DELPHI FINANCIAL GROUP INC/DE
Form 10-Q
November 09, 2010

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended September 30, 2010

o **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 001-11462

DELPHI FINANCIAL GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware	(302) 478-5142	13-3427277
(State or other jurisdiction of incorporation or organization)	(Registrant s telephone number, including area code)	(I.R.S. Employer Identification Number)

1105 North Market Street, Suite 1230, P.O. Box 8985, Wilmington, Delaware	19899
(Address of principal executive offices)	(Zip Code)

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 filing requirements for the past 90 days:

Yes þ No o

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

Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (check one):

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

As of November 1, 2010, the Registrant had 48,571,659 shares of Class A Common Stock and 5,753,833 shares of Class B Common Stock outstanding.

DELPHI FINANCIAL GROUP, INC.
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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(Dollars in Thousands, Except Per Share Data)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Revenue:				
Premium and fee income	$ 357,019	$ 342,610	$ 1,057,348	$ 1,052,776
Net investment income	86,886	88,682	249,170	243,560
Net realized investment gains (losses):				
Total other than temporary impairment losses	(13,886)	(73,771)	(62,818)	(137,007)
Less: Portion of other than temporary impairment losses recognized in other comprehensive income	7,498	21,748	12,599	42,467
Net impairment losses recognized in earnings	(6,388)	(52,023)	(50,219)	(94,540)
Other net realized investment gains (losses)	7,580	1,564	22,431	(5,389)
	1,192	(50,459)	(27,788)	(99,929)
Loss on early retirement of senior notes	(3,760)		(3,972)	
Total revenues	441,337	380,833	1,274,758	1,196,407
Benefits and expenses:				
Benefits, claims and interest credited to policyholders	250,594	240,956	741,602	748,361
Commissions	24,149	21,886	69,339	67,046
Amortization of cost of business acquired	30,124	26,740	81,861	76,217
Other operating expenses	63,285	60,943	190,860	181,587
	368,152	350,525	1,083,662	1,073,211
Operating income	73,185	30,308	191,096	123,196
Interest expense:				
Corporate debt	7,783	3,806	23,370	11,667
Junior subordinated debentures	3,241	3,247	9,730	9,728
	11,024	7,053	33,100	21,395
Income before income tax expense	62,161	23,255	157,996	101,801
Income tax expense	15,982	2,321	37,130	19,261

Net income	46,179	20,934	120,866	82,540
Less: Net income attributable to noncontrolling interest	42	111	115	226
Net income attributable to shareholders	$ 46,137	$ 20,823	$ 120,751	$ 82,314
Basic results per share of common stock:				
Net income attributable to shareholders	$ 0.83	$ 0.39	$ 2.18	$ 1.63
Diluted results per share of common stock:				
Net income attributable to shareholders	$ 0.83	$ 0.39	$ 2.17	$ 1.63
Dividends paid per share of common stock	$ 0.11	$ 0.10	$ 0.31	$ 0.30

See notes to consolidated financial statements.

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Dollars in Thousands, Except Per Share Data)

	September 30, 2010	December 31, 2009
Assets:		
Investments:		
Fixed maturity securities, available for sale	$ 5,724,161	$ 4,875,681
Short-term investments	360,415	406,782
Other investments	476,436	466,855
	6,561,012	5,749,318
Cash	77,248	65,464
Cost of business acquired	246,002	250,311
Reinsurance receivables	362,481	355,030
Goodwill	93,929	93,929
Other assets	335,791	293,835
Assets held in separate account	117,321	113,488
Total assets	$ 7,793,784	$ 6,921,375
Liabilities and Equity:		
Future policy benefits:		
Life	$ 339,566	$ 341,736
Disability and accident	793,841	781,701
Unpaid claims and claim expenses:		
Life	52,721	58,665
Disability and accident	448,863	433,273
Casualty	1,277,071	1,187,814
Policyholder account balances	1,662,176	1,454,114
Corporate debt	368,750	365,750
Junior subordinated debentures	175,000	175,000
Other liabilities and policyholder funds	908,761	647,269
Liabilities related to separate account	117,321	113,488
Total liabilities	6,144,070	5,558,810
Equity:		
Preferred Stock, $.01 par; 50,000,000 shares authorized, none issued		
Class A Common Stock, $.01 par; 150,000,000 shares authorized; 56,303,328 and 55,995,995 shares issued, respectively	563	560
Class B Common Stock, $.01 par; 20,000,000 shares authorized; 5,981,049 shares issued	60	60
Additional paid-in capital	675,428	661,895
Accumulated other comprehensive income (loss)	138,180	(33,956)

Retained earnings		1,031,307		927,706
Treasury stock, at cost; 7,761,216 shares of Class A Common Stock and 227,216 shares of Class B Common Stock		(197,246)		(197,246)
Total shareholders equity		1,648,292		1,359,019
Noncontrolling interest		1,422		3,546
Total equity		1,649,714		1,362,565
Total liabilities and equity	$	7,793,784	$	6,921,375

See notes to consolidated financial statements.

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EQUITY
(Dollars in Thousands)
(Unaudited)

	Class A Common Stock	Class B Common Stock	Additional Paid in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Treasury Stock	Total Shareholders Equity	Non-controlling Interest	Total Equity
Balance, January 1, 2009	$ 489	$ 60	$ 522,596	$ (351,710)	$ 846,390	$ (197,246)	$ 820,579	$ 4,035	$ 824,614
Cumulative effect adjustment, April 1, 2009				(2,372)	2,372				
Net income					82,314		82,314	226	82,540
Other comprehensive income:									
Decrease in net unrealized depreciation on investments				325,660			325,660		325,660
Increase in other than temporary impairment losses recognized in other comprehensive income				(19,343)			(19,343)		(19,343)
Decrease in net loss on cash flow hedge				589			589		589
Change in net periodic pension cost				873			873		873
Comprehensive income							390,093	226	390,319
Net contribution from								37	37

noncontrolling interest									
Issuance of common stock	65		121,056				121,121		121,121
Exercise of stock options	5		9,189				9,194		9,194
Stock-based compensation			6,842				6,842		6,842
Cash dividends					(14,767)		(14,767)		(14,767)
Balance, September 30, 2009	$ 559	$ 60	$ 659,683	$ (46,303)	$ 916,309	$ (197,246)	$ 1,333,062	$ 4,298	$ 1,337,360
Balance, January 1, 2010	$ 560	$ 60	$ 661,895	$ (33,956)	$ 927,706	$ (197,246)	$ 1,359,019	$ 3,546	$ 1,362,565
Net income					120,751		120,751	115	120,866
Other comprehensive income:									
Increase in net unrealized appreciation on investments				165,893			165,893		165,893
Decrease in other than temporary impairment losses recognized in other comprehensive income				4,407			4,407		4,407
Decrease in net loss on cash flow hedge				1,682			1,682		1,682
Change in net periodic pension cost				154			154		154
Comprehensive income							292,887	115	293,002
Net distribution to noncontrolling interest								(2,239)	(2,239)
	3		8,604				8,607		8,607

Exercise of stock options									
Stock-based compensation			4,929				4,929		4,929
Cash dividends					(17,150)		(17,150)		(17,150)
Balance, September 30, 2010	$ 563	$ 60	$ 675,428	$ 138,180	$ 1,031,307	$ (197,246)	$ 1,648,292	$ 1,422	$ 1,649,714

See notes to consolidated financial statements.

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in Thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2010	2009
Operating activities:		
Net income attributable to shareholders	$ 120,751	$ 82,314
Adjustments to reconcile net income attributable to shareholders to net cash provided by operating activities:		
Change in policy liabilities and policyholder accounts	180,506	225,538
Net change in reinsurance receivables and payables	(9,657)	(4,613)
Amortization, principally the cost of business acquired and investments	65,264	38,295
Deferred costs of business acquired	(101,002)	(97,936)
Net realized losses on investments	27,788	99,929
Net change in federal income taxes	12,197	6,632
Other	(42,849)	(14,101)
Net cash provided by operating activities	252,998	336,058
Investing activities:		
Purchases of investments and loans made	(1,599,851)	(1,206,214)
Sales of investments and receipts from repayment of loans	1,057,614	177,957
Maturities of investments	70,801	637,166
Net change in short-term investments	46,367	(171,162)
Change in deposit in separate account		4,845
Net cash used by investing activities	(425,069)	(557,408)
Financing activities:		
Deposits to policyholder accounts	277,854	242,614
Withdrawals from policyholder accounts	(82,832)	(131,337)
Proceeds from issuance of 2020 Senior Notes	250,000	
Borrowings under revolving credit facility	50,000	17,000
Principal payments under revolving credit facility	(222,000)	(2,000)
Early retirement of senior notes	(75,000)	
Proceeds from issuance of common stock		121,121
Cash dividends paid on common stock	(17,150)	(14,767)
Other financing activities	2,983	7,151
Net cash provided by financing activities	183,855	239,782
Increase in cash	11,784	18,432
Cash at beginning of period	65,464	63,837

Cash at end of period	$	77,248	$	82,269

See notes to consolidated financial statements.

DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note A Significant Accounting Policies

The financial statements of Delphi Financial Group, Inc. (the Company, which term includes the Company and its consolidated subsidiaries unless the context indicates otherwise) included herein were prepared in conformity with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. The information furnished includes all adjustments and accruals of a normal recurring nature, which, in the opinion of management, are necessary for a fair presentation of results for the interim periods. Certain reclassifications have been made in the September 30, 2009 and December 31, 2009 consolidated financial statements to conform to the September 30, 2010 presentation. Operating results for the three and nine months ended September 30, 2010 are not necessarily indicative of the results that may be expected for the year ended December 31, 2010. For further information refer to the consolidated financial statements and footnotes thereto included in the Company s annual report on Form 10-K for the year ended December 31, 2009 (the 2009 Form 10-K). Capitalized terms used herein without definition have the meanings ascribed to them in the 2009 Form 10-K.

Accounting Changes

Fair Value Measurements. As of January 1, 2010, the Company adopted new guidance issued by the Financial Accounting Standards Board (FASB) requiring additional disclosures regarding fair value measurements. This guidance requires entities to disclose (1) the amounts of significant transfers between Level 1 and Level 2 of the fair value hierarchy, (2) the reasons for any transfers into or out of Level 3 of the fair value hierarchy and (3) additional information in the reconciliation of recurring Level 3 measurements about purchases, sales, issuances and settlements on a gross basis. The new guidance also clarifies existing fair value measurement disclosure requirements concerning the level of disaggregation and the disclosure of valuation inputs and techniques. Except for the requirement to separately disclose purchases, sales, issuances and settlements on a gross basis in the reconciliation of recurring Level 3 measurements, this guidance is effective for interim and annual reporting periods beginning after December 15, 2009. The requirement to separately disclose purchases, sales, issuances and settlements on a gross basis in the reconciliation of recurring Level 3 measurements is effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. The adoption of this guidance did not have any effect on the Company s consolidated financial position or results of operations.

Recently Issued Accounting Standards

In April 2010, the FASB issued guidance clarifying that an insurance company should not consider any separate account interests in an investment held for the benefit of policyholders to be the insurer s own interests and should not combine those interests with any interest of its general account in the same investment when assessing the investment for consolidation. Insurance companies are also required to consider a separate account a subsidiary for purposes of evaluating whether the retention of specialized accounting for investments in consolidation is appropriate. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2010. Early adoption is permitted. The Company has not yet determined the impact, if any, that the adoption of this guidance will have on its consolidated financial position or results of operations.

In October 2010, the FASB issued guidance limiting the extent to which an insurer may capitalize costs incurred in the acquisition of an insurance contract. The guidance provides that, in order to be capitalized, such costs must be incremental and directly related to the acquisition of a new or renewal insurance contract. Insurers may only capitalize costs related to successful efforts in attaining a contract and advertising costs may only be capitalized if certain direct response advertising criteria are met. This guidance will be effective for interim and annual reporting periods beginning after December 15, 2011, with either prospective or retrospective adoption permitted. If the initial application of this guidance results in the capitalization of acquisition costs that had not been capitalized previously by an entity, the entity may elect not to capitalize those types of costs. The Company has not yet determined the impact that the adoption of this guidance will have on its consolidated financial position or results of operations.

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

Note B Investments

At September 30, 2010, the Company had fixed maturity securities available for sale with an amortized cost of $5,498.1 million and a carrying value and a fair value of $5,724.2 million. At December 31, 2009, the Company had fixed maturity securities available for sale with an amortized cost of $4,933.4 million and a carrying value and a fair value of $4,875.7 million. Declines in fair value relative to such securities amortized cost which are determined to be other than temporary pursuant to the Company s methodology for such determinations and to represent credit losses are reflected as reductions in the amortized cost of such securities, as further discussed below.

The amortized cost and fair value of investments in fixed maturity securities available for sale are as follows:

	September 30, 2010				
		Gross Unrealized			
	Amortized Cost	Gains	Losses	Other Than Temporary Impairments	Fair Value
	(dollars in thousands)				
Agency residential mortgage-backed securities	$ 751,900	$ 58,302	$ (59)	$	$ 810,143
Non-agency residential mortgage-backed securities	818,537	76,740	(44,397)	(22,726)	828,154
Commercial mortgage-backed securities	35,786	343	(3,383)	(254)	32,492
Corporate securities	1,340,171	110,915	(14,509)	(457)	1,436,120
Collateralized debt obligations	208,005	1,644	(43,297)	(2,964)	163,388
U.S. Treasury and other U.S. Government guaranteed securities	213,588	10,062	(4)		223,646
U.S. Government-sponsored enterprise securities	106,858	439	(38)		107,259
Obligations of U.S. states, municipalities and political subdivisions	2,023,266	105,235	(5,542)		2,122,959
Total fixed maturity securities	$ 5,498,111	$ 363,680	$ (111,229)	$ (26,401)	$ 5,724,161

	December 31, 2009				
		Gross Unrealized			
	Amortized Cost	Gains	Losses	Other Than Temporary Impairments	Fair Value
	(dollars in thousands)				
Agency residential mortgage-backed securities	$ 699,257	$ 33,417	$ (2,625)	$	$ 730,049
Non-agency residential mortgage-backed securities	842,947	48,235	(62,404)	(29,450)	799,328
Commercial mortgage-backed securities	29,773	206	(3,682)	(288)	26,009

Corporate securities	1,219,711	49,373	(30,918)		1,238,166
Collateralized debt obligations	215,301	868	(98,281)	(3,444)	114,444
U.S. Treasury and other U.S. Government guaranteed securities	108,114	3,036	(344)		110,806
U.S. Government-sponsored enterprise securities	16,750	483	(231)		17,002
Obligations of U.S. states, municipalities and political subdivisions	1,801,595	59,108	(20,826)		1,839,877
Total fixed maturity securities	$ 4,933,448	$ 194,726	$ (219,311)	$ (33,182)	$ 4,875,681

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

Note B Investments (Continued)

The following table contains information, as of September 30, 2010, regarding the portions of the Company s investments in non-agency residential mortgage-backed securities (RMBS) represented by securities whose underlying mortgage loans are categorized as prime, Alt-A and subprime, respectively, and the distributions of the securities within these categories by the years in which they were issued (vintages) and the highest of their ratings from Standard & Poor s, Moody s and Fitch. All dollar amounts in this table are based upon the fair values of these securities as of September 30, 2010. As of this date, based upon the most recently available data regarding the concentrations by state of the mortgage loans underlying these securities, the states having loan concentrations in excess of 5% were as follows: California (38.7%), New York (6.9%) and Florida (6.5%).

	Non-Agency Prime RMBS Fair Value					
Vintage	AAA	AA	A	BBB	BB and Below [1]	Total
	(dollars in thousands)					
2001 and prior	$ 2,254	$	$	$	$	$ 2,254
2002	8,519	1,505	2,591		498	13,113
2003	85,508	2,133	2,949	7,159	5,956	103,705
2004	44,680	1,110		1,633	5,329	52,752
2005	11,332	6,215	1,784	18,667	56,995	94,993
2006	14,979	678			27,058	42,715
2007					85,408	85,408
2008	954				671	1,625
Total	$ 168,226	$ 11,641	$ 7,324	$ 27,459	$ 181,915	$ 396,565

[1] The securities enumerated in this column include securities having a total of $169.5 million in fair value that have received the equivalent of an investment grade rating from the National Association of Insurance Commissioners (the NAIC) under the process initiated by the NAIC in 2009 which takes into account, among other things, the discounts at which the Company originally purchased the securities and modeling of the potential losses with respect to the securities underlying loans.

	Non-Agency Alt-A RMBS Fair Value					
Vintage	AAA	AA	A	BBB	BB and Below [1]	Total
	(dollars in thousands)					
2001 and prior	$	$	$	$ 1,911	$	$ 1,911
2002	269	1,882				2,151
2003	49,381				1,960	51,341
2004	19,336	2,242	139	202	1,708	23,627
2005	2,434	17,394		1,122	40,157	61,107
2006	10,363	31	5,437	9,084	77,625	102,540
2007	332			9	125,133	125,474
Total	$ 82,115	$ 21,549	$ 5,576	$ 12,328	$ 246,583	$ 368,151

(1) The securities enumerated in this column include securities having a total of $195.5 million in fair value that have received the equivalent of an investment grade rating from the NAIC under the process initiated by the NAIC in 2009 which takes into account, among other things, the discounts at which the Company originally purchased the securities and modeling of the potential losses with respect to the securities underlying loans.

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

Note B Investments (Continued)

	Non-Agency Subprime RMBS Fair Value					
Vintage	AAA	AA	A	BBB	BB and Below [1]	Total
	(dollars in thousands)					
2003	$ 9,500	$ 1,341	$	$	$	$ 10,841
2004	12,671		519	2,903	484	16,577
2005	12,639	17,871	546			31,056
2006				2,475	1,066	3,541
2007					1,423	1,423
Total	$ 34,810	$ 19,212	$ 1,065	$ 5,378	$ 2,973	$ 63,438

(1) The securities enumerated in this column include securities having a total of $2.7 million in fair value that have received the equivalent of an investment grade rating from the NAIC under the process initiated by the NAIC in 2009 which takes into account, among other things, the discounts at which the Company originally purchased the securities and modeling of the potential losses with respect to the securities underlying loans.

The amortized cost and fair value of fixed maturity securities available for sale at September 30, 2010, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations, with or without prepayment penalties.

	Amortized Cost	Fair Value
	(dollars in thousands)	
Agency residential mortgage-backed securities	$ 751,900	$ 810,143
Non-agency residential mortgage-backed securities	818,537	828,154
Commercial mortgage-backed securities	35,786	32,492
Other fixed maturity securities:		
One year or less	100,506	99,705
Greater than 1, up to 5 years	573,623	592,968
Greater than 5, up to 10 years	904,601	939,650
Greater than 10 years	2,313,158	2,421,049
Total	$ 5,498,111	$ 5,724,161

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

Note B Investments (Continued)

The gross unrealized losses and fair value of fixed maturity securities available for sale, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows:

	September 30, 2010					
	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(dollars in thousands)					
Agency residential mortgage-backed securities	$ 16,111	$ (22)	$ 426	$ (37)	$ 16,537	$ (59)
Non-agency residential mortgage-backed securities	22,449	(1,053)	242,945	(66,070)	265,394	(67,123)
Commercial mortgage-backed securities	11,490	(368)	4,786	(3,269)	16,276	(3,637)
Corporate securities	31,403	(529)	88,309	(14,437)	119,712	(14,966)
Collateralized debt obligations	12,007	(2,009)	141,112	(44,252)	153,119	(46,261)
U.S. Treasury and other U.S. Government guaranteed securities	14,680	(4)			14,680	(4)
U.S. Government-sponsored enterprise securities	17,773	(38)			17,773	(38)
Obligations of U.S. states, municipalities and political subdivisions	36,257	(280)	77,896	(5,262)	114,153	(5,542)
Total fixed maturity securities	$ 162,170	$ (4,303)	$ 555,474	$ (133,327)	$ 717,644	$ (137,630)

	December 31, 2009					
	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(dollars in thousands)					
Agency residential mortgage-backed securities	$ 126,097	$ (2,573)	$ 269	$ (52)	$ 126,366	$ (2,625)
Non-agency residential mortgage-backed securities	109,508	(4,210)	312,491	(87,644)	421,999	(91,854)
Commercial mortgage-backed securities	3,484	(17)	18,466	(3,953)	21,950	(3,970)

Corporate securities	111,656	(3,739)	200,186	(27,179)	311,842	(30,918)
Collateralized debt obligations	9,097	(4,179)	95,651	(97,546)	104,748	(101,725)
U.S. Treasury and other U.S. Government guaranteed securities	56,693	(344)			56,693	(344)
U.S. Government-sponsored enterprise securities	9,769	(231)			9,769	(231)
Obligations of U.S. states, municipalities and political subdivisions	331,027	(5,128)	160,359	(15,698)	491,386	(20,826)
Total fixed maturity securities	$ 757,331	$ (20,421)	$ 787,422	$ (232,072)	$ 1,544,753	$ (252,493)

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Note B Investments (Continued)

Net investment income was attributable to the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(dollars in thousands)			
Gross investment income:				
Fixed maturity securities, available for sale	$ 82,926	$ 77,648	$ 244,109	$ 226,702
Mortgage loans	630	1,121	3,948	2,527
Short-term investments	32	26	69	348
Other	10,130	16,510	21,477	37,238
	93,718	95,305	269,603	266,815
Less: Investment expenses	(6,832)	(6,623)	(20,433)	(23,255)
	$ 86,886	$ 88,682	$ 249,170	$ 243,560

Net realized investment gains (losses) arose from the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(dollars in thousands)			
Credit related other than temporary impairment losses:				
Fixed maturity securities, available for sale	$ (5,840)	$ (44,411)	$ (32,802)	$ (79,468)
Mortgage loans	(57)	(3,202)	(15,159)	(5,220)
Other investments	(491)	(4,410)	(2,258)	(9,852)
	(6,388)	(52,023)	(50,219)	(94,540)
Other net realized investment gains (losses):				
Fixed maturity securities, available for sale	7,544	680	19,290	(8,273)
Mortgage loans	(1)	503	418	503
Other investments	37	381	2,723	2,381
	7,580	1,564	22,431	(5,389)
Total	$ 1,192	$ (50,459)	$ (27,788)	$ (99,929)

Proceeds from sales of fixed maturity securities during the first nine months of 2010 and 2009 were $357.5 million and $394.2 million, respectively. Gross gains of $24.8 million and gross losses of $(5.5) million were realized on the 2010 sales and gross gains of $17.4 million and gross losses of $(25.6) million were realized on the 2009 sales. Proceeds from sales of fixed maturity securities during the third quarters of 2010 and 2009 were $100.0 million and $76.2 million, respectively. Gross gains of $8.5 million and gross losses of $(1.0) million were realized on sales

during the third quarter of 2010 and $3.7 million of gross gains and gross losses of $(3.0) million were realized on sales during the third quarter of 2009. Net realized investment gains and losses on investment sales are determined under the specific identification method and are included in income. The change in unrealized appreciation and depreciation on investments, primarily relating to fixed maturity securities, is included as a component of accumulated other comprehensive income or loss.

The Company regularly evaluates its investment portfolio utilizing its established methodology to determine whether declines in the fair values of its investments below the Company s amortized cost are other than temporary. Under this methodology, management evaluates whether and when the Company will recover an investment s amortized cost, taking into account, among other things, the financial position and prospects of the issuer, conditions in the issuer s industry and geographic area, liquidity of the investment, the expected amount and timing of future cash flows from the investment, recent changes in credit ratings of the issuer by nationally recognized rating agencies and the length of time and extent to which the fair value of the investment has been lower than its amortized cost to determine if and when a decline in the fair value of an investment below amortized cost is other than temporary. In the case of structured securities such as RMBS, commercial mortgage-backed securities and collateralized debt obligations, the most significant factor in these evaluations is the expected amount and timing

DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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Note B Investments (Continued)

of the future cash flows from the investment. In the case of fixed maturity securities, in instances where management determines that a security s amortized cost will be recovered during its remaining term to maturity, an additional component of this methodology is the Company s evaluation of whether it intends to, or will more likely than not be required to, sell the security before such anticipated recovery.

If the fair value of a fixed maturity security declines in value below the Company s amortized cost and the Company intends to sell, or determines that it will more likely than not be required to sell, the security before recovery of its amortized cost basis, management considers the security to be other than temporarily impaired and reports its decline in fair value as a realized investment loss in the income statement. If, however, the Company does not intend to sell the security and determines that it is not more likely than not that it will be required to do so, a decline in its fair value that is considered in the judgment of management to be other than temporary is separated into the amount representing credit loss and the amount related to other factors. Amounts representing credit losses are reported as realized investment losses in the income statement and amounts related to other factors are included as a component of accumulated other comprehensive income or loss, net of the related income tax benefit and the related adjustment to cost of business acquired. Declines in the fair value of all other investments below the Company s amortized cost that are considered in the judgment of management to be other than temporary are reported as realized investment losses in the income statement.

In the case of structured securities such as RMBS, commercial mortgage-backed securities and collateralized debt obligations as to which a decline in fair value is judged to be other than temporary, the amount of the credit loss arising from the impairment of the security is determined by discounting such security s expected cash flows at its effective interest rate, taking into account the security s purchase price. The key inputs relating to such expected cash flows consist of the future scheduled payments on the underlying loans and the estimated frequency and severity of future defaults on these loans. For those securities as to which the Company recognized credit losses in 2010 as a result of determinations that such securities were other than temporarily impaired, representative default frequency estimates ranged from 2.3% to 6.9% and representative default severity estimates ranged from 37.6% to 60.0%.

In the case of corporate securities as to which a decline in fair value is determined to be other than temporary, the key input utilized to establish the amount of credit loss arising from the impairment of the security is the market price for such security. For each such security, the Company obtains such market price from a single independent nationally recognized pricing service. The Company has not in any instance adjusted the market price so obtained; however, management reviews these prices for reasonableness, taking into account both security-specific factors and its knowledge and understanding of pricing methodologies used by the service. The credit loss is determined to be equal to the excess of the Company s amortized cost over such market price for such security, as measured at the time of the impairment; as such, the entirety of the market depreciation in value is deemed to be reflective of credit loss.

At September 30, 2010, the total amortized cost of the Company s holdings of collateralized debt obligations was $208.0 million and their total fair value was $163.4 million. These holdings consist of a highly diversified portfolio of fifty-one different collateralized loan obligation (CLO) investments, substantially all of which are within senior tranches in the CLO structure and a substantial majority of which were issued in the 2004-2007 time frame. Substantially all of these CLOs are collateralized by an actively managed, highly diversified portfolio of floating rate senior secured loans to numerous public and private corporate borrowers. The 2008-2009 global financial crisis resulted in significant and ongoing dislocations in the market for securities of this type, resulting in the cessation of new issuances of such securities and decreased market liquidity for existing issues, such as those held by the Company, as well as widespread and significant declines in their market values. However, the effects of the financial crisis on the Company s CLO holdings have diminished over time; moreover, these securities have performed in accordance with their contractual payment terms since their acquisition by the Company (with the exception of four securities, which management has determined to be other than temporarily impaired). Further, despite the extraordinarily challenging environment that has prevailed in recent years due to the such crisis, the defaults having

occurred on the loans underlying these CLOs since their issuances, taking into account their incidence and severity, have been at levels at which losses to the holders of the CLOs would be borne solely by the securities in the subordinated tranches. Based upon this actual experience and upon the Company s estimates of the future cash flows with respect to these CLOs, which take into account the estimated frequency and severity of future defaults on the underlying loans, as well as the senior positions of the individual CLOs in their securitization structures and the sizes of the subordinate tranches in these structures that would first absorb losses arising from such defaults, and taking into account that the Company does not intend to sell any of these securities and that it is not more likely than not that it will be required to do so before recovery of the security s amortized cost

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(Unaudited)

Note B Investments (Continued)

basis in any instance, the Company concluded that the declines in the fair values of these securities did not represent other than temporary impairments. During the quarter ended September 30, 2010, the Company elected to utilize an independent pricing service as the key valuation input in place of the internal discounted cash flow methodologies previously utilized for these securities. See Note C to the Consolidated Financial Statements. The Company will continue to conduct evaluations of these securities for other than temporary impairment in future periods, and since the results of these evaluations will depend upon future developments; for example, the future performance of the loans underlying these securities, no assurance can be given as to the outcome of such evaluations.

During the first nine months of 2010, the Company recognized $40.8 million of after-tax other than temporary impairment losses, of which $32.6 million was recognized as after-tax realized investment losses in the income statement related to credit losses and $8.2 million was recognized, net of the related income tax benefit, as a component of accumulated other comprehensive income on the balance sheet related to noncredit losses.

The following table provides a reconciliation of the beginning and ending balances of other than temporary impairments on fixed maturity securities held by the Company for which a portion of the other than temporary impairment was recognized in accumulated other comprehensive income or loss:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(dollars in thousands)			
Balance at the beginning of the period	$ 83,156	$ 59,420	$ 89,658	$
Increases attributable to credit losses on securities for which an other than temporary impairment was not previously recognized	1,995	17,775	12,359	77,384
Increases attributable to credit losses on securities for which an other than temporary impairment was previously recognized	3,548	2,332	16,759	2,143
Reductions due to sales, maturities, pay downs or prepayments of securities for which an other than temporary impairment was previously recognized	(7,997)	(9,454)	(38,074)	(9,454)
Balance at the end of the period	$ 80,702	$ 70,073	$ 80,702	$ 70,073

The gross unrealized losses at September 30, 2010 are attributable to 451 different fixed maturity security positions, with the largest unrealized loss associated with any one security equal to $3.6 million. Unrealized losses attributable to fixed maturity securities having investment grade ratings by a nationally recognized statistical rating organization comprised 31.4% of the aggregate gross unrealized losses at September 30, 2010, with the remainder of such losses being attributable to non-investment grade fixed maturity securities.

At September 30, 2010, the Company held approximately $813.1 million of insured municipal fixed maturity securities, which represented approximately 12.4% of the Company s total invested assets. Based upon the highest of the ratings assigned to the respective securities by Standard & Poor s, Moody s and Fitch, the securities had a weighted average credit rating of A at September 30, 2010. For the portion of these securities having ratings by nationally recognized statistical rating organizations without giving effect to the credit enhancement provided by the insurance, which totaled $764.8 million at September 30, 2010, this weighted average credit rating at such date was AA . Insurers of significant portions of the municipal fixed maturity securities held by the Company at September 30, 2010 included National Public Finance Guarantee Corp. ($309.2 million), Assured Guaranty ($230.7 million), Ambac Financial

Group, Inc. ($151.1 million), Financial Guaranty Insurance Company ($37.2 million) and Radian ($31.3 million). At September 30, 2010, the Company did not have significant holdings of credit enhanced asset-backed or mortgage-backed securities, nor did it have any significant direct investments in the guarantors of the municipal fixed maturity securities held by the Company.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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Note C Fair Value Measurements

The Company measures its assets and liabilities recorded at fair value in the consolidated balance sheet based on the framework set forth in the GAAP fair value accounting guidance. This framework establishes a fair value hierarchy of three levels based upon the transparency and availability of information used in measuring the fair value of assets or liabilities as of the measurement date. The levels are categorized as follows:

Level 1 Valuation is based upon quoted prices for identical assets or liabilities in active markets. Level 1 fair value is not subject to valuation adjustments or block discounts.

Level 2 Valuation is based upon quoted prices for similar assets or liabilities in active markets or quoted prices for identical or similar instruments in markets that are not active. In addition, a company may use various valuation techniques or pricing models that use observable inputs to measure fair value.

Level 3 Valuation is generated from techniques in which one or more of the significant inputs for valuing such assets or liabilities are not observable. These inputs may reflect the Company s best estimates of the various assumptions that market participants would use in valuing the financial assets and financial liabilities.

For these purposes, the Company determines the existence of an active market for an asset or liability based on its judgment as to whether transactions for the asset or liability occur in such market with sufficient frequency and volume to provide reliable pricing information. If the Company concludes that there has been a significant decrease in the volume and level of activity for an investment in relation to normal market activity for such investment, adjustments to transactions and quoted prices are made to estimate fair value.

