credit borrowings with Silicon Valley Bank. Our only floating-rate debt obligation at December 31, 2007 was the outstanding industrial development bonds covering our Grand Junction facility.

Our outstanding debt and capitalized lease obligations at December 31, 2007 and December 31, 2006 were as follows:

Table 13

	2007	2006
	(Dollars in thousands)	
Debt:		
Silicon Valley Bank credit facility	$	$ 8,200
Industrial development revenue bonds	3,325	3,545
Total	3,325	11,745
Capitalized lease obligations:		
Current portion of capitalized lease obligation	181	168
Capitalized lease obligation, less current portion	8,663	8,844
Total	8,844	9,012
Subordinated debt:		
6% convertible subordinated debentures		15,354
Total current portion	3,506	11,913
Total long-term portion	8,663	24,198
Total debt	$ 12,169	$ 36,111

Silicon Valley Bank loan and security agreement

On October 1, 2007, our loan and security agreement, as amended, with Silicon Valley Bank expired in accordance with its terms. At that time, the Company had $1.7 million of foreign exchange contracts outstanding with Silicon Valley Bank, with settlement dates through November 14, 2007, which Silicon Valley Bank agreed to permit to remain outstanding until their settlement dates. The credit facility had provided that we and certain of our subsidiaries could borrow up to $15 million of revolving loans, subject to a borrowing base tied to our accounts receivable. The credit facility included sub-limits for letters of credit and foreign exchange facilities and was secured by a first lien in favor of the Bank on certain of our assets, including domestic accounts receivable, inventory and certain fixed assets.

Interest accrued on outstanding borrowings at either the Bank s prime rate in effect from time to time or at a LIBOR rate plus a borrowing margin. Under the credit facility as last amended, the borrowing margins were 0 basis points for prime-rate loans and 275 basis points for LIBOR-rate loans. Prior to this amendment, the borrowing margins for prime-rate loans and LIBOR-rate loans were 100 basis points and 325 basis points, respectively. We were obligated to pay, on a quarterly basis, a commitment fee equal to 0.375% per annum of the unused amount of the credit facility prior to its expiration.

The credit facility imposed certain limitations on our activities, including limitations on the incurrence of debt and other liens, limitations on the disposition of assets, limitations on the making of certain investments and limitations on the payment of dividends on our common stock. The credit facility also required that we comply with certain financial covenants, including (a) commencing as of January 1, 2007 and continuing through October 1, 2007, a modified quick ratio (as defined in the credit facility) of at least 0.70 to 1.00 and, as of December 31, 2006 and for prior periods, a modified quick ratio (as defined in the credit facility) of at least 0.80 to 1.00 and (b) a ratio of total liabilities less subordinated debt to tangible net worth (as each such term is defined in the credit facility) of not more than 2.00 to 1.00 as of December 31, 2006 and at the end of each calendar quarter thereafter. The credit facility also required that we comply with a modified minimum EBITDA (as defined in the credit facility) of not less than $3 million, $1 million and $2.5 million for the calendar quarters ended December 31, 2006, March 31, 2007 and June 30, 2007, respectively. For each subsequent twelve month period ending prior to October 1, 2007, the minimum EBITDA was $15 million. These requirements expired upon the expiration of the credit facility.

At December 31, 2006, we had $8.2 million of revolving borrowings outstanding under this credit facility. At December 31, 2006, we had $0.5 million of foreign exchange forward contracts outstanding with the Bank.

Capitalized lease obligations

Our outstanding capitalized lease obligations relate to two lease agreements that we entered into during 2006 with respect to our Rock Hill facility, one of which covers the facility itself and the other of which covers certain furniture and fixtures that we acquired for use in the facility. The carrying values of the headquarters facility lease and the furniture and fixture lease at December 31, 2007 and 2006, respectively, were $8.8 million and $9.0 million. See Note 22 to the Consolidated Financial Statements.

Industrial development bonds

Our Grand Junction, Colorado facility was financed by industrial development bonds in the original aggregate principal amount of $4.9 million. At December 31, 2007 and December 31, 2006, the outstanding principal amount of these bonds was $3.3 million and $3.5 million, respectively. Interest on the bonds accrues at a variable rate of interest and is payable monthly. The interest rate at December 31, 2007 and December 31, 2006 was 3.52% and 4.01%, respectively. Principal payments are due in semi-annual installments through August 2016.

We reclassified this indebtedness to current indebtedness in 2006 in anticipation of the sale of the Grand Junction facility. We have made all scheduled payments of principal and interest on these bonds. The bonds are collateralized by, among other things, a first mortgage on the facility, a security interest in certain equipment and an irrevocable letter of credit issued by Wells Fargo Bank, N.A. pursuant to the terms of a reimbursement agreement between us and Wells Fargo. We are required to pay an annual letter of credit fee equal to 1% of the stated amount of the letter of credit.

This letter of credit is in turn collateralized by $1.2 million of restricted cash that Wells Fargo holds, which we reclassified as a short-term asset during 2006 in anticipation of the sale of the Grand Junction facility. Wells Fargo has a security interest in that restricted cash as partial security for the performance of our obligations under the reimbursement agreement. We have the right, which we have not exercised, to substitute a standby letter of credit issued by a bank acceptable to Wells Fargo as collateral in place of the funds held by Wells Fargo.

The reimbursement agreement, as amended, contains financial covenants that require, among other things, that we maintain a minimum tangible net worth (as defined in the reimbursement agreement) of $23 million plus 50% of net income from July 1, 2001 forward and a fixed-charge coverage ratio (as defined in the reimbursement agreement) of no less than 1.25 to 1.00. We are required to demonstrate our compliance with these financial covenants as of the end of each calendar quarter. We obtained a waiver from compliance with these covenants at December 31, 2006 and for each subsequent period ending before December 31, 2007. We were in compliance with the financial covenants for the period ended December 31, 2007.

6% convertible subordinated debentures

On July 20, 2007, all of our outstanding 6% convertible subordinated debentures were converted by their holders into 1.5 million shares of our common stock following a conditional call for redemption that we issued in June 2007, and we paid the holders $0.1 million of accrued and unpaid interest upon the conversion of the debentures.

Prior to this conversion, these debentures bore interest at the rate of 6% per year payable semi-annually in arrears in cash on May 31 and November 30 of each year. They were convertible into shares of common stock at the option of the holders at any time prior to maturity at $10.18 per share. At December 31, 2006, $15.4 million aggregate principal amount of these debentures were outstanding.

Financial instruments

We conduct business in various countries using both the functional currencies of those countries and other currencies to effect cross border transactions. As a result, we are subject to the risk that fluctuations in foreign exchange rates between the dates that those transactions are entered into and their respective settlement dates will result in a foreign exchange gain or loss. When practicable, we endeavor to match assets and liabilities in the same currency on our balance sheet and those of our subsidiaries in order to reduce these risks. We also, when we consider it to be appropriate, enter into foreign currency contracts to hedge exposures arising from those transactions. We have not adopted hedge accounting under SFAS No. 133, Accounting for Derivatives and Hedging Activities, as amended by SFAS No. 137 and SFAS No. 138, and we recognize all gains and losses (realized or unrealized) in cost of sales in our Consolidated Statements of Operations.

The dollar equivalent of our foreign currency contracts and their related fair values as of December 31, 2007 and December 31, 2006 were as follows:

Table 14

	Foreign Currency Purchase Contracts		Foreign Currency Sales Contracts	
	2007	2006	2007	2006
	(Dollars in thousands)			
Notional amount	$ 2,905	$ 536	$	$ 2,487
Fair value	2,891	526		2,595
Net unrealized gain (loss)	$ (14)	$ (10)	$	$ (108)

At December 31, 2007 and 2006, the notional amount of these contracts at their respective settlement dates amounted to $2.9 million and $3.0 million, respectively. The 2007 contracts related primarily to purchases of inventory from third parties, and the 2006 contracts related primarily to intercompany payments from our subsidiaries. The notional amount of the purchase contracts aggregated CHF 3.3 million and CHF 0.6 million, respectively (equivalent to $2.9 million and $0.5 million, respectively, at settlement date.) The respective notional amounts of the intercompany purchase obligations at December 31, 2006 aggregated 1.5 million euros (equivalent to $1.9 million at the settlement date) and 0.3 million pound sterling (equivalent to $0.6 million at the settlement date). The fair value of these contracts at December 31, 2006 was $3.1 million. There were no such contracts at December 31, 2007.

The net fair value of all foreign exchange contracts at December 31, 2007 and 2006 reflected nominal unrealized losses at December 31, 2007 and $0.1 million of unrealized losses at December 31, 2006. The foreign currency contracts outstanding at December 31, 2007 expire at various times between January 3, 2008 and February 13, 2008.

Changes in the fair value of derivatives are recorded in cost of sales in our Consolidated Statements of Operations. Depending on their fair value at the end of the reporting period, derivatives are recorded either in prepaid and other current assets or in accrued liabilities in our Consolidated Balance Sheets.

The total impact of foreign currency related items on our Consolidated Statements of Operations was a nominal gain for 2007, a $0.1 million loss and $0.8 million loss for 2006 and 2005, respectively.

Commitments and contingencies

On February 8, 2006, we entered into a lease agreement with KDC-Carolina Investments 3, LP pursuant to which KDC constructed and leased to us an approximately 80,000 square foot building in Rock Hill, South Carolina. Under the terms of this lease, KDC agreed to lease the building to us for an initial 15-year term following completion. See Note 22 to the Consolidated Financial Statements. We took occupancy of the building in November 2006.

After its initial term, the lease provides us with the option to renew the lease for two additional five-year terms as well as the right to cause KDC, subject to certain terms and conditions, to expand the leased premises during the term of the lease, in which case the term of the lease would be extended. The lease is a triple net lease and provides for the payment of base rent of approximately $0.1 million in 2006, $0.7 million annually from 2007 through 2020, including rent escalations in 2011 and 2016, and $0.5 million in 2021. Under the terms of the lease, we will be obligated to pay all taxes, insurance, utilities and other operating costs with respect to the leased premises.

The lease also grants us the right to purchase the leased premises and undeveloped land surrounding the leased premises on terms and conditions described more particularly in the lease.

In accordance with SFAS No. 13, Accounting for Leases, we are considered an owner of the property. Therefore, as required by SFAS No. 13, as of December 31, 2006, we recorded $8.5 million as building in our consolidated balance sheet with a corresponding capitalized lease obligation in the liabilities section of the consolidated balance sheet. We also entered into several amendments to the lease in 2006 pursuant to which, among other things, we agreed to pay $3.4 million of the costs incurred and capitalized related to certain additional tenant improvements and change orders. See Note 22 to the Consolidated Financial Statements.

We lease certain other facilities under non-cancelable operating leases expiring through 2011. The leases are generally on a net-rent basis, under which we pay taxes, maintenance and insurance. Except for the lease of our former headquarters in Valencia, California, which expired at the end of January 2008, we expect leases that expire to be renewed or replaced by leases on other properties. Rental expense for the years ended December 31, 2007, 2006 and 2005 was $2.7 million, $2.4 million and $2.5 million, respectively.

For a discussion of debt commitments at December 31, 2007, see our discussion above under the heading *Industrial development bonds.*

Future contractual payments at December 31, 2007 are set forth in Table 20 below.

Table 15

	Year Ending December 31				
	2008	**2009-2010**	**2011-2012**	**Later Years**	**Total**
Capitalized lease obligations	$ 793	$ 1,586	$ 1,485	$ 14,403	$ 18,267
Non-cancelable operating leases	1,885	1,535	882	73	4,375
Industrial development bonds(1)	355	763	846	1,994	3,958
Total	$ 3,033	$ 3,884	$ 3,213	$ 16,470	$ 26,600

(1) Includes accrued interest at the 3.52% rate in effect at December 31, 2007 and scheduled principal payments in each year. Also assumes that these bonds will not be paid off until their scheduled maturity. We intend to repay these bonds upon sale of the Grand Junction facility.

Series B convertible preferred stock

No preferred stock was issued or outstanding at December 31, 2007 or December 31, 2006. On June 8, 2006, all of our then outstanding Series B Convertible Preferred Stock was converted by its holders into 2,639,772 shares of common stock, including 23,256 shares of common stock covering accrued and unpaid dividends to June 8, 2006. For the year ended December 31, 2006, we recognized $1.4 million of dividend cost.

