DIEBOLD INC
Form 10-K
September 30, 2008

United States Securities and Exchange Commission
Washington, D.C. 20549

F O R M 10 - K

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (D) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2007
OR
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 1-4879

Diebold, Incorporated
(Exact name of registrant as specified in its charter)

Ohio (State or other jurisdiction of incorporation or organization)	**34-0183970** (IRS Employer Identification Number)
5995 Mayfair Road, P.O. Box 3077, North Canton, Ohio (Address of principal executive offices)	**44720-8077** (Zip Code)

REGISTRANT S TELEPHONE NUMBER, INCLUDING AREA CODE: (330) 490-4000

SECURITIES REGISTERED PURSUANT TO SECTION 12 (B) OF THE ACT:

Title of each class	**Name of each Exchange on Which Registered:**
Common Shares $1.25 Par Value	New York Stock Exchange

SECURITIES REGISTERED PURSUANT TO SECTION 12 (G) OF THE ACT:
None

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

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

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

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

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

Large accelerated filer 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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2007, the last business day of the registrant s most recently completed second fiscal quarter. The aggregate market value was computed by using the closing price on the New York Stock Exchange on June 30, 2007 of $52.20 per share.

Common Shares, Par Value $1.25 per Share	$ 3,391,411,136

Indicate the number of shares outstanding of each of the registrant s classes of common stock, as of the latest practicable date.

Class	**Outstanding at August 29, 2008**
Common Shares $1.25 Par Value	66,100,607

DOCUMENTS INCORPORATED BY REFERENCE

None.

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Special Note

Concurrently with filing this annual report on Form 10-K, we are filing our delayed quarterly reports for the quarters ended June 30, 2007, September 30, 2007, March 31, 2008 and June 30, 2008. These reports were delayed due to the Company s discussions with the Office of the Chief Accountant (OCA) of the Securities and Exchange Commission (SEC) with regard to the Company s practice of recognizing certain revenue on a bill and hold basis in its North America business segment, as well as due to the review of other accounting matters described below. As a result of those discussions with the OCA, the Company determined that its previous, long-standing method of accounting for bill and hold transactions was in error, representing a misapplication of generally accepted accounting principles, and that it would discontinue its use of bill and hold as a method of revenue recognition in its North America and International businesses. On January 9, 2008, management of the Company, in consultation with the Audit Committee of the Company s Board of Directors and KPMG LLP, the Company s independent registered public accounting firm, concluded that the Company s financial statements for the fiscal years ended December 31, 2006, 2005, 2004 and 2003; the quarterly data in each of the quarters for the years ended December 31, 2006 and 2005; and the quarter ended March 31, 2007, must be restated and should no longer be relied upon. In addition, the Company, in consultation with its outside advisors, reviewed other accounting and financial reporting matters. This review has been completed and the results have been reported to the Audit Committee. Accordingly, the Company is restating its previously issued financial statements for those periods to reflect the discontinuation of the use of the bill and hold method of revenue recognition as well as the results of the review.

The adjustments made as a result of the restatement are more fully discussed in Note 2 to the Consolidated Financial Statements included in Part II Item 8 Financial Statements and Supplementary Data, and the cumulative impact of the restated financial results at the beginning of Fiscal 2003 is presented in Part II Item 6 Selected Financial Data. Also, for discussion of the background of the restatement, see Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Audit of Restatement of Consolidated Financial Statements. For a description of the material weaknesses identified by management as a result of the review and management s plan to remediate those material weaknesses, see Part II Item 9A Controls and Procedures.

Part I

ITEM 1: BUSINESS
(Dollars in thousands)

GENERAL DEVELOPMENT OF BUSINESS

Diebold, Incorporated (collectively with its subsidiaries, the Company) was incorporated under the laws of the state of Ohio in August 1876, succeeding a proprietorship established in 1859, and is engaged primarily in the sale, manufacture, installation and service of automated self-service transaction systems, electronic and physical security products, election systems and software. The Company specializes in technology that empowers people worldwide to access services when, where and how they may choose.

FINANCIAL INFORMATION ABOUT SEGMENTs

The Company s segments comprise its three main sales channels: Diebold North America (DNA), Diebold International (DI) and Election Systems (ES) & Other. The DNA segment sells financial and retail systems, and also services financial and retail systems in the United States and Canada. The DI segment sells and services financial and retail systems over the remainder of the globe. The ES & Other segment includes the operating results of Premier Election Solutions, Inc. (PESI) and the voting and lottery related business in Brazil. Segment financial information can be found in Note 16 to the Consolidated Financial Statements, which is incorporated herein by reference.

