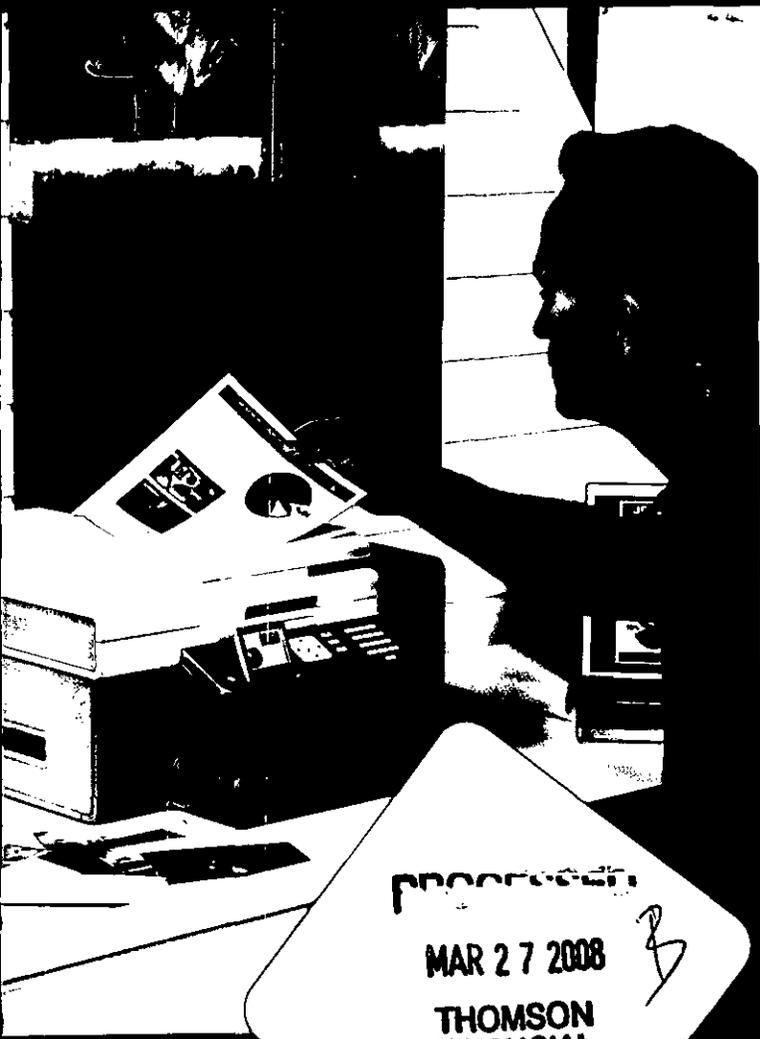




LEXMARKTM

at home



at work



processed
MAR 27 2008
THOMSON
FINANCIAL

7 ANNUAL REPORT

Received SEC
MAR 24 2008
Washington, DC 20549

Financial Highlights

(Dollars in millions, except per share data)

Statement of Earnings Data:	2007	2006	2005	2004	2003
Revenue	\$ 4,973.9	\$ 5,108.1	\$ 5,221.5	\$ 5,313.8	\$ 4,754.7
Cost of revenue (1)	3,410.3	3,462.1	3,585.9	3,522.4	3,209.6
Gross profit	1,563.6	1,646.0	1,635.6	1,791.4	1,545.1
Research and development	403.8	370.5	336.4	312.7	265.7
Selling, general and administrative (1)	812.8	761.8	755.1	746.6	685.5
Restructuring and other, net (1)	25.7	71.2	10.4	-	-
Operating expense	1,242.3	1,203.5	1,101.9	1,059.3	951.2
Operating income (1) (2)	321.3	442.5	533.7	732.1	593.9
Interest (income) expense, net	(21.2)	(22.1)	(26.5)	(14.5)	(0.4)
Other (income), net	(7.0)	5.3	6.5	0.1	0.8
Earnings before income taxes (1) (2) (3)	349.5	459.3	553.7	746.5	593.5
Provision for income taxes (4)	48.7	120.9	197.4	177.8	154.3
Net earnings (1) (2) (3) (4)	\$ 300.8	\$ 338.4	\$ 356.3	\$ 568.7	\$ 439.2
Diluted net earnings per common share (1) (2) (3) (4)	\$ 3.14	\$ 3.27	\$ 2.91	\$ 4.28	\$ 3.34
Shares used in per share calculation	95.8	103.5	122.3	132.9	131.4

Statement of Financial Position Data:

Working capital	\$ 569.5	\$ 506.0	\$ 935.9	\$ 1,533.2	\$ 1,260.5
Total assets	3,121.1	2,849.0	3,330.1	4,124.3	3,450.4
Total debt	149.9	149.8	149.6	151.0	150.4
Stockholders' equity	1,278.3	1,035.2	1,428.7	2,082.9	1,643.0

Other Key Data:

Net cash from operations (5)	\$ 564.2	\$ 670.9	\$ 576.4	\$ 775.4	\$ 747.6
Capital expenditures	\$ 182.7	\$ 200.2	\$ 201.3	\$ 198.3	\$ 93.8
Debt to total capital ratio (6)	10%	13%	9%	7%	8%

(1) Amounts in 2007 include restructuring-related charges and project costs of \$52.0 million. Restructuring-related charges of \$5.1 million relating to accelerated depreciation on certain fixed assets are included in Cost of revenue. Restructuring-related charges of \$25.7 million relating to employee termination benefit charges are included in Restructuring and other, net. Project costs of \$11.9 million and \$9.3 million are included in Cost of revenue and Selling, general and administrative, respectively.

Amounts in 2006 include the impact of restructuring-related charges and project costs of \$125.2 million (net of a \$9.9 million pension curtailment gain). Restructuring-related charges of \$40.0 million relating to accelerated depreciation on certain fixed assets are included in Cost of revenue. Restructuring-related charges of \$81.1 million relating to employee termination benefits and contract termination and lease termination charges and the \$9.9 million pension curtailment gain are included in Restructuring and other, net. Project costs of \$2.1 million and \$11.9 million are included in Cost of revenue and Selling, general and administrative, respectively.

Amounts in 2005 include one-time termination benefit charges of \$10.4 million in connection with a workforce reduction.

(2) Amounts in 2007 and 2006 include \$41.3 million and \$43.2 million, respectively, of stock-based compensation expense due to the Company's adoption of SFAS 123R on January 1, 2006.

(3) Amounts in 2007 include an \$8.1 million pre-tax foreign exchange gain realized upon the substantial liquidation of the Company's Scotland entity.

(4) Amounts in 2007 include an \$18.4 million benefit from the reversal of previously accrued taxes primarily related to the settlement of a tax audit outside the U.S. and \$11.2 million of benefits resulting from adjustments to previously recorded taxes.

Amounts in 2006 include a \$14.3 million benefit from the reversal of previously accrued taxes related to the finalization of certain tax audits and the expiration of various domestic and foreign statutes of limitations.

Amounts in 2005 include a \$51.9 million charge from the repatriation of foreign dividends under the American Jobs Creation Act of 2004.

Amounts in 2004 include a \$20.0 million benefit from the resolution of income tax matters.

(5) Cash flows from investing and financing activities, which are not presented, are integral components of total cash flow activity.

(6) The debt to total capital ratio is computed by dividing total debt (which includes both short-term and long-term debt) by the sum of total debt and stockholders' equity.



Paul J. Curlander
Chairman and CEO

SEC Mail Processing
Section

MAR 24 2008

Washington, DC
110

To my fellow shareholders,

2007 was a challenging year for Lexmark. Despite many positive things happening in our business, we saw a significant decline in 2007 in our operating income driven by issues in our consumer market segment. As a result, in October 2007 we announced a set of key initiatives to improve our performance while continuing to invest for the long term success of Lexmark. These key initiatives are:

Continue the Growth in the Business Market Segment

In 2007, revenue in our business market segment grew to a record \$3 billion as we continued to leverage Lexmark's unique strengths in output related workflow solutions and services. For the year we had strong growth in our Lexmark branded workgroup laser units. We had on-going good growth in our laser supplies sales. We strengthened the product line in 2007 with the introduction of a new family of color laser printers and multi-function devices. In addition, we implemented a significant expansion of our large account sales force to improve the reach of our enterprise solutions and services proposition. We believe these investments will continue to drive workgroup laser sales and supplies sales in the years ahead.

Shift our Consumer Market Strategy

One of the major issues in our consumer segment is that our business is too skewed to the low end of the market and to low usage devices. In the second half of 2007, we started to aggressively shift our focus to geographic regions, market segments, and customers that generate higher supplies usage. As part of this initiative we are optimizing our marketing and sales spending, prioritizing specific markets and channels relative to supplies usage, and reducing or eliminating units in lower priority markets and channels. In the near term, this action is negatively impacting our inkjet unit sales and we expect this to continue through 2008. However, we believe that in the long term we will build a stronger business on the foundation of higher usage devices.

As part of this focus shift to higher usage customers and products, we are shifting our inkjet research and development (R&D) efforts to areas such as wireless printing. Although this is still a small percentage of inkjet market units, we believe wireless to be the fastest growing segment in the inkjet market. In 2007 we introduced a new family of wireless inkjet products. By year end 2007, we had captured significant market share in the wireless inkjet segment in a number of major countries, including the US.

Improve our Cost and Expense Structure

In October 2007, we announced a restructuring plan to improve our cost and expense structure, which includes further consolidation of our inkjet supplies manufacturing facilities. This restructuring will impact about 1,650 positions, with most moving to lower cost countries, at a cost of \$90 million. Savings in 2008 are projected to be about \$40 million with annualized savings of \$60 million starting in 2009.

Continue to Invest in the Long Term

In 2007, we continued to expand our investments in R&D with the goal of strengthening and broadening our product line in the areas of color laser, laser multifunction products (MFPs), and inkjet all-in-ones (AIOs). These investments are producing a steady stream of new products. In 2007, our products received significant industry recognition, winning awards from leading industry magazines and test laboratories. In addition to awards for our monochrome lasers, we also earned honors for our color lasers, wireless inkjet AIOs and laser MFPs.

We are also continuing to invest in developing the Lexmark brand. In 2007, we evolved our advertising campaign, which highlights that 75 percent of the largest banks, retailers and pharmacies use Lexmark, to also emphasize the industry-leading performance of our products and the recognition Lexmark received versus the competition. We ran our advertising through the year in our top countries (U.S., U.K., France and Germany). In the fourth quarter, we focused our advertising on our new line of wireless inkjet products, targeting small office and home office users.

Importantly, Lexmark continues to maintain a strong financial position, with good cash generation and a solid balance sheet, which enables us to invest in the future of the business and compete effectively even during challenging times.

Looking ahead, we have more work to do in the consumer market segment to complete our planned strategy transition, strengthen our product line and improve our distribution to better reach higher usage customers. In the business market segment we also have more work to do to fully leverage our investments in R&D and sales force expansion. However, we remain optimistic due to our significant strengths in the distributed output market. We internally develop all three of the market's core print technologies: color inkjet, mono laser and color laser. We believe this allows us to be more responsive to our customers. We leverage this responsiveness through our industry focus and our close and frequent customer interaction. This has allowed us to develop unique and differentiating workflow solutions and services capabilities to meet the needs of our industry customers.

But I believe our greatest strength is our people. At Lexmark, our people make the difference. It's their commitment to our vision of creating customers for life that enables us to continue to win and renew our business with some of the largest enterprises in the world. It's their continued dedication to our customers that will enable us to work through our current challenges to emerge as a stronger company.

In closing, I want to thank our customers, employees, business partners and investors for your continued support.

Sincerely,



Paul J. Curlander
Chairman and Chief Executive Officer
Lexmark International, Inc.

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

(Mark One)



Annual Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934

For the Fiscal Year Ended December 31, 2007

OR



Transition Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934

Commission File No. 1-14050

LEXMARK INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction
of incorporation or organization)

06-1308215

(I.R.S. Employer
Identification No.)

**One Lexmark Centre Drive
740 West New Circle Road
Lexington, Kentucky**

(Address of principal executive offices)

40550

(Zip Code)

(859) 232-2000

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Class A Common Stock, \$.01 par value	New York Stock Exchange

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

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

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

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

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

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

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

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

The aggregate market value of the shares of voting common stock held by non-affiliates of the registrant was approximately \$4.7 billion based on the closing price for the Class A Common Stock on the last business day of the registrant's most recently completed second fiscal quarter.

As of February 21, 2008, there were outstanding 94,959,172 shares (excluding shares held in treasury) of the registrant's Class A Common Stock, par value \$0.01, which is the only class of voting common stock of the registrant, and there were no shares outstanding of the registrant's Class B Common Stock, par value \$0.01.

Documents Incorporated by Reference

Certain information in the Company's definitive Proxy Statement for the 2008 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission pursuant to Regulation 14A, not later than 120 days after the end of the fiscal year, is incorporated by reference in Part III of this Form 10-K.

LEXMARK INTERNATIONAL, INC. AND SUBSIDIARIES

FORM 10-K

For the Year Ended December 31, 2007

**Page of
Form 10-K**

PART I

Item 1.	BUSINESS	1
Item 1A.	RISK FACTORS	12
Item 1B.	UNRESOLVED STAFF COMMENTS	18
Item 2.	PROPERTIES	18
Item 3.	LEGAL PROCEEDINGS	18
Item 4.	SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS	19

PART II

Item 5.	MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES	20
Item 6.	SELECTED FINANCIAL DATA	23
Item 7.	MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	24
Item 7A.	QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK ..	51
Item 8.	FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA	52
Item 9.	CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE	96
Item 9A.	CONTROLS AND PROCEDURES	96
Item 9B.	OTHER INFORMATION	97

PART III

Item 10.	DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE ...	97
Item 11.	EXECUTIVE COMPENSATION	97
Item 12.	SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS	98
Item 13.	CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE	98
Item 14.	PRINCIPAL ACCOUNTANT FEES AND SERVICES	98

PART IV

Item 15.	EXHIBITS AND FINANCIAL STATEMENT SCHEDULES	98
----------	--	----

Forward-Looking Statements

This Annual Report on Form 10-K contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements, other than statements of historical fact, are forward-looking statements. Forward-looking statements are made based upon information that is currently available or management's current expectations and beliefs concerning future developments and their potential effects upon the Company, speak only as of the date hereof, and are subject to certain risks and uncertainties. We assume no obligation to update or revise any forward-looking statements contained or incorporated by reference herein to reflect any change in events, conditions or circumstances, or expectations with regard thereto, on which any such forward-looking statement is based, in whole or in part. There can be no assurance that future developments affecting the Company will be those anticipated by management, and there are a number of factors that could adversely affect the Company's future operating results or cause the Company's actual results to differ materially from the estimates or expectations reflected in such forward-looking statements, including, without limitation, the factors set forth under the title "Risk Factors" in Item 1A of this report. The information referred to above should be considered by investors when reviewing any forward-looking statements contained in this report, in any of the Company's public filings or press releases or in any oral statements made by the Company or any of its officers or other persons acting on its behalf. The important factors that could affect forward-looking statements are subject to change, and the Company does not intend to update the factors set forth in the "Risk Factors" section of this report. By means of this cautionary note, the Company intends to avail itself of the safe harbor from liability with respect to forward-looking statements that is provided by Section 27A and Section 21E referred to above.

Part I

Item 1. BUSINESS

General

Lexmark International, Inc., ("Lexmark" or the "Company") is a Delaware corporation and the surviving company of a merger between itself and its former parent holding company, Lexmark International Group, Inc., ("Group") consummated on July 1, 2000. Group was formed in July 1990 in connection with the acquisition of IBM Information Products Corporation from International Business Machines Corporation ("IBM"). The acquisition was completed in March 1991. On November 15, 1995, Group completed its initial public offering of Class A Common Stock and Lexmark now trades on the New York Stock Exchange under the symbol "LXK."

Lexmark makes it easier for businesses and consumers to move information between the digital and paper worlds. Since its inception in 1991, Lexmark has become a leading developer, manufacturer and supplier of printing and imaging solutions for offices and homes. Lexmark's products include laser printers, inkjet printers, multifunction devices, and associated supplies, services and solutions. Lexmark develops and owns most of the technology for its laser and inkjet products and related solutions. Lexmark also sells dot matrix printers for printing single and multi-part forms by business users. The Company operates in the office products industry. The Company is primarily managed along Business and Consumer market segments. Refer to Part II, Item 8, Note 17 of the Notes to Consolidated Financial Statements for additional information regarding the Company's reportable segments.

Revenue derived from international sales, including exports from the United States of America ("U.S."), accounts for approximately 57% of the Company's consolidated revenue, with Europe accounting for approximately two-thirds of international sales. Lexmark's products are sold in more than 150 countries in North and South America, Europe, the Middle East, Africa, Asia, the Pacific Rim and the Caribbean. This geographic diversity offers the Company opportunities to participate in new markets, provides diversification to its revenue stream and operations to help offset geographic economic trends, and utilizes the technical and business expertise of a worldwide workforce. Currency exchange rates had a

material favorable impact on international revenue in 2007. Refer to *Management's Discussion and Analysis of Financial Condition and Results of Operations — Effect of Currency Exchange Rates and Exchange Rate Risk Management* for more information. A summary of the Company's revenue and long-lived assets by geographic area is found in Part II, Item 8, Note 17 of the Notes to Consolidated Financial Statements included in this Annual Report on Form 10-K.

Market Overview¹

Lexmark management believes that the total distributed office and home printing output opportunity was approximately \$95 billion in 2007, including hardware, supplies and related services. This opportunity includes printers and multifunction devices as well as a declining base of copiers and fax machines that are increasingly being integrated into multifunction devices. Based on industry analyst information, Lexmark management estimates that this market will grow annually at low- to mid-single digit percentage rates through 2011. Management believes that the integration of print/copy/fax/scan capabilities favors companies like Lexmark due to its experience in providing industry-leading network printing solutions. In general, as the hardcopy industry matures and printer and copier markets converge, management expects competitive pressures to continue.

The Internet is positively impacting the distributed home and office printing market opportunity in several ways. As more information is available over the Internet, and new tools and solutions are being developed to access it, more of this information is being printed on distributed home and office printers. Management believes that an increasing percentage of this distributed output includes color and graphics, which tend to increase supplies usage. Growth in high-speed Internet access to the home is also contributing to increased printing on distributed devices.

The laser product market primarily serves business customers. Laser products can be divided into two major categories — shared workgroup products and lower-priced desktop products. Shared workgroup products are typically attached directly to large workgroup networks, while lower-priced desktop products are attached to personal computers ("PCs") or small workgroup networks. Both product categories include color and monochrome laser offerings. The shared workgroup products include laser printers and multifunction devices, which typically include high-performance internal network adapters that are easily upgraded to include additional input and output capacity as well as additional memory and storage. Most shared workgroup products also have sophisticated network management tools and some printers include multifunction upgrades that enable copy/fax/scan to network capabilities.

Industry laser printer unit growth in recent years has generally exceeded the growth rate of laser printer revenue due to unit growth in lower-priced desktop color and monochrome laser printers and unit price reductions. Additionally, color and multifunction laser printer units represent a more significant component of laser unit growth. Management believes these trends will continue. The pricing pressure is partially offset by the tendency of customers in the shared workgroup laser market to add higher profit margin optional features including document management solutions, additional memory, paper handling and multifunction capabilities. Pricing pressure is also partially offset by the opportunity to provide business solutions and services to customers who are increasingly looking for assistance to better manage and leverage their document-related costs and output infrastructure.

The inkjet product market is predominantly a consumer market but also includes business users who may choose inkjet products as a lower-priced alternative or supplement to laser products. Also, there is an increasing trend in inkjet products being designed for business purposes such as small office home office ("SOHO"), small business, student and home offices. Additionally, over the past couple years, the number of consumers seeking productivity-related features has driven significant growth in all-in-one ("AIO") products. Key factors promoting this trend are greater affordability of AIOs containing productivity features like full fax capabilities, automatic document feeders, duplex capabilities and wireless connectivity.

¹ Certain information contained in the "Market Overview" section has been obtained from industry sources, public information and other internal and external sources. Data available from industry analysts varies widely among sources. The Company bases its analysis of market trends on the data available from several different industry analysts.

Management believes the combination of business features made for the home will continue to drive AIO growth. Growth in inkjet hardware revenue on an industry basis has been lower than unit growth due to price reductions.

Strategy

Lexmark's strategy is based on a business model of investing in technology to develop and sell printing solutions, including printers and multifunction products ("MFPs"), with the objective of growing its installed base, which drives recurring supplies sales. Supplies are the profit engine of the business model. Supplies profit then funds new technology investments in products and solutions, which drive the cycle again and again. Management believes that Lexmark has the following strengths related to this business model:

- First, Lexmark is exclusively focused on distributed home and office network or desktop computer printing and imaging, and related solutions. Management believes that this focus has enabled Lexmark to be more responsive and flexible than competitors at meeting specific customer and channel partner needs.
- Second, Lexmark internally develops all three of the key print technologies associated with distributed printing, including inkjet, monochrome laser and color laser. The Company's laser printer technology platform has historically allowed it to be a leader in product price/performance and also build unique capabilities into its products that enable it to offer customized solutions.
- Third, Lexmark has leveraged its technological capabilities and its commitment to flexibility and responsiveness to build strong relationships with large-account customers and channel partners, including major retail chains, distributors, direct-response catalogers and value-added resellers. Lexmark's path-to-market includes industry-focused consultative sales and services teams that deliver unique and differentiated solutions to both large accounts and channel partners that sell into the Company's target industries. Retail-centric teams also have enabled Lexmark to meet the specific needs of major retail channel partners.

Lexmark's business market strategy requires that it provide its array of high-quality, technologically-advanced products and solutions at competitive prices. Lexmark continually enhances its products to ensure that they function efficiently in increasingly-complex enterprise network environments. It also provides flexible tools to enable network administrators to improve productivity. Lexmark's business target markets include large corporations, small and medium businesses ("SMBs") and the public sector. Lexmark's business market strategy also requires that it continually identify and focus on industry-specific issues and processes so that it can differentiate itself by offering unique industry solutions and related services.

The Company's consumer market strategy is to generate demand for Lexmark products by offering competitively-priced products to consumers and businesses primarily through retail channels and original equipment manufacturer ("OEM") partner arrangements. Lexmark's goal is to create printing products and innovative solutions that make it easier for consumers and small business owners to create, share and manage information and images. Lexmark continues to invest in brand building efforts that are reflected in its core product offerings, advertising campaigns and public relations efforts, all of which reinforce Lexmark's value proposition.

Lexmark's strategy involves the following core strategic initiatives:

- Expand the penetration of the product segments in which the Company participates. Lexmark is focused on increasing its participation in a number of higher-usage growth segments such as workgroup monochrome lasers, workgroup color lasers, workgroup laser MFPs and non-entry inkjet AIOs.
- Expand the penetration of the market segments in which the Company participates. Lexmark is driving to expand the Company's presence in enterprise, SMB and the non-entry segment of the consumer market.

- Continue to develop Lexmark's brand awareness and brand positioning. Management believes that its product and market segment initiatives will be aided by improving its brand awareness and brand image with the objective of reaching higher-usage customers that drive supplies sales. To drive these improvements, Lexmark launched a new advertising campaign in 2006 that has continued through 2007. The core message of the campaign highlights the Company's deep and proven experience helping some of the world's leading companies to be more productive. In 2007, the campaign also highlighted the industry-leading recognition and awards for its laser product line. Lexmark believes that this campaign will continue to build brand image and awareness, and in the long term will support the execution of its strategic initiatives.

In addition to investments in the Lexmark brand, the successful execution of this strategy involves increased investments in both the Company's sales force and product and solution development. The Company increased its research and development spending by 9% in 2007, by 10% in 2006 and by 8% in 2005. This investment has led to new products and solutions aimed at targeted growth segments as well as a pipeline of future products.