Stockholders equity

Stockholders equity increased by $35.1 million to $104.8 million at December 31, 2007 from $69.7 million at December 31, 2006. This increase was primarily attributable to a $41.1 million increase in additional paid-in-capital consisting of:

- $20.4 million of net proceeds, after deducting costs of issuance, from the private placement of common stock that we completed in June 2007;

$15.1 million arising from the conversion of our 6% convertible subordinated debentures during 2007;

$2.8 million of net proceeds from stock option exercises and other equity compensation awards during 2007;

$2.4 million of stock compensation expense recorded in stockholders equity in accordance with SFAS No. 123(R) during 2007; and

$0.4 million related to the issuance of restricted stock.

Critical Accounting Policies and Significant Estimates

The discussion and analysis of our results of operations and financial condition set forth in this Annual Report on Form 10-K is based on our Consolidated Financial Statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires us to make critical accounting estimates that directly impact our Consolidated Financial Statements and related disclosures.

Critical accounting estimates are estimates that meet two criteria:

The estimates require that we make assumptions about matters that are highly uncertain at the time the estimates are made; and

There exist different estimates that could reasonably be used in the current period, or changes in the estimates used are reasonably likely to occur from period to period, both of which would have a material impact on our results of operations or financial condition.

On an ongoing basis, we evaluate our estimates, including those related to stock-based compensation, revenue recognition, the allowance for doubtful accounts, income taxes, inventories, goodwill and other intangible and long-lived assets and contingencies. We base our estimates and assumptions on historical experience and on various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

The following paragraphs discuss the items that we believe are the critical accounting policies most affected by significant management estimates and judgments. Management has discussed and periodically reviews these critical accounting policies, the basis for their underlying assumptions and estimates and the nature of our related disclosures herein with the Audit Committee of the Board of Directors.

Revenue recognition

Revenue from the sale of systems and related products and materials is recognized upon shipment or when services are performed, provided that persuasive evidence of a sales arrangement exists, both title and risk of loss have passed to the customer and collection is reasonably assured. Persuasive evidence of a sales arrangement exists upon execution of a written sales agreement that constitutes a fixed and legally binding commitment between us and the buyer. In instances where sales are made to an authorized reseller, the same criteria cited above is applied to determine the recognition of revenue. The reseller s creditworthiness is evaluated prior to such sale. The reseller takes ownership of the related systems, products or materials and payment is not dependent upon the reseller s sale to an end user.

Sales of our systems generally include equipment, a software license, a warranty on the equipment, training and installation. We allocate and record revenue for these transactions based on vendor-specific objective evidence that has been accumulated through historic operations, which, in most cases, is the price charged for the deliverable when sold separately. If fair value for all deliverables cannot be determined, we will use the residual method to determine the amount of the consideration to be allocated to the delivered items. We also evaluate the impact of undelivered items on the functionality of delivered items for each sales transaction and, where appropriate, defer revenue on delivered items when that functionality has been affected.

Functionality is determined to be met if the delivered products or services represent a separate earnings process.

Revenue from services is recognized at the time of performance. We provide end-users with maintenance under a warranty agreement for up to one year and defer a portion of the revenue from the related systems sale at the time of sale based on the relative fair value of those services. After the initial warranty period, we offer these customers optional maintenance contracts. Deferred maintenance revenue is recognized ratably, on a straight-line basis, over the period of the contract.

Our systems are sold with licensed software products that are integral to the operation of the systems. We sell equipment with embedded software to our customers. The embedded software is not sold separately, it is not a significant focus of the marketing effort and we do not provide post-contract customer support specific to the software or incur significant costs that are within the scope of SFAS No. 86. Additionally, the functionality that the software provides is marketed as part of the overall product. The software embedded in the equipment is incidental to the equipment as a whole such that SOP No. 97-2, *Software Revenue Recognition*, is not applicable. Sales of these products are recognized in accordance with SEC Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition.*

Shipping and handling costs billed to customers for equipment sales are included in product revenue in the Consolidated Statement of Operations. Costs we incur that are associated with shipping and handling are included in product cost of sales in the Consolidated Statement of Operations.

Credit is extended, and creditworthiness is determined, based on an evaluation of each customer s financial condition. New customers are generally required to complete a credit application and provide references and bank information to facilitate an analysis of creditworthiness. Customers with a favorable profile may receive credit terms based on that profile that differ from our general credit terms. Creditworthiness is considered, among other things, in evaluating our relationship with customers with past due balances.

Our terms of sale generally require payment within 30 to 60 days after shipment of a product although we also recognize that longer payment periods are customary in some countries in which we transact business. To reduce credit risk in connection with systems sales, we may, depending upon the circumstances, require significant deposits prior to shipment and may retain a security interest in a system sold until fully paid. In some circumstances, we may require payment in full for our products prior to shipment and may require international customers to furnish letters of credit. For services, we either bill customers on a time-and-materials basis or sell customers service agreements that are recorded as deferred revenue and provide for payment in advance on either an annual or other periodic basis.

Allowance for doubtful accounts

Our estimate for the allowance for doubtful accounts related to trade receivables is based on two methods. The amounts calculated from each of these methods are combined to determine the total amount reserved.

First, we evaluate specific accounts where we have information that the customer may have an inability to meet our financial obligations (for example, aging over 90 days past due or bankruptcy). In these cases, we use our judgment, based on available facts and circumstances, and record a specific reserve for that customer against amounts due to reduce the receivable to the amount that is expected to be collected. These specific reserves are reevaluated and adjusted as additional information is received that impacts the amount reserved.

Second, a reserve is established for all customers based on a range of percentages applied to aging categories. These percentages are based on historical collection and write-off experience. If circumstances change (for example, we experience higher-than-expected defaults or an unexpected material adverse change in a major customer s ability to meet its financial obligations to us), the estimate of the recoverability of amounts due to us could be reduced by a material amount.

The Company also provides an allowance account for returns and discounts. This allowance is evaluated on a specific account basis. In addition, the Company provides a general reserve for all customers that have not been specifically identified based on historical experience.

Our allowance for doubtful accounts declined to $2.1 million at December 31, 2007 from $2.4 million at December 31, 2006. This change resulted primarily from the write down of uncollectible receivables and a reduction in the percentage of receivables over 90 days past due. We believe that our allowance for doubtful accounts is a critical accounting estimate because it is susceptible to change and dependent upon events that may or may not occur and because the impact of recognizing additional allowances for doubtful accounts may be material to the assets reported on our balance sheet and in our results of operations.

Income taxes

We and our domestic subsidiaries file a consolidated U.S. federal income tax return. Our non-U.S. subsidiaries file income tax returns in their respective local jurisdictions. We provide for income taxes on those portions of our foreign subsidiaries accumulated earnings that we believe are not reinvested indefinitely in their business.

We account for income taxes under the asset and liability method. Deferred income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and tax benefit carry-forwards. Deferred income tax liabilities and assets at the end of each period are determined using enacted tax rates.

We record deferred income tax assets arising from temporary timing differences between recorded net income and taxable net income when and if we believe that future earnings will be sufficient to realize the tax benefit. We provide a valuation allowance for those jurisdictions where the expiration date of tax benefit carry-forwards or the projected taxable earnings indicate that realization is not likely.

Under the provisions of SFAS No. 109, Accounting for Income Taxes, a valuation allowance is required to be established or maintained when, based on currently available information and other factors, it is more likely than not that all or a portion of a deferred income tax asset will not be realized. SFAS No. 109 provides that an important factor in determining whether a deferred income tax asset will be realized is whether there has been sufficient income in recent years and whether sufficient income is expected in future years in order to utilize the deferred income tax asset. Based upon our accumulated losses and our then continuing operating losses for years prior to 2003, we established and maintain a valuation allowance against our deferred income tax assets.

At December 31, 2005, we performed an analysis pursuant to SFAS No. 109 to determine whether, in light of the improvement in our operations in 2004 and 2005, it was more likely than not that all or a portion of our deferred income tax assets would be able to be utilized. In performing this analysis, we considered, among other things, the amount of our taxable income in 2004 and 2005 and whether we had a basis to expect sufficient taxable income in future years to utilize our deferred income tax assets. Based on this analysis, we determined that it was more likely than not that we would be able to utilize a portion of our deferred income tax assets attributable to U.S. taxable income in 2006, and we accordingly reversed $2.5 million of our valuation allowance and recognized a corresponding benefit against our provision for income taxes in our Consolidated Statement of Operations for the year ended December 31, 2005. The $2.5 million net deferred income tax asset arising from this reversal was recorded as a current asset on our Consolidated Balance Sheet at December 31, 2005. As a result of this reversal and the other changes to our deferred income tax assets and liabilities during 2005, at December 31, 2005 our valuation allowance declined to $23.0 million.

During the year ended December 31, 2006; however, we recorded a $2.5 million valuation allowance against the deferred income tax assets that we recorded at the end of 2005. We determined that, as a result of the losses that we incurred during 2006 and our related prospects for the near future, it was more likely than not that we would be unable to utilize a portion of these deferred income tax assets attributable to anticipated U.S. income. We believe that recording a valuation allowance against this deferred income tax asset was prudent and appropriate in accordance with

SFAS No. 109. As a result of this valuation allowance and other changes to our deferred income tax assets and liabilities during 2006, at December 31, 2006, our valuation allowance fully offset our net deferred income tax assets attributable to the U.S.

However, at December 31, 2006, we determined that it is more likely than not that we will be able to utilize a portion of our deferred income tax assets related to certain of our foreign operations in the near future. Accordingly, we reduced the valuation allowance attributable to our non-U.S. deferred income tax assets and recorded a $0.7 million deferred income tax asset related thereto in our Consolidated Balance Sheet at December 31, 2006, and we used this deferred tax asset in 2006 to reduce the foreign income taxes otherwise payable to those local jurisdictions. We conducted a similar review at December 31, 2007 and determined that it is more likely than not that we will be able to utilize an additional portion of our non-U.S. deferred income tax assets related to certain of our foreign operations in the near future. Accordingly, we reduced the valuation allowance by $0.4 million and recognized a corresponding benefit against our income tax provision in the Consolidated Statement of Operations for the year ended December 31, 2007.

We believe that our estimate of deferred income tax assets and our maintenance of a valuation allowance against such assets are critical accounting estimates because they are subject to, among other things, an estimate of future taxable income in the U.S. and in other non-U.S. tax jurisdictions, which are susceptible to change and dependent upon events that may or may not occur, and because the impact of our valuation allowance may be material to the assets reported on our balance sheet and in our results of operations. We intend to continue to assess our valuation allowance in accordance with the requirements of SFAS No. 109.

The determination of our income tax provision is complex because we have operations in numerous tax jurisdictions outside the U.S. that are subject to certain risks that ordinarily would not be expected in the U.S. Tax regimes in certain jurisdictions are subject to significant changes, which may be applied on a retroactive basis. If this were to occur, our tax expense could be materially different than the amounts reported.

We periodically estimate the probable tax obligations using historical experience in tax jurisdictions and our informed judgment. There are inherent uncertainties related to the interpretation of tax regulations in the jurisdictions in which we transact business. The judgments and estimates made at a point in time may change based on the outcome of tax audits, as well as changes to, or further interpretations of, regulations. Income tax expense is adjusted in the period in which these events occur, and these adjustments are included in our consolidated statements of operations. If such changes take place, there is a risk that our effective tax rate may increase or decrease in any period.

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation 48, *Accounting for Uncertainty in Income Taxes-an Interpretation of FASB Statement No. 109* (FIN 48), which became effective during the year ended December 31, 2007. FIN 48 addresses the determination of how tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, a company must recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate resolution. See Note 20 to the Consolidated Financial Statements.

Inventories

Inventories are stated at the lower of cost or net realizable value, cost being determined predominately on the first-in, first-out method. Reserves for inventories are provided based on historical experience and current product demand. Our inventory reserve was $2.3 million and $2.4 million at December 31, 2007 and 2006, respectively. We evaluate the adequacy of these reserves quarterly. Our determination of the allowance for inventory reserves is subject to change because it is based on management s current estimates of required reserves and potential adjustments.

We believe that the allowance for inventory obsolescence is a critical accounting estimate because it is susceptible to change and dependent upon events that may or may not occur and because the impact of recognizing additional obsolescence reserves may be material to the assets reported on our balance sheet and in our results of operations.

Goodwill and other intangible and long-lived assets

The annual impairment testing required by SFAS No. 142, Goodwill and Other Intangible Assets, requires us to use our judgment and could require us to write down the carrying value of our goodwill and other intangible assets in future periods. As required by SFAS No. 142, we have allocated goodwill to identifiable reporting units, which are tested for impairment using a two-step process detailed in that statement. See Notes 2 and 7 to the Consolidated Financial Statements. The first step requires comparing the fair value of each reporting unit with our carrying amount, including goodwill. If that fair value exceeds the carrying amount, the second step of the process is not required to be performed, and no impairment charge is required to be recorded. If that fair value does not exceed that carrying amount, we must perform the second step, which requires an allocation of the fair value of the reporting unit to all assets and liabilities of that unit as if the reporting unit had been acquired in a purchase business combination and the fair value of the reporting unit was the purchase price. The goodwill resulting from that purchase price allocation is then compared to the carrying amount with any excess recorded as an impairment charge.