NARRATIVE DESCRIPTION OF BUSINESS

The Company develops, manufactures, sells and services self-service transaction systems, electronic and physical security systems, software and various products used to equip bank facilities and electronic voting terminals. The Company s primary customers include banks and financial institutions, as well as public libraries, government agencies, utilities and various retail outlets. Sales of systems and equipment are made directly to customers by the Company s sales personnel and by manufacturers representatives and distributors globally. The sales/support organization works closely with customers and their consultants to analyze and fulfill the customers needs. In 2007, 2006 and 2005, the Company s sales and services of financial systems and equipment and security solutions accounted for 97.9, 92.1 and 94.0 percent, respectively, of consolidated net sales.

PRODUCT GROUPS

Self-Service Products

The Company offers an integrated line of self-service banking products and Automated Teller Machines (ATMs). The Company is a leading global supplier of ATMs and holds the leading market position in many countries around the world.

Physical Security and Facility Products

The Company s Physical Security and Facility Products division designs and sells several of the Company s financial service solutions offerings, including the RemoteTeller^{tm} System (RTS). The business unit also develops vaults, safe deposit boxes and safes, drive-up banking equipment and a host of other banking facilities products.

Election Systems

The Company, through its wholly-owned subsidiaries PESI and Procomp Industria Eletronica S.A., is one of the larger providers of voting system equipment and related products in the world.

Integrated Security Solutions

Diebold Integrated Security Solutions provide global sales, service, installation, project management and monitoring of original equipment manufacturer (OEM) electronic security products to financial, government, retail and commercial customers. These solutions provide the Company s customers a single-source solution to their electronic security needs.

Software Solutions and Services

The Company offers software solutions consisting of multiple applications that process events and transactions. These solutions are delivered on the appropriate platform, allowing the Company to meet customer requirements while adding new functionality in a cost-effective manner.

The Company also provides professional services to assist in the implementation of software solutions. These services include communication network review, systems integration, custom software and project management that encompass all facets of a successful financial self-service implementation.

OPERATIONS

The principal raw materials used by the Company are steel, plastics, and electronic components, which are purchased from various major suppliers. Electronic parts and components are also procured from various suppliers. These materials and components are generally available in quantity at this time.

The Company had no customers that accounted for more than 10 percent of total net sales in 2007, 2006 and 2005.

The Company s operating results and the amount and timing of revenue are affected by numerous factors including production schedules, customer priorities, sales volume and sales mix. During the past several years, the Company has dramatically changed the focus of its self-service business to that of a total solutions approach. The value of unfilled orders is not as meaningful an indicator of future revenues due to the significant portion of revenues derived from the Company s growing service-based business, for which order information is not available. Therefore, the Company believes that backlog information is not material to an understanding of its business and does not disclose backlog information.

The Company carries working capital mainly related to accounts receivable and inventories. Inventories, generally, are only manufactured as orders are received from customers. The Company s normal and customary payment terms are net 30 days from date of invoice. The Company generally does not offer extended payment terms. The Company s government customers represent a small portion of the Company s business. Domestically, with the exception of PESI, the Company s contracts with its government customers do not contain fiscal funding clauses. In the event that such a clause exists, revenue would not be recognizable until the funding clause was satisfied. Internationally, contracts with Brazil s government are subject to a twenty-five percent quantity adjustment prior to Diebold s purchasing any raw materials under the contracted purchasing schedule. In general, with the exception of PESI, the Company recognizes revenue for delivered elements only when the fair values of undelivered elements are known, uncertainties regarding customer acceptance are resolved and there are no customer-negotiated refunds or return rights affecting the revenue recognized for the delivered elements.

COMPETITION

All phases of the Company s business are highly competitive; some products being in competition directly with similar products and others competing with alternative products having similar uses or producing similar results. The

Company believes, based upon outside independent industry surveys, that it is a leading manufacturer of self-service systems in the United States and is also a market leader internationally. In the area of automated transaction systems, the Company competes primarily with NCR Corporation, Wincor-Nixdorf, Grg Equipment Co., and Itautec. In serving the security products market for the financial services industry, the Company competes with national, regional and local security companies. Of these competitors, some compete in only one or two product lines, while others sell a broader spectrum of products competing with the Company. The unavailability of comparative sales information and the large variety of individual products make it difficult to give reasonable estimates of the Company s competitive ranking in or share of the market in its security product fields of activity. However, Diebold is ranked as one of the top integrators in the security market.

In the election systems market, the Company provides product solutions and support for customers within the United States and Brazil. Competition in this market is typically from smaller, privately held, niche companies.

PATENTS, TRADEMARKS, LICENSES

The Company owns patents, trademarks and licenses relating to certain products in the United States and internationally. While the Company regards these as items of importance, it does not deem its business as a whole, or any industry segment, to be materially dependent upon any one item or group of items.

