GALLAGHER ARTHUR J & CO
Form 10-K
February 05, 2010
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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2009

¨ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _______ to _______

Commission file number 1-9761

ARTHUR J. GALLAGHER & CO.

(Exact name of registrant as specified in its charter)

DELAWARE	36-2151613
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

Two Pierce Place	**60143-3141**
Itasca, Illinois	**(Zip Code)**
(Address of principal executive offices)	

Registrant s telephone number, including area code (630) 773-3800

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

Title of each class	**Name of each exchange on which registered**
Common Stock, par value $1.00 per share	**New York Stock Exchange**

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

None

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

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

Note: Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Exchange Act from their obligations under those Sections.

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 x 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 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. (Check one):

Large accelerated filer x	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 x.

The aggregate market value of the voting common equity held by non-affiliates of the registrant, computed by reference to the last reported price at which the stock was sold on June 30, 2009 (the last day of the registrant s most recently completed second quarter) was $2,130,392,000.

The number of outstanding shares of the registrant s Common Stock, $1.00 par value, as of January 31, 2010 was 102,483,000.

Documents incorporated by reference:

Portions of Arthur J. Gallagher & Co. s definitive 2010 Proxy Statement are incorporated by reference into this Form 10-K in response to Parts II and III to the extent described herein.

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Arthur J. Gallagher & Co.

Annual Report on Form 10-K

For the Fiscal Year Ended December 31, 2009

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Part I

Item 1. Business.

Overview

Arthur J. Gallagher & Co. and its subsidiaries (collectively referred to as Gallagher unless the context otherwise requires) are engaged in providing insurance brokerage and third-party claims settlement and administration services to entities in the U.S. and abroad. Gallagher believes that its major strength is its ability to deliver comprehensively structured insurance and risk management services to its clients. Gallagher s brokers, agents and administrators act as intermediaries between insurers and their customers and Gallagher does not assume underwriting risks.

Since its founding in 1927, Gallagher has grown from a one-man agency to the world s fifth largest insurance broker based on revenues (according to *Business Insurance* magazine s July 20, 2009 edition) and the world s largest third-party property/casualty (P/C) claims administrator (according to *Business Insurance* magazine s March 16, 2009 edition). Gallagher generates approximately 89% of its revenues domestically, with the remaining 11% derived primarily from operations in Australia, Bermuda, Canada, New Zealand and the United Kingdom (U.K.).

Shares of Gallagher s common stock are traded on the New York Stock Exchange under the symbol AJG, and Gallagher had a market capitalization at December 31, 2009 of $2.3 billion. Gallagher was reincorporated as a Delaware corporation in 1972. Gallagher s executive offices are located at Two Pierce Place, Itasca, Illinois 60143-3141, and its telephone number is (630) 773-3800.

Gallagher operates three business segments: Brokerage, Risk Management and Financial Services and Corporate, which contributed approximately 74%, 26% and less than 1%, respectively, to 2009 revenues.

Information Concerning Forward-Looking Statements

This annual report contains forward-looking statements within the meaning of that term in the Private Securities Litigation Reform Act of 1995 (the Act) found at Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). Additional written or oral forward-looking statements may be made by Gallagher from time-to-time in filings with the Securities and Exchange Commission (SEC), press releases, its website or otherwise. Statements contained in this report that are not historical facts are forward-looking statements made pursuant to the safe harbor provisions of the Act and the Exchange Act.

Forward-looking statements may include, but are not limited to, discussions concerning revenues, expenses, earnings, cash flow, capital structure and financial losses, as well as market and industry conditions, premium rates, financial markets, interest rates, foreign exchange rates, contingencies and matters relating to Gallagher s operations and income taxes. In addition, when used in this report, the words anticipates, believes, should, estimates, expects, intends, plans and variations thereof and similar expressions, are intended to identify forward-lookin statements.

Forward-looking statements made by or on behalf of Gallagher are subject to risks and uncertainties that could cause Gallagher s actual results to be materially different than those expressed in our forward-looking statements, including but not limited to the following: Gallagher s commission revenues are highly dependent on premiums charged by insurers, which are subject to fluctuation; alternative insurance markets continue to grow, which could unfavorably impact commission and favorably impact fee revenue, though not necessarily to the same extent; Gallagher s revenues vary significantly from period-to-period as a result of the timing of policy inception dates and the net effect of new and lost business production; Gallagher faces significant competitive pressures; disruptions in the credit and financial markets could limit access to capital and credit and make it more difficult for Gallagher to obtain financing for its operations or investments or increase its cost of obtaining financing; the recession could adversely affect Gallagher s business in a number of ways, including by causing its clients to purchase less insurance coverage, by leading to a continued reduction in the number of claims processed by Gallagher, or by causing insurance companies with which Gallagher does business to experience liquidity problems, withdraw from writing certain coverages, or fail; Gallagher s ability to grow has been enhanced through acquisitions, which may or may not be available on acceptable terms in the future and which, if consummated, may or may not be advantageous to Gallagher; Gallagher s debt agreements contain restrictions and covenants that could significantly impact Gallagher s ability to operate its business; Gallagher could incur substantial losses if one of the commercial banks it uses fails; Gallagher s non-U.S. operations expose it to certain risks such as exchange rate fluctuations, geopolitical risk, and risks related to regulatory requirements including those imposed by the U.S. Foreign Corrupt Practices Act; Gallagher is subject to insurance industry regulation worldwide, and such regulations could change at any time; changes in Gallagher s accounting estimates and assumptions could adversely affect its financial position and operating results; Gallagher is subject to a number of contingencies and legal proceedings; rising employee benefits costs (including pension

expense) could reduce Gallagher s profitability; Gallagher s effective income tax rate and obligations under tax indemnity

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agreements may be subject to increase as a result of changes in income tax laws, unfavorable interpretations of past, current or future tax laws or developments resulting in the loss or unavailability of historically claimed tax credits under Section 29 of the Internal Revenue Code (IRC); there are significant uncertainties related to Gallagher s IRC Section 45-related investments, which must be favorably resolved in order for Gallagher to recoup these investments and generate earnings on them; and operations at the IRC Section 45 facilities could subject Gallagher to environmental and product liability claims and environmental compliance costs. These and other risks and uncertainties are described in more detail in Item 1A, Risk Factors.

Readers are cautioned not to place undue reliance on any forward-looking statements contained in this report, which speak only as of the date set forth on the signature page hereto. Gallagher undertakes no obligation to publicly release the result of any revisions to these forward-looking statements that may be made to reflect events or circumstances after such date or to reflect the occurrence of anticipated or unanticipated events.

Operating Segments

Gallagher has identified three operating segments: Brokerage, Risk Management and Financial Services and Corporate. The two major sources of operating revenues for Gallagher are commissions and fees from Brokerage operations and fees from Risk Management operations. Information with respect to all sources of revenue, by operating segment, for each of the three years in the period ended December 31, 2009, is as follows (in millions):

	2009		2008		2007	
	Amount	% of Total	Amount	% of Total	Amount	% of Total
Brokerage						
Commissions	$ 1,003.7	58%	$ 922.5	56%	$ 867.3	54%
Fees	256.3	15%	227.6	14%	216.8	13%
Investment income and other	16.2	1%	37.7	2%	30.1	2%
	1,276.2	74%	1,187.8	72%	1,114.2	69%
Risk Management						
Fees	451.7	26%	461.1	28%	439.4	27%
Investment income and other	1.5	%	3.8	%	4.1	%
	453.2	26%	464.9	28%	443.5	27%
Financial Services and Corporate						
Investment income and other	(0.1)	%	(7.7)	%	65.6	4%
Total revenues	$ 1,729.3	100%	$ 1,645.0	100%	$ 1,623.3	100%

See Note 20 to Gallagher s 2009 Consolidated Financial Statements for additional financial information, including earnings from continuing operations before income taxes and identifiable assets by operating segment for 2009, 2008 and 2007.

Gallagher s business, particularly its brokerage business, is subject to seasonal fluctuations. Commission and fee revenues and the related brokerage and marketing expenses can vary from quarter-to-quarter as a result of the timing of policy inception dates and timing of receipt of information from insurance carriers. Alternatively, salaries and employee benefits, rent, depreciation and amortization expenses generally tend to be more uniform throughout the year. In addition, the timing of acquisitions and recognition of investment gains and losses also impact the trends in Gallagher s quarterly operating results. See Note 19 to Gallagher s 2009 Consolidated Financial Statements for unaudited quarterly operating results for 2009 and 2008.

Brokerage Segment

The Brokerage Segment accounted for 74% of Gallagher s revenue from continuing operations in 2009. Gallagher s Brokerage Segment is primarily comprised of Retail and Wholesale Brokerage operations. Gallagher s Retail Brokerage operations negotiate and place P/C,

employer-provided health and welfare insurance and retirement solutions principally for middle-market commercial, industrial, public entity, religious and not-for-profit entities. Many of Gallagher s Retail Brokerage customers choose to place their insurance with insurance underwriters, while others choose to use alternative vehicles such as self-insurance pools, risk retention groups or captive insurance companies. In addition, Gallagher s Wholesale Brokerage operations assist Gallagher brokers and other unaffiliated brokers and agents in the placement of specialized, unique and hard to place insurance programs.

The primary source for Gallagher s compensation for its Retail Brokerage services is commissions paid by insurance companies, which are usually based upon both percentage of the premium paid by insureds or brokerage and advisory fees paid directly by its clients. For Wholesale Brokerage services, Gallagher generally receives a share of the commission paid to the retail broker by the insurer. Commission rates are dependent on a number of factors, including the type of insurance, the particular insurance company underwriting the policy and whether Gallagher acts as a retail or wholesale broker. Advisory fees are dependent on the extent and value of services provided. Under certain circumstances, Gallagher may also receive contingent commissions, which are based on the estimated profit the underwriting insurance company earns and/or the overall volume of business placed by Gallagher in a given period of time. During the period from 2006 through September 2009, under an agreement with certain Illinois state agencies, Gallagher s Brokerage operations agreed not to accept U.S.-domiciled retail contingent compensation. However, as allowed under the agreement, Gallagher was allowed to continue to accept contingent compensation from non-retail business, including business generated by wholesalers, managing general agents and managing general underwriters. In addition, Gallagher was allowed to collect retail contingent compensation related to contracts in place at entities it had acquired for up to three years from the acquisition date. As of October 1, 2009, Gallagher is no longer prohibited from accepting retail contingent commissions under an agreement with the Illinois state agencies.

Gallagher operates its Brokerage operations through a network of more than 200 sales and service offices located throughout the U.S. and in fourteen countries abroad. Most of these offices are fully staffed with sales and service personnel. In addition, Gallagher does business through a network of correspondent insurance brokers and consultants in more than 100 countries around the world.