Because of Lexmark's exclusive focus on printing solutions, the Company has formed alliances and OEM arrangements to pursue incremental business opportunities through its alliance partners.

The Company's strategy for dot matrix printers is to continue to offer high-quality products while managing cost to maximize cash flow and profit.

Products

Laser Products

Lexmark offers a wide range of monochrome and color laser printers and MFPs in addition to customized solutions and services designed to help businesses move beyond printing to optimizing their printing environment and improve associated workflow and business processes.

In the monochrome category, the Company offers the Lexmark E series, which includes the Lexmark E120, the Lexmark E250, Lexmark E350 and Lexmark E450 printers. The E250, E350 and E450 combine new printhead technology, an instant warm-up fuser and two-sided printing standard on every model.

The Company continues to offer the Lexmark T640 series, which includes three models designed to support small, medium and large workgroups. All three models have optional paper input and output features, including a stapler and offset stacker. The Company's monochrome laser printer line extends into the wide format sector of the market with the Lexmark W840, which supports an array of paper handling and finishing options.

In 2007, the Company announced the new Lexmark C780 series and the Lexmark C935dn in the color laser printer category, which serve medium to large workgroups. Lexmark continues to offer the Lexmark C500n and the Lexmark C530 series for small and medium workgroups.

Lexmark's range of monochrome MFPs begins in the small workgroup category with the Lexmark X340 series and extends to the Lexmark X640 series, which is geared to medium to large workgroups. The Company also offers the Lexmark X850e series of monochrome MFPs that support large departments with wide format printing, finishing, and feature the same color eTask touch screen interface found on the Lexmark X644e and Lexmark X646e models.

In 2007, Lexmark introduced an entire new line of color laser MFPs, featuring five new products. The Lexmark X500n and Lexmark X502n are designed for small businesses and desktop users. The Lexmark X782e, Lexmark X940e and Lexmark X945e are designed for business workgroups and print on a wide variety of documents, including difficult media like heavy card stock and vinyl labels and specialty papers like weather- and fade-resistant outdoor media and oversized banners. All three feature Lexmark's eTask color touch screen interface, which can be customized to simplify complicated processes to the touch of an icon. This interface drives Lexmark's industry-specific workflow solutions, which are designed to help

customers in industries like retail, banking, health care, government, manufacturing and education improve paper-based processes.

Lexmark is vertically integrated, which gives the Company the ability to quickly respond to unique customer requirements and develop customized solutions to improve workflow. As a result of its insights into the specific processes required within industries, the Company can effectively customize the eTask interface on its MFPs to allow customers to reduce complicated, multi-step processes within these industries to the touch of an icon. The interface can easily be customized to meet each customer's unique workflow needs.

Also in 2007, the Company announced three new products customized specifically for vertical markets: the Clinical Assistant for health care, the Education Station for K-12 schools and the Legal Partner for law firms. All three are based off the Lexmark X646dte platform and feature workflow solutions on the eTask interface designed specifically to help customers in those industries improve productivity and reduce costs.

Inkjet Products

Lexmark's inkjet products include various desktop single function and AIO printers that offer print, copy, scan and fax functionality targeted at home users and SOHO users.

As broadband and wireless network penetration continues to increase substantially, Lexmark is meeting the growing demand for new printing products that afford the freedom of mobility. In fact, in 2007, Lexmark has established its wireless leadership by introducing the most affordable line of wireless inkjet products in the market, with products ranging from \$79 — \$249. This year, Lexmark introduced 11 inkjet products, six of which offer built-in 802.11g wireless connectivity and one that offers wireless connectivity as an option.

Additionally, Lexmark is better meeting the needs of SOHO professionals by offering higher end features such as automatic document feeding and automatic two-sided printing. Professional users also prefer print output with greater permanence. To meet this need, Lexmark offers pigmented ink technology which delivers output that resists fading, highlighting, water and humidity.

Leading the new Lexmark wireless lineup is the Lexmark X6570 Wireless All-in-One, a wireless four-in-one printer geared to SOHO users that includes business-class features such as two-sided printing, fax, a 25-page automatic document feeder for copying and faxing, and photo printing with Lexmark's pigmented inks. In 2007, Lexmark also introduced the Lexmark X7550, the Lexmark X4850 and the Lexmark X4550 AIO printers, all of which offer wireless connectivity. At the time of introduction, the Lexmark X4550 was the most affordable three-in-one printer in the inkjet market with built-in wireless capability. In addition, the Company announced the Lexmark X3550 AIO with wireless as an optional feature and continues to offer the Lexmark X9350 wireless AIO.

Lexmark also offers two wireless single-function printers, the Lexmark Z1420 and the Lexmark Z1520 color printers. At the time of introduction, the Z1420 was the most affordable wireless printer in the inkjet market.

For users who do not require wireless printing but need a feature-packed printer that is easy to use, the Company offers the new Lexmark X2500, the Lexmark X5070 and the Lexmark X5495 color AIO printers as well as the Lexmark Z1300 color inkjet printer.

In addition to the growing demand for wireless products, consumer trends in the market include a preference for the robust functionality of AIO printers and a shift away from printing photos at home, reducing the demand for stand-alone photo printing products. For those who want the convenience of photo printing at home, Lexmark offers quality photo printing in all of its inkjet AIOs, with photo features including a Pictbridge port, photo media card slots, flatbed scanner, color LCDs, scan-back proof sheets and optional six color printing.

Dot Matrix Products

Lexmark continues to market several dot matrix printer models for customers who print multi-part forms.

Supplies

Lexmark designs, manufactures and distributes a variety of cartridges and other supplies for use in its installed base of laser, inkjet and dot matrix printers. Lexmark's revenue and profit growth from its supplies business is directly linked to the Company's ability to increase the installed base of its laser and inkjet products and customer usage of those products. Management believes Lexmark is an industry leader with regard to the recovery, remanufacture, reuse and recycling of used laser supplies cartridges, helping to keep empty cartridges out of landfills. Attaining that leadership position was made possible by the Company's various empty cartridge collection programs around the world. Lexmark continues to launch new programs and expand existing cartridge collection programs to further expand its remanufacturing business and this environmental commitment.

Service and Support

Lexmark offers a wide range of services to bring together the Company's line of printing products and technology solutions along with maintenance, consulting, systems integration and distributed fleet management capabilities to provide a comprehensive output solution. Lexmark Global Services provide customers with an assessment of their current environment and a recommendation and implementation plan for the future state and ongoing optimization of their output environment and document related workflow/business processes. Managed print services allow organizations to outsource fleet management, technical support, supplies replenishment and maintenance activities to Lexmark.

Through its Distributed Fleet Management ("DFM") services, Lexmark provides large enterprise customers with managed print services, giving them complete visibility and control over their printing environment. These services include asset lifecycle management, consumables management and utilization management. These services can be tailored to meet each customer's unique needs and give them more extensive knowledge about their printing assets and infrastructure. Lexmark Fleet Manager is an offering for partners who wish to leverage Lexmark's enterprise infrastructure and capabilities to provide their small and medium business customers with managed print services.

The Company's printer products generally include a warranty period of at least one year, and customers typically have the option to purchase an extended warranty.

Marketing and Distribution

Lexmark employs large-account sales and marketing teams whose mission is to generate demand for its business printing solutions and services, primarily among large corporations as well as the public sector. Sales and marketing teams primarily focus on industries such as finance, services, retail, manufacturing, public sector and health care. Those teams, in conjunction with the Company's development and manufacturing teams, are able to customize printing solutions to meet customer needs for printing electronic forms, media handling, duplex printing and other document workflow solutions. Lexmark also markets its laser and inkjet products increasingly through SMB teams who work closely with channel partners. The Company distributes and fulfills its products to business customers primarily through its well-established distributor and reseller network. Lexmark's products are also sold through solution providers, which offer custom solutions to specific markets, and through direct response resellers.

Lexmark's international sales and marketing activities for the business market are organized to meet the needs of the local jurisdictions and the size of their markets. Operations in North America, Latin America, Asia Pacific and Western Europe focus on large-account demand generation with orders primarily filled through distributors and resellers.

The Company's business printer supplies are generally available at the customer's preferred point-of-purchase through multiple channels of distribution. Although channel mix varies somewhat depending upon the geography, most of Lexmark's business supplies products sold commercially in 2007 were sold through the Company's network of Lexmark-authorized supplies distributors and resellers, who sell directly to end-users or to independent office supply dealers.

For the consumer market, Lexmark distributes its branded inkjet products and supplies primarily through retail outlets worldwide. Lexmark's sales and marketing activities are organized to meet the needs of the various geographies and the size of their markets. In the U.S., products are distributed through large discount store chains, consumer electronics stores, office superstores and wholesale clubs. The Company's Western European and Latin American operations distribute products through major information technology resellers and in large markets through key retailers. Australian and Canadian marketing activities focus on large retail account demand generation, with orders filled through distributors or resellers.

Lexmark also sells its products through numerous alliances and OEM arrangements. During 2007, 2006 and 2005, one customer, Dell, accounted for \$717 million or approximately 14%, \$744 million or approximately 15% and \$782 million or approximately 15% of the Company's total revenue, respectively. Sales to Dell are included in both the Business and Consumer segments.

Lexmark launched a new advertising campaign in the third quarter of 2006 that has continued through 2007. The objective of the campaign is to gain broad awareness of the Company's proven track record of helping world-class companies to be more productive. Management believes that this campaign continues to build brand image and consideration, and in the long term will strengthen its position in the industry as the printing and imaging solutions service provider that makes it easy to get more done.

Economic and Seasonal Trends

Lexmark's business and results of operations have historically been affected by general economic conditions. From time to time, the Company's sales may be negatively affected by weak economic conditions in those markets in which the Company sells its products.

The Company experiences some seasonal market trends in the sale of its products and services. For example, sales in the business and consumer market segments are often stronger during the second half of the year and sales in Europe are often weaker in the summer months. Additionally, sales during the first half of the year may also be adversely impacted by market anticipation of seasonal trends such as new product introductions. The impact of these seasonal trends on Lexmark has become less predictable.

Competition

Lexmark continues to develop and market new products and innovative solutions at competitive prices. New product announcements by the Company's principal competitors, however, can have, and in the past, have had, a material adverse effect on the Company's financial results. Such new product announcements can quickly undermine any technological competitive edge that one manufacturer may enjoy over another and set new market standards for price, quality, speed and functionality. Furthermore, knowledge in the marketplace about pending new product announcements by the Company's competitors may also have a material adverse effect on Lexmark as purchasers of printers may defer buying decisions until the announcement and subsequent testing of such new products.

In recent years, Lexmark and its principal competitors, many of which have significantly greater financial, marketing and/or technological resources than the Company, have regularly lowered prices on printers and are expected to continue to do so. Lexmark has experienced and remains vulnerable to these pricing pressures. The Company's ability to grow or maintain market share has been and may continue to be affected, resulting in lower profitability. Lexmark expects that as it competes with larger competitors, the Company's increased market presence may attract more frequent challenges, both legal and commercial, including claims of possible intellectual property infringement.

The distributed printing market is extremely competitive. The distributed laser printing market is dominated by Hewlett-Packard ("HP"), which has a widely-recognized brand name and has been estimated to hold approximately 40% of the market as measured in annual units shipped. With the convergence of traditional printer and copier markets, major laser competitors now include traditional copier companies such as Canon, Ricoh and Xerox. Other laser competitors include Brother, Konica Minolta, Kyocera Mita, Oki and Samsung.

Lexmark's primary competitors in the inkjet product market are HP, Epson and Canon, who together account for approximately 80% of worldwide inkjet product unit sales. The Company must compete with these same vendors and other competitors, such as Brother and Kodak, for retail shelf space allocated to printers and their associated supplies. Lexmark sees other competitors and the potential for new entrants into the market possibly having an impact on the Company's growth and market share. The entrance of a competitor that is also focused on printing solutions could have a material adverse impact on the Company's strategy and financial results.

Refill, remanufactured, clones, counterfeits and other compatible alternatives for some of Lexmark's cartridges are available and compete with the Company's supplies business. However, these alternatives generally offer inconsistent quality and reliability. As the installed base of laser and inkjet products matures, the Company expects competitive supplies activity to increase. Historically, the Company has not experienced significant supplies pricing pressure, but if supplies pricing were to come under significant pressure, the Company's financial results could be materially adversely affected.

Manufacturing

Lexmark operates manufacturing control centers in Lexington, Kentucky; Shenzhen, China; and Geneva, Switzerland; and has manufacturing sites in Boulder, Colorado; Juarez and Chihuahua, Mexico; and Lapu-Lapu City, Philippines. The Company also has customization centers in each of the major geographies it serves. Lexmark's manufacturing strategy is to retain control over processes that are technologically complex, proprietary in nature and central to the Company's business model, such as the manufacture of inkjet cartridges, at Lexmark-owned and operated facilities. The Company shares some of its technical expertise with certain manufacturing partners, many of whom have facilities located in China, which collectively provide Lexmark with substantially all of its printer production capacity. The Company continually reviews its manufacturing capabilities and cost structure and makes adjustments as necessary.

Lexmark's manufacturing operations for toner and photoconductor drums are located in Boulder, Colorado and Juarez, Mexico. The Company continues to make significant capital investments in its Juarez, Mexico operation to expand cartridge assembly and selected key component manufacturing capabilities. Laser printer cartridges are assembled by a combination of in-house and third-party contract manufacturing. The manufacturing control center for laser printer supplies is located in Geneva, Switzerland.

Lexmark's manufacturing operations for inkjet printer supplies are located in Juarez and Chihuahua, Mexico and Lapu-Lapu City, Philippines. The manufacturing control center for inkjet supplies is located in Geneva, Switzerland.

Materials

Lexmark procures a wide variety of components used in the manufacturing process, including semiconductors, electro-mechanical components and assemblies, as well as raw materials, such as plastic resins. Although many of these components are standard off-the-shelf parts that are available from multiple sources, the Company often utilizes preferred supplier relationships, and in certain cases sole supplier relationships, to better ensure more consistent quality, cost and delivery. Typically, these preferred suppliers maintain alternate processes and/or facilities to ensure continuity of supply. Lexmark occasionally faces capacity constraints when there has been more demand for its products than initially projected. From time to time, Lexmark may be required to use air shipment to expedite product flow, which can adversely impact the Company's operating results. Conversely, in difficult economic times, the Company's inventory can grow as market demand declines.

During 2006 and 2007, the Company continued to execute supplier managed inventory ("SMI") agreements with its primary suppliers to improve the efficiency of the supply chain. Management believes these SMI agreements improve Lexmark's supply chain inventory pipeline and supply chain flexibility which enhances responsiveness to our customers. In addition, management believes these agreements improve supplier visibility to product demand and therefore improve suppliers' timeliness and management of their inventory pipelines. As of December 31, 2007, a significant majority of printers were purchased under SMI agreements. Any impact on future operations would depend upon factors such as the Company's ability to negotiate new SMI agreements and future market pricing and product costs.

Many components of the Company's products are sourced from sole suppliers, including certain custom chemicals, microprocessors, electro-mechanical components, application specific integrated circuits and other semiconductors. The Company is making changes in sourcing and design to drive commonality of sub components across product families while increasing dual sourcing for key components. In addition, Lexmark sources some printer engines and finished products from OEMs. Although Lexmark plans in anticipation of its future requirements, should these components not be available from any one of these suppliers, there can be no assurance that production of certain of the Company's products would not be disrupted. Such a disruption could interfere with Lexmark's ability to manufacture and sell products and materially adversely affect the Company's business. Conversely, during economic slowdowns, the Company may build inventory of components as demand decreases.

Research and Development

Lexmark's research and development activity is focused on laser and inkjet printers, MFPs, and associated supplies, features, and related technologies. The Company has accelerated its investment in research and development to support new product initiatives and to advance current technologies and expects this to continue. Lexmark's primary research and development activities are conducted in Lexington, Kentucky; Boulder, Colorado; Cebu City, Philippines; and Kolkata, India. In the case of certain products, the Company may elect to purchase products or key components from third-party suppliers rather than develop them internally.

Lexmark is actively engaged in the design and development of new products and enhancements to its existing products. Its engineering efforts focus on technologies associated with laser, inkjet, connectivity, document management and other customer facing solutions, as well as design features that will increase performance, improve ease of use and lower production costs. Lexmark also develops related applications and tools to enable it to efficiently provide a broad range of services. The process of developing new products is complex and requires innovative designs that anticipate customer needs and technological trends. Research and development expenditures were \$404 million in 2007, \$371 million in 2006 and \$336 million in 2005. The Company must make strategic decisions from time to time as to which technologies will produce products and solutions in market sectors that will experience the greatest future growth. There can be no assurance that the Company can develop the more technologically-advanced products required to remain competitive.

Backlog

Although Lexmark experiences availability constraints from time to time for certain products, the Company generally fills its orders within 30 days of receiving them. Therefore, Lexmark usually has a backlog of less than 30 days at any one time, which the Company does not consider material to its business.

Employees

As of December 31, 2007, of the approximately 13,800 employees worldwide, 3,800 are located in the U.S. and the remaining 10,000 are located in Europe, Canada, Latin America, Asia Pacific, the Middle East and Africa. None of the U.S. employees are represented by a union. Employees in France are represented by a Statutory Works Council.

Available Information

Lexmark makes available, free of charge, electronic access to all documents (including annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports, as well as any beneficial ownership filings) filed with or furnished to the Securities and Exchange Commission ("SEC" or the "Commission") by the Company on its website at <http://investor.lexmark.com> as soon as reasonably practicable after such documents are filed. The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at www.sec.gov.

Executive Officers of the Registrant

The executive officers of Lexmark and their respective ages, positions and years of service with the Company are set forth below.

<u>Name of Individual</u>	<u>Age</u>	<u>Position</u>	<u>Years With The Company</u>
Paul J. Curlander	55	Chairman and Chief Executive Officer	17
John W. Gamble, Jr.	45	Executive Vice President and Chief Financial Officer	3
Paul A. Rooke	49	Executive Vice President and President of Consumer Printer Division	17
Martin S. Canning	44	Vice President and President of Printing Solutions and Services Division	9
Vincent J. Cole, Esq	51	Vice President, General Counsel and Secretary	17
Jeri L. Isbell	50	Vice President of Human Resources	17
Gary D. Stromquist	52	Vice President and Corporate Controller	17

Dr. Curlander has been a Director of the Company since February 1997. Since April 1999, Dr. Curlander has been Chairman of the Board of the Company. In May 1998, Dr. Curlander was elected President and Chief Executive Officer of the Company. Prior to such time, Dr. Curlander served as President and Chief Operating Officer and Executive Vice President, Operations of the Company.

Mr. Gamble has been Executive Vice President and Chief Financial Officer of the Company since September 2005 when he joined the Company. Prior to joining the Company and since February 2003, Mr. Gamble served as Executive Vice President and Chief Financial Officer of Agere Systems, Inc. ("Agere"). From January 2003 to February 2003, Mr. Gamble served as Senior Vice President and Business Controller of Agere.

Mr. Rooke has been Executive Vice President and President of the Company's Consumer Printer Division since July 2007. From October 2002 to July 2007, Mr. Rooke served as Executive Vice President and President of the Company's Printing Solutions and Services Division ("PS&SD").

Mr. Canning has been Vice President and President of PS&SD since July 2007. Prior to such time and since January 2006, Mr. Canning served as Vice President and General Manager, PS&SD Worldwide Marketing and Lexmark Services and PS&SD North American Sales and Marketing. From August 2002 to January 2006, Mr. Canning served as Vice President and General Manager, PS&SD Worldwide Marketing and Lexmark Services.

Mr. Cole has been Vice President and General Counsel of the Company since July 1996 and Corporate Secretary since February 1996.

Ms. Isbell has been Vice President of Human Resources of the Company since February 2003. From January 2001 to February 2003, Ms. Isbell served as Vice President of Worldwide Compensation and Resource Programs in the Company's Human Resources department.

Mr. Stromquist has been Vice President and Corporate Controller of the Company since July 2001.

Intellectual Property

The Company's intellectual property is one of its major assets and the ownership of the technology used in its products is important to its competitive position. Lexmark seeks to establish and maintain the proprietary rights in its technology and products through the use of patents, copyrights, trademarks, trade secret laws, and confidentiality agreements.

Lexmark holds a portfolio of approximately 1,350 U.S. patents and approximately 975 pending U.S. patent applications. The Company also holds approximately 2,900 foreign patents and pending patent applications. The inventions claimed in these patents and patent applications cover aspects of the Company's current and potential future products, manufacturing processes, business methods and related technologies. The Company is developing a portfolio of patents that protects its product lines and offers the possibility of entering into licensing agreements with others.

Lexmark has a variety of intellectual property licensing and cross-licensing agreements with a number of third parties. Certain of Lexmark's material license agreements, including those that permit the Company to manufacture some of its current products, terminate as to specific products upon certain "changes of control" of the Company.

The Company has trademark registrations or pending trademark applications for the name LEXMARK in approximately 80 countries for various categories of goods and services. Lexmark also owns a number of trademark applications and registrations for various product names. The Company holds worldwide copyrights in computer code and publications of various types. Other proprietary information is protected through formal procedures, which include confidentiality agreements with employees and other entities.

Lexmark's success depends in part on its ability to obtain patents, copyrights and trademarks, maintain trade secret protection and operate without infringing the proprietary rights of others. While Lexmark designs its products to avoid infringing the intellectual property rights of others, current or future claims of intellectual property infringement, and the expenses resulting therefrom, could materially adversely affect its business, operating results and financial condition. Expenses incurred by the Company in obtaining licenses to use the intellectual property rights of others and to enforce its intellectual property rights against others also could materially affect its business, operating results and financial condition. In addition, the laws of some foreign countries may not protect Lexmark's proprietary rights to the same extent as the laws of the U.S.

Environmental and Regulatory Matters

Lexmark's operations, both domestically and internationally, are subject to numerous laws and regulations, particularly relating to environmental matters that impose limitations on the discharge of pollutants into the air, water and soil and establish standards for the treatment, storage and disposal of solid and hazardous wastes. Over time, the Company has implemented numerous programs to recover, remanufacture and recycle certain of its products and intends to continue to expand on initiatives that have a positive effect on the environment. Lexmark is also required to have permits from a number of governmental agencies in order to conduct various aspects of its business. Compliance with these laws and regulations has not had, and in the future is not expected to have, a material effect on the capital expenditures, earnings or competitive position of the Company. There can be no assurance, however, that future changes in environmental laws or regulations, or in the criteria required to obtain or maintain necessary permits, will not have an adverse effect on the Company's operations.

Item 1A. RISK FACTORS

The following significant factors, as well as others of which we are unaware or deem to be immaterial at this time, could materially adversely affect our business, financial condition or operating results in the future. Therefore, the following information should be considered carefully together with other information contained in this report. Past financial performance may not be a reliable indicator of future performance, and historical trends should not be used to anticipate results or trends in future periods.

The Company's ability to be successful in shifting its strategy and selling its products into the higher-usage segments of the inkjet market.

- The Company's future operating results may be adversely affected if it is unable to successfully develop, manufacture, market and sell products into the geographic and customer and product segments of the inkjet market that support higher usage of supplies.

The Company may experience difficulties in product transitions negatively impacting the Company's performance and operating results.

- The introduction of products by the Company or its competitors, or delays in customer purchases of existing products in anticipation of new product introductions by the Company or its competitors and market acceptance of new products and pricing programs, any disruption in the supply of new or existing products as well as the costs of any product recall or increased warranty, repair or replacement costs due to quality issues, the reaction of competitors to any such new products or programs, the life cycles of the Company's products, as well as delays in product development and manufacturing, and variations in cost, including but not limited to component parts, raw materials, commodities, energy, products, distributors, fuel and variations in supplier terms and conditions, may impact sales, may cause a buildup in the Company's inventories, make the transition from current products to new products difficult and could adversely affect the Company's future operating results.

