STRATASYS INC
Form 10-K
March 12, 2012

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

FORM 10-K

(Mark One)

[√] **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2011
OR
[ ] **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _____ to _____

Commission file number 1-13400

STRATASYS, INC.

(Exact name of registrant as specified in its charter)

Delaware State or other jurisdiction of incorporation or organization	**36-3658792** (I.R.S. Employer Identification No.)
7665 Commerce Way, Eden Prairie, Minnesota (Address of Principal Executive Offices)	**55344** (Zip Code)
Registrant s telephone number, including area code	**(952) 937-3000**

Securities registered pursuant to Section 12(b) of the Act: Title of each class	Name of each exchange on which registered
Common stock, $.01 par value	**NASDAQ Global Select Market**

Securities registered pursuant section 12(g) of the Act:
None

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes [ ] No [√]

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period than 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 the definitions of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer [ ] Accelerated filer [√]

Non-accelerated filer [ ] Smaller reporting company [ ]

(Do not check if a smaller reporting company)

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

The aggregate market value of the registrant s Common Stock held by non-affiliates of the registrant as of June 30, 2011, the last business day of the registrant s most recently completed second quarter, was approximately $682,000,000. On such date, the closing price of the Registrant s Common Stock, as quoted on the Nasdaq Global Select Market was $33.70.

The registrant had 21,287,065 shares of common stock outstanding as of March 1, 2012.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s Definitive Proxy Statement to be filed with the Securities and Exchange Commission with respect to the registrant s Annual Meeting of Stockholders are incorporated by reference into Part III of this Annual Report.

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Signatures

PART I

Item 1. Business.

General Development of Business

Stratasys, Inc. is a worldwide leading manufacturer of three-dimensional (3D) printers and 3D production systems for the office-based rapid prototyping (RP) and direct digital manufacturing (DDM) markets. Our 3D printers and 3D production systems provide 3D computer-aided design (CAD) users a fast, office-friendly, and low-cost alternative for building functional 3D parts. We develop, manufacture and sell a broad product line of 3D printers and 3D production systems (and related proprietary consumable materials) that create physical parts from CAD designs. We also offer rapid prototyping and production part manufacturing services through our centers located in North America, Europe and Australia. As of December 31, 2011, we hold more than 350 granted or pending additive fabrication patents globally. Stratasys products are used in the aerospace, defense, automotive, medical, business and industrial equipment, education, jewelry, architecture, dental, and consumer-products markets.

We were incorporated in Delaware in 1989 and our executive offices are located in Eden Prairie, Minnesota. Most of our systems are based on our core patented fused deposition modeling (FDM®) technology and on our patented Genisys® technology, which we purchased from IBM in 1994. We sold our first commercial product in April 1992, and in February 2002, we introduced the first 3D printer in our Dimension® product line. The Dimension line offers modeling capabilities in durable ABS plastic using a desktop 3D printer platform. In May 2007, we began offering high-performance systems that were specifically designed for DDM, which is the production of end use parts and tools used in fabrication and assembly. Other recent significant developments in our business are set forth below:

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

- In July 2011, we introduced the Fortus 250mc Production System. The Fortus 250mc combines the ease-of-use and affordability of Dimension 3D Printers with the control of Insight Software, used to drive the Fortus line of production systems. With Insight, users will have added control of build speed, part accuracy, and feature detail. The Fortus 250mc uses Stratasys SR-30 soluble support material, which has a faster dissolve time than other soluble support materials.

- In September 2011, we completed the initial term of a Master Original Equipment Manufacturer Agreement (the OEM Agreement) with Hewlett-Packard Company (HP), and are now in an extension term, which currently expires September 30, 2012. Under the OEM Agreement, we are manufacturing a line of FDM (Fused Deposition Modeling) 3D printers and related accessories and consumables exclusively for HP for resale under the HP DesignJet brand in certain countries. The OEM Agreement now includes Austria, Switzerland and Ireland in addition to France, Germany, Italy, Spain and the United Kingdom. We believe this distribution channel continues to be a valuable approach to increase sales and enhance awareness of 3D printing.

- In December 2011, we extended our collaborative agreement with a Fortune 500 global manufacturing company to develop new platforms for DDM applications. Due to the success of this arrangement, we are continuing this relationship under similar terms and objectives and have received a purchase order for $1.9 million expected to be fulfilled in 2012. In 2011, 2010 and 2009, we offset approximately $0.7 million, $1.2 million and $2.2 million, respectively, of R&D expenses with monies received from this customer. As a result of prior collaborations with this Fortune 500 company, we had a commercial release of the Fortus 900mc in August 2008, which has the largest build envelop in our current product line.

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- In July 2011, we introduced our newest ABS-ESD7 part build material. ABS-ESD7 is a thermoplastic with static dissipative properties for applications where a static charge can damage products, impair their performance or cause an explosion. This makes ABS-ESD7 ideal for DDM applications and is most widely used to create jigs and fixtures for the assembly of electronic components, but it is also useful for building functional prototypes of fuel storage and delivery products, as well as cases, enclosures and packaging. ABS-ESD7 also eliminates another common static electricity problem: the attraction and buildup of particulate, such as dust or powders, which can degrade product performance.

- In February 2011, we obtained ISO 9001:2008 certification. ISO 9001:2008 is a standard established by the International Organization for Standardization that provides a set of standardized requirements for a quality management system. We believe that ISO certification of our quality management systems will help us expand our products applicability to RP and DDM in key markets such as aerospace, defense, medical and automotive.

- In February 2012, RedEye obtained AS9100C certification. AS9100 is the quality management system for the aviation, space, and defense industries. AS9100 fully incorporates ISO 9001:2008 while adding nearly 100 additional requirements specific to quality and safety for aerospace. We believe that AS9100C certification in RedEye will help us expand our services applicability to DDM in the aerospace and defense markets.

- In December 2010, we purchased a 90,000 square foot facility that will be used to expand production capacity for machines and consumables, as well as streamline and consolidate warehousing and shipping operations. Initial improvements to the facility were made and a portion of the building was occupied in July 2011.

Description of Business

We develop, manufacture, market, and service a family of 3D printers and 3D production systems that enable design and manufacturing engineers to create physical models, parts, tooling and prototypes out of plastic and other materials directly from a CAD workstation. Our high-performance RP systems are used both to create prototype models as well as produce parts for end-user, or DDM, applications. Our 3D printers and 3D production systems can be used in office environments without expensive facility modification. In many industries, the models and prototypes required for product development are produced laboriously by hand-sculpting or machining, a traditional process that can take days or weeks. Our computerized modeling systems use our proprietary technology to make models and prototypes as well as end-use parts directly from a designer s 3D CAD file in a matter of hours. This can eliminate machining and tooling costs and allows for inexpensive design changes. In addition to selling high-performance RP systems and 3D printers, our RedEye paid parts service makes and sells physical models, tooling, prototypes and parts for RP and DDM applications based on the customers CAD files.

The 3D printers and high-performance RP systems using our FDM technology to produce prototypes and parts from industrial production-grade plastic do not rely on lasers. This affords our products a number of significant advantages over other commercially available 3D rapid prototyping technologies that rely primarily on lasers to create models. Such benefits include:

- the ability to use the device in an office environment due to the absence of hazardous emissions

- little or no post-processing

- minimal material waste

- better processing and build repeatability

- ease of use
- minimal system set up
- the availability of a variety of thermoplastic materials
- modeling in product-grade plastics for functional testing

- no need for costly replacement lasers and laser parts

- higher reliability

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

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

Our Solidscape 3D printing technology uses a Drop-on-Demand (DoD) thermoplastic ink-jetting technology to produce wax-like patterns for lost-wax casting/investment casting and mold making applications. The process begins with the creation of a 3D geometric design on a CAD workstation. The CAD file is then input into the 3D printer using Solidscape proprietary graphical front-end software, ModelWorks®. The 3D printer creates solid 3D parts through an additive, layer-by-layer process, using patent-protected, DoD thermoplastic ink-jetting technology and high-precision milling of each layer. The parts produced are extremely high resolution with precise details and fine surface finish.

Based upon data and estimates furnished in the 2011 Wohlers Report, through 2010 we shipped approximately 38% of all industrial RP systems sold worldwide since 1996. The 2011 Wohlers Report also states that we sold 42% of all industrial RP systems sold globally in 2010.

Applications for 3D Production Systems and 3D Printers

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

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

DDM involves the use of our systems for the direct manufacture of parts that are subsequently incorporated into the user s end product or process. DDM is particularly attractive in applications that require short-run or low-volume parts that require rapid turn-around, and for which tooling would not be appropriate due to small volumes. For example, customers produce parts for high-end, specialized vehicles or parts that are subsequently used in the assembly of their unique products. Our Fortus 360mc, 400mc, 900mc and Solidscape systems are well suited for these types of applications.

An emerging portion of the DDM market segment is the production of manufacturing tools that aid in the customer s production and assembly process. We believe this fabrication and assembly tool market is substantially larger than the $1.1 billion additive fabrication market that we currently serve. In addition, we have seen a growing number of applications for end-use parts.

We have shipped over 22,000 systems since our inception. A wide variety of design and manufacturing organizations use our systems. Current markets and applications include:

- Aerospace
- Automotive
- Consumer Products
- Direct digital manufacturing of custom parts
- Electronics
- Architecture
- Business Machines
- Defense
- Educational Institutions
- Fixtures

- Jewelry
- Heavy Equipment
- Medical Systems
- Tooling
- Medical Analysis
- Mold Making
- Dental

Additional future applications may include:

- Aerospace and automotive spare parts
- Aerospace ground support equipment
- Free-form graphic design
- Gaming, art and animation
- Secondary tooling
- Unmanned air and robotic systems

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

Products

3D Production Systems and 3D Printers

We have been developing, enhancing and expanding our high-performance systems and 3D printers since our inception in 1989. We have improved both the speed and the accuracy of our high-performance Fortus systems, expanded their build envelopes, introduced a number of new modeling materials and developed and introduced a low-cost 3D printer. We have also enhanced and upgraded the software that our systems use to read CAD files and build parts. In May 2011, we acquired Solidscape whose 3D printers use DoD thermoplastic ink-jetting technology and high-precision milling produces extremely high resolution parts with precise details and fine surface finish.

Each of our products is based upon either our patented FDM process, Solidscape DoD thermoplastic ink-jetting technology or technology acquired from IBM. Our products are sold as integrated systems, consisting of an RP machine, the software to convert the CAD designs into a machine compatible format and modeling and support materials. Each of our products is compatible with an office environment and does not require an operator to be present while it is running.

Our family of 3D printers and high-performance systems affords a customer s product development team, including engineers, designers and managers, the ability to create prototypes through all stages of the development cycle. Our products meet the needs of a demanding and diverse industrial base by offering a wide range of capability and price from which to choose. The domestic end user list prices of our systems range from $13,900 for the uPrint Personal 3D Printer to $379,900 for our high performance Fortus 900mc.

The Dimension line of 3D printers allows users to create parts in ABS*plus* plastic. ABS usually offers the part strength required for true form, fit and functional testing. Dimension 3D printers operate in an office environment and provide speed, ease of use and networking capabilities at a competitive price. They feature our Catalyst EX® software, which offers a single push-button operation by automating all of the required build procedures. We introduced the uPrint Personal 3D Printer in January 2009 at a list price of $14,900. In January 2010, we expanded the Dimension uPrint product line by introducing the uPrint Plus. This system offers the same small footprint as the previously introduced uPrint but offers a 33% larger build envelop. It also allows the user to print in seven additional colors and offers two resolution settings. Using Dimension s proven FDM technology, the uPrint and uPrint Plus build models with Stratasys ABS*plus* a material that is on average 40 percent stronger than our standard ABS material, making it ideal for testing the form, fit and function of models and prototypes. The Dimension 1200es SST, introduced in January 2008 and priced at a domestic end user list price of $32,900, offers the ability to build larger parts and creates parts from our ABS*plus* material as well.

The Fortus 400mc was introduced in July 2007 and allowed for an increase in repeatability, part accuracy and material strength. In addition, in January 2008, we introduced the Fortus 360mc, which offers similar part quality to the Fortus 400mc, but fewer material choices and slower build speeds. Both of these systems can be configured to meet specific customer needs. The InSight software used by our Fortus systems offers the customer an array of features that is more flexible than Catalyst EX, ranging from a fully automated build process to one that allows the user to customize each step. Domestic end user prices for these systems range from of $85,900 to $258,900 depending on the configuration and needs of the customer.

In December 2007, we introduced the Fortus 900mc, which represents our largest system ever. It is capable of building parts measuring 4.5 feet diagonally, nine times larger volumetrically than parts built by the Fortus 400mc. The Fortus 900mc uses ball-screw technology, which improves part accuracy, positional repeatability and tolerances. This product is the direct result of a $3.6 million development contract from a Fortune 500 global manufacturing company entered into in September 2005 to advance our proprietary FDM® technology for direct digital manufacturing applications.

Our 3D printers and 3D production systems incorporate our WaterWorks soluble support system. The patented WaterWorks process allows for the easy removal of supports from a completed prototype by simple immersion into a water-based solution. Because our support materials dissolve in a solution, many post-processing steps required in our competitors systems are not required with our systems.