Goodwill set forth on the Consolidated Balance Sheet as of December 31, 2007 arose from acquisitions carried out in years prior to December 31, 2003. Goodwill arising from the acquisition of DTM Corporation in 2001 was allocated to reporting units based on the percentage of SLS® systems then installed by geographic area. Goodwill arising from other acquisitions was allocated to reporting units based on geographic dispersion of the acquired companies sales at the time of their acquisition.

Pursuant to the requirements of SFAS No. 142, we are required to perform a valuation of our reporting units annually, or upon significant changes in our business environment. We have performed an evaluation of our reporting units for each year that SFAS No. 142 has been in effect, including the years ended December 31, 2007, 2006 and 2005 and concluded that, based on the discounted cash flow method, the fair values of our reporting units exceeded their carrying values for each year. Accordingly, no goodwill impairment adjustments were recorded for these years for goodwill recorded on our Consolidated Balance Sheets for those years.

We evaluate long-lived assets other than goodwill for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. If the estimated future cash flows (undiscounted and without interest charges) from the use of an asset are less than the carrying value, a write-down would be recorded to reduce the related asset to its estimated fair value.

We believe that our determination whether or not to recognize an impairment of goodwill or of intangible assets or other long-lived assets is a critical accounting estimate because it is susceptible to change, dependent upon estimates of the fair value of our reporting units and because the impact of recognizing an impairment may be material to the assets reported on our balance sheet and to our results of operations.

Stock-based compensation

Effective January 1, 2006, we adopted SFAS No. 123(R), Share-Based Payment, that establishes standards for accounting for transactions in which we exchange our equity instruments for employee services based on the fair value of those equity instruments. Through December 31, 2005, we applied the intrinsic-value-based method of accounting prescribed by APB Opinion No. 25 (APB No. 25), Accounting for Stock Issued to Employees, and we adhered to the pro forma disclosure provisions of SFAS No. 123 and related interpretations to account for stock options previously issued under our stock option plans. These interpretations include FASB Interpretation No. 44, Accounting for Certain Transactions Involving Stock Compensation, an interpretation of APB Opinion No. 25, issued in March 2000.

Under this method, compensation expense was generally recorded on the date of a stock option grant only if the current market price of the underlying stock exceeded the exercise price. We had also adopted the disclosure only provisions of SFAS No. 123, Accounting for Stock-Based Compensation, and SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, which was released in December 2002 as an amendment to SFAS No. 123. These statements established accounting and disclosure requirements using a fair-value-based method of accounting for stock-based employee compensation plans. As allowed by SFAS No. 123 and SFAS No. 148, we elected to continue to apply the intrinsic-value-based method of accounting described above through December 31, 2005.

SFAS No. 123(R), as in effect prior to January 1, 2006, required the use of option pricing models that were not developed for use in valuing employee stock options. The Black-Scholes option pricing model was developed for use in estimating the fair value of short-lived exchange-traded options that have no vesting restrictions and are fully transferable. In addition, option pricing models require the input of highly subjective assumptions, including the option s expected life and the price volatility of the underlying stock. Because our employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in our opinion, the existing models do not necessarily provide a reliable single measure of the fair value of employee stock options.

We believe that our valuation of stock-based compensation is a critical accounting estimate because it is susceptible to change and dependent upon events that may or may not occur and because the impact of recognizing stock-based compensation expense may be material to our results of operations.

Contingencies

We account for contingencies in accordance with SFAS No. 5, Accounting for Contingencies. SFAS No. 5 requires that we record an estimated loss from a loss contingency when information available prior to issuance of our financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated. Accounting for contingencies such as legal and income tax matters requires us to use our judgment.

Recent Accounting Pronouncements

In September 2006, FASB issued SFAS No. 157, Fair Value Measurements. This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. This statement does not require any new fair value measurements. This statement is expected to be applied prospectively and is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. However, on February 12, 2008, the FASB issued FSP FAS 157-2 which delays the effective date of SFAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). This FSP partially defers the effective date of Statement 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for items within the scope of this FSP. We are currently assessing the impact that SFAS No. 157 may have on our consolidated financial statements.

In February 2007, FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 , which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The objective of SFAS No. 159 is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS No. 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 does not affect any existing accounting literature that requires certain assets and liabilities to be carried at fair value, nor does it eliminate disclosure requirements included in other accounting standards, including requirements for disclosures about fair value measurements included in SFAS No. 157, Fair Value Measurements, and SFAS No. 107, Disclosures about Fair Value of Financial Instruments. SFAS No. 159 is effective for our fiscal year beginning January 1, 2008. We are currently assessing the impact that the adoption of SFAS No. 159 may have on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (Revised), Business Combinations (SFAS No. 141 (R)), replacing SFAS No. 141, Business Combinations (SFAS No. 141). SFAS No. 141(R) retains the fundamental requirements of SFAS No. 141, broadens its scope by applying the acquisition method to all transactions and other events in which one entity obtains control over one or more other businesses, and requires, among other things, that assets acquired and liabilities assumed be measured at fair value as of the acquisition date, that liabilities related to contingent consideration be recognized at the acquisition date and remeasured at fair value in each subsequent reporting period, that acquisition-related costs be expensed as incurred, and that income be recognized if the fair value of the net assets acquired exceeds the fair value of the consideration transferred. SFAS No. 141 (R) is to be applied prospectively in financial statements issued for fiscal years beginning after December 15, 2008. We are currently assessing the impact that the adoption of SFAS No. 141 (R) may have on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an Amendment of ARB No. 51 (SFAS No. 160). SFAS No. 160 establishes accounting and reporting standards for noncontrolling interests (i.e., minority interests) in a subsidiary, including changes in a parent s ownership interest in a subsidiary and requires, among other things, that noncontrolling interests in subsidiaries be classified as a separate component of equity. Except for the presentation and disclosure requirements of SFAS No. 160, which are to be applied retrospectively for all periods presented, SFAS No. 160 is to be applied prospectively in financial statements issued for fiscal years beginning after December 15, 2008. We are currently assessing the impact that the adoption of SFAS No. 160 may have on our consolidated financial statements.

Item 7A. ***Quantitative and Qualitative Disclosures about Market Risk***

We are exposed to market risk from fluctuations in interest rates, foreign currency exchange rates, and commodity prices, which may adversely affect our results of operations and financial condition. We seek to minimize these risks through regular operating and financing activities and, when we consider it to be appropriate, through the use of derivative financial instruments. We do not purchase, hold or sell derivative financial instruments for trading or speculative purposes.

Interest rates

Our exposure to market risk for changes in interest rates relates primarily to our cash and cash investments and our outstanding industrial development bonds. We seek to minimize the risk to our cash and cash investments by investing cash in excess of our operating needs in short-term, high-quality instruments issued by highly creditworthy financial institutions, corporations or governments. With the amount of cash and cash equivalents and floating-rate borrowings that we maintained at December 31, 2007, a hypothetical 1% or 100 basis point change in interest rates would have a $0.3 million effect on our financial position and results of operations.

From time to time, we may use derivative financial instruments, including interest rate swaps, collars or options, to manage our exposure to fluctuations in interest rates. At December 31, 2007, we had no such financial instruments outstanding.

The fair value of fixed-rate debt varies with changes in interest rates. Generally, the fair value of these fixed-rate instruments will increase as interest rates fall and decrease as interest rates rise. The carrying amounts and estimated fair values of our financial instruments at December 31, 2007 were as follows:

Table 16

	2007	
	Carrying Amount	**Fair Value**

Financial liabilities:		
Industrial development bonds	$ 3,325	$ 3,325
Capitalized lease obligations	8,844	9,064
Total debt	$ 12,169	$ 12,389

No adjustment was necessary to reflect fair value of the industrial development bonds in 2007 due to the floating-rate nature of those bonds, interest on which varies weekly. The fair value of the amounts outstanding under the capitalized lease obligations at December 31, 2007 was determined by evaluating the nature and terms of the instrument and considering prevailing economic and market conditions. The interest rate used to discount the contractual payments associated with the capitalized lease obligations was 6.74% for 2007. See Note 11 to the Consolidated Financial Statements. Such estimates are subjective and involve uncertainties and matters of significant judgment. Changes in assumptions could significantly affect our estimates.

Foreign exchange rates

We transact business globally and are subject to risks associated with fluctuating foreign exchange rates. More than 50% of our consolidated revenue is derived from sales outside of the U.S. See Business Global Operations above. This revenue is generated primarily from the operations of our foreign sales subsidiaries in their respective countries and surrounding geographic areas and is denominated in each subsidiary s local functional currency although certain sales are denominated in other currencies, including U.S. dollars or euros, rather than the local functional currency. These subsidiaries incur most of their expenses (other than intercompany expenses) in their local functional currency. These currencies include the euro, pound sterling, Swiss franc and Japanese yen.

The geographic areas outside the U.S. in which we operate are generally not considered to be highly inflationary. Nonetheless, these foreign operations are sensitive to fluctuations in currency exchange rates arising from, among other things, certain intercompany transactions that are generally denominated in U.S. dollars rather than their respective functional currencies. Our operating results as well as our assets and liabilities are also subject to the effect of foreign currency translation when the operating results, assets and liabilities of our foreign subsidiaries are translated into U.S. dollars in our consolidated financial statements.

The total impact of foreign currency related items on our Consolidated Statements of Operations was a nominal gain for 2007, a $0.1 million loss and $0.8 million loss for 2006 and 2005, respectively. The unrealized effect of foreign currency translation in 2007 resulted in a $0.4 million gain that was recorded in stockholders equity as other comprehensive income, compared to a $1.6 million gain in 2006 and a $2.2 million loss in 2005. At December 31, 2007, a hypothetical change of 10% in foreign currency exchange rates would cause a $9.2 million change in revenue in our consolidated statement of operations assuming all other variables were held constant.

We and our subsidiaries conduct business in various countries using both the functional currencies of those countries and other currencies to effect cross border transactions. As a result, we and our subsidiaries are subject to the risk that fluctuations in foreign exchange rates between the dates that those transactions are entered into and their respective settlement dates will result in a foreign exchange gain or loss. When practicable, we endeavor to match assets and liabilities in the same currency on our U.S. balance sheet and those of our subsidiaries in order to reduce these risks. We also, when we consider it to be appropriate, enter into foreign currency contracts to hedge exposures arising from those transactions. We apply SFAS No. 133, Accounting for Derivatives and Hedging Activities, as amended by SFAS No. 137 and SFAS No. 138, to report all derivative instruments on the balance sheet at fair value. We have not adopted hedge accounting, and all gains and losses (realized or unrealized) are recognized in cost of sales in the Consolidated Statements of Operations.

The dollar equivalent of our foreign currency contracts and their related fair values as of December 31, 2007 and 2006 was as follows:

Table 17

	Foreign Currency Purchase Contracts	**Foreign Currency Sales Contracts**

	2007	2006	2007	2006
	(Dollars in thousands)			
Notional amount	$ 2,905	$ 536	$	$ 2,487
Fair value	2,891	526		2,595
Net unrealized gain (loss)	$ (14)	$ (10)	$	$ (108)

At December 31, 2007 and 2006, the notional amount of these contracts at their respective settlement dates amounted to $2.9 million and $3.0 million, respectively. The 2007 contracts related primarily to purchases of inventory from third parties, and the 2006 contracts related primarily to intercompany payments from our subsidiaries.. The notional amount of the purchase contracts related to purchases aggregated CHF 3.3 million and CHF 0.6 million, respectively (equivalent to $2.9 million and $0.5 million, respectively, at settlement date.) At December 31, 2006 the respective notional amounts of the contracts related to intercompany purchase obligations and 2006 aggregated euro 1.5 million (equivalent to $1.9 million at settlement date) pounds sterling 0.3 million (equivalent to $0.6 million at settlement date.). The fair value of these contracts at December 31, 2006 was $3.1 million. There were no such contracts at December 31, 2007.

The net fair value of all foreign exchange contracts at December 31, 2007 and 2006 reflected nominal unrealized losses of at December 31, 2007 and $0.1 million of unrealized losses at December 31, 2006. The foreign currency contracts outstanding at December 31, 2007 expire at various times between January 3, 2008 and February 13, 2008.

Changes in the fair value of derivatives are recorded in cost of sales in our Consolidated Statements of Operations. Depending on their fair value at the end of the reporting period, derivatives are recorded either in prepaid and other current assets or in accrued liabilities in our Consolidated Balance Sheets.

