LINCOLN ELECTRIC HOLDINGS INC
Form DEF 14A
March 20, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14A

(RULE 14a-101)

INFORMATION REQUIRED IN PROXY STATEMENT

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the Securities

Exchange Act of 1934 (Amendment No.)

Filed by the Registrant þ Filed by a Party other than the Registrant ¨

Check the appropriate box:

¨ Preliminary Proxy Statement

¨ **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

þ Definitive Proxy Statement

¨ Definitive Additional Materials

¨ Soliciting Material Pursuant to Section 240.14a-12

LINCOLN ELECTRIC HOLDINGS, INC.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if Other Than the Registrant)

Payment of Filing Fee (Check the appropriate box):

þ No fee required.

¨ Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

---

(2) Aggregate number of securities to which transaction applies:

---

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

---

(4) Proposed maximum aggregate value of transaction:

---

(5) Total fee paid:

¨ Fee paid previously with preliminary materials.

¨ Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

Dear Shareholder:

You are cordially invited to attend the Annual Meeting of Shareholders of Lincoln Electric Holdings, Inc., which will be held at 11:30 a.m. on Friday, April 25, 2008 at the Marriott Cleveland East, 26300 Harvard Road, Warrensville Heights, Ohio. A map showing the location of the Annual Meeting is printed on the outside back cover of the proxy statement.

Enclosed with this letter are the Annual Meeting Notice, Proxy Statement, Proxy and Voting Instruction Form and an envelope in which to return the Proxy and Voting Instruction Form. Also enclosed is a copy of the Annual Report. The Annual Report and proxy statement contain important information about the Company, its Board of Directors and its executive officers. Please read these documents carefully.

If you are a registered holder of Lincoln shares or a participant in The Lincoln Electric Company Employee Savings Plan (401(k) plan), as a convenience to you and as a means of reducing costs, you may choose to vote your proxy electronically using the Internet or a touch-tone telephone instead of using the conventional method of completing and mailing the enclosed Proxy and Voting Instruction Form. Electronic proxy voting is permitted under Ohio law and the Company s Regulations. You will find instructions on how to vote electronically in the proxy statement and on the Proxy and Voting Instruction Form. Having the freedom to vote by means of the Internet, telephone or mail does not limit your right to attend or vote in person at the Annual Meeting, if you prefer. If you plan to attend the Annual Meeting, please check the attendance box on the enclosed Proxy and Voting Instruction Form, or when prompted if you cast your vote over the Internet or by telephone.

We look forward to seeing you at the Annual Meeting.

Sincerely,

John M. Stropki, Jr.

Chairman, President and Chief Executive Officer

Lincoln Electric Holdings, Inc.

March 20, 2008

TABLE OF CONTENTS

Lincoln Electric Holdings, Inc.

22801 Saint Clair Avenue

Cleveland, Ohio 44117-1199

NOTICE OF

ANNUAL MEETING OF SHAREHOLDERS

The Annual Meeting of Shareholders of Lincoln Electric Holdings, Inc. will be held at 11:30 a.m. on Friday, April 25, 2008, at the Marriott Cleveland East, 26300 Harvard Road, Warrensville Heights, Ohio. Shareholders will be asked to vote on the following proposals:

(1) Election of three Directors, each for a term scheduled to expire in 2011;

(2) Approval of amendments to the Company s Code of Regulations relating to shareholder meetings, including shareholder proposals and adding provisions regarding the mechanics of shareholder meetings;

(3) Approval of amendments to the Company s Code of Regulations relating to procedures for Director nominations;

(4) Approval of amendments to the Company s Code of Regulations to allow the Board of Directors to amend the Regulations to the extent permitted by law;

(5) Ratification of the appointment of Ernst & Young LLP as the Company s independent auditors for the year ending December 31, 2008; and

(6) Any other business properly brought before the meeting, or any postponement(s) or adjournment(s) of the meeting.

Shareholders of record as of the close of business on March 14, 2008, the record date, are entitled to vote at the Annual Meeting.

Frederick G. Stueber

Senior Vice President,

General Counsel and Secretary

March 20, 2008

IMPORTANT NOTICE REGARDING THE AVAILABILITY OF PROXY MATERIALS FOR THE ANNUAL MEETING OF SHAREHOLDERS TO BE HELD ON APRIL 25, 2008.

This proxy statement, along with our Annual Report on Form 10-K for the fiscal year ended December 31, 2007 and our Annual Report, are available free of charge on the following website: www.lincolnelectric.com/proxymaterials.

GENERAL INFORMATION

Who is soliciting proxies and why?

The enclosed Proxy is being solicited by the Directors of the Company, and the Company will pay the cost of the solicitation. Certain officers and other employees of the Company may also solicit proxies by telephone, letter or personal interview. The Company will begin mailing this proxy statement on or about March , 2008.

If your shares are held in your name, in order to vote your shares you must either attend the Annual Meeting and vote in person or appoint a proxy to vote on your behalf. Because it would be highly unlikely that all shareholders would be able to attend the Annual Meeting, the Directors recommend that you appoint a proxy to vote on your behalf, as indicated on the accompanying Proxy and Voting Instruction Form, or appoint your proxy electronically via telephone or the Internet.

What is Householding?

To reduce the expense of delivering duplicate voting materials to shareholders who share the same address, we have taken advantage of the householding rules enacted by the Securities and Exchange Commission (SEC). As long as we provide proper notice to such shareholders, these rules permit us to deliver only one set of voting materials to shareholders who share the same address, meaning only one copy of the Annual Report, proxy statement and any other shareholder communication will be sent to those households. Each shareholder will, however, receive a separate Proxy and Voting Instruction Form.

How do I obtain a separate set of communications to shareholders?

If you share an address with another shareholder and have received only one copy of the Annual Report, proxy statement or any other shareholder communication, you may request that the Company send a separate copy of these materials to you at no cost to you. The Company will promptly send a copy of these materials to you upon your written or oral request. For this meeting and for future Annual Meetings, you may request separate copies of these materials, or request that the Company send only one set of these materials to you if you are receiving multiple copies, by sending a written notice to the Corporate Secretary at Lincoln Electric Holdings, Inc., c/o National City Bank, Corporate Trust Operations, Locator 5352, P.O. Box 92301, Cleveland, Ohio 44197-1200. You may also request separate copies of these materials for this meeting and for future Annual Meetings by calling Roy Morrow, the Company s Director, Corporate Relations, at 216-383-4893.

Who may vote?

Record holders of the common shares of Lincoln Electric Holdings, Inc. as of the close of business on March 14, 2008, the record date, are entitled to vote at the Annual Meeting. On that date, 42,721,931 shares of Lincoln common stock were outstanding. Each share is entitled to one vote on each proposal brought before the meeting.

What shares are included on the proxy card?

If you are both a registered shareholder of the Company and a participant in The Lincoln Electric Company Employee Savings Plan (401(k) plan), you may have received one Proxy and Voting Instruction Form that shows all shares of Lincoln common stock registered in your name, including any Dividend Reinvestment Plan shares, and all shares you have (based on the units credited to your account) under the 401(k) plan. Accordingly, your Proxy and Voting Instruction Form also serves as your voting directions to the 401(k) plan Trustee.

Please note, however, that unless the identical name or names appeared on all your accounts, we were not able to consolidate your share information. If that was the case, you received more than one Proxy and Voting Instruction Form and must vote each one separately.

If your shares are held through a bank, broker, trustee or some other nominee, you will receive either a voting form or a proxy card from the nominee, instructing you on how to vote your shares, which may also include instructions on telephone and electronic voting.

What are the proposals on which I will be voting?

You are being asked to vote on five proposals:

(1) Election of three Directors, each to serve for a term scheduled to expire in 2011;

(2) Approval of amendments to the Company s Code of Regulations relating to shareholder meetings, including shareholder proposals and adding provisions regarding the mechanics of shareholder meetings;

(3) Approval of amendments to the Company s Code of Regulations relating to procedures for Director nominations;

(4) Approval of amendments to the Company s Code of Regulations to allow the Board of Directors to amend the Regulations to the extent permitted by law; and

(5) Ratification of the appointment of Ernst & Young LLP as the Company s independent auditors for the year ending December 31, 2008.

The Directors do not know of any other matters that are to be presented at the meeting. If any other matters come before the meeting of which we did not have notice prior to February 14, 2008 or that applicable laws otherwise would permit proxies to vote on a discretionary basis, it is intended that the persons authorized under solicited proxies will vote on the matters in accordance with their best judgment.

How do I vote?

Registered Holders. If your shares are registered in your name, you may vote in person or by proxy. If you decide to vote by proxy, you may do so in any **ONE** of the following three ways.

By telephone. After reading the proxy materials and with your Proxy and Voting Instruction Form in front of you, you may call the toll-free number **1-888-693-8683**, using a touch-tone telephone. You will be prompted to enter your Control Number from your Proxy and Voting Instruction Form. This number will identify you and the Company. Then you can follow the simple instructions that will be given to you to record your vote.

Over the Internet. After reading the proxy materials and with your Proxy and Voting Instruction Form in front of you, you may use a computer to access the website **www.cesvote.com**. You will be prompted to enter your Control Number from your Proxy and Voting Instruction Form. This number will identify you and the Company. Then you can follow the simple instructions that will be given to you to record your vote.

By mail. After reading the proxy materials, you may mark, sign and date your Proxy and Voting Instruction Form and return it in the enclosed prepaid and addressed envelope.

The Internet and telephone voting procedures have been set up for your convenience and have been designed to authenticate your identity, allow you to give voting instructions and confirm that those instructions have been recorded properly.

Whether you choose to vote by telephone, over the Internet or by mail, you can specify whether your shares should be voted for all, some or none of the nominees for Director (Proposal 1 on the Proxy and Voting

Instruction Form). You can also specify whether you want to vote for or against, or abstain from voting for, the approval of the proposed amendments to the Company s Code of Regulations (Proposals 2 through 4 on the Proxy and Voting Instruction Form) and the ratification of the appointment of the independent auditors (Proposal 5 on the Proxy and Voting Instruction Form). If you make such specifications, your shares will be voted in accordance therewith. If you sign, date and return your Proxy and Voting Instruction Form but do not specify how you want to vote your shares, your shares will be voted **FOR** the election of all the Director nominees, **FOR** the approval of all of the amendments to the Company s Code of Regulations and **FOR** the ratification of the appointment of the independent auditors.

Participants in the 401(k) Plan. If you participate in the 401(k) plan, the plan s independent Trustee, Fidelity Management Trust Company, will vote your 401(k) plan shares according to your voting directions. You may give your voting directions to the plan Trustee in any **ONE** of the three ways set forth above under Registered Holders. If you do not return your Proxy and Voting Instruction Form or do not vote over the Internet or by telephone, the Trustee will not vote your plan shares. Each participant who gives the Trustee voting directions acts as a named fiduciary for the 401(k) plan under the provisions of the Employee Retirement Income Security Act of 1974, as amended.

Nominee shares. If your shares are held by a bank, broker, trustee or some other nominee, that entity will give you separate voting instructions.

May I revoke my proxy or change my vote?

Yes. You may change or revoke your proxy prior to the closing of the polls in any one of the following four ways:

(1) by sending a written notice to the Company s Corporate Secretary stating that you want to revoke your proxy;

(2) by submitting a properly completed and signed Proxy and Voting Instruction Form with a later date (which will automatically revoke the earlier proxy);

(3) by entering later-dated telephone or Internet voting instructions (which will automatically revoke the earlier proxy); or

(4) by voting in person at the Annual Meeting after requesting that the earlier proxy be revoked. **NOTE: Because your 401(k) plan shares are held in a qualified plan, you are not able to vote 401(k) plan shares at the Annual Meeting.**

If your shares are held by a bank, broker, trustee or some other nominee, you will have to check with your bank, broker, trustee or other nominee to determine how to change your vote. Also note that if you plan to attend the Annual Meeting, you will not be able to vote in person at the meeting any of your shares held by a nominee unless you have a valid proxy from the nominee. If you plan to attend the Annual Meeting, please check the attendance box on the enclosed Proxy and Voting Instruction Form or indicate so when prompted if you are voting by telephone or over the Internet.

How are the votes counted?

Shareholder votes will be tabulated by an independent inspector of elections for the Annual Meeting. All properly signed Proxy and Voting Instruction Forms and all properly recorded Internet and telephone votes (including votes marked abstain and broker non-votes) will be counted to determine whether or not a quorum is present at the meeting.

Election of Directors (Proposal 1). Votes for the Director nominees (Proposal 1) that are marked withhold, and any broker non-votes or other abstentions, will not be counted in determining the election of Directors.

Approval of Amendments to the Code of Regulations Relating to Shareholder Meetings (Proposal 2). Votes on Proposal 2 that are marked abstain and broker non-votes will have the same effect as votes **AGAINST** that proposal.

Approval of Amendments to the Code of Regulations Relating to Procedures for Director Nominations (Proposal 3). Votes on Proposal 3 that are marked abstain and broker non-votes will have the same effect as votes **AGAINST** that proposal.

Approval of Amendments to the Code of Regulations to Allow the Board of Directors to Amend the Regulations to the Extent Permitted by Law (Proposal 4). Votes on Proposal 4 that are marked abstain and broker non-votes will have the same effect as votes **AGAINST** that proposal.

Ratification of the Appointment of Ernst & Young LLP as the Company s Independent Auditors for the Year Ending December 31, 2008 (Proposal 5). Votes on Proposal 5 that are marked abstain will have the same effect as votes **AGAINST** that proposal, and broker non-votes will have no effect on the result of that proposal.

A broker non-vote occurs when a nominee holding shares for the beneficial owner does not vote those shares on a particular proposal because the nominee does not have discretionary authority to do so, and has not received voting instructions with respect to the proposal from the beneficial owner.

May I receive future shareholder communications over the Internet?

If you are a registered shareholder, you may consent to accessing future shareholder communications (*e.g.*, proxy materials, Annual Reports and interim communications) over the Internet instead of receiving copies in the mail. You may give your consent by marking the appropriate box on your Proxy and Voting Instruction Form or following the prompts given you when you vote by telephone or over the Internet. If you choose electronic access to future shareholder communications, once there is sufficient interest in electronic delivery we will discontinue mailing the proxy statement and Annual Report to you, but you will receive a Proxy and Voting Instruction Form, together with a formal notice of the meeting, in the mail with instructions containing the Internet address or addresses to access shareholder communications.

Providing shareholder communications over the Internet will reduce the Company s printing and postage costs and the number of paper documents that you would otherwise receive. If you give your consent, there is no cost to you for this service other than charges you may incur from your Internet provider, telephone and/or cable company. Once you give your consent, it will remain in effect until you inform us otherwise.

If your shares are held through a bank, broker, trustee or some other nominee, check the information provided by that entity for instructions on how to choose to access future shareholder communications over the Internet.

In addition, our Annual Report on Form 10-K for the fiscal year ended December 31, 2007, Annual Report and this proxy statement are available free of charge on the following website: www.lincolnelectric.com/proxymaterials.

When are shareholder proposals due for the 2009 Annual Meeting?

In order for proposals to be considered for inclusion in next year s proxy statement, a shareholder proposal must be submitted in writing to the Corporate Secretary at Lincoln Electric Holdings, Inc., 22801 Saint Clair Avenue, Cleveland, Ohio 44117-1199 by November 20, 2008. If a shareholder intends to present a proposal at the 2009 Annual Meeting without the inclusion of that proposal in the proxy statement, written notice of the proposal must be received no later than January 25, 2009 and no earlier than December 26, 2008 (if Proposal 2 is adopted), or no later than February 3, 2009 (if Proposal 2 is not adopted), or proxies solicited by the Board for the 2009 Annual Meeting will confer discretionary authority to vote on the proposal if presented at the 2009 Annual Meeting.

May I submit a nomination for Director?

The Company s Regulations permit shareholders to nominate one or more persons for election as a Director but require that nominations be received by the Company by a certain date as described below. This date will vary depending on whether Proposal 3 is adopted. To nominate a candidate for election, you must send a written notice to the Corporate Secretary at Lincoln Electric Holdings, Inc., 22801 Saint Clair Avenue, Cleveland, Ohio 44117-1199. The notice must include certain information about you as a shareholder of the Company and about the person you intend to nominate, including a statement about the person s willingness to serve, if elected. Specifically, each notice must include: (1) the name and address of the shareholder who intends to make the nomination and of the person(s) to be nominated, (2) a representation that the shareholder is a holder of record of stock of the Company entitled to vote for the election of directors on the date of such notice and intends to appear in person or by proxy at the meeting to nominate the person(s) specified in the notice, (3) a description of all arrangements or understandings between the shareholder and each nominee and any other person(s) (naming such person(s)) pursuant to which the nomination(s) are to be made by the shareholder, (4) such other information regarding each nominee proposed by the shareholder as would be required to be included in the proxy statement filed pursuant to the proxy rules of the SEC, had the nominee been nominated, or intended to be nominated, by the Board of Directors of the Company, and (5) the consent of each nominee to serve as a director of the Company if so elected.

If Proposal 3 is Adopted. If Proposal 3 is adopted, this written notice must be delivered to or received at our principal executive offices not less than 90 days nor more than 120 days prior to the first anniversary of the previous year s annual meeting of shareholders. Accordingly, nominations for the 2009 Annual Meeting must be delivered to or received at our principal executive offices no later than January 25, 2009 and no earlier than December 26, 2008. If the date of the 2009 Annual Meeting is advanced more than 30 days prior to or delayed by more than 30 days after the anniversary of the 2008 Annual Meeting, written notice must be delivered no later than the close of business on the later of the 90^{th} day prior to the 2009 Annual Meeting or the tenth calendar day following the date of public disclosure of the date of the 2009 Annual Meeting.

If Proposal 3 is Not Adopted. If Proposal 3 is not adopted, this written notice must be received in the Corporate Secretary s Office at least 80 days before the date of the annual meeting at which the nomination is to be made in those instances when the Company publicly announced the date of the annual meeting more than 90 days prior to the annual meeting date **or** no later than the close of business on the tenth day following the day on which the Company publicly announced the date of the annual meeting in those instances when the Company has not publicly announced the date of the annual meeting more than 90 days prior to the annual meeting date. For complete details on the nomination process, contact the Company s Corporate Secretary.

For this year s Annual Meeting, the Company must have received nominations not later than the close of business on February 5, 2008 as the Company publicly announced the date of this year s Annual Meeting on January 10, 2008, which is more than 90 days prior to this year s Annual Meeting date. Accordingly, no additional nominations can be made for this year s Annual Meeting.

How do I contact the Company?

For general information, shareholders may contact the Company at the following address:

Lincoln Electric Holdings, Inc.

22801 Saint Clair Avenue

Cleveland, Ohio 44117-1199

Attention: Roy Morrow, Director, Corporate Relations

Throughout the year, you may visit our website at www.lincolnelectric.com for information about current developments at the Company.

How do I contact the Directors?

Shareholders may send communications to any or all of the Directors of the Company through the Corporate Secretary at the following address:

Lincoln Electric Holdings, Inc.

22801 Saint Clair Avenue

Cleveland, Ohio 44117-1199

Attention: Corporate Secretary

The name of any specific intended Board recipient should be noted in the communication. The Corporate Secretary will forward such correspondence only to the intended recipients. Prior to forwarding any correspondence, the Corporate Secretary will review such correspondence and, in his discretion, not forward certain items if they are deemed of a frivolous nature or otherwise inappropriate for the Board s consideration. In such cases, some of that correspondence may be forwarded elsewhere in the Company for review and possible response.

ELECTION OF DIRECTORS

Proposal No. 1

The Company s Regulations provide for three classes of Directors whose terms expire in different years. Ohio s General Corporation Law provides that, unless another voting standard is stipulated in the Articles of Incorporation, if a quorum is present, the Director nominees receiving the greatest number of votes will be elected as Directors of the Company. During 2007, the Company adopted a majority voting policy with respect to uncontested elections of Directors, which is described in detail below under Corporate Governance. For the 2008 Annual Meeting, if any Director fails to receive a majority of the votes cast in his or her favor, the Director will be required to submit his or her resignation to the Board promptly after the certification of the election results. The Nominating and Corporate Governance Committee of the Board would then consider each resignation and recommend to the Board whether to accept or reject it.

Unless otherwise directed, shares represented by proxy will be voted **FOR** the following:

Class of 2011. The class of Directors whose term ends in 2011 has been fixed at three. David H. Gunning, G. Russell Lincoln and Hellene S. Runtagh are standing for election. All of the nominees have been elected previously by the shareholders.

Each of the nominees has agreed to stand for election and has agreed, in accordance with the Company s majority voting policy, to tender his or her resignation in the event that he or she fails to receive a majority of the votes cast in his or her favor. If any of the nominees is unable to stand for election, the Board may provide for a lesser number of nominees or designate a substitute. In the latter event, shares represented by proxies solicited by the Directors may be voted for the substitute. We have no reason to believe that any of the nominees will be unable to stand for election.

All Directors are expected to attend the Annual Meeting. All of the Director nominees, as well as the continuing Directors, plan to attend this year s Annual Meeting. At the 2007 Annual Meeting, all of the Directors of the Company were in attendance.

DIRECTORS BIOGRAPHIES

The following table sets forth biographical information about the Director nominees and the Directors whose terms of office will continue after this Annual Meeting. Except as otherwise indicated, each of the Director nominees and continuing Directors has held the occupation listed below for more than five years.

None of the Director nominees or continuing Directors has any special arrangement or understanding with any other person pursuant to which the Director nominee or continuing Director was or is to be selected as a Director or nominee. There are no family relationships, as defined by SEC rules, among any of our Directors or executive officers. SEC rules define the term family relationship to mean any relationship by blood, marriage or adoption, not more remote than first cousin.

NOMINEES FOR ELECTION

David H. Gunning

Age:	65
Term Expires/Service:	2008; standing for election at this Annual Meeting to serve until 2011; Director since 1987.
Recent Business Experience:	Mr. Gunning is the former Vice Chairman of Cleveland-Cliffs Inc (an iron ore and coal mining company), a position he held from April 2001 until his retirement May 31, 2007. Effective June 1, 2007, Mr. Gunning became a consultant for Cleveland-Cliffs Inc.
Other Directorships:	Development Alternatives, Inc., MFS Funds, Inc. and Portman Ltd.

G. Russell Lincoln

Age:	61
Term Expires/Service:	2008; standing for election at this Annual Meeting to serve until 2011; Director since 1989.
Recent Business Experience:	Mr. Lincoln is President of N.A.S.T. Inc. (a personal investment firm), a position he has held since 1996.

Hellene S. Runtagh

Age:	59
Term Expires/Service:	2008; standing for election at this Annual Meeting to serve until 2011; Director since 2001.
Recent Business Experience:	Ms. Runtagh was President and Chief Executive Officer of the Berwind Group (a diversified pharmaceutical services, industrial manufacturing and real estate company) in 2001. From 1998 through 2000, Ms. Runtagh was Executive Vice President of Universal Studios (a media and entertainment company). Prior to joining Universal Studios, Ms. Runtagh spent 27 years at General Electric Company (a diversified industrial company) in a variety of leadership positions.
Other Directorships:	IKON Office Solutions, Inc. and NeuStar, Inc.

CONTINUING DIRECTORS

Harold L. Adams

Age:	68
Term Expires/Service:	2009; Director since 2002 and Lead Director since December 2004.
Recent Business Experience:	Mr. Adams is Chairman Emeritus of RTKL Associates Inc. (an architectural and engineering firm) since November 2003, and the former Chairman, President and Chief Executive Officer of RTKL, a position he held from 1967 to November 2003.
Other Directorships:	Commercial Metals Company and Legg Mason, Inc.

Robert J. Knoll

Age:	66
Term Expires/Service:	2009; Director since 2003.
Recent Business Experience:	Mr. Knoll is a former Partner of Deloitte & Touche LLP (an accounting firm), a position he held from 1978 to his retirement in 2000. From 1995 to 1999, Mr. Knoll served as National Director of the firm s Accounting and Auditing Professional practice with oversight responsibility for the firm s accounting and auditing consultation process, SEC practice and risk management process.

John M. Stropki, Jr.

Age:	57
Term Expires/Service:	2009; Director since 1998.
Recent Business Experience:	Mr. Stropki is Chairman, President and Chief Executive Officer of the Company. Mr. Stropki was elected President and Chief Executive Officer in June 2004 and Chairman in October 2004. From May 2003 to June 2004, Mr. Stropki was Executive Vice President and Chief Operating Officer of the Company. From May 1996 to May 2003, Mr. Stropki was Executive Vice President of the Company and President, North America of The Lincoln Electric Company.

CONTINUING DIRECTORS
Stephen G. Hanks

Age:	57
Term Expires/Service:	2010; Director since July 2006.
Recent Business Experience:	Mr. Hanks is the former President of the Washington Division of URS Corporation, and a former member of the Board of Directors of URS Corporation (a design, engineering, construction and management solutions company) headquartered in San Francisco, California, positions he held from November 2007 until his retirement in January 2008. From 2000 to November 2007, Mr. Hanks served as the President, and from 2001 to November 2007, served as the Chief Executive Officer and a member of the Board of Directors, of Washington Group International, Inc. (a design, engineering, construction and management solutions company), which merged with URS Corporation in 2007. Mr. Hanks also formerly served as Washington Group International, Inc. s Executive Vice President, Chief Legal Officer and Secretary.

Kathryn Jo Lincoln

Age:	53
Term Expires/Service:	2010; Director since 1995.
Recent Business Experience:	Ms. Lincoln is Chairman of the Lincoln Institute of Land Policy (a non-profit educational institution teaching land economics and taxation), a position she has held since 1996. Ms. Lincoln also served as President of the Lincoln Foundation, Inc. (a non-profit foundation that supported the foregoing Institute until the two entities merged in 2006) from 1999 through October 2006.
Other Directorships:	Johnson Bank Arizona, NA.

CONTINUING DIRECTORS
William E. MacDonald, III

Age:	61
Term Expires/Service:	2010; Director since 2007.
Recent Business Experience:	Mr. MacDonald is the former Vice Chairman of National City Corporation (a diversified financial holding company), a position he held from 2001 until his retirement December 31, 2006, where he was responsible for its seven-state regional and national corporate banking businesses, the Risk Management and Credit Administration unit, Capital Markets and the Private Client Group. Mr. MacDonald joined National City in 1968 and, during his tenure, held a number of key management positions, including Senior Executive Vice President of National City Corporation and President and Chief Executive Officer of National City s Ohio bank.
Other Directorships:	MTC Technologies, Inc. and American Greetings Corporation.

George H. Walls, Jr.

Age:	65
Term Expires/Service:	2010; Director since 2003.
Recent Business Experience:	General Walls is the former Chief Deputy Auditor of the State of North Carolina, a position he held from January 2001 through December 2004. General Walls retired from the U.S. Marine Corps in 1993 with the rank of Brigadier General, after nearly 29 years of distinguished service.
Other Directorships:	The PNC Financial Services Group, Inc.

DIRECTOR COMMITTEES AND MEETINGS

The Company has a separately-designated standing Audit Committee established in accordance with SEC rules. The Company also has standing Compensation and Executive Development, Nominating and Corporate Governance and Finance Committees. Information on each Committee is set forth below.

Audit Committee

Members:	Robert J. Knoll (Chair), Kathryn Jo Lincoln, Hellene S. Runtagh and George H. Walls, Jr., each of whom meets the independence standards set forth in the NASDAQ listing standards, and each of whom the Board of Directors has determined to have the financial competency required by the listing standards. In addition, because of Mr. Knoll s professional training and past employment experience as described above under the caption Director Biographies, the Board of Directors has determined that he is a financially sophisticated Audit Committee Member under the NASDAQ listing standards and that he qualifies as an audit committee financial expert in accordance with SEC rules. Shareholders should understand that Mr. Knoll s designation as an audit committee financial expert is an SEC disclosure requirement and that it does not impose upon him any duties, obligations or liabilities that are greater than those generally imposed on him as a member of the Audit Committee and the Board.
Number of 2007 Meetings:	Five
Principal Responsibilities:	appoints and determines whether to retain or terminate the independent auditors approves all audit engagement fees, terms and services; approves any non-audit engagements reviews and discusses the independent auditors quality control reviews and discusses the independence of the auditors, the audit plan, the conduct of the audit and the results of the audit reviews and discusses with management the Company s financial statements and disclosures, its interim financial reports and its earnings press releases reviews with the Company s General Counsel legal matters that might have a significant impact on the Company s financial statements and issues relating to compliance with the Company s Code of Corporate Conduct and Ethics reviews with management the appointment, replacement, reassignment or dismissal of the Director of internal audit, the internal audit charter, internal audit plans and reports reviews with management the adequacy of internal controls over financial reporting A copy of this Committee s Charter (i) may be found on the Company s website at www.lincolnelectric.com/corporate/about/governance.asp and (ii) will be made available upon request to the Company s Corporate Secretary.

Compensation and Executive Development Committee

Members:	Hellene S. Runtagh (Chair), Harold L. Adams, Stephen G. Hanks, G. Russell Lincoln and William E. MacDonald, III, each of whom meets the independence standards set forth in the NASDAQ listing standards and each of whom is deemed to be an outside Director within the meaning of Section 162(m) of the U.S. Internal Revenue Code and each of whom is deemed to be a non-employee director within the meaning of Rule 16b-3 of the Securities Exchange Act of 1934.
Number of 2007 Meetings:	Six
Principal Responsibilities:	reviews and establishes total compensation of the Chief Executive Officer and the other executive officers annually assesses the performance of the Chief Executive Officer and the other executive officers monitors the Company s key management resources, structure, succession planning, development and selection processes and the performance of key executives reviews and recommends to the Board the appointment and removal of elected officers of the Company administers the Company s employee stock and incentive plans and reviews and makes recommendations to the Board concerning all employee benefit plans reviews and recommends to the Board new or amended executive compensation plans The Committee does not generally delegate any of its authority to other persons, although it has the power to delegate authority. Two exceptions to the foregoing are that the authority to delegate is not permitted with respect to awards under our 2006 Equity and Performance Incentive Plan to any executive officers or any person subject to Code Section 162(m) and any delegation under our 2007 Management Incentive Compensation Plan (or 2007 MICP), which was adopted by the shareholders at last year s Annual Meeting and relates to awards subject to Code Section 162(m). See the Compensation Discussion and Analysis section below for more information on the Committee s role with respect to executive compensation.
	A copy of this Committee s Charter (i) may be found on the Company s website at www.lincolnelectric.com/corporate/about/governance.asp and (ii) will be made available upon request to the Company s Corporate Secretary.