RESEARCH, DEVELOPMENT & ENGINEERING

The Company charged to expense $73,950 in 2007, $71,625 in 2006 and $59,937 in 2005 for research, development and engineering costs.

ENVIRONMENTAL

Compliance by the Company with federal, state and local environmental protection laws during 2007 had no material effect upon capital expenditures, earnings or the competitive position of the Company and its subsidiaries.

EMPLOYEES

The total number of employees at December 31, 2007 was 16,942 compared with 15,451 at the end of the preceding year. Diebold s service staff is one of the financial industry s largest, with professionals in more than 600 locations worldwide.

FINANCIAL INFORMATION ABOUT GEOGRAPHIC AREAS

Sales to customers outside the United States in relation to total consolidated net sales were $1,434,931 or 48.4 percent in 2007, $1,373,514 or 46.7 percent in 2006, and $1,038,549 or 40.2 percent in 2005.

Property, plant and equipment, at cost, located in the United States totaled $424,657, $398,425 and $423,267 as of December 31, 2007, 2006 and 2005, respectively, and property, plant and equipment, at cost, located outside the United States totaled $151,139, $152,072, $122,991 as of December 31, 2007, 2006 and 2005, respectively.

Additional information regarding the Company s international operations is included in the Note 16 to the Consolidated Financial Statements, which is incorporated herein by reference.

The Company s non-U.S. operations are subject to normal international business risks not generally applicable to domestic business. These risks include currency fluctuation, new and different legal and regulatory requirements in local jurisdictions, political and economic changes and disruptions, tariffs or other barriers, potentially adverse tax consequences and difficulties in staffing and managing foreign operations.

AVAILABLE INFORMATION

This annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports are available, free of charge, on or through its website, www.diebold.com, as soon as practicable after such material is electronically filed with or furnished to the SEC. Additionally, these reports can be furnished free of charge to shareholders upon written request to Diebold Global Communications at the corporate address, or call +1 330 490-3790 or [800] 766-5859. The public may read and copy any materials that we file with the SEC at the SEC s Public Reference Room at 100 F Street, N.E., Room 1580, Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at www.sec.gov.

ITEM 1A: RISK FACTORS

The following are certain risk factors that could affect the business, financial condition, operating results and cash flows of the Company. These risk factors should be considered in connection with evaluating the forward-looking statements contained in this annual report on Form 10-K because these risk factors could cause the Company s actual results to differ materially from those expressed in any forward-looking statement. The risks the Company has highlighted below are not the only ones the Company faces. If any of these events actually occurs, the Company s business, financial condition, operating results or cash flows could be negatively affected. The Company cautions the reader to keep in mind these risk factors and to refrain from attributing undue certainty to any forward-looking statements, which speak only as of the date of this annual report.

Demand for and supply of the Company s products and services may be adversely affected by numerous factors, some of which the Company cannot predict or control, which could adversely affect the Company s results of operations.

Numerous factors may affect the demand for and supply of the Company s products and services, including:

changes in the market acceptance of the Company s products and services;

customer and competitor consolidation;

changes in customer preferences;

declines in general economic conditions;

changes in environmental regulations that would limit the Company s ability to sell products and services in specific markets; and

macro-economic factors affecting banks, credit unions and other financial institutions may lead to cost-cutting efforts by our customers, which could cause us to lose current or potential customers or achieve less revenue per customer.

If any of these factors occurs, the demand for and supply of the Company s products and services could suffer, which would adversely affect the Company s results of operations.

Increased raw material and energy costs could reduce the Company s income.

The primary raw materials in the Company s financial self-service, security and election systems business segments are steel, plastics and electronic components. The majority of the Company s raw materials are purchased from various local, regional and global suppliers pursuant to long-term supply contracts. However, the price of these materials fluctuates under these contracts in tandem with the prices of raw materials that are used in the manufacture of the Company s products.

In addition, energy prices, particularly petroleum, are cost drivers for the Company s business. In recent years, the price of petroleum has been highly volatile, particularly due to the unstable political conditions in the Persian Gulf.

Any increase in the costs of energy would also increase the Company s transportation costs. Although the Company attempts to pass on higher raw material and energy costs to the Company s customers, given the Company s competitive markets, it is often not possible to pass on all of these increased costs.

Our business may be affected by general economic conditions and uncertainty that may cause customers to defer or cancel sales commitments previously made to us.