We are exposed to credit risk if the counterparties to such transactions are unable to perform their obligations. However, we seek to minimize such risk by entering into transactions with counterparties that are believed to be creditworthy financial institutions.

As noted above, we may use derivative financial instruments, including foreign exchange forward contracts and foreign currency options, to fix or limit our exposure to currency fluctuations. We do not enter into derivative financial instruments for speculative or trading purposes. The terms of such instruments are generally twelve months or less. We do not hedge our foreign currency exposures in a manner that would entirely eliminate the effects of changes in foreign exchange rates on our consolidated net income or loss.

Commodity prices

We use various commodity raw materials and energy products in conjunction with our manufacturing processes. Generally, we acquire such components at market prices and do not use financial instruments to hedge commodity prices. As a result, we are exposed to market risks related to changes in commodity prices of these components. At December 31, 2007, a hypothetical 10% change in commodity prices for raw materials would cause a $1.0 million change to cost of sales in our consolidated statement of operations.

Item 8. ***Financial Statements and Supplementary Data.***

Our consolidated financial statements set forth below on pages F-1 through F-40 are incorporated herein by reference.

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

Not applicable.

Item 9A. ***Controls and Procedures.***

Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act) are controls and other procedures that are designed to provide reasonable assurance that the information that we are required to disclose in the reports that we file or submit under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

In connection with the preparation of this Annual Report, our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2007. In making this evaluation, our management considered the material weaknesses in our internal control over financial reporting that we disclosed in prior filings of our periodic reports under Section 13(a) of the Securities Exchange Act and the status of their remediation as discussed below, as well as the additional material weakness in our internal control over financial reporting that is discussed below. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective as of December 31, 2007 due to the continued existence of material weaknesses.

However, giving full consideration to the material weaknesses described below, we performed additional analyses and other procedures in order to provide assurance that our Consolidated Financial Statements included in this Annual Report were prepared in accordance with generally accepted accounting principles (GAAP) and present fairly, in all material respects, our financial position, results of operations and cash flows for the periods presented in conformity with GAAP. As a result of these and other expanded procedures as described below, we concluded that the Consolidated Financial Statements included in this Annual Report present fairly, in all material respects, our financial position, results of operations and cash flows for the periods presented in conformity with GAAP.

Management s Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act. Internal control over financial reporting is a process designed under the supervision of our principal executive and principal financial officers to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.

Our internal control over financial reporting is supported by written policies and procedures that pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets; provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP and that our receipts and expenditures are being made and recorded only in accordance with authorizations of our management and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

In connection with the preparation of this Annual Report, with the participation of our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2007 based on the criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Our assessment included an evaluation of the design of our internal control over financial reporting and testing of the operational effectiveness of our internal control over financial reporting. That evaluation also included an evaluation of the material weaknesses that we previously disclosed in our Annual Report on Form 10-K, as amended, for the year ended December 31, 2006 as well as in other prior filings of our periodic reports under Section 13(a) of the Securities Exchange Act, the actions taken to remediate those material weaknesses and the testing of the effectiveness of those actions.

With the exception of our inventory as more fully discussed below, our management has concluded that the material weaknesses that we previously disclosed in our 2006 Form 10-K and in other prior filings of our periodic reports under Section 13(a) of the Securities Exchange Act have been fully remedied as of December 31, 2007.

The remedial actions that we have taken to remedy such material weaknesses may be regarded as material changes in our internal control over financial reporting that have occurred since December 31, 2006. These remedial actions are described in our prior periodic filings with the SEC. Due, among other things, to the difficulties that we experienced in preparing timely financial statements for the period ended September 30, 2006 and for subsequent periods ended prior to June 30, 2007, it is not practicable to determine the financial periods within those time periods during which each of those changes became effective.

With respect to our previously reported failure to adequately control access to the databases in our new ERP system, during the fourth quarter of 2007, we:

- Conducted a review of employee access to our ERP system world-wide;
- Used built-in ERP security features to implemented targeted access to the various data applications in our ERP system;
- Implemented formal request and approval process for any ERP access changes;
- Moved control of all ERP access changes to our corporate offices; and
- Implemented a formal periodic access review program for ERP users.

These actions may also be regarded as material changes in our internal control over financial reporting that have occurred since December 31, 2006.

Despite the remediation of prior material weaknesses, as a result of the material weaknesses described below, our management concluded that as of December 31, 2007 we did not maintain effective internal control over financial reporting based on the criteria established in Internal Control Integrated Framework, issued by COSO.

A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of annual or interim financial statements will not be prevented or detected on a timely basis. A significant deficiency is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those responsible for oversight of financial reporting.

As of December 31, 2007, the following material weaknesses in our internal control over financial reporting had not been fully remedied and continued to exist:

1. There was a lack of oversight and review of our inventory costing system.

   With respect to accounting for inventory, we determined that this material weakness resulted from the lack of a system based methodology and lack of oversight and review of the inventory cost variance and reserve calculations. In order to fully remediate this material weakness, we plan to implement further controls and to conduct such testing as is necessary to conclude that remediation has occurred during 2008.

2. Ineffective design and operation of controls for certain inventory shipments and recognition of the related revenue.

   At December 31, 2007, we determined that a material weakness existed in connection with the third-party service provider that we utilize for outsourcing logistics and warehousing of our spare-parts inventory and certain of our finished goods supply activities. Certain processes adopted by this service provider affected the accurate accounting for inventory and our timing of the recognition of the related revenue. We reviewed the effect of this material weakness on each accounting period that was affected and concluded that it did not result in a material misstatement of our financial statements in any accounting period. While we believe that this material weakness has subsequently been fully remediated, our testing for periods subsequent to December 31, 2007 is not yet complete.

Each of the material weaknesses described above could result in a material misstatement to the annual or interim Consolidated Financial Statements that would not be prevented or detected. As a result, management has determined that each of the control deficiencies discussed above constitutes a material weakness.

Because of its inherent limitations, a system of internal control over financial reporting can provide only reasonable assurance and may not prevent or detect misstatements. In addition, projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions and that the degree of compliance with the policies or procedures may deteriorate.

Item 9A(T). ***Controls and Procedures.***

Not applicable.

Item 9B. ***Other Information.***

None.

PART III

Item 10. ***Directors, Executive Officers and Corporate Governance.***

The balance of the information required in response to this Item will be set forth in our Proxy Statement for our 2008 Annual Meeting of Stockholders under the captions Election of Directors Information Concerning Nominees, Section 16(a) Beneficial Ownership Reporting Compliance, Corporate Governance Matters Code of Conduct and Code of Ethics , Corporate Governance Matters Corporate Governance and Nominating Committee, and Corporate Governance Matters Audit Committee. Such information is incorporated herein by reference.

Item 11. ***Executive Compensation.***

The information in response to this Item will be set forth in our Proxy Statement for our 2008 Annual Meeting of Stockholders under the captions Director Compensation, Executive Compensation, Corporate Governance Matters Compensation Committee, and Executive Compensation Compensation Committee Report. Such information is incorporated herein by reference.

Item 12. ***Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

Except as set forth below, the information required in response to this Item will be set forth in our Proxy Statement for our 2008 Annual Meeting of Stockholders under the caption Security Ownership of Certain Beneficial Owners and Management. Such information is incorporated herein by reference.

Equity Compensation Plans

The following table summarizes information about the equity securities authorized for issuance under our compensation plans as of December 31, 2007. For a description of these plans, please see Note 14 to the Consolidated Financial Statements.

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans

	(Number of securities in thousands)			
Equity compensation plans approved by stockholders	740	$	9.51	861
Equity compensation plans not approved by stockholders	344		7.22	
Total	1,084		8.78	861

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

The information required in response to this Item will be set forth in our Proxy Statement for our 2008 Annual Meeting of Stockholders under the caption Corporate Governance Matters Director Independence. Such information is incorporated herein by reference.

Item 14. ***Principal Accounting Fees and Services.***

The information in response to this Item will be set forth in our Proxy Statement for our 2008 Annual Meeting of Stockholders under the caption Fees of Independent Registered Public Accounting Firm. Such information is incorporated herein by reference.

PART IV

Item 15. ***Exhibits, Financial Statement Schedules.***

(a)(3)	**Exhibits**
	The following exhibits are included as part of this filing and incorporated herein by this reference:
3.1	Certificate of Incorporation of Registrant. (Incorporated by reference to Exhibit 3.1 to Form 8-B filed on August 16, 1993, and the amendment thereto, filed on Form 8-B/A on February 4, 1994.)
3.2	Amendment to Certificate of Incorporation filed on May 23, 1995. (Incorporated by reference to Exhibit 3.2 to Registrant s Registration Statement on Form S-2/A, filed on May 25, 1995.)
3.3	Certificate of Designation of Rights, Preferences and Privileges of Preferred Stock. (Incorporated by reference to Exhibit 2 to Registrant s Registration Statement on Form 8-A filed on January 8, 1996.)
3.4	Certificate of Designation of the Series B Convertible Preferred Stock, filed with the Secretary of State of Delaware on May 2, 2003. (Incorporated by reference to Exhibit 3.1 to Registrant s Current Report on Form 8-K, filed on May 7, 2003.)
3.5	Certificate of Elimination of Series A Preferred Stock filed with the Secretary of State of Delaware on March 4, 2004. (Incorporated reference to Exhibit 3.6 of Registrant s Annual Report on Form 10-K for the year ended December 31, 2003, filed on March 15, 2004.)
3.6	Certificate of Elimination of Series B Preferred Stock filed with the Secretary of State of Delaware on June 9, 2006. (Incorporated reference to Exhibit 3.1 of Registrant s Current Report on Form 8-K, filed on June 9, 2006.)
3.7	Certificate of Amendment of Certificate of Incorporation filed with Secretary of State of Delaware on May 19, 2004. (Incorporated by reference to Exhibit 3.1 of the Registrant s Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2004, filed on August 5, 2004.)
3.8	Certificate of Amendment of Certificate of Incorporation filed with Secretary of State of Delaware on May 17, 2005. (Incorporated by reference to Exhibit 3.1 of the Registrant s Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2005, filed on August 1, 2005.)
3.9	Amended and Restated By-Laws. (Incorporated by reference to Exhibit 3.2 of the Registrant s Current Report on Form 8-K, filed on December 1, 2006.)
4.1*	3D Systems Corporation 1996 Stock Incentive Plan. (Incorporated by reference to Appendix A to Registrant s Definitive Proxy Statement filed on March 30, 2001.)
4.2*	Form of Incentive Stock Option Contract for Executives pursuant to the 1996 Stock Incentive Plan. (Incorporated by reference to Exhibit 4.6 of Registrant s Annual Report on Form 10-K for the year ended December 31, 2000, filed on March 16, 2001.)
4.3*	

	Form of Non-Statutory Stock Option Contract for Executives pursuant to the 1996 Stock Incentive Plan. (Incorporated by reference to Exhibit 4.7 of Registrant s Annual Report on Form 10-K for the year ended December 31, 2000, filed on March 16, 2001.)
4.4*	Form of Employee Incentive Stock Option Contract pursuant to the 1996 Stock Incentive Plan. (Incorporated by reference to Exhibit 4.8 of Registrant s Annual Report on Form 10-K for the year ended December 31, 1999, filed on March 30, 2000.)