Weak economic conditions could negatively impact sales of the Company's products and future operating results.

- Unfavorable global economic conditions may adversely impact the Company's future operating results. The Company continues to experience some weak markets for its products. Continued softness in certain markets and uncertainty about global economic conditions could result in lower demand for the Company's products, particularly supplies. Weakness in demand has resulted in intense price competition and may result in excessive inventory for the Company and/or its reseller channel, which may adversely affect sales, pricing, risk of obsolescence and/or other elements of the Company's operating results. Ongoing weakness in demand for the Company's hardware products may also cause erosion of the installed base of products over time, thereby reducing the opportunities for supplies sales in the future.

The revenue and profitability of our operations have historically varied, which makes our future financial results less predictable.

- Our revenue, gross margin and profit vary among our hardware, supplies and services, product groups and geographic markets and therefore will likely be different in future periods than our current results. Overall gross margins and profitability in any given period is dependent upon the hardware/supplies mix, the mix of hardware products sold, and the geographic mix reflected in that period's revenue. Overall market trends, seasonal market trends, competitive pressures, pricing, commoditization of products, increased component or shipping costs and other factors may result in reductions in revenue or pressure on gross margins in a given period.

The Company's inability to meet customer product requirements on a cost competitive basis may negatively impact the Company's operating results.

- The Company's future operating results may be adversely affected if it is unable to continue to develop, manufacture and market products that are reliable, competitive, and meet customers' needs. The markets for laser and inkjet products and associated supplies are aggressively competitive, especially with respect to pricing and the introduction of new technologies and products offering improved features and functionality. In addition, the introduction of any significant new and/or disruptive technology or business model by a competitor that substantially changes the markets into which the Company sells its products or demand for the products sold by the Company could severely impact sales of the Company's products and the Company's operating results. The impact of competitive activities on the sales volumes or revenue of the Company, or the Company's inability to effectively deal with these competitive issues, could have a material adverse effect on the Company's ability to attract and retain OEM customers, maintain or grow retail shelf space or maintain or grow market share. The competitive pressure to develop technology and products and to increase the Company's investment in research and development and marketing expenditures also could cause significant changes in the level of the Company's operating expense.

Any failure by the Company to execute planned cost reduction measures timely and successfully could result in total costs and expenses that are greater than expected or the failure to meet operational goals as a result of such actions.

- The Company has undertaken cost reduction measures over the last few years in an effort to optimize the Company's expense structure. Such actions have included workforce reductions, the consolidation of manufacturing capacity, and the centralization of support functions to shared service centers in each geography. In particular, the Company's manufacturing and support functions are becoming more heavily concentrated in China and the Philippines. The Company expects to realize cost savings in the future through these actions and may announce future actions to further reduce its worldwide workforce and/or centralize its operations. The risks associated with these actions include potential delays in their implementation, particularly workforce reductions, due to regulatory requirements; increased costs associated with such actions; decreases in employee morale and the failure to meet operational targets due to unplanned departures of employees, particularly key employees and sales employees.

The competitive pricing pressure in the market may negatively impact the Company's operating results.

- The Company and its major competitors, many of which have significantly greater financial, marketing and/or technological resources than the Company, have regularly lowered prices on their products and are expected to continue to do so. In particular, both the inkjet and laser printer markets have experienced and are expected to continue to experience significant price pressure. Price reductions on inkjet or laser products or the inability to reduce costs, including warranty costs, to contain expenses or to increase or maintain sales as currently expected, as well as price protection measures, could result in lower profitability and jeopardize the Company's ability to grow or maintain its market share. In recent years, the gross margins on the Company's hardware products have been under pressure as a result of competitive pricing pressures in the market. If the Company is unable to reduce costs to offset this competitive pricing or product mix pressure, and the Company is unable to support declining gross margins through the sale of supplies, the Company's operating results and future profitability may be negatively impacted. Historically, the Company has not experienced significant supplies pricing pressure, but if supplies pricing was to come under significant pressure, the Company's financial results could be materially adversely affected.

The entrance of additional competitors that are focused on printing solutions could negatively impact the Company's strategy and operating results.

- The entrance of additional competitors that are focused on printing solutions could further intensify competition in the inkjet and laser printer markets and could have a material adverse impact on the Company's strategy and financial results.

The Company's inability to perform satisfactorily under service contracts for managed print services may negatively impact the Company's strategy and operating results.

- The Company's inability to perform satisfactorily under service contracts for managed print services and other customer services may result in the loss of customers, loss of reputation and/or financial consequences that may have a material adverse impact on the Company's financial results and strategy.

Decreased consumption of supplies could negatively impact the Company's operating results.

- The Company's future operating results may be adversely affected if the consumption of its supplies by end users of its products is lower than expected or declines, if there are declines in pricing, unfavorable mix and/or increased costs.

Increased competition in the Company's aftermarket supplies business may negatively impact the Company's revenues and gross margins.

- Refill, remanufactured, clones, counterfeits and other compatible alternatives for some of the Company's cartridges are available and compete with the Company's supplies business. The Company expects competitive supplies activity to increase. Various legal challenges and governmental activities may intensify competition for the Company's aftermarket supplies business.

Any failure by the Company to successfully outsource the infrastructure support of its information technology system and application maintenance functions and centralize certain of its support functions may disrupt these systems or functions and could have a material adverse effect on the Company's systems of internal control and financial reporting.

- The Company has migrated the infrastructure support of its information technology system and application maintenance functions to new third-party service providers. The Company is in the process of centralizing certain of its accounting and other finance functions and order-to-cash functions from various countries to shared service centers. The Company is also in the process of reducing, consolidating and moving various parts of its general and administrative resource, supply chain resource and marketing and sales support structure. Many of these processes and functions are moving to lower-cost countries, including China, India and the Philippines. Any disruption in these systems, processes or functions could have a material adverse impact on the Company's operations, its financial results, its systems of internal controls and its ability to accurately record and report transactions and financial results.

The Company's failure to manage inventory levels or production capacity may negatively impact the Company's operating results.

- The Company's performance depends in part upon its ability to successfully forecast the timing and extent of customer demand and reseller demand to manage worldwide distribution and inventory levels of the Company. Unexpected fluctuations in reseller inventory levels could disrupt ordering patterns and may adversely affect the Company's financial results. In addition, the financial failure or loss of a key customer or reseller could have a material adverse impact on the Company's financial results. The Company must also be able to address production and supply constraints, including product disruptions caused by quality issues, and delays or disruptions in the supply of key components necessary for production, including without limitation component shortages due to

increasing global demand in the Company's industry and other industries. Such delays, disruptions or shortages may result in lost revenue or in the Company incurring additional costs to meet customer demand. The Company's future operating results and its ability to effectively grow or maintain its market share may be adversely affected if it is unable to address these issues on a timely basis.

New legislation, fees on the Company's products or litigation costs required to protect the Company's rights may negatively impact the Company's cost structure, access to components and operating results.

- The European Union has adopted the Waste Electrical and Electronic Equipment Directive (the "Directive") which requires producers of electrical and electronic goods, including printing devices, to be financially responsible for specified collection, recycling, treatment and disposal of past and future covered products. The deadline for enacting and implementing the Directive by individual European Union governments was August 13, 2004 (such legislation, together with the Directive, the "WEEE Legislation"), although extensions were granted to some countries. Producers were to be financially responsible under the WEEE Legislation beginning in August 2005. Similar legislation may be enacted in the future in other jurisdictions as well. The impact of this legislation could adversely affect the Company's operating results and profitability.
- Certain countries (primarily in Europe) and/or collecting societies representing copyright owners' interests have commenced proceedings to impose fees on devices (such as scanners, printers and multifunction devices) alleging the copyright owners are entitled to compensation because these devices enable reproducing copyrighted content. Other countries are also considering imposing fees on certain devices. The amount of fees, if imposed, would depend on the number of products sold and the amounts of the fee on each product, which will vary by product and by country. The financial impact on the Company, which will depend in large part upon the outcome of local legislative processes, the Company's and other industry participants' outcome in contesting the fees and the Company's ability to mitigate that impact by increasing prices, which ability will depend upon competitive market conditions, remains uncertain. The outcome of the copyright fee issue could adversely affect the Company's operating results and business.
- The European Union has adopted the "RoHS" Directive (Restriction of use of certain Hazardous Substances) which restricts the use of nine substances in electrical and electronic equipment placed on the market on or after July 1, 2006. Compliance with the RoHS Directive could create shortages of certain components or impact continuity of supply that could adversely affect the Company's operating results and profitability.

The Company's inability to obtain and protect its intellectual property and defend against claims of infringement by others may negatively impact the Company's operating results.

- The Company's success depends in part on its ability to develop technology and obtain patents, copyrights and trademarks, and maintain trade secret protection, to protect its intellectual property against theft, infringement or other misuse by others. The Company must also conduct its operations without infringing the proprietary rights of others. Current or future claims of intellectual property infringement could prevent the Company from obtaining technology of others and could otherwise materially and adversely affect its operating results or business, as could expenses incurred by the Company in obtaining intellectual property rights, enforcing its intellectual property rights against others or defending against claims that the Company's products infringe the intellectual property rights of others, that the Company engages in false or deceptive practices or that its conduct is anti-competitive.

The Company's reliance on international production facilities, international manufacturing partners and certain key suppliers could negatively impact the Company's operating results.

- The Company relies in large part on its international production facilities and international manufacturing partners, many of which are located in China and the Philippines, for the manufacture of its products and key components of its products. Future operating results may also be adversely affected by several other factors, including, without limitation, if the Company's international operations or manufacturing partners are unable to perform or supply products reliably, if there are disruptions in international trade, disruptions at important geographic points of exit and entry, if there are difficulties in transitioning such manufacturing activities among the Company, its international operations and/or its manufacturing partners, or if there arise production and supply constraints which result in additional costs to the Company. The financial failure or loss of a sole supplier or significant supplier of products or key components, or their inability to produce the required quantities, could result in a material adverse impact on the Company's operating results.

Due to the international nature of our business, changes in a country's or region's political or economic conditions or other factors could negatively impact the Company's revenue, financial condition or operating results.

- Revenue derived from international sales make up about half of the Company's revenue. Accordingly, the Company's future results could be adversely affected by a variety of factors, including changes in a specific country's or region's political or economic conditions, foreign currency exchange rate fluctuations, trade protection measures and unexpected changes in regulatory requirements. In addition, changes in tax laws and the ability to repatriate cash accumulated outside the U.S. in a tax efficient manner may adversely affect the Company's financial results, investment flexibility and operations. Moreover, margins on international sales tend to be lower than those on domestic sales, and the Company believes that international operations in new geographic markets will be less profitable than operations in the U.S. and European markets, in part, because of the higher investment levels for marketing, selling and distribution required to enter these markets.
- In many foreign countries, particularly those with developing economies, it is common for local business practices to be prohibited by laws and regulations applicable to the Company, such as employment laws, fair trade laws or the Foreign Corrupt Practices Act. Although the Company implements policies and procedures designed to ensure compliance with these laws, our employees, contractors and agents, as well as those business partners to which we outsource certain of our business operations, may take actions in violation of our policies. Any such violation, even if prohibited by our policies, could have a material adverse effect on our business and our reputation. Because of the challenges in managing a geographically dispersed workforce, there also may be additional opportunities for employees to commit fraud or personally engage in practices which violate the policies and procedures of the Company.

Conflicts among various sales channels may negatively impact the Company's operating results.

- The Company markets and sells its products through several sales channels. The Company has also advanced a strategy of forming alliances and OEM arrangements with many companies. The Company's future operating results may be adversely affected by any conflicts that might arise between or among its various sales channels, the volume reduction in or loss of any alliance or OEM arrangement or the loss of retail shelf space. Aggressive pricing on laser and inkjet products and/or associated supplies from customers and resellers, including, without limitation, OEM customers, could result in a material adverse impact on the Company's strategy and financial results.

The failure of information technology systems may negatively impact the Company's operating results.

- The Company depends on its information technology systems for the development, manufacture, distribution, marketing, sales and support of its products and services. Any failure in such systems, or the systems of a partner or supplier, may adversely affect the Company's operating results. Furthermore, because vast quantities of the Company's products flow through only a few distribution centers to provide product to various geographic regions, the failure of information technology systems or any other disruption affecting those product distribution centers could have a material adverse impact on the Company's ability to deliver product and on the Company's financial results.

Changes in the Company's tax provisions or tax liabilities could negatively impact the Company's profitability.

- The Company's effective tax rate could be adversely affected by changes in the mix of earnings in countries with differing statutory tax rates. In addition, the amount of income tax the Company pays is subject to ongoing audits in various jurisdictions. A material assessment by a taxing authority or a decision to repatriate foreign cash could adversely affect the Company's profitability.

Business disruptions could seriously harm our future revenue and financial condition and increase our costs and expenses.

- Our worldwide operations and those of our manufacturing partners, suppliers, and freight transporters, among others, are subject to natural and manmade disasters and other business interruptions such as earthquakes, tsunamis, floods, hurricanes, typhoons, fires, extreme weather conditions, environmental hazards, power shortages, water shortages and telecommunications failures. The occurrence of any of these business disruptions could seriously harm our revenue and financial condition and increase our costs and expenses. As the Company continues its consolidation of certain functions into shared service centers and movement of certain functions to lower cost countries, the probability and impact of business disruptions may be increased over time.

Cost reduction efforts associated with the Company's share-based payment awards and other compensation and benefit programs could adversely affect our ability to attract, motivate and retain employees.

- The Company has historically used stock options and other forms of share-based payment awards as key components of the total rewards program for employee compensation in order to align employees' interests with the interests of stockholders, motivate employees, encourage employee retention and provide competitive compensation and benefits packages. As a result of Statement of Financial Accounting Standards No. 123R, the Company would incur increased compensation costs associated with its share-based compensation programs and as a result has reviewed its compensation strategy in light of the current regulatory and competitive environment and has decided to change the form of its share-based awards. Due to this change in compensation strategy, combined with other benefit plan changes undertaken to reduce costs, the Company may find it difficult to attract, retain and motivate employees, and any such difficulty could materially adversely affect its operating results.

Terrorist acts, acts of war or other political conflicts may negatively impact the Company's ability to manufacture and sell its products.

- Terrorist attacks and the potential for future terrorist attacks have created many political and economic uncertainties, some of which may affect the Company's future operating results. Future terrorist attacks, the national and international responses to such attacks, and other acts of war or hostility may affect the Company's facilities, employees, suppliers, customers, transportation

networks and supply chains, or may affect the Company in ways that are not capable of being predicted presently.

The outbreak of a communicable disease may negatively impact the health and welfare of the Company's employees and those of its manufacturing partners and negatively impact the Company's operating results.

- The Company relies heavily on the health and welfare of its employees and the employees of its manufacturing partners. The widespread outbreak of any form of communicable disease affecting a large number of workers could adversely impact the Company's operating results.

Any variety of factors unrelated to the Company's operating performance may negatively impact the Company's operating results or the Company's stock price.

- Factors unrelated to the Company's operating performance, including the financial failure or loss of significant customers, resellers, manufacturing partners or suppliers; the outcome of pending and future litigation or governmental proceedings; and the ability to retain and attract key personnel, could also adversely affect the Company's operating results. In addition, the Company's stock price, like that of other technology companies, can be volatile. Trading activity in the Company's common stock, particularly the trading of large blocks and intraday trading in the Company's common stock, may affect the Company's common stock price.

Item 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

Item 2. PROPERTIES

Lexmark's corporate headquarters and principal development facilities are located on a 374 acre campus in Lexington, Kentucky. At December 31, 2007, the Company owned or leased 8.0 million square feet of administrative, sales, service, research and development, warehouse and manufacturing facilities worldwide. The properties are used by both the Business and Consumer segments of the Company. Approximately 4.6 million square feet is located in the U.S. and the remainder is located in various international locations. The Company's principal international manufacturing facilities are located in Mexico and the Philippines. The principal domestic manufacturing facility is located in Colorado. The Company leases facilities for development in India and the Philippines. The Company owns approximately 64 percent of the worldwide square footage and leases the remaining 36 percent. The leased property has various lease expiration dates. The Company believes that it can readily obtain appropriate additional space as may be required at competitive rates by extending expiring leases or finding alternative space.

None of the property owned by Lexmark is held subject to any major encumbrances and the Company believes that its facilities are in good operating condition.

Item 3. LEGAL PROCEEDINGS

On December 30, 2002 ("02 action") and March 16, 2004 ("04 action"), the Company filed claims against Static Control Components, Inc. ("SCC") in the U.S. District Court for the Eastern District of Kentucky (the "District Court") alleging violation of the Company's intellectual property and state law rights. At various times in 2004, Pendl Companies, Inc. ("Pendl"), Wazana Brothers International, Inc. ("Wazana") and NER Data Products, Inc. ("NER"), were added as additional defendants to the claims brought by the Company in the 02 action and/or the 04 action. The Company entered into separate settlement agreements with each of NER, Pendl and Wazana pursuant to which the Company released each party, and each party released the Company, from any and all claims, and at various times in May 2007 the District Court entered orders dismissing with prejudice all such litigation. Similar claims in a separate action were filed by the Company in the District Court against David Abraham and Clarity Imaging Technologies, Inc. ("Clarity") on October 8, 2004. SCC and Clarity have filed counterclaims against the Company in the District Court alleging that the

Company engaged in anti-competitive and monopolistic conduct and unfair and deceptive trade practices in violation of the Sherman Act, the Lanham Act and state laws. SCC has stated in its legal documents that it is seeking approximately \$17.8 million to \$19.5 million in damages for the Company's alleged anticompetitive conduct and approximately \$1 billion for Lexmark's alleged violation of the Lanham Act. Clarity has not stated a damage dollar amount. SCC and Clarity are seeking treble damages, attorney fees, costs and injunctive relief. On September 28, 2006, the District Court dismissed the counterclaims filed by SCC alleging that the Company engaged in anti-competitive and monopolistic conduct and unfair and deceptive trade practices in violation of the Sherman Act, the Lanham Act and state laws. On October 13, 2006, SCC filed a Motion for Reconsideration of the District Court's Order dismissing SCC's claims, or in the alternative, to amend its pleadings, which the District Court denied on June 1, 2007. On October 13, 2006, the District Court issued an order to stay the action brought against David Abraham and Clarity until a final judgment or settlement are entered into in the consolidated 02 and 04 actions. On June 20, 2007, the District Court Judge ruled that SCC directly infringed one of Lexmark's patents-in-suit. On June 22, 2007, the jury returned a verdict that SCC did not induce infringement of Lexmark's patents-in-suit. As to SCC's defense that the Company has committed patent misuse, in an advisory, non-binding capacity, the jury did find some Company conduct constituted misuse. In the jury's advisory, non-binding findings, the jury also found that the relevant market was the cartridge market rather than the printer market and that the Company had unreasonably restrained competition in that market. The misuse defense will be decided by the District Court Judge at a later date. A final judgment for the 02 action and the 04 action has not yet been entered by the District Court. SCC filed an appeal of the 02 action and the 04 action with the United States Court of Appeals for the Sixth Circuit Court ("Sixth Circuit") on November 14, 2007. On December 21, 2007, the Clerk of the Sixth Circuit ordered that SCC show cause why its appeal should not be dismissed for lack of appellate jurisdiction since a final judgment has not been entered by the District Court. On January 18, 2008, SCC amended its civil appeals statement to confine its appeal to orders entered in the 02 action. The question of lack of appellate jurisdiction is pending before the Sixth Circuit.

The Company is also party to various litigation and other legal matters, including claims of intellectual property infringement and various purported consumer class action lawsuits alleging, among other things, various product defects and false and deceptive advertising claims, that are being handled in the ordinary course of business. In addition, various governmental authorities have from time to time initiated inquiries and investigations, some of which are ongoing, concerning the activities of participants in the markets for printers and supplies. The Company intends to cooperate fully with those governmental authorities in these matters.

Although it is not reasonably possible to estimate whether a loss will occur as a result of these legal matters, or if a loss should occur, the amount of such loss, the Company does not believe that any legal matters to which it is a party is likely to have a material adverse effect on the Company's financial position, results of operations and cash flows. However, there can be no assurance that any pending legal matters or any legal matters that may arise in the future would not have a material adverse effect on the Company's financial position, results of operations or cash flows.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

Part II

Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information

Lexmark's Class A Common Stock is traded on the New York Stock Exchange under the symbol LXX. As of February 21, 2008, there were 1,240 holders of record of the Class A Common Stock and there were no holders of record of the Class B Common Stock. Information regarding the market prices of the Company's Class A Common Stock appears in Part II, Item 8, Note 18 of the Notes to Consolidated Financial Statements.

Dividend Policy

The Company has never declared or paid any cash dividends on the Class A Common Stock and has no current plans to pay cash dividends on the Class A Common Stock. The payment of any future cash dividends will be determined by the Company's board of directors in light of conditions then existing, including the Company's earnings, financial condition and capital requirements, restrictions in financing agreements, business conditions, tax laws, certain corporate law requirements and various other factors.

Issuer Purchases of Equity Securities

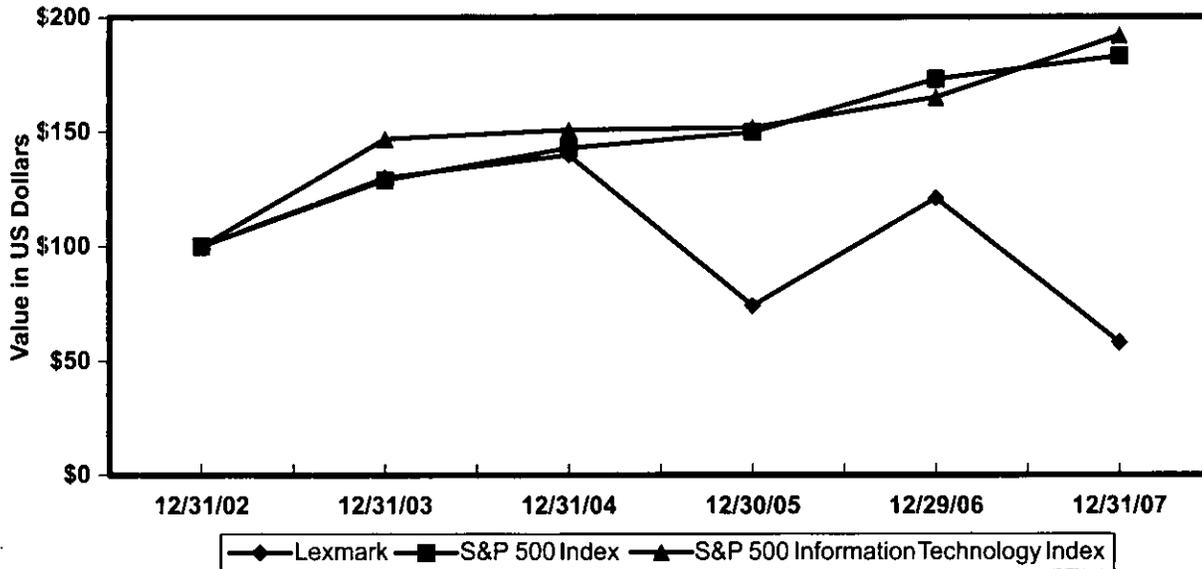
Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs (In Millions) ⁽¹⁾
October 1-31, 2007	—	\$—	—	\$295.5
November 1-30, 2007	—	—	—	295.5
December 1-31, 2007	—	—	—	295.5
Total	—	\$—	—	

(1) In January 2006, the Company received authorization from the board of directors to repurchase an additional \$1.0 billion of its Class A Common Stock for a total repurchase authority of \$3.9 billion. As of December 31, 2007, there was approximately \$0.3 billion of share repurchase authority remaining. This repurchase authority allows the Company, at management's discretion, to selectively repurchase its stock from time to time in the open market or in privately negotiated transactions depending upon market price and other factors. During 2007, the Company repurchased approximately 2.7 million shares at a cost of approximately \$0.2 billion. As of December 31, 2007, since the inception of the program in April 1996, the Company had repurchased approximately 74.1 million shares for an aggregate cost of approximately \$3.6 billion. As of December 31, 2007, the Company had reissued approximately 0.5 million shares of previously repurchased shares in connection with certain of its employee benefit programs. As a result of these issuances as well as the retirement of 44.0 million and 16.0 million shares of treasury stock in 2005 and 2006, respectively, the net treasury shares outstanding at December 31, 2007, were 13.6 million.