Retail Insurance Brokerage Operations

Gallagher s Retail Insurance Brokerage operations accounted for 81% of Gallagher s Brokerage Segment revenues in 2009. Gallagher s Brokerage operations place nearly all lines of commercial P/C and health and welfare insurance coverage. Significant lines of insurance coverage brokered are as follows:

Aviation	Disability	Life	Property
Casualty	Earthquake	Marine	Retirement Solutions
Commercial Auto	Errors & Omissions	Medical	Voluntary Benefits
Dental	Fire	Products Liability	Wind
Directors & Officers Liability	General Liability	Professional Liability	Workers Compensation

Gallagher s Retail Brokerage operations are organized in 180 geographical profit centers located in the U.S., Australia and Canada and operate within certain key Niche/Practice Groups, which account for approximately 65% of its Retail Brokerage revenues. These specialized teams target areas of business and/or industries in which Gallagher has developed a depth of expertise and a large client base. Significant Niche/Practice Groups that Gallagher serves are as follows:

Agribusiness	Global Risks	Marine	Real Estate
Aviation & Aerospace	Habitational	Manufacturing	Religious/Not-for-Profit
Captive Consulting	Healthcare	Personal	Restaurant
Construction	Higher Education	Professional Groups	Scholastic
Energy	Hospitality	Private Equity	Technology/Telecom
Entertainment	Institutional Services	Public Entity	Transportation

Gallagher s specialized focus on these Niche/Practice Groups allows for highly-focused marketing efforts and facilitates the development of value-added products and services specific to those industries or business segments. Gallagher believes that the detailed understanding and broad client contacts developed within these Niche/Practice Groups provide Gallagher with a competitive advantage.

Gallagher anticipates that its greatest revenue growth over the next several years for its Retail Brokerage operations will continue to come from: its Niche/Practice Groups and middle-market accounts, cross-selling other brokerage products to existing customers, developing and managing alternative market mechanisms such as captives, rent-a-captives, deductible plans/self-insurance and mergers and acquisitions.

Wholesale Insurance Brokerage Operations

Gallagher s Wholesale Insurance Brokerage operations accounted for 19% of Gallagher s Brokerage Segment revenues in 2009. Gallagher s wholesale brokers assist Gallagher s retail brokers and other non-Gallagher brokers in the placement of specialized and hard to place insurance

coverages through over sixty geographical profit centers across the U.S., Bermuda and through Gallagher s approved Lloyd s of London brokerage in London. In certain cases, Gallagher acts as a brokerage wholesaler and, in other cases, Gallagher acts as a managing general agent (MGA) or managing general underwriter (MGU) distributing specialized

insurance coverages for insurance carriers. MGAs and MGUs are agents authorized by an insurance company to manage all or a part of the insurer s business in a specific geographic territory. Activities performed on behalf of the insurer may include marketing, underwriting, issuing policies, collecting premiums, appointing and supervising other agents, paying claims and negotiating reinsurance.

Over 80% of Gallagher s Wholesale Brokerage revenues come from non-Gallagher brokerage customers. Based on revenues, Gallagher s domestic Wholesale Brokerage operation currently ranks as the largest domestic MGA/underwriting manager (according to *Business Insurance* magazine s October 5, 2009 edition).

Gallagher anticipates growing its Wholesale Brokerage operations by increasing the number of broker-clients, developing new managing general agency and underwriter programs and through mergers and acquisitions.

Risk Management Segment

The Risk Management Segment accounted for 26% of Gallagher s revenues from continuing operations in 2009. The Risk Management Segment provides contract claim settlement and administration services for enterprises that choose to self-insure some or all of their P/C coverages and for insurance companies that choose to outsource some or all of their P/C claims departments. Approximately 69% of the Risk Management Segment s revenues are from workers compensation related claims, 27% are from general and commercial auto liability related claims and 4% are from property related claims. In addition, Gallagher generates revenues from integrated disability management programs, information services, risk control consulting (loss control) services and appraisal services, either individually or in combination with arising claims. This Segment s revenues for risk management services are in the form of fees that are generally negotiated in advance on a per-claim or per-service basis, depending upon the type and estimated volume of the services to be performed.

Risk management services are primarily marketed directly to Fortune 1000 companies, larger middle-market companies, not-for-profit organizations and public entities on an unbundled basis independent of Gallagher s Brokerage operations. Gallagher manages its third-party claims adjusting operations through a network of 110 offices located throughout the U.S., Australia, Canada, New Zealand and the U.K. Most of these offices are fully staffed with Gallagher claims adjusters and other service personnel. Revenues are usually generated on a negotiated per-claim or per-service basis. Gallagher s adjusters and service personnel act solely on behalf and under the instruction of their clients and customers.

While this Segment complements Gallagher s insurance brokerage offerings, over 84% of the Risk Management Segment s revenues come from non-Gallagher brokerage customers, such as insurance companies and clients of other insurance brokers. Based on revenues, Gallagher s Risk Management operation currently ranks as the world s largest third party P/C claims administrator (according to *Business Insurance* magazine s March 16, 2009 edition).

The Risk Management Segment expects its most significant growth prospects through the next several years will come from Fortune 1000 companies, larger middle-market companies, captives, program business and the outsourcing of insurance company claims departments.

Financial Services and Corporate Segment

The Financial Services and Corporate Segment manages Gallagher s interests primarily in alternative energy (clean-energy/tax-advantaged) investments and venture capital funds. Operations are in Itasca, Illinois and Gallagher has been winding down its legacy financial services activities since 2003. At December 31, 2009, significant investments managed by this Segment include:

Clean-Energy

Gallagher has a 13.4% ownership interest in a Biomass company which owns a Biogas pipeline that removes and sells Biogas from landfills, a 42.0% interest in a privately-held enterprise (Chem-Mod) that has commercialized multi-pollutant reduction technologies that remove mercury, sulfur dioxide and other toxic emissions created by coal-fired power plants and a 5.0% interest in a privately-held start-up enterprise, which owns technologies that reduce carbon dioxide emissions created by burning fossil fuels. Utilization of the Chem-Mod technologies may qualify for tax credits under IRC Section 45, which substantially expires on December 31, 2019.

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Tax-Advantaged Investments

Prior to January 1, 2008, Gallagher owned certain partnerships that were formed to develop energy that qualified for tax credits under what was formerly called IRC Section 29. These consisted of waste-to-energy partnerships and synthetic coal facilities. These investments helped to substantially reduce Gallagher s effective income tax rate from 2002 through 2007. The law that permitted Gallagher to claim IRC Section 29 tax credits expired on December 31, 2007.

In 2009, Gallagher built eight commercial facilities that will produce clean-burning coal using Chem-Mod s technologies. Gallagher believes these facilities will produce energy that will qualify for IRC Section 45 tax credits.

Real Estate and Venture Capital

Gallagher has ownership interests in four venture capital funds and an investment management company, none of which is over 20%. The funds primarily invest in turn-around companies and the investment management firm primarily invests in hedge fund managers.

International Operations

Gallagher s total revenues by geographic area for each of the three years in the period ended December 31, 2009 were as follows (in millions):

	2009		2008		2007	
	Amount	% of Total	Amount	% of Total	Amount	% of Total
United States	$ 1,532.9	89%	$ 1,435.0	87%	$ 1,425.9	88%
Foreign, principally Australia, Bermuda, Canada and the U.K.	196.4	11%	210.0	13%	197.4	12%
Total revenues	$ 1,729.3	100%	$ 1,645.0	100%	$ 1,623.3	100%

See Notes 7, 18 and 20 to Gallagher s 2009 Consolidated Financial Statements for additional financial information related to Gallagher s foreign operations, including goodwill allocation, earnings from continuing operations before income taxes and identifiable assets, by operating segment, for 2009, 2008 and 2007.

Gallagher s foreign operations are subject to a variety of legal, economic and market risks, including risks relating to staffing, political and economic instability, the requirement of complying with foreign regulations and U.S. regulations applicable to Gallagher s foreign operations (e.g., the U.S. Foreign Corrupt Practices Act), changes in trade policies and tax rates, and restrictions on the transfer of funds. Gallagher s foreign operations are also subject to the risk of exchange rate fluctuations. Please see the risk factor regarding Gallagher s non-U.S. operations under Item 1A, Risk Factors, for more information regarding these risks.

Brokerage Operations in Australia, Bermuda, Canada and the U.K.

The majority of Gallagher s international presence in its Brokerage operations is in Australia, Bermuda, Canada and the U.K.

Gallagher operates in Australia and Canada primarily as a retail commercial property and casualty broker. In the U.K., Gallagher has a significant Wholesale Brokerage operation for U.S. and international clients looking to access the Lloyd s of London and other international insurance markets, a program operation offering customized risk management products and services to U.K. public entities and a small retail commercial property casualty brokerage. In Bermuda, Gallagher acts principally as a wholesaler for clients looking to access the Bermuda insurance markets and also provides services relating to the formation and management of offshore captive insurance companies.

Gallagher also has ownership interests in two Bermuda-based insurance companies that operate segregated account rent-a-captive facilities that enable clients to receive the benefits of owning a captive insurance company without certain disadvantages of ownership. Captive insurance companies are created for clients to insure their risks and capture underwriting profit and investment income, which is then available for use by the insureds generally for reducing future costs of their insurance programs.

Gallagher also has strategic brokerage alliances with a variety of international brokers in countries where it does not have a physical presence. Through a network of correspondent insurance brokers and consultants in more than 100 countries globally, Gallagher is able to fully serve its clients coverage and service needs in virtually any geographic area where their operations are located.

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Risk Management Operations in Australia, Canada, New Zealand and the U.K.

Gallagher s international Risk Management operations are principally in Australia, Canada, New Zealand and the U.K. Services are similar to those provided in the U.S. and are provided primarily on behalf of commercial and public entity clients.

Markets and Marketing

Gallagher operates its Brokerage operations through a network of more than 200 sales and service offices located throughout the U.S. and in fourteen countries abroad. Gallagher manages its third-party claims adjusting operations through a network of 110 offices located throughout the U.S., Australia, Canada, New Zealand and the U.K. Gallagher s customer base is highly diversified and includes commercial, industrial, public entity, religious and not-for-profit entities. No material part of Gallagher s business is dependent upon a single customer or on a few customers. The loss of any one customer would not have a material adverse effect on Gallagher. In 2009, Gallagher s largest single customer accounted for approximately 1% of total revenues and the ten largest customers represented 7% of total revenues in the aggregate. Gallagher s revenues are geographically diversified, with both domestic and international operations.

