DIEBOLD INC
Form 10-Q
May 10, 2007

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

Form 10-Q

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

For the quarterly period ended March 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	34-0183970
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification Number)
5995 Mayfair Road, PO Box 3077, North Canton, Ohio	44720-8077
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: (330) 490-4000

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 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

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

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

Common Stock, $1.25 Par Value 65,794,283 shares as of May 7, 2007

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share amounts)

	(Unaudited) March 31, 2007	December 31, 2006
ASSETS		
Current assets		
Cash and cash equivalents	$ 94,295	$ 253,814
Short-term investments	95,407	99,571
Trade receivables, less allowances of $28,167 and $29,751, respectively	600,165	610,893
Inventories	470,178	442,804
Prepaid expenses	37,202	37,019
Other current assets	156,897	151,580
Total current assets	1,454,144	1,595,681
Securities and other investments	67,877	70,088
Property, plant and equipment, at cost	489,762	489,188
Less accumulated depreciation and amortization	287,755	286,653
	202,007	202,535
Goodwill	472,384	460,339
Other assets	209,668	185,636
	$ 2,406,080	$ 2,514,279
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities		
Notes payable	$ 25,608	$ 11,324
Accounts payable	131,136	158,388
Deferred income	213,607	170,921
Other current liabilities	244,521	258,103
Total current liabilities	614,872	598,736
Notes payable long-term	544,784	665,481
Other long-term liabilities	145,922	158,661
Commitments and contingencies		
Shareholders equity		
Preferred shares, no par value, authorized 1,000,000 shares, none issued		

Common shares, par value $1.25, authorized 125,000,000 shares; issued 75,314,222 and 75,145,662 shares, respectively outstanding 65,722,363 and 65,595,596 shares, respectively		94,143		93,932
Additional capital		241,723		235,229
Retained earnings		1,148,283		1,169,607
Treasury shares, at cost (9,591,859 and 9,550,066 shares, respectively)		(405,052)		(403,098)
Accumulated other comprehensive income (loss)		21,405		(4,269)
Total shareholders equity		1,100,502		1,091,401
	$	2,406,080	$	2,514,279

See accompanying notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands, except per share amounts)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Net sales		
Products	$ 282,149	$ 291,981
Services	346,295	331,710
	628,444	623,691
Cost of sales		
Products	229,672	207,847
Services	278,586	270,971
	508,258	478,818
Gross profit	120,186	144,873
Selling, general and administrative expense	102,432	102,244
Research, development and engineering expense	16,576	19,120
	119,008	121,364
Operating profit	1,178	23,509
Other income (expense)		
Investment income	5,622	4,120
Interest expense	(9,426)	(7,829)
Miscellaneous, net	3,235	732
Minority interest	(769)	(992)
(Loss) income before taxes	(160)	19,540
Taxes on income	(5,725)	(6,839)
Net (loss) income	$ (5,885)	$ 12,701
Basic weighted-average shares outstanding	65,673	68,534
Diluted weighted-average shares outstanding	66,156	68,840
Basic (loss) earnings per share	$ (0.09)	$ 0.19

Diluted (loss) earnings per share	$	(0.09)	$	0.18
Cash dividends paid per common share	$	0.235	$	0.215

See accompanying notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Cash flow from operating activities:		
Net (loss) income	$ (5,885)	$ 12,701
Adjustments to reconcile net (loss) income to cash provided by operating activities:		
Minority share of income	769	992
Depreciation and amortization	19,165	18,889
Share-based compensation	3,516	3,642
Deferred income taxes	3,381	(192)
Loss (gain) on sale of assets, net	794	(945)
Cash provided (used) by changes in certain assets and liabilities:		
Trade receivables	19,224	29,522
Inventories	(22,347)	(39,004)
Prepaid expenses	10	(7,010)
Other current assets	(1,608)	219
Accounts payable	(28,301)	(27,959)
Certain other assets and liabilities	6,864	56,563
Net cash (used) provided by operating activities	(4,418)	47,418
Cash flow from investing activities:		
Payments for acquisitions, net of cash acquired		(9,044)
Proceeds from maturities of investments	17,283	15,229
Payments for purchases of investments	(6,897)	(15,873)
Capital expenditures	(12,088)	(4,941)
Increase in certain other assets	(18,800)	(14,899)
Net cash used by investing activities	(20,502)	(29,528)
Cash flow from financing activities:		
Dividends paid	(15,439)	(14,745)
Notes payable borrowings	229,007	596,133
Notes payable repayments	(336,215)	(446,458)
Distribution of affiliates earnings to minority interest holder	(15,440)	(590)
Issuance of common shares	1,267	393
Repurchase of common shares		(51,921)
Net cash (used) provided by financing activities	(136,820)	82,812
Effect of exchange rate changes on cash	2,221	2,713

(Decrease) increase in cash and cash equivalents	(159,519)	103,415
Cash and cash equivalents at the beginning of the period	253,814	207,900
Cash and cash equivalents at the end of the period	$ 94,295	$ 311,315

See accompanying notes to condensed consolidated financial statements.