Nominating and Corporate Governance Committee

Members: Harold L. Adams (Chair), David H. Gunning, Kathryn Jo Lincoln and George H. Walls, Jr., each of whom meets the independence standards set forth in the NASDAQ listing standards.

Number of 2007 Meetings: Five

Principal Responsibilities:

reviews external developments in corporate governance matters, and develops and recommends to the Board corporate governance principles for the Company

identifies and evaluates Board member candidates

reviews Director compensation, benefits and expense reimbursement programs

reviews periodically the quality, sufficiency and currency of information furnished to the Board by Company management

In evaluating candidates for Director, including persons nominated by shareholders, the Committee expects that any candidate for election as a Director of the Company must have these minimum qualifications:

demonstrated character, integrity and judgment

high-level managerial experience or experience dealing with complex problems

ability to work effectively with others

sufficient time to devote to the affairs of the Company and these specific qualifications

specialized experience and background that will add to the depth and breadth of the Board

independence as defined by the NASDAQ listing standards

financial literacy

The Committee s process for identifying and evaluating nominees for Director includes annually preparing and discussing prospective Director specifications, which serve as the baseline to evaluate candidates. From time-to-time, the Company has retained an outside firm to help identify candidates, but no firm was retained on that basis in 2007, and no firm is currently being retained.

Shareholders may nominate one or more persons for election as Director of the Company. The process for doing so is set forth above under the caption May I submit a nomination for Director?

See the narrative following the Director compensation table below for specific information on the Committee s involvement in determining Director compensation.

A copy of this Committee s Charter (i) may be found on the Company s website at www.lincolnelectric.com/corporate/about/governance.asp and (ii) will be made available upon request to the Company s Corporate Secretary.

Finance Committee

Members:	David H. Gunning (Chair), Stephen G. Hanks, Robert J. Knoll, G. Russell Lincoln and William E. MacDonald, III.
Number of 2007 Meetings:	Six
Principal Responsibilities:	Considers and makes recommendations, as necessary, on matters related to the financial affairs and policies of the Company, including financial performance, including comparing Company financial performance to budgets and goals capital structure issues, including dividend and share repurchasing policies financial operations capital expenditures strategic planning and financial policy matters, including merger and acquisition activity pension plan funding and plan investment management performance A copy of this Committee s Charter (i) may be found on the Company s website at www.lincolnelectric.com/corporate/about/governance.asp and (ii) will be made available upon request to the Company s Corporate Secretary.

Your Board held seven meetings in 2007. Each of the Directors attended at least 75 percent of the total number of meetings of Directors and meetings of committees on which he or she served.

CORPORATE GOVERNANCE

Director Independence

Each of the current non-employee Director nominees and continuing Directors meets the independence standards set forth in the NASDAQ listing standards. The NASDAQ independence standards include a series of objective tests, such as that the Director is not an employee of the Company and has not engaged in various types of business dealings with the Company, to determine whether there are any relationships which would interfere with the exercise of independent judgment in carrying out the responsibilities of the Director.

During 2007, the independent Directors met in Executive Session, separate from the sole management Director, in conjunction with each of the seven meetings of the Board. The Lead Director, discussed below, was the presiding Director of these sessions.

Lead Director

The Lead Director is appointed each year by the independent Directors at the organizational meeting of the Board following the Annual Meeting. The Lead Director serves as a liaison between the Chairman of the Board and the independent Directors, and presides over Executive Sessions attended only by independent Directors. The Lead Director consults with the Chairman on the format and adequacy of information the Directors receive and the effectiveness of the Board meeting process. As described under Guidelines on Significant Corporate Governance Issues below, during 2007, our Governance Guidelines were modified to enhance the role of the Lead Director and the Lead Director now has independent authority to review and approve Board meeting agendas and schedules, as well as the authority to request from the officers of the Company any Company information deemed desirable by the independent Directors. The Lead Director may also speak on behalf of the Company from time to time as the Board may decide.

In April 2007, Harold L. Adams was re-appointed as the Lead Director for 2007-2008, a position he has held since the position was created in December 2004. Mr. Adams has been a Director of the Company since 2002 and is the former Chairman, President and Chief Executive Officer of RTKL Associates Inc., an architectural and engineering firm.

Guidelines on Significant Corporate Governance Issues

Your Board has adopted Guidelines on Significant Corporate Governance Issues to assure good business practices, transparency in financial reporting and the highest level of professional and personal conduct. These guidelines address current developments in the area of corporate governance, including developments in Federal securities law, developments related to the Sarbanes-Oxley Act of 2002 and changes in the NASDAQ listing standards. The Governance Guidelines also provide for the annual appointment of our Lead Director. During 2007, the guidelines were modified by the Board to include an express confidentiality provision, which emphasizes that, unless otherwise authorized by the Board, Directors are not to discuss confidential corporate business with third parties, and instead are to refer all such matters to the appropriate company management. Other modifications included enhancing the authority of the Lead Director, including providing the Lead Director with independent authority to review and approve Board meeting agendas and schedules, as well as providing the Lead Director with the authority to request from the officers of the Company any Company information deemed desirable by the independent Directors, and the addition of a majority voting policy for the election of Directors, which is discussed in detail below.

Majority Voting Policy

Effective as of January 2008, Ohio corporate law permits the articles of incorporation of an Ohio corporation to set forth alternative standards (as opposed to plurality voting) for the election of directors. In order to be responsive to the majority voting movement, but in light of the uncertainty surrounding reaction to a full articles amendment, during 2007, the Company modified its Governance Guidelines to include a majority voting policy. The Board has the exclusive power and authority to administer the policy, as well as to repeal the policy, in whole or in part, or to adopt a new policy as it deems appropriate.

Under the policy, in uncontested elections of Directors, any Director who failed to receive a majority of the votes cast in his or her favor would be required to submit his or her resignation to the Board promptly after the certification of the election results. The Nominating and Corporate Governance Committee would then consider each resignation and recommend to the Board whether to accept or reject it. The Committee, in making its determination, may consider any factors or other information that it deems appropriate, including, the reasons (if any) given by shareholders as to why they withheld their votes, the qualifications of the tendering Director and his or her contributions to the Board and the Company, and the results of the most recent evaluation of the tendering Director s performance by the Committee and other members of the Board. Any Director who tenders his or her resignation under the policy shall not participate in the Committee s recommendation or Board action regarding whether to accept or reject the tendered resignation. If a Director s tendered resignation is rejected by the Board, the Director will continue to serve for the remainder of his or her term and until a successor is duly elected. If a Director s tendered resignation is accepted by the Board, then the Board, in its sole discretion, may fill any resulting vacancy or may decrease the size of the Board.

You can access the Guidelines on Significant Corporate Governance Issues on the Company s website at www.lincolnelectric.com/corporate/about/governance.asp.

Code of Corporate Conduct and Ethics

Your Board also has adopted a Code of Corporate Conduct and Ethics to govern the Company s Directors, officers and employees, including the principal executive officers and senior financial officers. During 2007, the Code of Conduct was modified slightly to reflect organizational changes to our corporate compliance program, namely the addition of a Director of Compliance.

The Company has satisfied, and in the future intends to satisfy, the disclosure requirements of Item 5.05 of Form 8-K regarding an amendment to, or a waiver from, any provision of its Code of Corporate Conduct and Ethics that applies to its principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, and relates to any element of the code of ethics definition as set forth in Item 406(b) of Regulation S-K of the Securities Exchange Act of 1934 by posting such information on its website. You can access the Code of Corporate Conduct and Ethics, and any such amendments or waivers thereto, on the Company s website at www.lincolnelectric.com/corporate/about/governance.asp. Other than the amendments relating to the corporate compliance program discussed above, there have been no amendments to the Code of Corporate Conduct and Ethics as of the date of this proxy statement, and there have been no waivers to the Code of Corporate Conduct and Ethics as of the date of this proxy statement.

RELATED PARTY TRANSACTIONS

Any related party transactions concerning the Company and any of its directors or officers (or any of their immediate family members as defined as children, stepchildren, parents, stepparents, spouses, siblings, mother-in-laws, father-in-laws, son-in-laws, daughter-in-laws, brother-in-laws, sister-in-laws and any other persons sharing a household (other than a tenant or employee)), including those that are reportable under Item 404(a) of Regulation S-K of the Securities Exchange Act of 1934, are to be disclosed to and approved by the Chief Compliance Officer, Compliance Counsel and the Audit Committee of the Board. The Company defines related party transactions generally as transactions in which the self-interest of the employee, officer or director may be at odds or conflict with the interests of the Company, such as doing business with entities that are or may be controlled or significantly influenced by such persons or their immediate family members. It is the Company s policy to avoid related party transactions; related party transactions involving officers of the Company are generally prohibited. Our related party transaction policies can be found in our Code of Corporate Conduct and Ethics, as well as the Audit Committee Charter, both of which are available on our website.

In February 2008, the Audit Committee considered and approved a related party transaction involving P&R Specialty, Inc., a supplier to the Company. Greg D. Blankenship, the brother of George D. Blankenship, Senior Vice President, Global Engineering, is the sole stockholder and President of P&R Specialty, Inc. During 2007, the Company purchased approximately $3 million worth of products from P&R Specialty in ordinary course of business transactions. George D. Blankenship has no ownership interest in or any involvement with P&R Specialty. The Company believes that the transactions with P&R Specialty were on terms no less favorable to the Company than those that could have been obtained from unaffiliated parties.

In February 2008, the Audit Committee also considered and approved an additional related party transaction involving Jones Day, a law firm that the Company has retained for specific legal services, on a case-by-case basis, for over ten years. Mr. Gunning, one of our Directors, is the father-in-law of Gina K. Gunning, a partner of Jones Day. The fees paid by the Company to Jones Day during 2007 were $2,172,932, which amount is less than 1% of Jones Day s gross revenues for 2007. Ms. Gunning does not personally render legal services to the Company or supervise any attorney in the rendering of legal services to the Company, and Ms. Gunning does not receive any direct compensation from fees paid by the Company to Jones Day.

DIRECTOR COMPENSATION

The following table details the cash retainers and fees, as well as stock-based compensation in the form of shares of restricted stock and stock options, received by our non-employee Directors or expensed by the Company during 2007.

Director	Fees Earned or Paid in Cash	Stock Awards (10)	Option Awards (11)	Non-Equity Incentive Plan Compensation	Change in Pension Value and Nonqualified Deferred Compensation Earnings	All Other Compensation	Total
Harold L. Adams (1)	$97,500	$17,947	$				$115,447
David H. Gunning (2)	82,500	17,947					100,447
Stephen G. Hanks (3)	77,500(3)	17,947	56,525				151,972
Robert J. Knoll (4)	86,000	17,947					103,947
G. Russell Lincoln (5)	77,500	17,947					95,447
Kathryn Jo Lincoln (6)	76,000	17,947					93,947
William E. MacDonald, III (7)	48,065	9,156					57,221
Hellene S. Runtagh (8)	87,500	17,947					105,447
George H. Walls, Jr. (9)	76,000(9)	17,947					93,947

(1) During 2007, Mr. Adams was the Lead Director, a member of the Compensation and Executive Development Committee and Chair of the Nominating and Corporate Governance Committee.

(2) During 2007, Mr. Gunning was a member of the Nominating and Corporate Governance Committee and Chair of the Finance Committee.

(3) During 2007, Mr. Hanks was a member of the Compensation and Executive Development Committee and the Finance Committee. All of the Board fees reported in the first column were deferred by Mr. Hanks under our Non-Employee Directors Deferred Compensation Plan, which is described in the narrative below.

(4) During 2007, Mr. Knoll was a member of the Finance Committee and Chair of the Audit Committee.

(5) During 2007, Mr. Lincoln was a member of the Compensation and Executive Development Committee and the Finance Committee.

(6) During 2007, Ms. Lincoln was a member of the Audit Committee and the Nominating and Corporate Governance Committee.

(7) Mr. MacDonald was initially elected to our Board at last year s Annual Meeting. During 2007, Mr. MacDonald was a member of the Compensation and Executive Development Committee and the Finance Committee.

(8) During 2007, Ms. Runtagh was a member of the Audit Committee and Chair of the Compensation and Executive Development Committee.

(9) During 2007, General Walls was a member of the Audit Committee and the Nominating and Corporate Governance Committee. All of the Board fees reported in the first column were deferred by Mr. Walls under our Non-Employee Directors Deferred Compensation Plan, which is described in the narrative below.

(10) On November 28, 2007, 729 shares of restricted stock were granted to each of the non-employee Directors pursuant to our 2006 Stock Plan for Non-Employee Directors. The Stock Awards column represents the 2007 FAS 123R expense for the November 28, 2007 restricted stock awards, as well as the 2007 compensation expense for 2006 restricted stock grants. The amount reported for Mr. MacDonald includes the 2007 compensation expense related to his April 2007 award of restricted shares, issued upon his initial election to the Board, as well as the 2007 restricted stock grant. See the discussion below entitled 2006 Stock Plan for Non-Employee Directors for additional information regarding the plan. Assumptions used in the calculation of these amounts are included in footnote (E) to the Company s audited financial statements for the fiscal year ended December 31, 2007 included in the Company s Annual Report on Form 10-K filed with the SEC on February 25, 2008.

As of December 31, 2007, the aggregate number of shares of restricted stock held by each non-employee Director was 1,550 shares, except for Mr. MacDonald, who holds 1,270 shares.

(11) No stock options were granted to the non-employee Directors during 2007. The Option Awards column represents the 2007 FAS 123R expense for stock options granted to Mr. Hanks who joined our Board during 2006 and received an award for 6,000 options consistent with the terms of our 2006 Stock Plan for Non-Employee Directors at the time of his election to the Board. The options vested in full in July 2007. See the discussion below entitled 2006 Stock Plan for Non-Employee Directors for additional information regarding the plan. Assumptions used in the calculation of these amounts are included in footnote (E) to the Company s audited financial statements for the fiscal year ended December 31, 2007 included in the Company s Annual Report on Form 10-K filed with the SEC on February 25**,** 2008.

As of December 31, 2007, the aggregate number of unexercised stock options held by each current non-employee Director was as follows: Mr. Adams, 15,500; Mr. Gunning, 5,500; Mr. Hanks, 6,000; Mr. Knoll, -0-; Mr. Lincoln, 13,500; Ms. Lincoln, 3,500; Mr. MacDonald -0-; Ms. Runtagh, 9,500; and General Walls, 7,500. All of the outstanding stock options were exercisable as of December 31, 2007.

General

Based upon the recommendations of the Nominating and Corporate Governance Committee, the Board determines Director compensation. The Committee periodically reviews the status of Board compensation in relation to other comparable companies, trends in Board compensation and other factors it deems appropriate. The Committee receives assistance and advice from compensation consultants at Watson Wyatt, an internationally-recognized human resources consulting firm, and from the management of the Company, particularly the Chief Executive Officer, General Counsel and Vice President, Human Resources, regarding the underlying philosophies, components and levels of Director compensation. An employee of Lincoln who also serves as a Director does not receive any additional compensation for serving as a Director, or as a member or chair of a Board committee.

In addition, the Committee administers our Director equity incentive plans, including approval of grants of stock options, restricted stock and other equity or equity-based awards, and makes recommendations to the Board with respect to equity-based plans for Directors. The Committee does not generally delegate any of its authority to other persons, although it has the power to do so.

2007 Director Compensation Package

During 2007, the Directors compensation package for non-employee Directors was based on the following principles:

a significant portion of Director compensation should be aligned with creating and sustaining shareholder value;

- Directors should have equity interest in Lincoln; and

- total compensation should be structured to attract and retain a diverse and truly superior Board of Directors.

With the above principles in mind, the compensation package for 2007 was comprised of the following components:

Cash Compensation

- an annual retainer of $40,000 for all Directors;

- an annual retainer of $15,000 for the Lead Director;

- an annual retainer of $10,000 for the Chairs of the Audit and the Compensation and Executive Development Committees and $5,000 for each other Committee Chair;

- Board meeting fees of $3,000 for each meeting attended; and

- Committee meeting fees of $1,500 for each meeting attended.

Stock-Based Compensation

Stock-based compensation is provided under the 2006 Stock Plan for Non-Employee Directors, which provides for various types of stock awards, including restricted stock and stock options. Beginning in 2005, the Company migrated stock awards from stock options to restricted stock in order to provide non-employee Directors with an opportunity to obtain more of a proprietary interest in Lincoln and in light of the new non-employee Director stock ownership guidelines discussed below. As it relates to 2007 compensation, the Nominating and Corporate Governance Committee resolved that annual awards of restricted stock would be made at a value of $50,000 to all non-employee Directors and that initial awards of restricted stock would be made at a value of $35,000 to any non-employee Director who becomes eligible by virtue of his or her election to the Board.

During 2007, the following stock-based awards were made to our non-employee Directors pursuant to the 2006 Stock Plan for Non-Employee Directors:

- an annual restricted stock award of 729 shares, or approximately $50,000 worth of restricted stock, to each non-employee Director; and

- an initial restricted stock award of 541 shares to Mr. MacDonald, or approximately $35,000 worth of restricted stock, who became eligible to receive this initial award by virtue of his election to the Board at last year s Annual Meeting.

Other Arrangements

We reimburse all Directors for out-of-pocket expenses incurred in connection with attendance at Board meetings, or when traveling in connection with the performance of their services for Lincoln. With respect to the use of private aircraft, we will reimburse the Director for the cost of a first-class ticket (which amount is increased proportionately should other Directors or executives travel on the same flight).

Continuing Education

Directors are reimbursed up to $5,000 annually for continuing education expenses (inclusive of travel expenses), in such amounts and on such programs and related expenses as each Director may elect. Fifty percent

of our Directors are certified by the Corporate Directors Institute of the National Association of Corporate Directors (NACD), which offers continuing education programs for both new and experienced directors.

Stock Ownership Guidelines

In keeping with the philosophy that Directors interests should be aligned with creating and sustaining shareholder value and as part of its continued focus on best practices with respect to corporate governance, we introduced stock ownership guidelines for the non-employee Directors effective January 1, 2006. Guidelines were also introduced for officers, which are described below in the Compensation Discussion and Analysis section. Under these new guidelines, non-employee Directors are required to accumulate over time a certain number of our common shares equal in value to at least three times the Board s 2006 annual cash retainer of $40,000 (or $120,000). Non-employee Directors have five years to satisfy the stock ownership guidelines, which can be satisfied by holding either (1) shares aggregating the specified dollar amount, or (2) 3,025 shares, which amount is the equivalent to three times the annual retainer in effect on January 1, 2006 ($120,000) divided by the closing price of a common share on December 30, 2005 ($39.66). Restricted stock awards count towards the stock ownership guidelines; common shares underlying stock options and shares held in another person s name (including a relative) do not. As of December 31, 2007, more than 85% of our non-employee Directors satisfied their ownership guidelines.

2006 Stock Plan for Non-Employee Directors

Approved by shareholders at our 2006 Annual Meeting, the 2006 Stock Plan for Non-Employee Directors provides for the annual and initial grants of stock-based awards as outlined above. The plan provides for various types of stock-based awards, including stock options and restricted stock.

During 2007, non-employee Directors received an annual award of shares of restricted stock valued at approximately $50,000. Mr. MacDonald received an award of restricted stock valued at approximately $35,000 upon his initial election to the Board at last year s Annual Meeting. Recipients of shares of restricted stock have all of the rights of a shareholder with respect to the restricted stock, including the right to vote such shares. Under the terms of the award, shares of restricted stock vest in full three years after the date of grant with accelerated vesting upon a change in control of the Company or upon the death, disability or retirement of the Director. During the period during which the shares remain forfeitable, dividends on the restricted stock are paid out to the non-employee Directors in cash. Awards of restricted stock made during 2006 contain the same terms, except that there is no accelerated vesting upon retirement under the terms of the 2006 awards. At the time of the 2006 awards, the definition of retirement as contained in the plan resulted in an unintended tax consequence to the Directors. The plan was amended in 2007 to eliminate the unintended result.

During 2007, no stock options were granted under the plan and only one Director, Mr. Hanks, received stock options during 2006 in connection with his initial election to the Board. An option becomes exercisable after the optionee has continuously served as a Director for one year from the date of grant, with accelerated vesting upon a change in control of the Company or upon the death, disability or retirement of the Director. Once the optionee has vested in his or her options, the option may be exercised in whole or in part with respect to 100% of the underlying common shares. Options granted under the plan have a 10-year term.

Non-Employee Directors Deferred Compensation Plan

Adopted in 1995, this plan allows the non-employee Directors to defer payment of all or a portion of their annual cash compensation. This plan allows each participating non-employee Director to:

- elect to defer a specified dollar amount or a percentage of his or her cash compensation;

- have the deferred amount credited to the Director s account and deemed invested in one or more of the options available under the plan; and elect to begin payment of the deferred amounts as of the earlier of termination of services as a Director, death or a date not less than one full calendar year after the year the fees are initially deferred.

The investment elections available under the plan are the same as those available to officers under our Top Hat Plan, which is discussed in the narrative of the Nonqualified Deferred Compensation Table following the Compensation Discussion and Analysis section of this proxy statement. On November 30, 2005, we amended the plan to allow future deferrals under the plan effective as of January 1, 2006. The plan previously had been frozen with respect to benefit accruals for the period after December 31, 2004 in response to the adoption of Section 409A of the U.S. Internal Revenue Code, which significantly changed the Federal tax law applicable to amounts deferred under the plan after that date. All benefit accruals vested prior to January 1, 2005 qualify for grandfathered status and continue to be governed by the law applicable to nonqualified deferred compensation prior to the addition of Section 409A of the Code. Two Directors, Mr. Hanks and Mr. Walls, elected to defer Board fees under the plan during 2007.

Directors Charitable Award Program

This program was terminated in 2003, other than for Directors already vested. Upon the death of a vested non-employee Director, we will donate an aggregate of $500,000 (in 10 annual installments) to one or more charitable organizations recommended by the vested Director and approved by Lincoln. This program is funded through insurance policies on the lives of the vested Directors. No premiums were paid during 2007 as the policies were fully-funded as of the end of 2005.

All charitable deductions and the cash surrender value of the policies accrue solely to Lincoln; the vested Directors derive no financial benefit. The current non-employee Directors who are vested in the program are David H. Gunning, G. Russell Lincoln and Kathryn Jo Lincoln.

EXECUTIVE COMPENSATION

COMPENSATION DISCUSSION AND ANALYSIS

The following explains the material elements of the compensation objectives and policies as it relates to our named executive officers included in the Summary Compensation Table.

Our executive compensation programs consist of four main components: base compensation, annual bonus, long-term incentives and benefits/perquisites, all of which are discussed in more detail below. Base pay is targeted at the 45th percentile of the competitive market (slightly below market), while target total cash compensation (which includes an annual bonus target) is set at the 65th percentile of the market (above market). Long-term incentive compensation is set at the 50th percentile (at market), and is divided equally among three programs: stock options, restricted stock and a cash long-term incentive program. Benefits are set at the market median or 50th percentile. Although not targeted to a specific competitive level, we believe our executive perquisites are below the market median.

The following discussion and analysis contains statements regarding future individual and company performance targets and goals. These targets and goals are disclosed in the limited context of our compensation programs and should not be understood to be statements of management s expectations or estimates of results or other guidance. We specifically caution investors not to apply these statements for other contexts.

Executive Summary

The Compensation and Executive Development Committee of the Board (the Committee), which consists solely of non-employee Directors, has responsibility for reviewing, establishing and monitoring all elements of compensation of our executives (see *Role of Committee, Consultants and Management* below). To set the levels of compensation for executive management, the Committee conducts an annual review of competitive market compensation, executive compensation trends, business needs, individual performance and our financial performance to peers. Based on these factors and the advice of its outside executive compensation consultant, Watson Wyatt, the Committee made certain program changes in 2007. Most notably, it added a working capital metric to the annual bonus program, it modified the matrix used to determine payouts for the annual bonus program to allow for payouts when financial performance exceeds 120% of budget and it increased the maximum payout under the cash long-term incentive plan from 140% of target to 200% of target, if significant financial performance is achieved. The Committee also took steps to implement the plan approved by shareholders at last year s Annual Meeting (the 2007 Management Incentive Compensation Plan or 2007 MICP) to qualify for the performance based exclusion from the deduction limitations under Section 162(m) of the Internal Revenue Code.

For each named executive officer, the Committee reviewed the levels and amounts of compensation based on an analysis of pay for performance, a summary of the Company s overall compensation philosophies, a comparison of current pay to the various competitive targets and individual performance. The Committee increased 2007 base salaries, MIP (bonus) targets and long-term incentives (Cash LTIP and equity awards) for the named executive officers (each of these actions is described in more detail in *Executive Compensation Components* below). Although the Company experienced strong financial performance during 2007, actual payouts for the 2007 MIP for the named executive officers, on average, decreased from 2006 amounts due to aggressive financial targets. However, as a result of that same strong financial performance during the most recent three fiscal years and due to higher target amounts for most of the named executive officers (as a result of increased responsibilities), the actual payout for the Cash LTIP for the named executive officers increased from 2006 amounts. In approving these incentive payments, the Committee noted that in both longer historical periods (2005 to 2007) and the most recent fiscal year (year to date 2007), pay levels were generally lower than the financial performance delivered (each of these components is described in more detail in *Executive Compensation Components* below).

Executive Compensation Philosophy

We place the greatest emphasis on programs that reward financial and individual performance while striking a balance between different programs that reward short-term and long-term financial performance. We believe that this structure is the most effective way to attract, motivate and retain exceptional employees. Our approach to executive compensation is generally the same as our approach to employee-wide compensation, with a strong belief in pay-for-performance and a long-standing commitment to incentive-based compensation. For example, virtually all domestic, welding business full-time employees participate in a bonus program designed to reward both company financial performance and individual contributions. In the 2007 bonus year, our broad-based bonus pool was $82.5 million, the average bonus paid was 57.12% of an employee s base pay and the average total cash compensation received by bonus-eligible employees was $73,409.

We expect base pay and benefits to deliver a level of predictable compensation since our structure is heavily weighted toward variable compensation. Therefore, fixed components, such as base compensation, are generally set below the competitive market for each position, while incentive-based compensation, such as annual bonuses, are set above the competitive market and require strong financial performance for payouts to result (method used for determining the competitive market is described in *Market Comparison Data* below). However, because annual bonuses reward operating performance and are paid in cash, our long-term incentive compensation programs are weighted more heavily toward rewards for share appreciation and non-cash awards.

Employees are rewarded when we achieve superior financial results but their compensation is significantly reduced when we do not achieve the expected level of financial performance. In addition, individual performance plays a key role in determining the amount of compensation delivered to an individual, with our philosophy being that the best performers should receive the greatest rewards.

Executive Compensation Methodologies

Role of Committee, Consultants and Management

Committee. The Committee regularly involves the full Board in its responsibilities. Its primary charge is to determine and report to the Board on the compensation (or method of calculating it) for the Chairman, President and Chief Executive Officer and the other executive officers. It establishes and then conducts a full Board review in executive session of the annual performance for the Chief Executive Officer. In addition, the Committee establishes procedures and conducts succession planning for the Chief Executive Officer and other executive management positions. It also reviews and makes recommendations to the Board concerning our employee stock, incentive compensation and employee benefit programs.

CEO and Management. The management of the Company (particularly the Chief Executive Officer, the Chief Financial Officer and the Vice President, Human Resources) provides recommendations to the Committee relative to the philosophies underlying our compensation programs, components of these programs and levels of compensation. Specifically, the Chief Executive Officer recommends the compensation for the other executive management positions and provides the Committee with assessments of their individual performance, both of which are subject to Committee review. Relative to compensation setting, the Committee reviews the Chief Executive Officer s recommendations and discusses them with Watson Wyatt to ensure the compensation recommendations are in line with the executive compensation program s stated philosophies and are reasonable when compared to our competitive market. Relative to individual performance assessments, which are based on achievement of various financial and leadership objectives set by the Chief Executive Officer at the beginning of each year, the Committee reviews specific performance components and makes suggestions for modifications where warranted.

Compensation Consultants. The Committee receives assistance and advice from its executive compensation consultants at Watson Wyatt, an internationally-recognized human resources consulting firm, on matters including competitive compensation surveys, executive compensation trend data, observations on the design of our incentive programs, peer company financial performance and peer company compensation analysis. These consultants report directly to the Chairperson of the Committee, although they are available to, and regularly do, provide advice to management. Changes to the incentive programs in 2007 were made in consultation with Watson Wyatt. The Committee, however, is not bound by the input, advice or recommendations of Watson Wyatt. Watson Wyatt also provides other human resources consulting to the Company, such as actuarial services for our U.S. and Canadian retirement programs and consulting on Director compensation. In order to ensure the independence of its consultants, the Committee requires that, with respect to non-executive compensation work, the Committee review and approve the work to be performed and Watson Wyatt must ensure that the specific executive compensation consultants will not perform such non-executive compensation work.

Selection of Compensation Elements

As part of its annual review, the Committee first evaluates whether changes in the philosophy or structure are warranted in light of emerging trends, business needs and/or our financial performance. Absent changes, the Committee uses competitive market data, performance assessments and management recommendations to set the pay components along the targets described above (i.e., 45th percentile for base pay). Actual pay for the executive officers will generally fall within a range of these targets (plus or minus 20%).

Consistent with our pay-for-performance and incentive-based philosophies is our belief that compensation for executives new to their positions should be brought to the levels described above over time, not all at once. Therefore, for a period of time, new executives may experience larger pay increases but their compensation will be set below the targets described above during a transition period. Absent these types of significant increases, increases for break-through individual performance or significant changes in the competitive market data, pay increases are generally expected to be in line with national trends.

Market Comparison Data

Competitive market compensation data is collected from multiple, nationally-published surveys, proxy data from a peer group of companies and, beginning in 2007, proxy data from companies in the S&P Midcap 400 Index (in which the Company began participating in mid-2006). The S&P Midcap 400 Index data is collected for all companies in that index as well as for the manufacturing companies only in that index. All competitive market compensation data is statistically determined (through regression analysis) to approximate the Company s revenue size. Survey data is also aged to approximate more current data.