Each of Gallagher s Retail and Wholesale Brokerage operations have small market-share positions and, therefore, have substantial organic growth potential. In addition, each of Gallagher s Retail and Wholesale Brokerage operations have the ability to grow through the acquisition of small to medium sized independent brokerages. See Business Combinations below.

Gallagher has historically grown its Risk Management operation organically and expects to continue to do so.

Gallagher requires its employees serving in a sales or marketing capacity, including all executive officers of Gallagher, to enter into agreements with Gallagher restricting disclosure of confidential information and solicitation of clients and prospects of Gallagher upon their termination of employment. The confidentiality and non-solicitation provisions of such agreements terminate in the event of a hostile change in control of Gallagher, as defined therein.

Competition

Brokerage Segment

Gallagher is the fifth largest insurance broker worldwide based on total revenues (according to *Business Insurance* magazine s July 20, 2009 edition). The insurance brokerage and service business is highly competitive and there are many insurance brokerage and service organizations and individuals throughout the world who actively compete with Gallagher in every area of its business.

Gallagher s Retail and Wholesale Brokerage operations compete with Marsh & McLennan Companies, Inc., Aon Corporation, Willis Group Holdings, Ltd. and Wells Fargo Insurance Services, Inc., each of which has greater revenues than Gallagher. In addition, there are various other competing firms, such as Brown & Brown Inc., Hub International Ltd., Lockton Companies, Inc. and USI Holdings Corporation that operate nationally or that are strong in a particular region or locality and may have, in that region or locality, an office that is as large as or larger than, in terms of revenues, the corresponding local office of Gallagher. Gallagher believes that the primary factors determining its competitive position with other organizations in its industry are the quality of the services rendered and the overall costs to its clients. In addition, for health and welfare products, Gallagher competes with larger firms such as Hewitt Associates, Inc., Towers Watson & Co. and the benefits consulting divisions of the national public accounting firms and also competes with a vast number of local and regional brokerages and agencies.

Gallagher s Wholesale Brokerage operations compete with large wholesalers such as Crump Group, Inc., CRC Insurance Services, Inc., AmWINS Group, Inc., Swett & Crawford Group, Inc., as well as a vast number of local and regional wholesalers.

Gallagher also competes with certain insurance companies that write insurance directly for their customers. Government benefits relating to health, disability, and retirement are also alternatives to private insurance and indirectly compete with Gallagher.

Risk Management Segment

Gallagher s Risk Management operation currently ranks as the world s largest P/C third party administrator based on revenues (according to *Business Insurance* magazine s March 16, 2009 edition). While many global and regional claims administrators operate within this space, Gallagher competes directly with Sedgwick Claims Management Services, Inc., Broadspire Services, Inc., a subsidiary of Crawford & Company, UMR, Inc., a subsidiary of United Health Group, Inc., Cambridge Solutions Ltd., ESIS, a subsidiary of ACE Limited, and Specialty

Risk Services, a subsidiary of Hartford Financial Services, Inc. There are also several large insurance companies, such as AIG Insurance and Zurich Insurance, that maintain their own claims administration units, which can be strong competitors, particularly during the softening insurance cycle. In addition, Gallagher competes with various smaller third party administrators on a regional level. Gallagher believes that its competitive position is due to its strong reputation for outstanding service quality and ability to resolve customers losses in the most cost efficient manner possible.

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Regulation

In nearly every state and foreign jurisdiction in which Gallagher does business, Gallagher is required to be licensed or receive regulatory approval in order to conduct business. In addition, most jurisdictions require that individuals who engage in brokerage, claim adjusting and certain other insurance service activities be personally licensed. These licensing laws and regulations vary from jurisdiction to jurisdiction. In most jurisdictions, the applicable licensing laws and regulations generally grant broad discretion to supervisory authorities in adopting and amending regulations and in supervising regulated activities. In addition, for the past several years, the insurance industry has been under scrutiny by State Attorneys General and departments of insurance and has been subject to legal actions by private litigants with respect to contingent compensation arrangements and various historical business practices.

Business Combinations

Gallagher has completed and integrated 235 acquisitions in the period from January 1, 1985 through December 31, 2009, almost exclusively within its Brokerage Segment. The majority of the acquisitions over this twenty-five year period have been smaller regional or local P/C retail or wholesale operations possessing a strong middle-market client focus or significant expertise in one of Gallagher s focus market areas. Over the last decade, Gallagher has also increased its acquisition activity in the Retail Employee Benefits Brokerage and Wholesale Brokerage areas. Acquisition prices typically fall within the $1 million to $50 million range.

Through acquisitions, Gallagher seeks to expand its talent pool, enhance its geographic presence and service capabilities, and/or broaden and further diversify its business mix. Gallagher also focuses on identifying:

- A corporate culture that matches its sales-oriented culture;
- A profitable, growing business whose ability to compete would be enhanced by gaining access to Gallagher s greater resources; and
- Clearly defined financial criteria.

In 2009, Gallagher acquired all of the policy renewal rights from Liberty Mutual s middle-market commercial P/C brokers located in their Midwest and Southeast regions. As part of the agreement, Gallagher hired approximately seventy-five Liberty Mutual producers in these regions. In addition, Gallagher acquired substantially all of the policy renewal rights and hired the national producer group from Wausau Signature Agency, Liberty Mutual s commercial P/C and employee benefits insurance agency headquartered in Wausau, Wisconsin. Gallagher also acquired substantially all the net assets or common stock of fourteen insurance brokerage firms in exchange for its common stock and/or cash. See Note 4 to the Gallagher s 2009 Consolidated Financial Statements for a summary of the 2009 acquisitions, the amount and nature of the consideration paid and the dates of acquisition.

Employees

As of December 31, 2009, Gallagher employed approximately 9,900 employees. Gallagher continuously reviews benefits and other matters of interest to its employees and considers its relations with its employees to be satisfactory.

Available Information

Gallagher makes available free of charge on its website at www.ajg.com its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, as soon as reasonably practicable after electronically filing or furnishing such material to the Securities and Exchange Commission.

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Item 1A. Risk Factors.

Volatility or declines in premiums or other adverse trends in the insurance industry may seriously undermine Gallagher s profitability.

Gallagher derives much of its revenue from commissions and fees for its brokerage services. Gallagher does not determine the insurance premiums on which its commissions are generally based. Moreover, insurance premiums are cyclical in nature and may vary widely based on market conditions. For example, for several years through late 2000, heavy competition for market share among insurance carriers, increased underwriting capacity and improved economies of scale following consolidations, resulted in flat or reduced premium rates (a soft market), which in turn put downward pressure on Gallagher s commission revenue in many lines and in many geographic areas. Beginning in late 2000, the insurance industry transitioned to a hard market, in which premium rates were stable or increasing. Because of the events of September 11th, many insurance lines became less available and premium rates increased, in some cases dramatically. Beginning in late 2003, the market softened again in many lines and geographic areas. While the high level of hurricane activity and other natural disasters in 2004 and 2005 caused a hard market in certain coastal areas, the low level of hurricane activity in 2006 and 2007 caused carriers to again become rate/price sensitive and the industry has remained in a soft market across most geographical areas and business lines. The higher level of hurricane activity in 2008 generally did not cause the carriers to deviate from the trends noted in 2006 and 2007. Because of these market cycles for insurance product pricing, which Gallagher cannot predict or control, its brokerage revenues and profitability can be volatile or remain depressed for significant periods of time.

As traditional risk-bearing insurance companies continue to outsource the production of premium revenue to non-affiliated brokers or agents such as Gallagher, those insurance companies may seek to reduce further their expenses by reducing the commission rates payable to insurance agents or brokers. The reduction of these commission rates, along with general volatility and/or declines in premiums, may significantly affect Gallagher s profitability. Because Gallagher does not determine the timing or extent of premium pricing changes, Gallagher cannot accurately forecast its commission revenues, including whether they will significantly decline. As a result, Gallagher s budgets for future acquisitions, capital expenditures, dividend payments, loan repayments and other expenditures may have to be adjusted to account for unexpected changes in revenues, and any decreases in premium rates may adversely affect the results of its operations.

In addition, there have been and may continue to be various trends in the insurance industry toward alternative insurance markets including, among other things, greater levels of self-insurance, captives, rent-a-captives, risk retention groups and non-insurance capital markets-based solutions to traditional insurance. While Gallagher historically has been able to participate in certain of these activities on behalf of its customers and obtain fee revenue for such services, there can be no assurance that Gallagher will realize revenues and profitability as favorable as those realized from its traditional brokerage activities.

Gallagher faces significant competitive pressures in each of its businesses.

The insurance brokerage and service business is highly competitive and there are many insurance brokerage and service organizations as well as individuals on a global basis who actively compete with Gallagher in one or more areas of its business. Gallagher competes with four firms that are as large as or significantly larger than Gallagher, in terms of revenues, in the global risk management and brokerage markets. In addition, there are various other competing firms that operate nationally or that are strong in a particular region or locality and may have, in that region or locality, an office that is as large as or larger than, in terms of revenues, the particular local office of Gallagher. Gallagher believes that the primary factors determining its competitive position with other organizations in its industry are the quality of the services rendered and the overall costs to its clients. Losing business to competitors offering similar products at lower prices or having other competitive advantages would adversely affect Gallagher s business.

In addition, the increase in competition due to new legislative or industry developments could adversely affect Gallagher. These developments include:

- An increase in capital-raising by insurance underwriting companies, which could result in new capital in the industry, which in turn may lead to lower insurance premiums and commissions;

- The selling of insurance by insurance companies directly to insureds without the involvement of a broker or other intermediary;

N/A				
Total property and equipment		48,277		46,741
Less: Accumulated depreciation and amortization		(23,133)		(21,952)
Total property and equipment, net	$	25,144	$	24,789

Depreciation and software amortization expense on property and equipment for the quarter and six months ended June 30, 2010 were $1,579 and $2,867, respectively, compared to $1,224 and $2,509 for the quarter and six months ended June 30, 2009.

(5) Intangible Assets

Intangible assets other than goodwill at June 30, 2010 and December 31, 2009 were as follows:

	2010			2009		
(in thousands)	Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
Licenses	$ 5,875	$ (5,834)	$ 41	$ 5,875	$ (5,586)	$ 289
Patent costs	16,158	(13,489)	2,669	16,069	(13,450)	2,619
Internally developed software	10,176	(9,021)	1,155	8,968	(8,968)	
Customer relationships	1,971	(79)	1,892	561	(10)	551
Non-compete agreements	1,308	(604)	704	803	(652)	151
Trade names	260	(34)	226	30	(6)	24
Other	855	(832)	23	806	(806)	
Total	$ 36,603	$ (29,893)	$ 6,710	$ 33,112	$ (29,478)	$ 3,634

Amortization expense for intangible assets for quarter and six months ended June 30, 2010 was $339 and $562 respectively, compared to $188 and $510 for the quarter and six months ended June 30, 2009. Annual amortization expense for intangible assets for 2010, 2011, 2012, 2013 and 2014 is expected to be $2,763; $3,578; $2,940; $2,274 and $1,871, respectively.