Performance Graph

The following graph compares cumulative total stockholder return on the Company's Class A Common Stock with a broad performance indicator, the S&P Composite 500 Stock Index, and an industry index, the S&P 500 Information Technology Index, for the period from December 31, 2002, to December 31, 2007. The graph assumes that the value of the investment in the Class A Common Stock and each index were \$100 at December 31, 2002, and that all dividends were reinvested.

COMPARISON OF CUMULATIVE TOTAL RETURNS



	12/31/02	12/31/03	12/31/04	12/30/05	12/29/06	12/31/07
Lexmark International, Inc.	\$100	\$130	\$140	\$ 74	\$121	\$ 58
S&P 500 Index	100	129	143	150	173	183
S&P 500 Information Technology Index	100	147	151	152	165	192

Source: Standard & Poor's Compustat

Equity Compensation Plan Information

The following table provides information about the Company's equity compensation plans as of December 31, 2007:

(Number of Securities in Millions)

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted Average Exercise Price of Outstanding Options, Warrants and Rights ⁽¹⁾	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans
Equity compensation plans approved by stockholders	11.8 ⁽²⁾	\$68.99	6.5 ⁽³⁾
Equity compensation plans not approved by stockholders ⁽⁴⁾	0.6	47.64	0.3
Total	12.4	\$67.82	6.8

(1) The numbers in this column represent the weighted average exercise price of stock options only.

(2) As of December 31, 2007, of the approximately 11.8 million awards outstanding under the equity compensation plans approved by stockholders, there were approximately 10.6 million stock options (of which 10,266,000 are employee stock options and 327,000 are nonemployee director stock options), 1.1 million restricted stock units ("RSUs") and supplemental deferred stock units ("DSUs") (of which 1,134,000 are employee RSUs and supplemental DSUs and 7,000 are nonemployee director RSUs), and 82,000 elective DSUs (of which 35,000 are employee elective DSUs and 47,000 are nonemployee director elective DSUs) that pertain to voluntary elections by certain members of management to defer all or a portion of their annual incentive compensation and by certain nonemployee directors to defer all or a portion of their annual retainer, chair retainer and/or meeting fees, that would have otherwise been paid in cash.

(3) Of the 6.5 million shares available, 4.1 million relate to employee plans (of which 2.1 million may be granted as full-value awards), 0.5 million relate to the nonemployee director plan and 1.9 million relate to the employee stock purchase plan.

(4) Lexmark has only one equity compensation plan which has not been approved by its stockholders, the Lexmark International, Inc. Broad-Based Employee Stock Incentive Plan (the "Broad-Based Plan"). The Broad-Based Plan, which was established on December 19, 2000, provides for the issuance of up to 1.6 million shares of the Company's common stock pursuant to stock incentive awards (including stock options, stock appreciation rights, performance awards, RSUs and DSUs) granted to the Company's employees, other than its directors and executive officers. The Broad-Based Plan expressly provides that the Company's directors and executive officers are not eligible to participate in the Plan. The Broad-Based Plan limits the number of shares subject to full-value awards (e.g., restricted stock units and performance awards) to 50,000 shares. The Company's board of directors may at any time terminate or suspend the Broad-Based Plan, and from time to time, amend or modify the Broad-Based Plan, but any amendment which would lower the minimum exercise price for options and stock appreciation rights or materially modify the requirements for eligibility to participate in the Broad-Based Plan, requires the approval of the Company's stockholders. In January 2001, all employees other than the Company's directors, executive officers and senior managers, were awarded stock options under the Broad-Based Plan. All 0.6 million awards outstanding under the equity compensation plan not approved by stockholders are in the form of stock options.

Item 6. SELECTED FINANCIAL DATA

The table below summarizes recent financial information for the Company. For further information refer to the Company's Consolidated Financial Statements and Notes thereto presented under Part II, Item 8 of this Form 10-K.

(Dollars in Millions, Except Per Share Data)

	2007	2006	2005	2004	2003
Statement of Earnings Data:					
Revenue	\$4,973.9	\$5,108.1	\$5,221.5	\$5,313.8	\$4,754.7
Cost of revenue ⁽¹⁾	3,410.3	3,462.1	3,585.9	3,522.4	3,209.6
Gross profit	1,563.6	1,646.0	1,635.6	1,791.4	1,545.1
Research and development	403.8	370.5	336.4	312.7	265.7
Selling, general and administrative ⁽¹⁾	812.8	761.8	755.1	746.6	685.5
Restructuring and other, net ⁽¹⁾	25.7	71.2	10.4	—	—
Operating expense	1,242.3	1,203.5	1,101.9	1,059.3	951.2
Operating income ⁽¹⁾⁽²⁾	321.3	442.5	533.7	732.1	593.9
Interest (income) expense, net	(21.2)	(22.1)	(26.5)	(14.5)	(0.4)
Other (income) expense, net ⁽³⁾	(7.0)	5.3	6.5	0.1	0.8
Earnings before income taxes ⁽¹⁾⁽²⁾⁽³⁾	349.5	459.3	553.7	746.5	593.5
Provision for income taxes ⁽⁴⁾	48.7	120.9	197.4	177.8	154.3
Net earnings ⁽¹⁾⁽²⁾⁽³⁾⁽⁴⁾	\$ 300.8	\$ 338.4	\$ 356.3	\$ 568.7	\$ 439.2
Diluted net earnings per common share ⁽¹⁾⁽²⁾⁽³⁾⁽⁴⁾	\$ 3.14	\$ 3.27	\$ 2.91	\$ 4.28	\$ 3.34
Shares used in per share calculation	95.8	103.5	122.3	132.9	131.4
Statement of Financial Position Data:					
Working capital	\$ 569.5	\$ 506.0	\$ 935.9	\$1,533.2	\$1,260.5
Total assets	3,121.1	2,849.0	3,330.1	4,124.3	3,450.4
Total debt	149.9	149.8	149.6	151.0	150.4
Stockholders' equity	1,278.3	1,035.2	1,428.7	2,082.9	1,643.0
Other Key Data:					
Net cash from operations ⁽⁵⁾	\$ 564.2	\$ 670.9	\$ 576.4	\$ 775.4	\$ 747.6
Capital expenditures	\$ 182.7	\$ 200.2	\$ 201.3	\$ 198.3	\$ 93.8
Debt to total capital ratio ⁽⁶⁾	10%	13%	9%	7%	8%

- (1) Amounts in 2007 include restructuring-related charges and project costs of \$52.0 million. Restructuring-related charges of \$5.1 million relating to accelerated depreciation on certain fixed assets are included in *Cost of revenue*. Restructuring-related charges of \$25.7 million relating to employee termination benefit charges are included in *Restructuring and other, net*. Project costs of \$11.9 million and \$9.3 million are included in *Cost of revenue* and *Selling, general and administrative*, respectively. Amounts in 2006 include the impact of restructuring-related charges and project costs of \$125.2 million (net of a \$9.9 million pension curtailment gain). Restructuring-related charges of \$40.0 million relating to accelerated depreciation on certain fixed assets are included in *Cost of revenue*. Restructuring-related charges of \$81.1 million relating to employee termination benefits and contract termination and lease termination charges and the \$9.9 million pension curtailment gain are included in *Restructuring and other, net*. Project costs of \$2.1 million and \$11.9 million are included in *Cost of revenue* and *Selling, general and administrative*, respectively. Amounts in 2005 include one-time termination benefit charges of \$10.4 million in connection with a workforce reduction.
- (2) Amounts in 2007 and 2006 include \$41.3 million and \$43.2 million, respectively, of stock-based compensation expense due to the Company's adoption of SFAS 123R on January 1, 2006.
- (3) Amounts in 2007 include an \$8.1 million pre-tax foreign exchange gain realized upon the substantial liquidation of the Company's Scotland entity.
- (4) Amounts in 2007 include an \$18.4 million benefit from the reversal of previously accrued taxes primarily related to the settlement of a tax audit outside the U.S. and \$11.2 million of benefits resulting from adjustments to previously recorded taxes. Amounts in 2006 include a \$14.3 million benefit from the reversal of previously accrued taxes related to the finalization of certain tax audits and the expiration of various domestic and foreign statutes of limitations. Amounts in 2005 include a \$51.9 million charge from the repatriation of foreign dividends under the American Jobs Creation Act of 2004. Amounts in 2004 include a \$20.0 million benefit from the resolution of income tax matters.
- (5) Cash flows from investing and financing activities, which are not presented, are integral components of total cash flow activity.
- (6) The debt to total capital ratio is computed by dividing total debt (which includes both short-term and long-term debt) by the sum of total debt and stockholders' equity.

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements and Notes thereto presented under Part II, Item 8 of this Form 10-K.

OVERVIEW

Products and Segments

Lexmark makes it easier for businesses and consumers to move information between the digital and paper worlds. Since its inception in 1991, Lexmark has become a leading developer, manufacturer and supplier of printing and imaging solutions for offices and homes. Lexmark's products include laser printers, inkjet printers, multifunction devices, and associated supplies, services and solutions. Lexmark also sells dot matrix printers for printing single and multi-part forms by business users.

The Company is primarily managed along Business and Consumer market segments:

- The Business market segment primarily sells laser products and serves business customers but also include consumers who choose laser products. Laser products can be divided into two major categories — shared workgroup products and lower-priced desktop products. Lexmark employs large-account sales and marketing teams, closely supported by its development and product marketing teams, to generate demand for its business printing solutions and services. The sales and marketing teams primarily focus on industries such as finance, services, retail, manufacturing, public sector and health care. Lexmark also markets its laser and inkjet products increasingly through SMB teams who work closely with channel partners. The Company distributes and fulfills its laser products primarily through its well-established distributor and reseller network. Lexmark's products are also sold through solution providers, which offer custom solutions to specific markets, and through direct response resellers.
- The Consumer market segment predominantly sells inkjet products to consumers but also includes business users who may choose inkjet products as a lower-priced alternative or supplement to laser products for personal desktop use. Also, there is an increasing trend in inkjet products being designed for business purposes such as SOHO, small business, student and home offices. Additionally, over the past couple years, the number of consumers seeking productivity-related features has driven significant growth in AIO products. For the consumer market, Lexmark distributes its branded inkjet products and supplies primarily through retail outlets worldwide. Lexmark's sales and marketing activities are organized to meet the needs of the various geographies and the size of their markets.

The Company also sells its products through numerous alliances and OEM arrangements.

Refer to Part II, Item 8, Note 17 of the Notes to Consolidated Financial Statements for additional information regarding the Company's reportable segments, which is incorporated herein by reference.

Operating Results Summary

2007

Lexmark believes it is experiencing shrinkage in its installed base of inkjet products and an associated decline in end-user demand for inkjet supplies. The Company sees the potential for continued erosion in end-user inkjet supplies demand due to the reduction in inkjet hardware unit sales reflecting the Company's decision to focus on more profitable printer placements, a mix shift between cartridges resulting in a higher percentage of moderate use cartridges and the weakness the Company is experiencing in its OEM business.

Beginning in the second quarter of 2007, the Company's Consumer segment experienced on-going declines in inkjet supplies and OEM unit sales, lower average unit revenues ("AURs") and additional costs

in its new products. As the Company has analyzed the situation, it saw that some of its unit sales were not generating adequate lifetime profitability, some markets and channels were on the low-end of the supplies generation distribution curve and its business was too skewed to the low-end versus the market.

As a result, the Company decided to more aggressively shift the Company's focus to geographic regions, market segments, and customers that generate higher page usage and minimize the unit sales that do not generate an acceptable profit over their life.

The above actions will entail several initiatives:

- Investing in research and development and core inkjet technology.
- Optimizing the Company's marketing and sales initiatives and prioritizing specific markets and channels relative to page generation and lifetime profitability.
- Improving the Company's cost and expense structure.

In 2007, Lexmark continued to make progress on its product expansion with the introduction of a new line of color multifunction devices and wireless inkjet products. Lexmark also continued to make progress in brand development with the continuation and evolution of its advertising campaign from 2006. In 2007, the Company experienced strong branded unit growth in workgroup laser devices and high-end inkjets.

2006

During 2006, the Lexmark announced a number of actions in January 2006 that were implemented during that year:

- The Company implemented a more rigorous process to improve lifetime profitability and payback on inkjet sales.
- The Company announced a plan to restructure its workforce, consolidate some manufacturing capacity and make certain changes to its U.S. retirement plans.

In 2006, Lexmark continued to make progress on its core strategic initiatives in both product segment expansion and brand development resulting in numerous new product introductions. In 2006, the Company also experienced branded unit growth in its key focus segments with strong growth in low-end monochrome lasers, color lasers, laser MFPs and inkjet AIOs.

Additionally, in late 2006, Lexmark launched the next step in its brand development initiative with the start of a new advertising campaign which the Company continued in 2007.

Refer to the section entitled "RESULTS OF OPERATIONS" that follows for a further discussion of the Company's results of operations.

Trends and Opportunities

Lexmark management believes that the total distributed office and home printing output opportunity was approximately \$95 billion in 2007, including hardware, supplies and related services. This opportunity includes printers and multifunction devices as well as a declining base of copiers and fax machines that are increasingly being integrated into multifunction devices. Based on industry analyst information, Lexmark management estimates that this market will grow annually at low- to mid-single digit percentage rates through 2011.

Market trends driving long-term growth include:

- Continuing improvement in price/performance points;
- Increased adoption of color and graphics output in business;
- Advancements in electronic movement of information, driving more pages to be printed by end users when and where it is convenient to do so;

- Continued convergence in technology between printers, scanners, copiers and fax machines into single, integrated AIO devices; and
- Advancements in digital photography driving the opportunity to print digital images on distributed output devices.

As a result of these market trends, Lexmark has growth opportunities in monochrome laser printers, color lasers, laser MFPs and inkjet AIOs.

Industry laser printer unit growth in recent years has generally exceeded the growth rate of laser printer revenue due to unit growth in lower-priced desktop color and monochrome laser printers and unit price reductions. Additionally, color and multifunction laser printer units represent a more significant component of laser unit growth. Management believes these trends will continue. This pricing pressure is partially offset by the tendency of customers in the shared workgroup laser market to add higher profit margin optional features.

In the inkjet product market, advances in inkjet technology have resulted in products with higher resolution and improved performance while increased competition has led to lower prices. Also, there is an increasing trend in inkjet products being designed for business purposes such as SOHO, small business, student and home offices.

Additionally, over the past couple years, the number of consumers seeking productivity-related features has driven significant growth in AIO products. Key factors promoting this trend are greater affordability of AIOs containing productivity features. Management believes the combination of business features made for the home will continue to drive AIO growth. Growth in inkjet hardware revenue on an industry basis in recent years has been lower than unit growth due to price reductions.

While profit margins on printers and MFPs have been negatively affected by competitive pricing pressure, supplies sales are higher margin and recurring. In general, as the hardcopy industry matures and printer and copier markets converge, management expects competitive pressures to continue.

Lexmark's dot matrix printers include mature products that require little ongoing investment. The Company expects that the market for these products will continue to decline, and has implemented a strategy to continue to offer high-quality products while managing cost to maximize cash flow and profit.

Challenges and Risks

In recent years, Lexmark and its principal competitors, many of which have significantly greater financial, marketing and/or technological resources than the Company, have regularly lowered prices on printers and are expected to continue to do so.

Other challenges and risks faced by Lexmark include:

- New product announcements by the Company's principal competitors can have, and in the past, have had, a material adverse effect on the Company's financial results.
- With the convergence of traditional printer and copier markets, major laser competitors now include traditional copier companies.
- The Company must compete with its larger competitors for retail shelf space allocated to printers and their associated supplies.
- The Company sees other competitors and the potential for new entrants into the market possibly having an impact on the Company's growth and market share.
- Historically, the Company has not experienced significant supplies pricing pressure, but if supplies pricing was to come under significant pressure, the Company's financial results could be materially adversely affected.

- Refill, remanufactured, clones, counterfeits and other compatible alternatives for some of the Company's cartridges are available and compete with the Company's supplies business. As the installed base of laser and inkjet products matures, the Company expects competitive supplies activity to increase.
- Lexmark expects that as it competes with larger competitors, the Company's increased market presence may attract more frequent challenges, both legal and commercial, including claims of possible intellectual property infringement.

Refer to the section entitled "Competition" in Item 1, which is incorporated herein by reference, for a further discussion of major uncertainties faced by the industry and Company. Additionally, refer to the section entitled "Risk Factors" in Item 1A, which is incorporated herein by reference, for a further discussion of factors that could impact the Company's operating results.

Strategy and Initiatives

Lexmark's strategy is based on a business model of investing in technology to develop and sell printing solutions, including printers and MFPs, with the objective of growing its installed base, which drives recurring supplies sales. Management believes that Lexmark has the following strengths related to this business model:

- Lexmark is exclusively focused on distributed home and office network or desktop computer printing and imaging, and related solutions.
- Lexmark internally develops all three of the key print technologies associated with distributed printing, including inkjet, monochrome laser and color laser.
- Lexmark has leveraged its technological capabilities and its commitment to flexibility and responsiveness to build strong relationships with large-account customers and channel partners.

Lexmark's strategy involves the following core strategic initiatives:

- Shift the Consumer market strategy to focus on customers, markets and channels that drive higher page generation and supplies;
- Leverage the Company's unique strengths in the Business market segment to grow workgroup devices; and
- Continue to develop Lexmark's brand awareness and brand positioning.

In addition to investments in the Lexmark brand, the successful execution of this strategy involves increased investments in both the Company's sales force and product and solution development. The Company increased its research and development spending by 9% in 2007, by 10% in 2006 and by 8% in 2005. This investment has led to new products and solutions aimed at targeted growth segments as well as a pipeline of future products.

The Company's strategy for dot matrix printers is to continue to offer high-quality products while managing cost to maximize cash flow and profit.

Refer to the section entitled "Strategy" in Item 1, which is incorporated herein by reference, for a further discussion of the Company's strategies and initiatives.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Lexmark's discussion and analysis of its financial condition and results of operations are based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the U.S. The preparation of consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, the Company evaluates its estimates, including those related to customer programs and incentives, product returns, doubtful accounts, inventories, stock-based compensation, income taxes, warranty obligations, copyright fees, restructurings, pension and other postretirement benefits, and contingencies and litigation. Lexmark bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on assumptions about matters that are uncertain at the time the estimate is made, if different estimates reasonably could have been used, or if changes in the estimate that are reasonably likely to occur could materially impact the financial statements. The Company believes the following critical accounting policies affect its more significant judgments and estimates used in the preparation of its consolidated financial statements.

Revenue Recognition

Lexmark records estimated reductions to revenue at the time of sale for customer programs and incentive offerings including special pricing agreements, promotions and other volume-based incentives. Estimated reductions in revenue are based upon historical trends and other known factors at the time of sale. Lexmark also records estimated reductions to revenue for price protection, which it provides to substantially all of its distributor and reseller customers. The amount of price protection is limited based on the amount of dealers' and resellers' inventory on hand (including in-transit inventory) as of the date of the price change. If market conditions were to decline, Lexmark may take actions to increase customer incentive offerings or reduce prices, possibly resulting in an incremental reduction of revenue at the time the incentive is offered.

Allowances for Doubtful Accounts

Lexmark maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. The Company estimates the allowance for doubtful accounts based on a variety of factors including the length of time receivables are past due, the financial health of its customers, unusual macroeconomic conditions and historical experience. If the financial condition of its customers deteriorates or other circumstances occur that result in an impairment of customers' ability to make payments, the Company records additional allowances as needed.

Stock-Based Compensation

On January 1, 2006, Lexmark implemented the provisions of Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), *Share-Based Payment* ("SFAS 123R") and related interpretations. SFAS 123R requires that all share-based payments to employees, including grants of stock options, be recognized in the financial statements based on their fair value. The Company selected the modified prospective transition method for implementing SFAS 123R and began recognizing compensation expense for stock-based awards granted on or after January 1, 2006, plus any unvested awards granted prior to January 1, 2006. Under this transition method, prior periods have not been restated. Stock-based compensation expense for awards granted on or after January 1, 2006, is based on the grant date fair value calculated in accordance with the provisions of SFAS 123R. Stock-based compensation related to any unvested awards granted prior to January 1, 2006, is based on the grant date fair value

calculated in accordance with the original provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*. The fair value of the Company's stock-based awards, less estimated forfeitures, is amortized over the awards' vesting periods on a straight-line basis.

Prior to the adoption of SFAS 123R on January 1, 2006, the Company accounted for the costs of its stock-based employee compensation plans under Accounting Principles Board ("APB") Opinion No. 25, *Accounting for Stock Issued to Employees* ("APB 25"), and related interpretations. Under APB 25, compensation cost was not recognized for substantially all options granted because the exercise price was at least equal to the market value of the underlying common stock on the date of grant.

The fair value of each option award on the grant date was estimated using the Black-Scholes option-pricing model with the following assumptions: expected dividend yield, expected stock price volatility, weighted average risk-free interest rate and weighted average expected life of the options. Under SFAS 123R, the Company's expected volatility assumption used in the Black-Scholes option-pricing model was based exclusively on historical volatility and the expected life assumption was established based upon an analysis of historical option exercise behavior. The risk-free interest rate used in the Black-Scholes model was based on the implied yield currently available on U.S. Treasury zero-coupon issues with a remaining term equal to the Company's expected term assumption. The Company has never declared or paid any cash dividends on the Class A Common Stock and has no current plans to pay cash dividends on the Class A Common Stock. The payment of any future cash dividends will be determined by the Company's board of directors in light of conditions then existing, including the Company's earnings, financial condition and capital requirements, restrictions in financing agreements, business conditions, tax laws, certain corporate law requirements and various other factors.

Restructuring

Lexmark records a liability for a cost associated with an exit or disposal activity at its fair value in the period in which the liability is incurred, except for liabilities for certain employee termination benefit charges that are accrued over time. Employee termination benefits associated with an exit or disposal activity are accrued when the obligation is probable and estimable as a postemployment benefit obligation when local statutory requirements stipulate minimum involuntary termination benefits or, in the absence of local statutory requirements, termination benefits to be provided are similar to benefits provided in prior restructuring activities. Specifically for termination benefits under a one-time benefit arrangement, the timing of recognition and related measurement of a liability depends on whether employees are required to render service until they are terminated in order to receive the termination benefits and, if so, whether employees will be retained to render service beyond a minimum retention period. For employees who are not required to render service until they are terminated in order to receive the termination benefits or employees who will not provide service beyond the minimum retention period, the Company records a liability for the termination benefits at the communication date. If employees are required to render service until they are terminated in order to receive the termination benefits and will be retained to render service beyond the minimum retention period, the Company measures the liability for termination benefits at the communication date and recognizes the expense and liability ratably over the future service period. For contract termination costs, Lexmark records a liability for costs to terminate a contract before the end of its term when the Company terminates the agreement in accordance with the contract terms or when the Company ceases using the rights conveyed by the contract. The Company records a liability for other costs associated with an exit or disposal activity in the period in which the liability is incurred. Once Company management approves an exit or disposal activity, the Company closely monitors the expenses that are reported in association with the activity.