Comparison Group

The peer group of companies consists of 28 publicly-traded industrial corporations that are headquartered in the United States, serve a number of different market segments and have significant foreign operations. These are companies for which Lincoln competes for talent and for shareholder investment. During 2007, the Committee reviewed the make-up of the peer group and made certain additions and deletions. As a result, during 2007, our peer group was comprised of the following companies:

AGCO Corp	Donaldson Co	Ingersoll-Rand Co	Power-One Inc
Ametek Inc	Dover Corp	ITT Corp	Rockwell Automation
Caterpillar Inc	Eaton Corp	Kennametal Inc	Roper Industries
Cooper Industries	Emerson Electric	Nordson Corporation	SPX Corp
Crane Company	Flowserve Corporation	Paccar Inc	Tecumseh Products Corp
Cummins Inc	Graco Inc	Pall Corp	Thomas & Betts
Deere & Co	Illinois Tool Works	Parker-Hannifin Corp	Trane Inc (formerly American Standard)

Compensation Structure

Business Needs. Compensation consultants assist in presenting information about emerging trends in executive compensation, along with Committee members own reading and study on these matters. These trends are considered by the Committee in light of our compensation philosophies and looking at various business needs. Business needs evaluated can include: talent attraction and retention strategies, growth expectations, cost-containment initiatives, management development needs, administrative complexity and our company culture. In evaluating the impact of these, no single factor guides whether changes will be made. Instead, the Committee adopts a holistic approach, considering various factors.

Individual Performance. Individual past performance is a significant factor in determining annual changes (up or down) to pay components (base pay, annual bonus targets and long-term incentive awards) as the Company views past performance as a strong indicator of future performance. In addition, as described in more detail below, the annual bonus includes an individual performance component in determining the percentage of target actually paid. Individual performance is measured against how well an executive achieves objectives established for him or her at the beginning of the year. Other than objectives tied to specific business needs (such as those described above), objectives could include: leadership of specific initiatives, participation in or support of strategic programs and individual development actions. A performance rating will generally range from .80 to 1.15, with all performance ratings capped at 1.15.

Pay and Performance Review. In determining whether changes will be made to the existing philosophy or structure and before setting compensation levels for the upcoming year, the Committee conducts an annual review of pay and performance. This review is used to evaluate whether executive pay levels are properly aligned with our financial performance, when compared to pay levels and financial performance of the peer group companies and, beginning in 2007, companies in the S&P Midcap 400 Index. The review looks at various financial metrics and compensation data for the most recent fiscal year and for a multi-year historical period. It then considers whether our financial performance is at, below or above that of the peer group companies/companies in the S&P Midcap 400 Index and whether our executive compensation is at, below or above the peer group companies/companies in the S&P Midcap 400 Index. In setting 2007 compensation (which was done in the fourth quarter of 2006), the Committee reviewed revenue growth, earnings before interest and taxes (EBIT) growth, net income growth, earnings per share (EPS) growth, return on invested capital and 1-year and 3-year total shareholder return for Lincoln versus the peer group (those same components were also reviewed for companies in the S&P Midcap 400 Index in setting 2008 compensation, which was done in the fourth quarter of 2007). Overall, Lincoln s historical financial performance was at or above the peer group s financial performance for the most recent fiscal year and the most recent three-year period. Specifically, revenue growth, EBIT growth, net income growth, EPS growth, return on invested capital and 1-year and 3-year total shareholder return for the Company for 2005 (the most recent fiscal year) were at or above the 75th percentile of peer group performance while compensation was at or below the median (50th percentile) of the peer group. Taken as a whole, the Committee used this information to conclude that, while no significant changes were needed to our overall executive compensation philosophies for 2007, certain adjustments in the incentive programs were appropriate to allow for larger payouts at higher levels of financial performance.

Timing of Compensation Determinations and Payouts

Base pay levels, annual bonus targets and long-term incentive awards (which include all equity-based awards, such as stock options and restricted stock, and a cash long-term incentive plan target) are set at the end of the immediately prior year at a regularly-scheduled Committee meeting. The date is fixed by the Committee well in advance and generally occurs at the same time each year (in the fourth quarter) in connection with regularly-scheduled Board and Committee meetings. Payout amounts for the annual bonus and the cash long-term incentive plan are determined after year-end, at the first regularly-scheduled Committee meeting of the following year, once complete financial results are available.

Executive Compensation Components

Base Compensation

Base compensation provides executives with a predictable minimum level of compensation. Base salaries are set based on the executive s experience, expertise, level of responsibility, seniority, leadership qualities, individual accomplishments and other factors. That being said, the Company aims to set base salaries at approximately the 45th percentile of the market (slightly below market) in keeping with our philosophy that greater emphasis should be placed upon variable compensation. For 2007, the base salaries for the named executive officers were just below the 45th percentile of the market and the average increase in their base pay was 5.3%.

Annual Bonus

Overview. The Management Incentive Plan, or MIP, provides the named executive officers an opportunity to receive an annual cash bonus. We believe that, given base pay is set below market, annual cash bonus opportunities should be above average to balance some of the risk associated with greater variable compensation. Therefore, we target total cash compensation (base and bonus target) at the 65th percentile of the market. We believe, however, that payments of above-average bonuses should only be made where the individual s performance, that of the entire Company and that of his or her particular business unit warrant it. As a result, financial goals are set aggressively. Actual bonus payments may be substantially above the market median (approaching total cash compensation in the upper quartile, or 75th percentile, of the market) if Lincoln delivers outstanding financial results that are well above targets. Conversely, actual bonus payments, and therefore total cash compensation, may be substantially below market if either individual performance or Company performance does not reach budgeted levels. For 2007, 31 individuals participated in the MIP worldwide. Two additional individuals were recommended for participation in the MIP for 2008.

Funding Formula MIP Matrix. The percentage of target actually paid is based upon a matrix that takes into account the level of achievement of financial performance and the executive s individual performance. If either of these factors is not met, the percentage of target paid is reduced, with the potential that no bonus will be paid. If either of these factors exceeds expectations, the percentage paid is above target.

For 2007, the Committee approved certain changes to the MIP structure. First, the Committee modified the MIP matrix to increase the level of financial performance that will be considered (up from 120% of budget to 150% of budget) and raised the maximum MIP payout (up from 135% of target to 160% of target). The Committee also added a second financial metric, namely the achievement of budget for average operating working capital (AOWC) to sales, in addition to the existing EBITB to budget financial metric. For 2007, the MIP matrix was as follows:

2007 MIP Matrix

And Individual	**Based on Financial Achievement to Budget of**										
	50%	60%	70%	80%	90%	100%	110%	120%	130%	140%	150%
Performance of	**A Participant Will Receive the Following Percentage of His or Her Target**										
1.15	0	60%	80%	100%	115%	120%	125%	135%	140%	150%	160%
1.10	0	45%	70%	90%	110%	115%	120%	130%	135%	145%	150%
1.05	0	30%	55%	80%	105%	110%	115%	125%	130%	135%	140%
1.00	0	15%	40%	65%	95%	100%	110%	120%	125%	130%	135%
0.95	0	0	25%	45%	75%	90%	100%	110%	115%	120%	125%
0.90	0	0	0	25%	40%	70%	85%	90%	100%	105%	110%
0.85	0	0	0	0	25%	40%	65%	70%	80%	90%	95%
0.80	0	0	0	0	0	25%	40%	50%	60%	70%	80%
0.75	0	0	0	0	0	0	25%	30%	40%	50%	60%
0.70	0	0	0	0	0	0	5%	10%	25%	30%	40%
0.65	0	0	0	0	0	0	0	0	0	0	0

This same matrix will be used for determining 2008 MIP payouts.

Consolidated Results and Business Unit Performance. A portion of the financial component is based upon achievement of Company consolidated financial results, and another portion may be attributable to regional/business unit financial results, depending upon the individual s span of responsibility. Given their corporate-wide responsibilities, for 2007, the financial component for Messrs. Stropki, Petrella and Stueber was 100% dependent upon Company consolidated financial results. For 2007, the financial components for Messrs. LeBlanc and Flohn were 25% dependent upon achievement of financial results for the consolidated Company and 75% dependent upon achievement of financial results for their particular business units/regions. By varying the financial metrics used based upon areas of responsibility, it is possible that certain participants will receive a higher percentage of target while others will receive a lower percentage of target where the business unit performance for one participant is better than the business unit performance for the other. This is a key component of our pay-for-performance and incentive-based philosophies. This was the case in 2007, where the consolidated and most business unit EBITB results were above budgets. As a result, most executives, including all of the named executive officers other than Mr. Flohn, received payouts that were above their target amounts.

EBITB Financial Metric. For 2007, one financial metric used was achievement of earnings before interest, taxes and the broad-based bonus referred to above (EBITB) to budget. This metric accounted for 80% of the MIP financial component. EBITB to budget has been used as the financial metric for the MIP since its inception in 1997 because it is an important indicator of profitability. Budgets for the consolidated company and the various business units are set aggressively (based on the local and global economic climate), at the beginning of the year, are reviewed by the Finance Committee of the Board and are approved by the full Board. In the last five years, EBITB to budget for the consolidated Company has ranged from 76.2% to 140.5% and has averaged 112.1%. For all of our business units, since 1997, EBITB to budgets have ranged from 7.1% to 162.1%, and have averaged 97.9%. When performance goals are set, we believe that there is an equal probability of achieving EBITB to budget in any year, although the cyclical nature of our business may increase the probability in some years and decrease it in others.

AOWC Financial Metric. For 2007, the Committee added a second financial metric, namely the achievement of budget for average operating working capital (AOWC) to sales, in addition to the existing EBITB to budget financial metric. This metric accounted for 20% of the MIP financial component. This metric was added to underscore the Company s commitment to improving cash flow. For 2007, for all business units, AOWC to sales ranged from 70.7% to 101.1% and averaged 93.0%. Like EBITB, we believe that there is an equal probability of achieving AOWC to sales in any given year, although the cyclical nature of our business may increase the probability in some years and decrease it in others.

Target Awards. The 2007 MIP targets for the named executive officers were established according to the principles discussed above. Their 2007 MIP targets placed their total cash compensation (base and bonus targets), on average, below the broad-based survey group 65th percentile and the average increase in their MIP targets was 9.6% (primarily due to increases that reflected the transition to greater job responsibilities).

2007 MIP Payments. The bonuses actually paid to the named executive officers for 2007 (as reported in the Summary Compensation Table) were below the amounts paid to them in 2006 (except for Mr. LeBlanc) but were above their 2007 targets (except for Mr. Flohn). These lower payments were due to aggressive 2007 financial budgets, even though overall financial performance for the Company and individual performance were all strong. On average, 2007 actual bonuses were 4.6% lower than 2006 actual bonuses and were 16% above targets. In approving the 2007 MIP payments, the Committee noted that the Company s growth in earnings before interest and taxes (EBIT) for the most recent trailing twelve month period was at the 75th percentile of the peer group and at the 71st percentile of the companies in the S&P Midcap 400 Index (growth in EBIT being the closest financial comparison available for the EBITB to budget metric used in the MIP), and that the Company s return on invested capital for the most recent fiscal year (2006) was at the 76th percentile of the peer group and at the 87th percentile of the companies in the S&P Midcap 400 Index (return on invested capital being the closest financial comparison available for the AOWC to sales metric used in the MIP). These bonus payments resulted in total cash compensation (base and actual bonus) for the group that was, on average, at the survey group 65th percentile.

2008 MIP Targets. During 2007, the Committee determined that the 2008 MIP matrix would be the same as the 2007 MIP matrix. MIP targets for 2008 for the named executive officers are set forth in the Grants of Plan-Based Awards Table below. The Committee determined these targets, in consultation with Watson Wyatt, based on the Company s compensation philosophies and competitive data. The 2008 MIP targets resulted in total compensation (base and target bonus) for the group that was, on average, slightly below the survey group 65th percentile.

Long-Term Incentives

Overview. We believe that long-term incentive opportunities should be provided to focus rewards on factors that deliver long-term sustainability for the Company and should be established at the median (or 50 th percentile) of the market. We have targeted the median of the market, in keeping with our pay-for-performance philosophy, because we believe that superior long-term financial growth itself should be the main driver of above-market long-term incentive compensation. We also believe that different financial metrics help drive long-term performance. Therefore, we have established a structure for long-term incentives that combines several different long-term metrics, with the greatest emphasis placed on share appreciation and non-cash awards.

Long-Term Components. Our long-term incentive program is made up of three components: stock options, restricted stock and a cash long-term incentive program. The value of each is weighted equally, such that one-third of an executive s long-term incentive value is delivered through stock options, one-third through restricted stock and one-third through a target cash award, because it provides an even balance with respect to the different attributes and timing associated with each type of award. Annual awards of all three components are made on a limited and selective basis to those individuals who have been designated as officers. The stock option and restricted stock awards for 2007 and 2008 were made under the 2006 Equity and Performance Incentive Plan. For 2007 and 2008 awards, 16 individuals received all three components, including all of the named executive officers.

Stock Options. Recognizing that equity awards are a valuable compensation tool, we extend the stock option portion of our long-term incentive program to senior managers and also make available certain one-time option grants to significant contributors, regardless of their position within Lincoln. Approximately 73% of the stock options covered by the 2007 award were made to employees other than our named executive officers, with a total of 337 employees receiving options worldwide. Approximately 69% of the stock options covered by the 2008 award (granted in the fourth quarter of 2007) were made to employees other than our named executive officers, with a total of 341 employees receiving options worldwide.

Restricted Stock. Historically limited to officers, beginning with the 2007 award (granted in the fourth quarter of 2006), all MIP participants received restricted stock awards.

Timing of Stock Options and Restricted Stock Awards. The Committee has sole discretion in awarding stock options and restricted stock and does not delegate such authority to our management nor does our management have the ability to select or influence award dates. The date used for awards is the date of a regularly-scheduled Committee meeting which is fixed by the Committee well in advance and generally occurs at the same time each year (in the fourth quarter). Occasionally, the Committee is asked to approve limited, out-of-cycle special awards for specific business purposes. Other than the additional stock option award made to Mr. Stropki upon his election as Chief Executive Officer (described in *Other Equity Compensation* below), all of these out-of-cycle stock option grants have been made at regularly-scheduled Committee meetings that have been set well in advance and all have been for minimal amounts. The Committee has not made any out-of-cycle restricted stock awards.

Cash Long-Term Incentive

Overview. A cash long-term incentive plan, or Cash LTIP, was introduced in 1997 for officers. The plan is designed to offer reward opportunities leveraged to the long-term performance of the Company and to provide line-of-sight for plan participants by tying rewards to operating performance. Target amounts are set each year at the beginning of a three-year performance cycle. Because awards are made each year and because each award relates to a three-year performance cycle, three different programs will be running at any point in time. The percentage of the target amount actually paid at the end of the applicable three-year cycle will be based upon achievement of three-year Company performance against pre-established performance thresholds. Each plan has six to seven performance thresholds with percentage payouts attributable to those thresholds ranging from 0% to 200% of target. For 2007, payments were capped at 140% of target.

Performance Measure. Since its inception, the performance measure used has been growth in net income over the three-year cycle. Beginning in 2005, we began measuring growth over the entire three-year period (instead of on a year-by-year basis) because we concluded it was a better metric of sustained growth. Although net income growth has been used consistently, any of the following performance measures may be used as deemed appropriate by the Committee: growth measures, profitability measures, cash flow measures, return on investment/asset measures, shareholder value, strategic or non-financial performance and other key business issues or initiatives. From time to time, the Committee has considered and approved certain limited adjustments to reported net income in determining achievement of the performance measure against the thresholds. Each adjustment is reviewed in detail before it is made. The types of adjustments the Committee has considered include: extraordinary items and other adjustments that are related to events that are infrequent or unusual, and inappropriately distort results. To the extent an adjustment relates to restructuring or rationalization charges that are intended to improve organizational efficiency, a corresponding charge (equal to the adjustment) is added and amortized against future years until that adjustment is fully offset against the intended savings.

Performance Thresholds. In setting the performance thresholds for a new three-year period, the factors that the Committee may consider include, but are not limited to, internal, external and macro-economic factors. Performance thresholds are set aggressively (based on the economic climate); accordingly, 2007 was the fifth time payments had been made under this plan (out of eight full cycles). Since its inception, the average percent of target paid has been 76.1%, with payments ranging from 0% to 140% of target. For all prior plan cycles, the average net income growth threshold required to achieve a 100% payout under the three-year period has been 17%, with a range of 6% to 30%. For the 2005-2007 cycle, the payments for which are reported in the Summary Compensation Table, the performance thresholds were as follows:

2005 Cash LTIP

(2005 to 2007 cycle) Growth in Net Income Over Entire 3-Year Cycle	% of Target Paid After 3-Year Cycle
Less than 6%	0
6%	30%
9%	50%
14%	**100%**
18%	120%
21%	140%

Performance thresholds for the 2005 to 2007 cycle (established in the fourth quarter of 2004) were set at a time when the Company (and other industrial companies) had experienced negative adjusted net income growth in several preceding years. Therefore, to anticipate a modest growth rate during a recovery period, the 2005 to 2007 thresholds were less aggressive than the performance thresholds used in some prior cycles and are less aggressive than the current performance thresholds. Current performance thresholds have been set higher in light of our recent superior net income performance and as a result of additional components of the review process that take into account peer company performance and macro-economic factors. Comparing the historical performance thresholds to past net income performance, we believe that there is an even probability of achieving the net income growth thresholds when initially determining the target growth for any cycle.

The Committee retains discretion to modify payments to any participant, to modify targets and/or to modify the performance thresholds. For the 2007 to 2009 cycle (established in the first quarter of 2007), the Committee raised the maximum Cash LTIP payment (up from 140% of target to 200% of target), although they tied that change to a significant increase in the performance threshold required for the maximum payout. The 2008 to 2010 plan cycle (established in the first quarter of 2008) uses similar thresholds as the 2007 to 2009 cycle.

Payouts under Cash LTIP. Payouts were achieved in 2007, based on net income growth over the three-year period that was above the 21% maximum performance threshold for that cycle. The following adjustments were made to reported net income to calculate net income growth under the plan: rationalization adjustments (charges for each of which are amortized over a three-year period), non-recurring tax adjustments and the loss on the sale of a business adjustment. However, net income results would have been above the 21% maximum performance threshold even without those adjustments. As a result, payouts were made at 140% of targets for 18 officers. In approving the 2007 Cash LTIP payments, the Committee noted that the Company s growth in net income for the most recent trailing 36-month period was at the 88th percentile of the peer group and at the 81st percentile of the companies in the S&P Midcap 400 Index. Although we had very strong performance between 2005 and 2007, the Committee determined that Cash LTIP payments would remain capped at 140% of targets.

Timing for Setting Performance Measure and Performance Thresholds. Although Cash LTIP target amounts are set at the end of the immediately prior year at a regularly-scheduled Committee meeting, the performance measure and the performance thresholds are now generally set at the beginning of the first fiscal year, which timing coincides with regularly-scheduled Board and Committee meetings. This timing allows the Committee to see our full financial results for the prior year and allows for more current macro-economic projections to be used.

Other Equity Compensation. From time-to-time, the Committee makes special one-time grants of equity compensation to meet a specific business need. Business needs could include, but are not limited to, retention and recruitment of key management. Mr. Stropki was given a special award of 30,000 stock options, in June 2004, upon his appointment as Chief Executive Officer. This special award was made to bring his long-term incentive compensation toward the competitive market 50 th percentile for a chief executive officer. The normal terms of our stock option awards applied to Mr. Stropki s grant. As a result, those options became fully vested on June 2007. There are no other currently outstanding special one-time grants of equity compensation for the executive officers.

Long-Term Incentive Timing and Amounts. Stock options, restricted stock and target Cash LTIP awards, are made each year, at the same time that base compensation and bonus targets are set. Awards reported in the footnotes to the Summary Compensation Table and the Grants of Plan-Based Awards Table, which were made in the fourth quarter of 2007, are evaluated as 2008 awards, since they relate to performance in 2008 and beyond. Therefore, the competitive market data, compensation trends, business needs, individual performance, individual role and Company financial performance to peers evaluated by the Committee to set the long-term incentive amounts reported in the footnotes to the Summary Compensation Table and the Grants of Plan-Based Awards Table will be different from those same components used to evaluate and set the base and bonus amounts reported in the Summary Compensation Table. The Cash LTIP payments reported in the Summary Compensation Table are an additional exception. Since these payments relate to the 2005 to 2007 three-year cycle, the target amounts for the Cash LTIP reported in the Summary Compensation Table were evaluated and set as 2005 awards (and made in the fourth quarter of 2004).

Each named executive officer received a 2007 stock option grant, a 2007 restricted stock award and a 2008 to 2010 Cash LTIP target (amounts for each reported in Summary Compensation Table and Grants of Plan-Based Awards Table). The total value of these three awards placed their long-term incentive compensation, on average, above the broad-based survey group 50th percentile, but below the peer group and the S&P Midcap 400 group 50th percentiles. The average increase in the potential value of their long-term incentive awards was 20.6%, primarily due to target increases as certain named executive officers transitioned to greater job responsibilities and due to changes in the market data as reflected in the proxy statements of the peer group companies and companies in the S&P Midcap 400 Index.

Benefits

Overview of Benefits Structure. We intend to provide a competitive group of benefits for all of our employees targeted at 50th percentile of the market. Some aspects of our benefit programs are considered non-traditional due to their relationship with our pay-for-performance and incentive-based philosophies. For example, employees, including the named executive officers, are required to have medical insurance coverage through the Company or an equivalent external source. The premiums for Company-provided medical coverage are 100% paid by employees, on a pre-tax basis. Premiums for dental coverage, which is a voluntary benefit, are also 100% paid by employees. Life insurance coverage paid fully by the Company is set at $10,000 per employee, including the named executive officers, although employees may purchase additional insurance at their own cost. The executive officers are not exempt from this cost-sharing approach. We continually review our benefits for overall competitiveness.

We attempt to balance our various non-traditional programs (such as those with a significant portion of the cost borne by the employee), with more traditional programs. As a result, we place the greatest emphasis with our benefit programs on the delivery of retirement benefits to our employees. This allows us to reward long-term service with the Company which, we believe, is not addressed in our other compensation and benefit programs. The value of our retirement benefits are intended to deliver a retirement benefits package that is, when viewed in isolation, above the market median (50th percentile). Because some of our other benefits might be viewed as less than competitive and because our retirement benefits are above the competitive market, we believe that our overall benefit structure is at the competitive market (50th percentile).

Retirement Benefits. Retirement benefits are provided to our named executive officers through the following programs:

Supplemental Executive Retirement Plan, or SERP, that became effective January 1, 1994. The purpose of the SERP is, in part, to make up for limitations imposed by the Code on payments of retirement benefits under our tax-qualified retirement plans, including the RAP (described below), and, primarily, to provide an aggregate competitive retirement benefit for SERP participants in line with our overall 50th percentile objective for benefits. Participation in the SERP is limited to individuals approved by the Committee. As of December 31, 2007, there were 13 active participants in the SERP. No new participants have been added to the SERP since January 1, 2005. Compensation covered by the SERP is the same as shown in the salary and bonus columns of the Summary Compensation Table below. Certain terms of the SERP may be modified as to individual participants, upon action by the Committee. Except with respect to the increase of Mr. Stropki s annual SERP benefit limit as described below in the narrative following the Grants of Plan-Based Awards Table, there have been no material modifications of terms of the SERP as to the named executive officers.

The Lincoln Electric Company Retirement Annuity Program, or RAP, in effect since 1936 and applies to all eligible domestic welding business employees. Effective January 1, 2006, new employees are no longer eligible to participate in the RAP but became eligible for FSP Plus benefits described below. The retirement benefits under the RAP for the named executive officers are estimated in the Pension Benefits Table based on the 2006 and 1997 elections they each made (those elections are described in the *Retirement and Other Post-Employment Benefits* section).

A supplemental deferred compensation plan, or Top Hat Plan. Our Top Hat Plan is designed to allow participants to defer their current income on a pre-tax basis and to receive a tax-deferred return on those deferrals. Top Hat Plan benefits are provided through two separate programs: the Lincoln Electric Holdings, Inc. 2005 Deferred Compensation Plan for Executives, or New Top Hat Plan, was adopted on December 30, 2004 to provide for ongoing deferrals in compliance with Section 409A of the Code and the Lincoln Electric Holdings, Inc. Deferred Compensation Plan for Executives, or Old Top Hat Plan, was originally adopted in 1994 and ultimately amended on December 30, 2005 to provide that all benefits under the plan would comply with the requirements of Section 409A of the Code. Participation in the Top Hat Plan is limited to individuals approved by the Committee. As of December 31, 2007, there were 17 active participants in the Top Hat Plan. No new participants entered the New Top Hat Plan in 2007 and no new participants or deferrals will be added to the Old Top Hat Plan.

A qualified 401(k) savings plan, formally known as The Lincoln Electric Company Employee Savings 401(k) Plan, established in 1994 and applies to all eligible domestic welding business employees. For 2007, all of the named executive officers deferred amounts under the 401(k) plan. We match participant contributions (other than catch-up contributions) at 35% up to the first 6% of pay (base and bonus) contributed. We may also provide additional contributions under a program we refer to as the Financial Security Plan (FSP) for those participants, including the named executive officers, who made an election to adopt this program in 1997 (in which case they receive an annual FSP contribution of 2% of base pay) or who made an election to adopt a revised program in 2006, which we refer to as the FSP Plus program, in which case they receive an annual FSP Plus contribution as follows:

After service of...	Lincoln will contribute...
1 year	4% of base pay
5 years	5% of base pay
10 years	6% of base pay
15 years	7% of base pay
20 years	8% of base pay
25 years	10% of base pay

We also provide accidental death benefits to officers, due to the significant amount of travel required in their jobs. Under this program, the premiums of which are paid by the Company, a participant s beneficiary would receive a payment of $750,000 upon an officer s accidental death. The policy also provides disability benefits of up to $7,500 per month in the event an officer is permanently and totally disabled as a result of an accident, and it provides for medical evacuation coverage as a result of an accident.

Supplemental Executive Retirement Plan. In 2005, we added a two-tier benefit structure applicable to new participants in the SERP in light of emerging trends in executive compensation. Under the two-tier benefit structure, future participants, if any, designated as Management Committee and Regional President Participants are entitled to a retirement benefit as follows:

$$\text{Management Committee/Regional Presidents} = \left[\underbrace{\left(1.333\% \times \text{years of service} \times \text{final average pay} \right)}_{\textit{to a maximum of 60\%}} - \text{applicable offsets} \right] \times \text{participation factor}$$

All future participants designated as Other Participants are entitled to a retirement benefit as follows:

$$\text{Other Participants} = \left[\underbrace{\left(1.111\% \times \text{years of service} \times \text{final average pay} \right)}_{\textit{to a maximum of 50\%}} - \text{applicable offsets} \right] \times \text{participation factor}$$

Generally, benefits under the SERP for current participants, including each named executive officer, are determined as follows:

$$\text{Current Participants} = \left[\underbrace{\left(1.445\% \times \text{years of service} \times \text{final average pay} \right)}_{\textit{to a maximum of 65\%}} - \text{applicable offsets} \right] \times \text{participation factor}$$

Perquisites

The Company will occasionally provide perquisites to officers or MIP participants to meet specific business needs. For example, because we believe in the importance of maintaining the health of all of our employees, including the named executive officers, we pay for an annual physical for MIP participants who are age 45 or older and for certain participants below that age on an *ad hoc* basis. We also make available financial planning services to officers. However, the cost of these financial planning services is included in the income of the participants. The physical and financial planning programs are optional programs. To assist us in conducting business meetings and/or entertainment, we pay the cost of certain club dues for some officers. Although these officers may derive some personal benefit from their use, club memberships are used extensively for business purposes, all personal expenses are born entirely by the executive and the club dues are included in the income of the participants. Initiation fees for club memberships are paid by the executive.

In 2007, Messrs. Stropki and Petrella opted to use the executive physical program. All of the named executive officers used the financial planning services. Finally, certain club dues were paid for Messrs. Stropki, Petrella and Stueber. The value of these perquisites is included in the Summary Compensation Table.

Change in Control Agreements

We entered into agreements in 1998 with certain officers, designed generally to assure continued management in the event of a change in control of Lincoln. As of December 31, 2007, three officers continue to have active

agreements, including Messrs. Stropki and Stueber. The agreements with Messrs. Stropki and Stueber were modified in March 2000. These arrangements are operative only if a change in control occurs and payments are only made if the officer s employment is terminated (or if the officer terminates his employment due to certain adverse changes in his terms of employment). Outside of these three change in control agreements, the Company does not maintain written change in control or severance agreements. With the assistance of Watson Wyatt and external legal advisors, the Committee periodically evaluates the existing change in control agreements, and considers whether additional or new agreements are warranted, in light of current market terms and practices.

Stock Ownership Guidelines

As with the Directors, in keeping with our philosophy that officers should maintain an equity interest in Lincoln and based on our view that such ownership is a component of good corporate governance, we adopted stock ownership guidelines for officers effective January 1, 2006. Under the guidelines, officers of Lincoln are required to own and hold a certain number of our common shares, currently at the levels set forth in the table below:

Executive Group	Ownership Guideline
CEO	3 times base salary
Management Committee Members*	1 times base salary
Other Officers **	1/2 times base salary

* Includes Messrs. Petrella and Stueber, as well as other officers of Lincoln.

** Includes Messrs. LeBlanc and Flohn, as well as other officers of Lincoln.

Officers have five years to satisfy the stock ownership guidelines, which can be satisfied either by holding (1) shares aggregating the dollar amount specified above, or (2) that number of shares needed to satisfy the ownership guidelines tied to the base salaries in effect on January 1, 2006 divided by the closing price of a common share on December 30, 2005 ($39.66). The Committee reserves the right to modify these guidelines in the future. Restricted stock awards will count towards the stock ownership guidelines; common shares underlying stock options and shares held in another person s name (including a relative) will not. As of December 31, 2007, more than 90% of our officers met the stock ownership requirements.

Accounting Impact

Effective January 1, 2003, we adopted the fair value method of recording equity-based compensation contained in SFAS No. 123 Accounting for Stock-Based Compensation. Effective January 1, 2006, we adopted SFAS No. 123 (Revised 2004), Share-Based Payment, which is a revision of SFAS No. 123. Generally, the approach under SFAS No. 123(R) is similar to the approach under SFAS No. 123. All employee stock option grants beginning January 1, 2003 are expensed over the stock option vesting period based on their fair value on the date the options are granted. Restricted shares or deferred shares require compensation expense to be measured by the quoted market price on the date of grant and expensed over the vesting period. No expense is recognized for any stock options, restricted shares or deferred shares that are forfeited, in which case the recipients have failed to meet the applicable vesting requirements.