For the six months ended June 30, 2010 and 2009, the Company capitalized $192 and $83, respectively, of costs incurred to acquire, develop and extend patents in the United States and various other countries.

(6) Accrued and Other Liabilities

Accrued liabilities at June 30, 2010 and December 31, 2009 were as follows:

(in thousands)	2010	2009
Compensation and benefits	$ 3,907	$ 3,680
Vendor accruals	1,207	1,197
Accrued professional fees	346	642
Accrued taxes	2,191	2,400
Royalties payable	187	244

Accrued interest		49		50
Contractual obligation due to acquisitions		1,329		2,224
Accrued other		467		677
Total	$	9,683	$	11,114

Other liabilities at June 30, 2010 and December 31, 2009 were as follows:

(in thousands)		**2010**		**2009**
Defined benefit pension obligation	$	2,803	$	3,237
Other long-term liabilities		722		707
Total	$	3,525	$	3,944

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(7) Hedging Activities and Financial Instruments

The Company conducts business in various countries using both the functional currencies of those countries and other currencies to effect cross border transactions. As a result, the Company is 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 balance sheet and those of its subsidiaries in order to reduce these risks. When appropriate, the Company enters into foreign currency contracts to hedge exposures arising from those transactions. The Company has not adopted hedge accounting under ASC 815, Derivatives and Hedging, and all gains and losses (realized or unrealized) are recognized in Interest and other expense, net in the condensed consolidated statements of operations. Depending on their fair value at the end of the reporting period, derivatives are recorded either in prepaid expenses and other current assets or in accrued liabilities on the condensed consolidated balance sheet.

At June 30, 2010 and December 31, 2009, these contracts included contracts for the purchase of currencies other than the U.S. dollar. The dollar equivalents of the foreign currency contracts and the related fair values as of June 30, 2010 and December 31, 2009 were as follows:

	Foreign Currency Purchase Contracts	
(in thousands)	**2010**	**2009**
Notional amount	$ 922	$ 1,587
Fair value	976	1,563
Net unrealized gain(loss)	$ 54	$ (24)

The foreign currency contracts outstanding at June 30, 2010 expire at various times between July 1, 2010 and July 21, 2010. The foreign currency contracts outstanding at December 31, 2009 expired at various times between January 6, 2010 and February 3, 2010.

The total impact of foreign currency items on the condensed consolidated statements of operations for the quarter and six months ended June 30, 2010 were losses of $217 and $541, respectively, compared to losses of $44 and $166, respectively, for the quarter and six months ended June 30, 2009.

(8) Stock-based Compensation Plans

The Company records stock-based compensation expense in selling, general and administrative expenses in the condensed consolidated statements of operations. Stock-based compensation expense for the quarter and six months ended June 30, 2010 and 2009 was as follows:

	Quarter Ended June 30,		Six Months Ended June 30,	
(in thousands)	**2010**	**2009**	**2010**	**2009**
Restricted stock awards	$ 522	$ 342	$ 789	$ 731

The number of shares of restricted common stock awarded and the weighted average fair value per share during the quarter and six months ended June 30, 2010 and 2009 were as follows:

	Quarter Ended June 30,			
	2010		2009	
(in thousands, except per share amounts)	**Shares Awarded**	**Weighted Average Fair Value**	**Shares Awarded**	**Weighted Average Fair Value**
Restricted stock awards:				
Granted under the 2004 Incentive Stock Plan	42	$ 14.28	4	$ 6.97

Granted under the 2004 Restricted Stock Plan for Non-Employee Directors	18		14.29	21		6.97
Total restricted stock awards	60	$	14.28	25	$	6.97

	Six Months Ended June 30,					
	2010			2009		
(in thousands, except per share amounts)	**Shares Awarded**		**Weighted Average Fair Value**	**Shares Awarded**		**Weighted Average Fair Value**
Restricted stock awards:						
Granted under the 2004 Incentive Stock Plan	52	$	13.91	182	$	6.81
Granted under the 2004 Restricted Stock Plan for Non-Employee Directors	18		14.29	21		6.97
Total restricted stock awards	70	$	14.01	203	$	6.83

Of the 52 shares of restricted stock awards granted in the six months ended June 30, 2010 pursuant to the Company s 2004 Incentive Stock Plan, none were awarded to executive officers of the Company. Additionally, 42 shares were granted in the second quarter of 2010 under the 2004 Incentive Stock Plan, but remained subject to acceptance at June 30, 2010. In the first six months of 2009, the Company granted restricted stock awards covering 182 shares of common stock pursuant to the Company s 2004 Incentive Stock Plan, including 100 shares awarded to executive officers of the Company.

In the second quarter of 2010 the Company issued a total of 18 shares of common stock pursuant to the Company s 2004 Restricted Stock Plan for Non-Employee Directors. Stock compensation expense for directors totaled $257 for the quarter and six months ended June 30, 2010, compared to $146 for the quarter and six months ended June 30, 2009.

(9) International Retirement Plan

The following table shows the components of net periodic benefit costs and other amounts recognized in the condensed consolidated statements of operations for the quarter and six months ended June 30, 2010 and 2009:

	Quarter Ended June 30,		Six Months Ended June 30,	
(in thousands)	**2010**	**2009**	**2010**	**2009**
Service cost	$ 27	$ 23	$ 50	$ 47
Interest cost	26	22	48	44
Total	$ 53	$ 45	$ 98	$ 91

(10) Earnings Per Share

The Company presents basic and diluted earnings (loss) per share (EPS) amounts. Basic EPS is calculated by dividing net income (loss) available to common stockholders by the weighted average number of common shares outstanding during the applicable period. Diluted EPS is calculated by dividing 3D Systems net income (loss) by the weighted average number of common and common equivalent shares outstanding during the applicable period. The following table reconciles basic weighted average outstanding shares to diluted weighted average outstanding shares for the quarters and six months ended June 30, 2010 and 2009:

	Quarter Ended June 30,		Six Months Ended June 30,	
(in thousands, except per share amounts)	**2010**	**2009**	**2010**	**2009**
Numerator:				
3D Systems net income (loss) numerator for basic net earnings (loss) per share	$ 2,737	$ (1,317)	$ 4,755	$ (3,401)
Add: Effect of dilutive securities				
Stock options and other equity compensation				
Numerator for dilutive earnings (loss) per share	$ 2,737	$ (1,317)	$ 4,755	$ (3,401)
Denominator:				
Weighted average shares denominator for basic net earnings (loss) per share	23,035	22,515	22,940	22,442
Add: Effect of dilutive securities				
Stock options and other equity compensation	301		290	
Denominator for dilutive earnings (loss) per share	23,336	22,515	23,230	22,442

Earnings (loss) per share								
Basic	$	0.12	$	(0.06)	$	0.21	$	(0.15)
Diluted	$	0.12	$	(0.06)	$	0.20	$	(0.15)

For the three months and six months ended June 30, 2010, the average outstanding diluted shares calculation excludes options with an exercise price that exceeds the average market price of shares during the period. Stock options excluded from the average outstanding diluted shares calculation were 280 for the three months and six months ended June 30, 2010.

For the three months and six months ended June 30, 2009, no dilutive securities were included in the diluted weighted average shares since the Company reported a net loss for these periods. The effect of their inclusion would have been anti-dilutive resulting in reduction to the net loss per share. Stock options excluded from the average outstanding diluted shares calculation were 870 for the three months and six months ended June 30, 2009.

For the six months ended June 30, 2010, average common shares for basic and diluted earnings per share was 22.9 million and 23.2 million, respectively, and basic and diluted earnings per share were $0.21 and $0.20, respectively.

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For the six months ended June 30, 2009, average common shares for basic and diluted earnings per share was 22.4 million, and basic and diluted earnings per share were ($0.15).

(11) Fair Value Measurements

ASC 820, Fair Value Measurements, defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

For the Company, this statement applies to cash equivalents and foreign exchange contracts. The Company utilizes the market approach to measure fair value for its financial assets and liabilities. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.

Assets and liabilities measured at fair value on a recurring basis are summarized below:

	Fair Value Measurements as of June 30, 2010			
(in thousands)	**Level 1**	**Level 2**	**Level 3**	**Total**
Description				
Cash equivalents	$ 19,977	$	$	$ 19,977
Currency derivative contracts(1)	976			976
Total	$ 20,953	$	$	$ 20,953

(1) Unrealized gains or losses on derivatives are recorded in Interest and other expense, net in the condensed consolidated statement of operations at each measurement date. See Note 7, *Hedging Activities and Financial Instruments*.

The Company did not have any transfers of assets and liabilities between Level 1 and Level 2 of the fair value measurement hierarchy during the quarter or six months ended June 30, 2010. The Company did not have any significant non-financial assets or non-financial liabilities that would be recognized or disclosed at fair value on a recurring basis as of June 30, 2010 or December 31, 2009.

(12) Income Taxes

The Company used effective tax rates of 8.3% and 9.2% for the quarter and six months ended June 30, 2010, respectively, compared to (19.1%) and (15.7%) for the quarter and six months ended June 30, 2009. Tax expense relates primarily to income from non-U.S. operations.

Tax years 2006 to 2009 remain subject to examination by the U.S. Internal Revenue Service. Should the Company utilize any of its remaining U.S. loss carry-forwards, which date from 1997, these would be subject to examination. The Company files income tax returns (which are open to examination beginning in the year shown in parentheses) in France (2004), Germany (2006), Japan (2004), Italy (2004), Switzerland (2004) and the United Kingdom (2006).

(13) Segment Information

The Company operates in one reportable business segment in which it develops, manufactures and markets worldwide 3-D printing, rapid prototyping and manufacturing systems designed to reduce the time it takes to produce three-dimensional objects. The Company conducts its business through subsidiaries in the United States, a subsidiary in Switzerland that operates a research and production facility, sales and service offices operated by subsidiaries in the European Community (France, Germany, the United Kingdom and Italy) and Japan, and a branch office in Hong Kong. The Company has historically disclosed summarized financial information for the geographic areas of operations as if they were segments, in accordance with ASC 280, Segment Reporting.