Warranty

Lexmark provides for the estimated cost of product warranties at the time revenue is recognized. The amounts accrued for product warranties is based on the quantity of units sold under warranty, estimated product failure rates, and material usage and service delivery costs. The estimates for product failure rates and material usage and service delivery costs are periodically adjusted based on actual results. For

extended warranty programs, the Company defers revenue in short-term and long-term liability accounts (based on the extended warranty contractual period) for amounts invoiced to customers for these programs and recognizes the revenue ratably over the contractual period. Costs associated with extended warranty programs are expensed as incurred. To minimize warranty costs, the Company engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of its component suppliers. Should actual product failure rates, material usage or service delivery costs differ from the Company's estimates, revisions to the estimated warranty liability may be required.

Inventory Reserves and Adverse Purchase Commitments

Lexmark writes down its inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value. The Company estimates the difference between the cost of obsolete or unmarketable inventory and its market value based upon product demand requirements, product life cycle, product pricing and quality issues. Also, Lexmark records an adverse purchase commitment liability when anticipated market sales prices are lower than committed costs. If actual market conditions are less favorable than those projected by management, additional inventory write-downs and adverse purchase commitment liabilities may be required.

Long-Lived Assets

Lexmark performs reviews for the impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment loss is recognized when estimated undiscounted future cash flows expected to result from the use of the asset and its eventual disposition are less than its carrying amount. If future expected undiscounted cash flows are insufficient to recover the carrying value of the assets, then an impairment loss is recognized based upon the excess of the carrying value of the asset over the anticipated cash flows on a discounted basis. Such an impairment review incorporates estimates of forecasted revenue and costs that may be associated with an asset, expected periods that an asset may be utilized and appropriate discount rates.

Lexmark also reviews any legal and contractual obligations associated with the retirement of its long-lived assets and records assets and liabilities, as necessary, related to the cost of such obligations. Costs associated with such obligations that are reasonably estimable and probable are accrued and expensed, or capitalized as appropriate. The asset recorded is recorded during the period in which it occurs and is amortized over the useful life of the related long-lived tangible asset. The liability recorded is relieved when the costs are incurred to retire the related long-lived tangible asset. The cost of each obligation is estimated based on current law and technology; accordingly, such estimates could change materially as the Company periodically evaluates and revises such estimates based on expenditures against established reserves and the availability of additional information. The Company's asset retirement obligations are currently not material.

Pension and Other Postretirement Plans

The Company's pension and other postretirement benefit costs and obligations are dependent on various actuarial assumptions used in calculating such amounts. The non-U.S. pension plans are not significant and use economic assumptions similar to the U.S. pension plan. Significant assumptions the Company must review and set annually related to its pension and other postretirement benefit obligations are:

- Expected long-term return on plan assets — based on long-term historical actual asset return information, the mix of investments that comprise plan assets and future estimates of long-term investment returns by reference to external sources.
- Discount rate — reflects the rates at which benefits could effectively be settled and is based on current investment yields of high-quality fixed-income investments. The Company uses a yield-curve approach to determine the assumed discount rate in the U.S. based on the timing of the cash flows of the expected future benefit payments.

- Rate of compensation increase — based on the Company's long-term plans for such increases. Effective April 2006, this assumption is no longer applicable to the U.S. pension plan due to the benefit accrual freeze in connection with the Company's 2006 restructuring actions.

Differences between actual and expected asset returns on equity investments are recognized in the calculation of net periodic benefit cost over five years. The deferred amounts resulting from this averaging process would have reduced 2007 pension expense by approximately \$6 million for US plans and are not expected to have a significant effect on the Company's results of operations for 2008.

Actual results that differ from assumptions that fall outside the "10% corridor", as defined by SFAS No. 87, *Employers' Accounting for Pensions*, are accumulated and amortized over the estimated future service period of active plan participants. For 2007, a 25 basis point change in the assumptions for asset return and discount rate would not have had a significant impact on the Company's results of operations.

Effective December 31, 2006, the Company adopted SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)* ("SFAS 158"). SFAS 158 requires recognition of the funded status of a benefit plan in the statement of financial position and recognition in other comprehensive earnings of certain gains and losses that arise during the period, but are deferred under pension accounting rules.

Income Taxes

The Company estimates its tax liability based on current tax laws in the statutory jurisdictions in which it operates. These estimates include judgments about deferred tax assets and liabilities resulting from temporary differences between assets and liabilities recognized for financial reporting purposes and such amounts recognized for tax purposes, as well as about the realization of deferred tax assets. If the provisions for current or deferred taxes are not adequate, if the Company is unable to realize certain deferred tax assets or if the tax laws change unfavorably, the Company could potentially experience significant losses in excess of the reserves established. Likewise, if the provisions for current and deferred taxes are in excess of those eventually needed, if the Company is able to realize additional deferred tax assets or if tax laws change favorably, the Company could potentially experience significant gains.

In July 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109* ("FIN 48"). FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold as "more-likely-than-not" that a tax position must meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting for income taxes in interim periods, financial statement disclosure and transition rules.

The evaluation of a tax position in accordance with FIN 48 is a two-step process. The first step is recognition: The enterprise determines whether it is more likely than not that a tax position will be sustained upon examination, including resolution of any litigation. The second step is measurement: A tax position that meets the more-likely-than-not recognition threshold is measured to determine the amount of benefit to recognize in the financial statements. The tax position is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate resolution.

The Company adopted the provisions of FIN 48 and related guidance on January 1, 2007. As a result of the implementation of FIN 48, the Company reduced its liability for unrecognized tax benefits and related interest and penalties by \$7.3 million, which resulted in a corresponding increase in the Company's January 1, 2007, retained earnings balance. The Company also recorded an increase in its deferred tax assets of \$8.5 million and a corresponding increase in its liability for unrecognized tax benefits as a result of adopting FIN 48.

Copyright Fees

Certain countries (primarily in Europe) and/or collecting societies representing copyright owners' interests have taken action to impose fees on devices (such as scanners, printers and multifunction devices)

alleging the copyright owners are entitled to compensation because these devices enable reproducing copyrighted content. Other countries are also considering imposing fees on certain devices. The amount of fees, if imposed, would depend on the number of products sold and the amounts of the fee on each product, which will vary by product and by country. The Company has accrued amounts that it believes are adequate to address the risks related to the copyright fee issues currently pending. The financial impact on the Company, which will depend in large part upon the outcome of local legislative processes, the Company's and other industry participants' outcome in contesting the fees and the Company's ability to mitigate that impact by increasing prices, which ability will depend upon competitive market conditions, remains uncertain.

Contingencies and Litigation

In accordance with SFAS No. 5, *Accounting for Contingencies*, Lexmark records a provision for a loss contingency when management believes that it is both probable that a liability has been incurred and the amount of loss can be reasonably estimated. The Company believes it has adequate provisions for any such matters.

RESULTS OF OPERATIONS

Operations Overview

Key Messages

Lexmark is focused on driving long-term performance by strategically investing in technology, demand generation and brand development to enable the Company to profitably capture supplies in high page-growth segments of the distributed printing market.

- The Business market segment strategy is focused on growth in higher page-generating workgroup class lasers including monochrome and color laser printers and MFPs. During 2007, the Company experienced double-digit unit growth in its branded workgroup and laser MFP units and growth in laser supplies.
- The Company is aggressively shifting its focus in the Consumer market segment to geographic regions, product segments, and customers that generate higher page usage. This strategy shift will increase the Company's focus on higher priced, higher usage devices, customers and countries and will accelerate its investments to better meet the needs of those customers and product segments. The Company's initiative in wireless inkjets is a part of the strategic shift and although wireless is a small part of the overall inkjet market, the Company believes it's the fastest growing part of the market and it has already captured some significant market share.

Lexmark is taking actions to improve its cost and expense structure including continuing to implement a restructuring of its business to lower its cost and better allow it to fund these strategic initiatives.

Lexmark continues to maintain a strong financial position with good cash generation and a solid balance sheet, which positions it to invest in the future of the business and compete effectively even during challenging times.

2007 Business Factors

Business segment

During 2007, Lexmark continued its investments in the Business market segment through new products and technology. The Company expects these investments to produce a steady stream of new products. Lexmark continued to make progress on its product expansion initiative with the introduction of a new line of color multifunction devices.

Lexmark continued to make progress on its brand development initiative with the continuation and evolution of its advertising campaign from 2006. The Company continued its investment in the

expansion of managed print services and industry sales initiatives. Lexmark also made a significant investment in its enterprise sales force in 2007 to improve its coverage and expand the reach of its solutions and services proposition.

The focus of all of these Business market investments is to drive workgroup laser growth and page generation.

Consumer segment

Lexmark believes it is experiencing shrinkage in its installed base of inkjet products and an associated decline in end-user demand for inkjet supplies. The Company sees the potential for continued erosion in end-user inkjet supplies demand due to the reduction in inkjet hardware unit sales reflecting the Company's decision to focus on more profitable printer placements, a mix shift between cartridges resulting in a higher percentage of moderate use cartridges and the weakness the Company is experiencing in its OEM business. Additionally, Lexmark expects to see continued declines in OEM unit sales and aggressive pricing and promotion activities in the inkjet and laser markets.

Beginning in the second quarter of 2007, the Company experienced the following issues in its Consumer segment:

- On-going declines in inkjet supplies and OEM unit sales.
- Lower average unit revenues due to aggressive pricing and promotion.
- Additional costs in its new products.

As the Company analyzed the situation, it saw the following:

- Some of its unit sales were not generating adequate lifetime profitability due to lower prices, higher costs and supplies usage below its model.
- Some markets and channels were on the low-end of the supplies generation distribution curve.
- Its business was too skewed to the low-end versus the market, resulting in lower supplies generation per unit.

As a result, Lexmark decided to take the following actions:

- The Company has decided to more aggressively shift its focus to geographic regions, market segments and customers that generate higher page usage.
- The Company is working to minimize the unit sales that do not generate an acceptable profit over their life.

The above actions will entail several initiatives:

- Investing in research and development and core inkjet technology to better support this higher usage customer set.
- Optimizing the Company's marketing and sales initiatives and prioritizing specific markets and channels relative to page generation and lifetime profitability. For the highest priority markets, this will mean a focus on expanding retail and non-retail sales, and associated marketing campaigns. For the lowest priority markets, this will mean less or no retail sales. As a result of this market prioritization and the previously mentioned business optimization, the Company estimates that approximately 30% of its full-year 2007 inkjet unit sales will not be anniversaried in 2008.
- Improving the Company's cost and expense structure. The Company announced a restructuring plan ("the 2007 Restructuring Plan") to reduce its cost and infrastructure, including the closure of one of its inkjet supplies manufacturing facilities in Mexico and additional optimization measures at the remaining inkjet facilities in Mexico and the Philippines. See "*Restructuring-related Charges, Project Costs and Other*" that follows for further discussion.

2006 Business Factors

To improve profitability and the Company's cost and expense structure, Lexmark announced a number of actions in January 2006 that were implemented during that year:

- The Company implemented a more rigorous process to improve lifetime profitability and payback on inkjet sales which resulted in a reduction of approximately 20% of its worldwide inkjet business.
- The Company announced a plan (collectively referred to as the "2006 actions") to restructure its workforce, to consolidate some supplies manufacturing capacity, to reduce costs and expenses in the areas of supply chain, general and administrative expense, as well as marketing and sales support functions and to make certain changes to its U.S. retirement plans. Except for approximately 100 positions that were eliminated in 2007, the restructuring-related activities related to the 2006 actions were substantially completed at the end of 2006.

In 2006, Lexmark continued to make progress on its core strategic initiatives in both product segment expansion and brand development resulting in new product introductions with new families of low-end monochrome lasers, color lasers, laser MFPs and inkjet AIOs. These new products received significant industry recognition and awards.

In 2006, the Company also experienced branded unit growth in its key focus segments with strong growth in low-end monochrome lasers, color lasers, laser MFPs and inkjet AIOs.

Additionally, in late 2006, Lexmark launched the next step in its brand development initiative with the start of a new television advertising campaign along with radio, print and outdoor advertising in targeted geographic and market segments. This integrated campaign highlights Lexmark's deep and proven experience serving 75% of the top banks, retailers and pharmacies while highlighting the opportunity for small and medium businesses and consumers to benefit from our business class expertise. The Company continued this campaign in 2007 as Lexmark's focus is to drive branded unit growth in its key growth segments.

Operating Results Summary

The following discussion and analysis should be read in conjunction with the Consolidated Financial Statements and Notes thereto. The following table summarizes the results of the Company's operations for the years ended December 31, 2007, 2006 and 2005:

<i>(Dollars in Millions)</i>	2007		2006		2005	
	Dollars	% of Rev	Dollars	% of Rev	Dollars	% of Rev
Revenue	\$4,973.9	100%	\$5,108.1	100%	\$5,221.5	100%
Gross profit	1,563.6	31%	1,646.0	32%	1,635.6	31%
Operating expense	1,242.3	25%	1,203.5	24%	1,101.9	21%
Operating income	321.3	6%	442.5	9%	533.7	10%
Net earnings	300.8	6%	338.4	7%	356.3	7%

During 2007, total revenue was \$5.0 billion or down 3% from 2006. Laser and inkjet supplies revenue increased 1% year-to-year ("YTY") while laser and inkjet hardware revenue decreased 10% YTY. In the Business segment, revenue increased 5% YTY while revenue in the Consumer segment decreased 12% YTY.

During 2006, total revenue was \$5.1 billion or down 2% from 2005. Laser and inkjet supplies revenue increased 3% YTY while laser and inkjet hardware revenue decreased 8% YTY. In the Business segment, revenue increased 3% YTY while revenue in the Consumer segment decreased 8% YTY.

Net earnings for the year ended December 31, 2007, decreased 11% from the prior year primarily due to lower operating income partially offset by a lower effective tax rate. Net earnings in 2007 included \$30.8 million of pre-tax restructuring-related charges in connection with the 2007 Restructuring Plan.

Additionally, during 2007, the Company incurred incremental charges related to the execution of its 2007 Restructuring Plan and its 2006 actions (collectively referred to as "project costs"). Net earnings in 2007 included \$21.2 million (net of a \$3.5 million pre-tax gain on the sale of the Rosyth, Scotland facility) of these pre-tax project costs. See "Restructuring-related Charges, Project Costs and Other" that follows for further discussion. Net earnings in 2007 also included an \$8.1 million pre-tax foreign exchange gain realized upon the substantial liquidation of the Company's Scotland entity, an \$18 million tax benefit primarily related to the settlement of a tax audit outside the U.S. and an \$11 million tax benefit resulting from adjustments to previously recorded taxes.

Net earnings for the year ended December 31, 2006, decreased 5% from the prior year primarily due to lower operating income partially offset by a lower effective tax rate. Net earnings in 2006 included \$135.1 million of pre-tax restructuring-related charges and project costs, a \$9.9-million pre-tax pension curtailment gain and a \$14.3 million income tax benefit from the reversal of previously accrued taxes related to the finalization of certain tax audits and the expiration of various domestic and foreign statutes of limitation. Net earnings in 2005 included increased income tax expense of \$51.9 million resulting from the repatriation of foreign dividends during 2005 and \$10.4 million of one-time pre-tax termination benefit charges related to a 2005 workforce reduction plan.

Additionally, for the years ended December 31, 2007 and 2006, the Company incurred pre-tax stock-based compensation expense under SFAS 123R of \$41.3 million and \$43.2 million, respectively. The Company recorded pre-tax compensation expense of \$2.9 million in 2005 related to its stock incentive plans prior to the adoption of SFAS 123R.

Revenue

The following tables provide a breakdown of the Company's revenue by product category, hardware unit shipments and market segment:

Revenue by product:

(Dollars in Millions)	2007	2006	% Change	2006	2005	% Change
Laser and inkjet printers . . .	\$1,498.3	\$1,663.0	(10)%	\$1,663.0	\$1,799.4	(8)%
Laser and inkjet supplies . . .	3,248.6	3,211.6	1%	3,211.6	3,117.2	3%
Other	227.0	233.5	(3)%	233.5	304.9	(23)%
Total revenue	\$4,973.9	\$5,108.1	(3)%	\$5,108.1	\$5,221.5	(2)%

Unit shipments:

(Units in Millions)	2007	2006	2005
Laser units	2.1	2.1	2.0
Inkjet units	12.1	14.7	18.4

During 2007, laser and inkjet supplies revenue increased 1% YTY as good growth in laser supplies was mostly offset by a decline in inkjet supplies. Laser and inkjet hardware revenue decreased 10% primarily due to a decline in inkjet units.

During 2006, laser and inkjet supplies revenue increased 3% YTY as good growth in laser supplies was partially offset by a decline in inkjet supplies. Laser and inkjet hardware revenue decreased 8% with growth in laser hardware units more than offset by the decline in inkjet hardware units.

During 2007, 2006 and 2005, one customer, Dell, accounted for \$717 million or approximately 14%, \$744 million or approximately 15% and \$782 million or approximately 15%, of the Company's total revenue, respectively. Sales to Dell are included in both the Business and Consumer segments.

Revenue by market segment:

<i>(Dollars in Millions)</i>	2007	2006	% Change	2006	2005	% Change
Business	\$2,999.2	\$2,869.1	5%	\$2,869.1	\$2,774.8	3%
Consumer	1,974.7	2,239.0	(12)%	2,239.0	2,446.7	(8)%
Total revenue	\$4,973.9	\$5,108.1	(3)%	\$5,108.1	\$5,221.5	(2)%

Business segment

During 2007, revenue in the Business segment increased \$130 million or 5% compared to 2006 due to growth in laser supplies revenue partially offset by a decline in laser hardware revenue. Laser hardware unit shipments decreased approximately 3% YTY reflecting strong unit growth in laser MFPs and branded workgroup printers which was more than offset by a decline in low-end monochrome lasers. Laser hardware AUR, which reflects the changes in both pricing and mix, increased approximately 1% YTY due to the positive mix shift.

During 2006, revenue in the Business segment increased \$94 million or 3% compared to 2005 principally due to higher laser supplies revenue. Laser hardware unit shipments increased approximately 9% YTY with strong growth in branded unit sales partially offset by declines in OEM unit sales. Laser hardware AUR decreased approximately 9% YTY reflecting price declines and a mix shift to low-end monochrome lasers.

Consumer segment

During 2007, revenue in the Consumer segment decreased \$264 million or 12% compared to 2006 due to decreased inkjet hardware and supplies revenue. Hardware revenue declined YTY due to lower unit shipments and lower AURs. Inkjet hardware unit shipments declined 18% YTY principally due to declines in OEM units and the Company's decision to prioritize certain markets, segments and customers and to reduce or eliminate others. Units were also impacted by the Company's decision to focus on more profitable printer placements in every geography. Inkjet hardware AUR decreased 3% YTY as price declines were partially offset by a favorable mix shift to AIOs.

During 2006, revenue in the Consumer segment decreased \$208 million or 8% compared to 2005 primarily due to decline in inkjet hardware units. Inkjet unit shipments decreased approximately 20% YTY. Inkjet hardware AUR increased approximately 2% YTY as a favorable product mix shift to AIOs was partially offset by price declines.

Revenue by geography:

The following table provides a breakdown of the Company's revenue by geography:

<i>(Dollars in Millions)</i>	2007	2006	% Change	2006	2005	% Change
United States	\$2,140.3	\$2,245.3	(5)%	\$2,245.3	\$2,360.5	(5)%
EMEA (Europe, the Middle East & Africa)	1,827.2	1,843.1	(1)%	1,843.1	1,853.8	(1)%
Other International	1,006.4	1,019.7	(1)%	1,019.7	1,007.2	1%
Total revenue	\$4,973.9	\$5,108.1	(3)%	\$5,108.1	\$5,221.5	(2)%

During 2007, revenue decreased in all geographies primarily due to the previously-mentioned decline in Consumer segment revenues. Currency exchange rates did have a material favorable impact on revenue in Europe and Other International geographies during 2007.

During 2006, revenue decreased in the U.S. primarily due to the decline in inkjet hardware units. Currency exchange rates did not have a material impact on revenue in Europe and Other International geographies during 2006.

Gross Profit

The following table provides gross profit information:

<i>(Dollars in Millions)</i>	2007	2006	Change	2006	2005	Change
Gross profit dollars	\$1,563.6	\$1,646.0	(5)%	\$1,646.0	\$1,635.6	1%
% of revenue	31.4%	32.2%	(0.8)pts	32.2%	31.3%	0.9pts

During 2007, consolidated gross profit and gross profit as a percentage of revenue decreased when compared to the prior year. The change in the gross profit margin over the prior period was primarily due to a 4.2 percentage point decrease in product margins, principally in inkjet hardware, partially offset by a 3.0 percentage point favorable mix shift among products, primarily driven by less inkjet hardware revenue and a 0.4 percentage point improvement attributable to restructuring-related actions primarily from a reduction in accelerated depreciation charges YTY. Gross profit in 2007 included \$5.1 million of restructuring-related charges and \$11.9 million of project costs in connection with its restructuring activities. See *"Restructuring-related Charges, Project Costs and Other"* that follows for further discussion.

During 2006, consolidated gross profit and gross profit as a percentage of revenue increased when compared to the prior year. The change in the gross profit margin over the prior period was primarily due to a 3.3 percentage point favorable mix shift among products, mostly from a decrease in the percentage of inkjet hardware and an increase in laser supplies, partially offset by a decrease in hardware margins in both inkjet and lasers. Gross profit in 2006 also included \$42.1 million (or a 0.8 percentage point impact) of restructuring-related charges, primarily relating to accelerated depreciation, and project costs. See *"Restructuring-related Charges, Project Costs and Other"* that follows for further discussion.

During 2006 and 2007, the Company continued efforts begun in 2002 to execute supplier managed inventory ("SMI") agreements with its primary suppliers to improve the efficiency of the supply chain. In instances where a non-cancelable commitment is made to purchase product at a cost greater than the expected sales price, the Company's accounting policy is to recognize a liability and related expense for future losses. Management believes these SMI agreements improve Lexmark's supply chain inventory pipeline and supply chain flexibility which enhances responsiveness to our customers. In addition, management believes these agreements improve supplier visibility to product demand and therefore improve suppliers' timeliness and management of their inventory pipelines. During 2005, several products transitioned to SMI agreements that were not previously under such agreements. The pre-tax benefit in 2005 to the Company of this transition was approximately \$49 million which was reflected as lower adverse purchase commitment charges. As of December 31, 2005, the significant majority of major printer suppliers were under new SMI agreements. There was no measurable benefit of products transitioning to SMI agreements in 2006 and 2007. As of December 31, 2007, a significant majority of printers were purchased under SMI agreements. Any impact on future operations would depend upon factors such as the Company's ability to negotiate new SMI agreements and future market pricing and product costs.

Operating Expense

The following table presents information regarding the Company's operating expenses during the periods indicated:

<i>(Dollars in Millions)</i>	2007		2006		2005	
	Dollars	% of Rev	Dollars	% of Rev	Dollars	% of Rev
Research and development . . .	\$ 403.8	8.1%	\$ 370.5	7.3%	\$ 336.4	6.4%
Selling, general & administrative	812.8	16.4%	761.8	14.9%	755.1	14.5%
Restructuring and other, net . . .	25.7	0.5%	71.2	1.4%	10.4	0.2%
Total operating expense	\$1,242.3	25.0%	\$1,203.5	23.6%	\$1,101.9	21.1%

Research and development increased in 2007 and 2006 compared to the prior year due to the Company's continued investment to support product and solution development. These continuing investments have led to new products and solutions aimed at targeted growth segments.

Selling, general and administrative ("SG&A") expenses in 2007 increased YTY as the Company continued to increase spending on marketing and sales activities. During 2007, demand generation activities, which include the brand development marketing campaign launched in late 2006, increased YTY. The initiative includes a television advertising campaign along with radio and print advertising in targeted geographic and market segments. Additionally, SG&A expenses in 2007 included \$9.3 million of project costs (net of a \$3.5 million pre-tax gain on the sale of the Rosyth, Scotland facility). SG&A expenses in 2006 included \$11.9 million of project costs related to the 2006 actions. See "Restructuring-related Charges, Project Costs and Other" that follows for further discussion. SG&A expenses in 2007 and 2006 also included \$31.7 million and \$30.3 million of stock-based compensation expense due to the Company's adoption of SFAS 123R.