Section 162(m) Of The U.S. Internal Revenue Code

Our general philosophy is to qualify future compensation for tax deductibility under Section 162(m) of the Code, wherever appropriate, recognizing that, under certain circumstances, the limitations may be exceeded. Qualification is sought to the extent practicable and only to the extent that it is consistent with our overall compensation objectives. For example, in the past, our MIP and Cash LTIP programs were not qualified under Section 162(m) of the Code because the Committee believed that it was important to retain a significant level of flexibility and simplicity in those programs to support our pay-for-performance philosophies and it believed that this required flexibility and simplicity could not be accomplished under the qualification rules. The Committee also believed that it employed other safeguards (such as a mechanism for comparing pay and performance) that, although not recognized under Section 162(m) of the Code, did ensure that payments made under these programs were performance-based. Finally, given that the impact of non-deductibility in the past under Section 162(m) of the Code had not been material, the Committee viewed non-qualification of those plans as appropriate in light of the significant level of flexibility and simplicity of the programs.

As a result of our on-going review of our compensation programs, the Committee determined that both the MIP and Cash LTIP plans could be structured in such a way as to maintain a suitable level of flexibility and simplicity and, at the same time, could be treated as performance-based compensation under Section 162(m) of the Code. Such treatment would allow those payments to be deductible under Section 162(m) of the Code, to the extent that an executive officer s compensation exceeded $1 million, which would be beneficial to the Company. Accordingly, the 2007 Management Incentive Compensation Plan (or 2007 MICP), approved by shareholders at last year s Annual Meeting, may allow the following components of executive compensation to be excluded in determining deductibility under Section 162(m) of the Code: annual bonus (MIP), Cash LTIP and stock option awards. Exclusion of those amounts under Section 162(m) means that they are fully deductible, regardless of amount, assuming they are otherwise considered reasonable compensation and are within the limits of the plan. Payments of base pay and restricted stock (as currently structured) would not be excludable and, thus, any of those amounts that exceed $1 million in a calendar year would be non-deductible.

Compensation paid to the named executive officers during 2007 was tax deductible for Federal income tax purposes, except with respect to a portion of the compensation paid to Mr. Stropki.

COMPENSATION COMMITTEE REPORT

The Compensation and Executive Development Committee has reviewed and discussed the Compensation Discussion and Analysis contained in this proxy statement with Lincoln s management and, based on this review and discussion, recommends that it be included in Lincoln s Annual Report on Form 10-K for the year ended December 31, 2007 and this proxy statement.

By the Compensation and Executive Development Committee:

/s/ Hellene S. Runtagh, Chair
Harold L. Adams

Stephen G. Hanks

G. Russell Lincoln

William E. MacDonald, III

EXECUTIVE COMPENSATION

2007 Summary Compensation Table

The following table provides information on the compensation for our Chief Executive Officer and Chief Financial Officer, as well as the three next highest paid executive officers, for 2007 and 2006.

Name and Principal Position	Year	Salary	Stock Awards (2)	Option Awards (3)	Non-Equity Incentive Plan Compensation (4)	Change in Pension and Nonqualified Deferred Compensation Earnings (6)	All Other Compensation	Total
John M. Stropki, Jr.	2007	$ 775,000(1)	$ 311,843	$ 587,288	$ 1,639,225(1)	$ 158,048(6)	$ 27,884(7)	$ 3,499,288
Chairman, President and Chief Executive Officer	2006	750,000	103,082	600,067	1,602,513	821,861	23,828	3,901,351
Vincent K. Petrella Senior Vice President, Chief Financial Officer and Treasurer	2007	345,000	81,663	158,259	524,353	26,000	29,368(8)	1,164,643
	2006	325,000	28,832	139,598	490,233	27,000	26,900	1,037,563
Frederick G. Stueber Senior Vice President, General Counsel and Secretary	2007	345,000	74,397	150,427	467,328(5)	234,199(6)	21,564(9)	1,292,915
	2006	325,000	26,056	163,514	463,500	362,000	17,639	1,357,709
David M. LeBlanc Lincoln Electric International Holding Company Vice President; President, Lincoln Electric Europe and Russia	2007	250,000	41,330	86,257	289,279	17,000	281,680(10)	965,546
	2006	235,000	14,487	90,296	273,000	19,000	189,956	821,739
Thomas A. Flohn	2007	230,000(11)	34,043	71,343	214,519(11)	26,293(6)	531,111(12)	1,107,309
Lincoln Electric International Holding Company Vice President; President, Lincoln Asia Pacific								

(1) Of the amounts shown as salary for 2007, $180,000 was deferred during 2007 under our 2005 Deferred Compensation Plan for Executives (or Top Hat Plan). Of the amounts shown that relate to our annual bonus program (or MIP), $275,000 was deferred for 2007 in February 2008 under our Top Hat Plan. See the narrative following the Nonqualified Deferred Compensation Table below for additional information on this plan.

(2) On November 28, 2007, the named executive officers received awards of restricted stock. See the Grants of Plan-Based Awards and Outstanding Equity Awards at Fiscal Year-End Tables below for additional information on these awards.

The amounts reported for 2007 reflect our 2007 FAS 123R expense for the November 28, 2007 restricted stock awards as follows: Mr. Stropki ($14,958 for 2007), Mr. Petrella ($2,718 for 2007), Mr. Stueber ($2,307 for 2007), Mr. LeBlanc ($1,416 for 2007) and Mr. Flohn ($1,085 for 2007). In addition to these grants, the amounts reported for 2007 include the additional 2007 compensation expense for prior year awards of restricted stock. Assumptions used in the calculation of these amounts are included in footnote (E) to the Company s audited financial statements for the fiscal year ended December 31, 2007 included in the Company s Annual Report on Form 10-K filed with the SEC on February 25, 2008.

(3) On November 28, 2007, the named executive officers received grants of stock options. See the Grants of Plan-Based Awards and Outstanding Equity Awards at Fiscal Year-End Tables below for additional information on these grants.

The amounts reported for 2007 reflect our 2007 FAS 123R expense for the November 28, 2007 stock option grants as follows: Mr. Stropki ($15,958 for 2007), Mr. Petrella ($4,836 for 2007), Mr. Stueber ($4,112 for 2007), Mr. LeBlanc ($2,516 for 2007) and Mr. Flohn ($1,935 for 2007). In addition to these grants, the amounts reported for 2007 include the additional 2007 compensation expense for prior year grants of stock options. Assumptions used in the calculation of these amounts are included in footnote (E) to the Company s audited financial statements for the fiscal year ended December 31, 2007 included in the Company s Annual Report on Form 10-K filed with the SEC on February 25, 2008.

(4) The amounts shown represent the sum of the payments under our annual bonus program (or MIP) and our cash long-term incentive plan (or Cash LTIP) for 2007 as follows: Mr. Stropki ($1,133,825 for MIP) ($505,400 for Cash LTIP), Mr. Petrella ($375,953 for MIP) ($148,400 for Cash LTIP), Mr. Stueber ($318,928 for MIP) ($148,400 for Cash LTIP), Mr. LeBlanc ($199,679 for MIP) ($89,600 for Cash LTIP) and Mr. Flohn ($140,319 for MIP) ($74,200 for Cash LTIP). For a description of our MIP and Cash LTIP, see the Compensation Discussion and Analysis section above.

(5) Of the amount shown that relates to our MIP, $100,000 was deferred for 2007 in February 2008 under our Top Hat Plan.

(6) The amounts shown for 2007 represent the increase in actuarial value of our two defined benefit plans, the RAP and the SERP, for 2007 as compared to 2006 as follows: Mr. Stropki ($62,000 for the RAP) ($90,000 for the SERP), Mr. Petrella ($26,000 for the RAP) ($0 for the SERP), Mr. Stueber ($52,000 for the RAP) ($182,000 for the SERP), Mr. LeBlanc ($17,000 for the RAP) ($0 for the SERP) and Mr. Flohn ($26,000 for the RAP) ($0 for the SERP). The amounts shown for Messrs. Stropki, Stueber and Flohn also include $6,048, $199 and $293, respectively, representing in each case the difference between actual 2007 earnings credited to their respective deferred compensation accounts under our Top Hat Plan (which was based on the rate of return for Moody s Corporate Bond Average Index in accordance with the plan) and $147,623, $4,953 and $12,191**,** respectively (the hypothetical market-rate return specified by SEC rules for proxy statement disclosure purposes, which is based on 120% of the applicable federal long-term rate, compounded monthly for 2007).

(7) The amount shown for 2007 is comprised of $4,725 of company matching contributions under our 401(k) plan and $155 in life and accidental death insurance premiums paid by Lincoln during 2007, as well as the following perquisites: club membership dues, financial planning services and an annual physical examination. None of the individual perquisites was greater than $25,000.

(8) The amount shown for 2007 is comprised of $4,725 in company matching contributions under our 401(k) plan, $4,500 in company contributions under the FSP program and $155 in life and accidental death insurance premiums paid by Lincoln during 2007, as well as the following perquisites: club membership dues, financial planning services and an annual physical examination. None of the individual perquisites was greater than $25,000.

(9) The amount shown for 2007 is comprised of $4,725 in company matching contributions under our 401(k) plan, $4,500 in company contributions under the FSP program and $155 in life and accidental death

insurance premiums paid by Lincoln during 2007, as well as the following perquisites: club membership dues and financial planning services. None of the individual perquisites was greater than $25,000.

(10) The amount shown for 2007 is comprised of $4,725 in company matching contributions under our 401(k) plan, $4,500 in company contributions under the FSP program and $155 in life and accidental death insurance premiums paid by Lincoln during 2007, as well as financial planning services and the following other perquisites (based on actual cost) related to Mr. LeBlanc s expatriate assignment: a cost of living adjustment, a foreign service premium for taking a foreign assignment, housing rent and utilities (net of the hypothetical cost of U.S. housing), automobile lease payments, schooling for Mr. LeBlanc s children, home leave airfare, a tax reimbursement (for the overpayment of taxes in prior years), foreign taxes and a U.S. FICA/Medicare tax gross up of $3,069. None of the individual perquisites was greater than $25,000, other than the housing rent and utilities payment of $49,164, the tax reimbursement of $83,574 and foreign tax payments of $45,214. The amounts disclosed relating to Mr. LeBlanc s expatriate assignment were converted from Euros to U.S. dollars based on the conversion price of 1.4673 Euros to $1.00, as reported by Bloomberg on December 31, 2007.

(11) Of the amount shown as salary, $115,000 was deferred during 2007 under our 2005 Deferred Compensation Plan for Executives (or Top Hat Plan). Of the amount shown that relates to our annual bonus program (or MIP), $70,160 was deferred for 2007 in February 2008 under our Top Hat Plan. See the narrative following the Nonqualified Deferred Compensation Table for additional information on this plan.

(12) The amount shown for 2007 is comprised of $4,725 in company matching contributions under our 401(k) plan, $4,500 in company contributions under the FSP program and $155 in life and accidental death insurance premiums paid by Lincoln during 2007, as well as financial planning services and the following other perquisites (based on actual cost) related to Mr. Flohn s expatriate assignment: a cost of living adjustment, a foreign service premium for taking a foreign assignment, a foreign service hardship premium, a relocation allowance for moving from Singapore to China, housing rent and utilities (net of the hypothetical cost of U.S. housing), automobile lease payments, schooling for Mr. Flohn s children, home leave airfare, a tax reimbursement (for the overpayment of taxes in prior years), foreign taxes and a U.S. FICA/Medicare tax gross up of $3,183. None of the individual perquisites was greater than $25,000, other than the foreign service premium of $30,000, the foreign service hardship premium of $34,500, the housing rent and utilities payment of $84,806, dependent schooling payments of $46,336 and foreign tax payments of $240,610 (primarily related to the acceleration of taxation upon his move from Singapore). The amounts disclosed related to Mr. Flohn s expatriate assignment were converted from Singapore Dollars (SGD) to U.S. dollars based on the conversion price of .6952 Singapore Dollars to $1.00, and from Chinese Yuan Renminbi (CNY) to U.S. dollars based on the conversion price of .1369 Chinese Yuan Renminbi to $1.00, in both cases as reported by Bloomberg on December 31, 2007.

2007 Grants of Plan-Based Awards

The following table provides information relating to plan-based awards granted in 2007 to those individuals named in the Summary Compensation Table.

Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards Threshold ($)	Target ($)	Maximum ($)	Estimated Future Payouts Under Equity Incentive Plan Awards (#) (3)	All Other Option Awards: Number of Securities Underlying Options (#) (4)	Exercise or Base Price of Option Awards ($/Sh)	Grant Date Fair Value of Stock and Option Awards ($) (5)
John M. Stropki, Jr.	11/28/07	$ 0	$ 1,120,000(1)	$ 1,792,000(1)				
	11/28/07	0	550,000(2)	1,100,000(2)				
	11/28/07				7,860			$ 538,489
	11/28/07					40,090	$ 68.51	574,490
Vincent K. Petrella	11/28/07	0	350,000(1)	560,000(1)				
	11/28/07	0	166,667(2)	333,334(2)				
	11/28/07				2,380			163,054
	11/28/07					12,150	68.51	174,110
Frederick G. Stueber	11/28/07	0	290,000(1)	464,000(1)				
	11/28/07	0	141,667(2)	283,334(2)				
	11/28/07				2,020			138,390
	11/28/07					10,330	68.51	148,029
David M. LeBlanc	11/28/07	0	185,000(1)	296,000(1)				
	11/28/07	0	86,667(2)	173,334(2)				
	11/28/07				1,240			84,952
	11/28/07					6,320	68.51	90,566
Thomas A. Flohn	11/28/07	0	160,000(1)	256,000(1)				
	11/28/07	0	66,667(2)	133,334(2)				
	11/28/07				950			65,085
	11/28/07					4,860	68.51	69,644

(1) The performance-based amounts shown represent the estimated cash payouts for 2008 under our annual bonus program (or MIP). Under the MIP, payments are based on the achievement of Company financial performance goals and the executive s individual performance. Target awards are set by the Compensation and Executive Development Committee of the Board in the fourth quarter of the year preceding the bonus year. Actual payment amounts are determined by the Compensation and Executive Development Committee of the Board in the first quarter of the year following the bonus year. For additional information regarding the MIP, see the Compensation Discussion and Analysis section above.

(2) The performance-based amounts shown represent estimated cash payouts for the 2008 to 2010 cycle under our cash long-term incentive plan. Under the plan, payments are based on net income growth over a three-year cycle. Target awards are set by the Compensation and Executive Development Committee of the Board in fourth quarter of the year before the three-year cycle. Actual payment amounts are determined by the Compensation and Executive Development Committee of the Board in the first quarter of the year following the three-year cycle.

(3) The amounts shown in this column represent restricted stock grants made under our 2006 Equity and Performance Incentive Plan on November 28, 2007. The restricted stock vests upon the earlier of (1) the recipient remaining in continuous employment for five years (to November 28, 2012), or (2) a determination

by the Compensation and Executive Development Committee of the Board that the financial targets for our cash long-term incentive plan (discussed above) are met (i.e., 3 years) (2008-2010 cycle), with accelerated vesting upon a change in control in the event the employee is terminated or in the event any successor to the Company does not honor the terms of the award or in the event of death, disability or retirement. Beginning with the 2007 awards (made in the fourth quarter of 2006), accelerated vesting upon a change in control began requiring a termination of employment in connection with the change in control or in the event any successor to the Company does not honor the terms of the award in connection with the change in control. Any cash dividends on the restricted stock are sequestered by us until the shares are nonforfeitable, at which time such dividends are paid in common shares. The dividend rate for dividends paid on the restricted stock to the named executive officers is the same as for all other shareholders (in other words, it is not preferential).

(4) The amounts shown in this column represent stock option grants made under our 2006 Equity and Performance Incentive Plan on November 28, 2007. The stock options were granted at the closing price of our common shares on the date of the grant. All stock options are non-qualified for tax purposes. We value stock options using the Black-Scholes valuation method. The stock options vest over a three-year period (in equal annual increments), with accelerated vesting upon retirement, death, disability or a change in control in the event the employee is terminated or if the plan is not assumed upon a change in control. Beginning with 2007 awards, accelerated vesting upon a change in control began requiring a termination of employment in connection with the change in control. Three-year vesting applies to stock option awards given to senior managers and officers. Options awarded to non-management employees vest after one year, with accelerated vesting upon retirement, death or disability. The options have 10-year terms.

(5) The amounts shown represent the full value of the restricted stock awards and the stock option grants calculated in accordance with FAS 123R. The actual amount, if any, realized upon the exercise of stock options will depend upon the market price of our common shares relative to the exercise price per share of the stock option at the time of exercise. The actual amount realized upon vesting of restricted stock will depend upon the market price of our common shares at the time of vesting. There is no assurance that the hypothetical full values of the awards reflected in this table will actually be realized.

The narrative below describes the material terms of each named executive officer s employment agreement or arrangement with us to the extent it is not otherwise discussed above in the Compensation Discussion and Analysis section and/or in the Summary Compensation Table and its corresponding footnotes.

Additional Employment Terms for the Chief Executive Officer

Mr. Stropki was elected President and Chief Executive Officer of the Company effective June 3, 2004. In connection with his election, Mr. Stropki and Lincoln entered into a letter agreement modifying the terms of his retirement benefits. Under the terms of the letter agreement, Mr. Stropki will continue to participate in the SERP under the same terms and conditions that existed prior to his appointment as Chief Executive Officer, except that his annual benefit limit under the SERP was increased from the standard $300,000 to $500,000. For a general discussion of the SERP, see the Compensation Discussion and Analysis above and the Pension Benefits Table below.

For 2007, Mr. Stropki s salary and bonus accounted for 59% of his total compensation, based on the value of his 2007 base salary, 2007 actual MIP (or bonus) paid in February 2008 and assumes one-third of his actual Cash LTIP payment for the 2005 to 2007 performance cycle.

Additional Employment Terms for the Chief Financial Officer

As part of its review of the Company s cash long-term incentive plan, the Compensation and Executive Development Committee of the Board determined that it would institute pro-rata target awards for any open performance cycle for those individuals who became officers or for those officers who received significant promotions during these periods. As a result, the Committee determined that Mr. Petrella s 2004 to 2006 cash long-term incentive target would be raised from $40,000 to $74,667 to reflect his promotion to Chief Financial Officer in 2004. The 2006 cash long-term incentive plan payment to Mr. Petrella that is reported in the Summary Compensation Table above was calculated based on this revised target.

For 2007, Mr. Petrella s salary and bonus accounted for 66% of his total compensation, based on the value of his 2007 base salary, 2007 actual MIP (or bonus) paid in February 2008 and assumes one-third of his actual Cash LTIP payment for the 2005 to 2007 performance cycle.

Additional Employment Terms for the Other Named Executive Officers

Mr. Stueber entered into an employment agreement in February 1995, which was modified in May 1998. The agreement contains many terms no longer in effect. The agreement grants credited service for purposes of the SERP of 22 years as of his date of hire, assuming a normal retirement age of 60 and service of 45 years at age 65.

Both Messrs. LeBlanc and Flohn are U.S. employees, working overseas. As such, they receive certain expatriate benefits under our overseas assignment policy. However, the benefits provided to Messrs. LeBlanc and Flohn are on the same terms as those provided to other expatriates. Therefore, the Company has not entered into any special employment agreement with Messrs. LeBlanc and Flohn.

For 2007, Mr. Stueber s salary and bonus accounted for 55% of his total compensation, Mr. LeBlanc s salary and bonus accounted for 50% of his total compensation and Mr. Flohn s salary and bonus accounted for 36% of his total compensation. The above percentages were based, in each case, on the value of the executive s 2007 base salary, 2007 actual MIP (or bonus) paid in February 2008 and assumes one-third of the executive s actual Cash LTIP payment for the 2005 to 2007 performance cycle.

HOLDINGS OF EQUITY-RELATED INTERESTS

The following table provides information relating to exercisable and unexercisable stock options and restricted stock at December 31, 2007 for those individuals named in the Summary Compensation Table.

Outstanding Equity Awards at December 31, 2007

	Option Awards				Stock Awards	
Name	Number of Securities Underlying Unexercised Options Exercisable (1)	Number of Securities Underlying Unexercised Options Unexercisable (1)	Option Exercise Price	Option Expiration Date	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (2)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested (3)
John M. Stropki, Jr.	55,000		$21.61	10-10-11		
	48,400		23.46	11-20-12		
	50,000		23.90	10-08-13		
	30,000		31.90	06-03-14		
	90,000		35.43	11-30-14		
	33,066	16,534	39.93	11-30-15	11,480	$817,146
	9,933	19,867	60.51	11-29-16	7,650	544,527
		40,090	68.51	11-28-17	7,860	559,475
Vincent K. Petrella	10,000		$23.90	10-08-13		
	25,000		35.43	11-30-14		
	9,600	4,800	39.93	11-30-15	3,330	$237,029
	2,883	5,767	60.51	11-29-16	2,220	158,020
		12,150	68.51	11-28-17	2,380	169,408
Frederick G. Stueber	17,000		$35.43	11-30-14		
	8,666	4,334	39.93	11-30-15	3,000	$213,540
	2,703	5,407	60.51	11-29-16	2,080	148,054
		10,330	68.51	11-28-17	2,020	143,784
David M. LeBlanc	10,000		$35.43	11-30-14		
	4,800	2,400	39.93	11-30-15	1,670	$118,871
	1,476	2,954	60.51	11-29-16	1,140	81,145
		6,320	68.51	11-28-17	1,240	88,263
Thomas A. Flohn	5,000		$23.90	10-08-13		
	12,500		35.43	11-30-14		
	3,933	1,967	39.93	11-30-15	1,380	$98,228
	1,226	2,454	60.51	11-29-16	940	66,909
		4,860	68.51	11-28-17	950	67,621

(1) Stock options vest in three equal annual installments, commencing on the first anniversary of the date of the grant.

(2) The amounts shown in this column represent restricted stock awards made pursuant to our 1998 Stock Plan (November 30, 2005 awards) and 2006 Equity and Performance Incentive Plan (November 28, 2007 and November 29, 2006 awards). For more information on our restricted stock awards, see the narrative discussion provided in the Grants of Plan-Based Award Table and its corresponding footnotes. The terms of the 2005 awards are the same as the 2006 and 2007 awards, except that the 2005 awards have accelerated vesting upon a change in control only and do not also require a termination of employment in connection with a change in control.

(3) Based on the closing price of our common stock on December 31, 2007 of $71.18.

2007 Option Exercises and Stock Vested

The following table provides information relating to amounts received upon exercise of stock options by those individuals named in the Summary Compensation Table during 2007. No restricted stock vested during 2007.

	Option Awards		Stock Awards	
Name	Number of Shares Acquired on Exercise	Value Realized On Exercise	Number of Shares Acquired on Vesting	Value Realized On Vesting
John M. Stropki, Jr.	70,000	$ 4,120,304		
Vincent K. Petrella				
Frederick G. Stueber	16,334	707,653		
David M. LeBlanc	9,000	340,905		
Thomas A. Flohn	12,500	662,755		

RETIREMENT AND OTHER POST-EMPLOYMENT BENEFITS

The following tables provide information relating to our retirement benefits.

2007 Pension Benefits

The following table provides information relating to potential payments and benefits under our Retirement Annuity Program, which we refer to as the RAP, and Supplemental Executive Retirement Plan, which we refer to as the SERP, for those individuals named in the Summary Compensation Table.

Name	Plan Name	Number of Years Credited Service	Present Value of Accumulated Benefit	Payments During Last Fiscal Year
John M. Stropki, Jr.	Retirement Annuity Program	35(1)	$ 813,000(3)	
	Supplemental Executive Retirement Plan	35(2)	4,724,000(4)	
Vincent K. Petrella	Retirement Annuity Program	12(1)	248,000(3)	
	Supplemental Executive Retirement Plan	12(2)	0(4)	
Frederick G. Stueber	Retirement Annuity Program	12(1)	446,000(3)	
	Supplemental Executive Retirement Plan	34(2)	1,657,000(4)	
David M. LeBlanc	Retirement Annuity Program	13(1)	178,000(3)	
	Supplemental Executive Retirement Plan	13(2)	0(4)	
Thomas A. Flohn	Retirement Annuity Program	24(1)	268,000(3)	
	Supplemental Executive Retirement Plan	24(2)	0(4)	

(1) Under the RAP, credited years of service are the same as actual years of service, both of which are calculated from the date of hire with the Company. Accordingly, there is no benefit increase for credited years of service under the plan. All of the named executive officers are currently under normal retirement age.

(2) Under the SERP, credited years of service versus actual years of service are the same for Messrs. Stropki, Petrella, LeBlanc and Flohn, all of which are calculated from their dates of hire with the Company. Credited years of service versus actual years of service vary for Mr. Stueber as follows: (actual: 12) (credited: 34). Mr. Stueber was granted additional years of service under the SERP for service with his prior employer. As a result, benefits earned at his prior employer will serve as an offset against his SERP benefits. The aggregate benefit increase under the SERP for enhanced credited years of service for Mr. Stueber is $1,557,000.

(3) This represents the actuarial present value of accrued benefits in the RAP for the named executive officers at December 31, 2007. However, this is an estimated full value number that is discounted to a current date. In addition, because the RAP does not provide for lump-sum payments, the amounts listed will not be paid in the form expressed here. The above actuarial present values were determined using a 6.35% discount rate, RP-2000 Mortality, age 60 commencement and no decrements for death or termination prior to age 60.

All of the named executive officers are currently vested in their RAP benefits because they each have at least five years of service with the Company.

Mr. Stropki will be eligible for a full, unreduced benefit under the RAP in 2010, when he reaches age 60. He may retire before that date and receive early retirement benefits, commencing as early as age 55; however, those early benefits will be actuarially reduced to account for an early payment. As of December 31, 2007, Mr. Stropki s accrued benefit payable at age 60 under the plan was $86,000 per year.

Mr. Petrella will be eligible for a full, unreduced benefit beginning in 2020**,** or an earlier reduced benefit after he reaches age 55. As of December 31, 2007, Mr. Petrella s accrued benefit payable at age 60 under the plan was $48,000 per year.

Mr. Stueber will be eligible for a full, unreduced benefit beginning in 2013, or an earlier reduced benefit after he reaches age 55. As of December 31, 2007, Mr. Stueber s accrued benefit payable at age 60 under the plan was $56,000 per year.

Mr. LeBlanc will be eligible for a full, unreduced benefit beginning in 2024, or an earlier reduced benefit after he reaches age 55. As of December 31, 2007, Mr. LeBlanc s accrued benefit payable at age 60 under the plan was $45,000 per year.

Mr. Flohn will be eligible for a full, unreduced benefit beginning in 2020, or an earlier reduced benefit after he reaches age 55. As of December 31, 2007, Mr. Flohn s accrued benefit payable at age 60 under the plan was $52,000 per year.

(4) This represents the actuarial present value of accrued benefits in the SERP for the named executive officers at December 31, 2007. However, this is an estimated full value number that is discounted to a current date. The above actuarial present values were determined using a 6.35% discount rate, RP-2000 Mortality, age 60 commencement and no decrements for death nor termination prior to age 60.

Mr. Stropki will be fully-vested in the SERP in 2010. Benefits may become vested earlier but this early vesting would require approval of our Compensation and Executive Development Committee of the Board. In addition, any benefits paid before age 60 would be actuarially reduced to account for an early payment. SERP benefits may be paid on a lump sum basis, but all payments under the SERP are subject to the requirements of U.S. Internal Revenue Code Section 409A. As of December 31, 2007, Mr. Stropki s accrued benefit payable at age 60 under the plan was $500,000 per year, his limit under the plan.

Mr. Petrella will be fully-vested in the SERP in 2020, subject to the potential early vesting treatment outlined above. As of December 31, 2007, Mr. Petrella s accrued benefit payable at age 60 under the plan was $0 per year, due to the fact that plan offsets currently exceed his SERP benefit.

Mr. Stueber will be fully-vested in the SERP in 2013, subject to the potential early vesting treatment outlined above. As of December 31, 2007, Mr. Stueber s accrued benefit payable at age 60 under the plan was $208,000 per year.

Mr. LeBlanc will be fully-vested in the SERP in 2024, subject to the potential early vesting treatment outlined above. As of December 31, 2007, Mr. LeBlanc s accrued benefit payable at age 60 under the plan was $0 per year, due to the fact that plan offsets currently exceed his SERP benefit.

Mr. Flohn will be fully-vested in the SERP in 2020, subject to the potential early vesting treatment outlined above. As of December 31, 2007, Mr. Flohn s accrued benefit payable at age 60 under the plan was $0 per year, due to the fact that plan offsets currently exceed his SERP benefit.

Supplemental Executive Retirement Plan. For purposes of the SERP:

Final average pay is the average base and bonus compensation for the three highest years in the seven-year period preceding retirement.

Years of service includes all service with the Company (and may include service with certain previous employers) but excludes service after age 65. Credited service for SERP purposes, as of December 31, 2007, for Messrs. Stropki, Petrella, Stueber, LeBlanc and Flohn was 35, 12, 34, 13 and 24 years, respectively. Mr. Stueber was awarded prior years of service under the SERP for service with his previous employer. Since 2001, however, it has not been customary for us to grant extra years of credited service under the SERP.

Benefits payable under the SERP are reduced by the maximum Social Security benefit payable in the year of retirement, the single life benefit payable under the RAP, the lifetime benefit equivalence of any account balance attributable to employer matching contributions, Employee Stock Ownership Plan contributions and/or Financial Security Program contributions under the 401(k) plan, and other employer-paid qualified plan benefits paid by previous employers (but only if prior years of service are awarded under the SERP for service with that previous employer). Benefits under the SERP are also reduced if the covered employee has participated in the SERP for fewer than eight years at the time of retirement.

Unless a different factor is set by the Committee, participants are credited with only 20% of the net amount of the benefit otherwise payable under the SERP when they first become participants, and in each of the next eight years, an additional 10% of the net amount of the benefit will become payable upon retirement. As of December 31, 2007, Messrs. Stropki and Stueber had 100% participation factors, Messrs. Petrella and LeBlanc had 80% participation factors, and Mr. Flohn had a 50% participation factor. Unless modified, the maximum net benefit payable under the SERP is $300,000 per year.

SERP benefits vest at the plan s normal retirement age of 60. None of the named executive officers is currently vested in the SERP. Benefits may become vested as early as age 55, but only if such vesting is approved by the Committee. If benefits are paid before age 60, they are reduced for early commencement. The SERP also provides accumulated benefits to eligible spouses of deceased employees or former employees.