(a)(3)	**Exhibits**
4.5*	Form of Employee Non-Statutory Stock Option Contract pursuant to the 1996 Stock Incentive Plan. (Incorporated by reference to Exhibit 4.9 of Registrant s Annual Report on Form 10-K for the year ended December 31, 1999, filed on March 30, 2000.)
4.6*	3D Systems Corporation 1996 Non-Employee Directors Stock Option Plan. (Incorporated by reference to Appendix B to Registrant s Definitive Proxy Statement filed on March 30, 2001.)
4.7*	Form of Director Option Contract pursuant to the 1996 Non-Employee Director Stock Option Plan. (Incorporated by reference to Exhibit 4.5 of Registrant s Annual Report on Form 10-K for the year ended December 31, 1999, filed on March 30, 2000.)
4.8*	3D Systems Corporation 1998 Employee Stock Purchase Plan. (Incorporated by reference to Exhibit 4.1 to Registrant s Registration Statement on Form S-8 filed on July 10, 1998.)
4.9*	3D Systems Corporation 2001 Stock Option Plan. (Incorporated by reference to Exhibit 10.1 to Registrant s Registration Statement on Form S-8 filed on June 11, 2001.)
4.10*	2004 Incentive Stock Plan of 3D Systems Corporation. (Incorporated by reference to Exhibit 4.1 to the Registrant s Registration Statement on Form S-8, filed on May 19, 2004.)
4.11*	Form of Restricted Stock Purchase Agreement for Employees. (Incorporated by reference to Exhibit 4.2 to the Registrant s Registration Statement on Form S-8, filed on May 19, 2004.)
4.12*	Form of Restricted Stock Purchase Agreement for Officers. (Incorporated by reference to Exhibit 4.3 to the Registrant s Registration Statement on Form S-8, filed on May 19, 2004.)
4.13*	Restricted Stock Plan for Non-Employee Directors of 3D Systems Corporation. (Incorporated by reference to Exhibit 4.4 to the Registrant s Registration Statement on Form S-8, filed on May 19, 2004.)
4.14*	Amendment No. 1 to Restricted Stock Plan for Non-Employee Directors. (Incorporated by reference to Exhibit 10.1 to the Registrant s Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2005, filed on August 1, 2005.)
4.15*	Form of Restricted Stock Purchase Agreement for Non-Employee Directors. (Incorporated by reference to Exhibit 4.5 to the Registrant s Registration Statement on Form S-8, filed on May 19, 2004.)
10.1*	Form of Indemnification Agreement between Registrant and certain of its executive officers and directors. (Incorporated by reference to Exhibit 10.18 to Form 8-B filed on August 16, 1993, and the amendment thereto, filed on Form 8-B/A on February 4, 1994.)
10.2	Patent License Agreement dated December 16, 1998 by and between 3D Systems, Inc., NTT Data CMET, Inc. and NTT Data Corporation. (Incorporated by reference to Exhibit 10.56 to Registrant s Annual Report on Form 10-K for the year ended December 31, 1998, filed on March 31, 1999.)
10.3	Lease Agreement dated February 8, 2006 between the Registrant and KDC-Carolina Investments 3, LP. (Incorporated by reference to Exhibit 99.1 to Registrant s Current Report on Form 8-K, filed on February 10, 2006.)
10.4	First Amendment to Lease Agreement dated August 7, 2006 between the Registrant and KDC-Carolina Investments 3, LP. (Incorporated by reference to Exhibit 10.1 of Registrant s Current Report on Form 8-K, filed on August 14, 2006.)
10.5	Second Amendment to Lease Agreement effective as of October 6, 2006 to Lease Agreement dated February 8, 2006 between 3D Systems Corporation and KDC-Carolina Investments 3, LP. (Incorporated by reference to Exhibit 10.1 of Registrant s Current Report on Form 8-K, filed on October 10, 2006.)
10.6	Third Amendment to Lease Agreement effective as of December 18, 2006 to Lease Agreement dated February 8, 2006 between 3D Systems Corporation and KDC-Carolina Investments 3, LP. (Incorporated by reference to Exhibit 10.1 of Registrant s Current Report on Form 8-K, filed on December 20, 2006.)
10.7	

	Fourth Amendment to Lease Agreement effective as of February 26, 2007 to Lease Agreement dated February 8, 2006 between 3D Systems Corporation and KDC-Carolina Investments 3, LP. (Incorporated by reference to Exhibit 10.1 of Registrant s Current Report on Form 8-K, filed on March 1, 2007.)
10.8	Sixth Amendment to Reimbursement Agreement dated November 8, 2002, between Registrant and Wells Fargo Bank West, National Association. (Incorporated by reference to Exhibit 10.10 to Registrant s Quarterly Report on Form 10-Q for the quarterly period ended September 27, 2002, filed on November 12, 2002.)

(a)(3)	Exhibits
10.9	Seventh Amendment to Reimbursement Agreement dated March 4, 2004, between Registrant and Wells Fargo Bank, N.A. (Incorporated by reference to Exhibit 10.1 to Registrant s Current Report on Form 8-K, filed on March 10, 2004.)
10.10	Waiver dated June 26, 2003, between Wells Fargo Bank West, N.A. and Registrant. (Incorporated by reference to Exhibit 10.2 to Registrant s Quarterly Report on Form 10-Q for the quarterly period ended March 28, 2003, filed on July 14, 2003.)
10.11	Waiver entered into on January 12, 2004, between Wells Fargo Bank, N.A. and 3D Systems Corporation. (Incorporated by reference to Exhibit 10.1 to Registrant s Current Report on Form 8-K, filed on January 21, 2004.)
10.12*	Employment Letter Agreement, effective September 19, 2003, by and between Registrant and Abraham N. Reichental. (Incorporated by reference to Exhibit 10.1 to Registrant s Current Report on Form 8-K, filed on September 22, 2003.)
10.13*	Agreement, dated December 17, 2003, by and between Registrant and Abraham N. Reichental. (Incorporated by reference to Exhibit 10.43 to Registrant s Amendment No. 1 to Registration Statement on Form S-1, filed on January 21, 2004.)
10.14*	First Amendment to Employment Agreement, dated July 24, 2007, by and between Registrant and Abraham N. Reichental. (Incorporated by reference to Exhibit 10.1 to Registrant s Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2007, filed on August 6, 2007.)
10.15	Letter Agreement by and between 3D Systems Corporation and Fred R. Jones. (Incorporated by reference to Exhibit 99.1 to Registrant s Current Report on Form 8-K, filed on April 2, 2007.)
10.16	Form of Securities Purchase Agreements, dated as of June 19, 2007, between 3D Systems Corporation and the investors signatory thereto. (Incorporated by reference to Exhibit 10.1 to Registrant s Current Report on Form 8-K, filed on June 20, 2007).
10.17	Registration Rights Agreement, dated as of June 19, 2007, between 3D Systems Corporation and the investors signatory thereto. (Incorporated by reference to Exhibit 10.2 to Registrant s Current Report on Form 8-K, filed on June 20, 2007).
14.1	Code of Conduct, as amended effective as of November 30, 2006 (Incorporated by reference to Exhibit 99.1 of the Registrant s Current Report on Form 8-K, filed on December 1, 2006.)
14.2	3D Systems Corporation Code of Ethics for Senior Financial Executives and Directors. (Incorporated by reference to Exhibit 14.2 of the Registrant s Annual Report on Form 10-K for the year ended December 31, 2003, filed on March 15, 2004.)
21.1	Subsidiaries of Registrant.
23.1	Consent of Independent Registered Public Accounting Firm dated March 17, 2008.
31.1	Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 dated March 17, 2008.
31.2	Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 dated March 17, 2008.
32.1	Certification of Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 dated March 17, 2008.
32.2	Certification of Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 dated March 17, 2008.

* Management contract or compensatory plan or arrangement.

SIGNATURES

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

3D Systems Corporation

By: /s/ Abraham N. Reichental

Abraham N. Reichental
President and Chief Executive Officer

Date: March 17, 2008

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

Signature	Title	Date
/s/ Abraham N. Reichental Abraham N. Reichental	Chief Executive Officer, President and Director (Principal Executive Officer)	March 17, 2008
/s/ Damon J. Gregoire Damon J. Gregoire	Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	March 17, 2008
/s/ Charles W. Hull Charles W. Hull	Executive Vice President, Chief Technology Officer and Director	March 17, 2008
/s/ G. Walter Loewenbaum, II G. Walter Loewenbaum, II	Chairman of the Board of Directors	March 17, 2008
/s/ Miriam V. Gold Miriam V. Gold	Director	March 17, 2008
/s/ Jim D. Kever Jim D. Kever	Director	March 17, 2008
/s/ Kevin S. Moore Kevin S. Moore	Director	March 17, 2008
/s/ Daniel S. Van Riper	Director	March 17, 2008

Daniel S. Van Riper		
/s/ William E. Curran	Director	March 17, 2008
William E. Curran		

3D Systems Corporation

Index to Consolidated Financial Statements
and Consolidated Financial Statement Schedule

Report of Independent Registered Public Accounting Firm

To the Stockholders and Board of Directors
3D Systems Corporation
Rock Hill, South Carolina

We have audited 3 D Systems Corporation and its subsidiaries (the Company) internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). 3 D Systems Corporation s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Item 9A, Management s Report on Internal Control Over Financial Reporting . Our responsibility is to express an opinion on the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

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

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

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company s annual or interim financial statements will not be prevented or detected on a timely basis. Material weaknesses regarding the lack of oversight and review of the Company s inventory costing system and the ineffective design and operation of controls for certain inventory shipments and recognition of the related revenue have been identified and described in management s assessment. These material weaknesses were considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2007 financial statements, and this report does not affect our report dated March 17, 2008 on those financial statements.

In our opinion, 3D Systems Corporation did not maintain, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on the COSO criteria.

We do not express an opinion or any other form of assurance on management s statements referring to any changes in internal controls over financial reporting during the year, or any corrective actions taken by the company after the date of management s assessment.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of 3D Corporation and its subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of operations, stockholders equity, comprehensive income (loss) and cash flows for each of the three years in the period ended December 31, 2007 and our report dated March 17, 2008 expressed an unqualified opinion thereon.

/s/ BDO Seidman, LLP

BDO Seidman, LLP
Charlotte, North Carolina
March 17, 2008

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors of
3D Systems Corporation
Rock Hill, South Carolina

We have audited the accompanying consolidated balance sheets of 3D Systems Corporation and its subsidiaries (the Company) as of December 31, 2007 and 2006 and the related consolidated statements of operations, stockholders equity, comprehensive income (loss) and cash flows for each of the three years in the period ended December 31, 2007. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of 3D Systems Corporation and its subsidiaries as of December 31, 2007 and 2006 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2007 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 20 to the consolidated financial statements, effective January 1, 2007 the Company adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an Interpretation of FASB No. 109.* As discussed in Notes 14 and 15 to the consolidated financial statements, effective January 1, 2006 the Company adopted Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment,* and Statement of Financial Accounting Standards No. 158 Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, respectively.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company s internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO Criteria) and our report dated March 17, 2008 expressed an adverse opinion thereon.

/s/ BDO Seidman, LLP

BDO Seidman, LLP
Charlotte, North Carolina
March 17, 2008

3D Systems Corporation

Consolidated Balance Sheets
As of December 31, 2007 and 2006

	2007	2006
	(In thousands, except par value)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 29,689	$ 14,331
Accounts receivable, net of allowance for doubtful accounts of $2,072 (2007) and $2,359 (2006)	31,115	34,513
Inventories, net of reserves of $2,306 (2007) and $2,353 (2006)	20,041	26,114
Prepaid expenses and other current assets	4,429	6,268
Deferred income tax assets	693	748
Restricted cash	1,200	1,200
Assets held for sale	3,454	3,454
Total current assets	90,621	86,628
Property and equipment, net	21,331	23,763
Intangible assets, net	5,170	6,602
Goodwill	47,682	46,867
Other assets, net	2,581	2,334
	$ 167,385	$ 166,194
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Bank credit facility	$	$ 8,200
Industrial development bonds	3,325	3,545
Current portion of capitalized lease obligation	181	168
Accounts payable	20,712	26,830
Accrued liabilities	12,248	12,577
Customer deposits	1,537	6,510
Deferred revenue	11,712	11,463
Total current liabilities	49,715	69,293
Long-term portion of capitalized lease obligation	8,663	8,844
Convertible subordinated debentures		15,354
Other liabilities	4,238	3,034
Total liabilities	62,616	96,525
Commitments and contingencies		
Stockholders equity:		

Preferred Stock, authorized 5,000 shares, none issued		
Common stock, $0.001 par value, authorized 60,000 shares; 22,224 (2007) and 19,113 (2006) issued	22	19
Additional paid-in capital	173,645	132,566
Treasury stock, at cost; 50 shares (2007) and 28 shares (2006)	(111)	(89)
Accumulated deficit in earnings	(72,403)	(64,455)
Accumulated other comprehensive income	3,616	1,628
Total stockholders equity	104,769	69,669
	$ 167,385	$ 166,194

See accompanying notes to consolidated financial statements.

3D Systems Corporation

Consolidated Statements of Operations
Years Ended December 31, 2007, 2006 and 2005

	2007	2006	2005
	(In thousands, except per share amounts)		
Revenue:			
Products	$ 120,147	$ 98,525	$ 99,781
Services	36,369	36,295	39,297
Total revenue	156,516	134,820	139,078
Cost of sales:			
Products	65,633	59,229	50,332
Services	27,423	29,334	26,584
Total cost of sales	93,056	88,563	76,916
Gross profit	63,460	46,257	62,162
Operating expenses:			
Selling, general and administrative	54,159	51,204	40,344
Research and development	14,430	14,098	12,176
Restructuring and related costs		6,646	1,227
Total operating expenses	68,589	71,948	53,747
Income (loss) from operations	(5,129)	(25,691)	8,415
Interest and other expense, net	1,120	1,410	700
Income (loss) before income taxes	(6,249)	(27,101)	7,715
Provision (benefit) for income taxes	491	2,179	(1,691)
Net income (loss)	(6,740)	(29,280)	9,406
Preferred stock dividends and accretion of unamortized issuance costs		1,414	1,679
Net income (loss) available to common stockholders	$ (6,740)	$ (30,694)	$ 7,727
Net income (loss) available to common stockholders per share basic	$ (0.33)	$ (1.77)	$ 0.52
Net income (loss) available to common stockholders per share diluted	$ (0.33)	$ (1.77)	$ 0.48

See accompanying notes to consolidated financial statements.