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Summarized financial information concerning the Company s geographical operations is shown in the following tables:

(in thousands)	Quarter Ended June 30, 2010	Quarter Ended June 30, 2009	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
Revenue from unaffiliated customers:				
United States	$ 17,399	$ 11,455	$ 31,544	$ 22,210
Germany	5,811	5,556	11,318	10,991
Other Europe	7,461	5,186	14,823	9,749
Asia Pacific	4,473	2,508	9,086	5,786
Total	$ 35,144	$ 24,705	$ 66,771	$ 48,736

The Company s revenues from unaffiliated customers by type are as follows:

(in thousands)	Quarter Ended June 30, 2010	Quarter Ended June 30, 2009	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
Systems and other products	$ 10,672	$ 5,882	$ 19,455	$ 10,741
Materials	13,973	11,702	27,587	22,332
Services	10,499	7,121	19,729	15,663
Total revenue	$ 35,144	$ 24,705	$ 66,771	$ 48,736

Intercompany sales are as follows:

	Quarter Ended June 30, 2010 Intercompany Sales to				
(in thousands)	United States	Germany	Other Europe	Asia Pacific	Total
United States	$	$ 3,120	$ 2,238	$ 709	$ 6,067
Germany	124		1,387		1,511
Other Europe	2,072	216			2,288
Asia Pacific	34				34
Total	$ 2,230	$ 3,336	$ 3,625	$ 709	$ 9,900

	Quarter Ended June 30, 2009 Intercompany Sales to				
(in thousands)	United States	Germany	Other Europe	Asia Pacific	Total
United States	$	$ 2,547	$ 1,489	$ 109	$ 4,145
Germany			1,059		1,059
Other Europe	1,708	308			2,016
Asia Pacific					
Total	$ 1,708	$ 2,855	$ 2,548	$ 109	$ 7,220

	Six Months Ended June 30, 2010 Intercompany Sales to				
(in thousands)	United States	Germany	Other Europe	Asia Pacific	Total
United States	$	$ 7,145	$ 4,379	$ 1,384	$ 12,908
Germany	234		2,237		2,471
Other Europe	4,164	248			4,412
Asia Pacific	34				34
Total	$ 4,432	$ 7,393	$ 6,616	$ 1,384	$ 19,825

	Six Months Ended June 30, 2009 Intercompany Sales to				
(in thousands)	United States	Germany	Other Europe	Asia Pacific	Total
United States	$	$ 5,751	$ 3,383	$ 1,566	$ 10,700
Germany	3		1,772		1,775
Other Europe	3,213	446			3,659
Asia Pacific					
Total	$ 3,216	$ 6,197	$ 5,155	$ 1,566	$ 16,134

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All revenue between geographic areas is recorded at prices that provide for an allocation of profit (loss) between entities. Income (loss) from operations and assets for each geographic area are as follows:

	Quarter Ended June 30,		Six Months Ended June 30,	
(in thousands)	2010	2009	2010	2009
Income (loss) from operations:				
United States	$ 1,233	$ (2,286)	$ 1,789	$ (5,230)
Germany	520	262	833	370
Other Europe	578	288	1,024	707
Asia Pacific	958	364	2,255	1,307
Subtotal	3,289	(1,372)	5,901	(2,846)
Inter-segment elimination	125	529	171	396
Total	$ 3,414	$ (843)	$ 6,072	$ (2,450)

(in thousands)	June 30, 2010	December 31, 2009
Assets:		
United States	$ 98,469	$ 93,595
Germany	18,326	16,690
Other Europe	28,185	28,383
Asia Pacific	11,799	11,735
Total	$ 156,779	$ 150,403

(14) Contingencies

On March 14, 2008, DSM Desotech Inc. filed a complaint, in an action titled *DSM Desotech Inc. v. 3D Systems Corporation* in the United States District Court for the Northern District of Illinois (Eastern Division) asserting that the Company engaged in anticompetitive behavior with respect to resins used in large-frame stereolithography machines. The complaint further asserted that the Company is infringing on two of DSM Desotech s patents relating to stereolithography machines. The Company understands that DSM Desotech estimates the damages associated with its claims to be in excess of $40,000.

Following a decision of the Court on the Company s motion to dismiss the non-patent causes of the action, DSM Desotech filed a second amended complaint on March 2, 2009 in which it reasserted causes of action previously dismissed by the Court. The Company filed an answer to the second amended complaint on March 19, 2009 in which, among other things, it denied the material allegations of the second amended complaint. Discovery is proceeding on the claims pending in this case.

The Company intends to continue vigorously contesting all the claims asserted by DSM Desotech.

The Company is also involved in various other legal matters incidental to its business. The Company s management believes, after consulting with counsel, that the disposition of these other legal matters will not have a material effect on the Company s consolidated results of operations or consolidated financial position.

(15) Subsequent Events

On July 7, 2010, the Company acquired the assets of CEP S.A. and its affiliate, Protometal S.A (collectively CEP). The acquisition is not significant to the Company s financial statements. Future revenue from the acquisition will be reported as services revenue. See Note 2.

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

This discussion should be read in conjunction with the unaudited condensed consolidated financial statements and the notes thereto included in Item 1 of this Quarterly Report on Form 10-Q (Form 10-Q).

We are subject to a number of risks and uncertainties that may affect our future performance that are discussed in greater detail in the sections entitled Forward-Looking Statements and Cautionary Statements and Risk Factors at the end of this Item 2 and that are discussed or referred to in Item 1A of Part II of this Form 10-Q.

Business Overview

We design, develop, manufacture, market and service 3-D printing, rapid manufacturing, and prototyping 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. We also operate 3Dproparts , a comprehensive service bureau that offers our customers rapid prototyping and manufacturing services for the production of precision 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.

Recent Developments

We have continued to execute on our strategy to grow our 3Dproparts service, through additional strategic acquisitions and by further expanding our distribution channel of 3-D printing reseller partners. We also announced the introduction of new materials, which were not material to our operating results.

In April 2010, we acquired the assets of Design Prototyping Technologies, Inc. (DPT) in Syracuse, New York. DPT is an online provider of fast turnaround, high quality functional parts and prototypes. The DPT acquisition enables us to enhance our online offerings for our 3Dproparts service.

In April 2010 we introduced our Accura® CeraMAX material for our iPro and Viper SLA® systems. Accura® CeraMAX is an engineered white plastic composite designed for use in applications that require extreme thermal stability, rigidity and excessive wear resistance.

In May 2010, we introduced our Accura® PEAK Plastic, an engineered SLA® plastic designed for performance, accuracy and stability during prolonged exposure to elevated temperature and humidity. Accura® PEAK Plastic is ideal for use in automotive, aerospace and motorsports applications.

In July 2010, we made our first 3Dproparts European acquisition, acquiring the assets of CEP S.A. and its affiliate, Protometal S.A. (collectively CEP), rapid prototyping and rapid manufacturing services providers located in Joué l Abbé, France. The Company acquired CEP to augment and expand its 3Dproparts business in Europe.

Results of Operations

Summary of 2010 financial results

We generated $1.0 million of net cash in the first six months of 2010 and finished the period with $25.9 million of unrestricted cash compared to $24.9 million of unrestricted cash at December 31, 2009.

As discussed in greater detail below, revenue for the second quarter of 2010 improved by 42% to $35.1 million from $24.7 million for the second quarter of 2009, due to improved global demand. Revenue increased across all classes of products and services. Revenue for the six months ended June 30, 2010 increased 37% to $66.8 million from $48.7 million in 2009, for primarily the same reasons.

Materials sales for the second quarter of 2010 rose by $2.3 million from the second quarter of 2009 as revenue from materials was favorably impacted by the higher large-frame systems sales, which are typically accompanied by significant initial materials purchases to charge up new systems and commence production, and increased demand due to the improving global economy.

We are encouraged by the improved trend in systems and materials sales during the second quarter of 2010, which increased by $4.8 million, or 81%, and $2.3 million, or 19%, respectively, from second quarter 2009 levels.

Revenue from services improved by $3.4 million to $10.5 million in the second quarter of 2010 from $7.1 million in the second quarter of 2009. Services revenue grew by $1.3 million in the second quarter of 2010 from $9.2 million in the first quarter of 2010.

For the second quarter of 2010 healthcare revenue made up 14% of our total revenue compared to 12% in the first quarter of 2010 and includes sales of systems, materials and services for the following applications:

- hearing aid,
- dental,
- medical device and
- other health-related.

Although system sales into these marketplaces can fluctuate from period to period due to timing, 73% of revenue from healthcare applications was from recurring revenue in the second quarter of 2010 compared to 68% in the first quarter of 2010.

Our higher gross profit in the second quarter and first six months of 2010 arose primarily from our higher level of revenue. Our gross profit margin increased to 45.4% in the second quarter of 2010 from 43.8% in the second quarter of 2009 due to product mix and improvements in our cost structure.

Our operating expenses increased by $0.8 million in the second quarter of 2010 to $12.5 million from $11.7 million in the 2009 quarter. The increase reflected higher selling, general and administrative expenses primarily related to the integration and operation of the acquisitions. We expect our SG&A expenses for the remainder of 2010 to be in the range of $19.0 to $21.5 million, and our research and development expenses to be in the range of $5.0 million to $6.0 million.

Results of Operations Second Quarter Comparisons

Second quarter comparison of revenue by class of product and service

Table 1 sets forth our change in revenue by class of product and service for the second quarter of 2010 compared to the second quarter of 2009:

Table 1

(Dollars in thousands)	Systems and Other Products		Materials		Services		Totals	
Revenue 2nd quarter 2009	$ 5,882	23.8%	$ 11,702	47.4%	$ 7,121	28.8%	$ 24,705	100%
Change in revenue:								
Volume								
Core products and services	1,290	21.9	3,265	27.9	2,661	37.3	7,216	29.2
New products and services	3,362	57.1	(352)	(3.0)	883	12.4	3,893	15.8
Price/Mix	481	8.2	(293)	(2.5)			188	0.8
Foreign currency translation	(343)	(5.8)	(349)	(3.0)	(166)	(2.3)	(858)	(3.5)
Net change	4,790	81.4	2,271	19.4	3,378	47.4	10,439	42.3
Revenue 2nd quarter 2010	$ 10,672	30.3%	$ 13,973	39.8%	$ 10,499	29.9%	$ 35,144	100%

We earn revenues from the sale of systems and other products, materials and services. On a consolidated basis, revenue for the second quarter of 2010 increased by $10.4 million, or 42.3%, compared to the second quarter of 2009 as a result of improvements in each revenue category.

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The increase in revenue from systems and other products that is due to volume for the second quarter of 2010 compared to the same quarter of 2009 was the result of higher sales of large frame systems and 3-D printers. Revenue from systems and other products consisted of:

- Large-frame systems, which represented 35% of total systems revenue for the second quarter of 2010, compared to 15% for the second quarter of 2009;
- Mid-frame systems, which accounted for 23% of total systems revenue for the 2010 period, compared to 45% for the same period in 2009; and
- 3-D printers, which made up the remaining 42% in the second quarter of 2010, compared to 40% in the second quarter of 2009.