Our Solidscape line of 3D printers incorporates ModelWorks software and printing technology, ideal for small parts and assemblies used in personal consumer electronics such as mobile phones, pagers, MP3 players; biomedical products such as biocompatible implants, dental prosthetics, orthodontic appliances, toys, medical research, orthopedics; and jewelry products such as investment cast fine jewelry, spin cast and plated fashion jewelry. The R66Plus is the entry point to the Solidscape line of 3D printers and is most often used by custom retail jewelers to produce high quality fully castable wax masters for intricate jewelry designs. The T76PLUS is ideal for traditional manufacturers, larger custom retailers and high volume service bureaus. This system is also capable of producing high quality, fully castable wax masters for intricate designs. The D76PLUS is ideal for medium sized dental laboratories and is used to produce high quality castable and pressable dental restorations. The end user list prices of our Solidscape 3D printers range from $30,650 to $45,650.

We periodically discontinue manufacturing older products. We discontinued the Prodigy Plus system in 2007, the Vantage and Titan systems during 2008, and the BST 768, SST 768, Fortus 200mc and Maxum systems during 2009. Although we have discontinued the manufacture of these systems, we continue to provide service support in the field and offer next generation systems in those categories.

Part Build Materials

The modeling and support filament used in the RP and DDM systems and 3D printers that we sell are consumable products that generate recurring revenue. We believe that FDM technology allows the use of a greater variety of production grade thermoplastic building materials than other RP technologies. We continue to develop filament modeling materials that meet our customers needs for increased speed, strength, accuracy, surface resolution, chemical and heat resistance, color, and mechanical properties. These materials are processed into our patented filament form, which is then fed into the FDM systems. Our spool-based system has proven to be a significant advantage for our products over ultraviolet (UV) polymer systems or powder based systems, because our system allows the user to quickly change material by simply mounting the lightweight spool and feeding the desired filament into the FDM devices. The spool-based system also compares favorably with stereo lithography (SLA) UV polymer systems, because the spool-based system allows the customer to use it in an office environment and to purchase a single spool, as compared to an entire vat of SLA UV polymer with a limited vat life, thereby reducing the customer s up-front costs.

Currently, we have ten part build materials in multiple colors commercially available for use with our FDM technology:

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

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

- PC-ABS is a blend of PC and ABS plastic. The blend combines the strength of PC with the flexibility of ABS.

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

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- PC-ISO is a derivative of PC that is translucent and can be sterilized for medical device or surgical jig and fixture production or prototyping.

- ABS-M30i is a biocompatible material ideal for direct digital manufacturing applications in the medical, food and pharmaceutical equipment industries with ISO 10993 certification relating to ethylene oxide sterilization requirements.

- ABS*plus* and M-30, like ABS, are thermoplastic materials with all the associated benefits. ABS*plus* has the added benefit of creating additional part strength. Parts built with these materials are on average 40% stronger than our standard ABS parts.

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

- ULTEM 9085 is a strong, light weight, flame and chemically resistant thermoplastic material that is frequently used in aerospace, automotive and military applications.

- ABS-ESD7 (our newest material) is an ABS thermoplastic with static dissipative properties for applications where a static charge can damage products, impair their performance or cause an explosion. Most widely used to create jigs and fixtures for the assembly of electronic components, it is also useful for building functional prototypes of fuel storage and delivery products, as well as cases, enclosures and packaging.

Our Solidscape 3D materials are non-toxic thermoplastic materials featuring excellent lost wax casting qualities, including fast melt out, no ash or residue and no thermal expansion. Currently, we have three modeling materials commercially available for use with our Solidscape technology:

- Indura®Cast is a thermalpolyester formula that completely vaporizes during burnout, leaving no ash residue, resulting in highly accurate casting. The resulting models accurately retain the finest details, greatly reducing the time needed for post processing refinement.

- *plus*Cast is a thermalpolyester formula developed to help retail jewelers and manufacturers meet the market demand for finished goods using less precious materials. Test results indicate it to be up to 30% stronger than InduraCast and the increased durability enables designers to incorporate even more intricate details with thinner walls into their work to produce lighter weight finished jewelry.

- DentaCast® is a thermalpolyester material formulated to deliver high casting yields for dental applications.

In addition to the modeling materials, support material is used during the build process. Our proprietary water-soluble support material, WaterWorks, is dissolved from the finished part after the FDM build process in our automatic WaveWash system, which was introduced in 2010. We also offer a soluble support material called SR-30, which can dissolve 69% faster than the previous soluble support material. Other proprietary support materials that are removed from the final model by hand are also available.

Our Solidscape 3D printing systems use Indura® Fill material to automatically generate a support structure for the model during the build process. This saves the CAD designer the time and effort of configuring supports. After the printing is complete, the InduraFill material dissolves away in a liquid solution.

Each material has specific characteristics that make it appropriate for various applications. The ability to use different materials allows the user to match the material to the end use application, whether it is a pattern for tooling, a concept model, a functional prototype, a DDM manufacturing tool, or a DDM end use part. ABS and ABS*plus* are offered in numerous colors, including white, black, red, blue, yellow, olive, nectarine and dark grey. We also offer a service to create custom colors for unique customer needs.

Operating Software

Our high-performance systems and 3D printers use one of two software products that convert the three-dimensional CAD databases into the appropriate code to operate our FDM system. The software products also provide a wide range of features, including automatic support generation, part scaling, positioning and nesting, as well as geometric editing capabilities. The software is integrated into the system and is not sold as a stand-alone product.

Catalyst EX, our entry-level software product, enables users to build prototype parts at the push of a button. It was introduced in 2000 and is used on Dimension 1200es SST and BST, Dimension Elite, uPrint, and uPrint Plus. HP s Designjet printers use a version of Catalyst EX, branded under the HP Designjet 3D Software Solution name.

Our InSight preprocessing software is used on our Fortus products Fortus 250mc, 360mc, 400mc, and 900mc. It increases build speed and improves the design engineer s control and efficiency over the entire build process. It has a broad set of features that facilitate demanding applications ranging from a single push button for automatic preprocessing to individual editing and manipulation tools for each process step.

We continuously improve both software products to meet the demands of our sophisticated customers. Our latest software enhancement is Smart Supports, a software feature that reconfigures the way support material is structured in the build process in order to reduce support material usage by as much as 40%. Throughput enhancements, advanced build algorithms and features such as Smart Supports are intended to keep pace with complex industrial geometric designs while saving valuable operator time.

Our Solidscape systems employ ModelWorks software that has a familiar Windows interface. ModelWorks permits selection of desired resolution and allows setup of variable slice thicknesses supported in the same model or pattern. ModelWorks also automatically generates the model support structure as well as the positioning and orientation on the build plate. Click-It® software controls the material deposition (Drop on Demand) utilizing the proprietary Smooth Curvature Printing technology, which enables the printers to deliver the high precision.

Services

Maintenance, Leasing, Training and Contract Engineering

We also provide a number of services in relation to our rapid prototyping business. We provide maintenance to our customers directly or through third-party service organizations under standard warranty contracts and separate maintenance contracts. In the United States, we lease or rent 3D printers and 3D production systems to customers that may not be interested in purchasing a printer. We offer training to our customers, particularly on our high-performance systems. We also offer contract engineering services to third parties in connection with the strategic development and use of our systems and services by incorporating our proprietary technology.

RedEye Paid Parts

Our RedEye paid parts service produces prototypes and end-use parts for customers from a customer-provided CAD file. This allows the customer to benefit from our knowledge base, capitalize on the variety of materials and machine types available through our service center, and take advantage of additional capacity using the latest in proven RP and DDM technologies and processes. Our RedEye on Demand website service, www.redeyeondemand.com, enables our customers to obtain quotes and order parts around the clock, seven days a week.

Foreign Service Bureaus

We have a relationship with two foreign service bureaus, RapidPro and the Materialise Group. These service bureaus utilize Stratasys printers, along with other technologies, to produce prototypes. Stratasys collects a portion of the revenue generated by these printers. RapidPro is an Australian-based rapid manufacturing bureau. The Materialise Group is headquartered in Belgium and specializes in the field of rapid industrial and medical prototyping.

Marketing, Distribution and Customers

Marketing and Customers

The focus of our marketing begins with the identification of customer needs. We feature a broad array of products that allow us to meet the precise needs of engineers, designers, educators, marketers and manufacturers. Our products range from uPrint, with a domestic end user price of $13,900, to a high productivity Fortus 900mc, priced domestically up to $379,900. We currently offer twelve systems, excluding the HP branded printers, between these price points, that meet diverse material, size and performance criteria.

We have sold systems to the following representative customers:

- Boeing
- BMW
- Cessna Aircraft
- Dell
- Ford Motor Company
- Graco
- Harley Davidson
- Hewlett Packard
- Honda
- General Electric
- Hyundai
- Intel
- Lego
- Lever
- Lockheed Martin
- Medtronic-Sofamar Danek
- Mitsubishi Electronics
- NASA
- Nike
- David Yurman
- Pioneer Speaker
- St. Jude Medical
- Toro
- Toyota
- University of Texas
- University of Wisconsin Madison
- US Army Depots
- US Navy Fleet Readiness Center
- Xerox
- Dolce & Gabbana

No customer accounted for more than 10% of sales in 2011, 2010, or 2009.

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

- Web-based marketing
- Trade magazine articles
- Brochures
- Websites
- Internet blogs
- Press releases
- Industry associations
- Print advertisements
- Direct mailings
- Trade show demonstrations
- Social media
- Broadcast e-mail
- Webinars
- Internet search engines

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

Sales Field Structure

Our sales organization uses a reseller network and is divided into two groups based on geographical areas. The Americas sales organization covers North, Latin American and the International sales organization covers all other areas of the world. This structure allows us to align our sales and marketing resources with our diverse customer base and, specifically in the United States, provides more than three times the sales

support for high-end systems compared to a direct sales channel.

Americas Sales Organization

The Americas sales organization provides sales support to a network of more than 100 reseller locations in North, Central and South America. On January 1, 2009, we began selling our Fortus 3D Production Systems through a select group of North American resellers that had previously distributed only the Dimension 3D printer product line. This sales strategy leverages our success with a network of independent regional resellers that we believe is the strongest sales channel in the industry. By replacing our Fortus 3D Production Systems direct sales channel with our existing reseller channel, we have converted a significant portion of our fixed selling costs to a variable cost structure.

International Sales Organization

The International sales organization uses a network of more than 100 resellers to market, sell, and service our 3D printers and Fortus 3D Production Systems. Our International sales organization supports all major regions of the world outside of the Americas including Europe, the Middle East, Korea, Taiwan, Japan, and China. We also operate international sales and service centers in Frankfurt, Germany; Genoa, Italy; Bangalore, India; and Hong Kong.

Reseller Network

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

In September 2011, we completed the initial term of a Master Original Equipment Manufacturer Agreement (the OEM Agreement) with Hewlett-Packard Company (HP), and are now in an extension term, which currently expires September 30, 2012. Under the OEM agreement we are developing and manufacturing a line of FDM 3D printers and related accessories and consumables exclusively for HP for resale under the HP brand in France, Germany, Italy, Spain, the United Kingdom, Austria, Switzerland and Ireland. In March of 2010, we delivered our first shipment of 3D printers to HP under this OEM Agreement. In April of 2010, HP launched our support removal system and the WaveWash system in those countries under the HP brand name, HP Designjet 3D Removal System.

HP has agreed not to sell any 3D printers manufactured by any other companies, including HP, throughout the world for the term of the OEM Agreement. The term of the OEM Agreement will be extended for additional one-year periods unless the agreement is terminated on advance notice by either party. During the term of the OEM Agreement, we have agreed not to sell comparable products covered by the Agreement directly or indirectly in the territory covered by the OEM Agreement. The OEM Agreement does not require HP to purchase any minimum quantity of products. After the initial term, or by mutual agreement, the territory in which HP will have the exclusive right to sell the 3D printers covered by the OEM Agreement may be expanded to additional countries. Ultimately, our mutual intention is for HP to sell our low-cost 3D printers globally.

RedEye Paid Parts

In 2006, we established a dedicated sales channel to offer our RedEye paid parts services through our RedEye on Demand instant Internet quoting system. This team is responsible for growing our paid parts service and nurturing customers who have RP and DDM part needs. Our objective is to ensure that the customer has a favorable experience when solving their internal part requirements. Besides a commitment to customer satisfaction, an essential objective of this operation is to increase the number of quality FDM parts in the marketplace, which, in turn, we believe will also support the expansion of our system sales. In 2007, we launched software that enabled instant part quoting via RedEye RPM, later rebranded as RedEye on Demand, in both Europe and Australia.

In December 2008, we announced that AutoCAD users can order digitally manufactured prototypes and production parts quickly and easily through an on-demand 3D printing capability supported by our RedEye paid parts service. AutoCAD 2009 subscription customers had access to this functionality via a bonus pack. Included in the bonus pack was on-line ordering capability, giving designers and engineers the ability to get instant quotes and place orders from our RedEye paid parts service. AutoCAD 2010 and 2011 subscription customers continue to have access to this functionality.

Customer Support

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

The uPrint maintenance and servicing is performed by a third-party service organization or selected resellers in certain international locations. For our high performance systems, we employ a field service organization and third-party service organizations that perform system installation, basic operation and maintenance training, and a full range of maintenance and repair services at customer sites. Field representatives have been trained and certified to service all of our products. Representatives are strategically located in regional offices across North America. They have secure remote access to a customer service database containing service history and technical documentation to aid in troubleshooting and repairing systems.

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

Warranty and Service

We offer a one-year warranty on Fortus 3D production systems and uPrint systems worldwide. In addition we offer a one-year warranty on all other systems sold internationally and systems sold into the education market domestically. All other domestically sold systems have a 90-day warranty. We also offer annual and multiple-year service and maintenance contracts for our systems. Service contracts for our systems have a domestic end user price from approximately $2,000 to $49,000 per year.