3D Systems Corporation

Consolidated Statements of Stockholders Equity
Years Ended December 31, 2007, 2006 and 2005

	Common Stock					Treasury Stock				
	Shares	**Par Value $0.001**	**Additional Paid in Capital**	**Preferred Stock**	**Deferred Compensation**	**Shares**	**Amount**	**Accumulated Deficit**	**Other Comprehensive Income (Loss)**	**Total Stockhold Equity**
				(In thousands, except par value)						
ance at cember 31, 2004	**14,498**	**$ 14**	**$ 100,260**	**$ (2,401)**	**$ (45)**	**8**	**$ (68)**	**$ (44,581)**	**$ 2,477**	**$ 55,65**
rcise of stock ons	672	1	7,991							7,99
ployee stock chase plan	9	(a)	126							12
ck compensation		(a)								
ance of restricted ck	121	(a)	2,378		(1,901)	4	(5)			47
ortization of ricted stock					485					48
nversion of ferred stock	4		26							2
nversion of ordinated entures	10		100							10
ferred stock dends				(1,615)						(1,61
cretion of ferred stock ance costs			(211)	(63)						(27
income								9,406		9,40
eign currency nslation ustment									(2,162)	(2,16
ance at cember 31, 2005	**15,314**	**15**	**110,670**	**(4,079)**	**(1,461)**	**12**	**(73)**	**(35,175)**	**315**	**70,21**
rcise of stock ons	288	(a)	2,607							2,60
ployee stock chase plan	2	(a)	33							3

ck compensation ense			2,677							2,67
uance purchase) of ricted stock	156	(a)	145			16	(16)			12
option of FASB R			(1,461)		1,461					
nversion of ferred stock	2,617	3	15,699							15,70
nversion of ordinated entures	713	1	7,249							7,25
mmon stock ued for preferred ck dividends	23	(a)	440							44
ferred stock dends		(a)	(5,493)	4,526						(96
cretion of ferred stock uance costs				(447)						(44
mulative loss on sion plan ealized									(267)	(26
loss								(29,280)		(29,28
eign currency nslation ustment									1,580	1,58
ance at cember 31, 2006	**19,113**	**19**	**132,566**			**28**	**(89)**	**(64,455)**	**1,628**	**69,66**
ercise of stock ions	269	1	2,843							2,84
nversion of ordinated entures	1,508	1	15,131							15,13
uance purchase) of ricted stock	84	(a)	70			22	(22)			4
ck compensation ense		(a)	2,668							2,66
vate placement	1,250	1	20,367							20,36
mulative effect of ption of ounting for ertainty of ome taxes								(1,208)		(1,20
loss								(6,740)		(6,74
eign currency nslation ustment									1,606	1,60

mulative gain on sion plan ealized									382	38
ance at cember 31, 2007	**22,224**	**$ 22**	**$ 173,645**	**$**	**$**	**50**	**$ (111)**	**$ (72,403)**	**$ 3,616**	**$ 104,7**

(a) Amounts not shown due to rounding.

See accompanying notes to consolidated financial statements.

3D Systems Corporation

Consolidated Statements of Comprehensive Income (Loss)
Years Ended December 31, 2007, 2006 and 2005

	2007	2006	2005
		(In thousands)	
Net income (loss)	$ (6,740)	$ (29,280)	$ 9,406
Other comprehensive income (loss):			
Unrealized gain (loss) on pension obligation	382	(267)	
Foreign currency translation adjustments	1,606	1,580	(2,162)
Comprehensive income (loss), net	$ (4,752)	$ (27,967)	$ 7,244

See accompanying notes to consolidated financial statements.

3D Systems Corporation

Consolidated Statements of Cash Flows
Years Ended December 31, 2007, 2006 and 2005

	2007	2006	2005
		(In thousands)	
Cash flows from operating activities:			
Net income (loss)	$ (6,740)	$ (29,280)	$ 9,406
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Provision for (benefit of) deferred income taxes	(268)	1,752	(2,500)
Depreciation and amortization	6,970	6,529	5,926
Provisions for (benefit of) bad debts	109	1,612	(48)
Stock-based compensation	2,668	2,677	835
(Gain) loss on disposition of property and equipment	6	7	(262)
Changes in operating accounts:			
Accounts receivable	4,988	(1,937)	(12,615)
Lease receivables		177	448
Inventories	6,055	(10,274)	(9,508)
Prepaid expenses and other current assets	2,000	2,979	(4,225)
Accounts payable	(7,141)	14,957	4,911
Accrued liabilities	(683)	(104)	107
Customer deposits	(4,977)	4,527	1,157
Deferred revenue	(160)	(2,735)	945
Other operating assets and liabilities	(202)	562	(337)
Net cash provided by (used in) operating activities	2,625	(8,551)	(5,760)
Cash flows used in investing activities:			
Purchases of property and equipment	(946)	(10,100)	(2,516)
Proceeds from disposition of property and equipment	21	248	727
Additions to license and patent costs	(683)	(506)	(372)
Software development costs	(597)	(658)	(508)
Net cash used in investing activities	(2,205)	(11,016)	(2,669)
Cash flows provided by financing activities:			
Bank borrowings	(8,200)	8,200	
Proceeds from issuance of common stock	20,367		
Stock options, stock purchase plan and restricted stock proceeds	2,890	2,775	8,135
Repayment of long-term debt	(388)	(226)	(180)
Payments under obligation to former stockholders of 3D Systems S.A.			(585)
Securities issuance costs			(211)
Payment of preferred stock dividends		(785)	(1,617)
Payment of accrued liquidated damages			(36)

Net cash provided by financing activities	14,669	9,964	5,506
Effect of exchange rate changes on cash	269	(394)	746
Net increase (decrease) in cash and cash equivalents	15,358	(9,997)	(2,177)
Cash and cash equivalents at the beginning of the period	14,331	24,328	26,505
Cash and cash equivalents at the end of the period	$ 29,689	$ 14,331	$ 24,328

See accompanying notes to consolidated financial statements.

3D Systems Corporation

Notes to Consolidated Financial Statements

Note 1 Basis of Presentation

The consolidated financial statements include the accounts of 3D Systems Corporation and all majority-owned subsidiaries (the Company). All significant intercompany accounts and transactions have been eliminated in consolidation. The Company s annual reporting period is the calendar year.

Certain prior-period amounts have been reclassified to conform to the current-year presentation.

Note 2 Significant Accounting Policies

Use of Estimates

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including, among others, those related to the allowance for doubtful accounts, income taxes, inventories, goodwill, other intangible assets, contingencies and revenue recognition. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

Revenue Recognition

Revenue from the sale of systems and related products and materials is recognized upon shipment or when services are performed, provided that persuasive evidence of a sales arrangement exists, both title and risk of loss have passed to the customer and collection is reasonably assured. Persuasive evidence of a sales arrangement exists upon execution of a written sales agreement that constitutes a fixed and legally binding commitment between the Company and the buyer. In instances where sales are made to an authorized reseller, the same criteria cited above is applied to determine the recognition of revenue. The reseller s creditworthiness is evaluated prior to such sale. The reseller takes ownership of the related systems, products or materials and payment is not dependent upon the reseller s sale to an end user.

Sales of the Company s systems generally include equipment, a software license, a warranty on the equipment, training and installation. The Company allocates and records revenue for these transactions based on vendor-specific objective evidence that has been accumulated through historic operations, which, in most cases, is the price charged for the deliverable when sold separately. If fair value for all deliverables cannot be determined, the Company will use the residual method to determine the amount of the consideration to be allocated to the delivered items. The Company also evaluates the impact of undelivered items on the functionality of delivered items for each sales transaction and, where appropriate, defers revenue on delivered items when that functionality has been affected. Functionality is determined to be met if the delivered products or services represent a separate earnings process.

Revenue from services is recognized at the time of performance. The Company provides end-users with maintenance under a warranty agreement for up to one year and defers a portion of the revenue from the related systems sale at the time of sale based on the relative fair value of those services. After the initial warranty period, the Company offers these customers optional maintenance contracts. Deferred maintenance revenue is recognized ratably on a straight-line basis over the period of the contract.

The software products licensed with the Company s systems are integral to the operation of the systems. We sell equipment with embedded software to our customers. The embedded software is not sold separately, it is not a significant focus of the marketing effort and we do not provide post-contract customer support specific to the software or incur significant costs that are within the scope of Statement of Financial Accounting

3D Systems Corporation

Notes to Consolidated Financial Statements (Continued)

Standards (SFAS) No. 86. Additionally, the functionality that the software provides is marketed as part of the overall product. The software embedded in the equipment is incidental to the equipment as a whole such that SOP No. 97-2, *Software Revenue Recognition*, is not applicable. Sales of these products are recognized in accordance with SEC Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition.*

Shipping and handling costs billed to customers for equipment sales and sales of materials are included in product revenue in the consolidated statements of operations. Costs incurred by the Company associated with shipping and handling are included in product cost of sales in the consolidated statements of operations.

Credit is extended, and creditworthiness is determined, based on an evaluation of each customer s financial condition. New customers are generally required to complete a credit application and provide references and bank information to facilitate an analysis of creditworthiness. Customers with a favorable profile may receive credit terms that differ from the Company s general credit terms. Creditworthiness is considered, among other things, in evaluating the Company s relationship with customers with past due balances.

The Company s terms of sale generally require payment within 30 to 60 days after shipment of a product, although the Company also recognizes that longer payment periods are customary in some countries where it transacts business. To reduce credit risk in connection with systems sales, the Company may, depending upon the circumstances, require significant deposits prior to shipment and may retain a security interest in a system sold until fully paid. In some circumstances, the Company may require payment in full for its products prior to shipment and may require international customers to furnish letters of credit. For services, the Company either bills customers on a time-and-materials basis or sells customers service agreements that are recorded as deferred revenue and provide for payment in advance on either an annual or other periodic basis.

Cash and Cash Equivalents

Investments with original maturities of three months or less are considered to be cash equivalents. The Company s policy is to invest cash in excess of short-term operating and debt-service requirements in such cash equivalents. These instruments are stated at cost, which approximates market value because of the short maturity of the instruments.

The Company is required as a condition of an existing financing arrangement with Wells Fargo Bank to maintain $1,200 of cash as collateral that is restricted from use by the Company. Such restricted cash is reported separately on the consolidated balance sheets at December 31, 2007 and 2006 as a current asset, and it is not available for the Company s operations. See Note 12.

Allowance for Doubtful Accounts

The Company s estimate of the allowance for doubtful accounts related to trade receivables is based on two methods. The amounts calculated from each of these methods are combined to determine the total amount reserved.

First, the Company evaluates specific accounts for which it has information that the customer may be unable to meet its financial obligations (for example, bankruptcy). In these cases, the Company uses its judgment, based on the available facts and circumstances, and records a specific reserve for that customer against amounts due to reduce the outstanding receivable balance to the amount that is expected to be collected. These specific reserves are re-evaluated and adjusted as additional information is received that impacts the amount reserved.

Second, a reserve is established for all customers based on percentages applied to aging categories. If circumstances change (for example, the Company experiences higher-than-expected defaults or an unexpected adverse change in a customer s financial condition), estimates of the recoverability of amounts due to the

3D Systems Corporation

Notes to Consolidated Financial Statements (Continued)

Company could be reduced. Similarly, if the Company experiences lower-than-expected defaults or improved customer financial condition, estimates of the recoverability of amounts due the Company could be increased.

The Company also provides an allowance account for returns and discounts. This allowance is evaluated on a specific account basis. In addition, the Company provides a general reserve for returns from customers that have not been specifically identified based on historical experience.

Inventories

Inventories are stated at the lower of cost or net realizable market value, cost being determined using the first-in, first-out method. Reserves for slow-moving and obsolete inventories are provided based on historical experience and current product demand. The Company evaluates the adequacy of these reserves quarterly. Certain inventories are accounted for in accordance with SFAS No. 49, Accounting for Product Financing Arrangements, issued by the Financial Accounting Standards Board (FASB).