The Company s investments in fixed maturity securities available for sale, equity securities available for sale, trading account securities, assets held in the separate account and its liabilities for securities sold, not yet purchased are carried at fair value. The methodologies and valuation techniques used by the Company to value its assets and liabilities measured at fair value are described below.

Instruments included in fixed maturity securities available for sale include mortgage-backed and corporate securities, U.S. Treasury and other U.S. government guaranteed securities, securities issued by U.S. government-sponsored enterprises, and obligations of U.S. states, municipalities and political subdivisions. The market liquidity of each security is taken into consideration in the valuation technique used to value such security. For securities where market transactions involving identical or comparable assets generate sufficient relevant information, the Company employs a market approach to valuation. If sufficient information is not generated from market transactions involving identical or comparable assets, the Company uses an income approach to valuation. The majority of the instruments included in fixed maturity securities available for sale are valued utilizing observable inputs; accordingly, they are categorized in either Level 1 or Level 2 of the fair value hierarchy described above. However, in instances where significant inputs utilized are unobservable, the securities are categorized in Level 3 of the fair value hierarchy.

The inputs used in the valuation techniques employed by the Company are provided by nationally recognized pricing services, external investment managers and internal resources. To assess these inputs, the Company s review process includes, but is not limited to, quantitative analysis including benchmarking, initial and ongoing evaluations of methodologies used by external parties to calculate fair value, and ongoing evaluations of fair value estimates based on the Company s knowledge and monitoring of market conditions.

Various valuation techniques and pricing models are utilized in connection with the measurement of the fair value of the Company s investments in residential mortgage-backed securities and commercial mortgage-backed securities, including option-adjusted spread models, volatility-driven multi-dimensional single cash flow stream models and matrix correlation to comparable securities. Residential mortgage-backed securities include U.S. agency securities and collateralized mortgage obligations. Inputs utilized in connection with the valuation techniques relating to this class of securities include monthly payment and performance information with respect to the underlying loans, including prepayments, default severity, delinquencies, market indices and the amounts of the tranches in the particular structure which are senior or subordinate, as applicable, to the tranche represented by the Company s investment. A portion of the Company s investments in mortgage-backed securities are valued using observable inputs and therefore categorized

in Level 2 of the fair value hierarchy. The remaining mortgage-backed securities are valued using non-binding broker quotes.

DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
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Note C Fair Value Measurements (Continued)

These methodologies rely on unobservable inputs and thus these securities are categorized in Level 3 of the fair value hierarchy.

During the quarter ended September 30, 2010, the Company elected to utilize a pricing service or, in instances where such service did not provide a price for a particular security, non-binding broker quotes as the key input in place of the internal discounted cash flow methodologies previously utilized in its valuation techniques for certain of its investments in RMBS, commercial mortgage-backed securities, asset-backed securities, and collateralized debt obligations. In each instance, the Company obtained the market price from a single independent nationally recognized pricing service or, where applicable, obtained a quote from a single broker believed to be knowledgeable regarding market conditions for the particular security. The Company did not in any instance adjust any market price or broker quote so obtained; however, management reviews these prices and quotes for reasonableness, taking into account both security-specific factors and its knowledge and understanding of the pricing methodologies used by the service or broker, as applicable. This change was made based on the Company s determination that, based upon the increased levels of orderly market trading activity, new issuances or both with respect to these securities arising from the ongoing improvements in capital and financial market conditions, that the markets for these investments had ceased to be inactive. The Company recategorized investments having a total of $96.2 million in fair value from Level 3 to Level 2 during the quarter ended September 30, 2010 as a result of this change.

Corporate securities primarily include fixed rate corporate bonds, floating and variable rate notes and securities acquired through private placements. Inputs utilized in connection with the Company s valuation techniques relating to this class of securities include recently executed transactions, market price quotations, benchmark yields, issuer spreads and, in the case of private placement corporate securities, cash flow models. These cash flow models utilize yield curves, issuer-provided information and material events as key inputs. Corporate securities are categorized in Level 2 of the fair value hierarchy, other than securities acquired through private placements, which are categorized in Level 3 of the fair value hierarchy.

Collateralized debt obligations consist of collateralized loan obligations, which are described in more detail in Note B to the Consolidated Financial Statements. The Company s valuation techniques relating to this class of securities utilize non-binding broker quotes as their key input. As this input is generally unobservable, collateralized debt obligations are categorized in Level 3 of the fair value hierarchy.

U.S. Treasury and other U.S. government guaranteed securities include U.S. Treasury bonds and notes, Treasury Inflation Protected Securities (TIPS) and other U.S. government guaranteed securities. The fair values of the U.S. Treasury securities and TIPS are based on quoted prices in active markets and are generally categorized in Level 1 of the fair value hierarchy.

Inputs utilized in connection with the Company s valuation techniques relating to its investments in other U.S. government guaranteed securities, as well as its investments in U.S. government-sponsored enterprise securities, which consist of medium term notes issued by these enterprises, include recently executed transactions, interest rate yield curves, maturity dates, market price quotations and credit spreads relating to similar instruments. These inputs are generally observable and accordingly, these securities are generally categorized in Level 2 of the fair value hierarchy.

Obligations of U.S. states, municipalities and political subdivisions primarily include bonds or notes issued by U.S. municipalities. Inputs utilized in connection with the Company s valuation techniques relating to this class of securities include recently executed transactions and other market data, spreads, benchmark curves including treasury and other benchmarks, trustee reports, material event notices, new issue data, and issuer financial statements. These inputs are generally observable and these securities are generally categorized in Level 2 of the fair value hierarchy.

Other investments held at fair value primarily consist of equity securities available for sale and trading account securities. These investments are primarily valued at quoted active market prices and are therefore categorized in Level 1 of the fair value hierarchy. For private equity investments, since quoted market prices are not available, the

transaction price is used as the best estimate of fair value at inception. When evidence is believed to support a change to the carrying value from the transaction price, adjustments are made to reflect expected exit values. Ongoing reviews by Company management are based on assessments of each underlying investment, and the inputs utilized in these reviews include, among other things, the evaluation of financing and sale transactions with third parties, expected cash flows, material events and market-based information. These investments are included in Level 3 of the fair value hierarchy.

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Note C Fair Value Measurements (Continued)

Assets held in the separate account represent funds invested in a separately administered variable life insurance product for which the policyholder, rather than the Company, bears the investment risk. These assets are invested in interests in a limited liability company that invests in funds which trade in various financial instruments. This limited liability company, all of whose interests are owned by the Company s separate account, utilizes the financial statements furnished by the funds to determine the values of its investments in such funds and the carrying value of each such investment, which is based on its proportionate interest in the relevant fund as of the balance sheet date. As such, these funds financial statements constitute the key input in the Company s valuation of its investment in this limited liability company. The Company concluded that the value calculated using the equity method of accounting on its investment in this limited liability company was reflective of the fair market value of such investment. The investment portfolios of the funds in which the fund investments are maintained vary from fund to fund, but are generally comprised of liquid, publicly traded securities that have readily determinable market values and which are carried at fair value on the financial statements of such funds, substantially all of which are audited annually. The amount that an investor is entitled to receive upon the redemption of its investment from the applicable fund is determined by reference to such security values. These investments are included in Level 3 of the fair value hierarchy.

Other liabilities measured at fair value include securities sold, not yet purchased. These securities are valued using the quoted active market prices of the securities sold and are categorized in Level 1 of the fair value hierarchy.

Assets and liabilities measured at fair value in the consolidated balance sheet on a recurring basis are summarized below:

	September 30, 2010			
	Total	Level 1	Level 2	Level 3
	(dollars in thousands)			
Assets:				
Fixed maturity securities, available for sale:				
Agency residential mortgage-backed securities	$ 810,143	$	$ 759,615	$ 50,528
Non-agency residential mortgage-backed securities	828,154		787,958	40,196
Commercial mortgage-backed securities	32,492		25,654	6,838
Corporate securities	1,436,120		1,370,383	65,737
Collateralized debt obligations	163,388			163,388
U.S. Treasury and other U.S. Government guaranteed securities	223,646	151,031	63,540	9,075
U.S. Government-sponsored enterprise securities	107,259		107,259	
Obligations of U.S. states, municipalities and political subdivisions	2,122,959	13,565	2,109,394	
Other investments	126,658	119,331		7,327
Assets held in separate account	117,321			117,321
Total	$ 5,968,140	$ 283,927	$ 5,223,803	$ 460,410
Liabilities:				
Other liabilities	$ 70,490	$ 70,490	$	$

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
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(Unaudited)

Note C Fair Value Measurements (Continued)

The following table provides reconciliations for Level 3 assets measured at fair value on a recurring basis. Transfers into Level 3 are recognized as of the end of the period.

	Three Months Ended September 30, 2010						
	Balance at Beginning of Quarter	Included in Earnings	Total (Losses) Gains Included in Other Comprehensive Income	Purchases Issuances and Settlements	Transfers Into Level 3	Transfers Out Level 3	Balance at End of the Period
	(dollars in thousands)						
Agency residential mortgage-backed securities	$ 37,282	$ (51)	$ 406	$ 12,891	$	$	$ 50,528
Non-agency residential mortgage- backed securities	111,257	(2,204)	(10,755)	(6,146)		(51,956)	40,196
Commercial mortgage-backed securities	27,130	(500)	(2,748)	5,224		(22,268)	6,838
Corporate securities	67,779	2,500	5,539	10,050	1,800	(21,931)	65,737
Collateralized debt obligations	119,892	1,212	44,566	(2,282)			163,388
U.S. Treasury and other U.S. Government guaranteed securities	11,445	(15)	622	(2,977)			9,075
U.S. Government-sponsored enterprise securities	13,794	32	(25)	(13,801)			
Other Investments	6,190	64	65	1,008			7,327
Assets held in separate account	113,532			3,789			117,321
Total	$ 508,301	$ 1,038	$ 37,670	$ 7,756	$ 1,800	$ (96,155)	$ 460,410

Net losses for the period included in earnings attributable to the net change in unrealized losses of assets measured at fair value using unobservable inputs and held at September 30, 2010 included corporate securities ($0.2 million) and other investments ($0.1 million). In the third quarter of 2010, net gain (losses) of $0.1 million and $(0.2) million were reported in the consolidated statements of income under the captions net investment income and net realized investment gains (losses) , respectively.

Nine Months Ended September 30, 2010

	Balance at Beginning of Year	Included in Earnings	Total (Losses) Gains Included in Other Comprehensive Income	Purchases Issuances and Settlements	Transfers Into Level 3	Transfers Out Level 3	Balance at End of the Period
	(dollars in thousands)						
Agency residential mortgage-backed securities	$ 13,187	$ (248)	$ 1,530	$ 36,059	$	$	$ 50,528
Non-agency residential mortgage- backed securities	130,326	(16,346)	(7,407)	(14,286)		(52,091)	40,196
Commercial mortgage-backed securities	26,009	(1,885)	460	4,522		(22,268)	6,838
Corporate securities	95,920	(1,058)	5,747	(6,994)	5,625	(33,503)	65,737
Collateralized debt obligations	114,444	(889)	56,240	(6,407)			163,388
U.S. Treasury and other U.S. Government guaranteed securities	11,367	(39)	290	(2,543)			9,075
U.S. Government-sponsored enterprise securities		35		(35)			
Other investments	9,707	530	(294)	(2,616)			7,327
Assets held in separate account	113,488			3,833			117,321
Total	$ 514,448	$ (19,900)	$ 56,566	$ 11,533	$ 5,625	$ (107,862)	$ 460,410

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Note C Fair Value Measurements (Continued)

Net losses for the period included in earnings attributable to the net change in unrealized losses of assets measured at fair value using unobservable inputs and held at September 30, 2010 included non-agency residential mortgage-backed securities ($14.2 million), commercial mortgage-backed securities ($1.4 million), corporate securities ($4.8 million), collateralized debt obligations ($2.2 million) and other investments ($0.1 million). In the first nine months of 2010, net losses of $(0.1) million and $(22.6) million were reported in the consolidated statements of income under the captions net investment income and net realized investment gains (losses) , respectively.

The carrying value and estimated fair value of certain of the Company s financial instruments not recorded at fair value in the consolidated balance sheets are shown below. Because fair values for all balance sheet items are not included, the aggregate fair value amounts presented below are not reflective of the underlying value of the Company.

	September 30, 2010		December 31, 2009	
	Carrying Value	Fair Value	Carrying Value	Fair Value
	(dollars in thousands)			
Assets:				
Short-term investments	360,415	360,415	406,782	406,782
Other investments	349,778	349,778	370,565	370,565
Liabilities:				
Policyholder account balances	1,573,093	1,750,623	1,351,565	1,471,669
Corporate debt	368,750	402,546	365,750	361,754
Junior subordinated debentures	175,000	161,205	175,000	124,600
Advances from Federal Home Loan Bank	55,342	75,639	55,342	68,320
Liabilities related to separate account	117,321	117,321	113,488	113,488

The carrying values for short-term investments approximate fair values based on the nature of the investments. Other investments primarily include investment funds organized as limited partnerships and limited liability companies and real estate investment held by limited liability companies which are reflected in the Company s financial statements under the equity method of accounting. In determining the fair value of such investments for purposes of this footnote disclosure, the Company concluded that the value calculated using the equity method of accounting was reflective of the fair market value of such investments. The investment portfolios of the funds in which the fund investments are maintained vary from fund to fund, but are generally comprised of liquid, publicly traded securities that have readily determinable market values and which are carried at fair value on the financial statements of such funds, substantially all of which are audited annually. The amount that an investor is entitled to receive upon the redemption of its investment from the applicable fund is determined by reference to such security values. The Company utilizes the financial statements furnished by the funds to determine the values of its investments in such funds and the carrying value of each such investment, which is based on its proportionate interest in the relevant fund as of the balance sheet date. The carrying values of all other invested assets and separate account liabilities approximate their fair value.

The fair values of policyholder account balances are net of reinsurance receivables and the carrying values have been decreased for related acquisition costs of $79.8 million and $94.0 million at September 30, 2010 and December 31, 2009, respectively. Fair values for policyholder account balances were determined by estimating future cash flows discounted at a current market rate.

The Company believes the fair value of its variable rate long-term debt is equal to its carrying value. The Company pays variable rates of interest on this debt, which are reflective of market conditions in effect from time to time. The fair values of the 2033 Senior Notes, 7.875% Senior Notes due 2020 (2020 Senior Notes) and the 7.376% fixed-to-floating rate junior subordinated debentures due 2067 (Junior Subordinated Debentures) are based on the

expected cash flows discounted to net present value. The fair values for fixed rate advances from the FHLB were calculated using discounted cash flow analyses based on the interest rates for the advances at the balance sheet date.

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Note D Corporate Debt

On January 20, 2010, the Company issued the 2020 Senior Notes pursuant to an effective registration statement. The 2020 Senior Notes were issued in an aggregate principal amount of $250 million with an interest rate of 7.875% and a maturity date of January 31, 2020. The interest on the 2020 Senior Notes is paid semi-annually in arrears on January 31 and July 31.. The 2020 Senior Notes may be redeemed in whole at any time or in part from time to time, at the Company s option, at a redemption price equal to the greater of 100% of the principal amount of the 2020 Senior Notes being redeemed and the applicable make-whole amount (which, in general, would consist of the sum of the present values of the remaining scheduled payments of principal and interest on the 2020 Senior Notes being redeemed discounted to the redemption date by the applicable U.S. Treasury security yield plus an applicable spread), in each case plus any accrued and unpaid interest. The Company used the proceeds from the issuance of the 2020 Senior Notes to repay in full the $222.0 million of outstanding borrowings under the Amended Credit Agreement and for general corporate purposes.

During the second quarter of 2010, the Company repurchased $5.0 million principal amount of the 2033 Senior Notes. During the third quarter of 2010, the Company effected two partial redemptions of the 2033 Senior Notes relating to a total of $70.0 million in aggregate principal amount of such notes, $20.0 million in aggregate principal amount on July 14, 2010 and $50.0 million in aggregate principal amount on September 21, 2010. The Company recognized a loss of $2.6 million, net of an income tax benefit of $1.4 million during the first nine months of 2010 from the early retirement of such notes pursuant to these transactions. In addition, the September 2010 redemption resulted in the redesignation of the series of covered debt benefiting from the replacement capital covenant into which the Company entered in connection with the issuance of its Junior Subordinated Debentures. Accordingly, the 2033 Senior Notes ceased being the covered debt under such covenant and the 2020 Senior Notes became the covered debt under such covenant. At September 30, 2010, $68.8 million in aggregate principal amount of the 2033 Senior Notes remained outstanding. On November 8, 2010, the Company gave notice of redemption of all of the outstanding 2033 Senior Notes. Such redemption will occur on December 23, 2010.

Note E Segment Information

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(dollars in thousands)			
Revenues:				
Group employee benefit products	$ 399,976	$ 385,809	$ 1,173,139	$ 1,163,866
Asset accumulation products	32,020	32,775	94,107	95,740
Other [(1)]	11,909	12,708	39,272	36,730
	443,905	431,292	1,306,518	1,296,336
Net realized investment gains (losses)	1,192	(50,459)	(27,788)	(99,929)
Loss on early retirement of senior notes	(3,760)		(3,972)	
	$ 441,337	$ 380,833	$ 1,274,758	$ 1,196,407
Operating income:				
Group employee benefit products	$ 73,071	$ 74,678	$ 212,746	$ 212,284
Asset accumulation products	10,596	13,792	32,324	35,497
Other [(1)]	(7,914)	(7,703)	(22,214)	(24,656)

	75,753	80,767	222,856	223,125
Net realized investment gains (losses)	1,192	(50,459)	(27,788)	(99,929)
Loss on early retirement of senior notes	(3,760)		(3,972)	
	$ 73,185	$ 30,308	$ 191,096	$ 123,196

(1) Primarily consists of operations from integrated disability and absence management services and certain corporate activities.

Note F Comprehensive Income (Loss)

Total comprehensive income (loss) attributable to common shareholders is comprised of net income and other comprehensive income (loss), which includes the change in unrealized gains and losses on securities available for sale, the change in other than temporary impairments recognized in other comprehensive income, the change in net periodic pension cost and the change in the loss on the cash flow hedge. Total comprehensive income attributable to common shareholders was $292.9 million and

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DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

Note F Comprehensive Income (Loss) (Continued)

$390.1 million for the first nine months of 2010 and 2009, respectively, and $151.1 million and $207.3 million for the third quarters of 2010 and 2009, respectively. Net unrealized losses on securities available for sale decreased $170.3 million in the first nine months of 2010 and $103.7 million in the third quarter of 2010.

Note G Stock-Based Compensation

The Company recognized stock-based compensation expenses of $6.5 million and $7.7 million in the first nine months of 2010 and 2009, respectively, of which $2.1 million and $2.8 million was recognized in the third quarter of 2010 and 2009, respectively. The remaining unrecognized compensation expense related to unvested awards at September 30, 2010 was $18.3 million and the weighted average period of time over which this expense will be recognized is 3.1 years.

The fair values of options were estimated at the grant date using the Black-Scholes option pricing model with the following weighted average assumptions for the first nine months of 2010: expected volatility 43.0%, expected dividends 1.83%, expected lives of the options 6.1 years, and the risk free rate 2.7%. The following weighted average assumptions were used for the first nine months of 2009: expected volatility 39.4%, expected dividends 1.82%, expected lives of the options 7.3 years, and the risk free rate 3.0%.

The expected volatility reflects the Company s past monthly stock price volatility. The dividend yield is based on the Company s historical dividend payments. The Company used the historical average period from the Company s issuance of an option to its exercise or cancellation and the average remaining years until expiration for the Company s outstanding options to estimate the expected life of options for which the Company had sufficient historical exercise data. The Company used the simplified method to estimate the expected life of options for which sufficient historical data was not available due to significant differences in the vesting periods of these grants compared to previously issued grants. The risk-free rate is derived from public data sources at the time of each option grant. Compensation cost is recognized over the requisite service period of the option using the straight-line method.

Option activity with respect to the Company s plans, excluding the performance-contingent incentive options referenced further below, was as follows:

Options	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value ($000)
Outstanding at January 1, 2010	3,927,758	$29.10		
Granted	553,470	21.73		
Exercised	(239,860)	13.84		
Forfeited	(188,775)	28.82		
Expired	(20,323)	29.27		
Outstanding at September 30, 2010	4,032,270	29.01	6.7	$6,362
Exercisable at September 30, 2010	2,216,015	$30.47	5.7	$2,385

The weighted average grant date fair value of options granted during the first nine months of 2010 and 2009 was $8.22 and $8.89, respectively, and during the third quarter of 2010 and 2009 was $0 and $9.81, respectively. The cash proceeds from stock options exercised were $1.8 million and $4.2 million in the first nine months of 2010 and 2009, respectively, and $0.5 million and $2.0 million for the third quarter of 2010 and 2009, respectively. The total intrinsic value of options exercised during the first nine months of 2010 and 2009 was $2.5 million and $2.8 million,

respectively.

At September 30, 2010, 5,673,250 performance-contingent incentive options were outstanding with a weighted average exercise price of $25.67, a weighted average contractual term of 5.5 years and an intrinsic value of $7.8 million. Of such options, 3,208,250 options with a weighted average exercise price of $24.84, a weighted average contractual term of 3.5 years and an intrinsic value of $7.7 million were exercisable at September 30, 2010.

DELPHI FINANCIAL GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

Note H Computation of Results per Share

The following table sets forth the calculation of basic and diluted results per share:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(amounts in thousands, except per share data)			
Numerator:				
Net income attributable shareholders	$ 46,137	$ 20,823	$ 120,751	$ 82,314
Denominator:				
Weighted average common shares outstanding	55,404	52,947	55,284	50,376
Effect of dilutive securities	396	438	390	241
Weighted average common shares outstanding, assuming dilution	55,800	53,385	55,674	50,617
Basic results per share of common stock:				
Net income attributable to shareholders	$ 0.83	$ 0.39	$ 2.18	$ 1.63
Diluted results per share of common stock:				
Net income attributable to shareholders	$ 0.83	$ 0.39	$ 2.17	$ 1.63

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DELPHI FINANCIAL GROUP, INC.
ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

Introduction

The Company, through its subsidiaries, underwrites a diverse portfolio of group employee benefit products, primarily long-term and short-term disability, life, excess workers compensation insurance for self-insured employers, large casualty programs including large deductible workers compensation, travel accident, dental and limited benefit health insurance. Revenues from this group of products are primarily comprised of earned premiums and investment income. The profitability of group employee benefit products is affected by, among other things, differences between actual and projected claims experience, the retention of existing customers, product mix and the Company s ability to attract new customers, change premium rates and contract terms for existing customers and control administrative expenses. The Company transfers its exposure to a portion of its group employee benefit risks through reinsurance ceded arrangements with other insurance and reinsurance companies. Accordingly, the profitability of the Company s group employee benefit products is affected by the amount, cost and terms of reinsurance it obtains. The profitability of those group employee benefit products for which reserves are discounted, in particular, the Company s disability and primary and excess workers compensation products, is also significantly affected by the difference between the yield achieved on invested assets and the discount rate used to calculate the related reserves.

The Company continues to benefit from the favorable market conditions which have in recent years prevailed for its excess workers compensation products as to pricing and other contract terms for these products. However, due primarily to improvements in the primary workers compensation market resulting in lower premium rates in that market, conditions relating to new business production and growth in premiums for the Company s excess workers compensation products have been less favorable in recent years. In response to these conditions, the Company has enhanced its focus on its sales and marketing function for these products and has been achieving significantly improved levels of new business production for these products. In addition, based on the growth and development of the Company s assumed workers compensation and casualty reinsurance product, the Company included this product in its core products beginning with the third quarter of 2009.

For its other group employee benefit products, the Company is presently experiencing challenging market conditions from a competitive standpoint, particularly as to pricing. These conditions, in addition to the downward pressure on employment and wage levels exerted by the recent recession, are adversely impacting the Company s ability to achieve levels of new business production and growth in premiums for these products commensurate with those achieved in prior years. For these products, the Company is continuing to enhance its focus on the small case niche (insured groups of 10 to 500 individuals), including employers which are first-time providers of these employee benefits, which the Company believes to offer opportunities for superior profitability. The Company is also emphasizing its suite of voluntary group insurance products, which includes, among others, its group limited benefit health insurance product. In response to the recently adopted federal health care reform legislation, the Company, effective in September 2010, is issuing all of its new and renewal limited benefit health policies under a fixed indemnity benefit structure that will be exempt from certain of the requirements of the legislation that will then become effective. However, it is uncertain whether this product can be effectively marketed once the minimum medical coverage requirements of the legislation become effective in 2014, since this product s coverage will not satisfy these requirements. The Company markets its other group employee benefit products on an unbundled basis and as part of an integrated employee benefit program that combines employee benefit insurance coverages and absence management services. The integrated employee benefit program, which the Company believes helps to differentiate itself from competitors by offering clients improved productivity from reduced employee absence, has enhanced the Company s ability to market its other group employee benefit products to large employers.

The Company also operates an asset accumulation business that focuses primarily on offering fixed annuities to individuals. In addition, during the first quarter of 2006, the Company issued $100 million in aggregate principal amount of fixed and floating rate funding agreements with maturities of three to five years in connection with the issuance by an unconsolidated special purpose vehicle of funding agreement-backed notes in a corresponding

principal amount. In March 2009, the Company repaid $35.0 million in aggregate principal amount of the floating rate funding agreements at their maturity, resulting in a corresponding repayment of the funding agreement-backed notes. From time to time, the Company acquires blocks of existing SPDA and FPA policies from other insurers through indemnity assumed reinsurance transactions. The Company believes that

its funding agreement program and annuity reinsurance arrangements enhance the Company s asset accumulation business by providing alternative sources of funds for this business. The Company s liabilities for its funding agreements and annuity reinsurance arrangements are recorded in policyholder account balances. Deposits from the Company s asset accumulation business are recorded as liabilities rather than as premiums. Revenues from the Company s asset accumulation business are primarily comprised of investment income earned on the funds under management. The profitability of asset accumulation products is primarily dependent on the spread achieved between the return on investments and the interest credited with respect to these products. The Company sets the crediting rates offered on its asset accumulation products in an effort to achieve its targeted interest rate spreads on these products, and is willing to accept lower levels of sales on these products when market conditions make these targeted spreads more difficult to achieve.

The management of the Company s investment portfolio is an important component of its profitability. Beginning in the second half of 2007, due primarily to the extraordinary stresses affecting the banking system, the housing market and the financial markets generally, particularly the structured mortgage securities market, the financial markets have been the subject of extraordinary volatility. At the same time the overall level of risk-free interest rates has declined substantially. These market conditions resulted in a significant decrease in the Company s level of net investment income for 2008, due primarily to the adverse performance of those investments whose changes in value, positive or negative, are included in the Company s net investment income, such as investment funds organized as limited partnerships and limited liability companies, trading account securities and hybrid financial instruments. In an effort to reduce fluctuations of this type in its net investment income, the Company has repositioned its investment portfolio to reduce its holdings of these types of investments and, in particular, those investments whose performance had demonstrated the highest levels of variability. As part of this effort, the Company has increased its investments in more traditional sectors of the fixed income market such as mortgage-backed securities and municipal bonds. In addition, in light of these market conditions, the Company has been maintaining a significantly larger proportion of its portfolio in short-term investments, which totaled $360.4 million and $406.8 million at September 30, 2010 and December 31, 2009, respectively. The Company has recently been engaged in efforts to deploy a significant portion of these short-term investments into longer-term fixed maturity securities which offer more attractive yields. However, especially since the recent market environment, in which low interest rates and tight credit spreads have been prevailing, has made it particularly challenging to make new investments on terms which the Company deems attractive, no assurance can be given as to the timing of the completion of these efforts or their ultimate outcome.

The Company achieved significantly improved levels of investment income in its repositioned investment portfolio in 2009 and in the first nine months of 2010, during which more favorable market conditions emerged, as compared to 2008. However, market conditions may continue to be volatile and may result in significant fluctuations in net investment income, and as a result, in the Company s results of operations. Accordingly, there can be no assurance as to the impact of the Company s investment repositioning on the level or variability of its future net investment income. In addition, while the total carrying value of the Company s available for sale investment portfolio has increased in recent quarters, the Company s realized investment losses from declines in fair value relative to the amortized cost of various securities that it determined to be other than temporary increased significantly during 2009. Investment losses of this type moderated significantly during the first nine months of 2010 and in the third quarter of 2010, the Company had net realized investment gains. However, in light of the continuing effects of the market conditions discussed above, investment losses may recur in the future and it is not possible to predict the timing or magnitude of such losses.

The following discussion and analysis of the results of operations and financial condition of the Company should be read in conjunction with the Consolidated Financial Statements and related notes included in this document, as well as the Company s annual report on Form 10-K for the year ended December 31, 2009 (the 2009 Form 10-K). Capitalized terms used herein without definition have the meanings ascribed to them in the 2009 Form 10-K. The preparation of financial statements in conformity with GAAP requires management, in some instances, to make judgments about the application of these principles. The amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period could differ materially from the amounts reported if different conditions existed or different judgments were utilized. A discussion of how management applies

certain critical accounting policies and makes certain estimates is contained in the 2009 Form 10-K in the section entitled Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates and should be read in conjunction with the following discussion and analysis of results of operations and financial condition of the Company. In addition, a discussion of uncertainties and contingencies which can affect actual results and could cause future results to differ materially from those expressed in certain forward-looking statements contained in this Management s Discussion and Analysis of Financial Condition and Results of Operations can be found below under the caption Forward-Looking Statements And Cautionary Statements Regarding Certain Factors That May Affect Future Results, in Part I, Item 1A of the 2009 Form 10-K, Risk Factors .

Results of Operations

Nine Months Ended September 30, 2010 Compared to
Nine Months Ended September 30, 2009

Summary of Results. Net income attributable to shareholders was $120.8 million, or $2.17 per diluted share, in the first nine months of 2010 as compared to $82.3 million, or $1.63 per diluted share, in the first nine months of 2009. Net income in the first nine months of 2010 and 2009 included net realized investment losses, net of the related income tax benefit, of $18.1 million, or $0.32 per diluted share, and $65.0 million, or $1.28 per diluted share, respectively. Net income in the first nine months of 2010 as compared to the first nine months of 2009 benefited from an increase in net investment income and a decrease in the level of realized investment losses, and, on a per-share basis, was adversely impacted by the Company s two Class A Common Stock offerings completed during 2009. Net investment income in the first nine months of 2010, which increased 2% from the first nine months of 2009, reflects a 20% increase in average invested assets, partially offset by a decrease in the tax equivalent weighted average annualized yield to 6.0% from 7.0%. Net realized investment losses in the first nine months of 2010 and 2009 included losses, net of the related income tax benefit, of $32.6 million, or $0.59 per diluted share, and $61.5 million, or $1.21 per diluted share, respectively, due to the other than temporary declines in the fair values of certain fixed maturity securities and other investments.

Operating earnings, which is a non-GAAP financial measure, consist of net income attributable to shareholders excluding after-tax realized investment gains and losses, losses on early retirement of senior notes and junior subordinated deferrable interest debentures and results from discontinued operations, as applicable. The Company believes that because these excluded items arise from events that are largely within management s discretion and whose fluctuations can distort comparisons between periods, a measure excluding their impact is useful in analyzing the Company s operating trends. Investment gains or losses are realized based on management s decision to dispose of an investment, and investment losses are realized based on management s judgment that a decline in the fair value of an investment is other than temporary. Early retirement of senior notes and junior subordinated deferrable interest debentures occurs based on management s decision to redeem or repurchase these notes and debentures. Discontinued operations result from management s decision to exit or sell a particular business. Thus, these excluded items are not reflective of the Company s ongoing earnings capacity, and trends in the earnings of the Company s underlying insurance operations can be more clearly identified without their effects. For these reasons, management uses the measure of operating earnings to assess performance and make operating plans and decisions, and the Company believes that analysts and investors typically utilize measures of this type as one element of their evaluations of insurers financial performance. However, gains or losses from the excluded items, particularly as to investments, can occur frequently and should not be considered as nonrecurring items. Further, operating earnings should not be considered a substitute for net income attributable to shareholders, the most directly comparable GAAP measure, as an indication of the Company s overall financial performance and may not be calculated in the same manner as similarly titled measures utilized by other companies.