Recent economic difficulties in the Unites States credit markets and certain international markets may lead to an economic recession in some or all of the markets in which we operate. A recession or even the risk of a potential recession may be sufficient reason for customers to delay, defer or cancel purchase decisions, including decisions previously made. Under difficult economic conditions, customers may seek to reduce discretionary spending by forgoing purchases of our products and services. This risk is magnified for capital goods purchases such as ATMs and physical security products. As a result of economic conditions and other factors, financial institutions have failed and may continue to fail; resulting in a loss of current or potential customers or causing them to defer or cancel sales. Any customer delays or cancellation in sales orders could materially affect our level of revenues and operating results.

The Company s sales and operating results are sensitive to global economic conditions and cyclicality and could be adversely affected during economic downturns.

Demand for the Company s products is affected by general economic conditions and the business conditions of the industries in which the Company sells our products and services. The business of most of the Company s customers, particularly our financial institution and election systems customers is, to varying degrees, cyclical and has historically experienced periodic downturns. Any future downturns in general economic conditions could adversely affect the demand for our products and services and our sales and operating results. In addition, downturns in our customers industries, even during periods of strong general economic conditions, could adversely affect our sales and our operating results. As a result of economic conditions and other factors, financial institutions have failed and may continue to fail; resulting in a loss of current or potential customers or causing them to defer or cancel sales. Additionally, the unstable political conditions in the Persian Gulf could lead to financial, economic and political instability, which could lead to a further deterioration in general economic conditions.

The Company may be unable to achieve, or may be delayed in achieving, our cost-cutting initiatives, which may adversely affect our results of operations and cash flow.

The Company has launched a number of cost-cutting initiatives, including the Company s restructuring initiatives, to improve operating efficiencies and reduce operating costs. Although the Company is anticipating a substantial amount of annual cost savings associated with these cost-cutting initiatives, we may be unable to sustain the cost savings that the Company has achieved. In addition, if the Company is unable to achieve, or has any unexpected delays in achieving additional cost savings, the Company s results of operations and cash flow may be adversely affected. Even if the Company meets the goals pursuant to these initiatives, the Company may not receive the expected financial benefits of these initiatives.

The Company faces competition that could adversely affect our sales and financial condition.

All phases of the Company s business are highly competitive; some products being in competition directly with similar products and others competing with alternative products having similar uses or producing similar results. The Company encounters competition in price, delivery, service, performance, product innovation, product recognition and quality.

Because of the potential for consolidation in any market, the Company s competitors may become larger, which could make them more efficient and permit them to be more price-competitive. Increased size could also permit them to operate in wider geographic areas and enhance their abilities in other areas such as research and development and customer service, which could also reduce the Company s profitability.

The Company s competitors can be expected to continue to develop and introduce new and enhanced products, which could cause a decline in market acceptance of the Company s products. In addition, the Company s competitors could cause a reduction in the prices for some of the Company s products as a result of intensified price competition. Also, the Company may be unable to effectively anticipate and react to new entrants in the marketplace for the Company s products.

Competitive pressures can also result in the loss of major customers. An inability to compete successfully could have an adverse effect on our results of operations, financial condition and cash flows in any given period.

In international markets, we compete with local service providers that may have competitive advantages.

In a number of international markets, especially those in Asia Pacific and Latin America, we face substantial competition from local service providers that offer competing products and services. Some of these companies may have a dominant market share in their territories and may be owned by local stakeholders, which could give them a competitive advantage. Local providers of competing products and services may also have a substantial advantage over us in attracting customers in their country due to more established branding in that country, greater knowledge with respect to the tastes and preferences of customers residing in that country and/or their focus on a single market. Further, the local providers may have greater regulatory and operational flexibility than the Company due to the fact that we are subject to both U.S. and foreign regulatory requirements.

Because our operations are conducted worldwide, they are affected by risks of doing business abroad.

The Company generates a significant percentage of our revenue from sales and service operations conducted outside the United States. Revenue from international operations amounted to approximately 48.4 percent in 2007, 46.7 percent in 2006 and 40.2 percent in 2005 of total revenue during these respective periods. Accordingly, our international operations are subject to the risks of doing business abroad, including the following:

- fluctuations in currency exchange rates;
- transportation delays and interruptions;
- political and economic instability and disruptions;
- restrictions on the transfer of funds;
- the imposition of duties and tariffs;
- import and export controls;
- changes in governmental policies and regulatory environments;
- labor unrest and current and changing regulatory environments;
- the uncertainty of product acceptance by different cultures;
- the risks of divergent business expectations or cultural incompatibility inherent in establishing joint ventures with foreign partners;
- difficulties in staffing and managing multi-national operations;
- limitations on our ability to enforce legal rights and remedies;
- reduced protection for intellectual property rights in some countries; and
- potentially adverse tax consequences.