Manufacturing

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

We purchase major component parts for our Fortus 3D Production Systems and 3D printing systems from various outside suppliers, subcontractors and other sources and assemble them in our Minnesota facilities. Our production floor has been organized using demand-flow techniques (DFT) in order to maximize efficiency and quality. Using DFT, our production lines are balanced, and as capacity constraints arise, we can avoid the requirements of reconfiguring our production floor.

Computer-based Material Requirements Planning (MRP) is used for reordering to ensure on-time delivery of forecasted parts. All operators and assemblers are certified and trained on up-to-date assembly and test procedures, including Assembly Requirement Documents, which originate in engineering. The assembly process includes semi-automated functional tests of key subassemblies. Key functional characteristics are verified through these tests and the results are stored in a statistical database. At the completion of assembly, we perform a complete power up and final quality test to ensure the quality of our products before shipment to customers. The complete final quality tests must be run error free before the system can be cleared for shipment. We maintain a history log on all products that shows revision level configuration and a complete history during the manufacturing and test process. All issues on the system during the manufacturing process are logged, tracked and used to make continuous process improvements of our production processes. Other manufacturing strengths that are incorporated into our new designs are the commonality of designs among our different products as well as the incorporation of Six Sigma concepts. Our filament production utilizes Factory Physics® techniques to manage critical buffers of time, capacity and inventory to ensure product availability. We also utilize the 5S method (Sort, Set-in-order, Shine, Standardize and Sustain) as part of our lean manufacturing initiatives to improve organization and efficiency.

To provide customers with assurance regarding the quality and consistency of our systems, we obtained ISO 9001: 2008 certification in February 2011. ISO 9001: 2008 provides a structure for a quality management system that strives for customer satisfaction, consistent quality, and efficiency. In addition, there are internal benefits such as improved customer satisfaction, interdepartmental communications, work processes, and customer-and-supplier partnerships. The ISO 9000 family of standards relates to quality management systems and is designed to help organizations ensure they meet the needs of customers and other stakeholders.

We maintain an inventory of parts to facilitate the timely assembly of products required by the production plan. While most components are available from multiple suppliers, certain components used in our systems and consumables are only available from single or limited sources. We consider these single-source suppliers to be very reliable, but the loss of one of these suppliers could result in the delay of the manufacture and delivery of those materials and compounds. This type of delay could require us to find and re-qualify the product supplied by one or more new vendors. Although we consider our relationships with our suppliers to be good, we continue to develop risk management plans for these critical suppliers.

Research, Development and Engineering

We believe that ongoing research, development and engineering efforts are essential to our continued success. Accordingly, our engineering development efforts will continue to focus on customer requested enhancements, improvements to the FDM technology and development of new modeling processes, materials, software, user applications and products. We have devoted significant time and resources to the development of a universally compatible and user-friendly software system. We are committed to designing products using the principles of Six Sigma. We continue to standardize our product platforms, leveraging each new design so that it will result in multiple product offerings that are developed faster and at reduced expense. The Fortus, 250mc, 360mc, 400mc, 900mc, Dimension, and uPrint products as well as the Catalyst EX and InSight software products are examples of this successful strategic initiative. For the years ended December 31, 2011, 2010 and 2009, our research, development and engineering expenses were approximately $14.4 million, $9.8 million and $7.7 million, respectively.

Our relationship with HP has increased our focus on product reliability. HP requires a superior quality standard and demands extensive testing prior to production to ensure consistency. This focus, combined with HP s standards, has created a positive effect on the overall quality of our systems.

Our filament development and production operation is located at our facilities in Eden Prairie, MN. We regard the filament formulation and manufacturing process as a trade secret and hold patent claims on filament usage in our products. We purchase and formulate raw materials for our consumable filament production from various polymer resin suppliers with different levels of processing and value add applied to the raw materials.

Intellectual Property

We consider our proprietary technology to be material to the development, manufacturing, and sale of our products and services and seek to protect our technology through a combination of patents and confidentiality agreements with our employees and third parties. All patents and patent applications for rapid prototyping processes and apparatuses associated with the Stratasys FDM technology have been assigned to us by their inventors. As part of our purchase of rapid prototyping technology assets from IBM, we were also assigned the rights and title to several patents developed by IBM. We recorded these patents domestically and in certain foreign countries. The United States patents covering our proprietary technology will expire at various times through 2030. In total, we currently own over 255 FDM-related U.S. and international patents and patent applications, and we have been assigned rights under an additional 45 UV polymer-based U.S. patents.

Our registered trademarks include:

- Stratasys
- Stratasys, Inc.
- Shell Design
- QuickSlice
- Xpress 3D
- InduraCast
- ModelWorks
- D76PLUS
- Dimension BST
- uPrint
- Build FDM
- Fortus
- Ecoworks
- DentaCast
- Click-It
- R66PLUS
- Dimension SST
- Catalyst
- Dimension
- Redeye
- WaveWash
- Solidscape
- T76PLUS

Other trademarks include:

- FDM Maxum
- BASS
- InSight
- Fortus 200mc
- Fortus 250mc
- FDM Team
- FDM Technology
- Finishing Touch
- Fused Deposition Modeling
- FDM Titan
- WaterWorks
- Touchworks
- Fortus 360mc
- Prodigy
- Ready Part
- Print Pack
- *plus*Cast
- FDM Quantum
- SMART Supports
- Fortus 900mc
- Fortus 400mc
- uPrint SE
- Dimension Elite
- Make it Real
- SCP Technology

Each of the registered trademarks has a duration of 10 years and may be renewed every 10 years while it is in use. Trademark applications have also been filed in Japan, the European Community, China, the Republic of Korea, Canada, and Hong Kong.

We have also registered a number of Internet domain names, including the following:

- Stratasys.com
- BuildFDM.com
- 3Dprinter.com
- Paidparts.com
- uprint3dprinting.com
- Dimensionprinting.com
- 3D-fax.com
- Stratasysdimension.com
- Xpress3D.com
- Solid-scape.com
- RedEyeRPM.com
- DimensionDirect.com
- Fortus.com
- RedEyeonDemand.com

Backlog

Our total backlog of system orders at December 31, 2011 was approximately $12.5 million, as compared with approximately $8.6 million at December 31, 2010. We estimate that most of our backlog will ship by the end of first quarter of 2012.

Seasonality

Historically, our results of operations have been subject to seasonal factors. Stronger demand for our products has occurred in our fourth quarter primarily due to our customers capital expenditure budget cycles and our sales compensation incentive programs. Our first and third quarters have historically been our weakest quarters for overall unit demand. Although the first quarter has had higher volumes in recent years from the successful introduction of new products, it is typically a slow quarter for capital expenditures in general. The third quarter is typically when we see our largest volume of educational related sales, which normally qualify for special discounts as part of our long-term market penetration strategy.

Competition

We compete in a marketplace that is still primarily using conventional methods of model-making and prototype development. We believe that there is currently no other producer of industrial 3D modeling devices that uses a single-step, non-toxic technology similar to our FDM technology. Most of the commercial 3D printing and other RP systems manufactured by our competitors involve additional post-processing steps, such as curing the part after construction of the model or prototype. In addition, our FDM technology does not rely on the laser or light technology used by other commercial manufacturers in the RP industry.

Our competitors employ a number of different technologies in their RP devices. 3D Systems and CMET use stereo lithography (SLA) in their products. 3D Systems and EOS GmbH produce machines that use selective laser sintering (SLS) to harden powdered material. Z Corp. uses inkjet technology to bond powdered materials such as starch. 3D Systems and Objet Geometries have developed prototyping systems that use inkjet technology to deposit resin material layer by layer. A smoothing or milling process is often required between each deposited layer to maintain accuracy in these processes, which reduces material yields. Envisiontec utilizes a photopolymer mask and a light process to build models and Solido uses a plastic sheet lamination technique. In a new hobbyist market, we have also seen companies develop systems that are based on basic, early-stage, open-source technology but which lack the sophisticated system controls needed for the professional market. We believe that our FDM and Solidscape systems have important advantages over our competitors products. These advantages include:

- the ability to be used in an office environment
- the availability to use multiple production-grade modeling materials
- a one-step automated modeling process
- low acquisition price
- ease of use
- automatic hands free support removal
- higher reliability

Based on data and estimates presented in the 2011 Wohlers Report, in 2010 we shipped more commercial units globally than any other company in the RP industry, and we were the second largest in terms of revenue. The 2011 Wohlers Report also states that we sold 42% of all industrial RP systems sold globally in 2010. We believe that this trend continued in 2011 as well.

Employees

As of March 1, 2012, we had 530 full-time employees and contractors or temporary employees globally. While we have separate internal departments, such as manufacturing, marketing, engineering and sales, many employees perform overlapping functions within the organization. No employee is represented by a union, and we have not experienced any work stoppages. We believe our employee relations are good.

Governmental Regulation

We are subject to various local, state and federal laws, regulations and agencies that affect businesses generally. These include:

- regulations promulgated by federal and state environmental and health agencies
- the federal Occupational Safety and Health Administration

- the U.S. Foreign Corrupt Practices Act
- laws pertaining to the hiring, treatment, safety and discharge of employees
- export control regulations for U.S. made products
- CE regulations for the European market

Environmental Regulation

We offer innovative, high quality products and services that are environmentally friendly. We also offer a green recycling program that ensures a lower impact on the environment by recycling used filament cartridges, canisters and spools.

In the European marketplace, electrical and electronic equipment is required to comply with the Directive on Waste Electrical and Electronic Equipment (WEEE) and the Directive on Restriction of Use of Certain Hazardous Substances (RoHS). WEEE aims to prevent waste by encouraging reuse and recycling and RoHS restricts the use of six hazardous substances in electrical and electronic products. Our products and certain components of such products put on the market in the EU (whether or not manufactured in the EU) are potentially subject to WEEE and RoHS. We monitor the development of such directives and comply with such directives in the required time frames.

Available Information

We file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission. You may read and copy any document we file at the SEC s public reference room at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for information on the public reference room. The SEC maintains a website that contains annual, quarterly and current reports, proxy statements and other information that issuers (including Stratasys) file electronically with the SEC. The SEC s website is *www.sec.gov*.

Our website is *www.stratasys.com*. We make available free of charge through our Internet site, via a link to the SEC s website at *www.sec.gov*, our annual reports on Form 10-K; quarterly reports on Form 10-Q; current reports on Form 8-K; Forms 3, 4 and 5 filed on behalf of our directors and executive officers; and any amendments to those reports filed or furnished pursuant to the Securities Exchange Act of 1934 as soon as reasonably practicable after such material is electronically filed with, or furnished to, the SEC.

We make available on *www.stratasys.com* our most recent annual report on Form 10-K, our quarterly reports on Form 10-Q for the current fiscal year and our most recent proxy statement, although in some cases these documents are not available on our site as soon as they are available on the SEC s site. You will need to have on your computer the Adobe Acrobat Reader software to view these documents, which are in PDF format. If you do not have Adobe Acrobat, a link to Adobe s Internet site, from which you can download the software, is provided. The information on our website is not incorporated by reference into this report.

Financial Information About Operations In the United States and Other Countries

The information required by this item is incorporated by reference to our Financial Statements included elsewhere in this report. (See Part IV, Item 15, Note 19.)

Item 1A. Risk Factors.

Many of the factors that affect our business and operations involve risk and uncertainty. The following describes the principal risks affecting us and our business. Additional risks and uncertainties, not presently known to us or currently deemed material, could negatively impact our results of operations or financial condition in the future.

We may not be able to introduce new high-performance systems, 3D printing systems and materials acceptable to the market or to improve the technology and software used in our current systems.

Our ability to compete in the high-performance and 3D printing market depends, in large part, on our success in enhancing our existing product lines and in developing new products. Even if we successfully enhance existing systems or create new systems, it is likely that new systems and technologies that we develop will eventually supplant our existing systems or our competitors will create systems that will replace ours. The RP industry is subject to rapid and substantial innovation and technological change. We may be unsuccessful at enhancing existing systems or developing new systems or materials on a timely basis, and any of our products may be rendered obsolete or uneconomical by our or others technological advances.

If the 3D printing market does not continue to accept our systems, or if our Fortus high-performance systems do not meet the needs for DDM applications, our revenues may stagnate or decline.

We derive a substantial portion of our sales from the sale of 3D printers and Fortus 3D production systems. If the market for 3D printers or high-performance systems declines or if competitors introduce products that compete successfully against ours, we may not be able to sustain the sales of those products. If that happens, our revenues may not increase and could decline.

If we are unable to maintain revenues and gross margins from sales of our existing products, our profitability will be adversely affected.

Our current strategy is to attempt to manage the prices of our high-performance systems and 3D printers to expand the market and increase sales. In conjunction with that strategy, we are constantly seeking to reduce our direct manufacturing costs as well. Our engineering and selling, general and administrative expenses, however, generally do not vary substantially in relation to our sales. Accordingly, if our strategy is successful and we increase our revenues while maintaining our gross margins, our operating profits generally will increase faster as a percentage of revenues than the percentage increase in revenues. Conversely, if our revenues or gross margins decline, our operating profits generally will decline faster than the decline in revenues or gross margins. Therefore, declines in our revenues may lead to disproportionate reductions in our operating profits.

Hewlett-Packard may not expand distribution under our OEM Agreement beyond its current territory of eight European countries, and the OEM Agreement may not continue beyond its current term ending on September 30, 2012.