Operating earnings were $141.4 million, or $2.54 per diluted share, in the first nine months of 2010 as compared to $147.3 million, or $2.91 per diluted share in the first nine months of 2009, primarily due to the interest paid on the 2020 Senior Notes, which were issued in the first quarter of 2010, and, on a per share basis, the impact of the Company s two Class A Common Stock offerings completed during 2009.

The following table reconciles the amount of operating earnings to the corresponding amount of net income attributable to shareholders for the indicated periods:

	Nine Months Ended September 30,	
	2010	2009
Operating earnings	$ 141,395	$ 147,268
Net realized investment losses, net of taxes (A)	(18,062)	(64,954)
Loss on early retirement of senior notes (B)	(2,582)	

Net income attributable to shareholders	$ 120,751	$ 82,314
Diluted results per share of common stock:		
Operating earnings	$ 2.54	$ 2.91
Net realized investment losses, net of taxes [A]	(0.32)	(1.28)
Loss on early retirement of senior notes [B]	(0.05)	
Net income attributable to shareholders	$ 2.17	$ 1.63

(A) Net of an income tax benefit of $9.7 million and $35.0 million, or $0.17 per diluted share and $0.69 per diluted share, for the nine months ended September 30, 2010 and 2009, respectively. The tax effect is calculated using the Company s statutory tax rate of 35%.

(B) Net of an income tax benefit of $1.4 million or $0.02 per diluted share for the nine months ended September 30, 2010. The tax effect is calculated using the Company s statutory tax rate of 35%.

Premium and Fee Income. Premium and fee income in the first nine months of 2010 was $1,057.3 million as compared to $1,052.8 million in the first nine months of 2009. Premiums from core group employee benefit products, which include short-term and long-term disability, life, excess workers compensation, travel accident and dental insurance, assumed workers compensation and casualty reinsurance and limited benefit medical insurance, were $1,012.6 million and $1,013.4 million in first nine months of 2010 and 2009, respectively. Premiums from excess workers compensation insurance for self-insured employers increased 4% to $213.3 million in the first nine months of 2010 from $205.5 million in the first nine months of 2009. New business production, which represents the annualized amount of new premium sold, for excess workers compensation was $39.0 million and $41.0 million in the first nine months of 2010 and 2009, respectively. Premiums from assumed workers compensation and casualty reinsurance increased 45% to $36.8 million in the first nine months of 2010 from $25.4 million in the first nine months of 2009. Assumed workers compensation and casualty reinsurance production was $12.2 million in the first nine months of 2010 compared to $16.4 million in the first nine months of 2009. Retention of existing excess workers compensation customers in the first nine months of 2010 remained strong.

Premiums from the Company s other core group employee benefit products was $762.5 million in the first nine months of 2010 compared to $782.5 million in the first nine months of 2009. During the first nine months of 2010 and 2009, premiums from the Company s group life products were $291.8 million and $300.1 million, respectively, and premiums from the Company s group disability products were $406.2 million and $422.8 million, respectively. Premiums from the Company s turnkey disability business were $37.2 million in the first nine months of 2010 compared to $41.0 million in the first nine months of 2009. New business production for the Company s other core group employee benefit products was $141.6 million and $141.0 million in the first nine months of 2010 and 2009, respectively. The level of production achieved from these products reflects, among other things, the Company s focus on the small case niche (insured groups of 10 to 500 individuals). The payments received by the Company in connection with loss portfolio transfers, which are episodic in nature and are recorded as liabilities rather than as premiums, were $11.4 million in the first nine months of 2010 as compared to $30.9 million in the first nine months of 2009.

Deposits from the Company s asset accumulation products increased 16% to $270.4 million in the first nine months of 2010 from $232.2 million in the first nine months of 2009. Deposits from the Company s asset accumulation products, consisting of new annuity sales and issuances of funding agreements, are recorded as liabilities rather than as premiums. The Company is continuing to maintain its discipline in setting the crediting rates offered on its asset accumulation products in 2010 in an effort to achieve its targeted interest rate spreads on these products.

Net Investment Income. Net investment income in the first nine months of 2010 was $249.2 million as compared to $243.6 million in the first nine months of 2009. This increase reflects a higher level of investment income from the Company s fixed maturity security portfolio resulting from the portfolio repositioning discussed above. See Introduction . The level of net investment income in the first nine months of 2010 also reflects a 20% increase in average invested assets to $5,960.7 million in 2010 from $4,962.3 million in the first nine months of 2009, partially offset by a decrease in the tax equivalent weighted average annualized yield to 6.0% from 7.0%.

Net Realized Investment Gains (Losses). Net realized investment losses were $(27.8) million in the first nine months of 2010 compared to $(99.9) million in the first nine months of 2009. The Company monitors its investments on an ongoing basis. When the fair value of a security declines below its amortized cost, the decline is included as a component of accumulated other comprehensive income or loss, net of the related income tax benefit and adjustment to cost of business acquired, on the Company s balance sheet. In the case of a fixed maturity security, if management judges the decline to be other than temporary, the portion of the decline representing credit loss is recognized as a

realized investment loss in the Company s income statement and the remaining portion of the decline continues to be included as a component of accumulated other comprehensive income or loss. For all other types of investments, the entire amount of the decline is recognized as a realized investment loss. Due to the continuing effects of the adverse market conditions for financial assets described above, the Company recognized $(62.8) million and $(137.0) million of losses in the first nine months of 2010 and 2009, respectively, due to the other than temporary declines in the fair values of certain fixed maturity securities and other investments, of which $(50.2) million and $(94.5) million was recognized as credit-related realized investment losses and $(12.6) million and $(42.5) million remained as a component of accumulated other comprehensive income, respectively. See Introduction . The Company s investment strategy results in periodic sales of securities and, therefore, the recognition of realized investment gains and losses. During the first nine months of 2010 and 2009, the Company recognized $22.4 million and $(5.4) million,

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respectively, of net gains (losses) on the sales of securities.
The Company may continue to recognize losses due to other than temporary declines in security fair values in the future, and such losses may be significant. The extent of such losses will depend on, among other things, future developments in the United States and global economies, financial and credit markets, credit spreads, interest rates, expected future cash flows from structured securities, the outlook for the performance by the security issuers of their obligations and changes in security values. The Company continuously monitors its investments in securities whose fair values are below the Company s amortized cost pursuant to its procedures for evaluation for other than temporary impairment in valuation. See Note B to the Consolidated Financial Statements and the section in the 2009 Form 10-K entitled Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates for a description of these procedures, which take into account a number of factors. It is not possible to predict the extent of any future changes in value, positive or negative, or the results of the future application of these procedures, with respect to these securities. For further information concerning the Company s investment portfolio, see Liquidity and Capital Resources Investments.
Benefits and Expenses. Policyholder benefits and expenses were $1,083.7 million in the first nine months of 2010 as compared to $1,073.2 million in the first nine months of 2009. This increase does not reflect significant additions to reserves for prior years claims and claim expenses. However, there can be no assurance that future periods will not include additions to reserves of this type, which will depend on the Company s future loss development. If the Company were to experience significant adverse loss development in the future, the Company s results of operations could be materially adversely affected. The combined ratio (loss ratio plus expense ratio) for group employee benefit products was 94.2% and 93.3% in the first nine months of 2010 and 2009, respectively. The increase in the combined ratio in the first nine months of 2010 resulted from a higher level of commissions at RSLIC resulting from changes in its product mix, a lower level of premiums from the Company s group employee benefit products, and increased expenses associated with new product development at SNCC. The weighted average annualized crediting rate on the Company s asset accumulation products was 3.8% and 4.3% in the first nine months of 2010 and 2009, respectively.
Interest Expense. Interest expense was $33.1 million in the first nine months of 2010 as compared to $21.4 million in the first nine months of 2009. This increase primarily reflects interest expense associated with the 2020 Senior Notes, which were issued by the Company in the first quarter of 2010, partially offset by a decrease in the weighted average borrowings under the Amended Credit Agreement.
Income Tax Expense. Income tax expense was $37.1 million in the first nine months of 2010 as compared to $19.3 million in the first nine months of 2009, primarily due to the decrease in the income tax benefit resulting from realized investment losses. The Company s effective tax rate was 23.5% in the first nine months of 2010 compared to 18.9% in the first nine months of 2009.
Three Months Ended September 30, 2010 Compared to
Three Months Ended September 30, 2009
Summary of Results. Net income attributable to shareholders was $46.1 million, or $0.83 per diluted share, for the third quarter of 2010 as compared to $20.8 million, or $0.39 per diluted share, for the third quarter of 2009. Net income in the third quarter of 2010 and 2009 included net realized investment gains (losses), net of the related income tax expense (benefit), of $0.8 million, or $0.01 per diluted share, and $(32.8) million, or $(0.61) per diluted share, respectively. Net income in the third quarter of 2010 benefited from a decrease in the level of realized investment losses and was adversely impacted by a decrease in net investment income, primarily attributable to performance of the Company s investments in investment funds organized as limited partnerships and limited liability companies that was below the particularly strong performance of these investments in the prior year s quarter and a loss on the early retirement of the 2033 Senior Notes. Net realized investment gains (losses) in the third quarter of 2010 and 2009 included losses, net of the related income tax benefit, of $(4.2) million, or $(0.07) per diluted share, and $(33.8) million, or $(0.63) per diluted share, respectively, due to credit loss-related impairments in the values of certain investments.
Operating earnings, which is a non-GAAP financial measure, consist of net income attributable to shareholders excluding after-tax realized investment gains and losses, losses on early retirement of senior notes and junior subordinated deferrable interest debentures and results from discontinued operations, as applicable. The Company

believes that because these excluded items arise from events that are largely within management s discretion and whose fluctuations can distort comparisons between periods, a measure excluding their impact is useful in analyzing the Company s operating trends. Investment gains or losses are realized based on management s decision to dispose of an investment, and investment losses are realized based on management s judgment that a decline in the fair value of an investment is other than temporary. Early

retirement of senior notes and junior subordinated deferrable interest debentures occurs based on management s decision to redeem or repurchase these notes and debentures. Discontinued operations result from management s decision to exit or sell a particular business. Thus, these excluded items are not reflective of the Company s ongoing earnings capacity, and trends in the earnings of the Company s underlying insurance operations can be more clearly identified without their effects. For these reasons, management uses the measure of operating earnings to assess performance and make operating plans and decisions, and the Company believes that analysts and investors typically utilize measures of this type as one element of their evaluations of insurers financial performance. However, gains or losses from the excluded items, particularly as to investments, can occur frequently and should not be considered as nonrecurring items. Further, operating earnings should not be considered a substitute for net income attributable to shareholders, the most directly comparable GAAP measure, as an indication of the Company s overall financial performance and may not be calculated in the same manner as similarly titled measures utilized by other companies.
Operating earnings were $47.8 million in the third quarter of 2010 compared to $53.6 million in the third quarter of 2009. Operating earnings were $0.86 per diluted share in the third quarter of 2010 compared to $1.00 per diluted share in the third quarter of 2009, primarily due to the interest paid on the 2020 Senior Notes, which were issued in the first quarter of 2010 and, on a per share basis, the impact of the Company s two Class A Common Stock offerings completed during 2009.
The following table reconciles the amount of operating earnings to the corresponding amount of net income attributable to shareholders for the indicated periods:

	Three Months Ended September 30,	
	2010	2009
Operating earnings	$ 47,806	$ 53,621
Net realized investment gains (losses), net of taxes (A)	775	(32,798)
Loss on early retirement of senior notes (B)	(2,444)	
Net income attributable to shareholders	$ 46,137	$ 20,823
Diluted results per share of common stock		
Operating earnings	$ 0.86	$ 1.00
Net realized investment gains (losses), net of taxes (A)	0.01	(0.61)
Loss on early retirement of senior notes (B)	(0.04)	
Net income attributable to shareholders	$ 0.83	$ 0.39

(A) Net of an income tax expense (benefit) of $0.4 million and $(17.7) million, or $0.01 per diluted share and $(0.33) per diluted share, for the three months ended September 30, 2010 and 2009, respectively. The tax effect is calculated using the Company s statutory tax rate of 35%.

(B) Net of an income tax benefit of $1.3 million or $0.02 per diluted share for the three months ended September 30, 2010. The tax effect is calculated using the Company s statutory tax rate of 35%.

Premium and Fee Income. Premium and fee income for the third quarter of 2010 was $357.0 million as compared to $342.6 million for the third quarter of 2009, an increase of 4%. Premiums from core group employee benefit products increased 4% to $341.6 million for the third quarter of 2010 from $329.8 million for the third quarter of 2009. This increase reflects new business production and improved persistency. Premiums from excess workers compensation insurance for self-insured employers increased 8% to $74.4 million in the third quarter of 2010 from $68.7 million in the third quarter of 2009. Excess workers compensation new business production, which represents the annualized

amount of new premium sold, was $19.3 million in the third quarter of 2010 as compared to $15.7 million in the third quarter of 2009, an increase of 23%. Premiums from assumed workers compensation and casualty reinsurance increased 29% to $13.4 million in the third quarter of 2010 from $10.4 million in the third quarter of 2009. Assumed workers compensation and casualty reinsurance production was $3.7 million in the third quarter of 2010 as compared to $7.7 million in the third quarter of 2009. Average rates decreased less than 1% on third quarter 2010 excess workers compensation renewals and self-insured retentions are on average up modestly in third quarter 2010 on new and renewal policies. Retention of existing excess workers compensation customers in the third quarter of 2010 remained strong.

During the third quarter of 2010, premiums from the Company s other core group employee benefit products increased to $253.8 million from $250.7 million during the third quarter of 2009. Premiums from the Company s group life products increased to $97.9 million in the third quarter of 2010 from $95.8 million in the third quarter of 2009. Premiums from the Company s group disability products were $135.1 million and $135.6 million in the third quarters of 2010 and 2009,

respectively. Premiums from the Company s turnkey disability business were $12.0 million during the third quarter of 2010 compared to $13.0 million during the third quarter of 2009. New business production for the Company s other core group employee benefit products was $49.1 million and $48.8 million in the third quarters of 2010 and 2009, respectively. The level of production achieved from these products reflects the Company s focus on the small case niche (insured groups of 10 to 500 individuals).

Deposits from the Company s asset accumulation products were $153.6 million in the third quarter of 2010 as compared to $57.5 million in the third quarter of 2009, an increase of 167%. The increase in deposits is attributable to, among other things, particularly advantageous conditions for the Company in the fixed annuity marketplace having resulted from various competitors having either terminated their marketing of comparable fixed annuity products or experienced ratings downgrades. Deposits from the Company s asset accumulation products, consisting of new annuity sales and issuances of funding agreements, are recorded as liabilities rather than as premiums. The Company is continuing to maintain its discipline in setting the crediting rates offered on its asset accumulation products in 2010 in an effort to achieve its targeted interest rate spreads on these products.

Net Investment Income. Net investment income in the third quarter of 2010 was $86.9 million as compared to $88.7 million in the third quarter of 2009. This decrease reflects a decrease in the tax equivalent weighted average annualized yield on invested assets to 6.0% for the third quarter of 2010 from 7.0% for the third quarter of 2009, primarily attributable to a lower level of net investment income from the Company s investments in investment funds organized as limited partnerships and limited liability companies, whose performance in the prior year s quarter was particularly strong. This decrease was partially offset by a higher level of investment income from the Company s fixed maturity security portfolio resulting from the portfolio repositioning discussed above and a 16% increase in average invested assets to $6,283.9 million in the third quarter of 2010 from $5,417.7 million in the third quarter of 2009.

Net Realized Investment Gains (Losses). Net realized investment gains (losses) were $1.2 million in the third quarter of 2010 as compared to $(50.5) million in the third quarter of 2009. The Company monitors its investments on an ongoing basis. When the fair value of a security declines below its amortized cost, the decline is included as a component of accumulated other comprehensive income or loss, net of the related income tax benefit and adjustment to cost of business acquired, on the Company s balance sheet. In the case of a fixed maturity security, if management judges the decline to be other than temporary, the portion of the decline related to credit loss is recognized as a realized investment loss in the Company s income statement and the remaining portion of the decline continues to be included as a component of additional other comprehensive income or loss. For all other types of investments, the entire amount of the decline is recognized as a realized investment loss. The Company recognized $(13.9) million of losses in the third quarter of 2010 due to the other than temporary declines in the fair values of certain fixed maturity securities and other investments, of which $(6.4) million was recognized as realized investment losses related to credit losses and $(7.5) million remained as a component of accumulated other comprehensive income on the balance sheet related to non-credit losses. During the third quarter of 2009, the Company recognized $(73.8) million of losses due to the other than temporary declines in the fair values of certain fixed maturity securities and other investments, of which $(52.0) million was recognized as realized investment losses related to credit losses and $(21.7) million remained as a component of accumulated other comprehensive income on the balance sheet related to non-credit losses. The Company s investment strategy results in periodic sales of securities and, therefore, the recognition of realized investment gains and losses. During the third quarters of 2010 and 2009, the Company recognized $7.6 million and $1.6 million, respectively, of net gains on sales of securities.

The Company may recognize additional losses due to other than temporary declines in security values in the future, and such losses may be significant. See Nine Months Ended September 30, 2010 Compared to Nine Months Ended September 30, 2009 Net Realized Investment Gains (Losses).

Benefits and Expenses. Policyholder benefits and expenses were $368.2 million in the third quarter of 2010 as compared to $350.5 million in the third quarter of 2009. This increase primarily reflects the increase in premiums from the Company s group employee benefit products discussed above, and does not reflect significant additions to reserves for prior years claims and claim expenses. However, there can be no assurance that future periods will not include additions to reserves of this type, which will depend on the Company s future loss development. If the

Company were to experience significant adverse loss development in the future, the Company s results of operations could be materially adversely affected. The combined ratio (loss ratio plus expense ratio) for group employee benefit products was 94.9% and 93.7% in the third quarters of 2010 and 2009, respectively. The increase in the combined ratio in the third quarter of 2010 resulted primarily from a higher level of commissions at RSLIC, which followed changes in its product mix, as well as, increased expenses associated with new product development at SNCC. The weighted average annualized crediting rate on the Company s asset accumulation products was 3.7% and 4.5% in the third quarters of 2010 and 2009, respectively.

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Interest Expense. Interest expense was $11.0 million in the third quarter of 2010 as compared to $7.1 million in the third quarter of 2009. This increase primarily reflects interest expense associated with the 2020 Senior Notes, which were issued by the Company in the first quarter of 2010, partially offset by a decrease in the weighted average borrowings under the Amended Credit Agreement.

Income Tax Expense. Income tax expense was $16.0 million in the third quarter of 2010 as compared to $2.3 million in the third quarter of 2009. This increase primarily reflects the decrease in the income tax benefit resulting from realized investment losses, as well as a higher level of operating income. The Company s effective tax rates were 25.7% and 10.0% in the third quarter of 2010 and 2009, respectively.

Liquidity and Capital Resources

General. The Company s current liquidity needs include principal and interest payments on any outstanding borrowings under the Amended Credit Agreement and interest payments on the 2020 Senior Notes, 2033 Senior Notes and 2007 Junior Debentures, as well as funding its operating expenses and dividends to stockholders. The 2033 Senior Notes mature in their entirety in May 2033 and are not subject to any sinking fund requirements. During the second quarter of 2010, the Company repurchased $5.0 million in aggregate principal amount of the 2033 Senior Notes. During the third quarter of 2010, the Company effected two partial redemptions of the 2033 Senior Notes relating to a total of $70.0 million in aggregate principal amount of such notes, $20.0 million in aggregate principal amount on July 14, 2010 and $50.0 million in aggregate principal amount on September 21, 2010. The Company recognized a loss of $2.6 million, net of an income tax benefit of $1.4 million, during the first nine months of 2010 from the early retirement of such notes pursuant to these transactions. In addition, the September 2010 redemption resulted in the redesignation of the series of covered debt benefiting from the replacement capital covenant into which the Company entered in connection with the issuance of its Junior Subordinated Debentures. Accordingly, the 2033 Senior Notes ceased being the covered debt under such covenant and the 2020 Senior Notes became the covered debt under such covenant. At September 30, 2010, $68.8 million in aggregate principal amount of the 2033 Senior Notes remained outstanding. On November 8, 2010, the Company gave notice of redemption of all of the outstanding 2033 Senior Notes. Such redemption will occur on December 23, 2010. The 2007 Junior Debentures will become due on May 15, 2037, but only to the extent that the Company has received sufficient net proceeds from the sale of certain specified qualifying capital securities. Any remaining outstanding principal amount will be due on May 1, 2067. During the first quarter of 2010, the Company issued the 2020 Senior Notes, which will mature in January 2020 and pay interest semi-annually in arrears on January 31 and July 31, which commenced on July 31, 2010. The 2020 Senior Notes are not subject to any sinking fund requirements and contain certain provisions permitting their early redemption by the Company. See Note D to the Consolidated Financial Statements. The 2033 Senior Notes and the 2007 Junior Debentures also contain certain provisions permitting their early redemption by the Company. For descriptions of these provisions, see Notes E and H to the Consolidated Financial Statements included in the 2009 Form 10-K.

As a holding company that does not conduct business operations in its own right, substantially all of the assets of the Company are comprised of its ownership interests in its insurance subsidiaries. In addition, the Company held approximately $70.5 million of financial resources available at the holding company level at September 30, 2010, primarily comprised of short-term investments and in investment subsidiaries whose assets are primarily invested in investment funds organized as limited partnerships and limited liability companies. Other sources of liquidity at the holding company level include dividends paid from subsidiaries, primarily generated from operating cash flows and investments, and borrowings under the Amended Credit Agreement. The Company s insurance subsidiaries would be permitted, without prior regulatory approval, to make dividend payments totaling $112.8 million during 2010, of which $3.6 million has been paid to the Company during the first nine months of 2010. However, the level of dividends that could be paid consistent with maintaining the insurance subsidiaries RBC and other measures of capital adequacy at levels consistent with its current claims-paying and financial strength ratings from rating agencies is likely to be substantially lower than such amount. In general, dividends from the Company s non-insurance subsidiaries are not subject to regulatory or other restrictions. In addition, the Company is presently categorized as a well known seasoned issuer under Rule 405 of the Securities Act. As such, the Company has the ability to file automatically effective shelf registration statements for unspecified amounts of different securities, allowing for immediate, on-demand offerings.

In October 2006, the Company entered into the Amended Credit Agreement, which, among other things, increased the maximum borrowings available to $250 million, improved the pricing terms and extended the maturity date from May 2010 to October 2011. On November 8, 2007, the amount of the facility was increased to the amount of $350.0 million, and certain financial institutions were added as new lenders, pursuant to a supplement to the Amended Credit Agreement. Borrowings under the Amended Credit Agreement bear interest at a rate equal to the LIBOR rate for the borrowing period selected by the Company, which is typically one month, plus a spread which varies based on the Company s Standard & Poor s and Moody s credit ratings. Based on the current levels of such ratings, the spread is currently equal to 62.5 basis points. The Amended

Credit Agreement contains various financial and other affirmative and negative covenants, along with various representations and warranties, considered ordinary for this type of credit agreement. The covenants include, among others, a maximum Company consolidated debt to capital ratio, a minimum Company consolidated net worth, minimum statutory risk-based capital requirements for RSLIC and SNCC, and certain limitations on investments and subsidiary indebtedness. As of September 30, 2010, the Company was in compliance in all material respects with the financial and various other affirmative and negative covenants in the Amended Credit Agreement. At September 30, 2010, the Company had $50.0 million of outstanding borrowings and $300.0 million of borrowings remaining available under the Amended Credit Agreement.

During the first quarter of 2006, the Company issued $100.0 million in aggregate principal amount of fixed and floating rate funding agreements with maturities of three to five years in connection with the issuance by an unconsolidated special purpose vehicle of funding agreement-backed notes in a corresponding principal amount. Based on the Company s investment at risk compared to that of the holders of the funding agreement-backed notes, the Company has concluded that it is not the primary beneficiary of the special purpose vehicle that issued the funding agreement-backed notes. During the first quarter of 2009, the Company repaid $35.0 million in aggregate principal amount of floating rate funding agreements at their maturity. At September 30, 2010 and 2009, the Company s reserves related to the funding agreements were $65.2 million.

On November 4, 2010, the Company s Board of Directors declared a cash dividend of $0.11 per share, which will be paid on the Company s Class A Common Stock and Class B Common Stock on December 2, 2010.

The Company and its subsidiaries expect available sources of liquidity to exceed their current and long-term cash requirements.

Investments. The Company s overall investment strategy emphasizes safety and liquidity, while seeking the best available return, by focusing on, among other things, managing the Company s interest-sensitive assets and liabilities and seeking to minimize the Company s exposure to fluctuations in interest rates. The Company s investment portfolio, which totaled $6,561.0 million at September 30, 2010, consists primarily of investments in fixed maturity securities, short-term investments, mortgage loans and equity securities. The Company s investment portfolio also includes investments in investment funds organized as limited partnerships and limited liability companies and trading account securities which collectively totaled $296.5 million at September 30, 2010. At September 30, 2010, the total carrying value of the portfolio of private placement corporate loans, mortgage loans, interests in limited partnerships and limited liability companies and equity securities managed on the Company s behalf by Fortress Investment Group LLC was $40.2 million.

During the first nine months of 2010, the market value of the Company s available for sale investment portfolio, in relation to its amortized cost, increased by $285.5 million from year-end 2009, before the related decrease in the cost of business acquired of $23.5 million and an increase in the federal income tax provision of $91.7 million. At September 30, 2010, gross unrealized appreciation and gross unrealized depreciation, before the related income tax expense or benefit and the related adjustment to cost of business acquired, with respect to the Company s fixed maturity security holdings totaled $363.7 million (of which $319.0 million was attributable to investment grade securities) and $137.6 million (of which $43.3 million was attributable to investment grade securities), respectively.

During the first nine months of 2010, the Company recognized pre-tax net investment losses of $27.8 million. The weighted average credit rating of the securities in the Company s fixed maturity portfolio, based upon the highest of the ratings assigned to the respective securities by Standard & Poor s, Moody s and Fitch, was A at September 30, 2010. While ratings of this type are intended to address credit risk, they do not address other risks, such as prepayment and extension risks.

See Forward-Looking Statements and Cautionary Statements Regarding Certain Factors That May Affect Future Results, and Part I, Item 1A of the 2009 Form 10-K, Risk Factors , for a discussion of various risks relating to the Company s investment portfolio.

Reinsurance. The Company cedes portions of the risks relating to its group employee benefit products and variable life insurance products under indemnity reinsurance agreements with various unaffiliated reinsurers. The Company pays reinsurance premiums which are generally based upon specified percentages of the Company s premiums on the business reinsured. These agreements expire at various intervals as to new risks, and replacement agreements are

negotiated on terms believed appropriate in light of then-current market conditions. The Company currently cedes through indemnity reinsurance 100% of its excess workers compensation risks between $10.0 million and $50.0 million per occurrence, 100% of its excess workers compensation risks between $100.0 million and $150.0 million per occurrence, and 15% of its excess workers compensation risks between $200.0 million and $250.0 million, per occurrence. Effective in July 2010, the Company entered into a reinsurance agreement under which it cedes 100% (compared to 85% previously) of its excess workers compensation risks between $50.0 million and $100.0 million, per occurrence, and 65% (compared to 50% previously) of its excess workers compensation risks between $150.0 million and $200.0 million per occurrence.

In addition, effective in March 2010, the Company currently cedes through indemnity reinsurance up to $20 million of coverage (compared to $10 million previously) with respect to workers compensation losses resulting from certain naturally occurring catastrophic events. The Company also currently cedes through indemnity reinsurance risks in excess of $300,000 per individual and type of coverage for new and existing employer-paid group life insurance policies. Reductions in the Company s reinsurance coverages will decrease the reinsurance premiums paid by the Company under these arrangements and thus increase the Company s premium income, and will also increase the Company s risk of loss with respect to the relevant policies. Generally, increases in the Company s reinsurance coverages will increase the reinsurance premiums paid by the Company under these arrangements and thus decrease the Company s premium income, and will also decrease the Company s risk of loss with respect to the relevant policies.

Cash Flows. Operating activities increased cash by $253.0 million and $336.1 million in the first nine months of 2010 and 2009, respectively. Net investing activities used $425.1 million and $557.4 million of cash during the first nine months of 2010 and 2009, respectively, primarily for the purchase of securities. Financing activities provided $183.9 million of cash during the first nine months of 2010, principally from deposits to policyholder accounts and the issuance of the 2020 Senior Notes, partially offset by the full repayment of the then outstanding borrowings under the Amended Credit Agreement and the early retirement of $75.0 million in principal amount of the 2033 Senior Notes. During the first nine months of 2009, financing activities provided $239.8 million of cash, principally from deposits to policyholder accounts and proceeds from the issuance of 6.5 million shares of its Class A Common Stock in two separate public offerings, partially offset by the repayment of $35.0 million in aggregate principal amount of floating rate funding agreements at their maturity.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes in the Company s exposure to market risk or its management of such risk since December 31, 2009.

Item 4. Controls and Procedures

As of the end of the period covered by this report, an evaluation was performed under the supervision and with the participation of the Company s management, including the Company s Chief Executive Officer (CEO) and Senior Vice President and Treasurer (the individual who acts in the capacity of chief financial officer), of the effectiveness of the design and operation of the Company s disclosure controls and procedures (as defined in the rules and regulations of the Securities and Exchange Commission). Based on that evaluation, the Company s management, including the CEO and Senior Vice President and Treasurer, concluded that the Company s disclosure controls and procedures were effective. There were no changes in the Company s internal control over financial reporting during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

Forward-Looking Statements And Cautionary Statements Regarding Certain Factors That May Affect Future Results

In connection with, and because it desires to take advantage of, the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, the Company cautions readers regarding certain forward-looking statements in the above Management s Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this Form 10-Q and in any other statement made by, or on behalf of, the Company, whether in future filings with the Securities and Exchange Commission or otherwise. Forward-looking statements are statements not based on historical information and which relate to future operations, strategies, financial results, prospects, outlooks or other developments. Some forward-looking statements may be identified by the use of terms such as expects, believes, anticipates, intends, judgment, outlook, effort, attempt, achieve, project or other similar expressions. Fo statements are necessarily based upon estimates and assumptions that are inherently subject to significant business, economic, competitive and other uncertainties and contingencies, many of which are beyond the Company s control and many of which, with respect to future business decisions, are subject to change. Examples of such uncertainties and contingencies include, among other important factors, those affecting the insurance industry generally, such as the economic and interest rate environment, the performance of financial markets, prevailing levels of credit spreads, federal and state legislative and regulatory developments, including but not limited to changes in financial services, employee benefit, health care and tax laws and regulations, changes in accounting rules and interpretations thereof,

market pricing and competitive trends relating to insurance products and services, acts of terrorism or war, and the availability and cost of reinsurance, and those relating specifically to the Company s business, such as the level of its insurance premiums and fee income, the claims experience, persistency and other factors affecting the profitability of its insurance products, the performance of its investment portfolio and changes in the Company s investment strategy, acquisitions of companies or blocks of business, and ratings by major rating organizations of the Company and its insurance subsidiaries. These uncertainties and contingencies can affect actual results and could cause actual results to differ materially

from those expressed in any forward-looking statements made by, or on behalf of, the Company. Certain of these uncertainties and contingencies are described in more detail in Part I, Item 1A of the 2009 Form 10-K, Risk Factors . The Company disclaims any obligation to update forward-looking information.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

A putative class action, Moore v. Reliance Standard Life Insurance Company, was filed in the United States District Court for the Northern District of Mississippi in July 2008 against the Company s subsidiary, RSLIC. The action challenges RSLIC s ability to pay certain insurance policy benefits through a mechanism commonly known in the insurance industry as a retained asset account and contains related claims of breach of fiduciary duty and prohibited transactions under the federal Employee Retirement Income Security Act of 1974. The Company does not believe that the ultimate resolution of this action will have a material adverse effect on its results of operations, liquidity or financial condition.