Any of these events could have an adverse effect on our international operations in the future by reducing the demand for our products, decreasing the prices at which the Company can sell our products or otherwise having an adverse effect on our business, financial condition or results of operations. The Company may not be able to continue to operate in compliance with applicable customs, currency exchange control regulations, transfer pricing regulations or any other laws or regulations to which the Company may be subject. In addition, these laws or regulations may be modified in the future, and the Company may not be able to operate in compliance with those modifications.

The Company may expand operations into international markets in which we may have limited experience or rely on business partners.

We are continually looking to expand the Company s products and services into international markets. We have currently developed, through joint ventures, strategic investments, subsidiaries and branch offices, sales and service offerings in over 90 countries outside of the United States. As we expand into new international markets, we will have only limited experience in marketing and operating our products and services in such markets. In other instances, we may rely on the efforts and abilities of foreign business partners in such markets. Certain international markets may be slower than domestic markets in adopting our products and services and so our operations in international markets may not develop at a rate that supports our level of investment.

The failure of governments to certify election systems products may hinder our growth and harm our business.

The Help America Vote Act (HAVA) required that jurisdictions have HAVA-compliant equipment by January 1, 2006; however, despite that deadline, numerous jurisdictions have not yet become HAVA-compliant. Further, individual states and municipalities have the discretion as to how they will become compliant with HAVA. It is uncertain at this time the extent to which challenges raised about reliability and security of the Company s election systems products, including the risk that such products will not be certified for use or will be decertified, could adversely effect our business, financial condition and results of operation.

The Company could be subject to differing and inconsistent laws, regulations and certification requirements with respect to our election systems products. If that were to happen, the Company may find it necessary to eliminate, modify or cancel components of our services that could result in additional development costs and the possible loss of revenue. Future legislative changes or other changes in the laws could have an adverse effect on our business, financial condition and results of operations.

Our election systems products might not achieve market acceptance, which could adversely affect our growth.

The rate at which state and local government bodies have accepted electronic voting products has varied significantly by locale. Despite the passing of the HAVA deadline, the Company expects to continue to experience variations in the degree to which these programs are accepted. The Company s ability to grow will depend on the extent to which our potential customers accept our products. This acceptance may be limited by:

- the failure of jurisdictions to certify our election systems products;
- jurisdictions decertifying products that had previously been certified;
- the failure of prospective customers to conclude that our products are valuable and should be used;
- the reluctance of our prospective customers to replace their existing solutions with our products; and
- marketing efforts of our competitors.

Concerns about security and negative publicity regarding our election systems segment could slow acceptance of our election systems products.

Because of the political nature of our election systems business, various individuals and advocacy groups may raise challenges in the media and elsewhere, including legal challenges, about the reliability and security of the Company s election systems products and services. Our election systems business is vulnerable to these types of challenges because the electronic election systems industry is emerging. Furthermore, in the event of adverse publicity, whether directed at us or our competitors products, due to processing errors or other system failures, the electronic election systems industry could suffer as a whole, which would have an adverse effect on our business, financial condition and results of operations. In addition, these efforts may adversely affect the Company s relations with its election systems customers.

The Company is currently subject to shareholder class action litigation, the unfavorable outcome of which might have a material adverse effect on our financial condition, results of operations and cash flows.

A number of shareholder class action lawsuits have been filed against us and certain of our current and former officers and directors, alleging violations of the federal securities laws and breaches of fiduciary duties with respect to the Company s 401(k) savings plan. The shareholder class action was dismissed and the court entered a judgment in favor of the defendants in August 2008, but the plaintiffs have appealed the court s decision. The Company believes that these lawsuits are without merit and the Company intends to defend itself vigorously. The Company cannot, however, determine with certainty the outcome or resolution of these claims or any future related claims, or the timing for their resolution. In addition to the expense and burden incurred in defending this litigation and any damages that the Company may suffer, our management s efforts and attention may be diverted from the ordinary business operations in order to address these claims. If the final resolution of this litigation is unfavorable to us, our financial condition, results of operations and cash flows might be materially adversely affected.

Any failure by us to manage acquisitions, divestitures and other significant transactions successfully could harm our financial results, business and prospects.

As part of our business strategy, the Company frequently engages in discussions with third parties regarding possible investments, acquisitions, strategic alliances, joint ventures, divestitures and outsourcing arrangements and enter into agreements relating to such extraordinary transactions in order to further our business objectives. In order to pursue this strategy successfully, the Company must identify suitable candidates for and successfully complete extraordinary transactions, some of which may be large and complex, and manage post-closing issues such as the integration of acquired companies or employees. Integration and other risks of extraordinary transactions can be more pronounced for larger and more complicated transactions, or if multiple transactions are pursued simultaneously. If the Company failed to identify and complete successfully extraordinary transactions that further our strategic objectives, the Company may be required to expend resources to develop products and technology internally, the Company may be at a competitive disadvantage or the Company may be adversely affected by negative market perceptions, any of which may have a material adverse effect on our revenue, gross margin and profitability.