Our Agreement with HP has a current term that ends on September 30, 2012, and has an initial territory of eight European countries. There can be no assurance that HP will expand the territory in which they sell our 3D printers and other products. Furthermore, even though the OEM Agreement will automatically be renewed for one-year terms unless either party terminates it on advance written notice, there can be no assurance that the OEM Agreement will continue beyond its initial term or any renewal term. If HP does not expand the territory or the Agreement is terminated, we will not achieve the anticipated benefits of entering into the OEM Agreement, which include substantial additional revenue and profits as well as validation of our products in the market place.

Since we will be selling our 3D printers and related products to HP on an OEM basis, our margins on those products will be lower than those on the products that we presently sell, which may reduce our overall profitability.

HP will be selling our 3D printers and related products through its own reseller network. Accordingly, the prices we charge to HP for those products will be less than the prices we presently charge to our own reseller network. As a result, our margins will be lower on our sales to HP. We intend to compensate for these lower margins by expanding the market for our 3D printers, thereby substantially increasing the number of 3D printers sold and our overall revenues and profits. However, there can be no assurance that we will be able to increase our revenue sufficiently to maintain or increase our profitability over time.

If our present single or limited source suppliers become unavailable or inadequate, our customer relationships, results of operations and financial condition may be adversely affected.

We maintain an inventory for most of our necessary supplies, which facilitates the assembly of our systems and the manufacture of our consumables. While most components for our systems and materials and compounds for our consumables are available from multiple suppliers, certain of those items are only available from single or limited sources. Should any of our present single or limited source suppliers become unavailable or inadequate, we would be required to spend a significant amount of time and expense to develop alternate sources of supply. It would also require us to re-qualify any product supplied by one or more new vendors. Accordingly, the loss of a supplier with vendor-specific components, materials or compounds could result in a delay in the manufacture and delivery of our systems or consumables. In addition, if we were unable to find a suitable supplier for a particular component, material or compound, we could be required to modify our existing products to accommodate substitute components, material or compounds. As a result, the loss of a single or limited source supplier and resulting delays in delivery could adversely affect our relationship with our customers and our results of operations and financial condition.

If other manufacturers were to successfully develop and market consumables for use in our systems, our revenues and profits could be adversely affected.

We presently sell substantially all of the consumables that our customers use in our systems. However, even though we attempt to protect against replication of our consumables through patents and trade secrets and we provide that our warranties are valid only if customers use consumables that we certify, it is possible that other manufacturers could increase their development of consumables that could be used successfully in our systems. If our customers were to purchase consumables from other manufacturers, we would lose some of our sales and could be forced to reduce prices, which would impair our overall revenue and profitability.

If we fail to grow our RedEye paid parts service as anticipated, our net sales and profitability will be adversely affected.

We are attempting to grow our RedEye paid parts service substantially. To this end, we have made significant infrastructure, technological and sales and marketing investments. These investments include a dedicated facility, increased staffing, use of a substantial number of our Fortus 3D Production Systems exclusively for Paid Parts, and the development and launch of our RedEye on Demand service, which enables customers to obtain quotes for and order parts over the Internet. If our RedEye paid parts service does not generate the level of sales required to support our investment, our net sales and profitability will be adversely affected. Our competitors consolidation efforts in the service bureau industry may also adversely affect RedEye s efforts to grow.

If any of our manufacturing facilities is disrupted, sales of our products will be disrupted, and we could incur unforeseen costs.

We perform the final assembly of our 3D printers and high-performance systems and we manufacture our filament at our facilities in Eden Prairie, Minnesota. Our Solidscape subsidiary manufactures its 3D printers at a single facility in Merrimack, New Hampshire. If the operations of any of these facilities is disrupted, we would be unable to fulfill customer orders for the period of the disruption. We would not be able to recognize revenue on orders that we could not ship, and we might need to modify our standard sales terms to secure the commitment of new customers during the period of the disruption and perhaps longer. Depending on the cause of the disruption, we could incur significant costs to remedy the disruption and resume product shipments. Such a disruption could have a material adverse effect on our revenue, results of operations and earnings.

We own most of our manufacturing and office facilities, which may limit our ability to move our operations. If we were to move some of all of our operations, we could incur unforeseen charges.

We own four buildings in Eden Prairie, Minnesota, which we use to conduct most of our manufacturing and assembly operations. Ownership of these buildings may adversely affect our ability to move some or all of our operations to other locations that may be more favorable. If we were to move any of our operations to other locations, we may have difficulty selling or leasing the property that we have vacated. This could result in an impairment charge, which could have a material adverse effect on our results of operations in one or more periods.

A loss of a significant number of our resellers would impair our ability to sell and service our products and could result in a reduction of sales and net income.

We sell all of our products through resellers. We rely heavily on these resellers to sell our products to end users in their respective geographic regions and rely exclusively on resellers to service our products outside the United States. If a significant number of those resellers were to terminate their relationship with us or otherwise fail or refuse to sell or service our products, we may not be able to find replacements that are as qualified or as successful in selling or servicing our products. If we are unable to find qualified and successful replacements, our sales will suffer, which would have a material adverse affect on our net income.

Our failure to expand our intellectual property portfolio could adversely affect the growth of our business and results of operations.

Expansion of our intellectual property portfolio is one of the available methods of growing our revenues and our profits. This involves a complex and costly set of activities with uncertain outcomes. Our ability to obtain patents and other intellectual property can be adversely affected by insufficient inventiveness of our employees, by changes in intellectual property laws, treaties, and regulations, and by judicial and administrative interpretations of those laws treaties and regulations. Our ability to expand our intellectual property portfolio could also be adversely affected by the lack of valuable intellectual property for sale or license at affordable prices. There is no assurance that we will be able to obtain valuable intellectual property in the jurisdictions where we and our competitors operate or that we will be able to use or license that intellectual property.

We may not be able to adequately protect or enforce our intellectual property rights, which could impair our competitive position.

Our success and future revenue growth will depend, in part, on our ability to protect our intellectual property. We rely primarily on patents, trademarks and trade secrets, as well as non-disclosure agreements and other methods, to protect our proprietary technologies and processes globally. Despite our efforts to protect our proprietary technologies and processes, it is possible that competitors or other unauthorized third parties may obtain, copy, use or disclose our technologies and processes. We cannot assure you that any of our existing or future patents will not be challenged, invalidated or circumvented. As such, any rights granted under these patents may not provide us with meaningful protection. We may not be able to obtain foreign patents or pending applications corresponding to our U.S. patent applications. Even if foreign patents are granted, effective enforcement in foreign countries may not be available. If our patents and other intellectual property do not adequately protect our technology, our competitors may be able to offer products similar to ours. Our competitors may also be able to develop similar technology independently or design around our patents. Any of the foregoing events would lead to increased competition and lower revenue or gross margins, which would adversely affect our net income.

We may be subject to alleged infringement claims.

Although we perform extensive patent and trademark searches, we may be subject to intellectual property infringement claims from individuals, vendors and other companies who have acquired or developed patents in the fields of 3D printing or consumable production for purposes of developing competing products or for the sole purpose of asserting claims against us. Any claims that our products or processes infringe the intellectual property rights of others, regardless of the merit or resolution of such claims, could cause us to incur significant costs in responding to, defending and resolving such claims, and may prohibit or otherwise impair our ability to commercialize new or existing products. If we are unable to effectively defend our processes, our market share, sales and profitability could be adversely impacted.

As our patents expire, additional competitors using our technology could enter the market, which could require us to reduce our prices and result in a reduction of our market share. Competitors introduction of lower quality products using our technology could also negatively affect the reputation and image of our products in the marketplace.

The initial patents for our technology began expiring in 2011. Upon expiration of those patents, our competitors may introduce products using the same technology as ours that have lower prices than those for our products. To compete, we may need to reduce our prices, which would adversely affect our revenues, margins and profitability. Additionally, the expiration of our patents could reduce barriers to entry into the market for additive fabrication systems, which could result in the reduction of our market share and earnings potential. If competitors using our technology were to introduce products of inferior quality, our potential customers may view our products negatively, which would have an adverse effect on our image and reputation and on our ability to compete with systems using other additive fabrication technologies.

If our goodwill becomes impaired, we may be required to record a significant charge to earnings.

As of December 31, 2011, the book value of our goodwill was approximately $25.4 million, most of which was recorded as a result of our acquisition of Solidscape. Accounting rules require us to take a charge against our earnings to the extent that goodwill is impaired. Accordingly, market conditions or other factors related to our performance could result in a material impairment of our goodwill and attendant charge against our earnings, which could have a material adverse effect on our results of operations.

If our intangible assets become impaired, we may be required to record a significant charge to earnings.

As of December 31, 2011, the net book value of our other intangible assets was approximately $25.3 million. Accounting rules require us to take a charge against our earnings to the extent that any of these intangible assets were to be impaired. Accordingly, invalidation of our patents, trademarks or other intellectual property or the impairment of other intangible assets due to litigation, obsolescence, competitive factors or other reasons could result in a material charge against our earnings and have a material adverse effect on our results of operations.

If our investments become impaired, we may be required to record a significant charge to earnings.

Our investments include one tax-free auction rate security and municipal government bonds and commercial bonds. Given the current volatility in interest rates and the potential impact of higher interest rates on the issuers of these securities, a significant increase in interest rates could impair the ability of one or more issuers to pay interest on, or principal of, these obligations. Defaults by these issuers or their insurers could cause an impairment of the value of our investments, resulting in a charge against our earnings. Any such charge could have a material adverse effect on our results of operations.

Estimating our income tax rate is complex and subject to uncertainty.

The computation of income tax expense (benefit) is complex because it is based on the laws of numerous taxing jurisdictions and requires significant judgment on the application of complicated rules governing accounting for tax provisions under accounting principles generally accepted in the United States. Income tax expense (benefit) for interim quarters is based on a forecast of our global tax rate for the year, which includes forward looking financial projections. Such financial projections are based on numerous assumptions, including the expectations of profit and loss by jurisdiction. It is difficult to accurately forecast various items that make up the projections, and such items may be treated as discrete accounting. Examples of items that could cause variability in our income tax rate include our mix of income by jurisdiction, tax deductions for stock option expense, the application of transfer pricing rules, and tax audits. Future events, such as changes in our business and the tax law in the jurisdictions where we do business, could also affect our rate. For these reasons, our global tax rate may be materially different than our estimate.

If we do not generate sufficient future taxable income, we may be required to recognize deferred tax asset valuation allowances.

The value of our deferred tax assets depends, in part, on our ability to use them to offset taxable income in future years. If we are unable to generate sufficient future taxable income in the U.S. and certain other jurisdictions, or if there are significant changes in tax laws or the tax rates or the period within which the underlying temporary differences become taxable or deductible, we could be required to record valuation allowances against our deferred tax assets. Such allowances would result in an increase in our effective tax rate and have a negative impact on our operating results. If our estimated future taxable income is increased, the valuation allowances for deferred tax assets may be reduced. These changes may also contribute to the volatility of our financial results.

We operate a global business that exposes us to additional risks.

Our sales outside of the United States accounted for approximately 47% of our consolidated net sales in 2011. We continue to expand into international markets. The future growth and profitability of our foreign markets are subject to a variety of risks and uncertainties. Any of the following factors could adversely affect our sales to customers located outside of the United States:

- Fluctuations in foreign currency exchange rates.
- The inability to protect our intellectual property in foreign countries.
- Political or economic instability in regions where we sell our products.
- Changes in foreign regulatory requirements.
- Seasonal fluctuations in business activity in certain countries.
- Changes in export controls and tariffs.
- Energy costs.
- Public health issues.
- Unrest in the Middle East.

Our business depends on our customers demand for our products and services, the general economic health of current and prospective customers, and their desire or ability to make investments in technology. A deterioration of global, regional or local political, economic or social conditions could affect potential customers in ways that reduce demand for our products and disrupt our manufacturing and sales plans and efforts. Acts of terrorism, wars, public health issues and increased energy costs could disrupt commerce in ways that could impair our ability to get products to our customers and increase our manufacturing and delivery costs. Changes in foreign currency exchange rates may negatively impact reported revenue and expenses. In addition, our sales are typically made on unsecured credit terms that are generally consistent with the prevailing business practices in the country in which the customer is located. A deterioration of political, economic or social conditions in a given country or region could reduce or eliminate our ability to collect accounts receivable in that country or region. In any of these events, our results of operations could be materially and adversely affected.

Failure to comply with the U.S. Foreign Corrupt Practices Act or other applicable anti-corruption legislation could result in fines, criminal penalties and an adverse effect on our business.

We operate in a number of countries throughout the world, including countries known to have a reputation for corruption. We are committed to doing business in accordance with applicable anti-corruption laws. We are subject, however, to the risk that our affiliated entities or our respective officers, directors, employees and agents may take action determined to be in violation of such anti-corruption laws, including the U.S. Foreign Corrupt Practices Act of 1977 and the U.K. Bribery Act of 2010, as well as trade sanctions administered by the Office of Foreign Assets Control and the U.S. Department of Commerce. Any such violation could result in substantial fines, sanctions, civil and/or criminal penalties, curtailment of operations in certain jurisdictions, and might adversely affect our results of operations. In addition, actual or alleged violations could damage our reputation and ability to do business.

Our operating results and financial condition may fluctuate.