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DIEBOLD, INCORPORATED AND SUBSIDIARIES
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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(In thousands, except per share amounts)

1. CONSOLIDATED FINANCIAL STATEMENTS

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and therefore do not include all information and footnotes necessary for a fair presentation of financial position, results of operations and cash flows in conformity with United States generally accepted accounting principles; however, such information reflects all adjustments (consisting solely of normal recurring adjustments), which are, in the opinion of management, necessary for a fair statement of the results for the interim periods. The condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto together with management s discussion and analysis of financial condition and results of operations contained in the company s Annual Report on Form 10-K for the year ended December 31, 2006. In addition, some of the company s statements in this Quarterly Report on Form 10-Q may be considered forward-looking and involve risks and uncertainties that could significantly impact expected results. The results of operations for the three-month period ended March 31, 2007 are not necessarily indicative of results to be expected for the full year.

The company has reclassified the presentation of the cash flow statement for the three months ended March 31, 2006 to conform to the current year presentation.

The company changed its method of accounting for rotable spares used in its service business in 2006. The previous accounting method incorrectly classified rotable spares as long-lived assets and depreciated the parts over their estimated useful life. The company s new method of accounting is to classify rotable spares within inventories and to expense the cost of the parts in the period that they are used. In addition, rotable spares expenditures, which were previously included within *Cash flows from investing activities,* are now included within *Cash flows from operating activities* on the Condensed Consolidated Statements of Cash Flows. The impact of this correction is not material to income from operations, net (loss) income or (loss) earnings per share and as such the company has presented this correction as an immaterial revision of its financial statements consistent with the discussion of such matters within Staff Accounting Bulletin No. 108. As a result of applying this correction, net rotable spares of $55,592 and $53,697 are now classified within inventories at March 31, 2007 and December 31, 2006, respectively. Rotable spares expenditures of $5,676 and $3,104 are now included within *Cash flows from operating activities* for the three months ended March 31, 2007 and 2006, respectively.

In June 2006, the Emerging Issues Task Force (EITF) reached a consensus on Issue No. 06-03, How Sales Tax Collected from Customers and Remitted to Governmental Authorities Should be Presented in the Income Statement (That is, Gross versus Net Presentation). This EITF Issue clarifies that the presentation of taxes collected from customers and remitted to governmental authorities on a gross (included in revenues and costs) or net (excluded from revenues) basis is an accounting policy decision that should be disclosed pursuant to Accounting Principles Board (APB) Opinion No. 22, Disclosure of Accounting Policies. The EITF Issue is effective for the company beginning in fiscal year 2007. The company s accounting policy is to collect such taxes from customers and account for them on a net basis. The adoption of EITF Issue No. 06-03 did not impact the company s consolidated financial statements.

2. SHARE-BASED COMPENSATION

The company s share-based compensation policy is consistent with the requirements of Statement of Financial Accounting Standards No. 123(revised 2004), *Share-Based Payment* (SFAS No. 123(R)), which requires that all share-based payments to employees be recognized in the statement of income based on their grant-date fair values during the period in which the employee is required to provide services in exchange for the award.

Share-based compensation was recognized as a component of selling, general and administrative expenses. Total share-based compensation expense for the three months ended March 31, 2007 and 2006 was $3,516 and $3,642, respectively.

Options outstanding and exercisable under the 1991 Plan as of March 31, 2007 and changes during the three months ended March 31, 2007 were as follows:

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)
(In thousands, except per share amounts)

2. SHARE-BASED COMPENSATION (continued)

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (1)
Outstanding at January 1, 2007	2,945	$ 40.70		
Granted	234	47.27		
Exercised	(35)	34.80		
Cancelled/Forfeited	(11)	37.26		
Outstanding at March 31, 2007	3,133	$ 41.27	6	$ 24,476
Exercisable at March 31, 2007	2,253	$ 40.12	5	$ 20,394

(1) The aggregate intrinsic value represents the total pre-tax intrinsic value (the difference between the company s closing stock price on the last trading day of the first quarter of 2007 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on March 31, 2007. The amount of

aggregate
intrinsic value
will change
based on the fair
market value of
the company s
common stock.