Retirement Annuity Program (RAP). Under the RAP, each eligible employee accumulates 2.5% of each year s base compensation (limited to $220,000 for 2006 and $225,000 for 2007 for compensation earned during the period November 1, 2006 through October 31, 2007 and $230,000 thereafter per Code limits) in the form of an annuity payable at normal retirement age (age 60 or five years of employment, if later). Participants may also retire early and receive a benefit as early as age 55, but that benefit is reduced to reflect the early payments. For example, a participant commencing his or her RAP benefit at age 55 will receive a benefit equal to 63.82% of his or her normal retirement benefit. In addition to the 2.5% accumulation each year, we have granted, on a number of occasions, additional prospective past service benefits. The program also provides accumulated benefits to eligible spouses of deceased employees or former employees. Benefits under the program are in addition to those payable under Social Security. The RAP was modified in 1997 and again in 2006 to provide one-time elections to all employees at those times.

The 2006 election provided a one-time choice for existing employees (hired before January 1, 2006), between maintaining the current program or opting into an alternative program in which the prospective annual earned annuity in the RAP is reduced to 1.25% of each year s base compensation and the employee is entitled to an enhanced Lincoln contribution in the qualified 401(k) plan, based on service. The enhanced defined contribution program is known as the FSP Plus program and is described in more detail below. All employees hired after January 1, 2006 may participate in the FSP Plus program (and may not participate in any RAP benefits).

The 1997 election provided a one-time choice to existing employees (hired before November 1, 1997), between maintaining a feature in the RAP known as the Age 60 Feature (or Ramp) or eliminating that feature prospectively in lieu of receipt of employer-provided benefits in our 401(k) plan (referred to as FSP benefits and described in more detail below). Under the Ramp feature, if a participant, including a named executive officer, works past normal retirement age (60), he or she may be eligible for certain enhanced benefits to be paid in one of two ways at his/her election: (1) retirement benefits would commence at age 60 while the participant continued to work, or (2) retirement benefits would be delayed until actual retirement with the participant receiving higher payments. Under the Ramp, a participant must start his or her retirement benefits at age 65, even if he/she continues to work for us.

2007 Nonqualified Deferred Compensation

The following table provides deferred compensation information for 2007 for those individuals named in the Summary Compensation Table. Deferred compensation benefits are available under our 2005 Deferred Compensation Plan for Executives (or Top Hat Plan).

Name	Executive Contributions in Last Fiscal Year	Registrant Contributions in Last Fiscal Year	Aggregate Earnings in Last Fiscal Year	Aggregate Withdrawals/ Distributions	Aggregate Balance at Last Fiscal Year-End
John M. Stropki, Jr.	$ 380,000(1)		$ 153,697(2)		$ 2,754,489(3)
Vincent K. Petrella					
Frederick G. Stueber	100,000(4)		5,152(5)		105,152(6)
David M. LeBlanc					
Thomas A. Flohn	202,750(7)		53,774(8)		660,055(9)

(1) Of the amount reported, $180,000 is included in the Salary column of the Summary Compensation Table above. The remainder represents contributions made during 2007 from the 2006 MIP (bonus) amount, which was paid in March 2007 and reflected as part of Non-Equity Incentive Plan Compensation in last year s proxy statement.

(2) Of the amount reported, $6,048 is included as compensation for 2007 in the Change in Pension and Nonqualified Deferred Compensation Earnings column of the Summary Compensation Table above, which amount represents the difference between $153,671 (which was based on the rate of return for Moody s Corporate Bond Average Index in accordance with our Top Hat Plan) and $147,623 (the hypothetical market-rate return specified by SEC rules for proxy statement disclosure purposes, which is based on 120% of the applicable federal long-term rate, compounded monthly for 2007).

(3) The portions of the amount reported that relate to deferral contributions in prior years have all been reported in the Summary Compensation Table in those previous years to the extent Mr. Stropki was a named executive officer for those years.

(4) The amount reported represents contributions made during 2007 from the 2006 MIP (bonus) amount, which was paid in March 2007 and reflected as part of Non-Equity Incentive Plan Compensation in the last year s proxy statement.

(5) Of the amount reported, $199 is included as compensation for 2007 in the Change in Pension and Nonqualified Deferred Compensation Earnings column of the Summary Compensation Table above, which amount represents the difference between $5,152 (which was based on the rate of return for Moody s Corporate Bond Average Index in accordance with our Top Hat Plan) and $4,953 (the hypothetical market-rate return specified by SEC rules for proxy statement disclosure purposes, which is based on 120% of the applicable federal long-term rate, compounded monthly for 2007).

(6) Of the amount reported, no portion relates to deferral contributions in prior years.

(7) Of the amount reported, $115,000 is included in the Salary column of the Summary Compensation Table above. The remainder represents contributions made during 2007 from the 2006 MIP (bonus) amount, which was paid in March 2007.

(8) Of the amount reported, $293 is included as compensation for 2007 in the Change in Pension and Nonqualified Deferred Compensation Earnings column of the Summary Compensation Table above, which amount represents the difference between $12,484 (which was based on the rate of return for Moody s Corporate Bond Average Index in accordance with our Top Hat Plan) and $12,191 (the hypothetical market-rate return specified by SEC rules for proxy statement disclosure purposes, which is based on 120% of the applicable federal long-term rate, compounded monthly for 2007).

(9) The portions of the amount reported that relate to deferral contributions in prior years have not been reported in the Summary Compensation Table in those previous years because Mr. Flohn was not a named executive officer for those years.

2005 Deferred Compensation Plan (Top Hat Plan). Our plan is designed to be a top-hat plan that complies with Section 409A of the Code. In order for a deferral to be eligible for deferred taxation, it must be subject to a substantial risk of forfeiture and must follow limited deferral and distribution rules. Under Section 409A of the Code, non-qualified deferred compensation plan distributions are permitted only in the event of separation from service, disability, death, a change in control of the employer or an unforeseeable emergency. Distributions also can be made at a specified time or under a fixed schedule, as stated in the plan at the time of the deferral.

Participation in our Top Hat Plan is limited to management and highly compensated employees, approved by the Committee, who have elected to make the maximum elective contributions permitted under the terms of our 401(k) plan for the applicable deferral period/year ($15,500 for 2007). Participants may elect to defer portions of their regular salary and/or bonus, provided that the deferral amount under the plan and the 401(k) plan together cannot exceed 80% of base salary and/or 80% of bonus. Deferrals are credited to participant accounts based on their elections and accounts are also credited with earnings based on the investment elections made by the participant. There are currently 23 investment options, 22 of which mirror the third-party managed investment funds available under our 401(k) plan and one, Moody s Corporate Bond Average Index, that preserves an investment option previously available under our old deferred compensation plan. All of the third-party managed investment options track precisely with the returns reported by the investment managers for the funds to which they are associated. The Moody s Corporate Bond Average Index is derived from pricing data for approximately 100 corporate bonds in the U.S. market, each with current outstandings of over $100 million.

Amounts deferred under the plan are distributed when a participant terminates employment with us or elects to receive an in-service distribution, which is available to assist participants in meeting shorter-term financial needs. In-service distributions are elected at the time the deferral election is made and are payable in a lump-sum payment on a date that is at least one calendar year after the date of the applicable deferral period/plan year. Distributions following death or retirement may be made by payment in five, ten or fifteen annual installments or by payment of a single lump-sum, except that accounts valued at less than $35,000 are distributed in a single lump-sum payment. The retirement distribution is available for participants starting at age 60 (or age 55 if the participant has 25 years of service). The plan administrator, in its sole discretion, may also allow for financial hardship distributions in certain circumstances. Loans are not permitted under the plan.

TERMINATION AND CHANGE IN CONTROL ARRANGEMENTS

The table below reflects the estimated additional amounts of compensation each named executive officer would receive in the event of a termination of employment. Termination events include: a voluntary termination by the executive; normal retirement of the executive (defined as termination at age 60 or later); an involuntary, not-for-cause termination by the Company; a for-cause termination by the Company; a termination upon a change in control; and a termination due to death or disability. In addition, estimated additional compensation amounts are shown in the event of a change in control without termination of employment. The amounts shown assume that each event occurred on December 31, 2007, the last business day of the calendar year.

Termination of Employment

No written agreements exist that provide additional payments to a named executive officer in the event he voluntarily terminates his employment with Lincoln or Lincoln terminates his employment (whether for cause or not). Pursuant to our standard employment policies, however, upon termination of employment, a named executive officer would be entitled to receive the following:

- Earned but unpaid base pay, up to the date of termination;
- Earned and unused vacation, up to the date of termination;
- Vested amounts held in his account under our 401(k) Plan;
- Amounts held in his account under our Top Hat Plan;
- Deferred vested benefits under our RAP (pension plan)   payments for which could begin at normal retirement age (60) or as early as age 55 (but at a reduced amount); and
- Continuing medical and/or dental coverage under COBRA, for which the executive would pay 102% of the applicable premium.

In addition, the named executive officer generally would be entitled to exercise any vested stock options for a period of three months after termination (after which time the options would expire). However, vested options would be automatically cancelled if the executive s employment were terminated for cause or if the executive engaged in competitive conduct within six months of his termination. Annual bonus targets, cash long-term incentive targets, unvested stock options and restricted stock would be eliminated.

Normal Retirement

In addition to the entitlements described above, upon termination after normal retirement age, a named executive officer would be entitled to receive the following:

- A pro-rata portion of the annual bonus (MIP), based on his period of employment during the calendar year, subject to achievement of the applicable personal and financial goals;
- Pro-rata portions of each cash long-term incentive plan (Cash LTIP), based on his periods of employment during each of the open three-year cycles and upon completion of each cycle, subject to achievement of the applicable financial goals;
  - Vesting of any;border-bottom:1pt none #D9D9D9 ;border-right:1pt none #D9D9D9 ;background-color: #CCEEFF;height:15.75pt;font-family:Times New Roman;font-size:10pt;text-align:right;" nowrap="nowrap"> 30,050

		32,435			
Dilutive impact of non-vested stock and options outstanding	461		-	-	-
Dilutive impact of 2004 senior convertible notes	-		-	-	-

Weighted average shares outstanding - diluted	30,126	31,487	30,050	32,435
Income (loss) from continuing operations per share - diluted	$ 0.13	$ (0.24)	$ (0.30)	$ (0.57)

Incremental shares of 544,629 for the three months ended September 30, 2013, and 492,244 and 313,695 incremental shares for the nine months ended September 30, 2014 and 2013, respectively, related to dilutive securities were not included in the diluted net income (loss) per share calculation because the Company reported a loss for these periods. Incremental shares related to dilutive securities have an anti-dilutive impact on net income (loss) per share when a net loss is reported and therefore are not included in the calculation.

Options to purchase 377,235 and 589,943 shares for the three months ended September 30, 2014 and 2013, respectively, and 377,235 and 589,943 shares for the nine months ended September 30, 2014 and 2013 were not included in the computation of diluted net income (loss) per share because their effect on diluted net income (loss) per share would have been anti-dilutive.

Our remaining 2004 senior convertible notes were repurchased in the second quarter of 2014. Prior to the repurchase, the unissued shares underlying our 2004 senior convertible notes, 199,828 weighted average shares for the three months ended September 30, 2013, and weighted average shares of 583 and 199,828 for the nine months ended September 30, 2014 and 2013, respectively, were excluded for the purposes of calculating diluted net income (loss) per share, because their effect on diluted net income (loss) per share would have been anti-dilutive.

The unissued shares underlying our 2010 senior convertible notes, 2,751,414 and 6,019,607 weighted average shares for the three months ended September 30, 2014 and 2013, respectively, and 3,499,945 and 6,070,600 weighted average shares for the nine months ended September 30, 2014 and 2013, respectively, were excluded for the purpose of calculating diluted net income (loss) per share, because their effect on diluted net income (loss) per share would have been anti-dilutive.

Table of Contents

3. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) includes revenues, expenses, and gains and losses that are excluded from net earnings under GAAP. Items of comprehensive income (loss) are unrealized gains and losses on investments and foreign currency translation adjustments which are added to net income (loss) to compute comprehensive income (loss). Comprehensive income (loss) related to cumulative translation adjustments has no tax expense or benefit as these funds are indefinitely invested.

The following table summarizes the changes in accumulated other comprehensive income (loss), net of tax, by component for the periods ended September 30, 2014 and 2013, (in thousands):

	Foreign currency translation adjustment	Unrealized gain (loss) on investments	Total
Balance as of December 31, 2013	$ 3,720	$ 812	$ 4,532
Other comprehensive income (loss) before reclassifications	(10,876)	810	(10,066)
Reclassified adjustment for net loss included in net income (loss)	-	4	4
Net current period other comprehensive income (loss)	(10,876)	814	(10,062)
Balance as of September 30, 2014	$ (7,156)	$ 1,626	$ (5,530)
Balance as of December 31, 2012	$ 2,565	$ (5,735)	$ (3,170)
Other comprehensive income (loss) before reclassifications	524	3,393	3,917
Reclassified adjustment for net gain included in net income (loss)	-	(4)	(4)
Net current period other comprehensive income (loss)	524	3,389	3,913
Balance as of September 30, 2013	$ 3,089	$ (2,346)	$ 743

The following table shows the gross amounts reclassified from accumulated other comprehensive income (loss) into the Consolidated Statements of Operations and the associated financial statement line item, for the periods ended September 30, 2014 (in thousands):

		September 30, 2014	
Reclassification out of accumulated other comprehensive income	Financial statement line item	Three Months Ended	Nine Months Ended
Realized gains (losses) on investments			
	Other income (expense), net	$ -	$ (7)
	Income tax benefit (expense)	-	3
	Net income (loss)	$ -	$ (4)

4. FAIR VALUE MEASUREMENTS

Financial assets and liabilities that are remeasured and reported at fair value at each reporting period are classified and disclosed in one of the following three categories:

Level 1 — Observable inputs such as quoted prices in active markets;

8

Table of Contents

Level 2 — Other observable inputs available at the measurement date, other than quoted prices included in Level 1, either directly or indirectly, including:

· Quoted prices for similar assets or liabilities in active markets;
· Quoted prices for identical or similar assets in less active markets than Level 1 investments;
· Inputs other than quoted prices that are observable for assets or liabilities; and
· Inputs that are derived principally from or corroborated by other observable market data.

Level 3 — Unobservable inputs that cannot be corroborated by observable market data and reflect the use of significant management judgment. These values are generally determined using pricing models for which the assumptions utilize management's estimate of market participant assumptions.

Assets and Liabilities that are Measured at Fair Value on a Recurring Basis

The following table sets forth by level within the fair value hierarchy, our financial assets that were accounted for at fair value on a recurring basis at September 30, 2014 and December 31, 2013, (in thousands):

	Fair Value Measurements			
	Total	Level 1	Level 2	Level 3
Balance as of September 30, 2014				
Cash and cash equivalents	$ 233,405	$ 233,405	$ -	$ -
Restricted cash	2,025	2,025	-	-
Certificate of deposit	1,500	1,500		
U.S. government sponsored entities	999	-	999	-
Corporate bonds	129,343	129,343	-	-
Asset backed securities	20,560	-	20,560	-
Market basis equity investments	2,455	2,455	-	-
Auction rate securities	39,102	-	-	39,102
Total assets measured at fair value	$ 429,389	$ 368,728	$ 21,559	$ 39,102
Balance as of December 31, 2013				
Cash and cash equivalents	$ 483,868	$ 483,868	$ -	$ -
Restricted cash	3,560	3,560	-	-
Commercial paper	9,992	9,992	-	-
U.S. government sponsored entities	4,000	-	4,000	-
Corporate bonds	101,660	101,660	-	-
Market basis equity investments	3,549	3,549	-	-

Auction rate securities	41,993	-	-	41,993
Total assets measured at fair value	$ 648,622	$ 602,629	$ 4,000	$ 41,993

The assets held at September 30, 2014 and December 31, 2013 had no transfers between levels of the hierarchy during the respective periods then ended.

9

Table of Contents

The following table is a reconciliation of assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3 inputs) (in thousands):

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)
	Auction rate securities
Balance as of December 31, 2012	$ 37,001
Total unrealized gains (losses) included in other comprehensive income	5,092
Settlements	(100)
Balance as of December 31, 2013	$ 41,993
Total unrealized gains (losses) included in other comprehensive income	2,109
Settlements	(5,000)
Balance as of September 30, 2014	$ 39,102

The following methods and assumptions were used to estimate the fair value of each class of financial instrument. There have been no changes in the valuation techniques used by the Company to fair value our financial instruments:

Cash and Cash equivalents. Consist of cash on hand in bank deposits, highly liquid investments and money market accounts. The fair value was measured using quoted market prices and is classified as Level 1. The carrying amount approximates fair value.

Restricted Cash. Consist of cash and cash equivalents that are held in escrow accounts and restricted by agreements with third parties for a particular purpose. The carrying amount approximates fair value and is classified as Level 1.

Certificate of deposits. Consist of bank deposits with a carrying amount that approximates fair value and is classified as Level 1. Maturity dates within one year.

Commercial Paper. Consist of primarily high grade commercial paper. The fair value of these investments was measured using quoted market prices and is classified as Level 1. As of December 31, 2013, the contractual maturities of these investments were within one year.

U.S government sponsored entities. Consist of Fannie Mae, Freddie Mac and Federal Home Loan Bank investment grade bonds that are traded in less active markets than Level 1 investments. The fair value of these bonds is classified as Level 2. The contractual maturities of these investments are within four years.

Corporate Bonds. Consist of investment grade corporate bonds that trade with sufficient frequency and volume to enable us to obtain pricing information on an ongoing basis. The fair value of these bonds was measured using quoted market prices and is classified as Level 1. The contractual maturities of these investments are within three years.

Asset Backed Securities. Consist of securities backed by automobile loan receivables that are traded in less active markets than our Level 1 investments. The fair value is classified as Level 2. The contractual maturity of these investments is within six years.

Market Basis Equity Investments. Consist of available-for-sale equity securities that trade with sufficient frequency and volume to enable us to obtain pricing information on an ongoing basis. The fair value of these investments was measured using quoted market prices and is classified as Level 1.

Table of Contents

Auction Rate Securities. As of September 30, 2014, we held $40.7 million of Auction Rate Securities (ARS) at par value which we have recorded at $39.1 million fair value. As of December 31, 2013, we held $45.7 million of ARS at par value which was recorded at $42.0 million fair value. As of September 30, 2014 the ARS are 105—142% over-collateralized and the underlying student loans are guaranteed by the U.S. government.

Due to the illiquid market conditions, the fair value of our ARS is recorded at a discount to par value of $1.6 million, or 4.0%, as of September 30, 2014. This reduction from par value is considered temporary and is recorded in "Accumulated other comprehensive income (loss)". The temporary reduction from par value recorded in "Accumulated other comprehensive income (loss)" was $3.7 million, 8.2%, as of December 31, 2013. For the three months ended September 30, 2014 and 2013, we recorded unrealized gains on our ARS of $0.2 million and $0.1 million, respectively. For the nine months ended September 30, 2014 and 2013, we recorded unrealized gains on our ARS of $2.1 million and $3.3 million. Unrealized gains on our ARS are recorded in "Unrealized gain (loss) on investments" in our Consolidated Statements of Comprehensive Income (Loss).

In evaluating our ARS portfolio, we note sustained performance of our securities, strong parity levels, observed market redemption activity, continued receipt of interest and penalty payments, and an increase in fair value at September 30, 2014 compared to December 31, 2013. As we expect to receive all contractual cash flows, we do not believe the unrealized losses to be credit related. We continue to believe that we will be able to liquidate at par over time. We also anticipate we will have sufficient cash flow from operations to execute our business strategy and fund our operational needs. We do not intend to sell, or believe we will be required to sell, these investments prior to recovery of their amortized cost basis. Accordingly, we treated the fair value decline as temporary.

The discounted cash flow model we used to value these securities included the following assumptions:

	September 30, 2014			December 31, 2013		
Unobservable inputs						
Redemption period (in years)		6			7	
Credit ratings		A- to AAA			BB+ to AAA	
Penalty coupon rate	1.0 %	to	1.5 %	1.0 %	to	1.5 %
Weighted average annualized yield			1.1 %			1.6 %
Risk adjusted discount rate	4.3 %	to	5.1 %	4.7 %	to	7.8 %

Management makes estimates and assumptions about the ARS, which can be sensitive to changes and effect the determination of fair value. An increase in the length of redemption period or an increase in the discount rate assumption would decrease our fair value. Also, a decrease in the securities' credit ratings would decrease our fair value.

The portfolio had a weighted average maturity of 30.1 years at September 30, 2014, and 29.8 years as of December 31, 2013.

We classify our ARS as Level 3 long-term investments until we receive a call or partial call on the securities. As of September 30, 2014 and December 31, 2013, our entire ARS portfolio was classified as Level 3 long-term investments. During the quarter ended September 30, 2014, we settled $5.0 million of ARS due to a call at par. During the year ended December 31, 2013, we settled $0.1 million of ARS due to a partial call at par. The amount of Level 3 assets as a percentage of total assets measured at fair value on a recurring basis was 9.1% and 6.5% as of September 30, 2014 and December 31, 2013, respectively.

Assets and Liabilities that are Measured at Fair Value on a Nonrecurring Basis

Certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, they are not measured at fair value on an ongoing basis but are subject to fair value adjustments only in certain circumstances

Table of Contents

like evidence of impairment. For the three and nine months ended September 30, 2014 and 2013, other than the goodwill impairment recorded during the first quarter of 2013, as further discussed in Note 6 — Goodwill, we had no significant fair value adjustments of assets or liabilities on a nonrecurring basis subsequent to their initial recognition. The inputs used in goodwill impairment fair value calculations fall within Level 3 inputs due to the significant unobservable inputs used to determine fair value.

5. INVESTMENTS

As of September 30, 2014 and December 31, 2013, our available-for-sale securities consisted of the following (in thousands):

			Gross Unrealized Losses			Maturities/Reset Dates	
	Cost	Gross Unrealized Gains	Less than 12 Months	Greater than 12 Months	Fair Value	Less than 12 Months	Greater than 12 Months
Balance as of September 30, 2014							
Certificate of deposit	$ 1,500	$ -	$ -	$ -	$ 1,500	$ 1,500	$ -
U.S. government sponsored entities	1,000	-	(1)	-	999	-	999
Corporate bonds	129,395	85	(137)	-	129,343	56,532	72,811
Market basis equity investments	1,563	895	(3)	-	2,455	-	2,455
Asset backed securities	20,563	20	(23)	-	20,560	-	20,560
Auction rate securities	40,725	-	-	(1,623)	39,102	-	39,102
Total available-for-sale securities	$ 194,746	$ 1,000	$ (164)	$ (1,623)	$ 193,959	$ 58,032	$ 135,927

Balance as of December 31, 2013							
Commercial paper	$ 9,992	$ -	$ -	$ -	$ 9,992	$ 9,992	$ -
U.S. government sponsored entities	4,000	-	-	-	4,000	-	4,000
Corporate bonds	101,400	281	(21)	-	101,660	58,280	43,380
Market basis equity investments	1,668	1,881	-	-	3,549	-	3,549
Auction rate securities	45,725	-	-	(3,732)	41,993	-	41,993
Total available-for-sale securities	$ 162,785	$ 2,162	$ (21)	$ (3,732)	$ 161,194	$ 68,272	$ 92,922

We consider the fair value decline of our investments to be temporary, as we do not intend to sell the investments and it is not likely that we will be required to sell the investments before recovery of their amortized cost basis. See Note 4 — Fair Value Measurements, for further discussion regarding the fair value of ARS. Temporary, unrealized, gains and losses on available for sale securities are recorded in “Accumulated other comprehensive income (loss)” within our Consolidated Balance Sheets.

Realized gains or losses on investments are recorded in our Consolidated Statements of Operations within “Other income (expense), net”. Upon the sale of a security classified as available for sale, the amount reclassified out of “Accumulated other comprehensive income (loss)” into earnings is based on the specific identification method.

As of September 30, 2014 and December 31, 2013, the balance of our cost method equity investment was $11.4 million and $10.5 million, respectively, which is included in “Long-term investments” in our Consolidated Balance Sheets. During the first quarter of 2014, we invested an additional $0.6 million and converted a note receivable of $0.3 million into shares in our cost method equity investment. We have not estimated the fair value of

Table of Contents

our cost method equity investment as of September 30, 2014 as we are not aware of any facts or circumstances that would indicate a decline in the fair value of this investment below its carrying value.

During the first quarter of 2013, we sold a cost method equity investment to a third party and recorded a gain of $11.1 million. During the second quarter of 2013, we received additional funds based on our sales agreement and as a result we recorded an additional gain of $6.5 million. In the third quarter of 2014, we received the third of four anticipated payments under the sales agreement and recorded a gain of $2.2 million. All gains related to this cost basis investment have been recorded in "Other income (expense), net" in our Consolidated Statements of Operations. The fourth and final payment under the sales agreement is due in the third quarter of 2017 and we may receive up to $0.9 million of additional sale proceeds at that time. We have concluded that these additional funds represent contingent gains and have not accounted for them in our consolidated financial statements in accordance with U.S. GAAP.

6. GOODWILL

In the fourth quarter 2012, we determined our goodwill was impaired and recorded a preliminary non-cash pretax goodwill impairment charge. During the first quarter of 2013, we completed our goodwill impairment analysis and recorded an additional non-cash pretax goodwill impairment charge of $21.2 million relating to our single reporting unit. The tax benefit associated with the first quarter impairment was offset by our tax valuation allowance. As previously disclosed, a blended income and market approach was used to determine the applicable impairment changes. The application of goodwill impairment tests is a level 3 fair value measurement and requires management judgment for many of the inputs. Goodwill impairment charges are included as a separate operating expense line item, "Goodwill impairment" within Continuing Operations in our Consolidated Statements of Operations.

7. STOCK-BASED COMPENSATION

The following table summarizes stock-based compensation expense recognized related to employee stock options, restricted and performance stock awards and employee stock purchases (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Costs and expenses				
Direct cost of services	$ 38	$ 35	$ 122	$ 124

Network and infrastructure	380	341	1,127	1,083
Sales and marketing	1,452	1,718	4,029	5,349
Product research and development	849	782	2,570	2,553
General and administrative	1,866	1,465	5,391	7,186
Stock-based compensation included in costs and expenses	$ 4,585	$ 4,341	$ 13,239	$ 16,295

13

Table of Contents

8. INCOME TAXES

The provision (benefit) for income taxes from continuing operations is composed of the following (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Current tax expense (benefit):				
United States	$ (8,422)	$ (397)	$ (8,130)	$ 1,040
International	144	(248)	775	(1,448)
Total current provision for income taxes	$ (8,278)	$ (645)	$ (7,355)	$ (408)
Tax Rate	194.0 %	7.8 %	45.0 %	2.2 %

During the quarter ended September 30, 2014, $9.1 million of previously unrecognized tax benefits, including $1.4 million of related interest, were released due to the expiration of a statute of limitations. We have taken no new tax positions that result in unrecognized tax benefits during the three and nine month periods ended September 30, 2014. As of September 30, 2014, we had $2.7 million of remaining unrecognized tax benefits, excluding related interest. Approximately $2.1 million of these unrecognized tax benefits would affect our effective tax rate if recognized. As of September 30, 2014, we had approximately $0.4 million of accrued interest related to uncertain tax positions. Due to the potential resolution of examinations currently being performed by taxing authorities and the expiration of various statutes of limitation, it is reasonably possible that the balance of our gross unrecognized tax benefits may change within the next twelve months by a range of zero to $1.4 million.

Our quarterly estimate of our annual effective tax rate is subject to variation due to several factors, including our mix of earnings between tax jurisdictions and the corresponding statutory rates, discrete items and the non-recognition of tax benefits generated by net operating losses in jurisdictions with a valuation allowance.

On a quarterly basis, we assess whether a valuation allowance for net operating loss carryforwards and other deferred tax assets is needed. We concluded during the third quarter of 2014 evaluation that we are required to maintain a valuation allowance against our net U.S. tax assets and certain foreign tax assets.

9. COMMITMENTS AND CONTINGENCIES

Litigation

We are subject to legal proceedings, claims and litigation, and other disputes or regulatory inquires arising in the ordinary course of business. In addition, third parties have from time-to-time claimed, and others may claim in the future, that we have infringed their intellectual property rights. We have been notified of several potential patent disputes, and expect that we will increasingly be subject to patent infringement claims as our services expand in scope and complexity. While the final outcome of these matters is currently not determinable, we believe there is no ordinary course litigation or other matters that are currently pending against us that is likely to have, individually or in the aggregate, a material effect on our consolidated financial position, results of operations, stockholders' equity or cash flows. Because of the uncertainty inherent in litigation, disputes, and intellectual property matters, it is possible that unfavorable resolutions of these lawsuits, proceedings and claims could exceed the amount we have currently reserved for these matters.

On April 4, 2014, we settled two intellectual property lawsuits with DDR Holdings, LLC, each of which was dismissed with prejudice. The full settlement amount was paid in April 2014.

On March 31, 2014, the U.S. District Court for the District of Minnesota certified a class action against the Company of all persons in the United States who purchased Extended Download Service for Norton Products between January 24, 2005, and October 26, 2009. The plaintiffs have sued Symantec Corporation and the Company. The claims against the Company are for alleged violation of the Minnesota Consumer Fraud and False Statement in Advertising Acts and unjust enrichment, based on the Company's sale of Extended Download Service to purchasers of Norton products. We intend to continue to vigorously defend this matter, but cannot predict the timing or ultimate outcome, nor estimate a range of loss, if any, for this matter.

Indemnification Provisions

In the ordinary course of business we have included limited indemnification provisions in certain of our agreements with parties with whom we have commercial relations. Under these contracts, we generally indemnify, hold harmless and agree to reimburse the indemnified party for losses suffered or incurred by the indemnified party in connection with claims by any third party with respect to our domain names, trademarks, logos and other branding elements to the extent that such marks are applicable to our performance under the subject agreement. In certain agreements, including both agreements under which we have developed technology for certain commercial parties and agreements with our clients, we have provided an indemnity for other types of third-party claims.

In addition, we are required by our credit card processors to comply with credit card association operating rules, and we have agreed to indemnify our processors for any fines they are assessed by credit card associations as a result of processing payments for us. The credit card associations and their member banks set and interpret the credit card rules. Visa, MasterCard, American Express or Discover could adopt new operating rules or re-interpret existing rules that we or our credit card processors might find difficult to follow. We also could be subject to fines or increased fees from MasterCard and Visa.