Integration issues are complex, time-consuming and expensive and, without proper planning and implementation, could significantly disrupt our business. The challenges involved in integration include:

combining product offerings and entering into new markets in which the Company is not experienced;

convincing customers and distributors that the transaction will not diminish client service standards or business focus, preventing customers and distributors from deferring purchasing decisions or switching to other suppliers (which could result in our incurring additional obligations in order to address customer uncertainty), and coordinating sales, marketing and distribution efforts;

consolidating and rationalizing corporate information technology infrastructure, which may include multiple legacy systems from various acquisitions and integrating software code;

minimizing the diversion of management attention from ongoing business concerns;

persuading employees that business cultures are compatible, maintaining employee morale and retaining key employees, integrating employees into the Company, correctly estimating employee benefit costs and implementing restructuring programs;

coordinating and combining administrative, manufacturing, research and development and other operations, subsidiaries, facilities and relationships with third parties in accordance with local laws and other obligations while maintaining adequate standards, controls and procedures; and

achieving savings from supply chain and administration integration.

The Company evaluates and enters into extraordinary transactions on an ongoing basis. The Company may not fully realize all of the anticipated benefits of any transaction, and the timeframe for achieving benefits of a transaction may depend partially upon the actions of employees, suppliers or other third parties. In addition, the pricing and other terms of our contracts for extraordinary transactions require us to make estimates and assumptions at the time the Company enters into these contracts, and, during the course of our due diligence, the Company may not identify all of the factors necessary to estimate our costs accurately. Any increased or unexpected costs, unanticipated delays or failure to achieve contractual obligations could make these agreements less profitable or unprofitable.

Managing extraordinary transactions requires varying levels of management resources, which may divert our attention from other business operations. These extraordinary transactions could result in significant costs and expenses and charges to earnings, including those related to severance pay, early retirement costs, employee benefit costs, asset impairment charges, charges from the elimination of duplicative facilities and contracts, in-process research and development charges, inventory adjustments, assumed litigation and other liabilities, legal, accounting and financial advisory fees, and required payments to executive officers and key employees under retention plans. Moreover, the Company could incur additional depreciation and amortization expense over the useful lives of certain assets acquired in connection with extraordinary transactions, and, to the extent that the value of goodwill or intangible assets with indefinite lives acquired in connection with an extraordinary transaction becomes impaired, the Company may be required to incur additional material charges relating to the impairment of those assets. In order to complete an acquisition, the Company may issue common stock, potentially creating dilution for existing shareholders, or borrow funds, affecting our financial condition and potentially our credit ratings. Any prior or future downgrades in our credit rating associated with an acquisition could adversely affect our ability to borrow and result in more restrictive borrowing terms. In addition, our effective tax rate on an ongoing basis is uncertain, and extraordinary transactions could impact our effective tax rate. The Company also may experience risks relating to the challenges and costs of closing an extraordinary transaction and the risk that an announced extraordinary transaction may not close. As a result, any completed, pending or future transactions may contribute to financial results that differ from the investment community s expectations.

System security risks and systems integration issues could disrupt our internal operations or services provided to customers, and any such disruption could harm our revenue, increase our costs and expenses and harm our reputation and stock price.

Experienced computer programmers and hackers may be able to penetrate our network security and misappropriate our confidential information or that of third parties, create system disruptions or cause shutdowns. As a result, the Company could incur significant expenses in addressing problems created by security breaches of our network. Moreover, the Company could lose existing or potential customers or incur significant expenses in connection with our customers system failures. In addition, sophisticated hardware and operating system software and applications that the Company produce or procure from third parties may contain defects in design or manufacture, including bugs and other problems that could unexpectedly interfere with the operation of the system. The costs to us to eliminate or alleviate security problems, viruses and bugs could be significant, and the efforts to address these problems could result in interruptions, delays or cessation of service that could impede our sales, manufacturing, distribution or other critical functions.

Portions of our information technology infrastructure also may experience interruptions, delays or cessations of service or produce errors in connection with systems integration or migration work that takes place from time to time. The Company may not be successful in implementing new systems, and transitioning data and other aspects of the process could be expensive, time consuming, disruptive and resource-intensive. Such disruptions could adversely impact our ability to fulfill orders and interrupt other processes. Delayed sales, lower margins or lost customers resulting from these disruptions could adversely affect our financial results, stock price and reputation.

In order to be successful, the Company must attract, retain and motivate key employees, and failure to do so could seriously harm us.