Our operating results and financial condition may fluctuate from quarter-to-quarter and year-to-year and are likely to continue to vary due to a number of factors, many of which are not within our control. If our operating results do not meet the expectations of securities analysts or investors, who may derive their expectations by extrapolating data from recent historical operating results, the market price of our common stock will likely decline. Fluctuations in our operating results and financial condition may be due to a number of factors, including, but not limited to, those listed below and those identified throughout this Risk Factors section:

- changes in the pricing of HP products sales;
- changes in the volume of systems sold through HP and the impact on revenues and margins;

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- changes in the amount that we spend to develop, acquire or license new products, consumables, technologies or businesses;
- changes in the amount we spend to promote our products and services;
- changes in the cost of satisfying our warranty obligations and servicing our installed base of systems;
- delays between our expenditures to develop and market new or enhanced systems and consumables and the generation of sales from those products;
- development of new competitive systems by others;
- changes in accounting rules and tax laws;
- the mix of high-performance systems, 3D printers and consumables that we sell during any period;
- the geographic distribution of our sales;
- our responses to price competition;
- market acceptance of our products;
- general economic and industry conditions that affect customer demand;
- changes in interest rates that affect returns on our cash balances and short-term investments;
- failure of a development partner to continue supporting certain product development efforts it is funding; and
- our level of research and development activities.

Due to all of the foregoing factors, and the other risks discussed in this report, you should not rely on quarter-to-quarter comparisons of our operating results as an indicator of future performance.

Default in payment by one or more resellers that have large account receivable balances could adversely impact our results of operations and financial condition.

From time to time, accounts receivable balances have been concentrated with certain resellers. Default by one or more of these resellers or customers could result in a significant charge against our current reported earnings. We have reviewed our policies that govern credit and collections, and will continue to monitor them in light of current payment status and economic conditions. However, there can be no assurance that our efforts to identify potential credit risks will be successful. Our inability to timely identify resellers that are credit risks could result in defaults at a time when such resellers have high accounts receivable balances with us. Such a default would result in a significant charge against our earnings and adversely affect our results of operations and financial condition.

If we are unable to retain our key operating personnel and attract additional skilled operating personnel, our development of new products will be delayed and our personnel costs will increase.

Our growth plans require us to retain key employees in, and to hire additional skilled employees for, our operating departments, such as engineering and software development, to enhance existing products and develop new products. Our inability to retain and hire key engineers and other employees could delay our development and introduction of new products, which would adversely affect our revenues. In addition, a possible shortage of such personnel in the Minneapolis or New Hampshire regions could require us to pay more to retain and hire key employees, thereby increasing our costs.

Our common stock price has been and may continue to be highly volatile.

During 2011, our common stock traded at prices ranging between $18.00 and $55.43. Factors that we believe have caused or may cause this volatility include, among other things:

- investors expectations of the impact of our OEM agreement with HP and how the relationship with HP could change over time;
- the volatile global economy;
- actual or anticipated variations in quarterly or annual operating results;
- the issuance of patents or other technological innovations;

- announcements of new products;
- our competitors' announcements of new products;
- changes in financial estimates or recommendations by securities analysts;
- the employment and termination of key personnel; and
- sales or purchases of our common stock by our Company or by our executive officers or directors

Many of these factors are beyond our control. These factors may have a material adverse effect on the market price of our common stock, regardless of our operating performance.

If our internal controls over financial reporting do not comply with the requirements of the Sarbanes-Oxley Act, our business and stock price could be adversely affected.

Section 404 of the Sarbanes-Oxley Act of 2002 requires us to evaluate the effectiveness of our internal controls over financial reporting as of the end of each year, and to include a management report assessing the effectiveness of our internal controls over financial reporting in all annual reports. Section 404 also requires our independent registered public accounting firm to report on the effectiveness of our internal controls over financial reporting.

Our management, including our CEO and CFO, does not expect that our internal controls over financial reporting will prevent all error and fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system s objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, involving Stratasys have been, or will be detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and we cannot assure you that any design will succeed in achieving its stated goals under all potential future conditions. Over time, our controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Our management has determined, and our independent registered public accounting firm has concluded in its audit, that our internal controls over financial reporting were effective as of December 31, 2011. However, our evaluation did not include the internal controls related to the acquisition of Solidscape, Inc. that occurred on May 3, 2011. Total assets and net sales related to this acquisition represent 21.4% and 5.3%, respectively, of the related consolidated financial statement amounts as of and for the year ended December 31, 2011. Thus, we cannot assure you that we or our independent registered accounting firm will not identify a material weakness in our internal controls or the internal controls of our Solidscape subsidiary in the future. A material weakness in our internal controls over financial reporting would require management and our independent registered public accounting firm to evaluate our internal controls as ineffective. If our internal controls over financial reporting are not considered adequate, we may experience a loss of public confidence, which could have an adverse effect on our business and our stock price.

As part of our growth strategy, we may acquire or make investments in other businesses, patents, technologies, products or services, and our failure to do so successfully may adversely affect our competitive position or financial results.

We have made and expect to continue to make acquisitions or investments to expand our suite of products and services. Our growth could be hampered if we are unable to identify suitable acquisitions and investments or agree on the terms of any such acquisition or investment. We may not be able to consummate any such transaction if we lack sufficient resources to finance the transaction on our own and cannot obtain financing at a reasonable cost. If we are not able to complete such acquisitions and successfully integrate them, or to complete investments and successfully realize their intended benefits, our competitive position may suffer, which could have adverse impacts on our revenues, revenue growth and results of operations.

Our acquisition transactions may not succeed in generating the intended benefits and may, therefore, adversely affect shareholder value or our financial results.

Integration of new businesses or technologies into our business may have any of the following adverse effects:

- We may have difficulty transitioning customers and other business relationships to Stratasys.
- We may have problems unifying management following a transaction.
- We may lose key employees from our existing or acquired businesses.
- We may experience intensified competition from other companies seeking to expand sales and market share during the integration period.
- Our management s attention may be diverted to the assimilation of the technology and personnel of acquired businesses or new product or service lines.
- We may experience difficulties in coordinating geographically disparate organizations and corporate cultures and integrating management personnel with different business backgrounds.

The inability of our management to successfully integrate acquired businesses, and any related diversion of management s attention, could have a material adverse effect on our business, operating results and financial condition.

Business combinations and other acquisition transactions may have a direct adverse effect on our financial condition, results of operations or liquidity, or on our stock price.

In order to complete such transactions, we may have to use cash, issue new equity securities with dilutive effects on existing stockholders, take on new debt, assume contingent liabilities or amortize assets or expenses in a manner that might have a material adverse effect on our balance sheet, results of operations or liquidity. We are required to record certain acquisition-related costs and other items as current period expenses, which would have the effect of reducing our reported earnings in the period in which an acquisition is consummated. We are also required to record post-closing goodwill or other long-lived asset impairment charges in the period in which they occur, which could result in a significant charge to our earnings in that period. These and other potential negative effects of an acquisition transaction could prevent us from realizing the benefits of such transactions and have a material adverse impact on our stock price, revenues, revenue growth, balance sheet, results of operations and liquidity.

The foregoing list is not exhaustive. There can be no assurance that we have correctly identified and appropriately assessed all factors affecting our business or that the publicly available and other information with respect to these matters is complete and correct. Additional risks and uncertainties not presently known to us or that we currently believe to be immaterial also may adversely impact our business. Should any risks or uncertainties develop into actual events, these developments could have material adverse effects on our business, financial condition, and results of operations.

We assume no obligation (and specifically disclaim any such obligation) to update these Risk Factors or any other forward-looking statements contained in this Annual Report to reflect actual results, changes in assumptions or other factors affecting such forward-looking statements.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

Our executive offices and production facilities presently comprise approximately 287,800 available square feet in four buildings we own in Eden Prairie, Minnesota, near Minneapolis.

On August 1, 2001, we purchased our Eden Prairie manufacturing facility and land for approximately $3.0 million. The facility consists of 62,100 square feet, and is used for machine assembly, inventory storage, operations and sales support.

In March 2004, we purchased an additional 43,900 square foot manufacturing facility for approximately $1.2 million. The facility is located near our manufacturing facility in Eden Prairie, Minnesota, and is used for our RedEye paid parts service.

In November 2005, we purchased an additional 91,800 square foot manufacturing facility for approximately $5.1 million. By the end of 2008, we had substantially completed the improvements needed to make this facility suitable for our specific usage and had spent approximately $3.3 million. This facility is used for R&D, filament manufacturing, and administrative, marketing and sales activities and is adjacent to our system manufacturing facility in Eden Prairie, Minnesota.

In December 2010, we purchased an additional 90,000 square foot manufacturing facility for approximately $3.0 million. This facility is located in Eden Prairie, Minnesota and will be used to expand production capacity for machines and consumables, as well as streamline and consolidate warehousing and shipping operations. Initial improvements to the facility were made and a portion of the building was occupied in July 2011.

We occupy a 40,835 square foot warehouse in Eden Prairie, Minnesota, for shipping and storage under a lease that expires in March 2012. We also occupy a 9,070 square foot facility in Minneapolis, Minnesota, for research and development under a lease that expires in September 2012. We are also responsible for real estate taxes, insurance, utilities, trash removal, and maintenance expenses at these facilities.

Solidscape occupies a 28,590 square foot facility in Merrimack, New Hampshire that is under a lease that expires in August 2013. We are also responsible for real estate taxes, insurance, utilities, trash removal, and maintenance expenses at this facility.

We occupy a 7,583 square foot North American sales office in Rancho Cucamonga, California under a lease that expires in July 2016. We are also responsible for real estate taxes, insurance, utilities, trash removal, and maintenance expenses at this facility.

We have four international sales and service offices under lease. Our German subsidiary leases 16,081 square feet of space in Frankfurt, Germany under a lease that expires in June 2016. Our Italian subsidiary leases 6,857 square feet in Genoa, Italy, under a lease that expires in August 2016. We occupy a 30 square foot sales office located in Hong Kong under a lease that expires in March 2012. We have approximately 1,800 square feet, which is used for a sales office, in Bangalore, India, under a lease that expires in January 2014.

Item 3. Legal Proceedings.

We are party to various legal proceedings, the outcome of which, in the opinion of management, will not have a material adverse effect on the Company s financial position.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Market Information

Our common stock is traded on the Nasdaq Global Select Market under the symbol SSYS.

The following table sets forth the high and low closing sale prices of our common stock for each quarter from January 1, 2010 through the fiscal year ended December 31, 2011 reported on the Nasdaq Global Select Market.

	High Closing Sale Prices	Low
Fiscal Year Ended December 31, 2010		
January 1, 2010 March 31, 2010	$ 30.11	$ 17.35
April 1, 2010 June 30, 2010	27.40	21.79
July 1, 2010 September 30, 2010	27.84	20.81
October 1, 2010 December 31, 2010	34.87	26.48
Fiscal Year Ended December 31, 2011		
January 1, 2011 March 31, 2011	$ 49.59	$ 32.50
April 1, 2011 June 30, 2011	55.43	30.21
July 1, 2011 September 30, 2011	39.34	18.54
October 1, 2011 December 31, 2011	31.84	18.00

There were approximately 80 record and 11,919 beneficial owners of our common stock as of March 1, 2012.

Dividends

We have not paid or declared any cash dividends to date. We intend to retain earnings, if any, to support the growth of our business.

Repurchases of Common Stock

We did not repurchase any shares of our common stock during 2011.

Performance Graph

The following graph compares on a cumulative basis the yearly percentage change, assuming dividend reinvestment, over the last five fiscal years in (a) the total stockholder return on our Common Stock with (b) the total return on the Nasdaq (US) Composite Index, and (c) the total return on the information technology sector of the Standard & Poor s SmallCap 600 Index (S&P 600 Info Tech Index). The S&P 600 Info Tech Index consists of 125 of the 600 stocks comprising the Standard & Poor s SmallCap 600 Index, a capitalization-weighted index of domestic stocks chosen for market size, liquidity and industry representation. We are a component company of the S&P 600 Info Tech Index. The following graph assumes that $100 had been invested in each of Stratasys, the Nasdaq (US) Composite Index, and the S&P 600 Info Tech Index on December 31, 2006.

Comparison of Cumulative 5 Year Total Return

Item 6. Selected Financial Data.

The selected consolidated financial data as of and for the five-year period ended December 31, 2011, should be read in conjunction with the Consolidated Financial Statements and related Notes for the year ended December 31, 2011, and the Management s Discussion and Analysis of Financial Condition and Results of Operations.

	Years Ended December 31, (In Thousands, Except Per Share Amounts)				
	2011	2010	2009	2008	2007
Statement of Operations Data:					
Net sales	$ 155,894	$ 117,843	$ 98,975	$ 124,495	$ 112,243
Gross profit	82,404	56,086	46,384	66,412	59,708
Research and development	14,360	9,755	7,737	8,973	7,465
Selling, general and administrative expenses	39,038	32,863	32,823	36,843	33,770
Operating income	29,006	13,467	5,824	20,596	18,473
Net income	20,626	9,370	4,116	13,615	14,324
Net income per basic common share	0.98	0.46	0.20	0.66	0.69
Weighted average basic shares outstanding	21,133	20,579	20,236	20,676	20,772
Net income per diluted common share	$ 0.95	$ 0.44	$ 0.20	$ 0.65	$ 0.66
Weighted average diluted shares outstanding	21,653	21,130	20,268	21,079	21,567
Balance Sheet Data:					
Working capital	$ 64,087	$ 60,196	$ 82,838	$ 63,296	$ 64,100
Total assets	221,770	178,460	153,137	147,743	148,757
Long term debt	---	---	---	---	---
Stockholders equity	183,311	152,282	129,583	122,562	123,834

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

Introduction

Management s Discussion and Analysis of Financial Condition and Results of Operations is intended to facilitate an understanding of our business and results of operations. It should be read in conjunction with our Consolidated Financial Statements and the accompanying Notes to Consolidated Financial Statements included elsewhere in this report. All amounts in the following discussions are stated in thousands, except employees, share and per share data, prices for systems, or as otherwise indicated.