Restructuring and other, net, in 2007 included \$25.7 million of restructuring-related charges in connection with the 2007 Restructuring Plan. Restructuring and other, net, in 2006 included \$81.1 million of restructuring-related charges for the 2006 restructuring plan partially offset by a \$9.9 million pension curtailment gain. In 2005, the Company incurred \$10.4 million of one-time termination benefit charges related to the 2005 workforce reduction. See "Restructuring-related Charges, Project Costs and Other" that follows for further discussion.

Operating Income (Loss)

The following table provides operating income by market segment:

<i>(Dollars in Millions)</i>	2007	2006	Change	2006	2005	Change
Business	\$ 612.0	\$ 600.1	2%	\$ 600.1	\$ 661.0	(9)%
% of segment revenue	20.4%	20.9%	(0.5)pts	20.9%	23.8%	(2.9)pts
Consumer	93.4	246.0	(62)%	\$ 246.0	232.1	6%
% of segment revenue	4.7%	11.0%	(6.3)pts	11.0%	9.5%	1.5pts
All other	(384.1)	(403.6)	5%	\$(403.6)	(359.4)	(12)%
Total operating income (loss)	\$ 321.3	\$ 442.5	(27)%	\$ 442.5	\$ 533.7	(17)%
% of total revenue	6.5%	8.7%	(2.2)pts	8.7%	10.2%	(1.5)pts

For the year ended December 31, 2007, the decrease in consolidated operating income was due to decreased gross profits and higher operating expenses partially offset by a reduction in restructuring-related charges and project costs YTY as discussed above. Operating income for the Business segment increased YTY as higher gross profits, reflecting increased supplies revenue, were partially offset by higher operating expense, reflecting higher marketing and sales and product development investments. Operating income for the Consumer segment decreased YTY due to lower supplies revenue, lower product margins and increased operating expenses.

For the year ended December 31, 2006, the decrease in consolidated operating income was due to increased operating expenses partially offset by increased gross profits. Operating income for the Business segment decreased due to lower gross profits, the impact of restructuring-related charges and project costs and the increased investment in research and development. Operating income for the Consumer segment increased due to increased gross profits partially offset by the impact of restructuring-related charges and project costs.

During 2007, the Company incurred total pre-tax restructuring-related charges and project costs of \$12.1 million in its Business segment, \$12.2 million in its Consumer segment and \$27.7 million in All other. During 2006, the Company incurred restructuring-related charges and project costs of \$35.9 million in its Business segment, \$57.2 million in its Consumer segment and \$42.0 million in All other. All other operating income in 2006 also included a \$9.9 million pension curtailment gain. During 2005, the Company

incurred one-time termination benefit charges of \$10.4 million related to a workforce reduction plan. For the \$10.4 million of one-time termination benefit charges, the Company recorded \$6.5 million in its Business segment, \$2.6 million in its Consumer segment and \$1.3 million in All other. See "Restructuring-related Charges, Project Costs and Other" that follows for further discussion.

Interest and Other

The following table provides interest and other information:

<i>(Dollars in Millions)</i>	2007	2006	2005
Interest (income) expense, net	\$(21.2)	\$(22.1)	\$(26.5)
Other expense (income), net	(7.0)	5.3	6.5
Total interest and other (income) expense, net	\$(28.2)	\$(16.8)	\$(20.0)

Total interest and other (income) expense, net, was income of \$28 million in 2007 compared to income of \$17 million in 2006. During 2007, the Company substantially liquidated the remaining operations of its Scotland entity and recognized an \$8.1 million pre-tax gain from the realization of the entity's accumulated foreign currency translation adjustment generated on the investment in the entity during its operating life.

Total interest and other (income) expense, net, was income of \$17 million in 2006 compared to income of \$20 million in 2005. This decrease was primarily due to lower interest income in 2006 compared to the prior year as a result of a decreased level of cash and marketable securities held by the Company during the year partially offset by higher interest rates in 2006 compared to 2005.

Provision for Income Taxes and Related Matters

The Company's effective income tax rate was approximately 13.9%, 26.3% and 35.6% in 2007, 2006 and 2005, respectively.

The 12.4 percentage point reduction YTY of the effective tax rate was primarily due to a geographic shift of earnings (6.9 percentage points) as well as reversals and adjustments of previously accrued taxes (5.4 percentage points). During 2007, the Company reversed \$18.4 million of previously accrued taxes mostly due to the settlement of a tax audit outside the U.S. and recorded \$11.2 million of adjustments to previously recorded tax amounts. Specific to the fourth quarter of 2007, the Company recorded adjustments of \$6.4 million to previously recorded tax amounts. The impact of these adjustments was insignificant to prior periods.

The 2006 effective income tax rate included a \$14.3 million benefit from the reversal of previously accrued taxes related to the finalization of certain tax audits and the expiration of various domestic and foreign statutes of limitation.

The 2005 effective income tax rate was impacted by the American Jobs Creation Act of 2004 (the "AJCA") signed by the President of the U.S. on October 22, 2004. The AJCA created a temporary incentive for U.S. corporations to repatriate accumulated income earned abroad by providing an 85 percent dividends-received deduction for certain dividends from controlled foreign corporations. On April 28, 2005, the Company's board of directors approved a Domestic Reinvestment Plan ("DRP") under the AJCA. Pursuant to the DRP, the Company repatriated \$684 million for which it will claim the 85 percent dividends-received deduction provided by the AJCA. The Company's 2005 income tax provision included \$51.9 million to cover the Federal, State, and foreign income taxes the Company has estimated it would owe in connection with its repatriation of the \$684 million.

During 2006, the Company was subject to a tax holiday in Switzerland with respect to the earnings of one of the Company's wholly-owned Swiss subsidiaries. The holiday expired at the end of 2006. The benefit derived from the tax holiday was \$1.6 million in 2006 and \$11.5 million in 2005.

Net Earnings

Net earnings for the year ended December 31, 2007, decreased 11% from the prior year primarily due to lower operating income partially offset by a lower effective tax rate. Net earnings in 2007 included \$30.8 million of pre-tax restructuring-related charges in connection with the 2007 Restructuring Plan. Additionally, during 2007, the Company incurred incremental charges related to the execution of its 2007 Restructuring Plan and its 2006 actions (collectively referred to as "project costs"). Net earnings in 2007 included \$21.2 million (net of a \$3.5 million pre-tax gain on the sale of the Rosyth, Scotland facility) of these pre-tax project costs. See "Restructuring-related Charges, Project Costs and Other" that follows for further discussion. Net earnings in 2007 also included an \$8.1 million pre-tax foreign exchange gain realized upon the substantial liquidation of the Company's Scotland entity, an \$18 million tax benefit primarily related to the settlement of a tax audit outside the U.S. and an \$11 million tax benefit resulting from adjustments to previously recorded taxes.

Net earnings for the year ended December 31, 2006, decreased 5% from the prior year primarily due to lower operating income partially offset by a lower effective tax rate. Net earnings in 2006 included \$135.1 million of pre-tax restructuring-related charges and project costs, a \$9.9 million pre-tax pension curtailment gain and a \$14.3 million income tax benefit from the reversal of previously accrued taxes related to the finalization of certain tax audits and the expiration of various domestic and foreign statutes of limitation. Net earnings in 2005 included increased income tax expense of \$51.9 million resulting from the repatriation of foreign dividends during 2005 and \$10.4 million of one-time pre-tax termination benefit charges related to a 2005 workforce reduction plan.

Additionally, for the years ended December 31, 2007 and 2006, the Company incurred pre-tax stock-based compensation expense under SFAS 123R of \$41.3 million and \$43.2 million, respectively. The Company recorded pre-tax compensation expense of \$2.9 million in 2005 related to its stock incentive plans prior to the adoption of SFAS 123R.

Earnings per Share

The following table summarizes basic and diluted net earnings per share:

	2007	2006	2005
Net earnings per share:			
Basic	\$3.16	\$3.29	\$2.94
Diluted	3.14	3.27	2.91

For the year ended December 31, 2007, the decreases in basic and diluted net earnings per share YTY were attributable to decreased earnings partially offset by the decreases in the average number of shares outstanding, primarily due to the Company's stock repurchases.

For the year ended December 31, 2006, the increases over the prior year in basic and diluted net earnings per share were primarily attributable to the decrease in the average number of shares outstanding, primarily due to the Company's stock repurchases.

RESTRUCTURING-RELATED CHARGES, PROJECT COSTS AND OTHER

Summary of Restructuring Impacts to 2007 Financial Results

The Company had two restructuring plans (and related projects) that impacted 2007 financial results that are discussed in detail further below. The following table summarizes the 2007 financial impacts of the Company's restructuring plans (and related projects):

	Restructuring- related Charges (Note 3)	2007 Project Costs	2006 Project Costs	Total
Accelerated depreciation charges/project costs	\$ 5.1	\$0.8	\$11.1	\$17.0
Employee termination benefit charges/project costs	25.7	2.6	6.7	35.0
Total restructuring-related charges/project costs	\$30.8	\$3.4	\$17.8	\$52.0

The \$17 million of accelerated depreciation charges and project costs are included in *Cost of revenue* on the Consolidated Statements of Earnings. The \$26 million of employee termination benefit charges are included in *Restructuring and other, net* while the \$9 million of related project costs are included in *Selling, general and administrative* on the Consolidated Statements of Earnings.

2007 Restructuring

As part of its ongoing efforts to optimize its cost and expense structure, the Company continually reviews its resources in light of a variety of factors. On October 23, 2007, the Company announced a plan (the "2007 Restructuring Plan") which includes:

- Closure of one of the Company's inkjet supplies manufacturing facilities in Mexico and additional optimization measures at the remaining inkjet facilities in Mexico and the Philippines.
- Reduction of the Company's business support cost and expense structure by further consolidating activity globally and expanding the use of shared service centers in lower-cost regions. The areas impacted are supply chain, service delivery, general and administrative expense, as well as marketing and sales support functions.
- Focusing consumer segment marketing and sales efforts into countries or geographic regions that have the highest supplies usage.

The 2007 Restructuring Plan is expected to impact approximately 1,650 positions by the end of 2008. Most of the impacted positions are being moved to lower-cost countries. The Company expects the 2007 Restructuring Plan will result in pre-tax charges of approximately \$55 million, of which \$40 million will require cash. The Company expects the 2007 Restructuring Plan to be substantially completed by the end of 2008.

For the year ended December 31, 2007, the Company incurred \$30.8 million for the 2007 Restructuring Plan as follows:

Accelerated depreciation charges	\$ 5.1
Employee termination benefit charges	25.7
Total restructuring-related charges	\$30.8

The accelerated depreciation charges were determined in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. The accelerated depreciation charges are included in *Cost of revenue* on the Consolidated Statements of Earnings.

Employee termination benefit charges were accrued in accordance with SFAS No. 112, *Employers' Accounting for Postemployment Benefits* and SFAS No. 146, *Accounting for Costs Associated with Exit*

or Disposal Activities, as appropriate. Employee termination benefit charges include severance, medical and other benefits and are included in *Restructuring and other, net* on the Consolidated Statements of Earnings.

The following table presents a rollforward of the liability incurred for employee termination benefits in connection with the 2007 Restructuring Plan. The liability is included in *Accrued liabilities* on the Company's Consolidated Statements of Financial Position.

	Employee Termination Benefits
Balance at January 1, 2007	\$ —
Costs incurred	25.7
Payments & other ⁽¹⁾	(4.6)
Balance at December 31, 2007	\$21.1

⁽¹⁾ Other consists of pension related items that will be settled through the Company's pension plans.

For the year ended December 31, 2007, the Company incurred restructuring-related charges of \$6.5 million in its Business segment, \$13.9 million in its Consumer segment and \$10.4 million in All other. The Company expects to incur charges related to the 2007 Restructuring Plan of approximately \$14 million in its Business segment, approximately \$19 million in its Consumer segment and approximately \$22 million in All other.

The Company also incurred and expects to continue to incur additional charges related to the execution of its 2007 Restructuring Plan (referred to as "2007 project costs"). These 2007 project costs are incremental to the Company's normal operating charges and are expensed as incurred. The 2007 project costs include such items as compensation costs for overlap staffing, travel expenses, consulting costs and training costs. The Company expects to incur total pre-tax 2007 project costs of approximately \$35 million resulting in a total of \$90 million of expected pre-tax restructuring-related charges and 2007 project costs in connection with the 2007 Restructuring Plan. Expected cash payments for the restructuring-related charges and 2007 project costs are approximately \$75 million.

For the year ended December 31, 2007, the Company incurred charges, including 2007 project costs, of \$34.2 million for the 2007 Restructuring Plan as follows:

	Restructuring- related Charges (Note 3)	2007 Project Costs	Total
Accelerated depreciation charges/project costs	\$ 5.1	\$0.8	\$ 5.9
Employee termination benefit charges/project costs	25.7	2.6	28.3
Total restructuring-related charges/project costs	\$30.8	\$3.4	\$34.2

For the year ended December 31, 2007, the Company incurred restructuring-related charges and 2007 project costs of \$6.4 million in its Business segment, \$14.9 million in its Consumer segment and \$12.9 million in All other. The Company expects to incur total restructuring-related charges and 2007 project costs of \$24 million in its Business segment, \$29 million in its Consumer segment and \$37 million in All other.

Of the total pre-tax restructuring-related charges and 2007 project costs of approximately \$90 million, approximately \$15 million will impact cost of revenue and \$75 million will impact operating expense. The 2007 Restructuring Plan (including related projects) is expected to save approximately \$40 million in 2008 with approximately 50% benefiting cost of revenue and 50% benefiting operating expense. Annual savings beginning in 2009 are expected to approximate \$60 million.

The Company expects to incur the additional \$56 million of pre-tax restructuring-related charges and 2007 project costs during 2008 with approximately \$18 million expected in the first quarter of 2008.

2006 Restructuring

During the first quarter of 2006, the Company approved a plan to restructure its workforce, consolidate some manufacturing capacity and make certain changes to its U.S. retirement plans (collectively referred to as the "2006 actions"). The workforce restructuring eliminated or transferred over 1,400 positions from various business functions and job classes, with over 850 positions being eliminated, and over 550 positions being transferred from various locations primarily to low-cost countries. Lexmark consolidated its manufacturing capacity to reduce manufacturing costs, including the closure of its Rosyth, Scotland inkjet cartridge manufacturing facility and Orleans, France laser toner facilities, and reduced its operating expenses, particularly in the areas of supply chain, general and administrative and marketing and sales support. Lexmark also froze pension benefits in its defined benefit pension plan for U.S. employees, effective April 3, 2006, and at the same time changed from a maximum Company matching contribution of three percent of eligible compensation to an automatic Company contribution of one percent and a maximum Company matching contribution of five percent to Lexmark's existing 401(k) plan. Except for approximately 100 positions that were eliminated in 2007, activities related to the 2006 actions were substantially completed at the end of 2006.

For the year ended December 31, 2006, the Company incurred pre-tax charges of \$121.1 million related to the 2006 actions which were partially offset by a \$9.9 million pension curtailment gain. Of the \$111.2 million of net pre-tax charges incurred, \$40.0 million is included in *Cost of revenue* and \$71.2 million in *Restructuring and other, net* on the Company's Consolidated Statements of Earnings. For the year ended December 31, 2006, the Company incurred total pre-tax restructuring-related charges of \$35.2 million in its Business segment, \$54.7 million in its Consumer segment and \$31.2 million in All other. All other operating income also included the \$9.9 million pension curtailment gain.

The following table presents a rollforward of the liability incurred for employee termination benefit and contract termination and lease charges in connection with the 2006 actions. The liability is included in *Accrued liabilities* on the Company's Consolidated Statements of Financial Position.

	Employee Termination Benefit Charges	Contract Termination & Lease Charges	Total
Balance at January 1, 2006	\$ —	\$ —	\$ —
Costs incurred	75.9	5.2	81.1
Payments	(46.2)	(0.4)	(46.6)
Other ⁽¹⁾	(4.4)	—	(4.4)
Balance at December 31, 2006	25.3	4.8	30.1
Payments & other ⁽²⁾	(14.0)	(1.7)	(15.7)
Reversals	(0.9)	(1.7)	(2.6)
Balance at December 31, 2007	\$ 10.4	\$ 1.4	\$ 11.8

(1) Other consists primarily of special termination benefits that are paid out of the U.S. pension plan.

(2) Other consists of additions due to positions being eliminated in 2007 and changes in the liability balance due to foreign currency translations.

During 2006 and 2007, the Company also incurred additional charges related to the execution of the Company's 2006 actions (referred to as "2006 project costs"). These 2006 project costs were incremental to the Company's normal operating charges and were expensed as incurred. The 2006 project costs included such items as compensation costs for overlap staffing, travel expenses, consulting costs and training costs.

For the year ended December 31, 2006, the Company incurred net pre-tax charges and 2006 project costs of \$125.2 million related to the 2006 actions. Of the \$125.2 million of pre-tax charges and 2006 project costs incurred, \$42.1 million is included in *Cost of revenue*, \$11.9 million in *Selling, general and administrative* and \$71.2 million in *Restructuring and other, net* on the Company's Consolidated Statements of Earnings. For the year ended December 31, 2006, the Company incurred total pre-tax

restructuring-related charges and 2006 project costs of \$35.9 million in its Business segment, \$57.2 million in its Consumer segment and \$42.0 million in All other. All other operating income also included the \$9.9 million pension curtailment gain.

For the year ended December 31, 2007, the Company incurred additional 2006 project costs of \$17.8 million related to the completion of the 2006 actions. Of the \$17.8 million of 2006 project costs incurred, \$11.1 million is included in *Cost of revenue* and \$6.7 million in *Selling, general and administrative* on the Company's Consolidated Statements of Earnings. For the year ended December 31, 2007, the Company incurred total pre-tax 2006 project costs of \$5.7 million in its Business segment and \$14.8 million in All other while the Consumer segment realized a \$2.7 million net benefit after the sale of the Rosyth, Scotland facility discussed further below. The Company does not expect to incur any additional 2006 project costs during 2008.

During the first quarter of 2007, the Company sold its Rosyth, Scotland facility for \$8.1 million and recognized a \$3.5 million pre-tax gain on the sale.

During the second quarter of 2007, the Company substantially liquidated the remaining operations of its Scotland entity and recognized an \$8.1 million pre-tax gain from the realization of the entity's accumulated foreign currency translation adjustment generated on the investment in the entity during its operating life. This gain is included in *Other (income) expense, net* on the Company's Consolidated Statements of Earnings.

2005 Workforce Reduction

In order to optimize the Company's expense structure, the Company approved a plan during the third quarter of 2005 that would reduce its workforce by approximately 275 employees worldwide from various business functions and job classes. The separation of the affected employees was completed by December 31, 2005.

As of December 31, 2005, the Company incurred one-time termination benefit charges of \$10.4 million related to the plan that is included in *Restructuring and other, net* on the Consolidated Statements of Earnings. For the \$10.4 million of one-time termination benefit charges, the Company recorded \$6.5 million in its Business segment, \$2.6 million in its Consumer segment and \$1.3 million in All other.

PENSION AND OTHER POSTRETIREMENT PLANS

The following table provides the total pre-tax cost related to Lexmark's retirement plans for the years 2007, 2006 and 2005. Cost amounts are included as an addition to the Company's cost and expense amounts in the Consolidated Statements of Earnings.

<i>(Dollars in Millions)</i>	2007	2006	2005
Total cost of pension and other postretirement plans	\$40.2	\$34.4	\$43.8
Comprised of:			
Defined benefit pension plans	\$13.2	\$12.5	\$26.1
Defined contribution plans	25.8	20.5	13.6
Other postretirement plans	1.2	1.4	4.1

The decrease in the cost of defined benefit pension plans in 2006 was primarily due to the \$9.9 million one-time curtailment gain from the freezing of benefit accruals in the U.S. The increases in the cost of defined contribution plans in 2007 and 2006 were primarily due to the enhancement of benefits in the U.S. Refer to Part II, Item 8, Note 3 of the Notes to Consolidated Financial Statements for further details. The decrease in the cost of other postretirement plans in 2006 was primarily due to plan design changes.

Changes in actuarial assumptions did not have a significant impact on the Company's results of operations in 2006 and 2007, nor are they expected to have a material effect in 2008. Future effects of retirement-related benefits on the operating results of the Company depend on economic conditions, employee

demographics, mortality rates and investment performance. Refer to Part II, Item 8, Note 14 of the Notes to Consolidated Financial Statements for additional information relating to the Company's pension and other postretirement plans.

The Pension Protection Act of 2006 ("the Act") was enacted on August 17, 2006. Most of its provisions will become effective in 2008. The Act significantly changes the funding requirements for single-employer defined benefit pension plans. The funding requirements will now largely be based on a plan's calculated funded status, with faster amortization of any shortfalls or surpluses. The Act directs the U.S. Treasury Department to develop a new yield curve to discount pension obligations for determining the funded status of a plan when calculating the funding requirements. The provisions of the Act are not expected to have a material impact on the Company's financial position, results of operations and cash flows.

LIQUIDITY AND CAPITAL RESOURCES

Financial Position

Lexmark's financial position remains strong at December 31, 2007, with working capital of \$570 million compared to \$506 million at December 31, 2006. The increase in working capital accounts was primarily due to the \$245 million increase in *Cash and cash equivalents* and *Marketable securities* offset partially by the reclassification of \$150 million of senior notes maturing in May 2008 from *Long-term debt* to *Current portion of long-term debt* in the second quarter of 2007. The Company had no amounts outstanding under its U.S. trade receivables financing program or its revolving credit facility at December 31, 2007, or December 31, 2006. The Company had no other short-term borrowings outstanding at December 31, 2007, or December 31, 2006. The debt to total capital ratio was 10% at December 31, 2007, compared to 13% at December 31, 2006.

Liquidity

The following table summarizes the results of the Company's Consolidated Statements of Cash Flows for the years indicated:

<i>(Dollars in Millions)</i>	2007	2006	2005
Net cash flows provided by (used for):			
Operating activities	\$ 564.2	\$ 670.9	\$ 576.4
Investing activities	(287.4)	112.7	4.9
Financing activities	(147.0)	(808.7)	(1,036.9)
Effect of exchange rate changes on cash	2.6	1.4	(2.3)
Net increase (decrease) in cash and cash equivalents	\$ 132.4	\$ (23.7)	\$ (457.9)

The Company's primary source of liquidity has been cash generated by operations, which totaled \$564 million, \$671 million and \$576 million in 2007, 2006 and 2005, respectively. Cash from operations generally has been sufficient to allow the Company to fund its working capital needs and finance its capital expenditures during these periods along with the repurchase of approximately \$0.2 billion, \$0.9 billion and \$1.1 billion of its Class A Common Stock during 2007, 2006 and 2005, respectively. Management believes that cash provided by operations will continue to be sufficient to meet operating and capital needs in the foreseeable future. However, in the event that cash from operations is not sufficient, the Company has other potential sources of cash through utilization of its accounts receivable financing program, revolving credit facility or other financing sources.