Due to the relatively high list price of certain systems, our customers purchasing decisions may have a long lead time; combined with 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.

Revenue from materials was also helped by the improvement in large-frame systems sales, which are typically accompanied by significant initial materials purchases to charge up new systems and commence production. Sales of integrated materials represented 35% of total materials revenue in the second quarter of 2010 compared to 30% in the second quarter of 2009.

The increase in services revenue reflects revenue from our 3Dproparts service, which was introduced in the fourth quarter of 2009 to expand our paid parts offerings.

Production and delivery of our systems is generally not characterized by long lead times, and backlog is therefore generally not a material factor in our business. At June 30, 2010 our backlog was approximately $5.2 million, compared to backlogs of $1.4 million at December 31, 2009 and $1.6 million at June 30, 2009, respectively. The increase in backlog this period resulted from the timing of the receipt of completed orders and customers requesting delivery after quarter end.

In addition to changes in sales volumes, there are two other primary drivers of changes in revenues from one period to another: the combined effect of changes in product mix and average selling prices, sometimes referred to as price and mix effects, and the impact of fluctuations in foreign currencies.

As used in this Management s Discussion and Analysis, the combined effect of changes in product mix and average selling prices, 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 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.

Change in second quarter revenue by geographic region

Each geographic region contributed to our higher level of revenue in the second quarter of 2010. Table 2 sets forth the change in revenue by geographic area for the second quarter of 2010 compared to the second quarter of 2009:

Table 2

(Dollars in thousands)	**U.S.**		**Europe**		**Asia-Pacific**		**Totals**	
Revenue 2nd quarter 2009	$ 11,455	46.3%	$ 10,742	43.5%	$ 2,508	10.2%	$ 24,705	100%
Change in revenue:								
Volume	5,557	48.5	3,808	35.5	1,745	69.6	11,109	45.0
Price/Mix	387	3.4	(311)	(2.9)	111	4.4	188	0.8
Foreign currency translation			(967)	(9.0)	109	4.3	(858)	(3.5)
Net change	5,944	51.9	2,530	23.6	1,965	78.3	10,439	42.3

Revenue 2nd quarter 2010	$ 17,399	49.5%	$ 13,272	37.8%	$ 4,473	12.7%	$ 35,144	100%

Revenue from U.S. operations increased by $5.9 million or 51.9% to $17.4 million in 2010 from $11.5 million in the second quarter of 2009. The increase was due to higher volume and the favorable combined effect of price and mix. Revenue from non-U.S. operations for the second quarter of 2010 increased by $4.5 million or 33.9% to $17.7 million from $13.2 million for the second quarter of 2009. Revenue from non-U.S. operations as a percent of total revenue was 50.5% and 53.7%, respectively, for the second quarters of 2010 and 2009. The increase in non-U.S. revenue, excluding the effect of foreign currency translation, was 40.4% in the second quarter of 2010.

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Revenue from European operations increased by $2.6 million or 23.6% to $13.3 million from $10.7 million in the prior year period. This increase was due to a $3.8 million increase in volume, partially offset by a $1.0 million unfavorable impact of foreign currency translation and a $0.3 million unfavorable combined effect of price and mix.

Revenue from Asia-Pacific operations increased by $2.0 million or 78.3% to $4.5 million from $2.5 million in the prior year period due primarily to the favorable $1.7 million increase in volume combined with a $0.2 million favorable impact of foreign currency translation and favorable price and mix.

Gross profit and gross profit margins second quarter

Table 3 sets forth gross profit and gross profit margin for our products and services for the second quarters of 2010 and 2009:

Table 3

	Quarter Ended June 30,			
	2010		2009	
(Dollars in thousands)	**Gross Profit**	**% Revenue**	**Gross Profit**	**% Revenue**
Systems and other products	$ 3,698	34.7%	$ 1,090	18.5%
Materials	8,333	59.6	7,051	60.3
Services	3,925	37.4	2,689	37.8
Total	$ 15,956	45.4%	$ 10,830	43.8%

On a consolidated basis, gross profit for the second quarter of 2010 increased by $5.2 million to $16.0 million from $10.8 million in the second quarter of 2009, primarily as a result of higher sales from all revenue categories.

Consolidated gross profit margin in the second quarter of 2010 improved by 1.6 percentage points to 45.4% of revenue from 43.8% of revenue for the 2009 quarter. The increase in gross profit margin reflected higher sales volumes coupled with the effect of various cost savings initiatives that we have pursued since 2008. The 2010 gross profit margin was adversely affected by approximately 2.3 percentage points due to the previously disclosed negative impact on margin of sales of our V-Flash® Desktop Printer. The negative impact of V-Flash® sales on margin in the 2009 quarter was 2.1 percentage points.

Systems and other products gross profit for the second quarter of 2010 increased to $3.7 million from $1.1 million for the 2009 quarter. Gross profit margin for systems increased by 16.2 percentage points to 34.7% of revenue from 18.5% of revenue in the 2009 quarter. Gross profit was positively impacted by higher revenue and benefits from changes to our manufacturing strategy.

Materials gross profit for the second quarter of 2010 increased by $1.2 million or 18% to $8.3 million from $7.1 million for the 2009 quarter, and gross profit margin for materials decreased by 0.7 percentage points to 59.6% of revenue from 60.3% of revenue in the 2009 quarter. The increased gross profit is due to the higher revenue and improved overhead absorption.

Gross profit for services for the second quarter of 2010 increased by $1.2 million or 46% to $3.9 million from $2.7 million for the 2009 quarter, and gross profit margin for services decreased by 0.4 percentage points to 37.4% of revenue from 37.8% of revenue in the 2009 quarter. The decline in gross profit margin for services is primarily due to lower levels of upgrades in the 2010 quarter, as well as to higher 3Dproparts revenues in 2010 which have a lower gross profit margin than the other components of service revenue during the initial quarters following acquisitions.

Operating expenses

As shown in Table 4, total operating expenses increased by $0.8 million or 7.4% to $12.5 million in the second quarter of 2010 from $11.7 million in the second quarter of 2009. This increase consisted of $1.0 million in higher selling, general and administrative expenses partially offset by $0.2 million of lower research and development expenses, both of which are discussed below.

Table 4

	Quarter Ended June 30,			
	2010		2009	
(Dollars in thousands)	Amount	% Revenue	Amount	% Revenue
Selling, general and administrative expenses	$ 9,776	27.8%	$ 8,818	35.7%
Research and development expenses	2,766	7.9	2,855	11.6
Total operating expenses	$ 12,542	35.7%	$ 11,673	47.3%

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Selling, general and administrative expenses

Selling, general and administrative expenses increased by $1.0 million to $9.8 million in the second quarter of 2010 compared to $8.8 million in the second quarter of 2009, but decreased to 27.8% of revenue in 2010 compared to 35.7% for 2009. The increase was due primarily to a $1.2 million increase in compensation costs primarily due to higher staffing levels from acquisitions and higher commissions, partially offset by $0.3 million reduction to bad debt expense.

Research and development expenses

Research and development expenses decreased by $0.2 million or 3.1% to $2.7 million in the second quarter of 2010 from $2.9 million in the second quarter of 2009.

Income (loss) from operations

Our income from operations of $3.4 million for the second quarter of 2010 improved from a loss of $0.8 million in the second quarter of 2009. See *Gross profit and gross profit margins* and *Operating expenses* above.

The following table sets forth operating income (loss) by geographic area for the second quarters of 2010 and 2009:

Table 5

	Quarter Ended June 30,	
(Dollars in thousands)	**2010**	**2009**
Income (loss) from operations		
United States	$ 1,233	$ (2,286)
Germany	520	262
Other Europe	578	288
Asia Pacific	958	364
Subtotal	3,289	(1,372)
Inter-segment elimination	125	529
Total	$ 3,414	$ (843)

With respect to the U.S., the changes in operating income (loss) from 2009 to 2010 reflected the same factors relating to our consolidated operating income (loss) that are discussed above. As most of our operations outside the U.S. are conducted through sales and marketing subsidiaries, the changes in operating income (loss) in our operations outside the U.S. from 2009 to 2010 resulted primarily from changes in transfer pricing which is a function of revenue levels.

Interest and other expense, net

Interest and other expense, net increased to $0.4 million in the second quarter of 2010 from $0.3 million in the 2009 quarter. Foreign currency loss for the second quarter of 2010 was $0.2 million and for 2009 was an insignificant amount. Interest expense for the second quarter of 2010 and 2009 was $0.1 million and $0.2 million, respectively.

Provision for income taxes

We recorded a provision for income taxes of $0.2 million in the quarter ended June 30, 2010 and the quarter ended June 30, 2009. Our provision for income taxes primarily reflects income taxes in foreign jurisdictions.

Net income (loss)

We moved from a net loss of $1.3 million for the second quarter of 2009 to net income of $2.7 million for the second quarter of 2010. The principal reasons for the improvement are discussed in more detail above.

For the quarter ended June 30, 2010, average common shares for basic and diluted earnings per share was 23.0 million and 23.3 million, respectively, and basic and diluted earnings per share was $0.12. For the quarter ended June 30, 2009, average common shares for basic and diluted earnings per share was 22.5 million and basic and diluted loss per share was $0.06.

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Results of Operations Six Month Comparisons

Six month comparison of revenue by class of product and service

Table 6 sets forth our change in revenue by class of product and service for the first six months of 2010 compared to the same period of 2009:

Table 6

(Dollars in thousands)	Systems and Other Products		Materials		Services		Totals	
Revenue six months 2009	$ 10,741	22.0%	$ 22,332	45.8%	$ 15,663	32.2%	$ 48,736	100.0%
Change in revenue:								
Volume								
Core products and services	3,001	27.9	6,540	29.3	3,033	19.4	12,574	25.8
New products and services	5,790	53.9	(861)	(3.9)	1,002	6.4	5,931	12.1
Price/Mix	93	0.9	(496)	(2.2)			(403)	(0.8)
Foreign currency translation	(170)	(1.6)	72	0.3	31	0.2	(67)	(0.1)
Net change	8,714	81.1	5,255	23.5	4,066	26.0	18,035	37.0
Revenue six months 2010	$ 19,455	29.1%	$ 27,587	41.3%	$ 19,729	29.6%	$ 66,771	100.0%

We earn revenues from the sale of systems and other products, materials and services. On a consolidated basis, revenue for the first six months of 2010 increased by $18.0 million, or 37.0%, compared to the first six months of 2009 as a result of improvements in each revenue category.