To date, no significant costs have been incurred, either individually or collectively, in connection with our indemnification provisions

Commitments and Guarantees

At certain times, we enter into agreements where a letter of credit is required to ensure payment of future obligations by counterparties, such as our credit card processors and international taxing jurisdictions. Upon withdrawal, we are obligated to fund the executor bank on demand. We have not set aside specific funds to cover this potential obligation as we can generally recover these costs from our clients. If drawn upon, we expect to fund this commitment with cash and cash equivalents. There were $0.5 million and $0.6 million in undrawn letters of credit as of September 30, 2014 and December 31, 2013.

10. DEBT

2010 Senior Convertible Notes

For the nine months ended September 30, 2014, we repurchased $160.6 million of our 2.00% senior convertible notes (2010 Notes) in the open market for $164.5 million, excluding accrued interest. All repurchases occurred in March 2014. For the nine months ended September 30, 2014, the loss on extinguishment of debt, including the premium on repurchase and acceleration of the recognition of deferred financing fees was $5.5 million. For the nine months ended September 30, 2013, we repurchased $5.4 million of the 2010 Notes in the open market for $5.3 million excluding accrued interest. No repurchases were made in the third quarter of 2013. For the nine months ended September 30, 2013, the net gain on extinguishment of debt, which is the net of the gain on sale and the loss on acceleration of the recognition of deferred financing fees, was immaterial. Notes repurchased are deemed to be extinguished for accounting purposes.

As of September 30, 2014, the carrying value of our 2010 Notes was $135.2 million and the fair value was $134.8 million. As of December 31, 2013, the carrying value of our 2010 Notes was $295.8 million and the fair value was $298.3 million. Fair values are based on the quoted fair market values of the debt. Debt is classified as a level 3 fair value measurement. We determine fair value based on the market approach.

Table of Contents

2004 Senior Convertible Notes

On January 1, 2014, holders of $8.7 million of our 1.25% senior convertible notes (2004 Notes) exercised the option to require us to repurchase those notes at par. The acceleration of the recognition of deferred financing fees related to these repurchased Notes resulted in a $0.1 million charge. On June 6, 2014, the remaining balance of our 2004 Notes of $0.1 million was repurchased. The 2004 Notes that were repurchased on January 1, 2014, were classified as current in "Other current liabilities" in our December 31, 2013, Consolidated Balance Sheet due to the subsequent repurchase.

As of December 31, 2013, the carrying value of our 2004 Notes was $8.8 million and the fair value was $8.9 million. Fair values are based on the quoted fair market values of the debt. Debt is classified as a level 3 fair value measurement. We determine fair value based on the market approach.

11. DISCONTINUED OPERATIONS

On September 30, 2013, we sold CustomCD, Inc., which was based in Portland, Oregon in a stock sale to a former employee. On October 1, 2013, we sold Digital River Education Services, Inc., which was based in Plano, Texas in a stock sale to two former employees. The results of operations of these entities, including the income (losses) on their respective sales, have been excluded from the results of continuing operations and are reported as discontinued operations. We do not allocate interest income or interest expense to discontinued operations. The operating results of the discontinued operations included in our Consolidated Statements of Operations, including adjustments to loss on the respective sales, for the three and nine months ended September 30, 2014 and 2013, were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Revenue	$ -	$ 3,064	$ -	$ 8,044
Income (loss) on discontinued operations before taxes and loss on sales	-	(99)	-	(1,619)
Income (loss) on disposal of discontinued businesses before taxes	41	(2,110)	317	(2,110)
Provision (benefit) for income taxes	(102)	2,682	-	2,509
Income (loss) on discontinued operations, net of tax	$ 143	$ (4,891)	$ 317	$ (6,238)

12. SUBSEQUENT EVENTS

On October 23, 2014, the Company entered into a definitive merger agreement to be acquired by an investor group led by Siris Capital Group, LLC (Siris) in a transaction valued at approximately $840 million. Under the terms of the agreement, Siris will acquire all of the outstanding common shares of Digital River for $26.00 per share in cash. The Company may solicit alternative acquisition proposals from third parties during a 45-day “go-shop” period, following the date of execution of the merger agreement. The Company may be required to pay a termination fee of up to $27.3 million if the merger agreement is terminated under certain circumstances. If approved, the merger agreement is expected to be finalized in early 2015.

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

The discussion in this Quarterly Report contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those discussed below. Additional factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in the section entitled "Risk Factors," included in Item 1A of Part II of this Quarterly Report. When used in this document, the words "believes," "expects," "anticipates," "intends," "plans," and similar expressions, are intended to identify certain of these forward-looking statements. However, these words are not the exclusive means of identifying such statements. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements. The cautionary statements made in this document should be read as being applicable to all related forward-looking statements wherever they appear in this document. We have no obligation to update the matters set forth herein, whether as a result of new information, future events or otherwise.

Business Overview

Digital River is a leading provider of global Commerce-as-a-Service (CaaS) solutions. We provide commerce, payments and marketing solutions to business-to-business (B2B) and business-to-consumer (B2C) digital product and cloud service companies as well as branded manufacturers across a variety of vertical markets through our multi-tenant technology, platform and service offerings. Our customers range in size from small to mid-sized companies to multi-national enterprises that serve a wide variety of markets, including, software, consumer electronics, computer games, publishing, travel, music, video games, electronic toys, housewares, medical equipment, power tools and direct-selling, among others.

We offer our customers a broad range of solutions to quickly and cost effectively establish, manage and grow commerce sales channels via Internet-connected devices. We have invested substantial resources to develop our solutions, services, infrastructure and platforms, and to mitigate the risks our customers may encounter when conducting global commerce.

Commerce

Our Commerce-as-a-Service suite includes our commerce experience, tools and capabilities; Commerce Business Infrastructure (CBI), which we believe is a competitive differentiator; and marketing services. Our solutions allow our customers to focus on promoting and marketing their products and brands worldwide while leveraging our technology and global infrastructure investments to facilitate the purchase of products or services through e-commerce stores. We generate a significant proportion of our revenue based on the difference between the selling price and our wholesale purchase price, which can be expressed on a revenue-share basis, meaning that we earn as margin a percentage of the selling price of each product sold through our commerce solution. We believe this model aligns our interests with those of our clients. In addition, we also offer our customers transaction-based models and hybrid combinations of revenue share and transaction models.

· Commerce experience, tools and capabilities: With our commerce experience, tools and capabilities we create and manage world-class commerce sites and online experiences that include all of the classic components of a commerce operation, such as responsive and adaptive design, development and hosting of commerce stores, in-application and in-product commerce experiences, shopping carts, store merchandising and optimization, digital product or license key delivery via download, physical product fulfillment, subscription management, e-marketing services, international payment processing services, web store optimization, web analytics and reporting.

When shoppers decide to purchase a customer’s product or service online, they are transferred to a commerce store and/or shopping cart operated by us using our multi-tenant commerce platform. Once on our system, shoppers can browse for products and make purchases using connected devices such as PCs, tablet computers, smartphones and other similar devices. After a purchase is made, we deliver the product or license key digitally via download over the Internet, enable access to the product via a time- or —usage-

17

based subscription model or transmit instructions to a third party partner for physical fulfillment of the order.

- Commerce business infrastructure (CBI): Our CBI is the underpinning for our Commerce-as-a-Service suite and our payments solution. We believe it is unique and differentiated, enabling us to manage the complexity of global commerce on behalf of our customers. It includes our merchant-of-record and seller-of-record capabilities, our fraud screening and management capabilities, our order management, business intelligence analytics, customer support services and our integration services capabilities as well as our local business entities, which enable us to have on-the-ground experts, strong localization capabilities and local payment methods and banking relationships; and it enables us to manage legal compliance requirements and export controls and management.

We have invested substantial resources to develop our CBI as part of our multi-tenant SaaS commerce and marketing platform and business processes. We provide access and use of our platform to our clients as a service as opposed to selling the software to be operated on our customers’ own in-house computer hardware.

Payments

Our Payments solutions offer our customers a global payments footprint, including a full range of domestic and international payment solutions, 180 global payment methods, 170 international currencies and 50 connections to local banks from across the globe. The payments services we provide ourselves or through third parties include transaction processing, global payment methods, fraud management, cloud-based billing, mobile payments services, and other payment optimization services. Our online payments solutions are designed to help our customers maximize credit card and transaction authorization rates, reduce online shopping cart abandonment, ease entry into new geographies and protect transactions from fraud on a global basis. Our payments offerings can function as independent online payment solutions and as fully integrated components of Digital River’s enterprise commerce solution.

Marketing

In addition to the services we provide that facilitate the completion of an online transaction, we also offer services designed to help our clients acquire customers more effectively, sell to those customers more often and more efficiently, and increase the lifetime value and retention of each customer. The e-marketing services we provide are supported through several channels. Our performance marketing services include:

- marketForce: Our marketForce™ digital marketing agency includes a global team of marketers that offer managed direct response e-marketing services. Digital River’s e-marketing experts offer managed services that span email and affiliate marketing management, search engine marketing, site optimization, multi-variate testing, mass dynamic personalization and contextual advertising.

· oneNetworkDirect: Through our large oneNetworkDirect™ affiliate network, we provide our customers access to a new sales channel, which can help grow their online businesses. Customers can offer any part of their product catalogs to our network of online channel partners, including online retailers and affiliates. This increases the exposure these products receive and can result in higher sales volumes.

· BlueHornet Email Marketing: Our BlueHornetTM enterprise email marketing service provides traditional as well as social and mobile email marketing capabilities. BlueHornet offers email marketing technology, a service model including account management by expert email marketers, and proactive inbox deliverability management.

We view our operations and manage our business as one reportable segment, providing solutions to companies that want to sell their products and services online.

Table of Contents

We were incorporated in Delaware in February 1994. Our headquarters are located at 10380 Bren Road West, Minnetonka, Minnesota and our telephone number is 952-253-1234.

General information about us can be found at www.digitalriver.com under the "Company/Investor Relations" link or follow the Company on Twitter at twitter.com/digitalriverinc. Our annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, as well as any amendments or exhibits to those reports, are available free of charge through our website as soon as reasonably practicable after we file such reports with the Securities and Exchange

Current Period Results

For the three months ended September 30, 2014, we recorded net income of $4.2 million, or $0.14 per diluted share, comprised of net income from continuing operations of $4.0 million, or $0.13 per diluted share and a $0.1 million gain from discontinued operations, $0.01 per diluted share. For the comparative period ended September 30, 2013, we recorded a net loss of $12.5 million, or loss of $0.40 per share, comprised of net loss from continuing operations of $7.6 million, or loss of $0.24 per share, and net loss from discontinued operations of $4.9 million, or loss of $0.16 per share. Revenue for the quarter ended September 30, 2014 was $88.8 million, compared to $87.3 million for the same period in the prior year. The 1.8% growth in revenue quarter over quarter was driven by the addition of new payments clients.

Total costs and expenses in continuing operations for the three months ended September 30, 2014 were $94.7 million compared to $93.8 million in the same period in the prior year, an increase of 1.0%.

As of September 30, 2014 and December 31, 2013, we had $385.8 million and $599.5 million in cash, cash equivalents and short-term investments, respectively.

Results of Operations

The results of the operations of CustomCD, Inc. (CustomCD) and Digital River Education Services, Inc. (DRES), which were sold on September 30, 2013 and October 1, 2013, respectively, have been classified within Discontinued Operations in our Consolidated Statements of Operations for all periods presented.

Table of Contents

The following table sets forth certain items from our Consolidated Statements of Operations as a percentage of total revenue for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Revenue	100.0 %	100.0 %	100.0 %	100.0 %
Costs and expenses (exclusive of depreciation and amortization expense shown separately below):				
Direct cost of services	20.6	18.5	19.4	19.1
Network and infrastructure	15.5	16.8	15.2	15.3
Sales and marketing	28.2	28.7	26.9	27.9
Product research and development	20.6	20.8	20.2	18.4
General and administrative	12.0	13.8	12.9	15.3
Goodwill impairment	-	-	-	7.4
Depreciation and amortization	7.5	6.5	7.1	5.4
Amortization of acquisition-related intangibles	2.3	2.4	2.3	2.2
Total costs and expenses	106.7	107.5	104.0	111.0
Income (loss) from operations	(6.7)	(7.5)	(4.0)	(11.0)
Interest income	0.5	0.6	0.6	0.6
Interest expense	(1.0)	(2.2)	(1.2)	(2.0)
Other income (expense), net	2.3	(0.3)	0.7	5.8
Gain (loss) on extinguishment of debt	-	-	(2.0)	-
Income (loss) from continuing operations before income taxes	(4.9)	(9.4)	(5.9)	(6.6)
Income tax expense (benefit)	(9.3)	(0.7)	(2.7)	(0.2)
Income (loss) from continuing operations	4.4	(8.7)	(3.2)	(6.4)
Income (loss) from discontinued operations, net of tax	0.2	(5.6)	0.1	(2.2)
Net income (loss)	4.6 %	(14.3) %	(3.1) %	(8.6) %

Revenue. Our revenue was $88.8 million and $87.3 million for the three months ended September 30, 2014 and 2013, respectively, an increase of $1.5 million or 1.8%. For the nine months ended September 30, 2014, revenue totaled $274.0 million, a decrease of $14.4 million or 5.0%, from revenue of $288.4 million for the same period in the prior year.

Our revenue is driven primarily by global commerce and payment services provided to a wide variety of companies in the software, consumer electronics, computer games and other markets.

Payments revenue for the three and nine months ended September 30, 2014, increased $1.8 million or 12.7%, and $4.6 million or 10.1%, respectively. The growth in both periods is mainly related to the addition of new clients.

Commerce revenue, including Microsoft, for the three months ended September 30, 2014 was consistent with the same period in the prior year, decreasing $0.3 million or 0.4%. For the nine months ended September 30, 2014, commerce revenue decreased $19.0 million or 7.8%, due primarily to client attrition, as well as one-time significant product launches that occurred in the first quarter of 2013.

International sales were approximately 46.4% and 47.6% of revenue from continuing operations in the three and nine month periods ended September 30, 2014, compared to 46.8% and 47.7% for the same periods in the prior year.

Table of Contents

Direct Cost of Services. Direct cost of services includes payment processing fees, chargeback expense, fraud detection and prevention, costs related to product fulfillment, delivery solutions and certain client-specific costs. Direct cost of services were $18.3 million for the three months ended September 30, 2014, compared to $16.2 million for the same period in the prior year. The increase was primarily related to higher payment processing costs. For the nine months ended September 30, 2014, direct cost of services was $53.3 million compared to $55.3 million for the same period in the prior year. Higher costs in 2013 were primarily due to CD costs related to one time significant product launches in the first quarter of 2013.

Network and Infrastructure. Our network and infrastructure expenses primarily include costs to operate and maintain our technology platforms, customer service, data communication and data center operations. Network and infrastructure expenses were $13.8 million and $14.6 million for the three months ended September 30, 2014 and 2013, respectively. For the nine months ended September 30, 2014 and 2013, network and infrastructure expenses were $41.7 million and $44.0 million, respectively. The decreases for both periods were primarily related to reductions in workforce, consulting, and overhead related expenses.

Sales and Marketing. Our sales and marketing expenses include personnel and related costs, advertising, promotional and product marketing expenses. Sales and marketing expenses were $25.1 million for the three months ended September 30, 2014, consistent with $25.0 million for the same period in the prior year. For the nine months ended September 30, 2014 and 2013, sales and marketing expenses were $73.6 million and $80.4 million, respectively. The decrease year-over year was driven by reductions in workforce costs, including severance and stock compensation expense incurred in 2013 as part of planned cost reduction strategies, and lower marketing expense, including the utilization of third parties.

Product Research and Development. Our product research and development expenses include costs associated with design, development and enhancement of our technology platforms and related systems. Research and development costs are expensed as incurred, except certain internal-use software development costs that are eligible for capitalization and costs directly associated with preparing a client website launch that are eligible to be deferred and amortized over the life of the site's associated revenue streams. Product research and development expenses were $18.3 million and $18.1 million for the three months ended September 30, 2014 and 2013, respectively, and $55.2 million and $53.0 million for the nine months ended September 30, 2014 and 2013, respectively. The increases for both periods were driven by employee and contractor expenses related to the continued investment in our platforms.

General and Administrative. Our general and administrative expenses primarily include executive, finance, human resources and other administrative workforce and other related expenses, fees for professional services, bank fees, litigation costs, insurance costs, acquisition and integration costs and non-income related taxes. General and administrative expenses were $10.7 million and $12.0 million for the three months ended September 30, 2014 and 2013, respectively. The decrease was primarily related to strategic consulting expenses incurred in 2013 associated with business transformation plans, as well as lower legal and professional services spending. For the nine months ended September 30, 2014 and 2013, general and administrative expenses were $35.3 million and $44.0 million, respectively. In addition to the quarter over quarter decreases, the nine months in 2013 included acquisition and integration costs associated with the acquisition of LML Payment Systems, Inc. and severance and stock compensation expense associated with an executive departure.

Goodwill Impairment. During the first quarter of 2013, we completed our fiscal year 2012 goodwill impairment analysis and recorded an additional non-cash pretax goodwill impairment charge of $21.2 million.

Depreciation and Amortization. Our depreciation and amortization expenses include the depreciation of computer equipment, office furniture and leasehold improvements and the amortization of purchased and internally developed software. Computer equipment, software and furniture are depreciated/amortized under the straight-line method using three to seven year lives and leasehold improvements are depreciated over the shorter of the life of the asset or the remaining length of the lease. Depreciation and amortization expense was $6.6 million and $5.7 million for the three months ended September 30, 2014 and 2013, respectively. Depreciation and amortization expense was $19.5 million and $15.7 million for the nine months ended September 30, 2014 and 2013, respectively. The increase in depreciation and amortization in both periods is primarily related to assets acquired for our new data center which were put into service during the third quarter of 2013.

Table of Contents

Amortization of Acquisition-Related Intangibles. Acquisition-related intangibles consists of the assets such as customer relationships, technology and trade names acquired in business combinations. Amortization of acquisition-related intangible assets was $2.0 million for the three months ended September 30, 2014, consistent with the $2.1 million recognized in the three months ended September 30, 2013. Amortization of acquisition-related intangible assets was $6.4 million for both of the nine months ended September 30, 2014 and 2013.

Interest Income. Our interest income represents the total of interest income on our cash, cash equivalents, short-term investments and certain long-term investments. Interest income was $0.5 million and $0.6 million for the three months ended September 30, 2014 and 2013, respectively. Interest income was $1.7 million and $1.9 million for the nine months ended September 30, 2014 and 2013, respectively. The small decrease in interest income in both periods is related to lower total cash and cash equivalent and investment balances due to senior convertible note and stock repurchases over the past year.

Interest Expense. Our interest expense includes the total of cash and non-cash interest expense attributable to our outstanding convertible debt. For the three months ended September 30, 2014 and 2013, interest expense was $0.9 million and $1.9 million, respectively, which included $0.2 million and $0.4 million of debt financing cost amortization, respectively. For the nine months ended September 30, 2014 and 2013, interest expense was $3.4 million and $5.9 million, respectively, which included $0.7 million and $1.3 million of debt financing cost amortization, respectively. The decrease in interest expense in both periods was due to the repurchase of our senior convertible notes during 2013 and the first quarter of 2014.

Other Income (Expense), Net. Other income (expense), net includes foreign currency transaction gains and losses, gains and losses on investments or asset disposals (excluding disposals of businesses included in discontinued operations), and dividend income. Other income (expense), net was $2.1 million of income compared to $0.3 million of expense for the three months ended September 30, 2014 and 2013, respectively. Other income (expense), net was $1.9 million of income compared to $16.7 million of income for the nine months ended September 30, 2014 and 2013, respectively. The other income, net that was recognized in the three and nine months ended September 30, 2014 was primarily related to additional gains recognized on the sale of a cost method investment that occurred in the first quarter of 2013. These gains were contingent on the release of an escrow amount that occurred in the third quarter of 2014. The other income, net that was recorded for the nine months ended September 30, 2013 was related to the initial gain on the sale of the same cost method investment.

Gain (Loss) on Extinguishment of Debt. During the first quarter of 2014, we repurchased $160.6 million of our 2.00% senior convertible notes in the open market for $164.5 million, excluding accrued interest. The loss on extinguishment of this debt, including the premium on repurchase and acceleration of the recognition of deferred financing fees was $5.5 million. In addition, we repurchased $8.7 million of our 1.25% senior convertible notes at par in the first quarter of 2014 and recorded a $0.1 million charge related to the acceleration of the recognition of deferred financing fees.

Income Tax Expense. For the three months ended September 30, 2014 and 2013, our tax benefit related to continuing operations was $8.3 million and $0.6 million, respectively. For the three months ended September 30, 2014 our tax benefit related to discontinued operations was $0.1 million compared to a tax expense of $2.7 million for the three months ended September 30, 2013. For the three months ended September 30, 2014, our tax benefit related to continuing operations consisted of $8.4 million U.S. tax benefit and $0.1 million of foreign tax expense. For the three months ended September 30, 2013, our tax benefit related to continuing operations consisted of $0.4 million of U.S. tax benefit and $0.2 million of foreign tax benefit. For the three months ended September 30, 2014 and 2013, the tax rate was a benefit of 194.0% and 7.8%, respectively.

For the nine months ended September 30, 2014 and 2013, our tax benefit related to continuing operations was $7.4 million and $0.4 million, respectively. For the nine months ended September 30, 2014, we had no tax expense related to discontinued operations compared to tax expense of $2.5 million for the nine months ended September 30, 2013. For the nine months ended September 30, 2014, our tax expense related to continuing operations consisted of $8.1 million of U.S. tax benefit and $0.8 million of foreign tax expense. For the nine months ended September 30, 2013, our tax expense related continuing operations consisted of $1.0 million of U.S. tax

Table of Contents

expense and $1.4 million of foreign tax benefit. For the nine months ended September 30, 2014 and 2013, the tax rate was 45.0% and 2.2%, respectively.

The tax benefit for both the three and nine month periods ended September 30, 2014 was driven by $9.1 million of previously unrecognized tax benefits, including $1.4 million of related interest, which was released in the third quarter of 2014 due to the expiration of a statute of limitations.

Discontinued Operations. The pre-tax gain related to the disposal of discontinued operations recorded in the three months ended September 30, 2014 was immaterial compared to a pre-tax loss related to the operation of the discontinued entities of $0.1 million and pre-tax loss of $2.1 million related to the disposal of those entities for the three months ended September 30, 2013. Total net gain from discontinued operations was $0.1 million for the three months ended September 30, 2014, compared to a net loss of $4.9 million for the same period in the prior year. The pre-tax gain related to the disposal of discontinued operations recorded in the nine months ended September 30, 2014 was $0.3 million compared to a pre-tax loss of $3.7 million for the nine months ended September 30, 2013, which consists of $1.6 million of pre-tax loss on the operation of the discontinued entities and $2.1 million pre-tax loss on disposal. Total net gain from discontinued operations was $0.3 million for the nine months ended September 30, 2014, compared to a net loss of $6.2 million for the same period in the prior year.

Off Balance Sheet Arrangements

None.

Liquidity and Capital Resources

	Nine Months Ended September 30,	
	2014	2013
Cash provided by (used in):		
Operating activities	$ 8,199	$ (45,555)
Investing activities	(44,875)	5,799
Financing activities	(204,667)	(51,176)
Effect of exchange rate changes on cash and cash equivalents	(9,120)	6,143
Net increase (decrease) in cash and cash equivalents	$ (250,463)	$ (84,789)

As of September 30, 2014, we had $233.4 million of cash and cash equivalents, approximately 63.2% was held by our international subsidiaries. Cash and cash equivalents are sufficient to fund our current and anticipated operations and we do not anticipate any local liquidity restrictions that would preclude us from funding our expansion or operating needs.

Operating Activities

Net cash provided by operations for the nine months ended September 30, 2014, of $8.2 million was due to net add backs for non-cash operating expenses, offset by changes in working capital, a $27.5 million use of cash. Excluding the impact of working capital changes, our operating cash flow for the nine months ended September 30, 2014, was $35.7 million. Net cash used in operations for the nine months ended September 30, 2013, was $45.6 million, and was primarily the result of changes in working capital, a $71.9 million use of cash. Excluding the impact of working capital changes, our operating cash flow for the nine months ended September 30, 2013, was $26.4 million.

Investing Activities

Table of Contents

Net cash used in investing activities for the nine months ended September 30, 2014, was $44.9 million and was the result of net purchases of investments of $31.8 million and purchases of equipment and capitalized software of $13.6 million, offset by proceeds from sale of equipment of $0.5 million. Net cash provided by investing activities for the nine months ended September 30, 2013, was $5.8 million and was the result of net sales of investments of $77.3 million, offset by cash paid for acquisitions of $55.8 million and $15.7 million of purchases of equipment and capitalized software.

Financing Activities

Net cash used in financing activities for the nine months ended September 30, 2014, was $204.7 million and was due to $173.3 million in repurchases of our senior convertible notes, $28.3 million in repurchases of our common stock and $4.1 million in repurchases of restricted stock to satisfy tax withholding obligations, offset by $1.0 million of sales of common stock under our employee stock purchase plan. Net cash used in financing activities for the nine months ended September 30, 2013, was $51.2 million and was due to $44.0 million in repurchases of common stock, $4.3 million in repurchases of restricted stock to satisfy tax withholding obligations and $5.4 million in repurchases of our senior convertible notes, offset by proceeds of $1.3 million related to the exercise of stock options and $1.2 million of sales of common stock under our employee stock purchase plan.

Effect of Exchange Rate Changes

For the nine months ended September 30, 2014 changes in foreign currency rates resulted in a decrease in our cash and cash equivalents of $9.1 million. For the nine months ended September 30, 2013 changes in foreign currency rates resulted in an increase in our cash and cash equivalents of $6.1 million. The changes are due to foreign currency volatility on our international entity balance sheet exposures, primarily from the Euro.

Auction Rate Securities

Information regarding auction rate securities is included in Note 4 to the Consolidated Financial Statements in Part I, Item 1.

Commitments and Guarantees

At certain times, we enter into agreements where a letter of credit is required to ensure payment of future obligations by counterparties, such as our credit card processors and international taxing jurisdictions. Upon withdrawal, we are obligated to fund the executor bank on demand. We have not set aside specific funds to cover this potential obligation as we can generally recover these costs from our clients. If drawn upon, we expect to fund this commitment with cash and cash equivalents. There were $0.5 million and $0.6 million in undrawn letters of credit at September 30, 2014 and December 31, 2013, respectively.

Application of Critical Accounting Policies

Critical Accounting Estimates and Policies

A detailed description of our significant accounting policies can be found in our most recent Annual Report filed on Form 10-K for the fiscal year ended December 31, 2013. There were no material changes in significant accounting policies during the nine months ended September 30, 2014.

Recent Accounting Pronouncements

Information regarding recently issued accounting standards is included in Note 1 to the Consolidated Financial Statements in Part I, Item 1.

Item 3. Qualitative and Quantitative Disclosure about Market Risk

Interest Rate Risk

24

Table of Contents

Our portfolio of cash equivalents, short-term and long-term investments is maintained in a variety of securities, including government agency obligations, corporate bonds, asset backed securities and money market funds. Investments are classified as available-for-sale securities and carried at their market value with cumulative unrealized gains or losses recorded as a component of "Accumulated other comprehensive income (loss)" within stockholders' equity. A sharp rise in interest rates could have an adverse impact on the market value of certain securities in our portfolio. We do not currently hedge our interest rate exposure and do not purchase financial instruments for trading or speculative purposes.

At September 30, 2014, we had long-term debt of $135.2 million associated with our Senior Convertible Notes, which are fixed rate instruments. The market value of our long-term debt will fluctuate with movements of interest rates, increasing in periods of declining rates of interest and declining in periods of increasing rates of interest.

Foreign Currency Risk

Growth in our international operations will incrementally increase our exposure to foreign currency fluctuations as well as other risks typical of international operations, including, but not limited to, differing economic conditions, changes in political climate, differing tax structures and other regulations and restrictions.

Foreign exchange rate fluctuations may adversely impact our consolidated results of operations as exchange rate fluctuations on transactions denominated in currencies other than our functional currencies result in gains and losses that are reflected in our Consolidated Statements of Operations. To the extent the U.S. dollar weakens against foreign currencies, the translation of these foreign currency-denominated transactions will result in increased net revenue and operating expenses. Conversely, our net revenue and operating expenses will decrease when the U.S. dollar strengthens against foreign currencies.

Transaction Exposure

The Company enters into short-term foreign currency forward contracts to offset the foreign exchange gains and losses generated by the re-measurement of certain assets and liabilities recorded in non-functional currencies. Changes in the fair value of these derivatives, as well as re-measurement gains and losses, are recognized in current earnings in "Other income (expense), net". Foreign currency transaction gains and losses were a loss of $0.1 million and a loss of $0.3 million for the three months ended September 30, 2014 and 2013, respectively. Foreign currency transaction gains and losses were a loss of $0.3 million and a loss of $0.8 million in the nine months ended September 30, 2014 and 2013, respectively.

Translation Exposure

Foreign exchange rate fluctuations may adversely impact our consolidated financial position as the assets and liabilities of our foreign operations are translated into U.S. dollars in preparing our Consolidated Balance Sheets. These gains or losses are recognized as an adjustment to stockholders' equity which is reflected in our Consolidated Balance Sheets under “Accumulated other comprehensive income (loss)”.

Other Market Risks

Investments in Auction Rate Securities

Information regarding auction rate securities is included in Note 4 to the Consolidated Financial Statements in Part I, Item 1. We may incur temporary unrealized losses, or other-than-temporary realized losses, in the future if we are unable to recover the investment principal in our ARS.

Table of Contents

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We are committed to maintaining disclosure controls and procedures designed to ensure that information required to be disclosed in our periodic reports filed under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a – 15(e) and 15d-15(e) under the Exchange Act) as of September 30, 2014. The term "disclosure controls and procedures" means controls and other procedures that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that such information is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate, to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives, and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on their evaluation of our disclosure controls and procedures as of September 30, 2014, our Chief Executive Officer and our Chief Financial Officer concluded that as of that date, our disclosure controls were effective at the reasonable assurance level.

Changes in Internal Control over Financial Reporting

There were no changes in the Company's internal control over financial reporting (as defined in Rule 13a – 15(f) and 15d – 15(f) under the Exchange Act) during the quarter ended September 30, 2014, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Limitations on the Effectiveness of Controls

Our management, including the Chief Executive Officer and Chief Financial Officer, is responsible for establishing and maintaining an adequate system of internal control over financial reporting. This system of internal accounting controls is designed to provide reasonable assurance that assets are safeguarded, transactions are properly recorded and executed in accordance with management's authorization and financial statements are prepared in accordance with generally accepted accounting principles. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within our company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We have provided information about legal proceedings in which we are involved in Note 9 to the Consolidated Financial Statements in Part I, Item 1.