The following tables summarize information on unvested restricted stock units and performance shares outstanding:

Restricted Stock Units (RSUs):	Number of Shares	Weighted-Average Grant-Date Fair Value
Unvested at January 1, 2007	308	$ 45.12
Forfeited	(16)	52.68
Vested	(45)	52.92
Granted	134	47.27
Unvested at March 31, 2007	381	$ 44.63

Performance Shares:	Number of Shares	Weighted-Average Grant-Date Fair Value
Unvested at January 1, 2007	556	$ 48.55
Cancelled/Forfeited	(166)	53.32
Vested	(51)	52.42
Granted	205	47.27
Unvested at March 31, 2007	544	$ 46.25

Unvested performance shares are based on a maximum potential payout. Actual shares granted at the end of the performance period may be less than the maximum potential payout level depending on achievement of performance share objectives.

3. (LOSS) EARNINGS PER SHARE

The basic and diluted (loss) earnings per share computations in the condensed consolidated statements of operations are based on the weighted-average number of shares outstanding during each period reported. The following table shows the amounts used in computing earnings per share and the effect on the weighted-average number of shares of potentially dilutive common stock.

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(Unaudited)
(In thousands, except per share amounts)

3. (LOSS) EARNINGS PER SHARE (continued)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Numerator:		
(Loss) income used in basic and diluted earnings per share:		
Net (loss) income	$ (5,885)	$ 12,701
Denominator:		
Basic weighted-average shares	65,673	68,534
Effect of dilutive share-based compensation	483	306
Diluted weighted-average shares	66,156	68,840
Basic (loss) earnings per share	$ (0.09)	$ 0.19
Diluted (loss) earnings per share	$ (0.09)	$ 0.18
Anti-dilutive shares not used in calculating diluted weighted-average shares	1,020	976

4. INVENTORIES

The company s inventories are valued at the lower of cost or market applied on a first-in, first-out (FIFO) basis, with the exception of Brazil and election systems, which are valued using the average cost method, which approximates FIFO. At each reporting period, the company identifies and writes down its excess or obsolete inventory to its net realizable value based on forecasted usage, orders and inventory aging. With the development of new products, the company also rationalizes its product offerings and will write down discontinued product to the lower of cost or net realizable value.

Major classes of inventories are summarized as follows:

	March 31, 2007	December 31, 2006
Finished goods	$ 152,020	$ 119,466
Service parts	157,724	152,066
Work in process	108,995	128,983
Raw materials	51,439	42,289
Total inventory	$ 470,178	$ 442,804

5. OTHER COMPREHENSIVE INCOME (LOSS)

Accumulated other comprehensive income (loss) is reported separately from retained earnings and additional capital in the condensed consolidated balance sheets. Items considered to be other comprehensive income (loss) include adjustments made for foreign currency translation (under SFAS No. 52) and pensions (under SFAS No. 87 and No. 158).

Components of accumulated other comprehensive income (loss) consist of the following:

	March 31, 2007	December 31, 2006
Translation adjustment	$ 63,007	$ 37,333
Pensions, less accumulated taxes of $(23,073) for 2007 and 2006	(41,602)	(41,602)
Accumulated other comprehensive income (loss)	$ 21,405	$ (4,269)

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(Unaudited)
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5. OTHER COMPREHENSIVE INCOME (LOSS) (continued)

Components of comprehensive income (loss) consist of the following for the three months ended March 31:

	2007	2006
Net (loss) income	$ (5,885)	$ 12,701
Other comprehensive income (loss) - translation adjustment	25,674	(23,482)
Comprehensive income (loss)	$19,789	$(10,781)

6. INCOME TAXES

First quarter 2007 restructuring charges were recorded with no associated tax benefit. Consequently, the company recorded taxes of $5,725 on a pre-tax loss of $160. As the restructuring is concluded, the company will pursue its ability to ultimately realize the tax benefits of these charges. The annual effective tax rate used for the three months ended March 31, 2007, excluding restructuring charges, was 27.0 percent versus 35.0 percent in the same period in 2006. The lower annual effective tax rate is primarily due to income mix, which favors lower tax jurisdictions and the successful implementation of global tax initiatives.

Effective January 1, 2007, the company adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48).* FIN 48 clarifies the recognition, measurement, presentation and disclosure in the company s financial statements of uncertain tax positions taken or expected to be taken in a tax return. The adoption of FIN 48 had no material effect on the financial statements. As a result, there was no cumulative effect related to adoption. However, certain amounts have been reclassified in the statement of financial position in order to comply with the requirements of FIN 48.