The increase in revenue from systems and other products that is due to volume for the first six months of 2010 compared to the same period of 2009 was the result of higher overall system sales as follows:

- Large-frame systems, which represented 30% of total systems revenue for the first six months of 2010, compared to 12% for the 2009 period;

- Mid-frame systems, which accounted for 22% of total systems revenue for the 2010 period, compared to 42% for the same period in 2009; and

- 3-D printers, which made up the remaining 48% in the first six months of 2010, compared to 46% in the same period of 2009.

Due to the relatively high list price of certain systems, our customers purchasing decisions may have a long lead time; combined with 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.

Revenue from materials was also helped by the improvement in large-frame systems sales, which are typically accompanied by significant initial materials purchases to charge up new systems and commence production. Sales of integrated materials represented 34% of total materials revenue in the first six months of 2010 compared to 32% in the first six months of 2009.

The increase in services revenue reflects revenue from our 3Dproparts service, which was introduced in the fourth quarter of 2009 to expand our paid parts offerings, partially offset by a decrease in sales of system upgrades.

In addition to changes in sales volumes, there are two other primary drivers of changes in revenues from one period to another: the combined effect of changes in product mix and average selling prices, sometimes referred to as price and mix effects, and the impact of fluctuations in foreign currencies.

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 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.

Change in six month revenue by geographic region

Each geographic region contributed to our higher level of revenue in the first six months of 2010. Table 7 sets forth the change in revenue by geographic area for the first six months of 2010 compared to the first six months of 2009:

Table 7

(Dollars in thousands)	U.S.		Europe		Asia-Pacific		Totals	
Revenue six months, 2009	$ 22,210	45.6%	$ 20,740	42.5%	$ 5,786	11.9%	$ 48,736	100%
Change in revenue:								
Volume	8,820	39.7	6,535	31.5	3,150	54.4	18,505	38.0
Price/Mix	514	2.3	(883)	(4.3)	(34)	(0.6)	(403)	(0.9)
Foreign currency translation			(251)	(1.2)	184	3.2	(67)	(0.1)
Net change	9,334	42.0	5,401	26.0	3,300	57.0	18,035	37.0
Revenue six months, 2010	$ 31,544	47.2%	$ 26,141	39.2%	$ 9,086	13.6%	$ 66,771	100%

Revenue from U.S. operations improved by $9.4 million or 42.0% to $31.6 million in 2010 from $22.2 million in the first six months of 2009. The increase was due to higher volume and the favorable combined effect of price and mix.

Revenue from non-U.S. operations for the first six months of 2010 increased by $8.7 million or 32.8% to $35.2 million from $26.5 million for the first six months of 2009. Revenue from non-U.S. operations as a percentage of total revenue was 52.8% and 54.4%, respectively, for the first six months of 2010 and 2009. The increase in non-U.S. revenue, excluding the effect of foreign currency translation, was 33.1% in the first six months of 2010.

Revenue from European operations increased by $5.4 million or 26.0% to $26.1 million from $20.7 million in the prior year period. This increase was due to a $6.5 million increase in volume, partially offset by a $0.9 million unfavorable combined effect of price and mix and a $0.2 million unfavorable impact of foreign currency translation.

Revenue from Asia-Pacific operations improved by $3.3 million or 57.0% to $9.1 million from $5.8 million in the prior year period due primarily to the favorable $3.1 million increase in volume and a $0.2 million favorable foreign currency translation.

Gross profit and gross profit margins six months

Table 8 sets forth gross profit and gross profit margin for our products and services for the first six months of 2010 and 2009:

Table 8

	Six Months Ended June 30,			
	2010		2009	
(Dollars in thousands)	Gross Profit	% Revenue	Gross Profit	% Revenue
Systems and other products	$ 6,840	35.2%	$ 1,943	18.1%
Materials	16,584	60.1	13,750	61.6
Services	6,853	34.7	5,616	35.9
Total	$ 30,277	45.3%	$ 21,309	43.7%

On a consolidated basis, gross profit for the first six months of 2010 increased by $9.0 million to $30.3 million from $21.3 million in the first six months of 2009, primarily as a result of increased sales from all revenue categories.

Consolidated gross profit margin in the first six months of 2010 increased by 1.6 percentage points to 45.3% of revenue from 43.7% of revenue for the 2009 period. The increase in gross profit margin reflected higher sales volumes coupled with the effect of various cost savings initiatives that we pursued since 2008.

Systems and other products gross profit for the first six months of 2010 increased to $6.8 million from $1.9 million for the 2009 period. Gross profit margin for systems increased by 17.1 percentage points to 35.2% of revenue from 18.1% of revenue in the 2009 period. Gross profit was positively impacted by higher revenue and benefits from changes to our manufacturing strategy.

Materials gross profit for the first six months of 2010 increased by $2.8 million or 20.6% to $16.6 million from $13.8 million for the 2009 period, and gross profit margin for materials decreased by 1.5 percentage points to 60.1% of revenue from 61.6% of revenue in the 2009 period. The increased gross profit is attributed to the higher revenue.

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Gross profit for services for the first six months of 2010 increased by $1.3 million or 22.0% to $6.9 million from $5.6 million for the 2009 period, and gross profit margin for services decreased by 1.2 percentage points to 34.7% of revenue from 35.9% of revenue in the 2009 period. The decline in gross profit margin for services is primarily due to lower levels of upgrades in the first six months of 2010, as well as higher 3Dproparts revenues in 2010, which have a lower gross profit margin than the other components of service revenue during the initial quarters following acquisitions.

Operating expenses

As shown in Table 9, total operating expenses increased by $0.4 million or 1.9% to $24.2 million in the first six months of 2010 from $23.8 million in the first six months of 2009.

Table 9

	Six Months Ended June 30,			
	2010		2009	
(Dollars in thousands)	Amount	% Revenue	Amount	% Revenue
Selling, general and administrative expenses	$ 18,934	28.4%	$ 18,006	36.9%
Research and development expenses	5,271	7.9	5,753	11.8
Total operating expenses	$ 24,205	36.3%	$ 23,759	48.7%

Selling, general and administrative expenses

Selling, general and administrative expenses increased by $0.9 million to $18.9 million in the first six months of 2010 compared to $18.0 million in the first six months of 2009. The increase was due primarily to a $2.1 million increase in compensation costs primarily due to higher staffing levels from acquisitions and higher commissions, partially offset by lower bad debt expense of $1.0 million and lower depreciation expense of $0.5 million.

Research and development expenses

Research and development expenses decreased by $0.5 million or 8.4% to $5.3 million in the first six months of 2010 from $5.8 million in the same period in 2009, principally due to a $0.3 million decrease in outside consulting services in the 2010 period.

Income (loss) from operations

Our income from operations for the six months ended June 30, 2010 increased by $8.6 million to $6.1 million from $2.5 million loss from operations during the six months ended June 30, 2009. See *Gross profit and gross profit margins* and *Operating expenses* above.

The following table sets forth operating income (loss) by geographic area for the first six months of 2010 and 2009:

Table 10

	Six Months Ended June 30,	
(Dollars in thousands)	2010	2009
Income (loss) from operations		
United States	$ 1,789	$ (5,230)
Germany	833	370
Other Europe	1,024	707
Asia Pacific	2,255	1,307
Subtotal	5,901	(2,846)
Inter-segment elimination	171	396
Total	$ 6,072	$ (2,450)

With respect to the U.S., the changes in operating income (loss) from 2009 to 2010 reflected the same factors relating to our consolidated operating income (loss) that are discussed above. As most of our operations outside the U.S. are conducted through sales and marketing subsidiaries, the changes in operating income (loss) in our operations outside the U.S. from 2009 to 2010 resulted primarily from changes in transfer pricing which is a function of revenue.

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Operating income from our Asia-Pacific operations includes a $0.5 million bad debt provision related to 2009 sales to our largest Japanese customer, which filed for court protection in February 2009. Receivables prior to the filing were fully reserved, while sales subsequent to the filing have been on a cash basis.

Interest and other expense, net

Interest and other expense, net increased to $0.8 million in the first six months of 2010 from $0.5 million in 2009. Foreign currency loss for the first six months of 2010 and 2009 was $0.5 million and $0.2 million, respectively. Interest expense for the first six months of 2010 and 2009 was $0.3 million for each period.

Provision for income taxes

We recorded a provision for income taxes of $0.5 million for both six month periods ending June 30, 2010 and June 30, 2009. Our provision for income taxes primarily reflects income taxes in foreign jurisdictions.

Net income (loss)

Our net income for the first six months of 2010 improved to $4.8 million, compared to our net loss of $3.4 million for the first six months of 2009.

For the six months ended June 30, 2010, average common shares for basic and diluted earnings per share was 22.9 million and 23.5 million, respectively, and basic and diluted earnings per share were $0.21 and $0.20, respectively. For the six months ended June 30, 2009, average common shares for basic and diluted earnings per share was 22.4 million and basic and diluted loss per share were $0.15.

Financial Condition and Liquidity

Table 11

(Dollars in thousands)	**June 30, 2010**	**December 31, 2009**
Cash and cash equivalents	$ 25,878	$ 24,913
Working capital	$ 39,934	$ 36,718
Total 3D Systems equity	$ 111,786	$ 104,697

Our unrestricted cash and cash equivalents increased by $1.0 million to $25.9 million at June 30, 2010 from $24.9 million at December 31, 2009. This increase principally resulted from the net $7.4 million of cash provided by operating activities, partially offset by the $6.2 million of cash used in investing activities. See *Cash flow* and *Capitalized lease obligations* below.

Our net working capital increased by $3.2 million to $39.9 million at June 30, 2010 from $36.7 million at December 31, 2009, primarily due to the factors discussed below.

Accounts receivable, net, decreased by $0.9 million to $22.9 million at June 30, 2010 from $23.8 million at December 31, 2009. This decline was primarily attributable to the collection of year end 2009 accounts receivable balances, which were primarily composed of sales from the fourth quarter. Accounts receivable declined even with our higher sales levels due to higher system revenue which typically includes upfront deposits from customers. Our days sales outstanding decreased to 59 days at June 30, 2010 from 60 days at December 31, 2009. Our gross accounts receivable declined by $1.2 million from December 31, 2009 to June 30, 2010. Accounts receivable more than 90 days past due decreased to 5.1% of gross receivables at June 30, 2010 compared to 5.9% of gross receivables at December 31, 2009.

Accounts payable increased by $1.8 to $14.8 at June 30, 2010 from $13.0 million at December 31, 2009. The increase primarily related to the increase in inventories, which is explained below, and the normal timing of our scheduled expense payments.

Inventories increased by $3.6 million to $22.0 million at June 30, 2010 from $18.4 million at December 31, 2009. This increase resulted primarily from a $2.8 million increase in finished goods inventory due to the timing of sales and revenue recognition at quarter end, which also impacts our backlog, and a $0.7 million increase in raw materials due to timing of sales and deliveries. We maintained $2.4 million of inventory reserves at June 30, 2010 and $2.7 million of such reserves at December 31, 2009.