In order to be successful, the Company must attract, retain and motivate executives and other key employees, including those in managerial, administration, technical, sales, marketing and information technology support positions. The Company also must keep employees focused on our strategies and goals. Hiring and retaining qualified executives, engineers and qualified sales representatives are critical to our future, and competition for experienced employees in these areas can be intense. The failure to hire or loss of key employees could have a significant impact on our operations.

The Company may not be able to generate sufficient cash flows to fund our operations and make adequate capital investments.

Our cash flows from operations depend primarily on sales and service margins. To develop new product and service technologies, support future growth, achieve operating efficiencies and maintain product quality, the Company must make significant capital investments in manufacturing technology, facilities and capital equipment, research and development, and product and service technology. In addition to cash provided from operations, the Company has from time to time utilized external sources of financing. Depending upon general market conditions or other factors, the Company may not be able to generate sufficient cash flows to fund our operations and make adequate capital investments.

New product developments may be unsuccessful.

The Company is constantly looking to develop new products and services that complement our traditional product and service offerings or leverage the underlying design or process technology of our traditional product and service offerings. The Company makes significant investments in product and service technologies and anticipates expending significant resources for new product development over the next several years. There can be no assurance that our product development efforts will be successful, that we will be able to cost effectively manufacture these new products, that we will be able to successfully market these products or that margins generated from sales of these products will recover costs of development efforts.

An adverse determination that our products or manufacturing processes infringe the intellectual property rights of others could materially adversely affect the Company s business, results of operations or financial condition.

As is common in any high technology industry, from time to time, others have asserted, and may in the future assert, that our products or manufacturing processes infringe their intellectual property rights. A court determination that our products or manufacturing processes infringe the intellectual property rights of others could result in significant liability and/or require us to make material changes to our products and/or manufacturing processes. The Company is unable to predict the outcome of assertions of infringement made against the Company. Any of the foregoing could have a material adverse effect on our business, results of operations or financial condition.

United Technologies unsolicited acquisition proposal has created a distraction for our management and uncertainty that may adversely affect our business.

On February 29, 2008, we received an unsolicited proposal from United Technologies Corporation (UTC) to acquire all of the outstanding common shares of the Company. On March 3, 2008, our Board of Directors announced that, after carefully reviewing the proposal, it unanimously concluded that the proposal is not in the best interests of the Company and its shareholders. Any further actions taken by UTC in connection with their proposal (and any alternate proposals that may be made by other parties) may be a significant distraction for our management and employees and may require the expenditure of significant time and resources by us. UTC s unsolicited acquisition proposal has also created uncertainty for our employees and this uncertainty may adversely affect our ability to retain key employees and to hire new talent. UTC s unsolicited acquisition proposal may also create uncertainty for current and potential customers, suppliers and other business partners, which may cause them to terminate, or not to renew or enter into, arrangements with us. Additionally, we and members of our Board of Directors had been named in at least one purported shareholder class action complaint relating to the UTC proposal as more fully described in Part I, Item 3

Legal Proceedings of this annual report. These lawsuits or any future lawsuits may become time consuming and expensive. These consequences, alone or in combination, may harm our business.

Anti-takeover provisions could make it more difficult for a third party to acquire us.

We have adopted a shareholder rights plan and initially declared a dividend distribution of one right for each outstanding share of common stock to shareholders of record as of February 11, 1999, including any transfer or new issuance of common shares of the Company. Under certain circumstances, if a person or group acquires 20 percent or more of our outstanding common stock, holders of the rights (other than the person or group triggering their exercise) will receive one one-thousandth of a share of Series A Junior Participating Preferred Stock, without par value. The rights expire on February 10, 2009, unless extended by our Board of Directors. Because the rights may substantially dilute the stock ownership of a person or group attempting to take us over without the approval of our Board of Directors, our rights plan could make it more difficult for a third party to acquire us (or a significant percentage of our outstanding capital stock) without first negotiating with our Board of Directors regarding that acquisition. Further, certain provisions of our charter documents, including provisions limiting the ability of shareholders to raise matters at a meeting of shareholders without giving advance notice and permitting cumulative voting, which may make it more difficult for a third party to gain control of our Board of Directors and may have the effect of delaying or preventing changes in control or management of the Company, which could have an adverse effect on the market price of our stock. Additionally, Ohio corporate law provides that certain notice and informational filings and special shareholder meeting and voting procedures must be followed prior to consummation of a proposed control share acquisition, as defined in the Ohio Revised Code. Assuming compliance with the prescribed notice and information filings, a proposed control share acquisition may be made only if, at a special meeting of shareholders, the acquisition is approved by both a majority of the voting power of the Company represented at the meeting and a majority of the voting power remaining after excluding the combined voting power of the interested shares, as defined in the Ohio Revised Code. The application of these provisions of the Ohio Revised Code also could have the effect of delaying or preventing a change of control.