In addition to this action, the Company is a party to various other litigation and proceedings in the course of its business, primarily involving its insurance operations. In some cases, these proceedings entail claims against the Company for punitive damages and similar types of relief. The ultimate disposition of such litigation and proceedings is not expected to have a material adverse effect on the Company s results of operations, liquidity or financial condition.

Item 1A. Risk Factors

The following discussion, which supplements the significant factors that may affect the Company s business and operations as described in Part I, Item 1A of the 2009 Form 10-K, Risk Factors. updates and supersedes the discussion contained therein under the heading The Company may be adversely impacted by a decline in the ratings of its insurance subsidiaries or its own credit ratings :

The Company may be adversely impacted by a decline in the ratings of its insurance subsidiaries or its own credit ratings.

Ratings with respect to claims-paying ability and financial strength have become an increasingly important factor impacting the competitive position of insurance companies. The financial strength ratings of RSLIC as of October 2010 as assigned by A.M. Best, Fitch, Moody s and Standard & Poor s were A (Excellent), A- (Strong), A3 (Good) and A (Strong), respectively. The financial strength ratings of SNCC as of October 2010 as assigned by A.M. Best, Fitch, Moody s and Standard & Poor s were A (Excellent), A- (Strong), A3 (Good) and A (Strong), respectively. These ratings are significantly influenced by the risk-based capital ratios and levels of statutory capital and surplus of these subsidiaries. In addition, these rating agencies may implement changes to their internal models that have the effect of increasing or decreasing the amount of capital these subsidiaries must hold in order to maintain these ratings. Each of the rating agencies reviews its ratings of companies periodically and there can be no assurance that current ratings will be maintained in the future. In September 2010, Standard & Poor s revised the outlook on its ratings relating to RSLIC, SNCC and the Company to stable from negative. In December 2009, A.M. Best revised the outlook on its rating relating to SNCC to stable from negative. In June 2010, Moody s revised the outlook on its ratings relating to RSLIC, SNCC and the Company to stable from negative. In April 2009, Fitch Ratings downgraded its ratings relating to RSLIC and SNCC to A- (Good) from A (Good). In December 2008, A.M. Best revised the outlook on its ratings relating to RSLIC, SNCC and the Company to negative from stable. Claims-paying and financial strength ratings relating to the Company s insurance subsidiaries are based upon factors relevant to the policyholders of such subsidiaries and are not directed toward protection of investors in the Company. Downgrades in the ratings of the Company s insurance subsidiaries could adversely affect sales of their products, increase policyholder withdrawals and could have a material adverse effect on the results of the Company s operations. In addition, downgrades in the Company s credit ratings, which are based on factors similar to those considered by the rating agencies in their evaluations of its insurance subsidiaries, could materially adversely affect its ability to access the capital markets and could increase the cost of its borrowings under the Amended Credit Agreement. The Company s senior unsecured debt ratings as of October 2010 from A.M. Best, Fitch, Moody s and Standard & Poor s were bbb, BBB-, Baa3 and BBB, respectively. The ratings for the Company s 2007 Junior Debentures as of October 2010 from A.M. Best, Fitch, Moody s and Standard & Poor s were bb+, BB, Ba1 and BB+, respectively. The ratings for RSLIC s funding agreements

as of October 2010 from A.M. Best, Moody s and Standard & Poor s were a, A3, and A, respectively.

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Item 6. Exhibits

3.1 Amended and Restated By-Laws of Delphi Financial Group, Inc.,

11.1 Computation of Results per Share of Common Stock (incorporated by reference to Note H to the Consolidated Financial Statements included elsewhere herein)

31.1 Certification by the Chairman of the Board and Chief Executive Officer of Periodic Report Pursuant to Rule 13a-14(a) or 15d-14(a)

31.2 Certification by the Senior Vice President and Treasurer of Periodic Report Pursuant to Rule 13a-14(a) or 15d-14(a)

32.1 Certification of Periodic Report Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

101. The following financial information from the Company s Quarterly Report on Form 10-Q for the nine months ended September 30, 2010, formatted in XBRL: (i) Consolidated Statements of Income for the three and nine months ended September 30, 2010 and 2009; (ii) Consolidated Balance Sheets at September 30, 2010 and December 31, 2009; (iii) Consolidated Statement of Equity for the nine months ended September 30, 2010 and 2009; (iv) Consolidated Statements of Cash Flows for the nine months ended September 30, 2010 and 2009; and (v) Notes to Consolidated Financial Statements, tagged as blocks of text.

SIGNATURES

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

DELPHI FINANCIAL GROUP, INC.

/s/ ROBERT ROSENKRANZ

Robert Rosenkranz
Chairman of the Board and Chief Executive Officer
(Principal Executive Officer)

/s/ THOMAS W. BURGHART

Thomas W. Burghart
Senior Vice President and Treasurer
(Principal Accounting and Financial Officer)

Date: November 9, 2010

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36,605 36,199 35,856 35,572 35,357

As of

January 3,

	December 29, 2009	December 30, 2007	December 31, 2006	January 1, 2005	2005 (1)
Working capital	$35,199	$35,337	$43,151	$37,558	$37,179
Total assets	$157,513	$192,827	$198,014	$181,487	$171,318
Total debt and capital lease obligations	$16,489	$35,535	$37,572	$35,643	$41,822
Stockholders' equity	$102,531	$106,892	$111,237	$98,633	$89,402

(1) Amounts include results of operations of ABD International, Inc. (which acquired certain assets and assumed certain liabilities of

The A.B. Dick Company on November 5, 2004) and Precision Lithograining Corp. (acquired July 30, 2004) for the periods subsequent

to their respective acquisitions.

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

The following Management's Discussion and Analysis should be read in connection with "Item 1. Business", "Item 1A. Risk Factors", "Item 6. Selected Financial Data", "Item 7A. Quantitative and Qualitative Disclosures about Market Risks" and the Company's Consolidated Financial Statements and Notes thereto included in this Annual Report on Form 10-K. Certain terms used in the discussion below are defined in Item 1 of this Annual Report on Form 10-K.

Overview of the Company

The Company is a provider of high-technology, digital-based printing solutions to the commercial print segment of the graphics communications industry. The Company designs, manufactures and distributes proprietary and non-proprietary solutions aimed at serving the needs of a wide range of print service providers worldwide. Our proprietary digital imaging and advanced technology consumables offer superior business solutions for commercial printing focusing on the growing need for short-run, high quality color applications. We are helping to lead the industry's transformation from analog print production methods to digital imaging technology. We are a leader in the development of advanced printing systems using digital imaging equipment, workflow and consumables-based solutions that economically benefit the user through streamlined operations and chemistry-free, environmentally responsible solutions. We are also a leading sales and service channel across a broadly served market in the small to mid-sized commercial, quick and in-plant printing segments.

Presstek's business model is a capital equipment and consumables model. In this model, approximately two-thirds of our revenue is recurring revenue. Our model is designed so that each placement of either a DI® press or a CTP system generally results in recurring aftermarket revenue for consumables and service.

Through our various operations, we:

- provide advanced digital print solutions through the development and manufacture of digital laser imaging equipment and advanced technology chemistry-free printing plates, which we call consumables, for commercial and in-plant print providers targeting the growing market for high quality, fast turnaround short-run color printing;
- are a leading sales and services company delivering Presstek digital solutions and solutions from other manufacturing partners through our direct sales and service force and through distribution partners worldwide;
- manufacture semiconductor solid state laser diodes for Presstek imaging applications and for use in external applications; and
- manufacture and distribute printing plates for conventional print applications.

We have developed DI® solution, a proprietary system by which digital images are transferred onto printing plates for direct imaging on-press applications. Our advanced DI® technology is integrated into a direct imaging press to produce a waterless, easy to use, high quality printing press that is fully automated and provides our users with competitive advantages over alternative print technologies. We believe that our process results in a DI® press which, in combination with our proprietary printing plates and streamlined workflow, produces a superior print solution. By combining advanced digital technology with the reliability and economic advantages of offset printing, we believe our customers are better able to grow their businesses, generate higher profits and better serve the needs of their customers.

Similar digital imaging technologies are used in our CTP systems. Our Presstek segment also designs and manufactures CTP systems that incorporate our technology to image our chemistry-free printing plates. Our

chemistry-free digital imaging systems enable customers to produce high-quality, full color lithographic printed materials more quickly and cost effectively than conventional methods that employ more complicated workflows and toxic chemical processing. This results in reduced printing cycle time and lowers the effective cost of production for commercial printers. Our solutions make it more cost effective for printers to meet the increasing demand for shorter print runs, higher quality color and faster turn-around times.

We have executed a major transformation in the way we go to market. In the past, we had been reliant on OEM partners to deliver our business solutions to customers. Today, more than 90% of our sales are through our own distribution channels.

In addition to marketing, selling and servicing our proprietary digital products, we also market, sell and service traditional (or analog) products for the commercial print market. This analog equipment is manufactured by third party strategic partners and the analog consumables are manufactured by either us or our strategic partners. The addition of these non-proprietary products and our ability to directly sell and service them was made possible by the A.B. Dick Acquisition and Precision acquisition, which we completed in 2004.

Our operations are currently organized into two segments: (i) Presstek and (ii) Lasertel. Segment operating results are based on the current organizational structure as reviewed by our management to evaluate the results of each business. A description of the types of products and services provided by each business segment follows.

- Presstek is primarily engaged in the development, manufacture, sale and servicing of our business solutions using patented digital imaging systems and patented printing plate technologies. We also provide traditional, analog systems and related equipment and supplies for the graphic arts and printing industries.
- Lasertel manufactures and develops high-powered laser diodes and related laser products for Presstek and for sale to external customers.

On September 24, 2008, the Board of Directors approved a plan to market the Lasertel subsidiary for sale; as such the Company has presented the results of operations of this subsidiary within discontinued operations.

We generate revenue through four main sources: (i) the sale of our equipment and related workflow software, including DI® presses and CTP devices, (ii) the sale of high-powered laser diodes for the graphic arts, defense and industrial sectors; (iii) the sale of our proprietary and non-proprietary consumables and supplies; and (iv) the servicing of offset printing systems and analog and CTP systems and related equipment.

Strategy

Our business strategy is centered on maximizing the sale of consumable products, such as printing plates, and therefore our business efforts focus on the sale of “consumable burning engines” such as our DI® presses and CTP devices, as well as the servicing of customers using our business solutions. Our strategy centers on increasing the number of our DI® and CTP units, which increases the demand for our consumables.

To complement our direct sales efforts, in certain territories, we maintain relationships with key press manufacturers such as Ryobi, Heidelberg, and KBA, who market printing presses and/or press solutions that use our proprietary consumables.

Another method of growing the market for consumables is to develop consumables that can be imaged by non-Presstek devices. In addition to expanding the base of our DI® and CTP units, an element of our focus is to reach beyond our proprietary systems and penetrate the installed base of CTP devices in all market segments with our chemistry-free and process-free offerings. The first step in executing this strategy was the launch of our Aurora chemistry-free printing plate designed to be used with CTP units manufactured by thermal CTP market leaders, such as Screen and Kodak. We continue to work with other CTP manufacturers to qualify our consumables on their systems. We believe this shift in strategy fundamentally enhances our ability to expand and control our business.

Since 2007, management has been taking steps to improve the Company's cost structure and strengthen its balance sheet in order to enable Presstek to increase profitability on improved revenue growth when economic conditions in the United States and elsewhere recover. Our improved level of profitability and balance sheet improvements to date are, in large part, the result of our Business Improvement Plan (the "BIP") as described in more detail below, as well as our review and strengthening of inventory and accounts receivable.

2008 Highlights

In fiscal 2008, deteriorating worldwide economic conditions caused significant volatility in many markets which adversely impacted our business. Overall commercial print industry volume is down as companies have cut back on general advertising and promotional materials, and uncertainty regarding the economy and tightening credit markets have led to delays in capital purchase decisions. As a result of this volatility, as well as continuing erosion due to technological changes in our traditional product business, revenues in fiscal 2008 of $193.3 million were down $53.3 million, or 21.6%, compared to the prior year.

The BIP plan resulted in significant reductions in costs, improved operating efficiencies, greater cash flow, and helped reduce debt levels. The cost benefits from this plan, as discussed below, have been very important in returning the Company to profitability in fiscal 2008 despite the challenging economic headwinds. Additional cost reduction actions, however, were implemented during the latter part of fiscal 2008 as the Company aggressively addressed current and expected future economic conditions.

Management Objectives

Our vision is to provide high quality, fully integrated digital solutions and services that enable us to form an all-encompassing relationship with our customers. Our business strategy is to offer innovative digital imaging and plate technologies that address the opportunities of today and tomorrow in the graphic arts and commercial printing markets across the globe.

This strategy includes several imperatives: (1) focus on the growth of our consumables product line; (2) emphasize attractive market segments such as larger print providers; (3)focus on growing existing segments such as print shops with less than 20 employees, (4) enable customers to better compete by offering a more diverse range of products; (5) continue to expand solutions that meet the growth in demand for short-run, fast turnaround high-quality color printing; and (6) provide environmentally responsible solutions through our application of technology.

Business Improvement Plan

In the fourth quarter of fiscal 2007, we announced the BIP. The plan involves virtually every aspect of the business and includes pricing actions, improved manufacturing efficiencies, increased utilization of field service resources, right-sizing of operating expenses, and cash flow improvements driven by working capital reductions and the sale of selected real estate assets.

The BIP plan, as well as additional cost actions implemented during the fourth quarter of fiscal 2008, accounted for a majority of the $2.1 million of restructuring charges recorded during fiscal 2008. Since the second quarter of fiscal 2007, headcount has been reduced by 16.3%, leased facilities have been consolidated; operating expenses, excluding special charges, have been reduced from $21.5 million in the second quarter of fiscal 2007 to $16.4 million in the fourth quarter of fiscal 2008, a decline of 23.6%; working capital has decreased from $39.8 million at June 30, 2007 to $35.2 million at January 3, 2009; short term debt decreased by 41% ($11.5 million) ; and in the third quarter of fiscal 2008 the Company completed the sale of real estate located in Tucson, AZ for $8.75 million, of which the net proceeds were used to pay down debt. The sale of this property included a leaseback of a portion of the facility for the Lasertel operations.

Internal Review

Beginning in the third quarter of fiscal 2007, we commenced a self-initiated internal review of certain practices and procedures surrounding inventory, accounts receivable and commercial receivable terms. We conducted a worldwide review of accounts receivable; conducted a worldwide physical inventory to assess the existence and valuation of inventory; and reviewed revenue practices surrounding the commercial terms granted in certain transactions, resulting in an enhanced revenue recognition policy. The culmination of these actions resulted in increased professional fees during the latter part of fiscal 2007 and a negative impact to revenue in the fourth quarter of fiscal 2007 and the first quarter of fiscal 2008 largely due to the disruption in our European operations related to the business reviews, as well as tightened commercial receivable terms.

General

We operate and report on a 52- or 53-week, fiscal year ending on the Saturday closest to December 31. Accordingly, the consolidated financial statements include the financial reports for the 53-week fiscal year ended January 3, 2009, which we refer to as “fiscal 2008”, the 52-week fiscal year ended December 29, 2007, which we refer to as “fiscal 2007” and the 52-week fiscal year ended December 30, 2006, which we refer to as “fiscal 2006”.

We intend the discussion of our financial condition and results of operations that follows to provide information that will assist in understanding our consolidated financial statements, the changes in certain key items in those financial statements from year to year, and the primary factors that accounted for those changes, as well as how certain accounting principles, policies and estimates affect our consolidated financial statements.

The discussion of results of operations at the consolidated level is presented below.

Result of Operation

Results of operations in dollars and as a percentage of revenue were as follows (in thousands of dollars):

	Fiscal year ended					
	January 3, 2009		December 29, 2007		December 30, 2006	
		% of revenue		% of revenue		% of revenue
Revenue						
Product	$ 158,743	82.1	$ 207,605	84.2	$ 213,966	82.6
Service and parts	34,509	17.9	38,968	15.8	44,970	17.4
Total revenue	193,252	100.0	246,573	100.0	258,936	100.0
Cost of revenue						
Product	99,088	51.2	145,724	59.1	149,333	57.7
Service and parts	25,423	13.2	31,622	12.8	32,466	12.5
Total cost of revenue	124,511	64.4	177,346	71.9	181,799	70.2
Gross profit	68,741	35.6	69,227	28.1	77,137	29.8
Operating expenses						
Research and development	5,144	2.6	4,969	2.0	5,320	2.1
Sales, marketing and customer support	29,937	15.5	39,194	15.9	39,451	15.2
General and administrative	25,496	13.2	33,172	13.4	18,879	7.3
Amortization of intangible assets	1,084	0.6	2,168	0.9	2,697	1.0
Restructuring and other charges	2,108	1.1	2,714	1.1	5,481	2.1
Total operating expenses	63,769	33.0	82,217	33.3	71,828	27.7
Operating income (loss)	4,972	2.6	(12,990)	(5.3)	5,309	2.1
Interest and other income (expense), net	938	0.5	(1,254)	(0.5)	(984)	(0.4)
Income (loss) from continuing operations before income taxes	5,910	3.1	(14,244)	(5.8)	4,325	1.7
Provision (benefit) for income taxes	2,780	1.4	(3,889)	(1.6)	(9,891)	(3.8)
Income (loss) from continuing operations	3,130	1.6	(10,355)	(4.2)	14,216	5.5
Loss from discontinued operations, net of income taxes	(2,606)	(1.3)	(1,849)	(0.7)	(4,472)	(1.7)
Net income (loss)	$ 524	0.3	$ (12,204)	(4.9)	$ 9,744	3.8

Fiscal 2008 Compared to Fiscal 2007

Revenue

Consolidated revenues were $193.3 million in fiscal 2008, a decrease of $53.3 million, or 21.6%, from $246.6 million in fiscal 2007, due in large part to deterioration in the global economy, as well as the continuing decline in our traditional lines of business. Specifically, sales of Presstek's "growth" portfolio of products, defined as 34DI® and 52DI® digital offset solutions and the Presstek family of chemistry free CTP solutions, decreased $24.3 million, or 20.3%, from $119.8 million in fiscal 2007 to $95.5 million in fiscal 2008. The global economic issues have heavily impacted the sale of capital equipment, particularly the smaller size printers. It has also resulted in lower volumes of printed materials, and thus impacted consumable and service revenues. Sales of Presstek branded DI® plates increased by $0.9 million, or 5%, during 2008, as the number of DI® installations continues to grow.

Equipment revenues were $52.7 million in fiscal 2008 compared to $87.7 million in fiscal 2007, a decrease of $35.0 million, or 39.9%, resulting primarily from the impact of the global economic downturn. In addition, European sales were negatively impacted in the first quarter of fiscal 2008 due to a disruption in operations related to the company's business reviews conducted in the fourth quarter of fiscal 2007. Revenues from the sale of DI® equipment in fiscal 2008 of $42.0 million reflect a decrease of $22.0 million, or 34.4%, compared to 2007. Unit sales of DI® presses declined from 177 in fiscal 2007 to 126 in fiscal 2008. Sales of our remaining growth portfolio of equipment, Presstek's CTP platesetters and Vector TX52 machines, declined from $13.1 million in fiscal 2007 to $9.2 million in fiscal 2008. Equipment sales of our "traditional" line of products, defined as QMDI® presses, polyester CTP platesetters, and conventional equipment, were all lower in fiscal 2008 compared to 2007 due primarily to the ongoing transition of our customer base to more modern digital technologies. As a percentage of total equipment revenue, net sales of growth portfolio products increased from 82.5% of revenue in fiscal 2007 to 88.9% of revenue in fiscal 2008.

Consumable product revenues decreased from $119.9 million in fiscal 2007 to $106.0 million in fiscal 2008, a reduction of $13.9 million, or 11.6%. The decrease in revenues resulted primarily from the anticipated decline in Presstek's "traditional portfolio" of product, defined as QMDI® plates, other DI® plates, polyester plates, and conventional consumables, and was consistent with industry trends. Sales of traditional plates declined from $47.2 million in fiscal 2007 to $38.9 million in fiscal 2008, a decrease of 17.6%. Sales of conventional consumables declined from $35.2 million in fiscal 2007 to $30.2 million in fiscal 2008. Presstek's "growth portfolio" of consumables, defined as 52DI, 34DI, and chemistry-free CTP plates, declined slightly (from $37.5 million in fiscal 2007 to $37.0 million in fiscal 2008) due to lower print volumes related to the economic slowdown. Sales of 52DI® plates, however, increased 84% from $1.6 million in fiscal 2007 to $2.9 million in fiscal 2008.

Service and parts revenues declined from $39.0 million in fiscal 2007 to $34.5 million in fiscal 2008, a decrease of 11.4%. Lower revenues resulted primarily from the anticipated shift away from our less profitable legacy service base which, in the short term, is declining faster than our digital service business is accelerating. In addition, lower print volume, as mentioned above, also had a negative impact on service revenue.

Cost of Revenue

Consolidated cost of revenue was $124.6 million in fiscal 2008, a decrease of $52.7 million, or 29.7%, compared to fiscal 2007.

Cost of product, consisting of costs of material, labor and overhead, shipping and handling costs and warranty expenses, was $99.2 million in fiscal 2008 compared to $145.7 million in fiscal 2007. In fiscal 2007, the Company recorded $6.0 million of charges consisting primarily of $2.3 million for the write-off of excess and obsolete

inventory, $2.5 million of inventory write-downs related to the Vector TX52, $0.6 million of warranty-related expenses, and $0.6 million of other adjustments. Lower cost of sales was primarily due to reduced sales volume, benefits resulting from our BIP including manufacturing productivity improvements, procurement savings, and rationalization of our service business, the impact of favorable product mix and lower freight costs.

Cost of service in fiscal 2007, was $31.6 million, including a $1.1 million write down of field service parts inventory, compared to $25.4 million in fiscal 2008. These amounts represent the costs of spare parts, labor and overhead associated with the ongoing service of products. Service costs in fiscal 2008 were favorably impacted by the improved utilization of the field service organization in North America, as well as improved controls over the field service parts inventory. These actions were the result of our BIP which included a realignment of our service organization with a declining analog revenue base.

Gross Profit

Consolidated gross profit as a percentage of total revenue was 35.5% in fiscal 2008 compared to 28.1% in fiscal 2007. The year over year improvement is driven by several factors, including favorable product mix, benefits from the BIP, the improvement of numerous operating disciplines which negatively impacted our 2007 results (ex. excess and obsolete inventory, field service parts inventory charges) and the absence in fiscal 2008 of significant warranty charges recorded during 2007 related to product portfolio changes.

Gross profit as a percentage of product revenue was 37.5% in fiscal 2008 compared to 29.8% in fiscal 2007. This improvement reflects the benefits described in the previous paragraph. 2008 margins were also favorably impacted by a higher mix of DI® revenues, which are predominately higher margin products than our CTP and traditional lines of business, as well as improved production efficiencies in our plate manufacturing.

Gross profit as a percentage of service revenue was 26.3% in fiscal 2008 compared to 18.9% in fiscal 2007. Service margins in 2007 were negatively impacted by charges for losses on field service parts inventory of $1.1 million. Higher service margins in fiscal 2008 also reflect the impact of cost savings resulting from our BIP.

Research and Development

Research and development expenses consist primarily of payroll and related expenses for personnel, parts and supplies, and contracted services required to conduct our equipment, consumables and laser diode development efforts.

Research and development expenses of $5.1 million in fiscal 2008 were essentially unchanged from $5.0 million in the prior year period.

Sales, Marketing and Customer Support

Sales, marketing and customer support expenses consist primarily of payroll and related expenses for personnel, advertising, trade shows, promotional expenses, and travel costs associated with sales, marketing and customer support activities.

Consolidated sales, marketing and customer support expenses were $29.9 million in fiscal 2008 compared to $39.2 million in fiscal 2007, a decrease of $9.3 million, or 23.6%. Lower expenses in fiscal 2008 were due primarily to the favorable impact of our BIP, lower advertising costs, and lower commission expense resulting from lower sales volume.

General and Administrative

Consolidated general and administrative expenses consist primarily of payroll and related expenses for personnel and contracted professional services necessary to conduct our finance, information systems, legal, human resources and

administrative activities. General and Administrative costs also include stock based compensation expenses, as well as bad debt reserves.

General and administrative expenses were $25.4 million in fiscal 2008 compared to $33.2 million in the comparable prior year period, a decrease of $7.8 million, or 23.6%. The decrease resulted from lower litigation costs and legal fees of $2.8 million and $0.7 million of lower stock compensation related to stock option grants to officers, directors and employees. In addition, 2007 included a one-time $1.5 million restricted stock grant to our CEO and $2.1 million of audit and accounting costs related to an extensive worldwide review of inventory and receivables, as well as certain European business processes and revenue recognition practices. This was partially offset by additional bad debt expense incurred in fiscal 2008 resulting from the impact of worsening global economic conditions.

Amortization of Intangible Assets

Amortization expense of $1.1 million in fiscal 2008 declined from $2.2 million in the comparable prior year period. These expenses relate to intangible assets recorded in connection with the Company's 2004 acquisition of assets of the A.B. Dick Company, patents and other purchased intangible assets. The year over year decline in amortization resulted primarily from the A.B. Dick name and A.B. Dick patents, which became fully amortized during the third quarter of fiscal 2007.

Restructuring and Other Charges

Consolidated restructuring and other charges of $2.1 million in fiscal 2008 decreased from $2.7 million in fiscal 2007. Expenses incurred in fiscal 2008 include restructuring costs related to the implementation of our BIP, severance and separation expenses of employment contracts of former executives and other employees, and costs related to the transfer of certain corporate functions from the Hudson, NH facility to the Greenwich, CT facility. Expenses incurred in fiscal 2007 include restructuring costs related to the implementation of our BIP, and cost of severance and separation expenses for employment contracts of former executives.

Interest and Other Income (Expense), Net

Consolidated net interest and other income in fiscal 2008 was $0.9 million compared to expense of $1.3 million in the comparable prior year period. The year over year improvement was due primarily to a $1.2 million reduction in interest expense resulting from lower debt levels, and increased foreign currency transaction gains of $0.9 million.

Provision (Benefit) for Income Taxes

Our effective tax rate was 47.0% in fiscal 2008 and 27.3% in fiscal 2007. The variance from the federal statutory rate for fiscal 2008 was primarily due to an increase in the valuation allowance provided against our net deferred tax assets in the United States.

Fiscal 2007 Compared to Fiscal 2006

Revenue

Consolidated revenues were $246.6 million in fiscal 2007, a decrease of $12.4 million, or 4.8%, from $258.9 million in 2006. Equipment revenues reflected a decrease of $3.1 million, or 3.5%, compared to 2006, as strong sales of 52DI® presses were not enough to offset significant declines in our analog and CTP product lines, particularly lower sales of DPM machines. Consumables revenues declined by $3.2 million, or 2.6%, due primarily to lower sales of QMDI® plates. Revenues in our service business were lower by $6.0 million, or 13.3%, in fiscal 2007 due to lower contract service revenues resulting from the transition of our customer base from analog to digital solutions. Overall, sales of Presstek's "growth" portfolio of products, defined as 34DI® and 52DI® digital offset solutions, and the Presstek family of chemistry free CTP solutions, increased $16.7 million, or 16.2%, from $103.1 million in 2006 to $119.8

million in fiscal 2007.

Equipment revenues were $87.7 million in fiscal 2007 compared to $90.8 million in 2006, a decrease of $3.1 million, or 3.5%. Gross sales of Presstek's growth portfolio of equipment increased to $77.1 million in fiscal 2007 from $69.3 million in 2006. Revenues from the sale of DI® equipment in fiscal 2007 of $64.0 million reflects an increase of $10.0 million, or 18.4%, compared to 2006 due to strong marketplace demand for the 52DI® press, which was first introduced in the third quarter of fiscal 2006. Total unit sales of the 52DI® press reached 59 in fiscal 2007, and 52DI® revenues as a percentage of total DI® press revenue increased from 10.0% in fiscal 2006 to 44.1% in fiscal 2007. Sales of our remaining growth portfolio of equipment, Presstek's CTP platesetters and Vector TX52 machines, declined from $15.3 million in fiscal 2006 to $13.1 million in fiscal 2007, a decrease of 14.2%, due in part to the company's continued emphasis on marketing higher margin DI® presses, as well as a large decline in the sale of DPM machines consistent with industry trends. In addition, unit sales of the Vector TX52 were negatively impacted early in fiscal 2007 from the carry-over impact of quality issues experienced during the second half of fiscal 2006. These issues have since been successfully resolved. Equipment sales of our "traditional" line of products, defined as QMDI® presses, polyester CTP platesetters, and conventional equipment, were all lower in fiscal 2007 compared to 2006 due to the ongoing transition of our customer base from analog to digital technologies. Gross revenues from our traditional equipment products decreased from $25.8 million in 2006 to $16.2 million in fiscal 2007, a decline of 37.2%. As a percentage of total equipment revenue within the Presstek segment, net sales of growth portfolio products increased from 73.0% of revenue in 2006 to 82.6% of revenue in fiscal 2007.

Consumables product revenues decreased from $123.1 million in 2006 to $119.9 million in fiscal 2007, a reduction of $3.2 million, or 2.6%. The decline in revenues resulted from the anticipated slowdown of certain products in Presstek's traditional line, including QMDI® plates and conventional consumables, and was consistent with industry trends. QMDI® plates declined from $24.6 million in 2006 to $19.5 million in fiscal 2007, a decrease of 20.5%. Sales of conventional consumables declined from $40.6 million in fiscal 2006 to $35.1 million in the comparable 2007 period. Partially offsetting this decline were sales of Presstek's "growth portfolio" of consumables, defined as 52DI, 34DI, and chemistry-free CTP plates, which grew from $30.4 million in 2006 to $37.5 million in fiscal 2007, an increase of $7.1 million, or 23.5%.

Service and parts revenues declined from $45.0 million in 2006 to $39.0 million in fiscal 2007, a decrease of 13.3%. Lower revenues resulted primarily from the anticipated shift away from our less profitable legacy service contract base which, in the short term, is declining faster than our digital service business is accelerating.

Cost of Revenue

Consolidated cost of revenue was $177.3 million in fiscal 2007, a decrease of $4.5 million, or 2.5%, compared to fiscal 2006. Product cost of revenue in fiscal 2007 includes $5.4 million of charges related to excess and obsolete inventory, warranty, and accrued purchase commitments related to product portfolio changes, planned changes for the Vector TX52 product line, physical inventory results, and other adjustments. Service and parts cost of revenue in fiscal 2007 includes a charge of $1.1 million related to write-downs of field service parts inventory.

Cost of product was $145.7 million in fiscal 2007 compared to $149.3 million in the same prior year period. In fiscal 2007, the Company recorded inventory-related charges of $4.9 million, consisting of $2.3 million for the write-off of excess and obsolete inventory, $2.5 million of inventory write-downs related to the Vector TX52, $0.6 million of warranty-related expenses, and other adjustments. Offsetting these costs were lower costs related to favorable equipment product mix, production efficiencies in our plate manufacturing processes, and lower freight costs.

Cost of service in fiscal 2007, including the previously discussed $1.1 million write down of field service parts inventory, was $31.6 million compared to $32.5 million same prior year period. These amounts represent the costs of spare parts, labor and overhead associated with the ongoing service of products. Service costs were favorably impacted by the improved utilization of the field service organization in North America, the result of a restructuring

plan intended to realign our service organization with a declining analog revenue base.

Gross Profit

Consolidated gross profit as a percentage of total revenue was 28.1% in fiscal 2007 compared to 29.8% in 2006. Gross margins were negatively impacted in fiscal 2007 by excess and obsolete inventory and warranty charges related to product portfolio changes and field service parts inventory changes.

Gross profit as a percentage of product revenue was 29.8% in fiscal 2007 compared to 30.2% in fiscal 2006. Gross margins were negatively impacted in fiscal 2007 by excess and obsolete inventory and warranty charges related principally to product portfolio changes and field service parts inventory changes. Offsetting this somewhat was the favorable impact of a higher mix of DI® revenues, which are predominately higher margin products than our CTP and traditional lines of business, as well as improved production efficiencies in our plate manufacturing.