General

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

Our Market Strategy

We believe that the Fused Deposition Modeling (FDM) technology used by most of our systems has significant advantages over other commercially available 3D printing technologies. When compared to other 3D printing technologies, our systems are typically easier to use, are more acceptable in an office environment and can produce durable models in a wide variety of production grade thermoplastics. Our Solidscape DoD thermoplastic ink-jetting technology offers easy to use systems producing high precision castable wax models. Our overall business strategies are designed to increase customer awareness of these advantages, provide our customers with high-quality new products and services based on the capabilities of these technologies, expand the distribution channel of our systems and lower the overall cost of creating physical models, parts, tooling and prototypes from a CAD file.

Our current market strategy focuses on the following areas:

- *Expanding the distribution channel for our Dimension products*. Although we continue to manufacture an HP-branded 3D printer for distribution in Europe, we are also making progress in expanding independent channel strategies that will augment our HP collaboration. We have initiated a program in the U.S to recruit and train a significant number of new selling agents that will focus exclusively on selling our most affordable products. We expect this initiative, combined with other programs we have planned, will drive incremental sales volume.

The OEM Agreement with HP now includes Austria, Switzerland and Ireland in addition to France, Germany, Italy, Spain and the United Kingdom. We believe this distribution channel continues to be a valuable approach to increase sales and enhance awareness of 3D printing.

- *Expand our market position in the 3D printing market by introducing new products.* In July 2011, we introduced the Fortus 250mc Production System. The Fortus 250mc combines the ease-of-use and affordability of Dimension 3D Printers with the control of Insight Software, used to drive the Fortus line of production systems. With Insight, users will have added control of build speed, part accuracy, and feature detail. The Fortus 250mc uses Stratasys SR-30 soluble support material, which has a faster dissolve time than other soluble support materials.

- *Expand our position in the RP and DDM markets by developing new and improved proprietary products.* We have built a leadership position in the RP and DDM markets by helping customers build stable, strong, and durable parts for testing and end-use. Our Fortus 3D Production Systems are ideally suited for DDM applications such as the production of manufacturing tools and low-volume end-use parts. Our Solidscape technology offers high precision castable wax models that are ideal when our customers have the need for fine feature detail and is particularly well suited for DDM applications in the jewelry and dental markets. We plan to expand our presence in these areas by offering improved system capabilities and new and improved material properties. We believe that the recent acquisition of Solidscape will open up additional industrial market opportunities as we continue to develop this technology. We also continued to collaborate with a Fortune 500 global manufacturing company to advance our proprietary FDM technology for direct digital manufacturing applications and will maintain this collaboration into 2012 for the seventh consecutive year.

- *Leverage our recent ISO 9001:2008 certification.* During 2010, we worked to refine and improve our internal processes and documentation in order to obtain ISO 9001:2008 certification, a standard published by the International Organization for Standardization. In February 2011, we obtained the ISO 9001:2008 certification by maintaining a highly developed quality management system and continually improving its effectiveness in accordance with the ISO requirements. We believe that ISO certification is a key requirement in expanding our products applicability to the RP and DDM markets that we are focusing on such as aerospace, defense, medical, and automotive. We will use this registration to demonstrate our ability to consistently provide products that meet customer and applicable regulatory requirements and enhance customer satisfaction through its effective application.
- *Expand our RedEye paid parts service.* We believe this is a fragmented global market dominated by a few large and numerous small companies. Sales from our RedEye paid parts service have improved during 2011. This growth has been driven in part by customers that do not have an FDM system but has also comes from current system users that have had short-term capacity constraints on their own FDM systems. We believe that another part of this sales growth has come from the rising demand for our technology in DDM applications because of the production grade thermoplastics used. To take advantage of the growth we see in our DDM customer base, we are adding staff to our existing sales force that will focus exclusively on large strategic accounts.

Description of Current Conditions

Our revenue increased 32.3% in 2011 due primarily to growth in systems and consumables sales, with service revenue increasing by 12% as compared to 2010. The increase in revenue from systems as compared to 2010 was driven mainly by higher unit volume in our Fortus 3D production systems and the acquisition of Solidscape in May 2011. We shipped 2,602 units in 2011 as compared to 2,555 in 2010. Our average selling price increased due to a shift in sales mix towards our higher-priced Fortus 3D production systems.

We have seen the professional design/engineering market environment for our products become more competitive as other manufacturers introduce systems with new technologies and capabilities that are becoming more comparable to our products. In the last 12 months, we have seen our traditional competitors lower their prices to match our prices. In a new hobbyist market, we have also seen companies develop systems that are based on basic, early-stage, open-source technology but which lack the sophisticated system controls needed for the professional market.

Despite the recent growth in market competition, we believe that over the last three years, we have been the market leader in the 3D printer commercial market and have followed a strategy of continuing to move down the price elasticity curve as evidenced by our introduction of the uPrint and uPrint Plus. Although the high-performance market is more competitive than the 3D printing market, we believe that the growth in sales of our Fortus 3D production systems has been driven mainly by the system and material performance capabilities of our systems rather than price.

As our installed base of systems has increased, the capacity to derive an increasing amount of revenue from sales of consumables, maintenance contracts, and other services has also increased. In 2011, total non-system product revenue increased by 28.2% as compared to the prior year due principally to higher consumable usage by our installed base of systems and the acquisition of Solidscape. Sales from our RedEye paid parts service increased 11.0% during 2011 as a result of increased new customer business and an increase in average sales price. Revenue from maintenance contracts increased by 12.4% in 2011 reflecting our growing installed base of systems and the reduced impact of an extension in system warranty periods implemented in 2009.

We expect to see unit volume increase faster than revenue growth in the near future. Revenue from our higher-priced Fortus system sales is expected to moderate relative to the high levels observed in 2011. Our recent 3D printing sales channel initiatives are expected to accelerate unit sales of our more affordable systems, which will result in lower margins on the sale of these 3D printers. We intend to compensate for these lower margins by the continued growth in the market for 3D printers and thereby substantially increasing the number of 3D printers sold and our overall revenues and profits. However, there can be no assurance that we will be able to increase our revenue sufficiently to maintain or increase our current profitability.

Given our strong cash position and no debt, we believe that we have adequate liquidity to fund our growth strategy in 2012. We may make investments in strategic acquisitions, fixed assets, process improvements, information technology (IT), and human resource development activities that will be required for future growth. Our expense levels are based in part on our expectations of future sales and we will make adjustments as we consider appropriate. While we have adjusted, and will continue to adjust, our expense levels based on both actual and anticipated sales, fluctuations in sales in a particular period could adversely impact our operating results.

We believe that our growth is largely dependent upon our ability to penetrate new markets and develop and market new RP, DDM and 3D printing systems, materials, applications, and services that meet the needs of our current and prospective customers. Our ability to implement our strategy for 2012 is subject to numerous uncertainties, many of which are described under Risk Factors, above, in this Management s Discussion and Analysis of Financial Condition and Results of Operations and in the section below captioned Forward Looking Statements and Factors That May Affect Future Results of Operations. We cannot ensure that our efforts will be successful.

Results of Operations

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

For the twelve months ended December 31,	2011	2010	2009
Net sales	100.0%	100.0%	100.0%
Cost of sales	47.1%	52.4%	53.1%
Gross profit	52.9%	47.6%	46.9%
Research & development	9.2%	8.3%	7.8%
Selling, general and administrative	25.0%	27.9%	33.2%
Operating income	18.6%	11.4%	5.9%
Other income	1.5%	0.3%	0.4%
Income before taxes	20.1%	11.7%	6.2%
Income taxes	6.9%	3.8%	2.1%
Net income	13.2%	8.0%	4.2%

Net Sales

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

	2011	Year-over-Year Change	2010	Year-over-Year Change	2009
Products	$ 127,476	30.8%	$ 97,467	32.0%	$ 73,829
Services	28,418	12.0%	25,365	0.9%	25,146
Fair value of warrant	-	-	(4,988)	-	-
	$ 155,894	32.3 %	$ 117,844	19.1 %	$ 98,975

Product Revenue

Revenues derived from products (including systems, consumable materials and other products) increased $30.0 million in 2011, or 30.8%, as compared to the prior year. The number of systems shipped increased by 1.8%, or 47 units, to 2,602 as compared to 2,555 units shipped in 2010. This increase in both revenue and number of systems shipped reflects strong unit sales of our higher priced Fortus 3D production systems, which increased by 78.5% as compared to the prior year, and the acquisition of Solidscape in May 2011. The increase in Fortus 3D production system unit sales was primarily due to a focus of our sales channel on selling systems into DDM applications. Consumable revenue in 2011 increased 27.4% primarily driven by an acceleration in customer usage and our growing installed base of systems.

During 2010, revenues derived from products increased $23.6 million in 2010, or 32.0%, as compared to the prior year. The number of systems shipped increased by 33.2%, or 637 units, to 2,555 as compared to 1,918 units shipped in 2009. This increase in both revenue and number of systems shipped reflects the positive impact of the economic recovery and strong sales of our Stratasys-brand 3D printer products and the HP Designjet line. Consumable revenue in 2010 increased 27.6%, which was driven by the improvement in market conditions, growing installed base of systems and new material offerings.

Service Revenue

Revenues from our service offerings (including RedEye paid parts, maintenance and other services) increased $3.1 million in 2011, or 12.0%, as compared to the prior year. Sales from our RedEye paid parts service increased 11.0% during 2011 as a result of increased new customer business and an increase in average sales price. Revenue from maintenance contracts increased by 12.4% in 2011 reflecting our acquisition of Solidscape as well as our growing base of installed systems and the reduced impact of an extension in system warranty periods implemented in 2009

Revenues from our service offerings for 2010 were relatively flat as compared to the prior year. Growth in our RedEye paid parts service revenue of 21.1% over the prior year resulted from the general economic upturn and continued recovery from a period of highly competitive pricing that occurred during the recession in 2009. This growth was offset by a decrease in maintenance revenue, which resulted from our expansion of the warranty period for our domestic Fortus systems from three months to one year.

Revenue by Region

Net sales, excluding the $5.0 million charge for the fair value of a warrant related to the OEM Agreement in 2010, and the percentage of net sales by region for the last three years, as well as the percentage change were as follows:

	2011		Year-over-Year Change	2010		Year-over-Year Change	2009	
North America	$ 82,373	53%	25.7%	$ 65,536	53%	18.1%	$ 55,503	56%
Europe	49,885	32%	44.3%	34,572	28%	30.6%	26,474	27%
Asia Pacific	21,506	14%	4.1%	20,662	17%	29.8%	15,914	16%
Other	2,130	1%	3.3 %	2,062	2%	90.2 %	1,084	1%
	$ 155,894	100%	26.9 %	$ 122,832	100%	24.1 %	$ 98,975	100%

Sales in all regions increased in 2011 as a result of strong sales of our Fortus 3D production systems, consumables and the acquisition of Solidscape in May 2011. Revenues in the North America region accounted for approximately 53% of total revenue in 2011. Revenues outside of North America accounted for approximately 47% of total revenue in 2011.

Sales in all regions increased in 2010 as a result of the economic recovery and continued improvement in business conditions across our core markets. Revenues in the North America region, accounted for approximately 53% of total revenue in 2011. Revenues outside of North America accounted for approximately 47% of total revenue in 2010. The international increase in sales percentage was led by higher system sales volumes in both high-performance systems as well as 3D Printers, particularly the HP Designjet line in the five European markets served by HP.

Fair Value of Warrant

During the first quarter of 2010, we signed the OEM Agreement with HP to develop and manufacture a line of HP-branded 3D printers. In connection with the OEM Agreement, we issued a warrant to HP during the first quarter of 2010 to purchase 500,000 shares of common stock at an exercise price of $17.78 per share. The exercise price was determined by the 20-day average market closing price of our common stock immediately prior to the issuance of the warrant. The warrant vested immediately and has a seven-year term. The grant date fair value of the warrant was classified as a reduction of revenue on the Consolidated Statement of Operations and Comprehensive Income for the year ended December 31, 2010. The warrant was not exercised during 2011 and remains outstanding.

Gross Profit

Gross profit and gross profit as a percentage of sales for our products and services for 2011, 2010 and 2009, as well as the percentage changes in gross profit were as follows:

	2011	Year-over-Year Change	2010	Year-over-Year Change	2009
Products	$ 65,932	40.0%	$ 47,109	45.9%	$ 32,285
Services	16,472	18.0%	13,965	-1.0%	14,099
Fair value of warrant		-	(4,988)	-	-
	$ 82,404	46.9%	$ 56,086	20.9%	$ 46,384
Gross Profit as a Percentage of Related Sales					
Products	51.7%		48.3%		43.7%
Services	58.0%		55.1%		56.1%
Total	52.9%		47.6%		46.9%

Product gross profit increased by $18.8 million, or 40.0%, to $65.9 million in 2011 as compared with $47.1 million in 2010. The increase is primarily attributable to increased sales of our higher-margin Fortus 3D production systems and consumables, combined with decreased lower-margin sales to HP.

Product gross profit increased by $14.8 million, or 45.9%, to $47.1 million in 2010 as compared with $32.3 million in 2009. This increase is primarily attributable to higher system revenues. The increase was also attributable to significant growth in our high-end RP systems that exceeded the rate of growth in revenue from our lower priced 3D printing systems.