With the outsourcing of substantially all our large-frame and mid-frame equipment assembly and refurbishment activities, the majority 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 large-frame and mid-frame systems. As a result, we generally no longer hold in inventory most parts for large-frame and mid-frame systems production or refurbishment. This trend is partially offset by an increase in raw materials and spare parts used in our in-house manufacturing and support service for 3-D printers.

The changes in the first six months of 2010 that make up the other components of working capital not discussed above arose in the ordinary course of business.

Differences between the amounts of working capital item changes in the cash flow statement and the balance sheet changes for corresponding items are primarily the result of foreign currency translation adjustments.

We intend to continue to rely upon our unrestricted cash and cash flow from operations to meet our liquidity needs. While we believe that actions taken since 2008 to reduce our operating costs, improve our gross profit margin and manage working capital should continue to benefit us in 2010, there can be no assurance in these uncertain economic times that these actions will be sufficient.

Our principal contractual commitments consists of the capital leases on our Rock Hill facility, which are discussed in greater detail below.

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 the first six months of 2010 and 2009.

Table 12

(Dollars in thousands)	**2010**	**2009**
Cash provided by operating activities	$ 7,438	$ 2,317
Cash used in investing activities	(6,220)	(711)
Cash provided by financing activities	133	255
Effect of exchange rate changes on cash	(386)	4
Net increase in cash and cash equivalents	$ 965	$ 1,865

Cash flow from operations

For the six months ended June 30, 2010, our operating activities, which is primarily composed of net income plus the effects of non-cash items and changes in working capital, provided $7.4 million of net cash. These changes in working capital included a $4.5 million increase in inventories, partially offset by a $2.1 million increase in accounts payable and a $0.7 million decrease in prepaid expenses and other current assets.

For the six months ended June 30, 2009, our operating activities provided $2.3 million of net cash. This source of cash consisted of $4.7 million of non-cash items included in our net loss and $1.0 million of cash provided by net changes in operating accounts that were partially offset by our $3.4 million net loss.

Cash flow from investing activities

Net cash used in investing activities in the first six months of 2010 increased to $6.2 million from $0.7 million for the first six months of 2009. The increase was primarily due to acquisitions related to our 3Dproparts business.

Cash flow from financing activities

Net cash provided by financing activities decreased to $0.1 million for the six months ended June 30, 2010 compared to $0.2 million in the 2009 period.

Capitalized lease obligations

Our principal contractual commitments consisted of capitalized lease obligations of $8.4 million at June 30, 2010. Our capitalized lease obligations decreased from $8.5 million at December 31, 2009 primarily due to scheduled payments of principal on capital lease installments.

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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 and the furniture and fixture leases at June 30, 2010 and December 31, 2009 were $8.4 million and $8.5 million, respectively.
Our outstanding capitalized lease obligations at June 30, 2010 and December 31, 2009 were as follows:
Table 13

(Dollars in thousands)	June 30, 2010	December 31, 2009
Capitalized lease obligations:		
Current portion of capitalized lease obligations	$ 219	$ 213
Capitalized lease obligations, long-term portion	8,145	8,254
Total capitalized lease obligations	$ 8,364	$ 8,467

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 ASC 815, Derivatives and Hedging, and we recognize all gains and losses (realized or unrealized) in interest and other expense, net in our Condensed Consolidated Statements of Operations.
The dollar equivalent of our foreign currency contracts and their related fair values as of June 30, 2010 and December 31, 2009 were as follows:
Table 14

	Foreign Currency Purchase Contracts	
(Dollars in thousands)	2010	2009
Notional amount	$ 922	$ 1,587
Fair value	976	1,563
Net unrealized gain (loss)	$ 54	$ (24)

At June 30, 2010 and December 31, 2009, the notional amount of these contracts at their respective settlement dates amounted to $0.9 million and $1.6 million, respectively. The 2010 and 2009 contracts related primarily to purchases of inventory from third parties. The notional amount of the purchase contracts aggregated CHF 1.1 million and CHF 1.6 million, respectively.
The net fair value of all foreign exchange contracts at June 30, 2010 and December 31, 2009 reflected a $0.1 million unrealized gain at June 30, 2010 and nominal unrealized loss at December 31, 2009. The foreign currency contracts outstanding at December 31, 2009 expired at various times between January 6, 2010 and February 3, 2010. The foreign currency contracts outstanding at June 30, 2010 expire at various times between July 1, 2010 and July 21, 2010.
Changes in the fair value of derivatives are recorded in interest and other expense, net, in our Condensed 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 Condensed Consolidated Balance Sheets.

The total impact of foreign currency related items on our Condensed Consolidated Statements of Operations for the six months ended June 30, 2010 and June 30, 2009 was a net loss of $0.5 million and a net loss of $0.2 million, respectively.

3D Systems stockholders equity

3D Systems stockholders equity increased by $7.1 million to $111.8 million at June 30, 2010 from $104.7 million at December 31, 2009. This increase includes the following:

- our $4.8 million net income reported for the first six months of 2010;
- $2.6 million of stock issued for acquisitions; and
- $0.8 million of stock compensation expense recorded in stockholders equity in accordance with ASC 738, Compensation Stock Compensation during the first six months of 2010.

Offsetting this increase was an unrealized loss on foreign currency translation of $1.3 million.

Recent Accounting Pronouncements

For information with respect to recent accounting pronouncements and the impact of these pronouncements on our consolidated financial statements, see Note 1 to the unaudited Condensed Consolidated Financial Statements.

Critical Accounting Policies and Significant Estimates

For a discussion of our critical accounting policies and estimates, refer to Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Significant Estimates in our Annual Report on Form 10-K for the year ended December 31, 2009.

Forward-Looking Statements

Certain statements made in this Form 10-Q that are not statements of historical or current facts are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include the cautionary statements and risk factors set forth below as well as other statements made in the Form 10-Q that may involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from historical results or from any future results expressed or implied by such forward-looking statements.

In addition to statements that explicitly describe such risks and uncertainties, readers are urged to consider statements in future or conditional tenses or that includes terms such as believes, belief, expects, intends, anticipates or be uncertain and forward-looking. Forward-looking statements may include comments as to our beliefs and expectations as to future events and trends affecting our business. Forward-looking statements are based upon management s current expectations concerning future events and trends and are necessarily subject to uncertainties, many of which are outside our control. The factors stated under the heading Cautionary Statements and Risk Factors set forth below and those described in our other SEC reports, including our Annual Report on Form 10-K for the year ended December 31, 2009, as well as other factors, could cause actual results to differ materially from those reflected or predicted in forward-looking statements.

Any forward-looking statements are based on management s beliefs and assumptions, using information currently available to us. We assume no obligation, and do not intend, to update these forward-looking statements.

If one or more of these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, actual results may vary materially from those reflected in or suggested by forward-looking statements. Any forward-looking statement you read in this Form 10-Q reflects our current views with respect to future events and is subject to these and other risks, uncertainties and assumptions relating to our operations, results of operations, growth strategy and liquidity. All subsequent written and oral forward-looking statements attributable to us or individuals acting on our behalf are expressly qualified in their entirety by this paragraph. You should specifically consider the factors identified or referred to in this Form 10-Q and our other SEC reports, including our Annual Report on Form 10-K for the year ended December 31, 2009, which could cause actual results to differ from those referred to in forward-looking statements.

Cautionary Statements and Risk Factors

We recognize that we are subject to a number of risks and uncertainties that may affect our future performance. The risks and uncertainties described in Item 1A in our Annual Report on Form 10-K for the year ended December 31, 2009 are not the only risks and uncertainties that we face. Additional risks and uncertainties not currently known to us or that we currently deem not to be material also may impair our business operations. If any of these risks actually

occur, our business, results of operations and financial condition could suffer. In that event the trading price of our common stock could decline, and you may lose all or part of your investment in our common stock. The risks in Item 1A in our Annual Report on Form 10-K for the year ended December 31, 2009 also include forward-looking statements, and our actual results may differ substantially from those discussed in these forward-looking statements.

Except as required by the federal securities laws, we undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

For a discussion of market risks at December 31, 2009, refer to Item 7A, Quantitative and Qualitative Disclosures about Market Risk, in our Annual Report on Form 10-K for the year ended December 31, 2009. During the first six months of 2010, there were no material changes or developments that would materially alter the market risk assessment performed as of December 31, 2009.

Item 4. Controls and Procedures.

Evaluation of disclosure controls and procedures

As of June 30, 2010, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act.)) pursuant to Rules 13a-15 and 15d-15 under the Exchange Act. These controls and procedures were designed to provide reasonable assurance that information required to be disclosed in the reports that we file or submit under the 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 management, including our Chief Executive Officer and Chief Financial Officer, in a manner to allow timely decisions regarding required disclosures. Based on this evaluation, including an evaluation of the rules referred to above in this Item 4, management has concluded that our disclosure controls and procedures were effective as of June 30, 2010 to provide reasonable assurance that information required to be disclosed in the reports that we file or submit under the 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 management, including our Chief Executive Officer and Chief Financial Officer, in a manner to allow timely decisions regarding required disclosures.

Changes in Internal Controls over Financial Reporting

There were no material changes in our internal controls over financial reporting during the period covered by this Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II OTHER INFORMATION

Item 1. Legal Proceedings.

The information set forth in Note 14 of the Condensed Consolidated Financial Statements in Part I, Item 1 of this Form 10-Q is incorporated herein by reference.

Item 1A. Risk Factors.

There have been no material changes from the risk factors as previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2009.

Item 6. 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	Certificate of Designations, Preferences and Rights of Series A Preferred Stock, filed with the Secretary of State of Delaware on December 9, 2008. (Incorporated by reference to Exhibit 3.1 of Registrant s Current Report on Form 8-K, filed on December 9, 2008.)
3.10	

	Amended and Restated By-Laws. (Incorporated by reference to Exhibit 3.2 of Registrant s Current Report on Form 8-K filed on December 1, 2006.)
10.1	Charles W. Hull Consulting Arrangement.
10.2	Kevin P. McAlea Severance Arrangement.
31.1	Certification of Principal Executive Officer filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 dated July 29, 2010.
31.2	Certification of Principal Financial Officer filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 dated July 29, 2010.
32.1	Certification of Principal Executive Officer filed pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 dated July 29, 2010.
32.2	Certification of Principal Financial Officer filed pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 dated July 29, 2010.

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SIGNATURE

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

3D Systems Corporation

By: /s/ Damon J. Gregoire
Damon J. Gregoire
Senior Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)
(Duly Authorized Officer)

Date: July 29, 2010

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