Property and Equipment

Property and equipment are carried at cost and depreciated on a straight-line basis over the estimated useful lives of the related assets, generally three to thirty years. Leasehold improvements are amortized on a straight-line basis over the shorter of (i) their estimated useful lives and (ii) the estimated or contractual lives of the leases. Realized gains and losses are recognized upon disposal or retirement of the related assets and are reflected in results of operations. Charges for repairs and maintenance are expensed as incurred.

Goodwill and Intangible Assets

The Company maintains goodwill on its consolidated balance sheets that resulted from prior transactions accounted for under SFAS No. 141, Business Combinations. This goodwill is subject to impairment testing as required by SFAS No. 142, Goodwill and Other Intangible Assets. SFAS No. 142 requires the use of judgment, and events impacting expected cash flows could result in a future impairment that previously was not required. SFAS No. 142 requires the Company to allocate goodwill to identifiable reporting units, which are then tested for impairment annually, or upon significant changes in the business environment, using a two-step process. The first step requires comparing the fair value of each reporting unit with its carrying amount, including goodwill. If that fair value exceeds the carrying amount, the second step of the process is not required to be performed and no impairment charge would be recorded. If, however, the fair value does not exceed that carrying amount, companies must perform a second step that requires an allocation of the fair value of the reporting unit to all assets and liabilities of that unit as if the reporting unit had been acquired in a purchase business combination as of the date of evaluation, and the fair value of the reporting unit was the purchase price. The goodwill resulting from that purchase price allocation is then compared to its carrying amount with any excess recorded as an impairment charge.

At December 31, 2007 goodwill was allocated as follows: $18,605 to U.S. operations, $22,147 to European operations and $6,930 to Asia-Pacific operations. Goodwill arose from acquisitions carried out in years prior to December 31, 2003. Goodwill arising from the acquisition of DTM Corporation in 2001 was allocated to reporting units based on the percentage of SLS® systems then installed by geographic area. Goodwill arising from other acquisitions was allocated to reporting units based on geographic dispersion of the acquired companies sales at the time of their acquisition.

The Company performed an evaluation of its reporting units in the fourth quarters of 2007, 2006 and 2005 in conjunction with annual impairment testing and concluded that the fair values of the Company s reporting units exceeded their carrying values. Accordingly, no goodwill impairment adjustments were recorded in 2007, 2006 or 2005.

3D Systems Corporation

Notes to Consolidated Financial Statements (Continued)

Licenses, Patent Costs and Other Long-Lived Assets

Licenses, patent costs and other long-lived assets include costs incurred for internally developed products or procedures, costs incurred to perfect license or patent rights under applicable domestic and foreign laws and the amount incurred to acquire existing licenses and patents. Licenses and patent costs are amortized on a straight-line basis over their estimated useful lives, which are approximately seven to twenty years. Amortization expense is included in cost of sales, research and development expenses and selling, general and administrative expenses, depending upon the nature and use of the technology.

The Company evaluates long-lived assets other than goodwill for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. If the estimated future cash flows (undiscounted and without interest charges) from the use of the asset are less than its carrying value, a write-down would be recorded to reduce the related asset to its estimated fair value.

Capitalized Software Costs

Certain software development and production costs are capitalized when the related product reaches technological feasibility. Costs capitalized in 2007, 2006 and 2005 were $599, $658 and $508, respectively. Amortization of software development costs begins when the related products are available for use in related systems. Amortization expense, included in cost of sales, amounted to $199, $349 and $725 for 2007, 2006 and 2005, respectively, based on the straight-line method using an estimated useful life of one year. Net capitalized software costs aggregated to $1,158 and $757 at December 31, 2007 and 2006, respectively, and are included in intangible assets in the accompanying consolidated balance sheets. The Company capitalized $400, $142, and $21 of software development costs in 2007, 2006 and 2005, respectively, related to development of its V-Flash[tm] desktop modeler.

Contingencies

The Company follows the provisions of SFAS No. 5, Accounting for Contingencies. SFAS No. 5 requires that an estimated loss from a loss contingency be accrued by a charge to income if it is both probable that an asset has been impaired or that a liability has been incurred and that the amount of the loss can be reasonably estimated.

Foreign Currency Translation

The Company transacts business globally and is subject to risks associated with fluctuating foreign exchange rates. More than 50% of the Company s consolidated revenue is derived from sales outside of the U.S. This revenue is generated primarily from the operations of a foreign research and production subsidiary in Switzerland and foreign sales subsidiaries in their respective countries and surrounding geographic areas and is primarily denominated in each subsidiary s local functional currency although certain sales are denominated in other currencies, including U.S. dollars or the euro, rather than the local functional currency. These subsidiaries incur most of their expenses (other than intercompany expenses) in their local functional currency. These currencies include euros, pounds sterling, Swiss francs and Japanese yen.

The geographic areas outside the U.S. in which the Company operates are generally not considered to be highly inflationary. Nonetheless, these foreign operations are sensitive to fluctuations in currency exchange rates arising from, among other things, certain intercompany transactions that are generally denominated in U.S. dollars rather than their respective functional currencies. The Company s operating results, assets and liabilities are subject to the effect of foreign currency translation when the operating results and the assets and liabilities of the Company s foreign subsidiaries are translated into U.S. dollars in the Company s consolidated financial statements. The assets and liabilities of the Company s foreign subsidiaries are translated from their respective functional currencies into U.S. dollars based on the translation rate in effect at the end of the related

3D Systems Corporation

Notes to Consolidated Financial Statements (Continued)

reporting period. The operating results of the Company s foreign subsidiaries are translated to U.S. dollars based on the average conversion rate for the related period.

Gains and losses resulting from foreign currency transactions (transactions denominated in a currency other than the functional currency of the Company or a subsidiary) are included in the consolidated statements of operations, except for inter-company receivables and payables for which settlement is not planned or anticipated in the foreseeable future, which are included as a component of accumulated other comprehensive income (loss) in the consolidated balance sheets.

Derivative Financial Instruments

The Company is exposed to market risk from changes in interest rates and foreign currency exchange rates and commodity prices, which may adversely affect its results of operations and financial condition. The Company seeks to minimize these risks through regular operating and financing activities and, when the Company considers it to be appropriate, through the use of derivative financial instruments. The Company does not purchase, hold or sell derivative financial instruments for trading or speculative purposes.

The Company applies SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended by SFAS No. 137 and SFAS No. 138 (SFAS No. 133), to report all derivative instruments on the balance sheet at fair value. The Company has not qualified for hedge accounting; therefore, except for the inter-company settlements mentioned above, all gains and losses (realized or unrealized) related to foreign currency derivative instruments are recognized in cost of sales and all gains and losses (realized or unrealized) related to interest rate derivative instruments are recognized in interest and other expense, net in the consolidated statements of operations.

The Company and its subsidiaries conduct business in various countries using both their functional currencies and other currencies to effect cross-border transactions. As a result, they are subject to the risk that fluctuations in foreign exchange rates between the dates that those transactions are entered into and their respective settlement dates will result in a foreign exchange gain or loss. When practicable, the Company endeavors to match assets and liabilities in the same currency on its U.S. balance sheet and those of its subsidiaries in order to reduce these risks. The Company, when it considers it to be appropriate, enters into foreign currency contracts to hedge the exposures arising from those transactions. At December 31, 2006, these contracts included contracts for both the purchase and sale of currencies other than the U.S. dollar. The purchase contracts related primarily to the procurement of inventory from a third party denominated in Swiss francs. The foreign currency sales contracts were denominated in euros, pound sterling and Swiss francs and were entered into to hedge intercompany purchase obligations of the Company s subsidiaries. At December 31, 2007, these contracts included contracts for the purchase of currencies other than the U.S. dollar.

The dollar equivalent of the foreign currency contracts and their related fair values as of December 31, 2007 and 2006 were as follows:

	Foreign Currency Purchase Contracts		Foreign Currency Sales Contracts	
	2007	2006	2007	2006

Notional amount	$ 2,905	$ 536	$	$ 2,487
Fair value	2,891	526		2,595
Net unrealized gain (loss)	$ (14)	$ (10)	$	$ (108)

The net fair value of all foreign exchange contracts at December 31, 2007 and 2006 reflected a net unrealized gain (loss) of $(14) and $(118), respectively. These foreign currency contracts outstanding at December 31, 2007 expire at various times between January 3, 2008 and February 13, 2008.

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Notes to Consolidated Financial Statements (Continued)

The total impact of foreign currency related items on the consolidated statements of operations was a net gain (loss) of $46, $(58) and $(755) for 2007, 2006 and 2005, respectively.

The Company is exposed to credit risk if the counterparties to such transactions are unable to perform their obligations. However, the Company seeks to minimize such risk by entering into transactions with counterparties that are believed to be creditworthy financial institutions.

Research and Development Costs

Research and development costs are expensed as incurred.

Earnings Per Share

Basic net income (loss) per share is computed by dividing net income (loss) available to common stockholders by the weighted average number of shares of common stock outstanding during the period. Diluted net income (loss) per share is computed by dividing net income (loss), as adjusted for the assumed issuance of all dilutive shares, by the weighted average number of shares of common stock outstanding plus the number of additional common shares that would have been outstanding if all dilutive common shares issuable upon exercise of outstanding stock options or conversion of convertible securities had been issued. Common shares related to convertible securities and stock options are excluded from the computation when their effect is anti-dilutive, that is, when their inclusion would increase the Company s net income per share or reduce its net loss per share.

Advertising Costs

Advertising costs are expensed as incurred. Advertising expenses were $1,450, $1,397 and $1,352 for the years ended December 31, 2007, 2006 and 2005, respectively.

Pension costs

The Company accounts for pension costs in accordance with SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Retirement Plans, which it adopted as of January 1, 2006. SFAS No. 158 requires that a plan s unrecognized net gain or loss be recognized on the balance sheet, net of the related tax effect, as an adjustment to Other Comprehensive Income (Loss) and in Other Liabilities in the consolidated balance sheet at December 31, 2007 and 2006. The Company included the expected service cost, benefit payments and interest cost for 2008 and 2007 in Accrued Liabilities at December 31, 2007 and 2006, respectively, and also included the non-current portion of the accrued pension liability in Other Liabilities at December 31, 2007 and 2006.

Equity Compensation Plans

The Company maintains stock-based compensation plans that are described more fully in Note 14. The Company adopted SFAS No. 123(R) effective January 1, 2006 and began recording compensation expense for previously issued stock options that vested subsequent to that date. In prior years, the Company s equity compensation plans were accounted for under the intrinsic value recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. The remainder of the

Company s unvested stock options vested during 2007.

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Notes to Consolidated Financial Statements (Continued)

The following pro forma net income and net income per share information is presented as if the Company accounted for stock-based compensation awarded under its equity compensation plans using the fair-value method for years prior to its adoption of SFAS No. 123(R). Under the fair-value method, the estimated fair value of stock-based incentive awards is charged against income on a straight-line basis over the vesting period, which is generally three years from the date of each award.

	2005
Net income available to common stockholders, as reported	$ 7,727
Deduct: Stock-based employee compensation expense determined under the fair value method for all awards, net of related tax effects	(1,144)
Pro forma net income	$ 6,583
Basic net income available to stockholders per common share:	
As reported	$ 0.52
Pro forma	$ 0.44
Diluted net income available to stockholders per common share:	
As reported	$ 0.48
Pro forma	$ 0.41

Income Taxes

The Company and its domestic subsidiaries file a consolidated U.S. federal income tax return. The Company s non-U.S. subsidiaries file income tax returns in their respective jurisdictions. The Company provides for income taxes on those portions of its foreign subsidiaries accumulated earnings that the Company believes are not reinvested permanently in their business.

Income taxes are accounted for under the asset and liability method. Deferred income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and tax benefit carry-forwards. Deferred income tax liabilities and assets at the end of each period are determined using enacted tax rates.

The Company records deferred income tax assets arising from temporary differences when and if it believes that future earnings will be sufficient to realize the tax benefit. The Company provides a valuation allowance for those jurisdictions in which the expiration date of tax benefit carry-forwards or projected taxable earnings leads the Company to conclude that it is not more likely than not that it will be able to realize the tax benefit of those carry-forwards.

In June 2006, the Financial Accounting Standards Board issued FIN 48 which the Company adopted as of January 1, 2007. This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS No. 109. FIN 48 prescribes a minimum recognition threshold defined by a standard that it must be more likely than not that a tax position will be sustained upon examination before being recognized in the financial statements. Under FIN 48, the impact of an uncertain income tax position on the income tax returns must be recognized at the largest amount that is more-likely-than-not to be required to be recognized upon audit by the relevant taxing authority. Under FIN 48, an uncertain income tax position should be recognized for financial statement reporting purposes only if the income tax provision has a greater than 50 percent likelihood of being sustained upon examination. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting for interim periods, disclosure and transition issues with respect to tax positions.