Gross profit from services increased by 18.0% in 2011 as compared to the prior year due to increased growth in system maintenance and RedEye paid parts service sales. Higher sales have a positive impact on gross profit as a large portion of costs associated with our service businesses are fixed.

Gross profit from services decreased by 1.0% in 2010 as compared to the prior year. This is primarily attributable to a decrease in maintenance revenue, which resulted from our expansion of the warranty period for our domestic Fortus systems from three months to one year.

Operating Expenses

Operating expenses and operating expense as a percentage of sales for 2011, 2010 and 2009, as well as the percentage change in operating expenses, were as follows:

	2011	Year-over-Year Change	2010	Year-over-Year Change	2009
Research and development	$ 14,360	47.2%	$ 9,755	26.1%	$ 7,737
Selling, general & administrative	39,038	18.8%	32,863	0.1%	32,823
	$ 53,398	25.3%	$ 42,618	5.1%	$ 40,560
Percentage of Sales	34.3%		36.2%		41.0%

Research and development expenses increased by 47.2% during 2011 and was driven primarily by new product initiatives within 3D printing and 3D production systems, including Solidscape, as well as a decrease in research and development expense reimbursements received in connection with our collaborative agreement further discussed below. During 2010, research and development expenses increased by 26.1% as we remained committed to designing new products and materials, reducing costs on existing products, and improving the quality and reliability of all of our platforms. This spending was focused on accelerating our development efforts to address both the 3D printer and DDM market opportunities as well as improving the quality and reliability of our products. In 2011, 2010 and 2009, capitalized software additions were approximately $1.1 million, $1.2 million and $1.4 million, respectively.

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

Due to the success of this initial arrangement, we have continued this relationship under similar terms and objectives. During the years ended December 31, 2011, 2010 and 2009, approximately $0.7 million, $1.2 million and $2.2 million, respectively, of research and development expenses were offset by payments that were received from that company.

Selling, general and administrative expenses increased by 18.8% in 2011 as compared to the prior year. The increase is primarily due to expenses related to the acquisition of Solidscape and increased employee-related expenses. Selling, general and administrative expenses were relatively flat in 2010 as compared to the prior year.

Operating Income

Operating income and operating income as a percentage of sales for 2011, 2010 and 2009, as well as the percentage change in operating income were as follows:

	2011	Year-over-Year Change	2010	Year-over-Year Change	2009
Operating income	$ 29,006	115.4%	$ 13,467	131.2%	$ 5,824
Percentage of Sales	18.6%		11.4%		5.9%

Operating income in 2011 increased by $15.5 million, or 115.4%, primarily due to increased product sales led by our higher-margin Fortus systems and consumables as well as a $5.0 million charge to revenue in 2010 related to the warrant issued to HP in connection with an OEM Agreement. Operating income in 2010 increased by $7.6 million, or 131.2%, primarily due to the significant increase in revenue, partially offset by increased indirect spending. Operating income as a percentage of sales increased due to effective control of indirect spending in 2011 and 2010.

Other Income

Other income and other income as a percentage of sales for 2011, 2010 and 2009, as well as the percentage change in operating income were as follows:

	2011	Year-over-Year Change	2010	Year-over-Year Change	2009
Interest income	$ 923	0.2%	$ 921	-7.0%	$ 990
Foreign currency transaction losses, net	(888)	43.9%	(617)	164.8%	(233)
Other	2,311	3510.9%	64	116.1%	(398)
	$ 2,346	537.5%	$ 368	2.5%	$ 359
Percentage of Sales	1.5%		0.3%		0.4%

Interest income in 2011 remained flat with the prior year while investments decreased due to a higher effective rate of our investment portfolio. Interest income in 2010 decreased by $69,000, or 7%, while investments increased over the prior year. This was primarily due to $170,000 of interest earned in 2009 on two bonds that were redeemed by the issuer before maturity.

We invoice sales to certain European distributors in Euros and reported results are therefore subject to fluctuations in the exchange rates of that currency in relation to the United States dollar. Our strategy is to hedge most of our Euro-denominated accounts receivable positions by entering into 30-day foreign currency forward contracts on a month-to-month basis to reduce the risk that our earnings will be adversely affected by changes in currency exchange rates. In addition, we held an unhedged Euro cash balance as of December 31, 2011 that was subject to fluctuations in foreign currency exchange rates. Subsequently, we have included this Euro cash balance in our hedging strategy to manage risks that our earnings will be adversely affected by changes in currency exchange rates. We do not use derivative financial instruments for speculative or trading purposes. Instruments to hedge risks may include foreign currency forward, swap, and option contracts. These instruments will be used to selectively manage risks, but there can be no assurance that we will be fully protected against material foreign currency fluctuations.

The increase in other income for 2011 as compared to the prior year is due to the gain on the sale of the Jefferson County, Alabama auction rate security that had been impaired in prior years and a gain on the sale of an equity investment that we maintained in an independent online parts quoting service. The decrease in other income for 2010 as compared to the prior year is due to a $350,000 reduction in the estimated fair value of an equity investment in 2009 that was considered to be other than temporary.

Income Taxes

Income taxes and income taxes as a percentage of net income before taxes for 2011, 2010 and 2009, as well as the percentage change were as follows:

	2011	Year-over-Year Change	2010	Year-over-Year Change	2009
Income taxes	$ 10,726	140.2%	$ 4,466	116.2%	$ 2,066
As a percent of income before income taxes	34.2%		32.3%		33.4%

The following is a reconciliation of the 2011 effective income tax rate compared with the 2010 effective rate and the 2010 effective income tax rate compared with the 2009 effective rate:

2009 Effective income tax rate	33.4%
2010 percentage decrease in research and development credits	3.0%
2010 percentage decrease in tax contingency reserve	(1.1%)
2010 percentage increase in manufacturing deduction	(1.5%)
Other, net	(1.5%)
2010 Effective income tax rate	32.3%
2011 percentage increase in tax contingency reserve	0.9%
2011 percentage decrease in manufacturing deduction	0.8%
Other, net	0.2%
2011 Effective income tax rate	34.2%

Net Income

Net income and net income as a percentage of sales for 2011, 2010 and 2009, as well as the percentage change in net income were as follows:

	2011	Year-over-Year Change	2010	Year-over-Year Change	2009
Net income	$ 20,626	120.1%	$ 9,370	127.6%	$ 4,116
Percentage of Sales	13.2%		8.0%		4.2%

For the reasons cited previously in this management discussion and analysis section, our net income for the year ended December 31, 2011 was higher than the prior year and net income for 2010 was higher than the prior year.

Liquidity and Capital Resources

A summary of our statement of cash flows for the three years ended December 31, 2011 is as follows:

	2011	2010	2009
Net income	$ 20,626	$ 9,370	$ 4,116
Depreciation and amortization	10,348	9,342	8,256
Stock-based compensation	1,587	1,242	1,137
Fair value of warrant related to OEM agreement	-	4,988	-
Change in working capital and other	(10,049)	(2,971)	11,981
Net cash provided by operating and other activities	22,512	21,971	25,490
Net cash used in investing activities	(38,806)	(49,294)	(6,831)
Net cash provided by financing activities	8,769	6,780	1,583
Effect of exchange rate changes on cash	63	(219)	128
Net increase (decrease) in cash and cash equivalents	(7,462)	(20,762)	20,370
Cash and cash equivalents, beginning of year	27,554	48,316	27,946
Cash and cash equivalents, end of year	$ 20,092	$ 27,554	$ 48,316

Our cash and cash equivalents balance decreased by $7.5 million to $20.1 million at December 31, 2011 from $27.6 million at December 31, 2010. The decrease is primarily due to $38.8 million spent for the acquisition of investments, property and equipment, intangible assets and Solidscape partially offset by $22.5 million of cash flows from operations and $6.1 million in proceeds from the exercise of stock options.

The net cash provided by our operating activities over the past three years has amounted to approximately $70.0 million, principally derived from $34.1 million in net income, plus adjustments for non-cash charges of $28.0 million in depreciation and amortization, $4.0 million in stock-based compensation, $5.0 million related to the fair value of a warrant issued to HP and $1.0 million attributable to changes in net working capital and other items.

In 2011, the principal source of cash from our operating activities was our net income, as adjusted to exclude the effects of non-cash charges. Our accounts receivable balance increased to $26.2 million at December 31, 2011 from $20.1 million as of December 31, 2010. This increase was principally due to sales growth and the acquisition of Solidscape. DSO s were 61 days in 2011, 60 days in 2010 and 68 days in 2009. We believe that adequate allowances have been established for any collectability issues in our accounts receivable balance.

For the years ended December 31, 2011, 2010, and 2009, our inventory balances were $22.8 million, $17.9 million, and $14.6 million, respectively. The increase in inventory in 2011 was principally due to strong order flow and anticipated sales growth for both systems and consumables and the acquisition of Solidscape. The increase in inventory in 2010 was principally due to strong order flow and forecasts for systems and consumables.

A portion of our inventory is dedicated to the fulfillment of our service contract and warranty obligations. As we have introduced new products over the past few years, there are more platforms and models to service than in the past, which increases the requirements to maintain spare parts inventory. With the introduction of these new products, older products have been discontinued, but a certain level of inventory is still required to fulfill our ongoing service contracts. Our procedures for dealing with this inventory are more fully explained in the section below captioned Critical Accounting Policies.

Investments in sales-type leases used cash of $2.6 million in 2011 and provided cash of $0.9 million in 2010 and $1.3 million in 2009. In mid-2003 we introduced a U.S. leasing program that was principally designed for the Dimension systems. The program now includes customers in both our 3D printer and our Fortus production system product lines and we plan to continue this leasing program for the foreseeable future.

Accounts payable and other current accrued liabilities provided cash of $6.5 million in 2011, $4.5 million in 2010 and $1.1 million in 2009. In 2011, the increase was related to the timing of payments for inventory purchases and employee compensation.

Unearned revenue, principally consisting of purchased maintenance contracts and implied maintenance contracts, provided cash of $0.6 million in 2011 and $0.9 million in 2010 and used cash of $2.1 million in 2009. The increase in the unearned revenue balance in 2011 was principally due to an increase in maintenance contract sales

Our investing activities used cash of $38.8 million in 2011, $49.3 million in 2010 and $6.8 million in 2009. The purchase of investments, net of proceeds from sales and maturity of investments, provided $16.9 million in 2011, and used cash of $40.2 million in 2010. We purchased Solidscape in 2011 for $38.6 million, net of cash acquired.

At December 31, 2011, our investments included:

- approximately $45.2 million in bonds maturing between February 2012 and November 2016, all of which had ratings between AAA and BAA1 at December 31, 2011; and
- approximately $2.0 million of a tax-free auction rate security (ARS), which re-prices approximately every 35 days. The ARS had a rating of A1 at December 31, 2011.

During 2011, we sold our investment in a tax-free ARS issued by Jefferson County, Alabama. During the economic downturn in 2008, with the assistance of outside consultants, we determined that the ARS had incurred both a temporary and other-than-temporary impairment to its fair value and recognized such write-down in value. Due to negotiations between Jefferson County and bondholders, the market for these bonds improved and in 2011 we were able to sell the investment for $1.8 resulting in a recognized a gain of $626,000.

Property and equipment acquisitions totaled $12.8 million, $7.8 million, and $2.3 million in 2011, 2010 and 2009, respectively. Over the three-year period ended December 31, 2011, our principal property and equipment acquisitions were for manufacturing or engineering development equipment, tooling, leasehold improvements and the acquisition of computer systems and software applications. Payments for intangible assets, including patents and capitalized software, amounted to $4.3 million, $1.3 million and $1.7 million in 2010, 2009, and 2008, respectively.

Proceeds from the exercise of stock options provided cash of $6.1 million, $6.4 million and $1.6 million in 2011, 2010 and 2009, respectively. During 2010, we used cash of $2.1 million for the repurchase of vested stock options. The excess tax benefit from the exercise of stock options was $2.6 million and $2.5 million for the years ended December 31, 2011 and 2010, respectively. We did not repurchase any common stock during the years ended December 31, 2011, 2010 and 2009. As of December 31, 2011, we had authorization to repurchase approximately $10.9 million of common stock.

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

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

Our total current assets amounted to $93.2 million at December 31, 2011, most of which consisted of cash and cash equivalents, investments, accounts receivable, and inventories. Total current liabilities amounted to $29.1 million and we have no long-term debt. We estimate that we will spend between approximately $13.0 million and $17.0 million in 2012 for property and equipment. We also estimate that as of December 31, 2011, we had approximately $23.7 million of purchase commitments for inventory from selected vendors. In addition to purchase commitments for inventory, we have future commitments for leased facilities. We intend to finance our purchase commitments from existing cash or from cash flows from operations. The future contractual cash obligations related to these commitments are as follows:

Year ending December 31,	Facilities	Inventory	Total
2012	$ 762	$ 23,700	$ 24,462
2013	586	-	586
2014	412	-	412
2015	416	-	416
2016	227	-	227
	$ 2,403	$ 23,700	$ 26,103

We have no contractual obligations beyond 2016. In addition to the above disclosed contractual obligations, the reserve for tax contingencies was $1.6 million at December 31, 2011. Based on the uncertainties associated with the settlement of these items, we are unable to make reasonably reliable estimates of the period of potential settlements, if any, with taxing authorities.