Gross profit as a percentage of service revenue was 18.9% in fiscal 2007 compared to 27.8% in 2006. Service margins in fiscal 2007 were negatively impacted by charges for losses on field service parts inventory of $1.1 million. Lower service margins also reflect the declining analog contract revenue base, which more than offset cost savings resulting from reductions in field service personnel.

Research and Development

Research and development expenses consist primarily of payroll and related expenses for personnel, parts and supplies, and contracted services required to conduct our equipment and consumables development efforts.

Research and development expenses were $5.0 million in fiscal 2007 compared to $5.3 million in 2006. The decrease was due to lower payroll related expenses resulting from turnover of personnel.

Sales, Marketing and Customer Support

Sales, marketing and customer support expenses consist primarily of payroll and related expenses for personnel, advertising, trade shows, promotional expenses, and travel costs associated with sales, marketing and customer support activities.

Sales, marketing and customer support expenses of $39.2 million in fiscal 2007 decreased $0.3 million from the comparable prior year period due primarily to lower payroll, commission, and travel and entertainment expenses, offset somewhat by increased marketing costs in Europe necessary to support planned growth.

General and Administrative

General and administrative expenses consist primarily of payroll and related expenses for personnel and contracted professional services necessary to conduct our finance, information systems, legal, human resources and administrative activities. General and Administrative costs also include stock based compensation expenses, as well as bad debt reserves.

General and administrative expenses were $33.2 million in fiscal 2007 compared to $18.9 million in 2006. General and administrative expense increases were primarily the result of higher patent defense and litigation activities of $4.6 million; increased bad debt expense of $2.0 million and increased professional fees of $3.4 million related primarily to various detailed financial reviews conducted during the year. General and administrative expenses in fiscal 2007 also include an increase of $2.1 million in stock compensation related to stock option grants to officers, directors and employees compared to the same period in fiscal 2006, as well as a $1.5 million increase in expense related to restricted stock compensation granted to our CEO.

Amortization of Intangible Assets

Amortization expense of $2.2 million in fiscal 2007 declined from $2.7 million in the comparable prior year period. These expenses relate to intangible assets recorded in connection with the Company's 2004 acquisition of the business of the A.B. Dick Company, patents and other purchased intangible assets.

Restructuring and Other Charges

Consolidated restructuring and other charges of $2.7 million in fiscal 2007 decreased from $5.5 million in 2006. 2007 restructuring expenses represent the cost of severance and separation expenses for employment contracts of former executives, as well as costs related to implementation of the BIP. The BIP costs include the consolidation of the Canadian back-office operations and certain Des Plaines, IL activities into the Hudson, NH operations, and include restructuring costs relating to severance, operating lease run-out and inventory consolidation.

In fiscal 2006, the Company recognized restructuring and other charges of $5.5 million. These charges included $2.3 million related to impairment of intangible assets associated with patent defense costs on the Creo/Kodak litigation matter, $2.8 million related to impairment of goodwill resulting from SFAS No. 144, Accounting for Impairment or Disposal of Long-Lived Assets ("SFAS 144") valuation adjustments of long lived assets at Precision as a result of the decision to discontinue its newspaper analog business, $0.5 million for merger-related costs primarily related to additional professional fees, and $0.3 million related to the impairment of other assets. In addition, approximately $0.4 million of previously established accruals at the Presstek segment were recognized in income in fiscal 2006 due principally to changes in the scope of previously announced severance programs.

Interest and Other Income (Expense), Net

Consolidated net interest and other expense in fiscal 2007 was ($1.3) million compared to ($1.0) million in the comparable prior year period. Increased expense in fiscal 2007 was due primarily to higher interest expense resulting from higher balances on our revolving credit facility, as well as higher interest rates. Offsetting this somewhat were gains on foreign currency translation.

Provision (Benefit) for Income Taxes

Our effective tax rate was 27.3% in fiscal 2007 and (228.6%) in fiscal 2006. The variance from the federal statutory rate for fiscal 2006 was primarily due to the reversal of valuation allowance provided against our net deferred tax assets in the U.S.

In fiscal 2006, in accordance with SFAS No. 109, "Accounting for Income Taxes", ("FAS 109"), the Company recognized through its tax provision a $11.2 million deferred tax benefit from the reversal of the previously recorded valuation allowance established on its U.S. federal, state and local deferred tax assets, except for that portion where the evidence does not yet support a reversal. To support the determination that is more likely than not that the Company's deferred tax assets will be realized in the future, FAS 109 requires that the Company consider all available positive and negative evidence. Based on a detailed analysis, the Company concluded that evidence exists to support the U.S. valuation allowance reversal as of December 30, 2006.

Discontinued Operations

The Company accounts for its discontinued operations under the provisions of SFAS 144. Accordingly, results of operations and the related charges for discontinued operations have been classified as "Loss from discontinued operations, net of income taxes" in the accompanying Consolidated Statements of Operations. Assets and liabilities of discontinued operations have been reclassified and reflected on the accompanying Consolidated Balance Sheets as "Assets of discontinued operations" and "Liabilities of discontinued operations". For comparative purposes, all prior periods presented have been reclassified on a consistent basis.

Precision

During December 2006, the Company terminated production in South Hadley, MA of Precision-branded analog plates used in newspaper applications.

Results of operations of the discontinued analog newspaper business of Precision consist of the following (in thousands, except per-share data):

	January 3, 2009	December 29, 2007	December 30, 2006
Revenue	$ --	$ 196	$ 10,816
Income (Loss) before income taxes	93	(108)	(2,267)
Provision (benefit) for income taxes	--	(54)	(771)
Income (Loss) from discontinued operations	93	(54)	(1,496)
Loss from disposal of discontinued operations, net of tax benefit of $915 for the year ended December 30, 2006	--	--	(1,777)
Net Income (Loss) from discontinued operations	$ 93	$ (54)	$ (3,273)
Loss per diluted share	$ (0.00)	$ (0.00)	$ (0.09)

As of December 30, 2006, and in accordance with SFAS 144 and SFAS 142, the Company reviewed the potential impairment of long-lived assets associated with the analog newspaper business and goodwill of the Precision reporting unit and determined that impairment charges aggregating $4.0 million were required. Of this amount $2.8 million relates to the impairment of goodwill, $0.3 million relates to the acceleration of depreciation on fixed assets abandoned, $0.6 million relates to the acceleration of amortization on certain intangible assets and $0.3 million relates to the adjustment of inventory on hand to the lower of cost or market. Impairment charges of the reporting unit goodwill resulting from the abandonment of the analog newspaper business are reflected within restructuring and other charges of continuing operations, and the remaining charges included in the loss from discontinued operations for fiscal 2006. There have been no further impairment charges incurred during fiscal years 2008 and 2007 relating to this matter.

Lasertel

On September 24, 2008, the Board of Directors approved a plan to market the Lasertel subsidiary for sale as the Lasertel business is not a core focus for the Presstek graphics business. Although Lasertel is a supplier of diodes for the Company, it has grown its presence in the external market, and management believes that Lasertel would be in a better position to realize its full potential in conjunction with other companies or investors who can focus resources on the external market. The process of identifying and working with interested potential buyers of Lasertel is well underway. The disposal of this asset group is currently anticipated to be a stock sale with a Section 338 election and to occur within a one year period. As such, the Company has presented the results of operations of this subsidiary within discontinued operations, and classified the assets as “Assets of discontinued operations” and liabilities as “Liabilities of discontinued operations”. The Lasertel business will continue to operate as it previously operated, including its marketing and new business/product development activities. Presstek has no intentions to shut down the business.

Results of operations of the discontinued business of Lasertel consist of the following (in thousands, except per-share data):

	January 3, 2009	December 29, 2007	December 30, 2006
Revenue	$ 8,686	$ 8,270	$ 6,758
Loss before income taxes	(4,336)	(2,924)	(1,951)
Provision (benefit) for income taxes	(1,637)	(1,129)	(752)
Net loss from discontinued operations	$ (2,699)	$ (1,795)	$ (1,199)
Loss per diluted share	$ (0.08)	$ (0.05)	$ (0.03)

Liquidity and Capital Resources

We finance our operating and capital investment requirements primarily through cash flows from operations and borrowings. At January 3, 2009, we had $4.7 million of cash and cash equivalents and $35.2 million of working capital, compared to $12.6 million of cash and cash equivalents and $35.3 million of working capital at December 29, 2007.

Continuing Operations

Our operating activities provided $15.2 million of cash in fiscal 2008. Cash provided by operating activities came from net income from continuing operations of $3.1 million; $12.7 million of adjustments to net income from continuing operations including non-cash depreciation, amortization, restructuring, provisions for warranty costs and accounts receivable allowances, stock compensation expense, deferred income taxes, and losses on the disposal of assets; and $0.5 million of other movements. Although a decrease in accounts receivable of $8.6 million plus a decrease in inventories of $7.0 million provided $15.6 million benefit to cash flow, this was more than offset by a decrease of $11.5 million in accrued expenses and a decrease of $5.3 million in accounts payable. The decrease in accounts receivable and inventory reflects the lower revenue in fiscal 2008 compared to 2007 as well as our continued focus on cash management. Accrued expenses decreased primarily due to a reduction in accounting fees and settlement of legal claims.

We used $1.9 million of net cash for investing activities during 2008, comprised of $1.8 million of additions to property, plant and equipment and $0.1 million of investments in patents and other intangible assets. Our additions to property, plant and equipment primarily relate to production equipment and investments in our infrastructure.

We used $18.7 million in our financing activities, comprised of $7.6 million related to payments made under our current line of credit and $11.4 million related to payments on our current Term Loan and capital lease. These amounts were offset by cash received from the exercise of stock options and purchase of common stock under our employee stock purchase program aggregating $0.3 million.

Discontinued Operations

Operating activities of discontinued operations used $3.5 million in cash in fiscal 2008. Cash provided by operating activities came from net income, after adjustments for non-cash depreciation, amortization, provisions for warranty, costs and accounts receivable allowances. In addition, cash used in operating activities consisted of $0.1 million relating to the increase in accounts receivable, $0.4 million relating to the increase in inventory, $0.1 million decrease in other current assets, $0.4 million decrease in accounts payable and a $0.1 million decrease in deferred revenue and $0.2 million decrease in accrued expenses.

Investing activities of discontinued operations provided $7.2 million made up of $7.9 million of net cash proceeds provided through the sale of property and $0.7 of cash used for additions of fixed assets.

Sale-Leaseback

On July 14, 2008, the Company completed a sale-leaseback transaction of its property located in Tucson, AZ (the "Property"). The Company sold the Property to an independent third party for approximately $8.75 million, or $8.4 million net of expenses incurred in connection with the sale, resulting in a gain of approximately $4.6 million. Concurrent with the sale, the Company entered in to an agreement to lease a portion of the property back from the purchaser for a term of 10 years. The lease, which management deemed to be an operating lease, has approximately $5.8 million in future minimum lease payments. The gain associated with the transaction was deferred at the inception of the arrangement and is expected to be amortized ratably over the lease term.

Liquidity

Our current senior secured credit facilities (the "Facilities"), include a $35.0 million five year secured term loan (the "Term Loan"), and a $45.0 million five year secured revolving line of credit (the "Revolver"). At January 3, 2009, the outstanding balance on the revolver was $12.4 million and we had $1.3 million outstanding under letters of credit, thereby reducing the amount available under the Revolver to $31.3 million. At January 3, 2009 and December 29, 2007, the interest rates on the outstanding balance of the Revolver were 2.69% and 7.5%, respectively. Prior to an amendment to the Facilities in the third quarter of fiscal 2008, principal payments on the Term Loan were payable in consecutive quarterly installments of $1.75 million, with a final settlement of all remaining principal and unpaid interest on November 4, 2009. In the third quarter of fiscal 2008, the Company used the net proceeds of the sale of its Arizona property to pay down the principal balance of the Term Loan and entered into an amendment to the Facilities dated July 29, 2008 which amended the payment schedule of the Term Loan to reduce the required quarterly installments of principal to $810,000, payable in January, March, June, and September of 2009, with no installment due in September of 2008 and a final installment of all remaining principal (approximately $834,000) due on November 4, 2009.

The Facilities were used to partially finance the A.B. Dick Acquisition, and are available for working capital requirements, capital expenditures, acquisitions, and general corporate purposes. Borrowings under the Facilities bear interest at either (i) the London InterBank Offered Rate, or LIBOR, plus applicable margins or (ii) the Prime Rate, as defined in the agreement, plus applicable margins. The applicable margins range from 1.25% to 4.0% for LIBOR, or up to 1.75% for the Prime Rate, based on certain financial performance. At January 3, 2009 and December 29, 2007, the effective interest rates on the Term Loan were 1.30% and 7.5%, respectively.

Under the terms of the Revolver and Term Loan, we are required to meet various financial covenants on a quarterly and annual basis, including maximum funded debt to EBITDA, a non-generally accepted accounting principles in the United States measurement that is defined in the Facilities as earnings before interest, taxes, depreciation, amortization and restructuring and other charges (credits), and minimum fixed charge coverage covenants. At January 3, 2009, we were in compliance with all financial covenants.

The Company entered into interest rate swap agreements with its lenders in October 2003, which were intended to protect the Company's long-term debt against fluctuations in LIBOR rates. Under the interest rate swaps LIBOR was set at a minimum of 1.15% and a maximum of 4.25%. Because the interest rate swap agreement did not qualify as a hedge for accounting purposes under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities ("SFAS 133"), and related amendments, including SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities, the Company recorded an increase to the expense of $7,550, in fiscal 2008 and a reduction to expense of $22,500 and $40,000 in fiscal 2007 and fiscal 2006, respectively, to mark these interest rate swap agreements to market. The swap agreements expired in October 2008.

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As of January 3, 2009, our Revolver and the Term Loan had outstanding balances of $12.4M and $4.1 M, respectively. These credit facilities will expire in November 2009. The Company is currently evaluating its financing options, and fully intends to have a new revolving line of credit in place by November 2009 to be used for working capital and other operating purposes. In the event that we are unable to have a new revolving line of credit in place by November 2009, we expect to be able to pay off our existing Revolver and Term Loan through a combination of the $4.7 million in cash at January 3, 2009, $1.2 million in cash received in January from our settlement with Continental Casualty Company, net cash generated from operations, and if needed, cash received from other sources. Other sources could include cash received from the sale of our Lasertel business, financing from new asset based lending agreements, and the sale-leaseback of currently owned property.

We believe that existing funds, cash flows from operations, and cash available from other sources as discussed above will be sufficient to satisfy cash requirements through at least the next 12 months. However, any inability to obtain adequate financing from debt and equity sources could force us to self-fund capital expenditures and strategic initiatives, forgo certain opportunities, or possibly discontinue certain of our operations. Similarly, we cannot be assured that such financing, as needed, would be available on acceptable terms.

Contractual Obligations

Our contractual obligations at January 3, 2009 consist of the following (in thousands):

		Payments due by period			
	Total	Less than one year	One to three years	Three to five years	Five or more years
Senior Secured Credit Facilities	$ 16,489	$ 16,489	$ --	$ --	$ --
Purchase Commitments	6,228	4,137	2,091	--	--
Royalty obligation	5,104	766	1,488	1,161	1,689
Operating leases	12,307	2,684	3,982	2,780	2,861
Total contractual obligations	$ 40,128	$ 24,076	$ 7,561	$ 3,941	$ 4,550

In fiscal 2000, we entered into an agreement with Fuji, whereby minimum royalty payments to Fuji are required based on specified sales volumes of our A3 format size four-color sheet-fed press. The agreement provides for total royalty payments to be no less than $6 million and not greater than $14 million over the life of the agreement. As of January 3, 2009, the Company had paid Fuji $8.9 million related to this agreement.

From time to time we have engaged in sales of equipment that is leased by or intended to be leased by a third party purchaser to another party. In certain situations, we may retain recourse obligations to a financing institution involved in providing financing to the ultimate lessee in the event the lessee of the equipment defaults on its lease obligations. In certain such instances, we may refurbish and remarket the equipment on behalf of the financing company, should the ultimate lessee default on payment of the lease. In certain circumstances, should the resale price of such equipment fall below certain predetermined levels, we would, under these arrangements, reimburse the financing company for any such shortfall in sale price (a “shortfall payment”). The maximum contingent obligation under these shortfall payment arrangements is estimated to be $1.9 million at January 3, 2009.

Effect of Inflation

Inflation has not had a material impact on our financial conditions or results of operations, although this risk is discussed under Item 1 of this Form 10-K.

Net Operating Loss Carryforwards

At January 3, 2009, we had net operating loss carryforwards for tax purposes totaling $77.5 million, of which $61.5 million resulted from stock option compensation deductions for U.S. federal tax purposes and $16.0 million resulted from operating losses. To the extent that net operating losses resulting from stock option compensation deductions result in reduction of current taxes payable, the benefit will be credited directly to additional paid-in capital. The Company's ability to utilize its net operating loss and credit carryforwards may be limited in the future if the Company experiences an ownership change, as defined by the Internal Revenue Code. An ownership change occurs when the ownership percentage of 5% or greater of stockholders changes by more than 50% over a three year period.

Critical Accounting Policies and Estimates

General

Our Management's Discussion and Analysis of Financial Condition and Results of Operations is based upon our consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles as adopted in the United States. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities and related disclosure of contingent assets and liabilities at the date of the financial statements. Estimates and assumptions also affect the amount of reported revenue and expenses during the period. Management believes the most judgmental estimates include those related to product returns; warranty obligations; allowances for doubtful accounts; slow-moving and obsolete inventories; income taxes; the valuation of goodwill, intangible assets, long-lived assets and deferred tax assets; stock-based compensation and litigation. We base our estimates and assumptions on historical experience and various other appropriate factors, the results of which form the basis for making judgments about the carrying values of assets and liabilities and the amounts of revenue and expenses that are not readily apparent from other sources. Actual results could differ from those estimates.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements. For a complete discussion of our accounting policies, see Note 2 to our consolidated financial statements appearing elsewhere herein.

Revenue Recognition

The Company recognizes revenue principally from the sale of products (equipment, consumables, laser diodes) and services (equipment maintenance contracts, installation, training, support, and spare parts). Revenue is recognized when persuasive evidence of a sales arrangement exists, delivery has occurred or services have been rendered, the price to the customer is fixed or determinable and collection is reasonably assured. In accordance with Staff Accounting Bulletin ("SAB") No. 104 Revenue Recognition ("SAB 104") and Emerging Issues Task Force ("EITF") Issue 00-21 Revenue Arrangements with Multiple Deliverables ("EITF 00-21"), when a sales arrangement contains multiple elements, such as equipment and services, revenue is allocated to each element using the residual method.

Product revenue

End-Users - Under the Company’s standard terms and conditions of sale of equipment, title and risk of loss are transferred to end-user customers upon completion of installation and revenue is recognized at that time, unless customer acceptance is uncertain or significant deliverables remain. Sales of other products, including printing plates, are generally recognized at the time of shipment.

OEMs - Product revenue and any related royalties for products sold to Original Equipment Manufacturers ("OEM") are recognized at the time of shipment as installation is not required and title and risk of loss generally pass at shipment. OEM contracts do not generally include price protection or product return rights; however, the Company may elect, in certain circumstances, to accept returns of product.

Distributors - Revenue for product sold to distributors, whereby the distributor is responsible for installation, is recognized at shipment, unless other revenue recognition criteria have not been met. Revenue for product sold to distributors under contracts which involve Company installation of equipment is recognized upon installation, unless end-user customer acceptance is uncertain, significant deliverables remain, or other revenue recognition criteria have not been met. Except in cases of contract termination (which may include limited product return rights), distributor contracts do not generally include price protection or product return rights; however, the Company may elect, in certain circumstances, to accept returns of product.

Service and parts revenue

Revenue for installation services, including time and material billings, are recognized as services are rendered. Revenue associated with maintenance or extended service agreements is recognized ratably over the contract period. Revenue associated with training and support services is recognized as services are rendered. Certain fees and other reimbursements are recognized as revenue when the related services have been performed or the revenue is otherwise earned.

Leases

The Company may offer customer financing to assist customers in the acquisition of Presstek products. At the time a financing transaction is consummated, which qualifies as a sales-type lease, the Company records equipment revenue equal to the net present value of future lease payments. Any remaining balance is recognized as finance income using the effective interest method over the term of the lease. Leases not qualifying as sales-type leases are accounted for as operating leases. The company recognizes revenue from operating leases on an accrual basis as the rental payments become due.

Multiple element arrangements

In accordance with SAB 104 and EITF 00-21, when a sales arrangement contains multiple elements, such as equipment, consumables or services, revenue is allocated to each element using the residual method.

Rights of return

A general right of return or cancellation does not exist once product is delivered to the customer; however, the Company may elect, in certain circumstances, to accept returns of product. Product revenues are recorded net of estimated returns, which are adjusted periodically, based upon historical rates of return.

Shipping and handling

The Company accounts for shipping and handling fees passed on to customers as revenue. Shipping and handling costs are reported as components of cost of revenue (product) and cost of revenue (service and parts).

Allowance for Doubtful Accounts

The Company’s accounts receivable are customer obligations due under normal trade terms, carried at face value less an allowance for doubtful accounts. The Company evaluates its allowance for doubtful accounts on an ongoing basis and adjusts for potential credit losses when it determines that receivables are at risk for collection based upon the length of time receivables are outstanding, past transaction history and various other criteria. Receivables are written off against reserves in the period they are determined to be uncollectible.

Inventory Valuation

Inventories are valued at the lower of cost or net realizable value, with cost determined using the first-in, first-out method. We assess the recoverability of inventory to determine whether adjustments for impairment are required. Inventory that is in excess of future requirements is written down to its estimated market value based upon forecasted demand for its products. If actual demand is less favorable than what has been forecasted by management, additional inventory write-downs may be required.

Goodwill and Intangible Assets

In accordance with the provisions of SFAS 142, goodwill is tested at least annually, on the first business day of the third quarter, for impairment, or more frequently, if indicators of potential impairment arise. The Company's impairment review is based on a fair value test. The Company uses its judgment in assessing whether assets may have become impaired between annual impairment tests. Indicators such as unexpected adverse business conditions, economic factors, unanticipated technological change or competitive activities, loss of key personnel and acts by governments and courts may signal that an asset has been impaired. Should the fair value of goodwill, as determined by the Company at any measurement date, fall below its carrying value, a charge for impairment of goodwill will be recorded in the period. The Company conducts ongoing assessments of the valuation of goodwill and determined no goodwill impairment existed during the year ended January 3, 2009. The Company will continue to assess the valuation of goodwill throughout 2009. Depending on market and economic conditions, goodwill impairment could be identified in 2009 which would result in a non-cash impairment charge.

Intangible assets with estimated lives and other long-lived assets are reviewed for impairment when events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets ("SFAS 144"). Recoverability of intangible assets with estimated lives and other long-lived assets is measured by comparison of the carrying amount of an asset or asset group to future net undiscounted pretax cash flows expected to be generated by the asset or asset group. If these comparisons indicate that an asset is not recoverable, the Company will recognize an impairment loss for the amount by which the carrying value of the asset or asset group exceeds the related estimated fair value. Estimated fair value is based on either discounted future pretax operating cash flows or appraised values, depending on the nature of the asset. The Company determines the discount rate for this analysis based on the expected internal rate of return of the related business and does not allocate interest charges to the asset or asset group being measured. Considerable judgment is required to estimate discounted future operating cash flows.

Patents represent the cost of preparing and filing applications to patent the Company's proprietary technologies, in addition to certain patent and license rights obtained in the Company's acquisitions or other related transactions. Such costs are amortized over a period ranging from five to seven years, beginning on the date the patents or rights are issued or acquired.

From time to time, the Company enters into agreements with third parties under which the party will design and prototype a product incorporating Presstek products and technology. The capitalized costs associated with rights or intellectual property under these agreements will be amortized over the estimated sales life-cycle and future cash flows of the product. The Company does not amortize capitalized costs related to either patents or purchased intellectual property until the respective asset has been placed into service.

The Company amortizes license agreements and loan origination fees over the term of the respective agreement. The amortizable lives of the Company's other intangible assets are as follows:

Trade names	2 – 3years

Customer relationships	2 – 10years
Software licenses	3 years
Non-compete covenants	5 years

Stock-Based Compensation

On January 1, 2006, we adopted SFAS No.123(R), Share-Based Payment ("SFAS 123R"), using the modified prospective transition method. We recognize the fair value of stock compensation in our consolidated financial statements over the requisite service period, generally on a straight-line basis for time-vested awards. Under the fair value recognition provisions of SFAS 123R, stock-based compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the service period. Further, we have elected under SFAS 123R to recognize the fair value of awards with pro-rata vesting on a straight-line basis. Previously, we had followed Accounting Principles Board ("APB") Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations, which resulted in the accounting for employee share options at their intrinsic value in the consolidated financial statements.

Under SFAS 123R, our stock-based compensation is affected by our stock price as well as valuation assumptions, including the volatility of our stock price, expected term of the option, risk-free interest rate and expected dividends. We utilize the Black-Scholes valuation model for estimating the fair value on the date of grant of employee stock options. We estimate volatility primarily using the historical volatility of Presstek common stock over the expected term. Any changes in these assumptions may materially affect the estimated fair value of the stock-based award.

Accounting for Income Taxes

The process of accounting for income taxes involves calculating our current tax obligation or refund and assessing the nature and measurements of temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences and our net operating loss ("NOL") and credit carryforwards, result in deferred tax assets and liabilities. In each period, we assess the likelihood that our deferred tax assets will be recovered from existing deferred tax liabilities or future taxable income in each jurisdiction. To the extent we believe that we would not meet the test that recovery is "more likely than not", we would establish a valuation allowance. To the extent that we establish a valuation allowance or change this allowance in a period, we would adjust our tax provision or tax benefit in the consolidated statement of operations. We use our judgment to determine our provision or benefit for income taxes, including estimates associated with uncertain tax positions and any valuation allowance recorded against our deferred tax assets based on the weight of all positive and negative factors, including cumulative trends in profitability.

We have accumulated U.S. federal and state income tax NOL carryforwards, research and experimentation tax credit carryforwards and alternative minimum tax credit carryforwards. In the fourth quarter of fiscal 2006, we reversed the valuation allowance on a deferred tax asset on our balance sheet primarily representing NOLs from our U.S. operations. Previously, we had recorded a valuation allowance against deferred tax assets on our balance sheet until it was "more likely than not" that the tax assets related to either our U.S. or international operations would be realized.

We assess our ability to utilize our NOL and tax credit carryforwards in future periods and record any resulting adjustments that may require deferred income tax expense. In addition, we reduce the deferred income tax asset for the benefits of NOL and tax credit carryforwards utilized currently. The future impact on net income may therefore be positive or negative, depending on the net result of such adjustments and charges.

Based upon a review of historical operating performance through 2008, and our expectation that we will generate profits in the U.S. and our international operations in the foreseeable future, we continue to believe it is more likely than not that the U.S. and international deferred tax assets, net of valuation allowance, will be fully realized.

Recently Issued Accounting Standards

In 2009, the Company will adopt the remaining provisions of Statement of Financial Accounting Standards No. 157, Fair Value Measurements, ("SFAS 157") for non-financial assets. The adoption of these provisions will not have an impact on the Company's statements of operations or statement of financial position.

In December 2007, the FASB issued SFAS No. 141 (R), Business Combinations. This statement replaces SFAS 141, Business Combinations, but retains the fundamental requirements of the statement that the acquisition method of accounting be used for all business combinations and for an acquirer to be identified for each business combination. The statement seeks to improve financial reporting by establishing principles and requirements for how the acquirer: a) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree; b) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase option and c) determines what information to disclose. This statement is effective prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company will apply the provisions of SFAS 141(R) to any acquisition after January 3, 2009.

In December 2007, the FASB issued SFAS 160, Noncontrolling Interests in Consolidated Financial Statements – an Amendment of ARB 51. This statement amends Accounting Research Bulletin (ARB) 51, Consolidated Financial Statements, to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. The statement clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. This statement is effective for fiscal years and interim periods within those fiscal years, beginning on or after December 15, 2008. The adoption of SFAS 160 will not impact the Company's consolidated financial position and results of operations because the Company does not have any noncontrolling interests.

In March 2008, the Financial Accounting Standards Boards ("FASB") issued Statement of Financial Accounting Standards No. 161, Disclosures about Derivative Instruments and Hedging Activities, ("SFAS 161"), which requires enhanced disclosures related to derivative instruments and hedging activities. This Statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, and the disclosure requirements will be applicable for the Company's 2009 consolidated financial statements.

Off-Balance Sheet Arrangements

We do not participate in transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities ("SPEs"), which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purpose. As of January 3, 2009, we were not involved in any unconsolidated SPE transactions.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

We are exposed to a variety of market risks, including changes in interest rates primarily as a result of our borrowing activities, commodity price risk, and to a lesser extent, our investing activities and foreign currency fluctuations.

Our borrowings are in variable rate instruments, with interest rates tied to either the Prime Rate or the LIBOR. A 100 basis point change in these rates would have an impact of approximately $0.03 million on our annual interest expense, assuming consistent levels of floating rate debt with those held at the end of fiscal 2008.

Commodity price movements create a market risk by affecting the price we must pay for certain raw materials. The Company purchases aluminum for use in manufacturing consumables products and is embedded in certain components we purchase from major suppliers. From time to time, we enter into agreements with certain suppliers to manage price risks within a specified range of prices; however, our suppliers generally pass on significant commodity price changes to us in the form of revised prices on future purchases. The Company has not used commodity forward or option contracts to manage this market risk.

The Company operates foreign subsidiaries in Canada and Europe and is exposed to foreign currency exchange rate risk inherent in our sales commitments, anticipated sales, anticipated purchases and assets and liabilities denominated in currencies other than the U.S. dollar. Presstek routinely evaluates whether the foreign exchange risk associated with its foreign currency exposures acts as a natural foreign currency hedge for other offsetting amounts denominated in the same currency. The Company has not hedged the net assets or net income of its foreign subsidiaries. In addition, certain key customers and strategic partners are not located in the United States. As a result, these parties may be subject to fluctuations in foreign exchange rates. If their home country currency were to decrease in value relative to the U.S. dollar, their ability to purchase and market our products could be adversely affected and our products may become less competitive to them. This may have an adverse impact on our business. Likewise, certain major suppliers are not located in the United States and thus, such suppliers are subject to foreign exchange rate risks in transactions with us. Decreases in the value of their home country currency, versus that of the U.S. dollar, could cause fluctuations in supply pricing which could have an adverse effect on our business.

PART II

Item 8. Financial Statements and Supplementary Data.

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Presstek, Inc.:

We have audited the accompanying consolidated balance sheets as of January 3, 2009 and December 29, 2007 of Presstek, Inc. and subsidiaries (the Company) and the related consolidated statements of operations, changes in stockholders' equity and comprehensive income, and cash flows for each of the fiscal years in the three-year period ended January 3, 2009. In connection with our audits of the consolidated financial statements, we also have audited financial statement schedule II. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of January 3, 2009 and December 29, 2007, and the results of their operations and their cash flows for each of the fiscal years in the three-year period ended January 3, 2009, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related financial statement schedule II, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of January 3, 2009, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 24, 2009 expressed an adverse opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Boston, Massachusetts
March 24, 2009

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

PRESSTEK, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

	January 3, 2009	December 29, 2007
ASSETS		
Current assets		
Cash and cash equivalents	$ 4,738	$ 12,558
Accounts receivable, net	30,757	41,094
Inventories	37,607	45,010
Assets of discontinued operations	13,332	16,689
Deferred income taxes	7,066	6,740
Other current assets	4,095	4,594
Total current assets	97,595	126,685
Property, plant and equipment, net	25,530	29,049
Intangible assets, net	4,174	5,209
Goodwill	19,114	19,891
Deferred income taxes	10,494	11,124
Other noncurrent assets	606	869
Total assets	$ 157,513	$ 192,827
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Current portion of long-term debt and capital lease obligation	$ 4,074	$ 7,035
Line of credit	12,415	20,000
Accounts payable	12,031	17,312
Accrued expenses	13,244	23,212
Deferred revenue	7,300	7,100
Liabilities of discontinued operations	5,748	2,776
Total current liabilities	54,812	77,435
Long-term debt and capital lease obligation, less current portion	-	8,500
Other long-term liabilities	170	-
Total liabilities	54,982	85,935
Commitments and contingencies (See Note 19)		
Stockholders' equity		
Preferred stock, $0.01 par value, 1,000,000 shares authorized, no shares issued	-	-
Common stock, $0.01 par value, 75,000,000 shares authorized, 36,637,181 and 36,565,474 shares issued and outstanding at January 3, 2009 and		

December 29, 2007, respectively		366		366
Additional paid-in capital		117,985		115,884
Accumulated other comprehensive income (loss)		(5,954)		1,032
Accumulated deficit		(9,866)		(10,390)
Total stockholders' equity		102,531		106,892
Total liabilities and stockholders' equity	$	157,513	$	192,827

The accompanying notes are an integral part of these consolidated financial statements.