Operating activities

The decrease in cash flows from operating activities from 2006 to 2007 primarily resulted from lower net earnings as well as unfavorable changes of \$69 million in *Accrued liabilities* and \$61 million in *Trade Receivables*. The change noted in *Accrued liabilities* was primarily due to unfavorable changes in accrued salaries and incentive compensation of \$49 million and restructuring-related accruals of \$27 million

compared to the prior year. The impact of accrued salaries and incentive compensation was driven by the payment of 2006 bonuses in the first quarter of 2007. Bonuses earned in 2006 were considerably higher than those earned in 2005 and 2007. Payments for such programs generally occur in the first quarter of the subsequent year. The impact of restructuring-related accruals was driven by the relatively small movement in the liability in 2007 compared to that of 2006, resulting in a lower non-cash addition to net earnings when deriving cash flows from operations. In 2007, there were approximately \$26 million of accruals offset by \$23 million of payments and other adjustments, resulting in a non-cash addition to net earnings of only \$3 million related to the Company's 2006 and 2007 restructuring actions. In 2006, there were approximately \$81 million of accruals offset partially by \$51 million of payments and other adjustments, resulting in a non-cash addition to net earnings of \$30 million related to the Company's 2006 restructuring actions. The \$61 million change noted in *Trade Receivables* is primarily the result of greater collections in the year 2006 versus 2007, the majority of which occurred in the first quarter. A significantly higher trade receivables balance existed at December 31, 2005 versus December 31, 2006 due to a larger portion of the fourth quarter sales for 2005 occurring in the later part of the quarter.

The increase in cash flows from operating activities from 2005 to 2006 resulted from favorable changes in *Accrued liabilities* and *Accounts payable* partially offset by unfavorable changes in *Inventories* and various other assets and liabilities accounts. The change noted in *Accrued liabilities* was primarily due to increases in salary and incentive compensation accruals and related payments of \$67 million, favorable changes in derivative liabilities of \$42 million and increases in restructuring-related accruals of \$28 million compared to the prior year. *Accounts payable* balances can fluctuate significantly between periods due to the timing of payments to suppliers. The unfavorable change in *Inventories* was primarily due to the growth in supplies inventory. The change noted in the *Other assets and liabilities* line item in 2006 on the Consolidated Statements of Cash Flows was primarily attributable to changes in various income tax-related accounts from 2005.

The Company's days of sales outstanding were 40 days at December 31, 2007, compared to 38 days at December 31, 2006 and 43 days at December 31, 2005. The days of sales outstanding are calculated using the quarter-end trade receivables, net of allowances, and the average daily revenue for the quarter.

The Company's days of inventory were 48 days at December 31, 2007, compared to 44 days at December 31, 2006 and 38 days at December 31, 2005. The days of inventory is calculated using the quarter-end net inventories balance and the average daily cost of revenue for the quarter.

In connection with the 2007 restructuring, the remaining accrued liability balance at December 31, 2007, of \$21.1 million, is expected to be paid out primarily over 2008 and 2009. These payments will relate mainly to employee termination benefits. In connection with the 2006 restructuring, the remaining accrued liability balance at December 31, 2007 was \$11.8 million. It is expected that the majority of this liability, which consists of employee termination benefits and contract termination and lease charges, will be paid by the end of 2008.

As of December 31, 2007, the Company had accrued approximately \$117 million for pending copyright fee issues, including litigation proceedings, local legislative initiatives and/or negotiations with the parties involved. These accruals are included in *Accrued liabilities* on the Consolidated Statements of Financial Position. Refer to Part II, Item 8, Note 16 of the Notes to Consolidated Financial Statements for additional information.

Investing activities

The Company decreased its marketable securities investments in 2005 by \$220 million and by \$315 million in 2006 due to its share repurchase program activity. In 2007, the Company increased its investment in marketable securities by \$113 million. Refer to the section, Stock Repurchase, which follows for further discussion of the Company's stock repurchase program during 2007. The fluctuations in the net cash flows (used for) provided by investing activities for the years provided were principally due to the Company's marketable securities investing activities.

At December 31, 2007, the Company's marketable securities portfolio consisted of asset-backed and mortgage-backed securities, corporate debt securities, municipal debt securities, U.S. government and agency debt securities, and preferred securities, including approximately \$79 million of auction rate securities. The Company's marketable securities were reported at fair value with the related unrealized gains and losses included in the *Accumulated other comprehensive earnings (loss)* section of stockholders' equity, net of tax. As of December 31, 2007 the Company had gross unrealized gains and gross unrealized losses of \$1.5 million and \$1.5 million, respectively. Based upon several factors including events that may affect the creditworthiness of a security's issuer, the length of time the security has been in a loss position, and the Company's ability and intent to hold the security until a forecasted recovery of fair value, the Company assessed its loss positions as temporary impairments. Substantially all of the unrealized losses and gains as of December 31, 2007, have been in a gain/loss position for less than 12 months.

The Company spent \$183 million, \$200 million and \$201 million on capital expenditures during 2007, 2006 and 2005, respectively. The capital expenditures in 2007 were related to new product development, infrastructure support and manufacturing capacity expansion.

During the first quarter of 2007, the Company sold its Rosyth, Scotland facility for \$8.1 million and recognized a \$3.5 million pre-tax gain on the sale.

Financing activities

The fluctuations in the net cash flows used for financing activities were principally due to the Company's share repurchase activity. The Company repurchased \$0.2 billion, \$0.9 billion and \$1.1 billion of treasury stock during 2007, 2006 and 2005, respectively.

Credit Facility

Effective January 20, 2005, Lexmark entered into a \$300 million 5-year senior, unsecured, multi-currency revolving credit facility with a group of banks. Under the credit facility, the Company may borrow in dollars, euros, British pounds sterling and Japanese yen. Under certain circumstances, the aggregate amount available under the facility may be increased to a maximum of \$500 million. As of December 31, 2007 and 2006, there were no amounts outstanding under the credit facility.

Lexmark's credit agreement contains usual and customary default provisions, leverage and interest coverage restrictions and certain restrictions on secured and subsidiary debt, disposition of assets, liens and mergers and acquisitions. The \$300 million credit facility has a maturity date of January 20, 2010.

Interest on all borrowings under the facility depends upon the type of loan, namely alternative base rate loans, swingline loans or eurocurrency loans. Alternative base rate loans bear interest at the greater of the prime rate or the federal funds rate plus one-half of one percent. Swingline loans (limited to \$50 million) bear interest at an agreed upon rate at the time of the borrowing. Eurocurrency loans bear interest at the sum of (i) a LIBOR for the applicable currency and interest period and (ii) an interest rate spread based upon the Company's debt ratings ranging from 0.18% to 0.80%. In addition, Lexmark is required to pay a facility fee on the \$300 million line of credit of 0.07% to 0.20% based upon the Company's debt ratings. The interest and facility fees are payable at least quarterly.

Senior Notes — Long-term Debt and Current Portion of Long-term Debt

Lexmark has outstanding \$150.0 million principal amount of 6.75% senior notes due May 15, 2008, which was initially priced at 98.998%, to yield 6.89% to maturity. A balance of \$149.9 million (net of the unamortized discount of \$0.1 million) was outstanding at December 31, 2007. At December 31, 2006, the balance was \$149.8 million (net of the unamortized discount of \$0.2 million). As the notes mature in May 2008, the senior notes were reclassified from *Long-term debt* to *Current portion of long-term debt* during 2007.

The senior notes contain typical restrictions on liens, sale leaseback transactions, mergers and sales of assets. There are no sinking fund requirements on the senior notes and they may be redeemed at any time at the option of the Company, at a redemption price as described in the related indenture agreement, as supplemented and amended, in whole or in part.

During October 2003, the Company entered into interest rate swap contracts to convert its \$150.0 million principal amount of 6.75% senior notes from a fixed interest rate to a variable interest rate. Interest rate swaps with a notional amount of \$150.0 million were executed whereby the Company will receive interest at a fixed rate of 6.75% and pay interest at a variable rate of approximately 2.76% above the six-month London Interbank Offered Rate ("LIBOR"). These interest rate swaps have a maturity date of May 15, 2008, which is equivalent to the maturity date of the senior notes.

Other Information

The Company is in compliance with all covenants and other requirements set forth in its debt agreements. The Company does not have any rating downgrade triggers that would accelerate the maturity dates of its revolving credit facility and public debt. However, a downgrade in the Company's credit rating could adversely affect the Company's ability to renew existing, or obtain access to new, credit facilities in the future and could increase the cost of such facilities. The Company's current credit ratings are Baa1 and BBB, as evaluated by Moody's Investors Service and Standard & Poor's Ratings Services, respectively.

Contractual Cash Obligations

The following table summarizes the Company's contractual obligations at December 31, 2007:

<i>(Dollars in Millions)</i>	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Current portion of long-term debt ⁽¹⁾	\$155	\$155	\$ —	\$ —	\$ —
Capital leases	2	1	1	—	—
Operating leases	115	38	46	23	8
Purchase obligations	145	145	—	—	—
Uncertain tax positions	46	16	30	—	—
Other long-term liabilities ⁽²⁾	24	4	4	—	16
Total contractual obligations	\$487	\$359	\$ 81	\$ 23	\$ 24

(1) includes final interest payment of \$5 million

(2) includes current portion of other long-term liabilities

Purchase obligations reported in the table above include agreements to purchase goods or services that are enforceable and legally binding on the Company and that specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction.

The Company's funding policy for its pension plans is to fund minimum amounts according to the regulatory requirements under which the plans operate. From time to time, the Company may choose to fund amounts in excess of the minimum for various reasons. The annual funding of pension obligations are not expected to be material and are not shown above.

The Company's financial obligation to collect, recycle, treat and dispose of the printing devices it produces, and in some instances, historical waste equipment it holds, is not shown above due to the lack of historical data necessary to project future dates of payment. At December 31, 2007, the Company's estimated liability for this obligation was a current liability of \$1 million and a long-term liability of \$27 million. These amounts were included in *Accrued liabilities* and *Other liabilities*, respectively, on the Consolidated Statement of Financial Position. Refer to the "Risk Factors" section in Part I, Item 1A of this report for additional information regarding the Waste Electrical and Electronic Equipment Directive adopted by the European Union.

Trade Receivables Facility

In the U.S., the Company transfers a majority of its receivables to its wholly-owned subsidiary, Lexmark Receivables Corporation ("LRC"), which then may transfer the receivables on a limited recourse basis to an unrelated third party. In October 2004, the Company entered into an amended and restated agreement to sell a portion of its trade receivables on a limited recourse basis. The amended agreement allows for a maximum capital availability of \$200 million under this facility. The primary purpose of the amendment was to extend the term of the facility to October 16, 2007, with required annual renewal of commitments.

During the first quarter of 2007, the Company amended the facility to allow LRC to repurchase receivables previously transferred to the unrelated third party. Prior to the 2007 amendment, the Company accounted for the transfer of receivables from LRC to the unrelated third party as sales of receivables. As a result of the 2007 amendment, the Company accounts for the transfers of receivables from LRC to the unrelated third party as a secured borrowing with a pledge of its receivables as collateral. The amendment became effective in the second quarter of 2007. In October 2007, the facility was renewed until October 3, 2008.

This facility contains customary affirmative and negative covenants as well as specific provisions related to the quality of the accounts receivables transferred. As collections reduce previously transferred receivables, the Company may replenish these with new receivables. Lexmark bears a limited risk of bad debt losses on the trade receivables transferred, since the Company over-collateralizes the receivables transferred with additional eligible receivables. Lexmark addresses this risk of loss in its allowance for doubtful accounts. Receivables transferred to the unrelated third-party may not include amounts over 90 days past due or concentrations over certain limits with any one customer. The facility also contains customary cash control triggering events which, if triggered, could adversely affect the Company's liquidity and/or its ability to transfer trade receivables. A downgrade in the Company's credit rating could reduce the Company's ability to transfer trade receivables.

At December 31, 2007, there were no secured borrowings under the facility. At December 31, 2006, there were no trade receivables outstanding under the facility.

Off-Balance Sheet Arrangements

At December 31, 2007 and 2006, the Company did not have any off-balance sheet arrangements.

Stock Repurchase

In January 2006, the Company received authorization from the board of directors to repurchase an additional \$1.0 billion of its Class A Common Stock for a total repurchase authority of \$3.9 billion. As of December 31, 2007, there was approximately \$0.3 billion of share repurchase authority remaining. This repurchase authority allows the Company, at management's discretion, to selectively repurchase its stock from time to time in the open market or in privately negotiated transactions depending upon market price and other factors. During 2007, the Company repurchased approximately 2.7 million shares at a cost of approximately \$0.2 billion. As of December 31, 2007, since the inception of the program in April 1996, the Company had repurchased approximately 74.1 million shares for an aggregate cost of approximately \$3.6 billion. As of December 31, 2007, the Company had reissued approximately 0.5 million shares of previously repurchased shares in connection with certain of its employee benefit programs. As a result of these issuances as well as the retirement of 44.0 million and 16.0 million shares of treasury stock in 2005 and 2006, respectively, the net treasury shares outstanding at December 31, 2007, were 13.6 million.

In December 2005 and October 2006, the Company received authorization from the board of directors to retire 44.0 million and 16.0 million shares, respectively, of the Company's Class A Common Stock currently held in the Company's treasury as treasury stock. The retired shares resumed the status of authorized but unissued shares of Class A Common Stock. Refer to the Consolidated Statements of Stockholders' Equity and Comprehensive Earnings for the effects on *Common stock*, *Capital in excess of par*, *Retained earnings* and *Treasury stock* from the retirement of the 44.0 million shares of Class A Common Stock in 2005 and 16.0 million shares of Class A Common Stock in 2006.

CAPITAL EXPENDITURES

Capital expenditures totaled \$183 million, \$200 million and \$201 million in 2007, 2006 and 2005, respectively. The capital expenditures in 2007 were attributable to new product development, infrastructure support and manufacturing capacity expansion. During 2008, the Company expects capital expenditures to be approximately \$225 million, primarily attributable to new product development, infrastructure support and manufacturing capacity expansion. The capital expenditures are expected to be funded through cash from operations.

EFFECT OF CURRENCY EXCHANGE RATES AND EXCHANGE RATE RISK MANAGEMENT

Revenue derived from international sales, including exports from the U.S., accounts for approximately 57% of the Company's consolidated revenue, with Europe accounting for approximately two-thirds of international sales. Substantially all foreign subsidiaries maintain their accounting records in their local currencies. Consequently, period-to-period comparability of results of operations is affected by fluctuations in currency exchange rates. Certain of the Company's Latin American and European entities use the U.S. dollar as their functional currency.

Currency exchange rates had a material favorable impact on international revenue in 2007. In 2006 and 2005, currency exchange rates did not have a material impact on international revenue. The Company acts to neutralize the effects of exchange rate fluctuations through the use of operational hedges, such as pricing actions and product sourcing decisions.

The Company's exposure to exchange rate fluctuations generally cannot be minimized solely through the use of operational hedges. Therefore, the Company utilizes financial instruments, from time to time, such as forward exchange contracts and currency options to reduce the impact of exchange rate fluctuations on actual and anticipated cash flow exposures and certain assets and liabilities, which arise from transactions denominated in currencies other than the functional currency. The Company does not purchase currency-related financial instruments for purposes other than exchange rate risk management.

RECENT ACCOUNTING PRONOUNCEMENTS

Refer to Part II, Item 8, Note 2 of the Notes to Consolidated Financial Statements for a description of recent accounting pronouncements which is incorporated herein by reference.

INFLATION

The Company is subject to the effects of changing prices and operates in an industry where product prices are very competitive and subject to downward price pressures. As a result, future increases in production costs or raw material prices could have an adverse effect on the Company's business. In an effort to minimize the impact on earnings of any such increases, the Company must continually manage its product costs and manufacturing processes.

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

MARKET RISK SENSITIVITY

The market risk inherent in the Company's financial instruments and positions represents the potential loss arising from adverse changes in interest rates and foreign currency exchange rates.

Interest Rates

At December 31, 2007, the fair value of the Company's senior notes was estimated at \$150 million using quoted market prices and yields obtained through independent pricing sources for the same or similar types of borrowing arrangements, taking into consideration the underlying terms of the debt. The fair value of the senior notes exceeded the carrying value as recorded in the Consolidated Statements of Financial Position at December 31, 2007, by approximately \$0.4 million. Market risk is estimated as the potential change in fair value resulting from a hypothetical 10% adverse change in interest rates and amounts to approximately \$0.3 million at December 31, 2007.

The Company has interest rate swaps that serve as a fair value hedge of the Company's senior notes. The fair value of the interest rate swaps at December 31, 2007, was an asset of \$0.1 million. Market risk for the interest rate swaps is estimated as the potential change in fair value resulting from a hypothetical 10% adverse change in interest rates and amounts to approximately \$0.3 million at December 31, 2007.

Foreign Currency Exchange Rates

The Company has employed, from time to time, a foreign currency hedging strategy to limit potential losses in earnings or cash flows from adverse foreign currency exchange rate movements. Foreign currency exposures arise from transactions denominated in a currency other than the Company's functional currency and from foreign denominated revenue and profit translated into U.S. dollars. The primary currencies to which the Company is exposed include the Euro, the Mexican peso, the British pound, the Philippine peso, the Australian dollar and other Asian and South American currencies. Exposures may be hedged with foreign currency forward contracts, put options, and call options generally with maturity dates of twelve months or less. The potential loss in fair value at December 31, 2007, for such contracts resulting from a hypothetical 10% adverse change in all foreign currency exchange rates is approximately \$24 million. This loss would be mitigated by corresponding gains on the underlying exposures.

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Lexmark International, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF EARNINGS

For the years ended December 31, 2007, 2006 and 2005

(In Millions, Except Per Share Amounts)

	2007	2006	2005
Revenue	\$4,973.9	\$5,108.1	\$5,221.5
Cost of revenue	3,410.3	3,462.1	3,585.9
Gross profit	1,563.6	1,646.0	1,635.6
Research and development	403.8	370.5	336.4
Selling, general and administrative	812.8	761.8	755.1
Restructuring and other, net	25.7	71.2	10.4
Operating expense	1,242.3	1,203.5	1,101.9
Operating income	321.3	442.5	533.7
Interest (income) expense, net	(21.2)	(22.1)	(26.5)
Other (income) expense, net	(7.0)	5.3	6.5
Earnings before income taxes	349.5	459.3	553.7
Provision for income taxes	48.7	120.9	197.4
Net earnings	\$ 300.8	\$ 338.4	\$ 356.3
Net earnings per share:			
Basic	\$ 3.16	\$ 3.29	\$ 2.94
Diluted	\$ 3.14	\$ 3.27	\$ 2.91
Shares used in per share calculation:			
Basic	95.3	102.8	121.0
Diluted	95.8	103.5	122.3

See notes to consolidated financial statements.

Lexmark International, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
As of December 31, 2007 and 2006
(In Millions)

	2007	2006
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 277.0	\$ 144.6
Marketable securities	519.1	406.3
Trade receivables, net of allowances of \$36.5 and \$38.0 in 2007 and 2006, respectively	578.8	584.3
Inventories	464.4	457.8
Prepaid expenses and other current assets	227.5	237.0
Total current assets	2,066.8	1,830.0
Property, plant and equipment, net	869.0	846.8
Other assets	185.3	172.2
Total assets	\$3,121.1	\$2,849.0
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	\$ 149.9	\$ —
Accounts payable	636.9	600.3
Accrued liabilities	710.5	723.7
Total current liabilities	1,497.3	1,324.0
Long-term debt	—	149.8
Other liabilities	345.5	340.0
Total liabilities	1,842.8	1,813.8
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$.01 par value, 1.6 shares authorized; no shares issued and outstanding	—	—
Common stock, \$.01 par value:		
Class A, 900.0 shares authorized; 94.7 and 97.0 outstanding in 2007 and 2006, respectively	1.1	1.1
Class B, 10.0 shares authorized; no shares issued and outstanding	—	—
Capital in excess of par	887.8	827.3
Retained earnings	935.7	627.5
Treasury stock, net; at cost; 13.6 and 10.9 shares in 2007 and 2006, respectively	(454.7)	(289.8)
Accumulated other comprehensive loss	(91.6)	(130.9)
Total stockholders' equity	1,278.3	1,035.2
Total liabilities and stockholders' equity	\$3,121.1	\$2,849.0

See notes to consolidated financial statements.

Lexmark International, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the years ended December 31, 2007, 2006 and 2005
(In Millions)

	2007	2006	2005
Cash flows from operating activities:			
Net earnings	\$ 300.8	\$ 338.4	\$ 356.3
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	192.3	200.9	158.5
Deferred taxes	(31.0)	(21.9)	(22.3)
Stock-based compensation expense	41.2	43.2	4.1
Tax shortfall from employee stock plans	(0.3)	(0.7)	—
Tax benefits from employee stock plans	—	—	15.8
Foreign exchange gain upon Scotland liquidation	(8.1)	—	—
Gain on sale of Scotland facility	(3.5)	—	—
Other	(9.4)	3.3	34.7
	482.0	563.2	547.1
Change in assets and liabilities:			
Trade receivables	5.5	66.6	93.5
Inventories	(6.6)	(48.6)	55.7
Accounts payable	36.6	27.5	(97.8)
Accrued liabilities	(7.4)	62.0	(134.7)
Other assets and liabilities	54.1	0.2	112.6
Net cash flows provided by operating activities	564.2	670.9	576.4
Cash flows from investing activities:			
Purchases of property, plant and equipment	(182.7)	(200.2)	(201.3)
Purchases of marketable securities	(968.2)	(1,406.2)	(1,604.3)
Proceeds from sales/maturities of marketable securities	855.3	1,721.0	1,824.7
Proceeds from sale of Scotland facility	8.1	—	—
Other	0.1	(1.9)	(14.2)
Net cash flows (used for) provided by investing activities	(287.4)	112.7	4.9
Cash flows from financing activities:			
(Decrease) increase in short-term debt	—	—	(1.5)
Issuance of treasury stock	0.1	0.5	0.5
Purchase of treasury stock	(165.0)	(871.0)	(1,069.9)
Proceeds from employee stock plans	15.6	52.8	37.0
Tax windfall from employee stock plans	3.9	12.5	—
Other	(1.6)	(3.5)	(3.0)
Net cash flows used for financing activities	(147.0)	(808.7)	(1,036.9)
Effect of exchange rate changes on cash	2.6	1.4	(2.3)
Net change in cash and cash equivalents	132.4	(23.7)	(457.9)
Cash and cash equivalents — beginning of period	144.6	168.3	626.2
Cash and cash equivalents — end of period	\$ 277.0	\$ 144.6	\$ 168.3

See notes to consolidated financial statements.

Lexmark International, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE EARNINGS
For the years ended December 31, 2007, 2006 and 2005
(In Millions)

	Class A and B Common Stock		Capital in Excess of Par	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Earnings (Loss)	Total Stockholders' Equity
	Shares	Amount					
Balance at December 31, 2004	127.6	\$ 1.7	\$1,076.0	\$ 2,663.7	\$(1,493.2)	\$(165.3)	\$ 2,082.9
Comprehensive earnings, net of taxes							
Net earnings				356.3			356.3
Minimum pension liability adjustment						(14.8)	
Cash flow hedges, net of reclassifications						35.9	
Translation adjustment						(19.3)	
Net unrealized gain (loss) on marketable securities						0.2	
Other comprehensive earnings (loss)						2.0	2.0
Comprehensive earnings, net of taxes							358.3
Deferred stock plan compensation	0.1		4.1				4.1
Shares issued upon exercise of options	1.0		28.4				28.4
Shares issued under employee stock purchase plan	0.1		8.6				8.6
Tax benefit related to stock plans			15.8				15.8
Treasury shares purchased	(17.0)				(1,069.9)		(1,069.9)
Treasury shares issued	0.1				0.5		0.5
Treasury shares retired		(0.5)	(300.4)	(2,031.2)	2,332.1		—
Balance at December 31, 2005	111.9	1.2	832.5	988.8	(230.5)	(163.3)	1,428.7
Comprehensive earnings, net of taxes							
Net earnings				338.4			338.4
Other comprehensive earnings (loss):							
Minimum pension liability adjustment						26.9	
Cash flow hedges, net of reclassifications						(6.4)	
Translation adjustment						22.3	
Net unrealized gain (loss) on marketable securities						0.6	
Other comprehensive earnings (loss)						43.4	43.4
Comprehensive earnings, net of taxes							381.8
Adjustment to initially apply SFAS 158, net of taxes						(11.0)	(11.0)
Shares issued under deferred stock plan compensation	0.1		0.1				0.1
Shares issued upon exercise of options	1.3		46.6				46.6
Shares issued under employee stock purchase plan	0.1		6.2				6.2
Tax benefit related to stock plans			9.6				9.6
Stock-based compensation			43.7				43.7
Treasury shares purchased	(16.5)				(871.0)		(871.0)
Treasury shares issued	0.1				0.5		0.5
Treasury shares retired		(0.1)	(111.4)	(699.7)	811.2		—
Balance at December 31, 2006	97.0	1.1	827.3	627.5	(289.8)	(130.9)	1,035.2
Comprehensive earnings, net of taxes							
Net earnings				300.8			300.8
Other comprehensive earnings (loss):							
Pension or other postretirement benefits, net of reclass.						17.5	
Cash flow hedges, net of reclassifications						(0.7)	
Translation adjustment						22.5	
Net unrealized gain (loss) on marketable securities						—	
Other comprehensive earnings (loss)						39.3	39.3
Comprehensive earnings, net of taxes							340.1
Adoption of FIN 48 ⁽¹⁾				7.4			7.4
Shares issued under deferred stock plan compensation			0.1				0.1
Shares issued upon exercise of options	0.3		10.0				10.0
Shares issued under employee stock purchase plan	0.1		5.6				5.6
Tax benefit related to stock plans			3.6				3.6
Stock-based compensation			41.2				41.2
Treasury shares purchased	(2.7)				(165.0)		(165.0)
Treasury shares issued					0.1		0.1
Balance at December 31, 2007	94.7	\$ 1.1	\$ 887.8	\$ 935.7	\$(454.7)	\$(91.6)	\$ 1,278.3

(1) Adjustment to retained earnings related to adoption of FIN 48 was \$7.340 million

See notes to consolidated financial statements.