Inflation

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

Foreign Currency Transactions

We invoice sales to certain European distributors in Euros and reported results are therefore subject to fluctuations in the exchange rates of that currency in relation to the United States dollar. Our strategy is to hedge most of our Euro-denominated accounts receivable positions by entering into 30-day foreign currency forward contracts on a month-to-month basis to reduce the risk that our earnings will be adversely affected by changes in currency exchange rates. In addition, we held an unhedged Euro cash balance as of December 31, 2011 that was subject to fluctuations in foreign currency exchange rates. Subsequently, we have included this Euro cash balance in our hedging strategy to manage risks that our earnings will be adversely affected by changes in currency exchange rates. We do not use derivative financial instruments for speculative or trading purposes. We enter into 30-day foreign currency forward contracts on the last day of each month and therefore the notional value of the contract equals the fair value at the end of the reporting period. As such, there is no related asset or liability or unrealized gains or losses recorded on the Balance Sheet as of the end of the period. All realized gains and losses related to hedging activities are recorded in current period earnings under the Statement of Operations caption Foreign currency transaction losses, net .

We hedged between €4.0 million and €5.6 million monthly during the year ended December 31, 2011, between €2.3 million and €4.5 million monthly during the year ended December 31, 2010 and between €2.8 million and €5.0 million monthly during the year ended December 31, 2009. The foreign currency forward contracts resulted in a currency translation gain of approximately $70,000 and $340,000 for the years ended December 31, 2011 and 2010, respectively, and a loss of approximately $115,000 for the year ended December 31, 2009. The resulting gain or loss from foreign currency forward contracts only partially offset the total foreign currency transactions gains or losses that we recorded.

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

Critical Accounting Policies

We have prepared our consolidated financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America. This has required us to make estimates, judgments, and assumptions that affected the amounts we reported. Note 1 of the Notes to Consolidated Financial Statements contains the significant accounting principles that we used to prepare our consolidated financial statements.

We have identified several critical accounting policies that required us to make assumptions about matters that were uncertain at the time of our estimates. Had we used different estimates and assumptions, the amounts we recorded could have been significantly different. Additionally, if we had used different assumptions or different conditions existed, our financial condition or results of operations could have been materially different. The critical accounting policies that were affected by the estimates, assumptions, and judgments used in the preparation of our consolidated financial statements are listed below.

Revenue Recognition

We derive revenue from sales of 3D printing, rapid prototyping (RP) and direct digital manufacturing (DDM) systems, consumables, and services. We recognize revenue when (1) persuasive evidence of a final agreement exists, (2) delivery has occurred or services have been rendered, (3) the selling price is fixed or determinable, and (4) collectability is reasonably assured. Our standard terms are FOB shipping point, and, as such, most of the revenue from the sale of 3D printers, production systems and consumables is recognized when shipped. Exceptions to this policy occur if a customer s purchase order indicates an alternative term or provides that the equipment sold would be subject to certain contingencies, such as formal acceptance. In these instances, revenues would be recognized only upon satisfying the conditions established by the customer as contained in its purchase order to us. Revenue from sales-type leases for the our high-performance systems is recognized at the time of lessee acceptance, which follows installation. Revenue from sales-type leases for our Dimension systems is recognized at the time of shipment, since either the customer or the reseller performs the installation. We recognize revenue from sales-type leases at the net present value of future lease payments. Revenue from operating leases is recognized ratably over the lease period.

Service revenue is derived from sales of maintenance contracts, installation services, and training. Service revenue from maintenance contracts is recognized ratably over the period of coverage ranging from one to three years. We offer warranty periods ranging from 90 days to 15 months. On certain sales that require a one-year warranty, the extended warranty is treated for revenue recognition purposes as a maintenance agreement. The fair value of this maintenance agreement is deferred and recognized ratably over the period of the extended warranty as an implied maintenance contract. Installation service revenues are recognized upon completion of the installation. Training revenues are recognized upon completion of the training.

In accordance with ASC 605, *Revenue Recognition*, when two or more product offerings with varying delivery dates are contained in a single arrangement, revenue is allocated between the items based on their relative selling price, provided that each item meets the criteria for treatment as a separate unit of accounting. An item is considered a separate unit of accounting if it has value to the customer on a standalone basis and there is objective and reliable evidence of the selling price of the items. We determine the selling price by reference to the prices we charge when the items are sold separately. If we do not sell the item separately, the selling price is determined by reference to comparable third-party evidence. If neither of these methods provides an appropriate basis for determining a selling price, then one is estimated based on the price at which we would sell the item if it was sold regularly on a standalone basis.

Revenues from training and installation are unbundled and are recognized after the services have been performed. Most of our products are sold through distribution channels, with training and installation services offered by the resellers. For the Dimension products neither installation nor training is offered. The equipment manufactured and sold by us is subject to factory testing that replicates the conditions under which the customers intend to use the equipment. All of the systems are sold subject to published specifications, and all systems sales involve standard models.

We assess collectability as part of the revenue recognition process. This assessment includes a number of factors such as an evaluation of the creditworthiness of the customer, past due amounts, past payment history, and current economic conditions. If it is determined that collectability cannot be reasonably assured, we will decline shipment, request a down payment, or defer recognition of revenue until ultimate collectability is reasonably assured.

Stock-Based Compensation

We calculate the fair value of stock-based option awards on the date of grant using the Black-Scholes option pricing model. The computation of expected volatility is based on historical volatility from traded options on our stock. The expected option term is calculated in accordance with ASC 718, *Compensation Stock Compensation*. The interest rate for periods within the contractual life of the award is based on the U.S. Treasury yield curve in effect at the time of grant. Each of the three factors requires us to use judgment and make estimates in determining the percentages and time periods used for the calculation. If we were to use different percentages or time periods, the fair value of stock-based option awards could be materially different.

Allowance for Doubtful Accounts

While we evaluate the collectability of a sale as part of our revenue recognition process, we must also make judgments regarding the ultimate realization of our accounts receivable. A considerable amount of judgment is required in assessing the realization of these receivables, including the aging of the receivables and the creditworthiness of each customer. We may not be able to accurately and timely predict changes to a customer s financial condition. If a customer s financial condition should suddenly deteriorate, calling into question our ability to collect the receivable, our estimates of the realization of our receivables could be adversely affected. We might then have to record additional allowances for doubtful accounts, which could have an adverse effect on our results of operations in the period affected.

Our allowance for doubtful accounts is adjusted quarterly using two methods. First, our overall reserves are based on a percentage applied to certain aged receivable categories that are predominately based on historical bad debt write-off experience. Then, we make an additional evaluation of overdue customer accounts, for which we specifically reserve. In our evaluation we use a variety of factors, such as past payment history, the current financial condition of the customer, and current economic conditions. We also evaluate our overall concentration risk, which assesses the total amount owed by each customer, regardless of its current status. As of both December 31, 2011 and December 31, 2010, our allowance for doubtful accounts amounted to $1.1 million.

Inventories

Our inventories are recorded at the lower of cost or market, with cost based on a first-in, first-out basis. We periodically assess this inventory for obsolescence and potential excess by reducing the difference between our cost and the estimated market value of the inventory based on assumptions about future demand and historical sales patterns. Our inventories consist of materials and products that are subject to technological obsolescence and competitive market conditions. If market conditions or future demand are less favorable than our current expectations, additional inventory write downs or reserves may be required, which could have an adverse effect on our reported results in the period the adjustments are made. Additionally, engineering or field change orders (ECO and FCO , respectively) introduced by our engineering group could suddenly create extensive obsolete and/or excess inventory. Although our engineering group considers the estimated effect that an ECO or FCO would have on our inventories, a mandated ECO or FCO could have an immediate adverse affect on our reported financial condition if it required the use of different materials in either new production or our service inventory.

Some of our inventory is returned to us by our customers and refurbished. This refurbished inventory, once fully repaired and tested, is functionally equivalent to new production and is utilized to satisfy many of our requirements under our warranty and service contracts. Upon receipt of the returned material, this inventory is recorded at a discount from original cost, and further reduced by estimated future refurbishment expense. While we evaluate this service material in the same way as our stock inventory (i.e., we periodically test for obsolescence and excess), this inventory is subject to changing demand that may not be immediately apparent. Adjustments to this service inventory, following an obsolescence or excess review, could have an adverse effect on our reported financial condition in the period when the adjustments are made. We review the requirements for service inventory for discontinued products using the number of active maintenance contracts per product line as the key determinant for inventory levels and composition. A sudden decline in the number of customers renewing service agreements in a particular period could lead to an unanticipated write down of this service inventory for a particular product line.

Intangible Assets

Intangible assets are capitalized and amortized over their estimated useful or economic lives using the straight-line method in conformity with ASC 350, *Intangibles Goodwill and Other*, as follows:

	Years
Capitalized software development costs	3
Trademarks	5-15
Patents	10
RP technology	6-11
Solidscape customer base	15
Solidscape non-compete agreement	3
In-process research and development	Indefinite

The costs of software development, including significant product enhancements, incurred subsequent to establishing technological feasibility have been capitalized in accordance with ASC 985-20, *Costs of Software to be Sold, Leased or Marketed*. Costs incurred prior to establishment of technological feasibility are charged to research and development expense.

We evaluate the recoverability of identifiable intangible assets whenever events or changes in circumstances indicate that an intangible asset s carrying amount may not be recoverable. Such circumstances could include, but are not limited to (1) a significant decrease in the market value of an asset, (2) a significant adverse change in the extent or manner in which an asset is used, or (3) an accumulation of costs significantly in excess of the amount originally expected for the acquisition of an asset. We measure the carrying amount of the asset against the estimated undiscounted future cash flows associated with it. Should the sum of the expected future net cash flows be less than the carrying value of the asset being evaluated, an impairment loss would be recognized. The impairment loss would be calculated as the amount by which the carrying value of the asset exceeds its fair value. The fair value is measured based on quoted market prices, if available. If quoted market prices are not available, the estimate of fair value is based on various valuation techniques, including the discounted value of estimated future cash flows.

We evaluate the carrying value of goodwill at December 31 of each year and between annual evaluations if events occur or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying amount. Such circumstances could include, but are not limited to (1) a significant adverse change in legal factors or in business climate, (2) unanticipated competition, or (3) an adverse action or assessment by a regulator. When evaluating whether goodwill is impaired, we compare the fair value of the reporting unit to which the goodwill is assigned to the reporting unit s carrying amount, including goodwill. The fair value of the reporting unit is estimated using the income, or discounted cash flows, approach. If the carrying amount of a reporting unit exceeds its fair value, then the amount of the impairment loss must be measured. The impairment loss would be calculated by comparing the implied fair value of reporting unit goodwill to its carrying amount. If the carrying value of the reporting unit exceeds its fair value, an additional calculation is done to determine if the goodwill has been impaired. In making that determination, the implied fair value of the reporting unit is allocated to all of the other assets and liabilities including items that may not be recorded on the balance sheet but which have some fair value. An impairment loss would be recognized if the remaining implied fair value after allocation to all other assets and liabilities exceeds the carrying value of the goodwill.

The evaluation of intangible asset and goodwill impairment requires us to make assumptions about future cash flows over the life of the asset being evaluated that include, among others, growth in revenues, margins realized, level of operating expenses and cost of capital. These assumptions require significant judgment and actual results may differ from assumed and estimated amounts.

Income Taxes

We comply with ASC 740, *Income Taxes*, which requires an asset and liability approach to financial reporting of income taxes. Deferred income tax assets and liabilities are computed for differences between the financial statement and tax basis of assets and liabilities that will result in taxable or deductible amounts in the future, based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce the deferred income tax assets to the amount expected to be realized.

In accordance with ASC 740, *Income Taxes*, we take a two-step approach to recognizing and measuring uncertain tax positions (tax contingencies). The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. We reevaluate these tax positions quarterly and make adjustments as required.

Impairment of Long-Lived Assets

We adhere to ASC 360, *Property, Plant, and Equipment*, and annually assess the recoverability of the carrying amounts of long-lived assets, including intangible assets, at year-end. An impairment loss would be recognized if expected undiscounted future cash flows are less than the carrying amount of the asset. This loss would be determined by calculating the difference by which the carrying amount of the asset exceeds its fair value. Based on our assessment as of December 31, 2011 and 2010, no long-lived assets were determined to be impaired.

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

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

These forward-looking statements include statements regarding projected revenue and income in future quarters; the size of the 3D printing market; our objectives for the marketing and sale of our Dimension and uPrint 3D Printers; our support removal systems; and our Fortus 3D production systems, particularly for use in direct digital manufacturing (DDM); the demand for our proprietary consumables; the expansion of our paid parts service; and our beliefs with respect to the growth in the demand for our products. Other risks and uncertainties that may affect our business include our ability to penetrate the 3D printing market; the success of our distribution agreement with HP; our ability to achieve the growth rates experienced in preceding quarters; our ability to introduce, produce and market consumable materials, and the market acceptance of these materials; the impact of competitive products and pricing; our timely development of new products and materials and market acceptance of those products and materials; the success of our recent R&D initiative to expand the DDM capabilities of our core FDM technology; and the success of our RedEyeOnDemand™ and other paid parts services. They also include statements about future financial and operating results of our company after the acquisition of Solidscape and anticipated benefits of the acquisition. Actual results may differ from those expressed or implied in our forward-looking statements. Such forward-looking statements involve and are subject to certain risks and uncertainties, which may cause our actual results to differ materially from those discussed in a forward-looking statement. Such risk factors include our ability to successfully integrate and market Solidscape products, our ability to attract and retain management and our ability to protect and defend intellectual property. These statements represent beliefs and expectations only as of the date they were made. We may elect to update forward-looking