PRESSTEK, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per-share data)

	Fiscal year ended		
	January 3, 2009	December 29, 2007	December 30, 2006
Revenue			
Product	$ 158,743	$ 207,605	$ 213,966
Service and parts	34,509	38,968	44,970
Total revenue	193,252	246,573	258,936
Cost of revenue			
Product	99,088	145,724	149,333
Service and parts	25,423	31,622	32,466
Total cost of revenue	124,511	177,346	181,799
Gross profit	68,741	69,227	77,137
Operating expenses			
Research and development	5,144	4,969	5,320
Sales, marketing and customer support	29,937	39,194	39,451
General and administrative	25,496	33,172	18,879
Amortization of intangible assets	1,084	2,168	2,697
Restructuring and other charges	2,108	2,714	5,481
Total operating expenses	63,769	82,217	71,828
Operating income (loss)	4,972	(12,990)	5,309
Interest and other income (expense), net	938	(1,254)	(984)
Income (loss) from continuing operations before income taxes	5,910	(14,244)	4,325
Provision (benefit) for income taxes	2,780	(3,889)	(9,891)
Income (loss) from continuing operations	3,130	(10,355)	14,216
Loss from discontinued operations, net of income taxes	(2,606)	(1,849)	(4,472)
Net income (loss)	$ 524	$ (12,204)	$ 9,744
Earnings (loss) per common share - basic			
Income (loss) from continuing operations	$ 0.09	$ (0.29)	$ 0.40
Loss from discontinued operations	(0.08)	(0.05)	(0.13)
	$ 0.01	$ (0.34)	$ 0.27
Earnings (loss) per common share - diluted			
Income (loss) from continuing operations	$ 0.09	$ (0.29)	$ 0.40
Loss from discontinued operations	(0.08)	(0.05)	(0.13)

	$ 0.01	$ (0.34)	$ 0.27
Weighted average shares outstanding			
Weighted average shares outstanding - basic	36,596	36,199	35,565
Dilutive effect of stock options	9	-	291
Weighed average shares outstanding - diluted	36,605	36,199	35,856

The accompanying notes are an integral part of these consolidated financial statements.

PRESSTEK, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
AND COMPREHENSIVE INCOME
(in thousands)

	Common stock Shares	Common stock Par value	Additional paid-in capital	Accumulated other comprehensive income (loss)	Retained earnings (accumulated deficit)	Total
Balance at December 31, 2005	35,366	354	106,268	(59)	(7,930)	$ 98,633
Issuance of common stock	296	3	2,127	-	-	2,130
Foreign currency translation adjustments	-	-	-	356	-	356
Share based compensation under SFAS No. 123(R)	-	-	374	-	-	374
Net income (loss)	-	-	-	-	9,744	9,744
Balance at December 30, 2006	35,662	357	108,769	297	1,814	111,237
Issuance of common stock	903	9	3,126	-	-	3,135
Foreign currency translation adjustments	-	-	-	735	-	735
Share based compensation under SFAS No. 123(R)	-	-	3,989	-	-	3,989
Net income (loss)	-	-	-	-	(12,204)	(12,204)
Balance at December 29, 2007	36,565	366	115,884	1,032	(10,390)	106,892
Issuance of common stock	72	-	298	-	-	298
Foreign currency translation adjustments	-	-	-	(6,986)	-	(6,986)
Share based compensation under SFAS No. 123(R)	-	-	1,803	-	-	1,803
Net income (loss)	-	-	-	-	524	524
Balance at January 3, 2009	36,637	$ 366	$ 117,985	$ (5,954)	$ (9,866)	$ 102,531

Comprehensive income (loss) is calculated as follows:

	Fiscal year ended January 3, 2009	December 29, 2007	December 30, 2006
Net income (loss)	$ 524	$ (12,204)	$ 9,744

Adjustments to accumulated other comprehensive income	(6,986)	735	356
Comprehensive income (loss)	$ (6,462)	$ (11,469)	$ 10,100

PRESSTEK, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Fiscal year ended		
	January 3, 2009	December 29, 2007	December 30, 2006
Operating activities			
Net income (loss)	$ 524	$ (12,204)	$ 9,744
Add loss from discontinued operations	2,606	1,849	4,472
Income (loss) from continuing operations	3,130	(10,355)	14,216
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation	4,519	5,564	5,618
Amortization of intangible assets	1,084	2,168	2,670
Restructuring and other charges	1,686	2,714	5,481
Writedown of asset to net realizable value	422	-	-
Provision for warranty costs	40	3,517	3,400
Provision for accounts receivable allowances	1,915	1,671	188
Stock compensation expense	1,803	3,989	374
Deferred income taxes	1,081	(6,187)	(11,677)
Loss on disposal of assets	127	572	72
Changes in operating assets and liabilities, net of effects from business acquisitions and divestures:			
Accounts receivable	8,556	6,841	(8,864)
Inventories	7,049	(2,082)	3,155
Other current assets	546	(2,137)	(1,367)
Other noncurrent assets	(219)	98	39
Accounts payable	(5,336)	(8,736)	9,220
Accrued expenses	(11,460)	7,364	(6,076)
Deferred revenue	219	(816)	(694)
Net cash provided by operating activities	15,162	4,185	15,755
Investing activities			
Purchase of property, plant and equipment	(1,777)	(2,514)	(3,391)
Business acquisitions, net of cash acquired	-	(119)	(832)
Investment in patents and other intangible assets	(146)	(204)	(2,791)
Net cash used in investing activities	(1,923)	(2,837)	(7,014)
Financing activities			
Net proceeds from issuance of common stock	298	3,135	2,130
Repayments of term loan and capital lease	(11,461)	(7,037)	(7,035)
Net borrowings (repayments) under line of credit agreement	(7,585)	5,000	8,964
Net cash provided by (used in) financing activities	(18,748)	1,098	4,059
Cash provided by (used in) discontinued operations			
Operating activities	(3,514)	273	(7,282)
Investing activities	7,240	(532)	(1,038)
Financing activities	-	-	-

Net cash provided by (used in) discontinued operations	3,726	(259)	(8,320)
Effect of exchange rate changes on cash and cash equivalents	(6,037)	824	(427)
Net increase (decrease) in cash and cash equivalents	(7,820)	3,011	4,053
Cash and cash equivalents, beginning of year	12,558	9,547	5,494
Cash and cash equivalents, end of year	$ 4,738	$ 12,558	$ 9,547
Supplemental disclosure of cash flow information			
Cash paid for interest	$ 1,605	$ 3,106	$ 2,364
Cash paid for income taxes	$ 727	$ 236	$ 1,252

The accompanying notes are an integral part of these consolidated financial statements.

PRESSTEK, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF THE BUSINESS

Presstek, Inc. and its subsidiaries (collectively, the "Company") is a market-focused company primarily engaged in the design, manufacture, sales and service of high-technology digital imaging solutions to the graphic arts industry worldwide. The Company is helping to lead the industry's transformation from analog print production methods to digital imaging technology. The Company is a leader in the development of advanced printing systems using digital imaging equipment and consumables-based solutions that economically benefit the user through a streamlined workflow and chemistry free, environmentally responsible operation. The Company is also a leading sales and service channel in the small to mid-sized commercial, quick and in-plant printing markets.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation and Basis of Presentation

The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated.

The Company has made certain organizational realignments in order to more closely align its financial reporting with its current business structure. During December 2006, the Company terminated production in South Hadley, MA of Precision-branded analog plates used in newspaper applications (the "analog newspaper business"). Accordingly, the financial results of the analog newspaper business are reported as discontinued operations. The Lasertel segment has been presented as discontinued operations in the third quarter of fiscal 2008 as the operations are currently held for sale. The Lasertel business will continue to operate as normal, as will all of its marketing and new business/product development activities. Presstek has no intentions to shut down the business.

The Company's operations are currently organized into two business segments: Presstek and Lasertel. The Presstek segment is primarily engaged in the development, manufacture, sale and servicing of the Company's patented digital imaging systems and patented printing plate technologies as well as traditional, analog systems and related equipment and supplies for the graphic arts and printing industries, primarily serving the short-run, full-color market segment. The Lasertel segment manufactures and develops high-powered laser diodes and related laser products for the Presstek segment and for sale to external customers and as stated above is now presented as discontinued operations.

The Company operates and reports on a 52- or 53-week fiscal year ending on the Saturday closest to December 31. Accordingly, the financial statements presented herein include the financial results for the 53-week fiscal year ended January 3, 2009 ("fiscal 2008"), the 52-week fiscal year ended December 29, 2007 ("fiscal 2007") and the 52-week fiscal year ended December 30, 2006 ("fiscal 2006").

Use of Estimates

The Company prepares its financial statements in accordance with U.S. generally accepted accounting principles ("U.S. GAAP"). The preparation of these financial statements requires management to make estimates and assumptions that affect reported amounts and related disclosures. Management believes the most judgmental estimates include those related to product returns; warranty obligations; allowance for doubtful accounts; slow-moving and obsolete inventories; income taxes; the valuation of goodwill, intangible assets, long-lived assets and deferred tax assets; stock-based compensation; and litigation. The Company bases its estimates and judgments on historical experience and various other appropriate factors, the results of which form the basis for making judgments

about the carrying values of assets and liabilities and the amounts of revenues and expenses that are not readily apparent from other sources. Actual results could differ from those estimates.

Revenue Recognition

The Company recognizes revenue principally from the sale of products (equipment, consumables, laser diodes) and services (equipment maintenance contracts, installation, training, support, and spare parts). Revenue is recognized when persuasive evidence of a sales arrangement exists, delivery has occurred or services have been rendered, the price to the customer is fixed or determinable and collection is reasonably assured. In accordance with Staff Accounting Bulletin ("SAB") No. 104 Revenue Recognition ("SAB 104") and Emerging Issues Task Force ("EITF") Issue 00-21 Revenue Arrangements with Multiple Deliverables ("EITF 00-21"), when a sales arrangement contains multiple elements, such as equipment and services, revenue is allocated to each element using the residual method.

Product revenue

End-Users - Under the Company's standard terms and conditions of sale of equipment, title and risk of loss are transferred to end-user customers upon completion of installation and revenue is recognized at that time, unless customer acceptance is uncertain or significant deliverables remain. Sales of other products, including printing plates, are generally recognized at the time of shipment.

OEMs - Product revenue and any related royalties for products sold to Original Equipment Manufacturers ("OEM") are recognized at the time of shipment as installation is not required and title and risk of loss pass at shipment. OEM contracts do not generally include price protection or product return rights; however, the Company may elect, in certain circumstances, to accept returns of product.

Distributors - Revenue for product sold to distributors, whereby the distributor is responsible for installation, is recognized at shipment, unless other revenue recognition criteria have not been met. Revenue for product sold to distributors under contracts which involve Company installation of equipment is recognized upon installation, unless end-user customer acceptance is uncertain, significant deliverables remain, or other revenue recognition criteria have not been met. Except in cases of contract termination (which may include limited product return rights), distributor contracts do not generally include price protection or product return rights; however, the Company may elect, in certain circumstances, to accept returns of product.

Service and parts revenue

Revenue for installation services, including time and material billings, are recognized as services are rendered. Revenue associated with maintenance or extended service agreements is recognized ratably over the contract period. Revenue associated with training and support services is recognized as services are rendered.

Leases

The Company may offer customer financing to assist customers in the acquisition of Presstek products. At the time a financing transaction is consummated, which qualifies as a sales-type lease, the Company records equipment revenue equal to the net present value of future lease payments. Any remaining balance is recognized as finance income using the effective interest method over the term of the lease. Leases not qualifying as sales-type leases are accounted for as operating leases. The company recognizes revenue from operating leases on an accrual basis as the rental payments become due.

Multiple element arrangements

In accordance with SAB 104 and EITF 00-21, when a sales arrangement contains multiple elements, such as equipment, consumables or services, revenue is allocated to each element using the residual method.

Rights of return

A general right of return or cancellation does not exist once product is delivered to the customer; however, the Company may elect, in certain circumstances, to accept returns of product. Product revenues are recorded net of estimated returns, which are adjusted periodically, based upon historical rates of return.

Shipping and handling

The Company accounts for shipping and handling fees passed on to customers as revenue. Shipping and handling costs are reported as components of cost of revenue (product) and cost of revenue (service and parts).

Fair Value of Financial Instruments

The carrying values of cash equivalents, accounts receivable and accounts payable approximate fair value due to the short-term maturity of these instruments. The carrying amounts of the Company's bank borrowings under its credit agreement, approximate fair value because the interest rates are based on floating rates identified by reference to market rates. At both January 3, 2009 and December 29, 2007, the fair value of the Company's long-term debt approximated carrying value.

The Company adopted SFAS No. 157, Fair Value Measurements ("SFAS 157") for financial assets and financial liabilities in the first quarter of fiscal 2008, which did not have a material impact on the Company's consolidated financial statements. In accordance with Financial Accounting Standards Board ("FASB") Staff Position 157-2, Effective Date of FASB Statement No. 157 ("FASB 157-2"), the Company has deferred application of SFAS 157 until January 4, 2009, the beginning of the next fiscal year, in relation to nonrecurring nonfinancial assets and nonfinancial liabilities including goodwill impairment testing, asset retirement obligations, long-lived asset impairments and exit and disposal activities.

Cash and Cash Equivalents

Cash and cash equivalents include savings deposits, certificates of deposit and money market funds that have original maturities of three months or less and are classified as cash equivalents.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash equivalents and accounts receivable. The Company may invest in high-quality money market instruments, securities of the U.S. government, and high-quality corporate issues. Accounts receivable are generally unsecured and are derived from the Company's customers located around the world. The Company performs ongoing credit evaluations of its customers and maintains an allowance for doubtful accounts.

Accounts Receivable, Net of Allowances

The Company's accounts receivable are customer obligations due under normal trade terms, carried at face value less allowances for doubtful accounts and sales returns. The Company evaluates its allowances on an ongoing basis and adjusts for potential uncollectible amounts when it determines that receivables are at risk for collection based upon the length of time receivables are outstanding, past transaction history and various other criteria. Receivables are written off against the allowance in the period they are determined to be uncollectible.

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Inventories

Inventories include material, direct labor and related manufacturing overhead, and are stated at the lower of cost (determined on a first-in, first-out basis) or net realizable value. The Company assesses the recoverability of inventory to determine whether adjustments for impairment are required. Inventory that is in excess of future requirements is written down to its estimated market value based upon forecasted demand for its products. If actual demand is less favorable than what has been forecasted by management, additional inventory impairments may be required.

Property, Plant and Equipment, Net

Property, plant and equipment are stated at cost and are depreciated using a straight-line method over their respective estimated useful lives. Leasehold improvements are amortized over the shorter of the remaining term of the lease or the life of the related asset. The estimated useful lives assigned to the Company's other property, plant and equipment categories are as follows:

Buildings and improvements	25 – 30years
Production equipment and other	5 – 10years
Office furniture and equipment	3 – 7years
Software	5 years

The Company periodically reviews the remaining lives of property, plant and equipment as a function of the original estimated lives assigned to these assets for purposes of recording appropriate depreciation expense. Factors that could impact the estimated useful life of a fixed asset, in addition to physical deterioration from the passage of time and depletion, include, but are not limited to, plans of the enterprise and anticipated use of the assets.

Acquisitions

In accordance with the purchase method of accounting, the fair values of assets acquired and liabilities assumed are determined and recorded as of the date of the acquisition. Costs to acquire the business, including transaction costs, are allocated to the fair value of net assets acquired. Any excess of the purchase price over the estimated fair value of the net assets acquired is recorded as goodwill.

As part of the allocation of purchase price, the Company records liabilities, including lease termination costs and certain employee severance costs, in accordance with Emerging Issues Task Force Issue No. 95-3, Recognition of Liabilities in Connection with a Purchase Business Combination. Throughout the allocation period, these accruals are reviewed and adjusted for changes in cost and timing assumptions.

Intangible Assets and Goodwill

Intangible assets consist of patents, intellectual property, license agreements and certain identifiable intangible assets resulting from business combinations, including trade names, customer relationships, non-compete covenants, software licenses and loan origination fees.

Patents represent the cost of preparing and filing applications to patent the Company's proprietary technologies, in addition to certain patent and license rights obtained in the Company's acquisitions or other related transactions. Such costs are amortized over a period ranging from five to seven years, beginning on the date the patents or rights are issued or acquired.

From time to time, the Company enters into agreements with third parties under which the party will design and prototype a product incorporating Presstek products and technology. The capitalized costs associated with rights or intellectual property under these agreements will be amortized over the estimated sales life-cycle and future cash flows of the product. The Company does not amortize capitalized costs related to either patents or purchased intellectual property until the respective asset has been placed into service.

At January 3, 2009 and December 29, 2007, the Company had recorded $0.4 million and $0.4 million, of costs related to patents and intellectual property not yet in service.

The Company amortizes license agreements and loan origination fees over the term of the respective agreement.

The amortizable lives of the Company's other intangible assets are as follows:

Trade names	2 – 3years
Customer relationships	2 – 10years
Software licenses	3 years
Non-compete covenants	5 years

Goodwill is recorded when the consideration paid for acquisitions exceeds the fair value of net tangible and identifiable intangible assets acquired. In accordance with Statement of Financial Accounting Standards ("SFAS") No. 142, Goodwill and Other Intangible Assets ("SFAS 142"), goodwill is not amortized, but rather, is tested at least annually for impairment at the reporting unit level. The Company has recorded goodwill aggregating $19.1 million and $19.9 million at January 3, 2009 and December 29, 2007, respectively, related to the A.B. Dick Acquisition and Precision acquisition.

Impairment of Goodwill and Long-Lived Assets

In accordance with the provisions of SFAS 142, goodwill is tested at least annually, on the first business day of the third quarter, for impairment, or more frequently, if indicators of potential impairment arise. The Company's impairment review is based on a fair value test. The Company uses its judgment in conducting ongoing assessments of whether assets may have become impaired between annual impairment tests. Indicators such as unexpected adverse business conditions, economic factors, unanticipated technological change or competitive activities, loss of key personnel and acts by governments and courts may signal that an asset has been impaired. Should the fair value of goodwill, as determined by the Company at any measurement date, fall below its carrying value, a charge for impairment of goodwill will be recorded in the period. The Company determined no goodwill impairment existed during the year ended January 3, 2009. The Company will continue to assess whether indicators of impairment of goodwill exist throughout 2009. Depending on market and economic conditions, goodwill impairment could be identified in 2009 which would result in a non-cash impairment charge.

Intangible assets with estimated lives and other long-lived assets are reviewed for impairment when events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets ("SFAS 144"). Recoverability of intangible assets with estimated lives and other long-lived assets is measured by comparison of the carrying amount of an asset or asset group to future net undiscounted pretax cash flows expected to be generated by the asset or asset group. If these comparisons indicate that an asset is not recoverable, the Company will recognize an impairment loss for the amount by which the carrying value of the asset or asset group exceeds the related estimated fair value. Estimated fair value is based on either discounted future pretax operating cash flows or appraised values, depending on the nature of the asset. The Company determines the discount rate for this analysis based on the expected internal rate of return of the related business and does not allocate interest charges to the asset or asset group being measured. Considerable judgment is required to estimate discounted future operating cash flows.

Product Warranties

The Company warrants its products against defects in material and workmanship for various periods generally from a period of ninety days to one year from the date of installation or shipment. The Company's typical warranties require it

to repair or replace defective products during the warranty period at no cost to the customer. The Company provides for the estimated cost of product warranties, based on historical experience, at the time revenue is recognized. The Company periodically assesses the adequacy of its recorded warranty liability and adjusts the amounts as necessary. The estimated liability for product warranties could differ materially from future actual warranty costs.

Claims and Litigation

The Company evaluates claims for damages and records its estimate of liabilities when such liabilities are considered probable and an amount or range can reasonably be estimated.

Research and Development Costs

Research and development costs include payroll and related expenses for personnel, parts and supplies, and contracted services. Research and development costs are charged to expense when incurred.

Advertising Costs

Advertising costs are expensed as incurred and are reported as a component of Sales, marketing and customer support expenses in the Company's Consolidated Statements of Operations. Advertising expenses were $0.8 million in fiscal 2008, $1.5 million in fiscal 2007 and $0.8 million in fiscal 2006.

Income Taxes

The process of accounting for income taxes involves calculating the current tax obligation or refund and assessing the nature and measurements of temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences and net operating loss ("NOL") and credit carryforwards, result in deferred tax assets and liabilities. In each period, the Company assesses the likelihood that the deferred tax assets will be recovered from existing deferred tax liabilities or future taxable income in each jurisdiction. To the extent the Company believes that it would not meet the test that recovery is "more likely than not", the Company would establish a valuation allowance. To the extent that a valuation allowance is established or changed in a period, the Company would adjust the tax provision or tax benefit in the consolidated statement of operations. The Company uses judgment to determine the provision or benefit for income taxes, including estimates associated with uncertain tax positions and any valuation allowance recorded against deferred tax assets based on the weight of all positive and negative factors, including cumulative trends in profitability.

The Company has accumulated U.S. federal and state income tax NOL carryforwards, research and experimentation tax credit carryforwards and alternative minimum tax credit carryforwards. In the fourth quarter of fiscal 2006, the Company reversed the valuation allowance on a deferred tax asset on the balance sheet primarily representing NOLs from U.S. operations. Previously, the Company had recorded a valuation allowance against deferred tax assets on the balance sheet until it was "more likely than not" that the tax assets related to either U.S. or international operations would be realized.

The Company assesses the ability to utilize NOL and tax credit carryforwards in future periods and record any resulting adjustments that may require deferred income tax expense. In addition, the Company reduces the deferred income tax asset for the benefits of NOL and tax credit carryforwards utilized currently. The future impact on net income may therefore be positive or negative, depending on the net result of such adjustments and charges.

Based upon a review of historical operating performance through 2008 and expected profits in the U.S. and international operations in the foreseeable future, the Company continues to believe it is more likely than not that the U.S. and international deferred tax assets, net of valuation allowance, will be fully realized except for certain tax credits that may expire before they are fully realized.

Stock-Based Compensation

On January 1, 2006, the Company adopted the fair value recognition provisions of SFAS No.123(R), Share-Based Payment ("SFAS 123R") using the modified prospective method, which requires measurement of compensation cost at fair value on the date of grant and recognition of compensation expense over the service period for awards expected to vest. See Note 15 for further discussion.

Comprehensive Income

Comprehensive income is comprised of net income, plus all changes in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources, including any foreign currency translation adjustments, unrealized gains and losses on marketable securities, or changes in derivative values. These changes in equity are recorded as adjustments to accumulated other comprehensive income in the Company's Consolidated Financial Statements. The components of accumulated other comprehensive income are unrealized gains or losses on foreign currency translation.

Foreign Currency Translation and Transactions

The Company's foreign subsidiaries use the local currency as their functional currency. Accordingly, assets and liabilities are translated into U.S. dollars at current rates of exchange in effect at the balance sheet date. The resulting unrealized gains or losses are reported under the caption accumulated other comprehensive income in the Company's Consolidated Financial Statements. Revenues and expenses from these subsidiaries are translated at average monthly exchange rates in effect for the periods in which the transactions occur.

Unrealized gains and losses arising from foreign currency transactions are reported as a component of Interest and other income (expense), net in the Company's Consolidated Statements of Operations.

Derivatives

The Company entered into interest rate swap agreements with its lenders in October 2003, which were intended to protect the Company's long-term debt against fluctuations in LIBOR rates. Under the interest rate swaps LIBOR was set at a minimum of 1.15% and a maximum of 4.25%. Because the interest rate swap agreement did not qualify as a hedge for accounting purposes under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities ("SFAS 133"), and related amendments, including SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities, the Company recorded an expense of $7,550 in fiscal 2008 and income of $22,500 and $40,000 in fiscal 2007 and fiscal 2006, respectively, to mark these interest rate swap agreements to market. The adjustment to fair value of the interest rate swap agreement was recorded in other income (expense). The swap agreements expired in October 2008.

Earnings (Loss) per Share

Earnings per share is computed under the provisions of SFAS No. 128, Earnings per Share. Accordingly, basic earnings (loss) per share is computed by dividing net income (loss) by the weighted average number of shares of common stock outstanding during the period. For periods in which there is net income, diluted earnings per share is determined by using the weighted average number of common and dilutive common equivalent shares outstanding during the period unless the effect is antidilutive. Potential dilutive common shares consist of the incremental common shares issuable upon the exercise of stock options and warrants.

Approximately 4,170,000, 1,922,000 and 1,425,700 options to purchase common stock were excluded from the calculation of diluted earnings per share for fiscal 2008, fiscal 2007 and fiscal 2006, respectively, as their effect would be antidilutive.

Reclassifications

Certain amounts in prior periods have been reclassified to conform to current presentation.

Recent Accounting Pronouncements

In 2009 the Company will adopt the remaining provisions of Statement of Financial Accounting Standards No. 157, "Fair Value Measurements", ("SFAS 157") for non-financial assets. The adoption of these provisions will not have an impact of the Company's statements of operations or statement of financial position.

In December 2007, the FASB issued SFAS No. 141 (R), Business Combinations. This statement replaces SFAS 141, Business Combinations, but retains the fundamental requirements of the statement that the acquisition method of accounting be used for all business combinations and for an acquirer to be identified for each business combination. The statement seeks to improve financial reporting by establishing principles and requirements for how the acquirer: a) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree; b) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase option and c) determines what information to disclose. This statement is effective prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company will apply the provisions of SFAS 141(R) to any acquisition after January 3, 2009.

In December 2007, the FASB issued SFAS 160, Noncontrolling Interests in Consolidated Financial Statements – an Amendment of ARB 51. This statement amends Accounting Research Bulletin (ARB) 51, Consolidated Financial Statements, to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. The statement clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. This statement is effective for fiscal years and interim periods within those fiscal years, beginning on or after December 15, 2008. The adoption of SFAS 160 will not impact the Company’s consolidated financial position and results of operations because the Company does not have any noncontrolling interests.

In March 2008, the Financial Accounting Standards Boards (“FASB”) issued Statement of Financial Accounting Standards No. 161, Disclosures about Derivative Instruments and Hedging Activities, (“SFAS 161”), which requires enhanced disclosures related to derivative instruments and hedging activities. This Statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, and the disclosure requirements will be applicable for the Company’s 2009 consolidated financial statements.

3. DISCONTINUED OPERATIONS

The Company accounts for its discontinued operations under the provisions of SFAS 144. Accordingly, results of operations and the related charges for discontinued operations have been classified as “Loss from discontinued operations, net of income taxes” in the accompanying Consolidated Statements of Operations. Assets and liabilities of discontinued operations have been reclassified and reflected on the accompanying Consolidated Balance Sheets as “Assets of discontinued operations” and “Liabilities of discontinued operations”. For comparative purposes, all prior periods presented have been reclassified on a consistent basis.

Precision

During December 2006, the Company terminated production in South Hadley, MA of Precision-branded analog plates used in newspaper applications.

Results of operations of the discontinued analog newspaper business of Precision consist of the following (in thousands, except per-share data):

	January 3, 2009	December 29, 2007	December 30, 2006
Revenue	$ --	$ 196	$ 10,816
Income (Loss) before income taxes	93	(108)	(2,267)
Provision (benefit) for income taxes	--	(54)	(771)
Income (Loss) from discontinued operations	93	(54)	(1,496)

Income (Loss) from disposal of discontinued operations, net of tax benefit of $915 for the year ended December 30, 2006	--	--	(1,777)
Net Income (Loss) from discontinued operations	$ 93	$ (54)	$ (3,273)
Loss per diluted share	$ (0.00)	$ (0.00)	$ (0.09)

As of December 30, 2006, and in accordance with SFAS 144 and SFAS 142, the Company reviewed the potential impairment of long-lived assets associated with the analog newspaper business and goodwill of the Precision reporting unit and determined that impairment charges aggregating $4.0 million were required. Of this amount $2.8 million relates to the impairment of goodwill, $0.3 million relates to the acceleration of depreciation on fixed assets abandoned, $0.6 million relates to the acceleration of amortization on certain intangible assets and $0.3 million relates to the adjustment of inventory on hand to the lower of cost or market. Impairment charges of the reporting unit goodwill resulting from the abandonment of the analog newspaper business are reflected within restructuring and other charges of continuing operations, and the remaining charges included in the loss from discontinued operations for fiscal 2006. There have been no further impairment charges incurred in fiscal 2007 and fiscal 2008 relating to this matter.

Assets and liabilities of the discontinued analog newspaper business of Precision consist of the following (in thousands):

	January 3, 2009	December 29, 2007
Receivables, net	$ 2	$ 15
Inventories, net	--	--
Total current assets	$ 2	$ 15
Accounts payable	$ 29	$ 189
Accrued expenses	17	699
Total current liabilities	$ 46	$ 888

Lasertel

On September 24, 2008, the Board of Directors approved a plan to market the Lasertel subsidiary for sale as the Lasertel business is not a core focus for the Presstek graphics business. Although Lasertel is a supplier of diodes for the Company, it has grown its presence in the external market, and management believes that Lasertel would be in a better position to realize its full potential in conjunction with other companies or investors who can focus resources on the external market. As such, the Company has presented the results of operations of this subsidiary within discontinued operations, classified the assets as “Assets of discontinued operations” and liabilities as “Liabilities of discontinued operations”. The Lasertel business will continue to operate as it previously operated, including its marketing and new business/product development activities. Presstek has no intentions to shut down the business.

Results of operations of the discontinued business of Lasertel consist of the following (in thousands, except per-share data):

	January 3, 2009	December 29, 2007	December 30, 2006
Revenue	$ 8,686	$ 8,270	$ 6,758
Loss before income taxes	(4,336)	(2,924)	(1,951)
Provision (benefit) for income taxes	(1,637)	(1,129)	(752)
Net loss from discontinued operations	$ (2,699)	$ (1,795)	$ (1,199)
Loss per diluted share	$ (0.08)	$ (0.05)	$ (0.03)

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Assets and liabilities of the discontinued business of Lasertel consist of the following (in thousands):

	January 3, 2009	December 29, 2007
Cash and cash equivalents	$ 369	$ 691
Receivables, net	2,187	1,785
Inventories	4,478	4,074
Other current assets	134	72
Property, plant & equipment, net	5,263	8,974
Intangible assets, net	899	1,078
Total assets	$ 13,330	$ 16,674
Accounts payable	$ 884	$ 1,291
Accrued expenses	448	501
Deferred revenue	--	96
Deferred gain on sale-leaseback transaction	4,370	--
Total Liabilities	$ 5,702	$ 1,888

4. ACCOUNTS RECEIVABLE, NET OF ALLOWANCES

The components of accounts receivable, net of allowances, are as follows (in thousands):

	January 3, 2009	December 29, 2007
Accounts receivable	$ 33,233	$ 43,632
Less allowances	(2,476)	(2,538)
	$ 30,757	$ 41,094

The activity related to the Company's allowances for losses, returns and deductions on accounts receivable for fiscal 2008, fiscal 2007 and fiscal 2006 is as follows (in thousands):

	Fiscal 2008	Fiscal 2007	Fiscal 2006
Balance at beginning of period	$ 2,538	$ 2,712	$ 3,215
Charged to costs and expenses	1,915	1,671	188
Deductions and write-offs	(1,977)	(1,845)	(691)
Balance at end of period	$ 2,476	$ 2,538	$ 2,712

5. INVENTORIES

The components of inventories, are as follows (in thousands):

	January 3, 2009	December 29, 2007
Raw materials	$ 2,946	$ 3,660
Work in process	4,950	4,939
Finished goods	29,711	36,411
	$ 37,607	$ 45,010

6. PROPERTY, PLANT AND EQUIPMENT, NET

The components of property, plant and equipment, net, are as follows (in thousands):

	January 3, 2009	December 29, 2007
Land and improvements	$ 1,301	$ 1,363
Buildings and leasehold improvements	22,016	22,695
Production and other equipment	42,363	42,204
Office furniture and equipment	9,402	7,098
Construction in process	1,098	2,355
Total property, plant and equipment, at cost	76,180	75,715
Accumulated depreciation and amortization	(50,650)	(46,666)
Net property, plant and equipment	$ 25,530	$ 29,049

Construction in process is primarily related to production equipment not yet placed into service.