Item 1A. Risk Factors

The risks described below are not the only ones facing our company. Additional risks not presently known to us or that we currently deem immaterial also may impair our business operations. Our business, financial condition or results of operations could be materially adversely affected by any of these risks and the value of our common stock could decline due to any of these risks, and you could lose all or part of the money you paid to buy our common stock. The following discussion of our risk factors should be read in conjunction with the consolidated financial statements and related notes thereto, and management's discussion and analysis, contained in this report, and the risk factors contained in our Annual Report on Form 10-K for the year ended December 31, 2013. Our business is also subject to general risks and uncertainties that affect many other companies. In addition, the current global economic climate amplifies many of these risks.

This report also contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including the risks faced by us described below and elsewhere in this report and in our Annual Report on Form 10-K for the year ended December 31, 2013.

Risks Related to the Agreement and Plan of Merger

There are risks and uncertainties associated with our proposed merger with and acquisition by an affiliate of Siris Capital Group, LLC.

On October 23, 2014, we entered into an agreement and plan of merger (the "Merger Agreement") providing for the acquisition of the Company by a newly formed affiliate of Siris Capital Group, LLC ("Siris"). Pursuant to the terms of the Merger Agreement and subject to the conditions thereof, the Siris affiliate will merge with and into the Company, and the Company will become a private company, wholly owned by the Siris affiliate.

There are a number of risks and uncertainties relating to the merger. For example, the merger may not be consummated or may not be consummated as currently anticipated, as a result of several factors. There can be no assurance that approval of our shareholders and requisite regulatory approvals will be obtained, that the other conditions to the closing of the merger will be satisfied or waived or that other events will not intervene to delay, or result in the termination of, the merger.

Our business could be adversely impacted as a result of uncertainty related to the proposed merger.

The proposed merger with and acquisition by an affiliate of Siris could cause disruptions in our business relationships and business generally, which could have an adverse effect on our business, financial condition, results of operations and cash flows. For example:

- the attention of our management may be directed to transaction-related considerations and may be diverted from the day-to-day operations of our business and the pursuit of our strategic initiatives;

- our key managers and other employees may experience uncertainty about their future roles at the Company, which might adversely affect our ability to retain and hire key managers and other employees; and

- customers and suppliers may experience uncertainty about the Company's future and seek alternative business relationships with third parties or seek to alter their business relationships with the Company.

Under the Merger Agreement, we are subject to certain restrictions on the conduct of our business prior to completing the proposed merger, which restrictions could adversely affect our ability to realize certain of our business strategies or pursue opportunities that may arise prior to the closing of the merger.

In addition, we have incurred, and will continue to incur, significant costs, expenses and fees for professional services and other transaction costs in connection with the proposed merger, and we must pay many of these fees and costs regardless of whether or not we consummate the merger.

Failure to complete the proposed merger could negatively impact our business, financial condition, results of operations and stock price.

The completion of the proposed merger is subject to a number of conditions, and there can be no assurance that the conditions to the completion of the proposed merger will be satisfied or that the proposed merger will otherwise occur. If the proposed merger is not completed, we will be subject to several risks, including:

- the current price of our common stock may reflect a market assumption that the proposed merger will occur, meaning that a failure to complete the proposed merger could result in a decline in the price of our common stock;

- we may be required to pay a termination fee of at least $12.6 million and up to $27.3 million if the Merger Agreement is terminated under certain circumstances, and any such payment would negatively affect our liquidity;

- we expect to incur substantial transaction costs in connection with the proposed merger, whether or not it is completed; and

- we would not realize any of the anticipated benefits of having completed the proposed merger.

The Company will no longer exist as an independent public company following the merger and the Company’s stockholders will forego any increase in our value.

If the merger is completed, the Company will be a subsidiary of Siris and will no longer be a publicly held corporation, and our stockholders will forego any increase in our value that might have otherwise resulted from our possible growth.

The Merger Agreement contains provisions that could discourage or make it difficult for a third party to acquire us prior to the completion of the proposed merger.

The Merger Agreement contains provisions that restrict our ability to solicit third party proposals to acquire us. These provisions include the general prohibition after the 45-day Go-Shop Period on our soliciting or engaging in discussions or negotiations regarding any alternative acquisition proposal, subject to certain exceptions, and the requirement that we pay a significant termination fee if the Merger Agreement is terminated in specified circumstances. These provisions might discourage an otherwise-interested third party from considering or proposing to acquire us, even one that may be deemed of greater value than the proposed merger to our stockholders. Furthermore, even if a third party elects to propose an acquisition, the concept of a termination fee may result in that third party offering a lower value to our stockholders than such third party might otherwise have offered.

Risks Related to Our Business

We may experience significant fluctuations in our revenues, operating results, growth rate and stock price.

Our quarterly and annual revenues, operating results, and growth rate have fluctuated significantly in the past and are likely to do so in the future due to a variety of factors, some of which are outside our control. As a result, we believe that quarter-to-quarter and year-to-year comparisons of our revenue and operating results are not necessarily meaningful, and that these comparisons may not be accurate indicators of future performance. If our annual or quarterly operating results fail to meet the guidance we provide to securities analysts and investors or otherwise fail to meet their expectations, the trading price of our common stock may be impacted.

Factors that may affect our revenues, operating results, continued growth, and our stock price include the risks described elsewhere in this section, as well as the following:

§ Client Development and Retention. We generate revenue by providing services to a wide variety of companies, primarily in the software and high-tech products markets and in industries requiring payment processing services. Therefore, it is important to our ongoing success that we maintain our key client relationships and, at the same time, both develop new client relationships and increase the number and type of products offered through our services. If we cannot successfully market our products and services, develop and maintain satisfactory relationships with software and digital products publishers, manufacturers of consumer electronics and other goods, online retailers and online channel partners on acceptable commercial terms, or if clients elect to end their relationships with us and we are unable to generate sufficient additional revenue to compensate for the loss of those relationships, we will likely experience a decline in revenue and operating profit. New product verticals or market segments, and further penetration of existing product verticals and market segments, may require us to work with companies which have a limited operating history or greater risks than more established companies. This may result in the engagement with clients and offering of products which are subject to higher chargeback rates or legal exposure and may generally expose us to greater legal and/or business risk. We may not be able to fully anticipate, mitigate or control all such risks. In the event claims are brought against us in connection with products offered by clients, especially clients with a limited operating history, weak sales, or who are or may become insolvent or bankrupt, we may not be successful in seeking indemnification for such claims from such clients and may be ultimately responsible for such claims. In the event a client becomes insolvent or bankrupt, we may not be successful in obtaining and retaining all amounts owed to us by that client, and the client may cease offering products for sale through our commerce services resulting in a decline in revenue and operating profit.

§ We also depend on our clients to create and support products that consumers will purchase. We generally purchase products for resale from consignment or from distributors at the time of the resale to the consumer, and do not maintain an inventory of products available for sale. If we are unable to obtain sufficient quantities of products for any reason, or if the quality of service provided by these publishers and manufacturers falls below a satisfactory level, we could also experience a decline in revenue, operating profit and consumer satisfaction, and our reputation could be harmed.

§ Our contracts with our clients are generally one to two years in duration, with an automatic renewal provision for additional one-year periods, unless we are provided with a written notice before the end of the contract. Some of our contracts are for longer periods, but may provide for early termination upon certain notice. For example, we recently amended our contract with Microsoft to extend the term through March 1, 2015, but the amendment did not modify the previously negotiated termination provisions. We have no material long-term or exclusive contracts or arrangements with any clients that guarantee the availability of products. Clients that currently supply products to us may not continue to do so, and we may be unable to establish new relationships with clients to supplement or replace existing relationships. Clients may elect to cease offering certain products through online commerce, or cease allowing us to resell certain of their products. A client who believes we have failed to deliver the contractually-required services and benefits could terminate their agreements and bring claims against us for substantial damages, these claims could exceed the level of any insurance coverage that may be available to us, and if successful could adversely affect our operating results and financial condition. If an existing significant customer elects to end their relationship with us or if our sales of a significant customer's products materially decreases, our revenue would decline and it may have a material adverse effect on our business, financial condition, results of operations, growth rate and stock price.

§ In addition, a limited number of our other software and physical goods clients contribute a large portion of our annual revenue. If any one of these key contracts is not renewed or otherwise terminates, or if revenues from these clients decline for any other reason (such as competitive developments), our revenue would decline and our ability to sustain profitability would be impaired. For example, please see the risk factor

29

Table of Contents

below regarding the impact that may result from a termination of Microsoft's e-commerce agreement with us.

§ Dependence on Key Personnel and Employee Turnover. Our future success significantly depends on our ability to continue to identify, attract, hire, train, retain and motivate highly skilled personnel, including the continued services and performance of our senior management. Competition for these personnel is intense, particularly in the Internet industry. This also applies to additional technical resources required for our platform evolution. Our performance also depends on our ability to attract, retain and motivate our key technical and other employees who are skilled in maintaining our proprietary technology platforms and business offerings. The loss of the services of any of our executive officers or other key employees could harm our business if we are unable to effectively replace that officer or employee, or if that person should decide to join a competitor or otherwise directly or indirectly compete with us. Employee turnover may also increase in light of the risks, uncertainties, expenses, delays and difficulties associated with operating a business in a relatively rapidly changing industry and environment.

§ Organizational Changes. In order to remain competitive and to control our costs, we have implemented in the past, and may be required to implement in the future, organizational changes within our company, such as the consolidation of e-commerce platforms or offices, utilization of subcontractors or outsourcing relationships, reorganization of our business, and reductions in force. We may incur significant costs in order to implement organizational changes to achieve efficiencies in our cost structure in the long term. Failure to effectively manage our subcontractors and outsourcing relationships may harm our business. These organizational changes may impact our ability to execute our business plans and could affect our operating results.

§ Operating Expenses. Our operating expenses are based on our expectations of future revenue. These expenses are relatively fixed in the short-term. If our revenue for a quarter falls below our expectations and we are unable to quickly reduce spending in response, our operating results for that quarter would be harmed.

§ Infrastructure. The introduction by us of new websites, web stores or services, new features and functionality, our utilization of new third-party Infrastructure-as-a-Service (IaaS), Platform-as-a-Service (PaaS), and Software-as-a-Service (SaaS) "cloud" computing services, and the continued upgrading, development and maintenance of our systems and infrastructure to meet emerging market needs, support 24x7 online commerce, leverage technical innovations, and remain competitive in our service and product offerings, may require a substantial investment of our resources and result in significant capital expenditures and operating costs and expose us to additional risk and legal liability despite efforts to control such risks and liabilities.

§ Fluctuations in Demand. Our quarterly and annual operating results are subject to fluctuations in demand for the products or services offered by us or our clients, such as personal computer software and consumer electronics. In particular, sales of personal computer software represented a significant portion of our revenues in recent years, and continue to be very important to our business. The introduction of products and services competitive to those offered by our current clients may materially adversely affect our revenues. In addition, revenue generated by our software and digital commerce services is likely to fluctuate on a seasonal basis that is typical for the markets for our clients' products, including the software publishing, consumer electronics, and computer and video games markets. Softening or weakening of traditionally high-volume periods, such as the holiday season, can materially adversely affect our revenues and operating results.

§ Changes in the E-commerce and Payments Industries. The nature of our business and the e-commerce and payments industries in which we operate has undergone, and continues to undergo, rapid development and change. For example, new protocols or technologies and new rules and regulations applicable to our business and the e-commerce and payments industries can be introduced which could affect the ways in which e-commerce operates and products are sold online; online commerce and payments continues to experience a rapid shift towards mobile and multi-channel commerce and payments; the payments industry continues to experience growth in new technologies such as the introduction of mobile-based payment systems; and consumers may continue to shift from traditional computing platforms to mobile and tablet-based computing platforms. It may be difficult for us to predict or adjust our business in light of such developments. Thus, our chances of financial and operational success should be evaluated in light of the risks, uncertainties, expenses,

Table of Contents

delays and difficulties associated with operating a business in a relatively rapidly changing industry and environment. If we are unable to address these issues, we may not be financially or operationally successful.

§ Other Factors. Additional industry risks that may affect our revenues, operating results, continued growth and our stock price include:

o Competitive developments, including the introduction of new products and services and the announcement of new client and strategic relationships by our competitors;

o Changes that affect our clients or the viability of their product lines, and client decisions to delay new product launches, invest in e-commerce initiatives, utilize the services of a competitor, or internalize their currently outsourced e-commerce operations;

o The cost of compliance with U.S. and foreign laws, rules and regulations relating to our business, including the potential effect of new laws, rules and regulations, or interpretations of existing laws, rules and regulations, that affect our business operations or otherwise restrict or affect online commerce and/or the Internet as a whole, as well as our compliance with the rules and policies of entities whose services are critical for our continued operations, such as banks and credit card associations;

o Our announcement of significant acquisitions, strategic partnerships, joint ventures, divestitures or capital commitments or results of operations or other developments related to those transactions, and our ability to successfully integrate and manage acquired businesses;

o Required changes in generally accepted accounting principles and disclosures;

o Sales or other transactions involving our common stock or our convertible notes;

o General macroeconomic conditions, including severe downturns or recessions in the United States and elsewhere, global unrest, terrorist activities, adverse effects of the ongoing sovereign debt crisis in Europe, potential impact of automatic sequesters, spending reductions, tax increases, and other austerity measures in the United States, and particularly those economic conditions affecting the e-commerce and retailer industries and affecting demand for products and services; and

o Conditions or trends in the Internet and online commerce industries in the United States and around the world, including slower-than-anticipated growth of the online market as a vehicle for the purchase of software products, changes in consumer confidence in the safety and security of online commerce, and changes in the usage of the Internet and e-commerce.

The following risks may also have a material adverse impact on our business, financial condition, results of operations and stock price:

Our stock price is volatile.

The stock market as a whole and the trading prices of companies in the electronic commerce industry in particular, has been notably volatile. The operating results of companies in the electronic commerce industry have experienced significant quarter-to-quarter fluctuations. This broad market and industry volatility could significantly reduce the price of our common stock at any time, without regard to our own operating performance.

The market price for our common stock has varied between a high of $16.04 and a low of $13.61 in the three months ended September 30, 2014. This volatility may affect the price at which you could sell your common stock. Our stock price is likely to continue to be volatile and subject to significant price and volume fluctuations in response to market and other factors; variations in our quarterly operating results from our expectations or those of securities analysts or investors; downward revisions in estimates by us or security analysts; and announcement by us or our competitors of significant acquisitions, strategic partnerships, joint ventures or capital commitments.

Table of Contents

In addition, the price of our common stock may be impacted by the short sales and actions of other parties who may disseminate misleading information about us in an effort to profit from fluctuations in the price of our common stock. Further, the price of our common stock may be impacted by the announcement of the financial results or other decisions by our larger clients whose products represent a significant portion of our sales.

A material decline in the price of our common stock may result in the assertion of certain claims against us, and/or the commencement of inquiries and/or investigations against us. A prolonged decline in the price of our common stock could result in:

- A reduction in the liquidity of our common stock and a reduction in our ability to raise capital and the inability for you to obtain a favorable selling price for your shares;
- An event or circumstance that drives us to determine that it is more likely than not that the fair value of our one reporting unit is less than its carrying amount and record an impairment to our goodwill.

Any reduction in our ability to raise equity capital in the future may force us to reallocate funds from other planned uses and could have a significant negative effect on our business plans and operations.

The termination of our e-commerce agreement with Microsoft may materially adversely affect our business, financial condition or results of operations and stock price.

Sales of products for one client, Microsoft, accounted for a significant portion of our revenue in the quarter ended September 30, 2014. In addition, a limited number of other software and physical goods clients contribute a large portion of our annual revenue. If any one of these key contracts is not renewed or otherwise terminates, or if revenues from these clients decline for any other reason (such as competitive developments), our revenue would decline and our ability to sustain profitability would be impaired. If our contract with Microsoft is renegotiated, not renewed, or is otherwise terminated, or if revenues from Microsoft decline for any other reason, our revenue and our ability to sustain profitability could be materially adversely impaired.

Loss of our credit card acceptance privileges, or changes to the fees, rules or practices of payment and card associations, networks and banks, would seriously hamper our ability to process the sale of merchandise and materially adversely affect our business.

The payment by consumers for the purchase of goods and services through our e-commerce systems is typically made by credit or debit card or similar payment method across many countries. As a result, we must rely on domestic and international banks and payment processors to process transactions, and must pay a fee for this service. From time to time, banks and credit card associations may increase the per-transaction fees that they charge or change surcharge or comparable rules. In addition, reductions in the volume of transactions processed by us may result in increased per-transaction processing fees. Any such increased fees will increase our operating costs and reduce our profit margins. We also are required by our processors to comply with credit card association operating rules, and we have agreed to reimburse our processors for any fines they are assessed by credit card associations as a result of processing payments for us. The credit card associations and their member banks set and interpret the credit card rules. Visa, MasterCard, American Express, Discover and other card associations whose cards we accept could adopt new operating rules or re-interpret existing rules that we, or our processors, might find difficult to follow.

Although we have been able to successfully switch to new payment processors in the past, such migrations require significant attention from our personnel, and may not achieve the anticipated cost savings or other desired results. Any disputes or problems associated with our payment processors could impair our ability to give customers the option of using credit or debit cards to fund their payments. If we were unable to accept credit or debit cards or other widely accepted forms of payment, our business would be seriously damaged. Any change to our business practices due to the adoption of card association operating rules or the re-interpretation of existing rules that reduces the attractiveness of our services to our clients or restricts our ability to offer our services may materially adversely affect our revenues and operating results. While we do screen new merchants and monitor their site activities for export and sanctions compliance, we also could be subject to fines or increased fees from Visa and MasterCard if we fail to detect that our clients are engaging in activities that are illegal or activities that are considered “high risk,” primarily the sale of certain types of digital content, or if the percentage of our sales transactions subject to chargeback increases as an absolute percentage of our overall transaction volume. We may be required to expend significant capital and other resources to monitor these activities.

Table of Contents

Excessive chargeback losses could significantly affect our results of operations and liquidity.

Our agreements with our sponsoring financial institutions and certain payment processors require us to assume and bear the risk of "chargeback" losses. Under the rules of card network associations (including without limitation Visa and MasterCard), when a merchant processor acquires card transactions, it has certain contingent liabilities for the transactions processed. This contingent liability arises in the event of a billing dispute between the merchant and a cardholder that is ultimately resolved in the cardholder's favor. In such a case, the disputed transaction is charged back to the merchant and the disputed amount is credited or otherwise refunded to the cardholder. If we are unable to collect this amount from the merchant's account, or if the merchant refuses or is unable to reimburse us for the chargeback due to merchant fraud, breach of contract, bankruptcy, insolvency or other reasons, we will bear the loss for the amount of the refund paid to the cardholders. In addition, if we are unable to recover these chargeback amounts from merchants, the obligation to pay the aggregate of any such amounts could have a material adverse effect on our results of operations and liquidity.

If our payments-related services are found to be in violation of, or subject to, applicable laws, rules or regulations or bank or card network rules or operating procedures, we may become subject to liability, licensing requirements, and regulatory approval, and may be required to change our business practices.

Our business is subject to various laws, rules and regulations in the U.S. and other countries where we provide payments-related services, including those laws, rules and regulations governing money transmission, export and sanctions compliance, electronic funds transfers, terrorist financing, money laundering, and consumer protection. The legal and regulatory requirements that apply to our business vary in the markets in which we operate. For our payment service provider business, we may be required to perform "know-your-customer" and other underwriting responsibilities, and may be subject to fines, penalties, financial reserves, or other enforcement actions from banks and payment card networks if we fail to detect improper use of our payment systems by our clients. While we have a compliance program focused on compliance with applicable laws, rules and regulations, we cannot ensure that we will not become subject to fines, penalties or other enforcement actions in one or more jurisdictions, or be required to make changes to our business practices or compliance programs to comply in the future. If we were found to be in violation of laws, rules or regulations, or bank or card network rules or operating procedures, we could become subject to liability and/or additional restrictions, forced to cease doing business or restrict the payment types we can offer in certain states or jurisdictions, forced to change business practices, or required to obtain additional licenses or regulatory approvals that could impose a substantial cost on us. We may not be able to pass such liabilities, fines and penalties to our clients or bank partners. Any change to our business practices that reduces the attractiveness of our services to our clients or restricts our ability to offer our services may materially adversely affect the revenues and operating results for our business.

Merchant fraud with respect to Internet-based bankcard and EFT transactions could cause us to incur significant losses.

We believe that we have significant experience in assessing the risks associated with providing payment processing services to small and medium-sized merchants through our Digital River World Payments and LML subsidiaries. These risks include the limited operating history of many of the small and medium-sized merchants we serve and the risk that these merchants could be subject to a higher rate of insolvency, which could adversely affect us financially. We apply varying levels of scrutiny in our application evaluation and underwriting of prospective merchant accounts, ranging from basic due diligence for merchants with a low risk profile to a more thorough and detailed review for higher risk merchants.

As a result of our exposure to potential liability for merchant fraud, chargebacks, reject and other losses created by our merchant services business, we view our risk management and fraud avoidance practices as integral to our operations and overall success.

For our merchant clients conducting card-not-present transactions, which we view as having a higher risk profile, we employ an extended underwriting and due diligence period and special account monitoring procedures. Through the underwriting process, we evaluate the applicants' financials, previous processing history and credit reports.

Table of Contents

Effective risk management helps us minimize merchant losses for the mutual benefit of our merchants and ourselves. Our risk management procedures also help protect us from fraud perpetrated by our merchants. We believe our knowledge and experience in dealing with attempted fraud has resulted in our development and implementation of effective risk management and fraud prevention systems and procedures for the types of fraud discussed in this section.

We have potential liability for fraudulent bankcard transactions initiated by merchants. Merchant fraud occurs when a merchant knowingly uses a stolen or counterfeit bankcard or card number to record a false sales transaction, processes an invalid bankcard or intentionally fails to deliver the merchandise or services sold in an otherwise valid transaction. We rely significantly on the processing revenue derived from bankcard and EFT transactions and, as a result, if any merchant or customer were to submit or process unauthorized or fraudulent bankcard or EFT transactions, depending on the dollar amount, we could incur significant losses which could have a material adverse effect on our business and results of operations and liquidity.

In addition, criminals are using increasingly sophisticated methods to engage in illegal activities such as counterfeit and fraud and, while we have systems and procedures designed to manage such risk and detect and reduce the impact of fraud, we cannot guarantee that our systems will prevent fraudulent transactions from being submitted and processed or that the funds set aside to address such activity will be adequate to cover all potential situations that might occur. We do not have insurance to protect us from these losses. There is no assurance that any chargeback or processing reserve will be adequate to offset against any unauthorized or fraudulent processing losses that we may incur. Accordingly, should we experience such fraudulent activity and such losses, our results of operations could be immediately and materially adversely affected.

Our business is subject to online and physical security risks, including security breaches.

Our business depends in large part on the secure transmission of confidential information over public networks, including customers' credit card and other payment account information, and the secure storage of confidential information. We rely on encryption and authentication technology licensed from third parties to provide the security and authentication necessary for secure transmission of confidential information, such as customer credit and debit card numbers. While we take significant steps to protect the security of confidential information in our possession, we cannot guarantee our security measures will prevent security breaches, or that future advances in computer and software capabilities and encryption technology, new cryptography tools and discoveries, and other events will enable us to prevent the breach or compromise of our security even if implemented by us. Further, the technology utilized in credit and debit cards, and the systems used for the transmission of payment card transactions, are controlled by the payment card industry, and vulnerabilities in these systems and technology can place payment card data at risk. Our servers are vulnerable to computer viruses, physical or electronic break-ins, "denial of service" attacks, and similar disruptions. Because techniques used to disable or impair systems, obtain unauthorized access to systems, or engage in other breaches of security change rapidly and are often not recognized until utilized against a target, we may be unable to anticipate these techniques or prevent them.

Any actual or perceived breach or compromise of our security or one of our clients, vendors or service providers could have a material adverse effect on consumer confidence in the safety and security of transactions processed through our systems, our reputation, business operations, operating results and financial condition, dissuade existing and new clients from using our services, dissuade customers from transacting business through our systems, and expose us to significant costs, fines, losses, litigation, governmental investigations and liabilities. A party who circumvents our security measures or the security measures of our clients, vendors or service providers could misappropriate proprietary information or interrupt our operations. We may be required to expend significant capital and other resources to protect against security breaches or address problems caused by such breaches. Security breaches could expose us to lawsuits from affected persons and companies, and to governmental inquiries. Concerns over the security of the Internet and other online transactions and the privacy of users could deter people from using the Internet to conduct transactions that involve transmitting personally identifiable and other confidential information, inhibiting the growth of our business.

We are exposed to foreign currency exchange risk.

As we generate a significant portion of our revenues outside the U.S. but report our financial results in U.S. dollars, we are exposed to adverse movements in currency exchange rates. Sales outside the United States accounted for approximately 46.4% of our total sales for the three months ended September 30, 2014. A significant portion of our

Table of Contents

cash and marketable securities are held in non-U.S domiciled countries, primarily Ireland and Germany. The results of operations of, and certain of our intercompany balances associated with, our internationally focused websites are exposed to foreign exchange rate fluctuations. Upon translation, net sales and other operating results from our international operations may differ materially from expectations, and we may record significant gains or losses on the re-measurement of intercompany balances. If the U.S. dollar weakens against foreign currencies, the translation of these foreign-currency-denominated transactions will result in increased net revenues and operating expenses. Similarly, our net revenues and operating expenses will decrease if the U.S. dollar strengthens against foreign currencies, for example, as a result of the ongoing sovereign debt crisis in Europe. As we have expanded our international operations, our exposure to exchange rate fluctuations has become more pronounced. We may enter into short-term currency forward contracts to offset the foreign exchange gains and losses generated by the re-measurement of certain assets and liabilities recorded in non-functional currencies. The use of such hedging activities may not offset more than a portion of the adverse financial impact resulting from unfavorable movements in foreign exchange rates.

Failure to enhance and expand our technology, systems and business offerings to accommodate increased traffic and to remain competitive could reduce demand for our services and impair the growth of our business.

We periodically enhance and expand our technology and transaction-processing systems, network infrastructure and other technologies to accommodate increases and spikes in the volume of traffic on our technology platforms due to factors including launches of new products and new commerce websites on our technology platforms, and seasonal fluctuations in consumer demand. To remain competitive, we must continue to enhance and improve the responsiveness, functionality and features of our e-commerce platforms and the underlying network infrastructure, and develop and introduce new business offerings and programs. Any inability to enhance and expand our existing technology, transaction-processing systems or network infrastructure to manage such increased traffic and traffic spikes may cause unanticipated system disruptions, slower response times and degradation in client services, including impaired quality and speed of order fulfillment. Failure to manage increased traffic and traffic spikes or an inability to maintain our competitiveness could harm our reputation and significantly reduce demand for our services, which would impair the growth of our business. If we incur significant costs without adequate results, or are unable to adapt rapidly to technological changes, we may fail to achieve our business plan. We may be unable to improve and increase the capacity of our network infrastructure sufficiently or to anticipate and react to expected or unexpected increases in the use of the platform to handle increased volume, or to obtain needed related services from third party suppliers. Our network and our suppliers' networks may be unable to maintain an acceptable data transmission capability, especially if demands on our platform increase. We may fail to use new technologies effectively or fail to adapt our proprietary technology and systems to client requirements or emerging industry standards.

We rely upon cloud-based service providers and other third party subcontractors in connection with our business operations, and any disruption of or interference with our use of the services provided by these providers would impact our operations and materially adversely affect our business.

We utilize, and may increase our utilization of, third-party Infrastructure-as-a-Service (IaaS), Platform-as-a-Service (PaaS), and Software-as-a-Service (SaaS) offerings, commonly referred to as "cloud" computing services. We also utilize third parties to support other aspects of our business operations, such as bandwidth providers, data center services, and fulfillment providers. While we seek to implement contractual obligations and indemnities in our agreements with our global cloud providers and other third party providers, we may not be successful in obtaining contractual terms sufficient to mitigate all risks. Problems faced by our third-party cloud computing and service providers, or our other third party providers, including technological or business-related disruptions and security breaches within a provider's service layer, could result in the loss or unauthorized disclosure of confidential information or otherwise adversely impact our business. In addition, fires, floods, earthquakes, power losses, telecommunications failures, break-ins and similar events could damage these third party systems, facilities and hardware or cause them to fail completely. A disrupting event could result in prolonged downtime of our operations and could adversely affect our business.

Table of Contents

If we are unable to enter into, achieve desired results from, or maintain our marketing and promotional agreements with third party marketing or technology providers to generate sales traffic and sales for our clients, our ability to generate revenue and our business could be adversely affected.

We have entered into multiple marketing and promotional agreements and operate certain affiliate networks and programs which are designed to increase both traffic to the e-commerce stores we operate and the number of customers purchasing products through such stores, including agreements with search engine providers, display advertising networks, comparison shopping engines, affiliate networks, operators of websites and marketing technology providers. Our ability to attract new clients and retain existing clients is based in part on our ability to generate increased traffic or better conversion rates resulting in increased online sales of their products through these agreements and programs. If we are unable to enter into such agreements on favorable terms, are unable to achieve the desired results under these agreements and programs, are unable to maintain these relationships, or fail to generate sufficient traffic or generate sufficient revenue from purchases pursuant to these agreements and programs, our ability to generate sales and our ability to attract and retain our clients may be impacted, negatively affecting our business and operating results.

New obligations to collect or pay transaction taxes could substantially increase the cost to us of doing business.

Many of the laws and regulations regarding the application of sales tax, use tax, value added tax (VAT) or other similar transaction taxes predate the growth of the Internet and online commerce. The application of transaction taxes to interstate and international sales over the Internet is complex and evolving. We currently collect taxes on certain product and service offerings in tax jurisdictions where we have taxable presence. A successful assertion by one or more tax jurisdictions that we should collect or were obligated to collect transaction taxes on the products we sell could harm our results of operations. The imposition by state and local governments of various taxes upon Internet commerce and related e-commerce activities could create administrative burdens for us, put us at a competitive disadvantage if they do not impose similar obligations on all of our online competitors, and decrease our future sales.

Changes in our tax rates could affect our future results.