The SEC investigation, Department of Justice investigation, internal accounting and financial reporting review and restatement of the Company s financial statements may harm the Company s business in the future.

The Company has incurred substantial expenses for legal and accounting services due to the SEC s investigation and the U.S. Department of Justice (DOJ) investigation as well as the Company s own internal investigation and the restatement of its financial statements. The Company could incur substantial additional costs to defend and resolve litigation or other governmental investigations or proceedings arising out of or related to the completed investigation. In addition, the Company could be exposed to enforcement or other actions with respect to these matters by the SEC s Division of Enforcement or the DOJ.

In addition, these activities have diverted the Company s management s attention from the conduct of its business. The diversion of resources to address issues arising out of the investigation and financial restatement may harm our business, operating results and financial condition in the future.

The Company s failure to maintain effective internal control over financial reporting may be insufficient to allow it to accurately report its financial results or prevent fraud, which could cause its financial statements to become materially misleading and adversely affect the trading price of its common stock.

The Company s management is responsible for maintaining a system of internal control over financial reporting (ICOFR) that provides reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles (GAAP). Management is also responsible for maintaining evidence, including documentation, to provide reasonable support for its assessment. This evidence will also allow a third party, such as the Company s external auditor, to validate the work performed by management.

ICOFR cannot provide absolute assurance due to its inherent limitations; it is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human error. ICOFR also can be circumvented by collusion or improper management override. Because of such limitations, ICOFR cannot prevent or detect all misstatements, whether unintentional errors or fraud. However, these inherent limitations are known features of the financial reporting process, therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

During the year ended December 31, 2007, the Company s management determined that there were material weaknesses in its internal control over financial reporting. The Company s material weaknesses could harm shareholder and business confidence in our financial reporting, our ability to obtain financing and other aspects of our business. The Company has enhanced, and is continuing to enhance, its internal controls in order to remediate the material weaknesses. Implementing new internal controls and testing the internal control framework will require the dedication of additional resources, management time and expense. If the Company fails to establish and maintain the adequacy of its internal control over financial reporting, including any failure to implement required new or improved controls, or if the Company experiences difficulties in their implementation, its business, financial condition and operating results could be harmed.

Any material weakness or unsuccessful remediation could affect investor confidence in the accuracy and completeness of the Company s financial statements. As a result, the Company s ability to obtain any additional financing, or additional financing on favorable terms, could be materially and adversely affected, which, in turn, could materially and adversely affect its business, its financial condition and the market value of its securities and require the Company to incur additional costs to improve its internal control systems and procedures. In addition, perceptions of the Company among customers, lenders, investors, securities analysts and others could also be adversely affected.

The Company can give no assurances that the measures it has taken to date, or any future measures it may take, will remediate the material weaknesses identified or that any additional material weaknesses will not arise in the future due to its failure to implement and maintain adequate internal controls over financial reporting. In addition, even if the Company is successful in strengthening its controls and procedures, those controls and procedures may not be adequate to prevent or identify irregularities or ensure the fair presentation of its financial statements included in its periodic reports filed with the SEC.

Delays in filing periodic reports and financial restatements may adversely affect the Company s stock price.

The Company did not file its quarterly reports on Form 10-Q for the quarters ended June 30, 2007, September 30, 2007, March 31, 2008 and June 30, 2008 and this annual report on Form 10-K for the year ended December 31, 2007 within the time periods required by SEC regulations. The Company s delays in filing its periodic reports and related financial statements may harm investor confidence and negatively affect the Company s stock price. In addition, the restatement may also result in other negative ramifications, including the potential loss of confidence by suppliers, customers, employees, investors, and security analysts, the loss of institutional investor interest and fewer business development opportunities.

ITEM 1B: UNRESOLVED STAFF COMMENTS

None.

ITEM 2: PROPERTIES

The Company s corporate offices are located in North Canton, Ohio. The Company owns manufacturing facilities in Canton and Newark, Ohio; Lynchburg, Virginia, and Lexington, North Carolina. The Company also has manufacturing facilities in Belgium, Brazil, China, Hungary and India. The Company has selling, service and administrative offices in the following locations: throughout the United States, and in Argentina, Australia, Austria, Barbados, Belgium, Belize, Brazil, Canada, Chile, China, Colombia, Costa Rica, Czech Republic, Dominican Republic, Ecuador, France, Germany, Greece, Guatemala, Haiti, Honduras, Hong Kong, Hungary, India, Indonesia, Italy, Japan, Malaysia, Mexico, Namibia, Netherlands, New Zealand, Nicaragua, Panama, Paraguay, Peru, Philippines, Po