The Company recorded depreciation expense of $4.5 million, $5.6 million and $5.7 million in fiscal 2008, fiscal 2007 and fiscal 2006, respectively. Under the Company’s financing arrangements (See Note 8), all property, plant and equipment is pledged as security.

7. GOODWILL AND OTHER INTANGIBLE ASSETS

The changes in the carrying amounts of goodwill are as follows (in thousands):

Balance at December 30, 2006	$ 20,280
Purchase accounting adjustments for prior period acquisitions	(389)
Impairment adjustments	--
Balance at December 29, 2007	$ 19,891
Purchase accounting adjustments for prior period acquisitions	(777)
Impairment adjustments	--
Balance at January 3, 2009	$ 19,114

In accordance with the provisions of SFAS 142, goodwill is tested at least annually, on the first business day of the third quarter, for impairment, or more frequently, if indicators of potential impairment arise. The Company conducts ongoing assessments of whether indicators exist requiring an evaluation of goodwill and determined no goodwill impairment existed during the year ended January 3, 2009. The Company will continue to assess whether indicators of impairment of goodwill exist throughout 2009. Depending on market and economic conditions, goodwill impairment could be identified in 2009 which would result in a non-cash impairment charge.

The components of the Company's identifiable intangible assets are as follows (in thousands):

	January 3, 2009		December 29, 2007	
	Cost	Accumulated amortization	Cost	Accumulated amortization
Patents and intellectual property	$ 9,390	$ 7,739	$ 9,360	$ 7,323
Trade names	2,360	2,360	2,360	2,360
Customer relationships	4,452	2,366	4,452	1,855
Software licenses	450	450	450	450
License agreements	750	368	750	296
Non-compete covenants	100	100	100	100
Loan origination fees	332	277	332	211
	$ 17,834	$ 13,660	$ 17,804	$ 12,595

The Company recorded amortization expense for its identifiable intangible assets of $1.1 million, $2.2 million and $2.7 million in fiscal 2008, fiscal 2007 and fiscal 2006, respectively. As of January 3, 2009, there was $0.4 million of patents not yet in service. Estimated future amortization expense for the Company's in-service patents and all other identifiable intangible assets recorded by the Company at January 3, 2009, are as follows (in thousands):

Fiscal 2009	$ 1,035
Fiscal 2010	906
Fiscal 2011	702
Fiscal 2012	405
Fiscal 2013	386
Thereafter	317

8. FINANCING ARRANGEMENTS

The components of the Company's outstanding borrowings are as follows (in thousands):

	January 3, 2009	December 29, 2007
Term loan	$ 4,074	$ 15,500
Line of credit	12,415	20,000
Capital lease	--	35
	16,489	35,535
Less current portion	(16,489)	(27,035)
Long-term debt	$ --	$ 8,500

In November 2004, in connection with the A.B. Dick Acquisition, the Company replaced its then-current credit facilities, which it had entered into in October 2003, with $80.0 million in Senior Secured Credit Facilities (the "Facilities") from three lenders. The terms of the Facilities include a $35.0 million five-year secured term loan (the "Term Loan") and a $45.0 million five-year secured revolving line of credit (the "Revolver") which expires in November 2009. The Company granted a security interest in all of its assets in favor of the lenders under the Facilities. In addition, under the Facilities agreement, the Company is prohibited from declaring or distributing dividends to shareholders.

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The Company has the option of selecting an interest rate for the Facilities equal to either: (a) the then applicable London Inter-Bank Offer Rate plus 1.25% to 4.0% per annum, depending on certain results of the Company's financial performance; or (b) the Prime Rate, as defined in the Facilities agreement, plus up to 1.75% per annum, depending on certain results of the Company's financial performance. Effective August 31, 2005, the Company amended its Facilities to reduce the current applicable LIBOR margin to 2.5%, from the previous applicable LIBOR margin of 3.5%.

The Company entered into interest rate swap agreements with its lenders in October 2003, which were intended to protect the Company's long-term debt against fluctuations in LIBOR rates. Under the interest rate swaps LIBOR was set at a minimum of 1.15% and a maximum of 4.25%. The Company recorded an increase to the expense of $7,550, in fiscal 2008 and a reduction to expense of $22,500 and $40,000 in fiscal 2007 and fiscal 2006, respectively, to mark these interest rate swap agreements to market. The swap agreements expired in October 2008.

The Facilities were used to partially finance the A.B. Dick Acquisition, and are available to the Company for working capital requirements, capital expenditures, business acquisitions and general corporate purposes.

At January 3, 2009 and December 29, 2007, the Company had outstanding balances on the Revolver of $12.4 million and $20.0 million, respectively, with interest rates of 2.69% and 7.5%, respectively. At January 3, 2009, there were $1.3 million of outstanding letters of credit, thereby reducing the amount available under the Revolver to $31.3 million at that date.

The Term Loan required an initial principal payment of $0.25 million on March 31, 2005, and requires subsequent quarterly principal payments of $1.75 million, with a final settlement of all remaining principal and unpaid interest on November 4, 2009. In the third quarter of fiscal 2008, the Company used the net proceeds of the sale of its Arizona property to pay down the principal balance of the Term Loan and entered into an amendment to the Facilities dated July 29, 2008 which amended the payment schedule of the Term Loan to reduce the required quarterly installments of principal to $810,000, payable in January, March, June and September of 2009, with no installment due in September of 2008 and a final installment of all remaining principal (approximately $834,000) due on November 4, 2009. At January 3, 2009 and December 29, 2007, outstanding balances under the Term Loan were $4.1 million and $15.5 million, respectively, with interest rates of 1.30% and 7.5%, respectively. For further discussion see Liquidity section in Management's Discussion and Analysis of Financial Condition and Results of Operations.

The Company's Revolver and Term Loan principal commitments are as follows (in thousands):

2009	$	16,489
2010		--

The weighted average interest rate on the Company's outstanding short-term borrowings was 2.3% at January 3, 2009.

Under the terms of the Revolver and Term Loan, the Company is required to meet various financial covenants on a quarterly and annual basis, including maximum funded debt to EBITDA (earnings before interest, taxes, depreciation, amortization and restructuring and other charges) and minimum fixed charge coverage covenants. At January 3, 2009, the Company was in compliance with all financial covenants.

9. ACCRUED EXPENSES

The components of the Company's accrued expenses are as follows (in thousands):

	January 3, 2009	December 29, 2007
Accrued payroll and employee benefits	$ 4,068	$ 5,478
Accrued warranty	2,102	3,534
Accrued restructuring and other charges	799	1,592
Accrued royalties	232	432
Accrued income taxes	282	569
Accrued legal	2,394	5,815
Accrued professional fees	1,122	2,545
Other	2,245	3,247
	$ 13,244	$ 23,212

10. ACCRUED WARRANTY AND DEFERRED REVENUES

Accrued Warranty

The Company provides for the estimated cost of product warranties, based on historical experience, at the time revenue is recognized. Presstek warrants its products against defects in material and workmanship for various periods, determined by the product, generally for a period of from ninety days to one year from the date of installation. Typical warranties require the Company to repair or replace defective products during the warranty period at no cost to the customer. Presstek engages in extensive product quality programs and processes, including monitoring and evaluation of component supplies; however, product warranty terms, product failure rates, and material usage and service delivery costs incurred in correcting a product failure may affect the estimated warranty obligation. If actual product failure rates, material usage or service delivery costs differ from current estimates, the Company will adjust the warranty liability. Accruals for product warranties are reflected as a component of accrued expenses in the Company's Consolidated Balance Sheets.

Product warranty activity in fiscal 2008, fiscal 2007 and fiscal 2006 is as follows (in thousands):

	Fiscal 2008	Fiscal 2007	Fiscal 2006
Balance at beginning of year	$ 3,534	$ 1,729	$ 1,481
Accruals for warranties	40	3,517	3,400
Utilization of accrual for warranty costs	(1,472)	(1,712)	(3,152)
Balance at end of year	$ 2,102	$ 3,534	$ 1,729

Deferred Revenues

Deferred revenues consist of amounts received or billed in advance for products for which revenue recognition criteria has not yet been met or service contracts where services have not yet been rendered. Deferred amounts are recognized as elements are delivered or, in the case of services, recognized ratably over the contract life, generally one year, or as services are rendered.
The components of deferred revenue are as follows (in thousands):

	January 3, 2009	December 29, 2007
Deferred service revenue	$ 6,507	$ 6,718
Deferred product revenue	793	382
	$ 7,300	$ 7,100

11. RESTRUCTURING AND OTHER CHARGES

A summary of restructuring and other charges follows (in thousands):

	January 3, 2009	December 29, 2007	December 30, 2006
Asset impairment – goodwill	$ --	$ --	$ 2,809
Impairment of intangible assets - patent defense costs	--	--	2,297
Impairment of other assets	--	--	260
Severance and fringe benefits	691	1,210	115
Executive contractual obligations	536	1,466	--
Other exit costs	881	38	--
Total net restructuring and other charges	$ 2,108	$ 2,714	$ 5,481

In fiscal 2008 the Company recognized $2.1 million in restructuring and other charges, including severance and separation costs resulting from the implementation of certain elements of the Business Improvement Plan (the “BIP”), exit costs related to the termination of a leased facility, severance costs incurred in the fourth quarter, and severance and retention bonuses related to the transfer of certain of its corporate functions from the Hudson, NH facility to the Greenwich, CT facility. The Company expects to incur additional expense related to this move through the second quarter of 2009.

In fiscal 2007 the Company recognized $2.7 million of restructuring and other charges consisting of expenses related to severance and separation costs under employment contracts of former executives, as well as costs related to the implementation of certain elements of the BIP including severance, operating lease run-outs, and consolidation of distribution centers.

In connection with the Company’s 2006 restructuring of the analog newspaper business of Precision Lithograining, as more fully described in Note 3, an impairment review of the Precision reporting unit goodwill was completed and charges totaling $2.8 million were recognized in the accompanying Statement of Operations in fiscal 2006.

Impairment of intangible assets for patent defense costs associated with the Creo/Kodak matter totaling $2.3 million were recognized as expense in fiscal 2006 as the Company determined that the future economic benefits of the patent were not assured of being increased.

The activity for fiscal 2008, fiscal 2007 and fiscal 2006 related to the Company's restructuring and other expense accruals is as follows (in thousands):

	Fiscal 2008 Activity				
	Balance December 29, 2007	Charged to Expense	Reversals	Utilization	Balance January 3, 2009
Executive contractual obligations	$ 904	$ 536	$ --	(978)	462
Severance and fringe benefits	688	691	--	(1,042)	337
Other exit costs	--	881	--	(881)	--
	$ 1,592	$ 2,108	$ --	$ (2,901)	$ 799

	Fiscal 2007 Activity				
	Balance December 30, 2006	Charged to Expense	Reversals	Utilization	Balance December 29, 2007
Executive contractual obligations	$ --	$ 1,466	$ --	(562)	904
Severance and fringe benefits	233	1,210	--	(755)	688
Other exit costs	--	38	--	(38)	--
	$ 233	$ 2,714	$ --	$ (1,355)	$ 1,592

	Fiscal 2006 Activity				
	Balance December 31, 2005	Charged to Expense	Reversals	Utilization	Balance December 30, 2006
Severance and fringe benefits	482	324	(390)	(183)	233
	$ 482	$ 324	$ (390)	$ (183)	$ 233

The Company anticipates that payments related to the above restructuring actions will be completed in 2009.

12. INTEREST AND OTHER INCOME AND EXPENSE

The components of Interest and other income (expense), net, in the Company's Consolidated Statements of Income are as follows (in thousands):

	Fiscal 2008	Fiscal 2007	Fiscal 2006
Interest expense	$ (946)	$ (2,142)	$ (1,511)
Interest income	111	90	108
Other income (expense), net	1,773	798	419
	$ 938	$ (1,254)	$ (984)

The amount reported as Other income (expense), net, for fiscal 2008, 2007 and 2006 includes $1.4 million, $0.5 million and $0.2 million, respectively, for net unrealized gains on foreign currency transactions.

13. INCOME TAXES

For the fiscal years ended January 3, 2009, December 29, 2007, and December 30, 2006, income (loss) before income taxes from continuing operations includes the following components (in thousands):

	Fiscal 2008	Fiscal 2007	Fiscal 2006
U.S.	$ 5,296	$ (15,899)	$ 5,149
Foreign	614	1,655	(824)
	$ 5,910	$ (14,244)	$ 4,325

For the fiscal years ended January 3, 2009, December 29, 2007, and December 30, 2006, the components of provision (benefit) for income taxes from continuing operations were as follows (in thousands):

	Fiscal 2008	Fiscal 2007	Fiscal 2006
Current:			
Federal	$ (131)	$ 138	$ 129
State	293	456	545
Foreign	(121)	507	37
	$ 41	$ 1,101	$ 711
Deferred:			
Federal	2,326	(4,458)	(9,659)
State	128	(532)	(665)
Foreign	285	--	(278)
	2,739	(4,990)	(10,602)
Provision (benefit) for income taxes	$ 2,780	$ (3,889)	$ (9,891)

A reconciliation of the Company's effective tax rate to the statutory federal rate is as follows:

	Fiscal 2008	Fiscal 2007	Fiscal 2006
Federal statutory tax rate	34.00%	34.00%	34.00%
Nondeductible Officer's compensation	1.90	(4.61)	--
State tax, net of federal benefit	4.70	0.35	(1.84)
Alternative minimum tax	--	--	--
Other	(2.76)	(2.44)	(1.44)
Change in valuation allowance	9.20	0.00	(259.41)
	47.04%	27.30%	(228.69) %

During the years ended January 3, 2009, December 29, 2007, and December 30, 2006 the Company recognized a tax benefit of approximately $1.6 million, $1.2 million, and $1.5 million, respectively, associated with the loss from discontinued operations

Deferred Income Taxes

Deferred income taxes result from net operating loss carryforwards, tax credit carryforwards and temporary differences between the recognition of items for income tax purposes and financial reporting purposes.

Principal components of deferred income taxes as of January 3, 2009, December 29, 2007, and December 30, 2006 were (in thousands):

	January 3, 2009	December 29, 2007	December 30, 2006
Deferred tax assets			
Net operating loss carryforwards	$ 5,745	$ 7,439	$ 5,751
Tax credits	4,073	3,875	3,757
Warranty provisions, litigation and other accruals	8,450	6,940	4,162
Accumulated depreciation and amortization	2,507	712	--
Gross deferred tax assets	20,775	18,966	13,670
Valuation allowance	(795)	(250)	(261)
Total deferred tax assets	19,980	18,716	13,409
Deferred tax liabilities			
Amortizable and depreciable assets	(2,420)	(852)	(136)
Accumulated depreciation and amortization	--	--	(1,596)
Total deferred tax liabilities	(2,420)	(852)	(1,732)
Net deferred tax assets (liabilities)	$ 17,560	$ 17,864	$ 11,677

On December 30, 2006, the Company recognized through its tax provision, a $11.2 million reversal of its U.S. deferred tax asset valuation allowance. In assessing the ability to realize its deferred tax assets, the Company considered whether it is more likely than not that some portion or all of the deferred tax assets will not be realized based on available positive and negative evidence. The Company considered historical book income, the scheduled reversal of deferred tax liabilities, and projected future book and taxable income in making this assessment. Based upon a detailed analysis of historical and expected book and taxable income, the Company determined that it is more likely than not that certain U.S. deferred tax assets for which a valuation allowance had been previously recorded will be realized in the future. The valuation allowance of $0.8 million as of January 3, 2009 relates to certain federal research and development credit carryforwards for which the Company has determined, based upon historical results and projected future book and taxable income levels, that a valuation allowance should be maintained.

The Company's net deferred tax assets include $0.8M related to Presstek Europe's net operating loss carryforward and temporary differences. The fiscal 2008 recognition of this deferred tax asset was applied to reduce goodwill in accordance with purchase business combination requirements.

At January 3, 2009, the Company had federal net operating loss carryforwards of approximately $77.5 million which will expire from 2012 to 2027. Approximately $61.5 million of our net operating loss carryforwards was generated from excess tax deductions from stock-based compensation, the tax benefit of which (approximately $24.6 million) will be credited to additional paid-in-capital when the deductions reduce current taxes payable. Upon the adoption of FAS 123(R), the Company netted its deferred tax asset and the related valuation allowance for the net operating loss carryforward generated from excess tax deductions from stock-based compensation.

At January 3, 2009 the Company had federal research and development credit carryforwards of approximately $3.4 million. The net operating loss and credit carryforwards will expire at various dates through 2022, if not utilized. The Company's tax credit carryforwards include $0.3 million of federal minimum tax credits which have no expiration

and $0.3 million of state credits that expire in 2012.

The Company's ability to utilize its net operating loss and credit carryforwards may be limited in the future if the company experiences an ownership change, as defined by the Internal Revenue Code. An ownership change occurs when the ownership percentage of 5% or greater stockholders changes by more than 50% over a three year period.

The cumulative amount of undistributed earnings of foreign subsidiaries, which is intended to be permanently reinvested and for which U.S. income taxes have not been provided, totaled approximately $0.9 million at January 3, 2009.

On December 31, 2006, the Company adopted FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes” (“FIN 48”). The adoption of FIN 48 did not have a material effect on our consolidated financial position or results of operations. Our unrecognized tax benefits at January 3, 2009 related to various foreign jurisdictions and U.S. tax credits. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

Balance at December 29, 2007	$	1,800
Increases related to prior year tax positions		--
Decreases related to prior year tax positions		(579)
Balance at January 3, 2009	$	1,221

The entire $1.2 million of unrecognized tax benefits at January 3, 2009 would reduce income tax expense if ultimately recognized. We do not expect any significant increases or decreases to our unrecognized tax benefits within 12 months of this reporting date. Subsequent to adoption, interest and penalties incurred associated with unresolved income tax positions will be included in income tax expense. Accrued interest and penalties are insignificant.

We conduct business globally and, as a result, file numerous consolidated and separate income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. In the normal course of business, the Company is subject to examination by tax authorities throughout the world, including such major jurisdictions as the U.S., United Kingdom and Canada. The Company is subject to U.S. federal, state and local, or non-U.S. income tax examinations for years after 2004. Carryforward attributes that were generated prior to 2004, however may still be adjusted by a taxing authority upon examination if the attributes have been or will be used in a future period.

14. PREFERRED STOCK

The Company’s certificate of incorporation empowers the Board of Directors, without stockholder approval, to issue up to 1,000,000 shares of $0.01 par value preferred stock, with dividend, liquidation, conversion and voting or other rights to be determined upon issuance by the Board of Directors. No preferred stock has been issued to date.

15. STOCK-BASED COMPENSATION PLANS

Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS 123R, using the modified prospective method, which requires measurement of compensation cost at fair value on the date of grant and recognition of compensation expense over the service period for awards expected to vest.

The Company has equity incentive plans that are administered by the Compensation Committee of the Board of Directors (the “Committee”). The Committee oversees and approves which employees receive grants, the number of shares or options granted and the exercise prices of the shares covered by each grant.

Stock Incentive Plans

The 1998 Stock Incentive Plan (the “1998 Incentive Plan”) provides for the award of stock options, restricted stock, deferred stock, and other stock based awards to officers, directors, employees, and other key persons (collectively “awards”). A total of 3,000,000 shares of common stock, subject to anti-dilution adjustments, have been reserved under this plan. Any future options granted under the 1998 Incentive Plan will become exercisable upon the earlier of a date set by the Board of Directors or Committee at the time of grant or the close of business on the day before the tenth

anniversary of the stock options' date of grant. At January 3, 2009, there were 489,325 options outstanding under the 1998 Incentive Plan. The options will expire at various dates as prescribed by the individual option grants. This plan expired on April 6, 2008 and therefore no options will be granted under this plan after this date.

The 2003 Stock Option and Incentive Plan (the "2003 Plan") provides for the award of stock options, stock issuances and other equity interests in the Company to employees, officers, directors (including those directors who are not an employee or officer of the Company, such directors being referred to as Non-Employee Directors), consultants and advisors of the Company and its subsidiaries. The 2003 Plan provides for an automatic annual grant of 7,500 stock options to all active Non-Employee Directors. A total of 2,000,000 shares of common stock, subject to anti-dilution adjustments, have been reserved under this plan. Any future options granted under the 2003 Plan will become exercisable at such times and subject to such terms and conditions as the Board of Directors or Committee may specify at the time of each grant. At January 3, 2009, there were 1,864,212 options outstanding under the 2003 Plan, and 80,388 options available for future grants under this plan. The options will expire at various dates as prescribed by the individual option grants.

The 2008 Omnibus Incentive Plan (the "2008 Plan"), approved by the stockholders of the Company on June 11, 2008, provides for the award of stock options, stock issuances and other equity interests in the Company to employees, officers, directors (including non-employee directors), consultants and advisors of the Company and its subsidiaries. A total of 3,000,000 shares of common stock, subject to anti-dilution adjustments, have been reserved under this plan. Awards granted under this plan may have varying vesting and termination provisions and can have no longer than a ten year contractual life. At January 3, 2009, there were 799,609 options outstanding and 2,200,391 options available for future grants under this plan.

The Company had previously adopted equity incentive plans that had expired as of January 3, 2009 and, accordingly, no future grants may be issued under these plans. These plans include the 1991 Stock Option Plan (the "1991 Plan"), which expired on August 18, 2001; the 1994 Stock Option Plan (the "1994 Plan"), which expired on April 8, 2004; the 1997 Interim Stock Option Plan (the "1997 Plan"), which expired on September 22, 2002; and the 1998 Stock Option Plan (the "1998 Plan"), which expired on April 6, 2008. At January 3, 2009, there were 33,400 options outstanding under the 1991 Plan, 143,367 options outstanding under the 1994 Plan, 14,175 options outstanding under the 1997 Plan and 489,325 options outstanding under the 1998 Plan.

Employee Stock Purchase Plan

The Company's 2002 Employee Stock Purchase Plan (the "ESPP") is designed to provide eligible employees of the Company and its participating U.S subsidiaries an opportunity to purchase common stock of the Company through accumulated payroll deductions. The purchase price of the stock is equal to 85% of the fair market value of a share of common stock on the first day or last day of each three-month offering period, whichever is lower. All employees of the company or participating subsidiaries who customarily work at least 20 hours per week and do not own five percent or more of the Company's common stock are eligible to participate in the ESPP. A total of 950,000 shares of the Company's common stock, subject to adjustment, have been reserved for issuance under this plan. In fiscal 2008, fiscal 2007 and fiscal 2006, approximately 80,300, 65,700 and 57,000 shares were issued, respectively, under the ESPP. The 2008, 2007 and 2006 amounts include approximately 27,000, 16,000 and 16,000 shares in transit at January 3, 2009, December 29, 2007 and December 30, 2006, respectively. These shares were issued on January 5, 2009, December 31, 2007 and January 2, 2007, respectively. At January 3, 2009, there were approximately 623,000 shares available for issuance under this plan.

Non-Plan Options

In fiscal 2007, the Company granted 300,000 shares of restricted stock and 1,000,000 stock options to its President and Chief Executive Officer ("CEO") under a non-plan, non-qualified stock option agreement. The award of restricted stock vested on May 10, 2007, the effective date of the CEO's employment agreement with the Company. The award of stock options vests 20% on the date of grant, and an additional 20% vests on each of January 1, 2008, 2009, 2010 and 2011. Each portion of the option that vests will remain exercisable for five years after the applicable vesting date.

As of January 3, 2009, 1,000,000 options remain outstanding.

Valuation Assumptions

The fair value of the rights to purchase shares of common stock under the Company's ESPP was estimated on the commencement date of the offering period using the Black-Scholes valuation model with the following assumptions:

Stock purchase right assumptions	Fiscal 2008	Fiscal 2007	Fiscal 2006
Risk-free interest rate	0.84%	4.03%	4.74%
Volatility	95.79%	51.77%	52.05%
Expected life (in years)	0.25	0.25	0.25
Dividend yield	--	--	--

Based on the above assumptions, the weighted average fair value of the stock purchase rights under the Company's ESPP for fiscal 2008, 2007 and 2006 was $1.09, $1.30 and $1.34, respectively.

The fair value of the options to purchase common stock granted in fiscal 2008, 2007 and 2006 under the 2008 Plan, 2003 Plan and 1998 Plan was estimated on the respective grant dates using the Black-Scholes valuation model with the following assumptions:

Stock option assumptions	Fiscal 2008	Fiscal 2007	Fiscal 2006
Risk-free interest rate	2.28%	4.25%	5.05%
Volatility	60.63%	60.97%	57.16%
Expected life (in years)	5.67	5.56	4.51
Dividend yield	--	--	--

The weighted average grant date fair value of the options granted of the Company's common stock during fiscal years 2008, 2007 and 2006 was $2.50, $3.72 and $4.62, respectively.

The fair value of the 300,000 restricted shares of common stock granted in the second quarter of fiscal 2007 was derived by obtaining the market value of the stock on the award date and applying a discount to that value due to the sale restrictions imposed by Rule 144 of the U.S. Securities and Exchange Commission (the "SEC"). The market value was calculated using the average of the high and low trading prices on the award date multiplied by the number of shares. A discount rate of 17.2% was estimated using a Black-Scholes put option model with the following assumptions:

	Fiscal 2007
Risk-free interest rate	4.9%
Volatility	50.0%
Expected life (in years)	1.0
Dividend yield	--

The fair value of the options to purchase shares of common stock under the non-plan, non-qualified stock option agreement with the Company's President and CEO granted in the second quarter of fiscal 2007 was estimated on the grant date using the Black-Scholes valuation model with the following assumptions:

	Fiscal 2007
Risk-free interest rate	4.3%
Volatility	48.0%
Expected life (in years)	4.1
Dividend yield	--

Based on the above assumptions, the weighted average fair value of options was $2.58.

Expected volatilities are based on historical volatilities of Presstek's common stock. The expected life represents the weighted average period of time that options granted are expected to be outstanding giving consideration to vesting schedules, the Company's historical exercise patterns and the ESPP purchase period. The risk-free rate is based on the U.S. Treasury Separate Trading of Registered Interest and Principal of Securities rate for the period corresponding to the expected life of the options or ESPP purchase period. The expense calculated using the Black-Scholes method is recognized on a straight line basis over the term of the service period. Stock-based compensation associated with stock option grants to all officers, directors, and employees is included as a component of "General and administrative expense" in the Company's Consolidated Statements of Operations. Stock based compensation expense for the twelve months ended January 3, 2009, December 29, 2007 and December 30, 2006 is as follows (in thousands):

	Twelve months ended		
Stock option plan	January 3, 2009	December 29, 2007	December 30, 2006
2008 Plan	$ 319	$ --	$ --
2003 Plan	718	1,379	268
1998 Plan	171	7	--
ESPP	79	71	106
Restricted Stock	--	1,500	--
Non-plan, non-qualified	516	1,032	--
Total	$ 1,803	$ 3,989	$ 374

As of January 3, 2009, there was $3.8 million of unrecognized compensation expense related to stock option grants. The weighted average period over which the remaining unrecognized compensation expense will be recognized is 2.4 years.

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Stock option activity for fiscal 2006, 2007 and 2008 is summarized as follows:

	Shares	Weighted average exercise price	Weighted average remaining contractual term	Aggregate intrinsic value
Outstanding at December 31, 2005	3,101,475	$ 8.86		
Granted	143,333	$ 9.12		
Exercised	(246,883)	$ 6.82		
Canceled/expired	(41,575)	$ 11.30		
Outstanding at December 30, 2006	2,956,350	$ 9.01		
Granted	2,203,333	$ 5.40		
Exercised	(836,950)	$ 3.36		
Canceled/expired	(506,166)	$ 8.29		
Outstanding at December 29, 2007	3,816,567	$ 8.26		
Granted	1,019,609	$ 5.14		
Exercised	(2,500)	$ 3.60		
Canceled/expired	(489,588)	$ 11.10		
Outstanding at January 3, 2009	4,344,088	$ 7.24	6.59 years	$ 0.006 million
Exercisable at January 3, 2009	2,693,920	$ 8.21	5.33 years	$0.006 million

The total intrinsic value of stock options exercised during fiscal 2008, fiscal 2007 and fiscal 2006 was $0.003 million, $0.8 million and $1.1 million, respectively.

The following table summarizes information about stock options outstanding at January 3, 2009:

	Outstanding			Exercisable	
Range of exercise prices	Shares	Weighted average remaining contractual life (years)	Weighted average exercise price	Shares	Weighted average exercise price
$ 0.00 - $ 4.96	221,967	7.55	3.85	80,967	4.04
$ 4.97 - $ 9.92	3,685,371	6.94	6.70	2,176,203	7.30
$ 9.93 - $ 14.88	233,750	5.08	11.28	233,750	11.28
$ 14.89 - $ 19.85	203,000	0.82	16.12	203,000	16.12
$ 0.00 - $ 19.85	4,344,088	6.59	$ 7.24	2,693,920	$ 8.21

In addition to the plans described above, the Company’s Lasertel subsidiary has a stock option plan, the Lasertel, Inc. 2000 Stock Incentive Plan (the “Lasertel Plan”). The Lasertel Plan, as amended in fiscal 2001, provides for the award, to employees and other key individuals of Lasertel and Presstek, of non-qualified options to purchase, in the aggregate, up to 2,100,000 shares of Lasertel’s common stock. Any future options granted under this plan will generally vest over four years, with termination dates ten years from the date of grant. These grants are subject to termination provisions as provided in the Lasertel Plan.

16. BUSINESS SEGMENT AND GEOGRAPHIC INFORMATION

Presstek is a market-focused high technology company that designs, manufactures and distributes proprietary and non-proprietary solutions to the graphic arts industries, primarily serving short-run, full-color customers. The Company's operations are organized based on the market application of our products and related services and consist of two business segments: Presstek and Lasertel. The Presstek segment is primarily engaged in the development, manufacture, sale and servicing of our patented digital imaging systems and patented printing plate technologies and related equipment and supplies for the graphic arts and printing industries, primarily serving the short-run, full-color market segment. Lasertel manufactures and develops high-powered laser diodes for sale to Presstek and external customers.

The Lasertel segment has been reclassified as discontinued operations in the third quarter of fiscal 2008 as the operations are currently held for sale. As such, the Presstek Segment makes up the entire results of continuing operations. The Lasertel business will continue to operate as previously operated, including its marketing and new business/product development activities. Presstek has no intentions to shut down the business.

Asset information for the Company's business segments is as follows (in thousands):

	January 3, 2009	December 29, 2007
Presstek	$ 144,183	$ 176,153
Lasertel (assets of discontinued operations)	13,330	16,674
	$ 157,513	$ 192,827

The Company's classification of revenue by geographic area is determined by the location of the Company's customer. The following table summarizes revenue information by geographic area (in thousands):

	Fiscal 2008	Fiscal 2007	Fiscal 2006
United States	$ 123,484	$ 150,703	$ 170,160
United Kingdom	20,732	27,426	28,706
Canada	9,010	15,410	14,699
Germany	8,398	6,187	8,645
Japan	2,810	5,451	5,845
All other	28,818	41,396	30,881
	$ 193,252	$ 246,573	$ 258,936

The Company's long-lived assets by geographic area are as follows (in thousands):

	January 3, 2009	December 29, 2007
United States	$ 58,580	$ 65,170
United Kingdom	602	752
Canada	736	220

	$ 59,918	$ 66,142

17. MAJOR CUSTOMERS

No customer accounted for greater than 10% of revenue in fiscal 2008, fiscal 2007 or fiscal 2006, or greater than 10% of the Company's accounts receivable balance at either January 3, 2009 or December 29, 2007.