The Company includes interest and penalties accrued in accordance with FIN 48 in the consolidated financial statements as a component of income tax expense.

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Notes to Consolidated Financial Statements (Continued)

Prior to 2007, the Company determined its tax contingencies in accordance with SFAS No. 5, Accounting for Contingencies. The Company recorded estimated tax liabilities to the extent the contingencies were probable and could be reasonably estimated.

Recent Accounting Pronouncements

In September 2006, FASB issued SFAS No. 157, Fair Value Measurements. This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. This statement does not require any new fair value measurements. This statement is expected to be applied prospectively and is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. However, on February 12, 2008, the FASB issued FSP FAS 157-2 which delays the effective date of SFAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). This FSP partially defers the effective date of Statement 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for items within the scope of this FSP. The Company is currently assessing the impact that SFAS No. 157 may have on the Company s consolidated financial statements.

In February 2007, FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 , which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The objective of SFAS No. 159 is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS No. 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 does not affect any existing accounting literature that requires certain assets and liabilities to be carried at fair value, nor does it eliminate disclosure requirements included in other accounting standards, including requirements for disclosures about fair value measurements included in SFAS No. 157, Fair Value Measurements, and SFAS No. 107, Disclosures about Fair Value of Financial Instruments. SFAS No. 159 is effective for the Company s fiscal year beginning January 1, 2008. The Company is currently assessing the impact that the adoption of SFAS No. 159 may have on the Company s consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (Revised), Business Combinations (SFAS No. 141(R)), replacing SFAS No. 141, Business Combinations (SFAS No. 141). SFAS No. 141(R) retains the fundamental requirements of SFAS No. 141, broadens its scope by applying the acquisition method to all transactions and other events in which one entity obtains control over one or more other businesses, and requires, among other things, that assets acquired and liabilities assumed be measured at fair value as of the acquisition date, that liabilities related to contingent consideration be recognized at the acquisition date and remeasured at fair value in each subsequent reporting period, that acquisition-related costs be expensed as incurred, and that income be recognized if the fair value of the net assets acquired exceeds the fair value of the consideration transferred. SFAS No. 141 (R) is to be applied prospectively in financial statements issued for fiscal years beginning after December 15, 2008. The Company is currently assessing the impact that the adoption of SFAS No. 141 (R) may have on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an Amendment of ARB No. 51 (SFAS No. 160). SFAS No. 160 establishes accounting and reporting standards for noncontrolling interests (i.e., minority interests) in a subsidiary, including changes in a parent s ownership interest in a subsidiary and requires, among other things, that noncontrolling interests in subsidiaries be classified as a separate component of equity. Except for the presentation and disclosure requirements of SFAS No. 160, which are to be applied retrospectively for all periods presented, SFAS No. 160

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Notes to Consolidated Financial Statements (Continued)

is to be applied prospectively in financial statements issued for fiscal years beginning after December 15, 2008. The Company is currently assessing the impact that the adoption of SFAS No. 160 may have on its consolidated financial statements.

Note 3 Outsourcing of Assembly and Refurbishment Activities

The Company has outsourced its equipment assembly and refurbishment activities as well as the assembly of field service kits for sale by the Company to its customers to several selected design and engineering companies and suppliers. These suppliers also carry out quality control procedures on the Company s systems prior to their shipment to customers. As part of these activities, these suppliers have responsibility for procuring the components and sub-assemblies that are used in the Company s systems. The Company purchases finished systems from these suppliers pursuant to forecasts and customer orders that the Company supplies to them. While the outsource suppliers of the Company s systems have responsibility for the supply chain of the components for the systems they assemble, the components, parts and sub-assemblies that are used in the Company s systems are generally available from several potential suppliers.

The activities that the Company outsourced include assembly of its 3-D modeling equipment, its SLA® systems, its SLS® systems and certain other equipment items, the refurbishment of certain used equipment systems and the assembly of field service kits for sale by the Company to its customers.

The Company sells components of its raw materials inventory related to those systems to those third-party suppliers from time to time. Those sales have been recorded in the financial statements as a product financing arrangement under SFAS No. 49, Accounting for Product Financing Arrangements. Pursuant to SFAS No. 49, as of December 31, 2007 and December 31, 2006, the Company recorded a non-trade receivable of $1,076 and $2,429, respectively, classified in prepaid expenses and other current assets on the consolidated balance sheets, reflecting the book value of the inventory sold to the assemblers for which the Company had not received payment. At December 31, 2007 and 2006, $197 and $1,048, respectively, remained in inventory with a corresponding amount included in accrued liabilities, representing the Company s non-contractual obligation to repurchase assembled systems and refurbished parts produced from such inventory.

Under these arrangements, the Company generally purchases assembled systems from the assemblers following its receipt of an order from a customer or as needed from the assembler to repair a component or to service equipment. Under certain circumstances, the Company anticipates that it may purchase assembled systems from the assemblers prior to the receipt of an order from a customer. At December 31, 2007 and December 31, 2006, the Company had advanced $866 and $698, respectively, of progress payments to assemblers for systems forecasted to be required for resale to customers. These progress payments were recorded in prepaid expenses and other current assets in the consolidated balance sheets.

Note 4 Inventories

Components of inventories, net at December 31, 2007 and 2006 are as follows:

	2007	2006

Raw materials	$ 835	$ 531
Inventory held by assemblers	197	1,048
Work in process	126	
Finished goods and parts	21,189	26,888
Total cost	22,347	28,467
Less: reserves	(2,306)	(2,353)
Inventories, net	$ 20,041	$ 26,114

The balance of parts at December 31, 2007 and 2006 was $8,894 and $8,982, respectively.

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Notes to Consolidated Financial Statements (Continued)

Note 5 Property and Equipment

Property and equipment at December 31, 2007 and 2006 are summarized as follows:

	2007	2006	Useful Life (In Years)
Building	$ 8,566	$ 8,496	25
Machinery and equipment	26,469	25,640	3-5
Capitalized software ERP	3,077	2,975	5
Office furniture and equipment	3,492	3,428	5
Leasehold improvements	7,730	7,901	Life of Lease
Rental equipment	726	1,192	5
Construction in progress	511	43	N/A
Total property and equipment	50,571	49,675	
Less: Accumulated depreciation	(29,240)	(25,912)	
Total property and equipment, net of accumulated depreciation	$ 21,331	$ 23,763	

Depreciation expense for 2007, 2006 and 2005 was $4,296, $3,389, and $2,814, respectively. Leasehold improvements are amortized on a straight-line basis over the shorter of (i) their estimated useful lives and (ii) the estimated or contractual life of the related lease. In the fourth quarter of 2005, the Company accelerated amortization of the leasehold improvements related to its Valencia facility as a result of its plan to substantially reduce use of or vacate the facility by September 30, 2006. Accordingly, such leasehold improvements were fully amortized as of September 30, 2006. Such accelerated amortization amounted to $59 in 2006.

Capitalized leases related to buildings had a cost of $8,496 at December 31, 2007 and 2006. Capitalized leases related to office furniture and equipment had a cost of $542 at December 31, 2007 and 2006.

For the years ended December 31, 2007 and 2006, the Company recognized software amortization expense of $596 and $445, respectively, for enterprise resource planning (ERP) system capitalization costs.

The Company ceased operations at its Grand Junction, Colorado facility on April 28, 2006. The facility was listed for sale or lease during the first quarter of 2006. Following the closing of the Grand Junction facility, approximately $3,454 of assets, net of accumulated depreciation, were reclassified on the Company s consolidated balance sheet from long-term assets to current assets, where they have been recorded as assets held for sale. During 2006, the Company received $248 in proceeds from the sale of certain personal property associated with this facility that was no longer required for the Company s operations. Following the closing of this facility, the Company ceased to record depreciation expense related to this facility, which amounted to $570 per year. See Note 12.

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Notes to Consolidated Financial Statements (Continued)

Note 6 Intangible Assets

(a) Licenses and patent costs at December 31, 2007 and 2006 are summarized as follows:

	2007	2006	Weighted Average Useful Life (In Years)
Licenses, at cost	$ 5,875	$ 5,875	2.6
Patent costs	15,908	15,233	5.3
	21,783	21,108	
Less: Accumulated amortization	(17,771)	(16,272)	
Net licenses and patent costs	$ 4,012	$ 4,836	

During 2007, 2006 and 2005, the Company capitalized $687, $506 and $372, respectively, for costs incurred to acquire, develop and extend patents in the United States and various other countries. Amortization of such previously capitalized patent costs was $1,467 in 2007, $1,195 in 2006, and $1,090 in 2005. The Company expects amortization expense with respect to previously capitalized patent costs to be $377 in 2008, $314 in 2009, $273 in 2010, $246 in 2011 and $210 in 2012.

(b) Acquired Technology

Acquired technology at December 31, 2007 and 2006 is summarized as follows:

	2007	2006
Acquired technology	$ 10,391	$ 10,268
Less: Accumulated amortization	(10,391)	(9,320)
Net acquired technology	$	$ 948

Acquired technology, which was purchased in 2001 in connection with the DTM Corporation acquisition, became fully amortized in 2007. In 2007, 2006 and 2005, the Company amortized $948, $1,517, and $1,517, respectively, of acquired technology. Acquired technology and the related accumulated amortization each increased $123 in 2007 for the effect of foreign currency exchange rates reflecting the impact of amounts recorded in currencies other than the U.S. dollar on the financial statements.

(c) Other Intangible Assets

The Company had $1,158 and $818 of other net intangible assets, including internally developed software, as of December 31, 2007 and 2006, respectively. Amortization expense related to such intangible assets was $279, $429, and $505 for the years ended December 31, 2007, 2006 and 2005, respectively.

Note 7 Goodwill

The following are the changes in the carrying amount of goodwill by geographic area and reporting units:

	U.S.	Europe	Asia-Pacific	Total
Balance at January 1, 2006	$ 18,605	$ 20,536	$ 6,930	$ 46,071
Effect of foreign currency exchange rates		796		796
Balance at December 31, 2006	18,605	21,332	6,930	46,867
Effect of foreign currency exchange rates		815		815
Balance at December 31, 2007	$ 18,605	$ 22,147	$ 6,930	$ 47,682

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Notes to Consolidated Financial Statements (Continued)

The effect of foreign currency exchange rates in the preceding table reflects the impact on goodwill amounts recorded in currencies other than the U.S. dollar on the financial statements of subsidiaries in these geographic areas resulting from the yearly effect of foreign currency translation between the applicable functional currency and the U.S. dollar. The remaining goodwill for Europe and the entire amount of goodwill for Asia-Pacific represent amounts allocated in U.S. dollars from the U.S. to those geographic areas for financial reporting purposes and is not subject to translation effects.

Note 8 Employee Benefits

The Company sponsors a Section 401(k) plan (the Plan) covering substantially all of its eligible U.S. employees. The Plan entitles eligible employees to make contributions to the Plan after meeting certain eligibility requirements. Contributions are limited to the maximum contribution allowances permitted under the Internal Revenue Code. The Company matches 50% of the employee contributions up to a maximum as set forth in the Plan. The Company may also make discretionary contributions to the Plan, which would be allocable to participants in accordance with the Plan. For the years ended December 31, 2007, 2006 and 2005, the Company expensed $213, $222 and $269, respectively, for contributions to the 401(k) Plan.

Note 9 Accrued and Other Liabilities

Accrued liabilities at December 31, 2007 and 2006 are as follows:

	2007	2006
Compensation and benefits	$ 4,916	$ 4,427
Vendor accruals	2,848	3,868
Accrued professional fees	1,287	1,560
Accrued taxes	1,381	374
Royalties payable	645	543
Non-contractual obligation to repurchase inventory held by assemblers. See Note 3	197	1,048
Accrued interest	74	78
Accrued other	900	679
	$ 12,248	$ 12,577

Other liabilities at December 31, 2007 and 2006 are summarized below.

	2007	2006
Defined benefit pension obligation. See Note 15	$ 2,367	$ 2,239
Other long-term liabilities	1,871	795

	$ 4,238	$ 3,034

Note 10 Restructuring and Related Costs

The Company incurred no restructuring and related costs during the year ended December 31, 2007. Restructuring costs were $6,646 and $1,227 in 2006 and 2005, respectively.

The Company moved its corporate headquarters, principal R&D activities and all other key corporate support functions into a new facility in Rock Hill, South Carolina in 2006.

Severance and other restructuring costs in 2005 related primarily to costs incurred in connection with the Company s relocation to Rock Hill. These costs included $778 of personnel, relocation and recruiting costs and $449 of non-cash charges associated with accelerated amortization and asset impairments.

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