Our future effective tax rates could be favorably or unfavorably affected by changes in the mix of earnings in countries with differing statutory tax rates, changes in the valuation of our deferred tax assets and liabilities, or by changes in tax laws or their interpretation. In addition, we are subject to the continuous examination of our income tax returns by the Internal Revenue Service and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. There can be no assurance that the outcomes from these continuous examinations will not have an adverse effect on our results of operations and financial condition.

Additional valuation allowances may be needed as we may not generate sufficient taxable income to utilize our deferred income tax assets.

We periodically assess whether we will generate sufficient taxable income to realize our deferred income tax assets. Valuation allowances are established if it is not likely that we will realize our deferred income tax assets. In making this determination, we consider all available positive and negative evidence and make certain assumptions. We consider, among other things, our deferred tax liabilities, the overall business environment, our historical financial results, and potential current and future tax planning strategies. We concluded during the third quarter of 2014 evaluation that we are required to maintain a valuation allowance against our net U.S. tax assets and certain foreign tax assets. Our assessment is ongoing and may conclude that we require additional valuation allowances in the future. Any release of the valuation allowance would reduce income tax expense.

Failure to properly manage and sustain our expansion efforts could strain our management and other resources.

Through acquisitions and organic growth, we are rapidly and significantly expanding our operations, both domestically and internationally. We will continue to expand further to pursue growth of our service offerings and customer base. This expansion increases the complexity of our business and places a significant strain on our management, operations, technical performance, financial resources, and internal financial control and reporting functions, and there can be no assurance that we will be able to manage it effectively. Our personnel, systems,

Table of Contents

procedures and controls may not be adequate to effectively manage our future operations, especially as we employ personnel in multiple domestic and international locations. We may not be able to hire, train, retain and manage the personnel required to address our growth. Failure to effectively manage our growth opportunities could damage our reputation, limit our future growth, negatively affect our operating results and harm our business.

Failure to properly manage and execute our plans to offer certain of our products and services on a modular basis could strain our resources and may not be successful in generating additional revenue.

We plan to offer certain of our product and service offerings on a modular basis. Offering product and services on a modular basis may require increases in costs of technology, marketing and business operations, and in the complexity of our business. This may place additional strain on our technical, operational and financial resources, and there can be no assurance that we will be able to manage or execute these plans effectively. Our personnel, systems, procedures and controls may not be adequate to effectively manage our future operations, especially as we seek to offer certain aspects of our products and services as standalone product and service offerings to clients and to implement a "go-to-market" strategy for our modular offerings. We have not fully evaluated the market opportunity and demand for the use of our products and services on a modular basis. As we implement our plan, we may incur additional expenses without a corresponding increase in revenue. If we fail to effectively manage and execute our plans to modularize our product and service offerings, or fail to adequately market and generate demand for our modular offerings, we may not be able to successfully compete with other providers and may not be successful in generating additional revenue, which could harm our operating results and financial condition.

Our international expansion efforts may not be successful in generating additional revenue.

We sell products and services to consumers outside the United States and we intend to continue expanding our international presence. For the three months ended September 30, 2014, our sales to international consumers represented approximately 46.4% of our total sales. Continued expansion into international markets, particularly the European and Asia-Pacific regions, requires significant resources that we may fail to recover through generating additional revenue. Conducting business internationally is subject to risks that may have a material adverse effect on our ability to increase or maintain foreign sales, including:

§ Changes in regulatory requirements and tariffs;
§ Difficulties in staffing and managing foreign subsidiary operations, and the increased costs of international operations;
§ Uncertainty of application of, and the burden and cost of complying with, local, commercial, tax, privacy and other laws and regulations;
§ Reduced protection of intellectual property rights;
§ Difficulties in physical distribution and logistics for international sales;
§ Higher incidences of credit card fraud and difficulties in accounts receivable collection;
§ Difficulties in transferring funds from certain countries;
§ Difficulties in enforcing contracts against international clients, especially in emerging markets;
§ Lower rates of Internet usage in certain countries, especially in emerging markets;
§ Different employer/employee relationships, the existence of workers' councils, and the possibility of unionization of our workforce outside the United States, particularly in Europe;
§ Political, social and economic instability and constraints on international trade; and
§

Import and export license requirements and restrictions of the United States and every other country in which we operate.

We may be unable to successfully and cost-effectively market, sell and distribute our services in foreign markets due to challenges, such as language barriers, currency exchange issues and the fact that the Internet infrastructure in some foreign countries may be less advanced than the U.S. Internet infrastructure. As international e-commerce grows, our competition will continue to intensify. If we are unable to successfully expand our international operations, or manage this expansion, our operating results and financial condition could be harmed.

Implementing our acquisition and strategic partnership strategy could result in dilution and operating difficulties leading to a decline in revenue and operating profit.

An element of our business strategy involves expansion through the acquisition of businesses, assets, products or technologies that allow us to complement our existing product offerings, expand our market coverage, increase our engineering workforce or enhance our technological capabilities. We evaluate and explore other strategic opportunities as they arise, including business combination transactions, strategic partnerships, and the purchase or sale of assets, including tangible and intangible assets such as intellectual property.

Acquisitions, strategic investments and strategic partnership agreements may require significant capital infusions, typically entail many risks, and could result in unforeseen difficulties, disruptions, distractions, and expenditures in assimilating and integrating with the operations, personnel, technologies, products and information systems of acquired companies or businesses. We have in the past and may in the future experience delays in the timing and successful completion of such activities. These challenges are magnified as the size of the acquisition increases. Furthermore, these challenges would be even greater if we acquired a business or entered into a business combination transaction with a company that was larger and more difficult to integrate than the companies we have historically acquired. Moreover, the anticipated benefits of any acquisition or strategic investment may not be realized. If a significant number of clients of the acquired businesses cease doing business with us, we would experience lost revenue and operating profit, and any synergies from the acquisition may be lost. In addition, key personnel of an acquired company may decide not to work for us. The acquisition of another company or its products and technologies may also require us to enter into a geographic or business market in which we have little or no prior experience. Future acquisitions could result in potentially dilutive issuances of equity securities, the incurrence of debt, contingent liabilities, and amortization of intangible assets or impairment of goodwill. Acquisitions could also result in a dilutive impact to our earnings.

Our clients' sales cycles and the implementation process for our commerce solution are time-consuming, which may cause us to incur substantial expenses and expend management time without generating corresponding consumer revenue, which would impair our cash flow.

We market our services directly to software publishers, online retailers, consumer electronics companies and other prospective customers. These relationships are typically complex and take time to finalize. Due to operating procedures in many organizations, a significant amount of time may pass between selection of our products and services by key decision-makers, the signing of a contract, and the launch of a revenue-generating commerce store. The period between the initial client sales call and the signing of a contract with significant sales potential is difficult to predict and typically ranges from six to twelve months, and completion of the implementation process typically ranges from one to four months. If at the end of a sales effort a prospective client does not purchase our products or services, we may have incurred substantial expenses and expended management time that cannot be recovered and that will not generate corresponding revenue. As a result, our cash flow and our ability to fund expenditures incurred during the sales cycle and implementation process may be impaired. We can incur substantial front-end costs to launch client sites and it may require a substantial time before those costs are recouped by us, if at all.

We may become liable for fraudulent, improper or illegal uses of our platforms and services.

Our "self-service" platforms typically have an automated structure that allows customers to sign up for and use our e-commerce services without significant participation from Digital River personnel. Despite our efforts to contractually prohibit the sale of inappropriate and illegal goods and services and our efforts to detect the same, the remote control nature of these platforms increases the risk that transactions involving the sale of unlawful goods or services or the violation of the proprietary rights of others may occur before we become aware of them. Furthermore, unscrupulous individuals may offer for sale, or attempt to purchase, illegal products via such platforms under innocuous names, further frustrating our attempts to prevent inappropriate use of our services. Failure to detect inappropriate or illegal uses of our platforms by third parties could expose us to a number of risks, including fines, increased fees or termination of services by payment processors or credit card associations, risks of lawsuits and governmental investigations, and civil and criminal penalties.

Compliance with and changes to applicable laws, rules, regulations, and certification requirements, may substantially increase our costs of doing business, limit our activities, or otherwise adversely affect our ability to offer our services.

We are subject to the same international, federal, state and local laws as other companies conducting business over the Internet. Because our services are accessible worldwide, and we facilitate sales of products to customers worldwide, international jurisdictions may claim that we are required to comply with their laws, rules and regulations. Laws regulating Internet companies outside of the United States may be less favorable than those in the United States, giving greater rights to consumers, content owners and users. Compliance with international, federal, state and local laws may be costly or may require us to change our business practices or restrict our service offerings relative to those provided in the United States. As our services are available over the Internet in multiple states and foreign countries, these jurisdictions may claim that we are required to qualify to do business as a foreign corporation in each state or foreign country. Failure to qualify as a foreign corporation in a required jurisdiction could subject us to taxes and penalties and could result in our inability to enforce contracts in these jurisdictions. Laws, rules and regulations applicable to our business include areas such as:

§ User privacy with respect to adults and minors;
§ Our ability to collect and/or share necessary information that allows us to conduct business on the Internet;
§ Export compliance;
§ Pricing, taxation, and regulatory fees;
§ Fraud;
§ Advertising;
§ Intellectual property rights;
§ Information security;
§ Quality of products and services;
§ Recycling of consumer products; and
§ Our investments in other companies.

Our acceptance of credit cards and similar payment methods requires us to maintain certain certifications, most notably Payment Card Industry (PCI) Level 1 compliance. Maintaining this certification requires an annual audit by a qualified third party auditor and a review and assessment of our security controls and a significant commitment of internal resources. Our loss of such certification may result in our inability to process credit card transactions and other payments, and would have a material adverse effect on our ability to do business.

Violation of any laws, rules or regulations applicable to our business could result in fines or other actions by regulatory agencies, increased costs of doing business, reduced profits, or restrictions on our ability to conduct business such as our ability to export products or bans on our ability to offer certain services. In addition, any significant changes, developments, or new interpretations of laws, rules, and regulations applicable to our business will increase our costs of compliance and may further restrict our overseas client base, may require significant management and other resources to respond appropriately, and may harm our operating results.

Failure to protect our intellectual property may jeopardize our competitive position and require us to incur significant expenses to enforce our rights.

We rely on a combination of patent, copyright, trademark, service mark and trade secret laws, and contractual restrictions with our employees and other parties with which we do business, to protect our proprietary rights and to limit access to and disclosure of our proprietary information. We also seek to protect our proprietary position by filing U.S. patent applications related to our proprietary technology, inventions and improvements that are important to the development of our business, and the registration of our trademarks and service marks in the U.S. and internationally.

The steps we have taken to protect our proprietary rights may be inadequate and third parties may infringe or misappropriate our trade secrets, trademarks and similar proprietary rights. Our contractual arrangements and the other steps taken by us to protect our intellectual property may not prevent misappropriation of our technology or deter independent third-party development of similar technologies. We may not be able to successfully obtain patents or trademarks for our technologies or brands. Effective protection of our intellectual property rights may not be available in every country in which our services are made available online, or cost-effective for us to obtain on a worldwide basis. Any significant failure on our part to protect our intellectual property could make it easier for our competitors to offer similar services and thereby adversely affect our market opportunities. In addition, litigation may be necessary in the future to enforce our intellectual property rights, to protect our trade secrets or to determine the validity and scope of the proprietary rights of others. Litigation could result in substantial costs and diversion of management and technical resources.

Claims against us related to infringement of other parties' intellectual property rights, by our products and services or the products we resell or deliver, could require us to expend significant resources, enter into unfavorable licenses, pay damages, prevent us from using certain technology, or require us to change our business plans.

Table of Contents

From time to time we are notified of potential patent disputes, and expect that we will increasingly be subject to the assertion of patent infringement claims against us and/or our customers as our services expand in scope and complexity. We have been, and from time-to-time may be, named as a defendant in lawsuits claiming that we have, in some way, violated the intellectual property rights of others. For example, we were named as a defendant in a patent litigation in the United States District Court for the Eastern District of Texas brought against us and various other defendants by DDR Holdings, LLC, seeking injunctive and monetary relief. In April 2014, we reached a final settlement with DDR Holdings, LLC.

Litigation over patents and other intellectual property rights is not uncommon with respect to e-commerce technologies, and often involves patent holding companies or other adverse patent owners who have no relevant product revenues and against whom our own patents may therefore provide little or no deterrence.

Claims may be made against us for negligence, copyright or trademark infringement, products liability or other theories based on the nature and content of software products or tangible goods that we deliver electronically and physically. Because we did not create these products, we are generally not in a position to know the quality or nature of the content of these products.

Any assertions or prosecutions of intellectual property claims could require us to expend significant financial, managerial and personnel resources. Although we carry general liability insurance and typically require that our customers indemnify us against consumer claims, our insurance and indemnification measures may not cover potential claims of this type, may not adequately cover all costs incurred in defense of potential claims, or may not reimburse us for all liability that may be imposed. We may elect to self-insure against certain claims. The defense of any claims, with or without merit, could be time-consuming, result in costly litigation and diversion of technical and management personnel, cause product enhancement delays or require that we develop non-infringing technology or enter into royalty or licensing agreements. Royalty or licensing agreements, if required, may be unavailable on terms acceptable to us or at all. In the event of a successful claim of infringement against us and our failure or inability to develop non-infringing technology or license the infringed or similar technology on a timely basis, we may be unable to continue to pursue our current business plan. We expect that we will increasingly be subject to patent infringement claims as our services expand in scope and complexity, and our results of operations and financial condition could be materially adversely affected.

We are subject to regulations relating to consumer privacy and the protection of personal information.

We collect and maintain customer data from our customers, which subjects us to increasing international, federal and state regulations related to online privacy and the use of personal user information. Congress has enacted anti-spam legislation with which we must comply when providing email campaigns for our clients. Legislation and regulations are pending in various domestic and international governmental bodies that address online privacy protections. Several governments have proposed, and some have enacted, legislation that would limit the use and transfer of personal user information or require online service providers to establish privacy policies. In addition, the U.S. Federal Trade Commission (FTC) has urged Congress to adopt legislation regarding the collection and use of personal identifying information obtained from individuals when accessing websites, including both adults and minors. The FTC and certain states, such as California, have released guidance for privacy practices associated with applications used on mobile devices such as smartphones and tablets.

Even in the absence of laws requiring companies to establish these procedures, the FTC has settled several proceedings resulting in consent decrees in which Internet companies have been required to establish programs regarding the manner in which personal information is collected from users and provided to third parties. We could become a party to a similar enforcement proceeding. These regulatory and enforcement efforts could limit our collection of and/or ability to share with our clients demographic and personal information from customers, which could adversely affect our ability to comprehensively serve our clients.

The European Union has adopted a privacy directive that regulates the collection and use of information that identifies an individual person (Directive 95/46/EC). In general, according to the Directive, personal data should not be processed at all, except when certain conditions are met. These conditions fall into three categories: transparency, legitimate purpose, and proportionality. This being said, the Directive and its regulations inhibit or prohibit the collection and sharing of personal information to a certain extent and in ways that could harm our clients or us.

Table of Contents

Failure to comply with member state implementations of the Directive may result in fines, private lawsuits and enforcement actions. These enforcement actions can include interruption or shutdown of operations relating to the collection and sharing of information pertaining to citizens of the European Union.

We have and post on our websites our own privacy statements, policies and practices concerning our collection, use and disclosure of user information. The FTC, state and international regulatory agencies continue to be aggressive in enforcing privacy and data protection laws and regulations. Any actual or perceived failure by us to comply with our posted privacy statements, policies and practices or with federal, state or international data privacy laws, rules and regulations could reduce consumer confidence in conducting transactions processed through our systems, and could result in actions or proceedings against us by governmental entities, individual or class action litigation, subject us to significant penalties and negative publicity, require us to change our business practices, increase our costs and adversely affect our business.

Our business is highly dependent on the efficient and uninterrupted operation of our computer network systems and data centers, and system failures, outages or errors could reduce the attractiveness of our service offerings.

We provide commerce, payments, marketing, and delivery services to our clients and consumers through our proprietary technology transaction processing, and client management systems and payment gateway connections. These systems also maintain an electronic inventory of products and gather consumer marketing information. Our ability to operate our business largely depends on the efficient and uninterrupted operation of our computer network systems and data centers. The satisfactory performance, reliability and availability of the technology and the underlying network infrastructure are critical to our operations, level of client service, reputation and ability to attract and retain clients. We have experienced periodic interruptions and have identified errors, affecting all or a portion of our systems, which we believe will continue to occur from time-to-time. While we attempt to correct every system error we identify, not all errors may be identified or corrected. The measures we have enacted, such as the implementation of security access and disaster recovery plans, may not be successful and we may experience problems other than system failures, or delays in restoring system availability when an outage occurs. We may be unable to prevent unanticipated system disruptions due to the failure of network or hardware components in our underlying network infrastructure. Any significant downtime interruptions in our facilities, computer networks, firewalls and databases could result in an immediate loss of revenue to us, harm our business and reputation, result in a loss of customers, and expose us to potential liability and increased operating expenses.

Although we maintain system redundancies in multiple physical locations, our systems and operations are vulnerable to damage or interruption, among other factors from:

§ Fire, flood, natural disasters, and other events beyond our control;
§ Defects introduced by third party technology;
§ Banking connections;
§ Defects introduced by outsourced services;
§ Third party and outsourced services technology failure due to defects in hardware and or firmware;
§ Catastrophic hardware failure of a third party;
§ Catastrophic hardware failure of an outsourced or cloud-based service provider;
§ Errors introduced by software and or hardware maintenance;
§ Operator negligence, improper operation by, or supervision of, employees, physical and electronic break-ins, misappropriation, computer viruses and similar events; and

§ Power loss, computer systems failures, denial-of-service attacks and Internet and telecommunications failure.
We may not carry sufficient business interruption insurance to fully compensate us for losses that may occur.

The listing of our network addresses on anti-spam lists could harm our ability to service our clients and deliver goods over the Internet.

Certain privacy and anti-email proponents have engaged in a practice of gathering, and publicly listing, network addresses that they believe have been involved in sending unwanted, unsolicited emails commonly known as spam. In response to user complaints about spam, Internet service providers have, from time to time, blocked such network addresses from sending emails to their users. If our network addresses mistakenly end up on these spam lists, our ability to provide services for our clients and consummate the sales of digital and physical goods over the Internet could be harmed.

Table of Contents

If our internal control over financial reporting or disclosure controls and procedures are not effective, there may be errors in our financial statements that could require a restatement or our filings may not be timely and investors may lose confidence in our reported financial information, which could lead to a decline in our stock price.

Section 404 of the Sarbanes-Oxley Act of 2002 requires us to evaluate the effectiveness of our internal control over financial reporting as of the end of each year, and to include a management report assessing the effectiveness of our internal control over financial reporting in each Annual Report on Form 10-K. Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our internal control over financial reporting will prevent all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. Over time, controls may become inadequate because changes in conditions or deterioration in the degree of compliance with policies or procedures may occur. Implementation of new technology related to the control system may result in misstatements due to errors that are not detected and corrected during testing. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and may not be detected.

As a result, we cannot assure you that significant deficiencies or material weaknesses in our internal control over financial reporting will not be identified in the future. Any failure to maintain or implement required new or improved controls, or any difficulties we encounter in their implementation, could result in significant deficiencies or material weaknesses, cause us to fail to timely meet our periodic reporting obligations, or result in material misstatements in our financial statements. Any such failure could also adversely affect the results of periodic management evaluations and annual auditor reports regarding disclosure controls and the effectiveness of our internal control over financial reporting required under Section 404 of the Sarbanes-Oxley Act of 2002 and the rules proclaimed after that. The existence of a material weakness could result in errors in our financial statements that could result in a restatement of financial statements, cause us to fail to timely meet our reporting obligations and cause investors to lose confidence in our reported financial information, leading to a decline in our stock price.

Anti-takeover provisions in our charter documents and under Delaware law could make an acquisition of us, which may be beneficial to our stockholders, more difficult and may prevent attempts by our stockholders to replace or remove our current management.

We are incorporated in Delaware. Certain anti-takeover provisions under Delaware law and in our certificate of incorporation and amended and restated bylaws, as currently in effect, may make a change of control of our company more difficult, even if a change in control would be beneficial to our stockholders. Our anti-takeover provisions include provisions such as a prohibition on stockholder actions by written consent, a classified board of directors and the authority of our board of directors to issue preferred stock without stockholder approval. In addition, we are governed by the provisions of Section 203 of the Delaware General Corporation Law, which generally prohibits stockholders owning 15% or more of our outstanding voting stock from merging or combining with us in certain circumstances. These provisions may delay or prevent an acquisition of us, even if the acquisition may be considered beneficial by some of our stockholders. In addition, they may frustrate or prevent any attempts by our stockholders to replace or remove our current management by making it more difficult for stockholders to replace members of our board of directors, which is responsible for appointing the members of our management.

Risks Related to Our Industry

Because the e-commerce industry is highly competitive and has low barriers to entry, we may be unable to compete effectively.

The market for e-commerce solutions is extremely competitive and we may find ourselves unable to compete effectively. Because there are relatively low barriers to entry in the e-commerce market, we expect continued intense competition as current competitors expand their product offerings and new competitors enter the market. In addition, our clients and partners may become competitors in the future. Increased competition is likely to result in price

42

Table of Contents

reductions, reduced margins, longer sales cycles and a decrease or loss of our market share, any of which could negatively impact our revenue and earnings. We face competition from the following sources:

§ In-house development of e-commerce capabilities using tools or applications from companies, such as Oracle Corporation (which acquired Art Technology Group, Inc.), IBM Corporation, Demandware, Inc. and SAP hybris GmbH, or through internally developed solutions;
§ E-Commerce capabilities custom-developed by companies, such as IBM Global Services and Accenture, Inc.;
§ New e-commerce models through which consumers can purchase software products for their computers and computing devices, such as app stores;
§ Other providers of outsourced e-commerce solutions, such as cleverbridge AG, eBay, Inc. (which acquired GSI Commerce, Inc. and Magento, Inc.), Demandware Inc., Avangate BV, asknet AG and arvato Systems, a division of Bertelsmann AG;
§ Companies that provide technologies, services or products that support a portion of the e-commerce process, such as payment processing, including WorldPay Ltd., GlobalCollect, CyberSource Corporation (a subsidiary of Visa, Inc.), Chase Paymentech, Stripe, Square, Inc., and PayPal Corporation and Braintree (subsidiaries of eBay, Inc.);
§ Companies that offer various online marketing services, technologies and products, including ValueClick, Inc. and Microsoft Advertising (formerly aQuantive, Inc.);
§ High-traffic, branded websites that generate a substantial portion of their revenue from e-commerce and may offer or provide to others the means to offer their products for sale, such as Amazon.com, Inc. and Buy.com, Inc.; and,
§ Web hosting, web services and infrastructure companies that offer portions of our solution and are seeking to expand the range of their offering, such as Network Solutions, LLC, Web.com Group, Inc., Shopify, Inc., PrestaShop, Inc., Akamai Technologies, Inc., Yahoo!, Inc., eBay, Inc. and Hostopia.com, Inc.

The online channel partners and the other companies described above may compete directly with us by adopting a business model similar to ours. Many of our competitors have, and new potential competitors may have, more experience developing Internet-based software and e-commerce solutions, larger technical staffs, larger customer bases, more established distribution channels and customer relationships, greater brand recognition and greater financial, marketing and other resources than we have. Some of our clients may also compete with us. In addition, competitors or our clients may be able to develop services that are superior to our services, achieve greater customer acceptance or have significantly improved functionality as compared to our existing and future products and services, which could result in the loss of existing clients and/or our inability to pursue and sign new clients. Our competitors may be able to respond more quickly to technological developments and changes in customers' needs. Our inability to compete successfully against current and future competitors could cause our revenue and earnings to decline.

The pace of recovery of U.S. and global economies, political and economic conditions, and the debt crisis in the United States and other countries may adversely affect our revenue and results of operations and stock price.

The U.S. and other global economies continue to experience slow recovery from the recent recession that affected the economy as a whole, resulting in continued issues with the pace of economic growth, loss of consumer confidence and uncertainty about economic stability, and increased unemployment. U.S. and foreign credit and financial markets continue to experience instability, resulting in increased volatility in the stock market and reduced availability of credit. The U.S. continues to face budgetary issues and constraints which may result in a failure to raise the "debt ceiling" and austerity measures such as automatic sequesters, cuts in government spending and programs, increased taxes, and other related actions or inactions by the U.S. government. Other countries and economies continue to experience adverse effects of sovereign debt crises and related austerity measures. These issues may cause a cascading effect impacting other countries and economies. Our revenue and growth is dependent on the continued growth in demand for our clients' products and the continued growth of Internet commerce, and depends significantly on geopolitical economic and business conditions. The continuing effects of instability in the credit and financial markets, general economic conditions, and the approach to addressing debt crises and austerity measures in the U.S. and other countries may continue to negatively impact our business and our clients, demand for our clients products, and consumer spending, such as causing delays in new product introductions, changes in client's outsourcing behavior, increasing our difficulty in collecting client receivables, and increasing the risk of client bankruptcies and/or interruption or cessation of business, which may have a negative impact on our business, operating results and financial condition. These factors could have a negative and adverse impact on companies with which we do business, which in turn could have a negative and adverse effect on our business. Continuing geopolitical instability in certain countries and regions may affect consumer spending behavior in those countries and regions. Instability in the credit and equity markets increases the risk that the actual amounts realized in the future on our financial instruments and investments may significantly differ from the fair values currently assigned to them. If macroeconomic and market conditions affecting us or our clients remain uncertain, weaken further, or otherwise fail to improve, they may have a material adverse effect on our business, operating results, financial condition and stock price.

Risks Related to the Securities Markets

We may need to raise additional capital to achieve our business objectives, which could result in dilution to existing investors or increase our debt obligations.

We require substantial working capital to fund our business. In February 2009, we filed a shelf registration that would allow us to sell an undetermined amount of equity or debt securities in accordance with the rules applying to "well-known seasoned issuers." In addition, we filed an acquisition shelf registration statement for up to approximately 1.5 million shares. On November 1, 2010, we sold and issued $345.0 million in aggregate principal amount of senior convertible notes (2010 Notes), in a private, unregistered offering. If additional funds are raised through the issuance of equity securities, the percentage ownership of our stockholders will be reduced and these equity securities may have rights, preferences or privileges senior to those of our common stock. Our capital requirements depend on several factors, including the rate of market acceptance of our products, the ability to expand our client base, the growth of sales and marketing and opportunities for acquisitions of other businesses. We have experienced significant operating losses and negative cash flow from operations during our operating history and may do so in the future. Additional financing may not be available when needed, on terms favorable to us or at all. If adequate funds are not available or are not available on acceptable terms, we may be unable to develop or enhance our services, take advantage of future opportunities or respond to competitive pressures, which would harm our operating results and adversely affect our ability to sustain profitability.

The investment of our substantial cash balance and our investments in marketable debt securities are subject to risks which may cause losses and affect the liquidity of these investments.

As of September 30, 2014, we held $40.7 million of auction rate securities (ARS) at par value which we have recorded at $39.1 million fair value. As of September 30, 2014 the ARS are 105–142% over-collateralized and the underlying student loans are guaranteed by the U.S. government.

Due to the illiquid market conditions, the fair value of our ARS is recorded at a discount to par value of $1.6 million, or 4.0%, as of September 30, 2014. This reduction from par value is considered temporary and is recorded in

“Accumulated other comprehensive income (loss)”.

The investment principal associated with failed auctions will not be accessible until successful auctions occur, a buyer is found outside of the auction process, the issuers establish a different form of financing to replace these securities, or final payments come due according to the contractual maturities of the debt issues. If none of these events occur or if the credit markets deteriorate, we may in the future be required to take a larger fair value discount and may be required to take a permanent impairment resulting in a reduction of earnings and liquidity. We intend to hold our auction rate securities until we can recover the full principal amount and have the ability to do so based on our other sources of liquidity. Based on our expected operating cash flows, and our other sources of cash, we do not anticipate the potential lack of liquidity on these investments will affect our ability to execute our current business plan.

Table of Contents

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Set forth below is information regarding the Company's stock repurchases during the three months ended September 30, 2014.

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plan	Approximate dollar value of shares that may yet be purchased under the plan (in millions)
July 1, 2014 - July 31, 2014	3,700	$ 13.88	3,700	$ 18.1
August 1, 2014 - August 31, 2014	-	$ -	-	$ 18.1
September 1, 2014 - September 30, 2014	-	$ -	-	$ 18.1
Total	3,700		3,700	

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

(a)Exhibits

See exhibits listed under the Exhibit Index below.

45

Table of Contents

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.

Date: October 31, 2014		DIGITAL RIVER, INC.
	By:	/s/ Stefan B. Schulz
		Stefan B. Schulz Chief Financial Officer (Principal Financial Officer)

46

Table of Contents

EXHIBIT INDEX

EXHIBIT NUMBER		DESCRIPTION OF DOCUMENTS
3.1	(1)	Amended and Restated Certificate of Incorporation, as amended, as currently in effect.
3.2	(2)	Amended and Restated Bylaws, as currently in effect.
4.1	(3)	Specimen of Common Stock Certificate.
4.2	(4)	Indenture dated as of September 1, 2004 between Digital River, Inc. and Wells Fargo Bank, N.A. as trustee, including therein the form of the 2004 Note.
4.3	(5)	Indenture dated as of November 1, 2010, between Digital River, Inc. and Wells Fargo Bank, N.A. as trustee, including therein the form of the 2010 Note.
31.1		Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2		Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1		Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2		Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101		The following financial information from Digital River, Inc.'s Quarterly Report on Form 10-Q for the period ended September 30, 2014, formatted in Extensible Business Reporting Language (XBRL): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations, (iii) Consolidated Statements of Cash Flows, and (iv) Notes to Consolidated Financial Statements.*

(1) Filed as an exhibit to the Company's Current Report on Form 8-K, filed on June 1, 2006, and incorporated herein by reference.
(2) Filed as an exhibit to our Annual Report on Form 10-K for the year ended December 31, 2000, filed on March 27, 2001, and incorporated herein by reference.
(3) Filed as an exhibit to our Registration Statement on Form S-1, File No. 333-56787, declared effective on August 11, 1998, and incorporated herein by reference.
(4) Incorporated by reference from the Company's Current Report on Form 8-K filed on July 13, 2004.
(5) Filed as an exhibit to the Company's Current Report on Form 8-K filed on November 1, 2010, and incorporated herein by reference.
* Pursuant to Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be "filed" for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be deemed part of a registration statement, prospectus or other document filed under the Securities Act or the Exchange Act, except as shall be expressly set forth by specific reference in such filings.