18. RELATED PARTIES

The Company engages the services of Amster, Rothstein & Ebenstein, a law firm of which a member of the Company's Board of Directors is a partner. Expenses incurred for services from this law firm were $2.4 million (including $0.5 million of pass-through expenses), $1.1 million and $2.4 million in fiscal 2008, fiscal 2007 and fiscal 2006, respectively.

The Company has had a long term relationship with Spinks Ink ("Spinks"), a subsidiary of Superior Printing Ink Company, Inc. Spinks supplies ink and related products to the Company. During fiscal 2008, the son of Board member John W. Dreyer became employed by Spinks. Prior to Mr. Dreyer's son becoming employed with Spinks and subsequent thereto, all transactions with Spinks have been conducted on an arm's length basis. The total amount paid to Spinks in fiscal 2008 was $0.3 million.

19. COMMITMENTS AND CONTINGENCIES

Commitments

The Company conducts operations in certain facilities under long-term operating leases. The Company also leases certain office and other equipment for use in its operations. These leases expire at various dates through 2018, with various options to renew as negotiated between the Company and its landlords. It is expected that in the normal course of business, leases that expire will be renewed or replaced. Rent expense under these leases was $1.7 million in fiscal 2008, $1.9 million in fiscal 2007 and $1.7 million in fiscal 2006.

The Company's obligations under its non-cancelable operating leases at January 3, 2009 were as follows (in thousands):

Fiscal 2009	$	2,684
Fiscal 2010		2,162
Fiscal 2011		1,820
Fiscal 2012		1,828
Fiscal 2013		953
Thereafter		2,860

The Company entered into an agreement in fiscal 2000 with Fuji, whereby minimum royalty payments to Fuji are required based on specified sales volumes of the Company's A3 format size four-color sheet-fed press. The agreement provides for total royalty payments to be no less than $6 million and not greater than $14 million over the life of the agreement. As of January 3, 2009, the Company had paid Fuji $8.9 million under the agreement. The Company's maximum remaining liability under the royalty agreement at January 3, 2009, was $5.1 million.

Contingencies

The Company has change of control agreements with certain of its employees that provide them with benefits should their employment with the Company be terminated other than for cause or their disability or death, or if they resign for good reason, as defined in these agreements, within a certain period of time from the date of any change of control of the Company.

From time to time the Company has engaged in sales of equipment that is leased by or intended to be leased by a third party purchaser to another party. In certain situations, the Company may retain recourse obligations to a financing institution involved in providing financing to the ultimate lessee in the event the lessee of the equipment defaults on its lease obligations. In certain such instances, the Company may refurbish and remarket the equipment on behalf of the financing company, should the ultimate lessee default on payment of the lease. In certain circumstances, should the resale price of such equipment fall below certain predetermined levels, the Company would, under these arrangements, reimburse the financing company for any such shortfall in sale price (a “shortfall payment”). Generally, the Company’s liability for these recourse agreements is limited to 9.5% of the amount outstanding. The maximum amount for which the Company was liable to the financial institutions for the shortfall payments was approximately $1.9 million at January 3, 2009.

Litigation

On October 26, 2006, the Company was served with a complaint naming the Company, together with certain of its former executive officers, as defendants in a purported securities class action suit filed in the United States District Court for the District of New Hampshire. The suit claims to be brought on behalf of purchasers of Presstek’s common stock during the period from July 27, 2006 through September 29, 2006. The complaint alleges, among other things, that the Company and the other defendants violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder based on allegedly false forecasts of fiscal third quarter and annual 2006 revenues. As relief, the plaintiff seeks an unspecified amount of monetary damages, but makes no allegation as to losses incurred by any purported class member other than himself, court costs and attorneys’ fees. On September 25, 2008 the parties reached a settlement of the action, subject to confirmatory discovery by plaintiffs and court approval.

On September 10, 2008 a purported shareholder derivative claim against certain current and former directors and officers of the Company was filed in the United States District Court for the District of New Hampshire. The complaint alleges breaches of fiduciary duty by the defendants and seeks unspecified damages. On September 25, 2008 the parties reached agreement on a settlement of the claim, subject to receipt of court approval.

On June 4, 2008 the Commonwealth of Massachusetts filed a complaint in the Superior Court of Massachusetts, Hampshire County against the Company and one of its subsidiaries seeking recovery of response costs related to the October 30, 2006 chemical release in South Hadley, MA noted above. In October 2008 the case was settled and the complaint was dismissed.

On February 4, 2008, the Company received from the SEC a formal order of investigation relating to the previously disclosed SEC inquiry regarding the Company's announcement of preliminary financial results for the third quarter of fiscal 2006. The Company is cooperating fully with the SEC's investigation.

Presstek is a party to other litigation that it considers routine and incidental to its business however it does not expect the results of any of these actions to have a material adverse effect on its business, results of operation or financial condition.

20. SALE-LEASEBACK

On July 14, 2008, the Company completed a sale-leaseback transaction of its property located in Tucson, AZ (the “Property”). The Property is used by the Lasertel business. The Company sold the Property to an independent third party for approximately $8.75 million, or $8.4 million net of expenses incurred in connection with the sale, resulting in a gain of approximately $4.6 million. Concurrent with the sale, the Company entered in to an agreement to lease a portion of the property back from the purchaser for a term of 10 years. The lease, which management deemed to be an operating lease, has approximately $5.8 million in future minimum lease payments. The gain associated with the

transaction was deferred and included in discontinued operations at the inception of the arrangement and is expected to be amortized ratably over the lease term.

21. SUBSEQUENT EVENTS

In October 2008, the Company filed a lawsuit in New Hampshire Superior Court against Continental Casualty Company (“Continental”), alleging that Continental had breached an insurance contract with the Company. In January 2009 the parties settled this claim, resulting in a payment by Continental to the Company in the amount of $1.2 million.

22. QUARTERLY RESULTS (UNAUDITED)

	First Quarter	Second Quarter	Third Quarter (2)	Fourth Quarter (3) (4)
Fiscal 2008				
Revenue	$ 50,794	$ 51,606	$ 48,534	$ 42,318
Gross profit	$ 18,400	$ 17,465	$ 16,849	$ 16,027
Income (loss) from continuing operations	887	1,003	626	614
Income (loss) from discontinued operations	(669)	(436)	(431)	(1,070)
Net income (loss)	$ 218	$ 567	$ 195	$ (456)
Earnings (loss) per share from continuing operations – basic	0.03	0.03	0.02	0.02
Earnings (loss) per share from discontinued operations – basic	(0.02)	(0.01)	(0.01)	(0.03)
Earnings (loss) per share – basic (1)	$ 0.01	$ 0.02	$ 0.01	$ (0.01)
Earnings (loss) per share from continuing operations – diluted	0.03	0.03	0.02	0.02
Earnings (loss) per share from discontinued operations – diluted	(0.02)	(0.01)	(0.01)	(0.03)
Earnings (loss) per share – diluted (1)	$ 0.01	$ 0.02	$ 0.01	$ (0.01)
Fiscal 2007				
Revenue	$ 63,463	$ 66,565	$ 57,662	$ 58,883
Gross profit	$ 17,854	$ 17,464	$ 15,108	$ 18,801
Income (loss) from continuing operations	(640)	(4,867)	(2,684)	(2,164)
Income (loss) from discontinued operations	(338)	37	(932)	(616)
Net income (loss)	$ (978)	$ (4,830)	$ (3,616)	$ (2,780)
Earnings (loss) per share from continuing operations – basic	(0.02)	(0.13)	(0.07)	(0.06)
Earnings (loss) per share from discontinued operations – basic	(0.01)	0.00	(0.03)	(0.02)
Earnings (loss) per share – basic (1)	$ (0.03)	$ (0.13)	$ (0.10)	$ (0.08)
Earnings (loss) per share from continuing operations – diluted	(0.02)	(0.13)	(0.07)	(0.06)
Earnings (loss) per share from discontinued operations – diluted	(0.01)	0.00	(0.03)	(0.02)
Earnings (loss) per share – diluted (1)	$ (0.03)	$ (0.13)	$ (0.10)	$ (0.08)

(1) Income (loss) per share is computed independently for each of the quarters presented; accordingly, the sum of the quarterly income (loss) per share may not equal the total computed for the year.
(2) In the third quarter of fiscal 2007, the Company identified revenue transactions totaling $1.5 million that were incorrectly recorded in prior periods. A determination was made that these errors were not material to prior periods or the current period and a correction was made by reducing revenue by $1.5 million and reducing gross profit by $0.2 million in the third quarter.
(3) In the fourth quarter of fiscal 2007, the Company recorded $2.5 million of legal expenses relating to pending and threatened litigation.

(4) In the fourth quarter of fiscal 2007, the Company recorded approximately $1.7 million of accounting fees related primarily to the fiscal 2007 audit and European review.

PRESSTEK, INC. AND SUBSIDIARIES

SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS AND RESERVES
FROM CONTINUING OPERATIONS
(in thousands)

	Balance at beginning of period	Additions Charged to costs and expenses	Deductions and write-offs	Balance at end of period
Allowance for losses on accounts receivable				
Fiscal year				
2008	$ 2,538	$ 1,915	$ (1,977)	$ 2,476
2007	$ 2,712	$ 1,671	$ (1,845)	$ 2,538
2006	$ 3,215	$ 188	$ (691)	$ 2,712
Reserves for excess and obsolete inventory				
Fiscal year				
2008	$ 13,530	$ 437	$ (4,901)	$ 9,066
2007	$ 13,868	$ 5,255	$ (5,593)	$ 13,530
2006	$ 16,391	$ 786	$ (3,309)	$ 13,868

(1) Purchase accounting adjustments

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

Not applicable

Item 9A. Controls and Procedures.

(a) Evaluation of Disclosure Controls and Procedures

The Company carried out, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended). Based on their evaluation, the Company's Chief Executive Officer and its Chief Financial Officer concluded that, as of January 3, 2009, the Company's disclosure controls and procedures were not effective because of the material weakness identified as of such date discussed in Item 9A(b). Notwithstanding the existence of the material weakness described below, management has concluded that the consolidated financial statements in this Form 10-K fairly present, in all material respects, the Company's financial position, results of operations and cash flows for the periods and dates presented.

(b) Management's Report on Internal Control over Financial Reporting

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

With the participation of the Company's Chief Executive Officer and Chief Financial Officer, management conducted an evaluation of the effectiveness of our internal control over financial reporting as of January 3, 2009, based on the framework and criteria established in Internal Control – Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected in a timely basis. In its assessment of the effectiveness of internal control over financial reporting as of January 3, 2009, the Company determined that the following material weakness existed.

Accounting Resources

The Company did not maintain a sufficient complement of personnel with the appropriate level of experience and training in the application of U.S. generally accepted accounting principles ("U.S. GAAP") to analyze, review, and monitor the accounting for significant or non-routine transactions. This deficiency resulted in a reasonable possibility that a material misstatement of the Company's annual or interim financial statements would not be prevented or detected on a timely basis.

Because of the material weakness described above, management has concluded that our internal control over financial reporting was not effective as of January 3, 2009.

The effectiveness of the Company's internal control over financial reporting as of January 3, 2009, has been audited by the Company's independent registered public accounting firm, whose report is included on page 91 of this Annual Report on Form 10-K.

(c) Remediation Plan for Material Weakness in Internal Control over Financial Reporting

The Company disclosed a material weakness related to accounting for significant or non-routine transactions in the December 29, 2007 Form 10-K. This material weakness was titled “Accounting Resources” in Item 9A(b) of the January 3, 2009 Form 10-K because one of the deficiencies that constituted this material weakness that existed as of December 29, 2007 did not exist as of January 3, 2009.

The Company is transitioning certain accounting activities to the Greenwich, Connecticut office during 2009, and this has resulted in the loss of key personnel prior to completion of the 2008 financial reporting cycle, which contributed to the material weakness. Also, certain of the Company’s accounting personnel were hired near the end of or after fiscal 2008 and did not have sufficient knowledge of the Company to complete an effective review of all transactions.

Our management team continues to engage in substantial efforts to remediate the material weakness noted above. The following remedial actions are intended both to address the identified material weakness and to enhance our overall internal control over financial reporting.

The following remedial actions have been implemented through January 3, 2009:

- The Company improved the accounting resources by hiring a new Vice President and Corporate Controller, Assistant Controller, European Finance Director, and Cost Accounting Manager.

- The Company has implemented a process designed to ensure the timely analysis and documentation of all significant or non-routine accounting transactions by qualified accounting personnel. In addition, the analysis and related documentation must be reviewed and approved by senior management.

The following remedial actions will be implemented after January 3, 2009:

- A new Director of Tax was appointed in January 2009, and will focus on building a knowledgeable tax department in the Greenwich, Connecticut office.

- Effective March 17, 2009, the Company established a Financial Resources Steering Committee to develop and implement a corrective action plan to complete remediation of the material weakness. The Steering Committee is headed by the Chief Financial Officer, Vice President and Corporate Controller, and the Vice President of Human Resources.

- A new Financial Reporting Manager will be appointed to oversee accounting for significant or non-routine transactions and to prepare SEC filings.

- The Assistant Controller, under the direction of the Chief Financial Officer and Vice President and Corporate Controller, has commenced a process to recruit and train new accounting personnel for the accounting functions being transferred to the Greenwich, Connecticut office.

(d) Actions to Address Previously Reported Material Weaknesses that no Longer Exist at January 3, 2009

Management applied substantial resources toward successful remediation of three material weaknesses reported in the Company’s 2007 Annual Report on Form 10-K. The following is a summary of the three material weaknesses that no longer exist as January 3, 2009 and management’s remediation for each deficiency.

Revenue Recognition

Our 2007 Annual Report on Form 10-K identified a material weakness because we did not maintain adequate internal controls applicable to equipment revenue recognition to ensure that sufficient documentation regarding terms and conditions of equipment contracts and agreements were maintained to permit proper evaluation relative to revenue recognition of such contracts and agreements in accordance with U.S. GAAP. In addition, review controls over accounting for equipment revenue transactions were not operating effectively to identify accounting errors, and monitoring controls designed to ensure that an appropriate review was properly performed were not operating effectively. Since December 29, 2007 we have completed the following remedial actions:

- The Company's revenue recognition process was strengthened to include:
  - o Enhanced documentation requirements to support revenue transactions and their related accounting treatment;
  - o Requirements for additional senior financial and legal management approvals on departures from standard terms and conditions on sales and service agreements; and
  - o Clarification of revenue recognition treatment on distributor equipment transactions.

- Additional training regarding revenue recognition practices was provided to all sales personnel worldwide.

- Internal controls at our European operation have been strengthened and reinforced through additional training and supervision, the addition of a full-time European revenue analyst, and requirements for additional credit approvals. In addition, certain personnel changes and realignment of work responsibilities have been implemented.

- Revenue recognition processes have been restructured to increase sales and accounting personnel participation earlier in the sales process and to improve communication of key terms and conditions in equipment transactions.

- Review and monitoring controls over equipment transactions involving foreign operations have been enhanced to include a timely review of the terms of transactions by corporate accounting personnel.

Based on the foregoing and the results of our testing of the effectiveness of these controls, we believe that the previously reported material weakness no longer exists as of January 3, 2009.

Account Reconciliations and Journal Entries

Our 2007 Annual Report on Form 10-K identified a material weakness because account reconciliations and journal entries were not consistently reviewed and approved with appropriate supporting documentation in order to ensure completeness and accuracy. In addition, monitoring controls designed to ensure that account reconciliations were properly performed were not operating effectively. Since December 29, 2007 we have completed the following remedial actions:

- Additional training of Company personnel has been performed to ensure that key account reconciliations are performed, documented, reviewed and approved as part of the monthly financial closing process.

- The Company improved the accounting resources by hiring a new Vice President and Corporate Controller, Assistant Controller, and European Finance Director.

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Review and monitoring controls over key account reconciliations have been enhanced to include detailed reviews of monthly reconciliations and supporting documentation by Senior Corporate Finance personnel.

- Management review controls have been enhanced to ensure that all journal entries are reviewed and approved with appropriate supporting documentation.

Based on the foregoing and the results of our testing of the effectiveness of these controls, we believe that the previously reported material weakness no longer exists as of January 3, 2009.

Inventory

Our 2007 Annual Report on Form 10-K identified a material weakness because calculations that are performed to determine the inventory adjustments necessary relative to excess and obsolete inventory and the capitalization of manufacturing variances were not reviewed for completeness and accuracy at a sufficient level of precision by someone independent of the preparer and the Company did not have adequate controls to ensure the mathematical accuracy of spreadsheets that were used to perform such calculations. Since December 29, 2007 we have completed the following remedial actions:

- An independent review, by appropriate management personnel, is performed and documented in a detailed manner to ensure that these complex calculations are performed accurately.
- The Company has enhanced the spreadsheet controls over the mathematical accuracy of spreadsheets for these inventory account calculations.
- The Company improved the accounting resources by hiring a new Vice President and Corporate Controller, Assistant Controller, European Finance Director, and Cost Accounting Manager.

Based on the foregoing and the results of our testing of the effectiveness of these controls, we believe that these previously reported material weaknesses no longer exists as of January 3, 2009.

(e) Changes in Internal Control over Financial Reporting

Other than the foregoing measures to remediate the material weaknesses described in Item 9A(d) which were completed during the quarter ended January 3, 2009, there was no change in the Company's internal control over financial reporting during the quarter ended January 3, 2009, that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Presstek, Inc.:

We have audited Presstek, Inc.'s internal control over financial reporting as of January 3, 2009, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Presstek, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting (Item 9Ab). Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

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

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

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

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. A material weakness related to accounting resources has been identified and included in management's assessment. We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Presstek, Inc. and subsidiaries as of January 3, 2009 and December 29, 2007 and the related consolidated statements of operations, changes in stockholders' equity and comprehensive income, and cash flows for each of the fiscal years in the three-year period ended January 3, 2009 of Presstek, Inc. and subsidiaries. The material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2009 consolidated financial statements, and this report does not affect our report dated March 24, 2009, which expressed an unqualified opinion on those consolidated financial statements.

In our opinion, because of the effect of the aforementioned material weakness on the achievement of the objectives of the control criteria, Presstek, Inc. has not maintained effective internal control over financial reporting as of January 3, 2009, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

/s/ KPMG LLP

Boston, Massachusetts
March 24, 2009

Item 9B. Other Information.

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance.

Directors

Information with respect to our directors and nominees may be found under the caption "Election of Directors" of the Company's proxy statement to be delivered to stockholders in connection with the Annual Meeting of Stockholders to be held on June 3, 2009 (the "Proxy Statement"). Such information is incorporated herein by reference.

Executive Officers

The Company's executive officers as of the date of this Annual Report on Form 10-K are as follows:

Executive Officer	Position	Age at January 3, 2009
Jeffrey Jacobson	Chairman, President and Chief Executive Officer	49
Jeffrey A. Cook	Executive Vice President and Chief Financial Officer	54
Mark J. Levin	President, Americas Region	52
Kathleen McHugh	Vice President and Chief Marketing Officer	50
Wayne L. Parker	Vice President, Corporate Controller and Chief Accounting Officer	51
James R. Van Horn	Vice President, General Counsel and Secretary	52

Jeffrey Jacobson was appointed President and Chief Executive Officer and a director of the Company in May 2007, and added the title of Chairman on January 1, 2009. From April 2005 until April 2007, he was a Corporate Vice President and the Chief Operating Officer of Kodak's Graphic Communications Group, a division formed by the integration of six different Kodak companies into a $3.6 billion global enterprise. From April, 2000 through April, 2005, Mr. Jacobson served as Chief Executive Officer of Kodak Polychrome Graphics, a $1.7 billion global joint venture between Sun Chemical Corporation and Kodak. In all, Mr. Jacobson has 22 years of experience in the graphics arts industry. Mr. Jacobson is a board member of the Electronic Document Systems Foundation, as well as a board member of the New York University Graphic Communications Management and Technology Advisory Board.

Jeffrey A. Cook was appointed Senior Vice President, Chief Financial Officer in February 2007 and appointed Executive Vice President in February 2008. From July 2005 until February 2007 he was self-employed. Prior thereto,

he served as Senior Vice President and Chief Financial Officer of Kodak Polychrome Graphics, a joint venture between Kodak and Sun Chemical Corporation.

Mark J. Levin was appointed President, Americas Region in November 2007. From October 2005 until March 2007 he served as President-Commercial Group of Sun Chemical Corporation. From October 2003 until October 2005 he served as President-Publication Inks of Sun Chemical. Prior thereto, he served as Senior Vice President of Heidelberg.

Kathleen McHugh was appointed Vice President and Chief Marketing Officer in May, 2008. Ms. McHugh, with over 20 years of industry experience, is focused on expanding Presstek's global presence in the growing digital color printing market. Ms. McHugh joined Kodak in 1984, and most recently served as Vice President and Regional Business Manager of Kodak's U.S. and Canadian Prepress Solutions. Previously, Ms. McHugh served as Kodak's Vice President, Global Marketing, Prepress Solutions. From 1998 to 2005, Ms. McHugh held high level strategic and marketing roles in Kodak Polychrome Graphics, a joint venture between Kodak and Sun Chemical companies.

Wayne L Parker was appointed Vice President, Corporate Controller and Chief Accounting Officer of the Company in April, 2008. Mr. Parker is a CPA with extensive financial experience, including compliance and audit, in major organizations across several industries. Mr. Parker joined Presstek in May, 2007 as Director of Internal Audit. Prior to joining Presstek, Mr. Parker served as Director, Sarbanes-Oxley Compliance at Kodak Company's Graphics Communications Group; and Director of Internal Audit at Kodak Polychrome Graphics.

James R. Van Horn was appointed Vice President and General Counsel of the Company in October 2007 and Secretary in December 2007. From January 2007 until October 2007 he served as a consultant to Sun-Times Media Group, Inc. From March 2004 to January 2007 he served as Vice President, General Counsel and Secretary of Sun-Times Media Group, Inc. Prior thereto he served as Chief Administrative Officer, General Counsel and Secretary of NUI Corporation.

Audit Committee

The information in the Proxy Statement under the caption "Audit Committee" is incorporated herein by reference.

Compliance With Section 16(A) of the Exchange Act

The information in the Proxy Statement under the caption "Section 16(a) Beneficial Ownership Reporting Compliance" is incorporated herein by reference.

Code of Ethics

The policies comprising the Company's code of ethics are set forth in the Company's Code of Business Conduct and Ethics. These policies contain provisions satisfying all the elements of the SEC's requirements for a "code of ethics," and apply to all directors, officers and employees, as well as the directors, officers and employees of any of its subsidiaries. The Code of Business Conduct and Ethics can be found on the Company's website at www.presstek.com/about-investor-code.htm. The Company will disclose any amendments to the Code of Business Conduct and Ethics with regard to the provisions of the Code required by SEC requirements, or any waivers from such provisions provided to any of the Company's principal executive, financial or accounting officers or controller (or persons performing similar functions), on that website or in a report on Form 8-K.

Item 11. Executive Compensation.

The information in the Proxy Statement under the captions "Executive Compensation" and "Compensation of Directors" is incorporated herein by reference.

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

The information in the Proxy Statement under "Security Ownership of Certain Beneficial Owners and Management" and "Securities Authorized for Issuance Under Equity Compensation Plans Information" is incorporated herein by reference.

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

The information in the Proxy Statement under the captions “Related Person Transactions” and “Board of Directors and Committee Independence” is incorporated herein by reference.

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Item 14. Principal Accounting Fees and Services.

The information in the Proxy Statement under the caption “Independent Audit Fees” is incorporated herein by reference.

PART IV

Item 15. Exhibits and Financial Statement Schedules.

(a) (1) Financial Statements

The consolidated financial statements of the Company are listed in the index under Part II, Item 8, of this Annual Report on Form 10-K.

(2) Financial Statement Schedule

The following financial statement schedule is filed as part of this report under Schedule II (Valuation and Qualifying Accounts and Reserves) for the 2006 – 2008 fiscal years. All other schedules called for by Form 10-K are omitted because they are inapplicable or the required information is contained in the consolidated financial statements, or notes thereto, included herein.

(3) Exhibits

The exhibits that are filed with this Annual Report on Form 10-K, or that are incorporated herein by reference, are set forth in the Exhibit Index hereto, which index is incorporated by reference herein.

SIGNATURES

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

PRESSTEK, INC.

/s/ Jeffrey Jacobson
Jeffrey Jacobson
Chairman, President and Chief Executive Officer

Date: March 24, 2009

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

/s/ Jeffrey Jacobson Jeffrey Jacobson	Chairman, President and Chief Executive Officer (Principal Executive Officer)	March 24, 2009
/s/ Jeffrey A. Cook Jeffrey A. Cook	Executive Vice President and Chief Financial Officer (Principal Financial Officer)	March 24, 2009
/s/ Wayne L. Parker Wayne L. Parker	Vice President – Corporate Controller (Principal Accounting Officer)	March 24, 2009
/s/ John W. Dreyer John W. Dreyer	Lead Director	March 24, 2009
/s/ Edward E. Barr Edward E. Barr	Director	March 24, 2009
/s/ Daniel S. Ebenstein, Esq. Daniel S. Ebenstein, Esq.	Director	March 24, 2009
/s/ Dr. Lawrence Howard Dr. Lawrence Howard	Director	March 24, 2009

/s/ Steven N. Rappaport Steven N. Rappaport	Director	March 24, 2009
/s/ Frank D. Steenburgh Frank D. Steenburgh	Director	March 24, 2009
/s/ Donald C. Waite, III Donald C. Waite, III	Director	March 24, 2009

Exhibit Number	Description	Reference
2.1	(i) Asset Purchase Agreement among Presstek, Inc., Silver Acquisitions Corp., Paragon Corporate Holdings, Inc., A.B. Dick Company, A.B. Dick Company of Canada, Ltd. And Interactive Media Group, Inc., dated July 13, 2004.	Incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K, filed on July 13, 2004.
	(ii) Amendment to Asset Purchase Agreement between the Presstek, Inc. and A.B. Dick Company dated August 20, 2004.	Incorporated by reference to Exhibit 2.2 to the Company's Current Report on Form 8-K, filed on November 12, 2004.
	(iii) Second Amendment to Asset Purchase Agreement between Presstek, Inc. and A.B. Dick Company dated November 5, 2004.	Incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K, filed on November 12, 2004.
3.1	Amended and Restated Certificate of Incorporation of Presstek, Inc.	Incorporated by reference to Exhibit 3(i) to the Company's Quarterly Report on Form 10-Q for the quarter ended June 29, 1996.
3.2	By-laws of Presstek, Inc.	Incorporated by reference to Exhibit 3(ii) to the Company's Annual Report on Form 10-K for the fiscal year ended December 30, 1995.
10.1**	1998 Stock Incentive Plan.	Incorporated by reference to Exhibit A to the Company's Definite Proxy Statement, filed April 24, 1998.
10.2**	2002 Employee Stock Purchase Plan of Presstek, Inc.	Incorporated by reference to Exhibit 4.3 to the Company's Registration Statement on Form S-8, filed August 9, 2002.
10.3**	2003 Stock Option and Incentive Plan of Presstek, Inc.	Incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 28, 2003.
10.4**	2008 Omnibus Incentive Plan.	Incorporated by reference to Appendix A to the Company's Definite Proxy Statement, filed May 9, 2008.
10.5*	OEM Consumables Supply Agreement by and between Presstek, Inc. and Heidelberger Druckmaschinen, AG., dated July 1, 2003.	Incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 27, 2003.
10.6*	OEM Consumables Supply Agreement by and between Presstek, Inc. and Heidelberg U.S.A., Inc. dated July 1, 2003.	Incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 27, 2003.
10.7	(i) Credit Agreement by and among Presstek, Inc., Lasertel Inc., Citizens	Incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report

Bank New Hampshire and Keybank National Association dated October 15, 2003.	on Form 10-Q for the quarter ended September 27, 2003.
(ii) Amended and Restated Credit Agreement among the Presstek, Inc., Citizens Bank New Hampshire, KeyBank National Association and Bank North N.A. dated November 5, 2004.	Incorporated by reference to Exhibit 99.1 to the Company's Form 8-K filed on November 12, 2004.

	(iii) Amendment to the Amended and Restated Credit Agreement among the Presstek, Inc., Citizens Bank New Hampshire, KeyBank National Association and Bank North N.A. dated July 29, 2008.	Incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K, filed July 31, 2008.
10.8	Security Agreement by and between Presstek, Inc. and Citizens Bank New Hampshire dated October 15, 2003.	Incorporated by reference to Exhibit 10.9 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 27, 2003.
10.9	Security Agreement by and between Lasertel, Inc. and Citizens Bank New Hampshire dated October 15, 2003.	Incorporated by reference to Exhibit 10.10 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 27, 2003.
10.10	Security Agreement (Intellectual Property) by and between Presstek, Inc. and Citizens Bank New Hampshire dated October 15, 2003.	Incorporated by reference to Exhibit 10.11 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 27, 2003.
10.11	Security Agreement (Intellectual Property) by and between Lasertel, Inc. and Citizens Bank New Hampshire dated October 15, 2003.	Incorporated by reference to Exhibit 10.12 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 27, 2003.
10.12	Mortgage and Security Agreement between Presstek, Inc. and Citizens Bank New Hampshire dated October 15, 2003.	Incorporated by reference to Exhibit 10.13 to the Company's Quarterly Report on Form 10-Q for the quarter ended November 12, 2003.
10.13	Deed of Trust, Assignment of Rents, Security Agreement and Fixture Filing by and among Presstek, Inc., First American Title Insurance Company and Citizens Bank New Hampshire dated October 15, 2003.	Incorporated by reference to Exhibit 10.14 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 27, 2003.
10.14	Amendment dated July 29, 2008, to the Amended Restated Credit Agreement among Presstek, Inc., Citizens Bank New Hampshire, KeyBank National Association and Bank North N.A. dated November 5, 2004.	Incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K, filed July 31, 2008.
10.15**	Employment Agreement by and between Presstek, Inc. and Jeffrey Cook dated February 27, 2007.	Incorporated by reference to Exhibit 10(u) to the Company's Annual Report on Form 10-K for the fiscal year ended December 30, 2007.
10.16**	Nonqualified Stock Option Agreement by and between Presstek, Inc. and Jeffrey Cook dated February 27, 2007.	Incorporated by reference to Exhibit 99.2 to the Company's Current Report on Form 8-K, filed March 2, 2007.
10.17**	Employment Agreement by and between Presstek, Inc. and Jeffrey Jacobson dated May 10, 2007.	Incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended

		March 31, 2007.
10.18**	Non-Plan, Non-qualified Stock Option Agreement by and between Presstek, Inc. and Jeffrey Jacobson dated May 10, 2007.	Incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the quarter end March 31, 2007.
10.19**	Forms of Stock Option Agreement under 2008 Omnibus Incentive Plan.	Filed with this report.
10.20	(i) Purchase and Sale Agreement and Escrow Instruction by and between Presstek, Inc. and EJC Properties, LLLP dated April 24, 2008.	Filed with this report.
	(ii) First Amendment to Purchase and Sale Agreement and Escrow Instruction by and between Presstek, Inc. and EJC Properties, LLLP dated June 27, 2008	Filed with this report.
21.1	Subsidiaries of the Registrant.	Filed with this report.
23.1	Consent of KPMG LLP.	Filed with this report.
31.1	Certification of Chief Executive Officer Pursuant to Section 240.13a-14 or Section 240.15d-14 of the Securities Exchange Act of 1934, as amended.	Filed with this report.
31.2	Certification of Chief Financial Officer Pursuant to Section 240.13a-14 or Section 240.15d-14 of the Securities Exchange Act of 1934, as amended.	Filed with this report.
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	Filed with this report.
32.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	Filed with this report.

* The SEC has granted Presstek's request of confidential treatment with respect to a portion of this exhibit.

** Management contract or compensatory plan or arrangement.