At January 1, 2007, the company had an unrecognized tax benefit of approximately $6,565. The entire amount of unrecognized tax benefits, if recognized, would affect the company s effective tax rate. As of the date of adoption, the company does not anticipate a material increase or decrease in the total unrecognized tax benefits during the next 12 months.

The company is currently under federal audit by the Internal Revenue Service (IRS) for tax years 2003 and 2004. All tax years prior to 2003 are closed by statute or have been audited and settled with the IRS, with the exception of tax years 1997 through 1999 and 2001 through 2006, which remain open due to amended returns, refund claims or by virtue of the statute of limitations.

The company is being audited by various state and international jurisdictions. In material jurisdictions, the company has statutes open back to and including 2001.

The company classifies interest expense and penalties related to the underpayment of income taxes in the financial statements as income tax expense. Consistent with the treatment of interest expense, the company accrues interest income on overpayments of income taxes where applicable and classifies interest income as a reduction of income tax expense in the financial statements. Total net interest expense and penalties as of the date of adoption were $266.

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7. BENEFIT PLANS

The company has several pension plans covering substantially all United States employees. Plans covering salaried employees provide pension benefits that are based on the employee s compensation during the 10 years before retirement. The company s funding policy for salaried plans is to contribute annually, if required, at an actuarially determined rate. Plans covering hourly employees and union members generally provide benefits of stated amounts for each year of service. The company s funding policy for hourly plans is to make at least the minimum annual contributions required by applicable regulations. Employees of the company s operations in countries outside of the United States participate to varying degrees in local pension plans, which in the aggregate are not significant.

In addition to providing pension benefits, the company provides healthcare benefits (referred to as Other Benefits) for certain retired employees. Eligible employees may be entitled to these benefits based upon years of service with the company, age at retirement and collective bargaining agreements. Currently, the company has made no commitments to increase these benefits for existing retirees or for employees who may become eligible for these benefits in the future. Currently, there are no plan assets and the company funds the benefits as the claims are paid.

	Pension Benefits		**Other Benefits**	
	2007	2006	2007	2006
Components of Net Periodic Benefit Cost Three months ended March 31				
Service cost	$ 2,865	$ 2,795	$ 2	$ 2
Interest cost	6,403	5,761	339	312
Expected return on plan assets	(8,252)	(7,749)		
Amortization of prior service cost	154	191	(129)	(153)
Recognized net actuarial loss	1,009	1,138	183	198
Net periodic pension benefit cost	$ 2,179	$ 2,136	$ 395	$ 359

Cash Flows

Previously, the company disclosed expected payments related to the 2007 plan year of $14,778 to its qualified and non-qualified pension plans and $2,441 to its other postretirement benefit plan. There have been no significant changes to the 2007 plan year contribution amounts previously disclosed. As of March 31, 2007 and 2006, contributions of $3,661 and $3,688 have been made to the pension plans, respectively.

8. SEGMENT INFORMATION

The company s segments are comprised of its three main sales channels: Diebold North America (DNA), Diebold International (DI) and Election Systems (ES) & Other. These sales channels are evaluated based on revenue from customers and operating profit contribution to the total corporation. The reconciliation between segment information and the condensed consolidated financial statements is disclosed. Revenue summaries by geographic segment and product and service solutions are also disclosed. All income and expense items below operating profit are not allocated to the segments and are not disclosed.

The DNA segment sells and 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 Diebold Election Systems, Inc. and the voting and lottery related business in Brazil. Each of the sales channels buys the goods it sells from the company s manufacturing plants through intercompany sales that are eliminated in consolidation, and intersegment revenue is not significant. Each year, intercompany pricing is agreed upon which drives sales channel operating profit contribution. As permitted under SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*, certain information not routinely used in the management of these segments, information not allocated back to the segments or information that is impractical to report is not

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(Unaudited)
(In thousands, except per share amounts)

8. SEGMENT INFORMATION (continued)

shown. Items not allocated are as follows: interest income, interest expense, equity in the net income of investees accounted for by the equity method, income tax expense or benefit, and other non-current assets.

	DNA	DI	ES & Other	Total
Segment Information by Channel for the quarter ended March 31, 2007				
Revenue	$336,173	$284,424	$ 7,847	$628,444
Operating profit (loss)	14,997	(14,639)	820	1,178
Capital expenditures	5,952	5,912	224	12,088
Depreciation	5,675	5,986	172	11,833
Property, plant and equipment	336,406	146,948	6,408	489,762
Segment Information by Channel for the quarter ended March 31, 2006				
Revenue	$332,809	$241,812	$49,070	$623,691
Operating profit (loss)	18,136	(1,641)	7,014	23,509
Capital expenditures	1,892	1,406	1,643	4,941
Depreciation	5,830			