Lexmark International, Inc. and Subsidiaries
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Tabular Dollars in Millions, Except Per Share Amounts)

1. ORGANIZATION AND BUSINESS

Since its inception in 1991, Lexmark International, Inc. ("Lexmark" or the "Company") has become a leading developer, manufacturer and supplier of printing and imaging solutions for offices and homes. The Company's products include laser printers, inkjet printers, multifunction devices, and associated supplies, services and solutions. Lexmark also sells dot matrix printers for printing single and multi-part forms by business users. The customers for Lexmark's products are large enterprises, small and medium businesses and consumers worldwide. The Company's products are principally sold through resellers, retailers and distributors in more than 150 countries in North and South America, Europe, the Middle East, Africa, Asia, the Pacific Rim and the Caribbean.

2. SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation:

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

Use of Estimates:

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("U.S.") requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, the Company evaluates its estimates, including those related to customer programs and incentives, product returns, doubtful accounts, inventories, stock-based compensation, intangible assets, income taxes, warranty obligations, copyright fees, restructurings, pension and other postretirement benefits, and contingencies and litigation. Lexmark bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Foreign Currency Translation:

Assets and liabilities of non-U.S. subsidiaries that operate in a local currency environment are translated into U.S. dollars at period-end exchange rates. Income and expense accounts are translated at average exchange rates prevailing during the period. Adjustments arising from the translation of assets and liabilities, changes in stockholders' equity and results of operations are accumulated as a separate component of *Accumulated other comprehensive earnings (loss)* in stockholders' equity.

Cash Equivalents:

All highly liquid investments with an original maturity of three months or less at the Company's date of purchase are considered to be cash equivalents.

Marketable Securities:

Based on the Company's expected holding period, Lexmark has classified all of its marketable securities as available-for-sale and reported these investments in the Consolidated Statements of Financial Position as current assets. Lexmark reports its available-for-sale marketable securities at fair value with unrealized gains or losses recorded in *Accumulated other comprehensive earnings (loss)* on the Consolidated Statements of Financial Position. The Company assesses its marketable securities for other-than-

temporary declines in value by considering various factors that include, among other things, any events that may affect the creditworthiness of a security's issuer, the length of time the security has been in a loss position and the Company's ability and intent to hold the security until a forecasted recovery of fair value that may include holding the security to maturity. Realized gains or losses are included in net earnings and are derived using the specific identification method for determining the cost of the securities.

Allowance for Doubtful Accounts:

Lexmark maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. The Company estimates the allowance for doubtful accounts based on a variety of factors including the length of time receivables are past due, the financial health of its customers, unusual macroeconomic conditions and historical experience. If the financial condition of its customers deteriorates or other circumstances occur that result in an impairment of customers' ability to make payments, the Company records additional allowances as needed.

Fair Value of Financial Instruments:

The financial instruments of the Company consist mainly of cash and cash equivalents, marketable securities, trade receivables, trade payables, short-term debt, current portion of long-term debt and derivatives. The fair value of cash and cash equivalents, trade receivables, trade payables and short-term debt approximates their carrying values due to the relatively short-term nature of the instruments. The fair value of Lexmark's marketable securities are based on quoted market prices or other observable market data, or in some cases, the Company's amortized cost, which approximates fair value due to the frequent resetting of interest rates resulting in repricing of the investments. The fair value of the current portion of long-term debt is estimated based on current rates available to the Company for debt with similar characteristics. The fair value of derivative financial instruments is based on pricing models or formulas using current market data, or where applicable, quoted market prices.

Inventories:

Inventories are stated at the lower of average cost or market using standard costs, which approximates the average cost method of valuing its inventories and related cost of goods sold. The Company considers all raw materials to be in production upon their receipt.

Lexmark writes down its inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value. The Company estimates the difference between the cost of obsolete or unmarketable inventory and its market value based upon product demand requirements, product life cycle, product pricing and quality issues. Also, Lexmark records an adverse purchase commitment liability when anticipated market sales prices are lower than committed costs.

Property, Plant and Equipment:

Property, plant and equipment are stated at cost and depreciated over their estimated useful lives using the straight-line method. Property, plant and equipment accounts are relieved of the cost and related accumulated depreciation when assets are disposed of or otherwise retired.

Internal Use Software Costs:

Lexmark capitalizes direct costs incurred during the application development and implementation stages for developing, purchasing, or otherwise acquiring software for internal use. These software costs are included in *Property, plant and equipment, net*, on the Consolidated Statements of Financial Position and are depreciated over the estimated useful life of the software, generally three to five years. All costs incurred during the preliminary project stage are expensed as incurred.

Goodwill and Other Intangible Assets:

Lexmark annually reviews its goodwill for impairment and currently does not have any indefinite-lived intangible assets. The Company's goodwill and intangible assets are immaterial, and therefore are not separately presented in the Consolidated Statements of Financial Position.

Long-Lived Assets:

Lexmark performs reviews for the impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment loss is recognized when estimated undiscounted future cash flows expected to result from the use of the asset and its eventual disposition are less than its carrying amount. If future expected undiscounted cash flows are insufficient to recover the carrying value of the assets, then an impairment loss is recognized based upon the excess of the carrying value of the asset over the anticipated cash flows on a discounted basis.

Lexmark also reviews any legal and contractual obligations associated with the retirement of its long-lived assets and records assets and liabilities, as necessary, related to the cost of such obligations. Costs associated with such obligations that are reasonably estimable and probable are accrued and expensed, or capitalized as appropriate. The asset recorded shall be recorded during the period in which it occurs and shall be amortized over the useful life of the related long-lived tangible asset. The liability recorded is relieved when the costs are incurred to retire the related long-lived tangible asset. The Company's asset retirement obligations are currently not material.

Warranty:

Lexmark provides for the estimated cost of product warranties at the time revenue is recognized. The amounts accrued for product warranties is based on the quantity of units sold under warranty, estimated product failure rates, and material usage and service delivery costs. The estimates for product failure rates and material usage and service delivery costs are periodically adjusted based on actual results. For extended warranty programs, the Company defers revenue in short-term and long-term liability accounts (based on the extended warranty contractual period) for amounts invoiced to customers for these programs and recognizes the revenue ratably over the contractual period. Costs associated with extended warranty programs are expensed as incurred.

Revenue Recognition:

General

Lexmark recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable and collectibility is reasonably assured. *Revenue* as reported in the Company's Consolidated Statements of Earnings is reported net of any taxes (e.g., sales, use, value added) assessed by a governmental entity that is directly imposed on a revenue-producing transaction between a seller and a customer.

The following are the policies applicable to Lexmark's major categories of revenue transactions:

Products

Revenue from product sales, including sales to distributors and resellers, is recognized when title and risk of loss transfer to the customer, generally when the product is shipped to the customer. When other significant obligations remain after products are delivered, such as contractual requirements pertaining to customer acceptance, revenue is recognized only after such obligations are fulfilled. At the time revenue is recognized, the Company provides for the estimated cost of post-sales support, principally product warranty, and reduces revenue for estimated product returns.

Lexmark records estimated reductions to revenue at the time of sale for customer programs and incentive offerings including special pricing agreements, promotions and other volume-based incentives. Estimated reductions in revenue are based upon historical trends and other known factors at the time of sale. Lexmark also records estimated reductions to revenue for price protection, which it provides to substantially all of its distributors and reseller customers.

Services

Revenue from support or maintenance contracts, including extended warranty programs, is recognized ratably over the contractual period. Amounts invoiced to customers in excess of revenue recognized on support or maintenance contracts are recorded as deferred revenue until the appropriate revenue recognition criteria are met. Revenue for time and material contracts is recognized as the services are performed.

Multiple Element Revenue Arrangements

Lexmark enters into transactions that include multiple elements, such as a combination of products and services. Revenue for these arrangements is allocated to each element based on its relative fair value and is recognized when the revenue recognition criteria for each element have been met. Relative fair value may be determined by the price of an element if it were sold on a stand-alone basis (referred to as vendor objective evidence ("VOE")). In the absence of VOE, third party evidence (e.g., competitors' prices of comparable products or services) is used to determine relative fair value.

Research and Development Costs:

Lexmark engages in the design and development of new products and enhancements to its existing products. The Company's research and development activity is focused on laser and inkjet printers, multifunction products ("MFPs"), and associated supplies, features and related technologies. The Company expenses research and development costs when incurred.

Advertising Costs:

The Company expenses advertising costs when incurred. Advertising expense was approximately \$111.5 million, \$98.7 million and \$98.7 million, in 2007, 2006 and 2005, respectively.

Pension and Other Postretirement Plans:

The Company accounts for its defined benefit pension and other postretirement plans using actuarial models. Liabilities are computed using the projected unit credit method. The objective under this method is to expense each participant's benefits under the plan as they accrue, taking into consideration future salary increases and the plan's benefit allocation formula. Thus, the total pension to which each participant is expected to become entitled is broken down into units, each associated with a year of past or future credited service.

The discount rate assumption for the pension and other postretirement benefit plan liabilities reflects the rates at which the benefits could effectively be settled and are based on current investment yields of high-quality fixed-income investments. The Company uses a yield-curve approach to determine the assumed discount rate in the U.S. based on the timing of the cash flows of the expected future benefit payments. This approach matches the plan's cash flows to that of a yield curve that provides the equivalent yields on zero-coupon corporate bonds for each maturity.

The Company's assumed long-term rate of return on plan assets is based on long-term historical actual return information, the mix of investments that comprise plan assets and future estimates of long-term investment returns by reference to external sources. Differences between actual and expected asset returns on equity investments are recognized in the calculation of net periodic benefit cost over five years.

The rate of compensation increase is determined by the Company based upon its long-term plans for such increases. Effective April 2006, this assumption is no longer applicable to the U.S. pension plan due to the benefit accrual freeze in connection with the Company's 2006 restructuring actions. Unrecognized actuarial gains and losses that fall outside the "10% corridor" are amortized on a straight-line basis over the remaining estimated service period of active participants. The Company has elected to continue using the average remaining service period over which to amortize the unrecognized actuarial gains and losses on the frozen U.S. plan.

The Company's funding policy for its pension plans is to fund the minimum amounts according to the regulatory requirements under which the plans operate. From time to time, the Company may choose to fund amounts in excess of the minimum for various reasons.

The Company accrues for the cost of providing postretirement benefits such as medical and life insurance coverage over the remaining estimated service period of participants. These benefits are funded by the Company when paid.

Effective December 31, 2006, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)* ("SFAS 158"). SFAS 158 requires recognition of the funded status of a benefit plan in the statement of financial position and recognition in other comprehensive earnings of certain gains and losses that arise during the period, but are deferred under pension accounting rules.

Stock-Based Compensation:

On January 1, 2006, the Company implemented the provisions of SFAS No. 123 (revised 2004), *Share-Based Payment* ("SFAS 123R") and related interpretations. SFAS 123R requires that all share-based payments to employees, including grants of stock options, be recognized in the financial statements based on their fair value. The Company selected the modified prospective transition method for implementing SFAS 123R and began recognizing compensation expense for stock-based awards granted on or after January 1, 2006, plus any unvested awards granted prior to January 1, 2006. Under this transition method, prior periods have not been restated. Stock-based compensation expense for awards granted on or after January 1, 2006, is based on the grant date fair value calculated in accordance with the provisions of SFAS 123R. Stock-based compensation related to any unvested awards granted prior to January 1, 2006, is based on the grant date fair value calculated in accordance with the original provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*. The fair value of the Company's stock-based awards, less estimated forfeitures, is amortized over the awards' vesting periods on a straight-line basis.

Prior to the adoption of SFAS 123R on January 1, 2006, the Company accounted for the costs of its stock-based employee compensation plans under Accounting Principles Board ("APB") Opinion No. 25, *Accounting for Stock Issued to Employees* ("APB 25"), and related interpretations. Under APB 25, compensation cost was not recognized for substantially all options granted because the exercise price was at least equal to the market value of the underlying common stock on the date of grant.

The fair value of each option award on the grant date was estimated using the Black-Scholes option-pricing model with the following assumptions: expected dividend yield, expected stock price volatility, weighted average risk-free interest rate and weighted average expected life of the options. Under SFAS 123R, the Company's expected volatility assumption used in the Black-Scholes option-pricing model was based exclusively on historical volatility and the expected life assumption was established based upon an analysis of historical option exercise behavior. The risk-free interest rate used in the Black-Scholes model was based on the implied yield currently available on U.S. Treasury zero-coupon issues with a remaining term equal to the Company's expected term assumption. The Company has never declared or paid any cash dividends on the Class A Common Stock and has no current plans to pay cash dividends on the Class A Common Stock. The payment of any future cash dividends will be determined by the Company's board of directors in light of conditions then existing, including the Company's earnings, financial condition

and capital requirements, restrictions in financing agreements, business conditions, tax laws, certain corporate law requirements and various other factors.

Restructuring:

Lexmark records a liability for a cost associated with an exit or disposal activity at its fair value in the period in which the liability is incurred, except for liabilities for certain employee termination benefit charges that are accrued over time. Employee termination benefits associated with an exit or disposal activity are accrued when the obligation is probable and estimable as a postemployment benefit obligation when local statutory requirements stipulate minimum involuntary termination benefits or, in the absence of local statutory requirements, termination benefits to be provided are similar to benefits provided in prior restructuring activities. Specifically for termination benefits under a one-time benefit arrangement, the timing of recognition and related measurement of a liability depends on whether employees are required to render service until they are terminated in order to receive the termination benefits and, if so, whether employees will be retained to render service beyond a minimum retention period. For employees who are not required to render service until they are terminated in order to receive the termination benefits or employees who will not provide service beyond the minimum retention period, the Company records a liability for the termination benefits at the communication date. If employees are required to render service until they are terminated in order to receive the termination benefits and will be retained to render service beyond the minimum retention period, the Company measures the liability for termination benefits at the communication date and recognizes the expense and liability ratably over the future service period. For contract termination costs, Lexmark records a liability for costs to terminate a contract before the end of its term when the Company terminates the agreement in accordance with the contract terms or when the Company ceases using the rights conveyed by the contract. The Company records a liability for other costs associated with an exit or disposal activity in the period in which the liability is incurred. Once Company management approves an exit or disposal activity, the Company closely monitors the expenses that are reported in association with the activity.

Income Taxes:

The provision for income taxes is computed based on pre-tax income included in the Consolidated Statements of Earnings. The Company estimates its tax liability based on current tax laws in the statutory jurisdictions in which it operates. These estimates include judgments about the recognition and realization of deferred tax assets and liabilities resulting from the expected future tax consequences of events that have been included in the financial statements. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement carrying amounts and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse.

The Company determines its effective tax rate by dividing its income tax expense by its income before taxes as reported in its Consolidated Statement of Operations. For reporting periods prior to the end of the Company's fiscal year, the Company records income tax expense based upon an estimated annual effective tax rate. This rate is computed using the statutory tax rate and an estimate of annual net income by geographic region adjusted for an estimate of non-deductible expenses.

In July 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109* ("FIN 48"). FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold as "more-likely-than-not" that a tax position must meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting for income taxes in interim periods, financial statement disclosure and transition rules.

The evaluation of a tax position in accordance with FIN 48 is a two-step process. The first step is recognition: The enterprise determines whether it is more likely than not that a tax position will be sustained upon examination, including resolution of any litigation. The second step is measurement: A tax position

that meets the more-likely-than-not recognition threshold is measured to determine the amount of benefit to recognize in the financial statements. The tax position is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate resolution.

Derivatives:

All derivatives, including foreign currency exchange contracts, are recognized in the Statements of Financial Position at fair value. Derivatives that are not hedges must be recorded at fair value through earnings. If a derivative is a hedge, depending on the nature of the hedge, changes in the fair value of the derivative are either offset against the change in fair value of underlying assets or liabilities through earnings or recognized in *Accumulated other comprehensive earnings (loss)* until the underlying hedged item is recognized in earnings. Any ineffective portion of a derivative's change in fair value is immediately recognized in earnings. Derivatives qualifying as hedges are included in the same section of the Consolidated Statements of Cash Flows as the underlying assets and liabilities being hedged.

Net Earnings Per Share:

Basic net earnings per share is calculated by dividing net income by the weighted average number of shares outstanding during the reported period. The calculation of diluted net earnings per share is similar to basic, except that the weighted average number of shares outstanding includes the additional dilution from potential common stock such as stock options and stock under long-term incentive plans.

Accumulated Other Comprehensive (Loss) Earnings:

Accumulated other comprehensive (loss) earnings refers to revenues, expenses, gains and losses that under accounting principles generally accepted in the U.S. are included in comprehensive earnings (loss) but are excluded from net income as these amounts are recorded directly as an adjustment to stockholders' equity, net of tax. Lexmark's *Accumulated other comprehensive (loss) earnings* is composed of deferred gains and losses related to pension or other postretirement benefits, foreign currency exchange rate adjustments, deferred gains and losses on cash flow hedges and net unrealized gains and losses on marketable securities.

Segment Data:

Lexmark manufactures and sells a variety of printing and multifunction products and related supplies and services and is primarily managed along Business and Consumer market segments.

Recent Accounting Pronouncements:

In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ("FIN 48"). The adoption of FIN 48 did not have a material impact on the Company's results of operations and cash flows. Refer to Note 11 of the Notes to the Consolidated Financial Statements for discussion of the impact of adoption on the Company's financial position.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles ("GAAP") and expands disclosures about fair value measurements. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, SFAS 157 does not require any new fair value measurements. The provisions of SFAS 157 should be applied prospectively as of the beginning of the fiscal year in which it is initially applied, with limited exceptions. SFAS 157 is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years, with earlier adoption permitted. In February 2008, the FASB issued FASB Staff Position No. 157-2 ("FSP 157-2") which defers the effective date of SFAS 157 to fiscal years beginning after November 15, 2008 for nonfinancial assets and nonfinancial liabilities that are

recognized or disclosed at fair value in the financial statements on a nonrecurring basis. The Company is currently evaluating the provisions of SFAS 157.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Liabilities* ("SFAS 159"). SFAS 159 provides entities with the option to report selected financial assets and liabilities at fair value. Business entities adopting SFAS 159 will report unrealized gains and losses in earnings at each subsequent reporting date on items for which the fair value option has been elected. SFAS 159 establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 requires additional information that will help investors and other financial statement users to understand the effect of an entity's choice to use fair value on its earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007, with earlier adoption permitted. The Company is currently evaluating the impact of SFAS 159.

In June 2007, the FASB reached consensus on Emerging Issues Task Force ("EITF") Issue No. 07-03, *Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities* ("EITF 07-03"). EITF 07-03 concludes that nonrefundable advance payments for goods or services that will be used for or rendered for future research and development activities should be deferred and capitalized. The capitalized payment should be charged to expense once the goods are delivered or services performed or at such time that the entity no longer expects goods to be delivered or services to be performed. EITF 07-03 is effective for fiscal years beginning after December 15, 2007, and should be applied prospectively for new contracts entered into on or after the effective date. The provisions of EITF 07-03 will not materially impact the Company's financial position, results of operations and cash flows upon adoption.

In December 2007, the SEC issued Staff Accounting Bulletin ("SAB") No. 110, *Certain Assumptions Used in Valuation Methods* ("SAB 110"), expressing the staff's consent to continue to accept, under certain circumstances, the use of a "simplified" method in developing an estimate of the expected term of "plain vanilla" share options as previously discussed in SAB 107. Companies having sufficient historical share option exercise experience may not apply the simplified method. Because Lexmark's expected term assumption was based upon an analysis of historical option exercise behavior, SAB 110 will have no impact to the Company's financial position, results of operations and cash flows.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* ("SFAS 141R"), replacing SFAS No. 141, *Business Combinations* ("SFAS 141"). SFAS 141R retains the fundamental requirements of purchase method accounting for acquisitions as set forth previously in SFAS 141. However, this statement defines the acquirer as the entity that obtains control of a business in the business combination, thus broadening the scope of SFAS 141 which applied only to business combinations in which control was obtained through transfer of consideration. SFAS 141R also requires several changes in the way assets and liabilities are recognized and measured in purchase accounting including expensing acquisition-related costs as incurred, recognizing assets and liabilities arising from contractual contingencies at the acquisition date, and capitalizing in-process research and development. SFAS 141R also requires the acquirer to recognize a gain in earnings for bargain purchases, or the excess of the fair value of net assets over the consideration transferred plus any noncontrolling interest in the acquiree, a departure from the concept of "negative goodwill" previously recognized under SFAS 141. SFAS 141R is effective for the Company beginning January 1, 2009, and will apply prospectively to business combinations completed on or after that date.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB 51* ("SFAS 160"). SFAS 160 applies to all companies that prepare consolidated financial statements but will only affect companies that have a noncontrolling interest in a subsidiary or that deconsolidate a subsidiary. SFAS 160 clarifies that noncontrolling interests be reported as a component separate from the parent's equity and that changes in the parent's ownership interest in a subsidiary be recorded as equity transactions if the parent retains its controlling interest in the subsidiary. The statement also requires consolidated net income to include amounts attributable to both the parent

and the noncontrolling interest on the face of the income statement. In addition, SFAS 160 requires a parent to recognize a gain or loss in net income on the date the parent deconsolidates a subsidiary, or ceases to have a controlling financial interest in a subsidiary. SFAS 160 is effective for the Company beginning January 1, 2009, and will apply prospectively, except for the presentation of disclosure requirements, which must be applied retrospectively. The Company does not expect the adoption of SFAS 160 will have a material impact on its financial position, results of operations and cash flows.

Reclassifications:

Certain prior year amounts have been reclassified, if applicable, to conform to the current presentation.

3. RESTRUCTURING-RELATED CHARGES AND OTHER

2007 Restructuring

As part of its ongoing efforts to optimize its cost and expense structure, the Company continually reviews its resources in light of a variety of factors. On October 23, 2007, the Company announced a plan (the "2007 Restructuring Plan") which includes:

- Closure of one of the Company's inkjet supplies manufacturing facilities in Mexico and additional optimization measures at the remaining inkjet facilities in Mexico and the Philippines.
- Reduction of the Company's business support cost and expense structure by further consolidating activity globally and expanding the use of shared service centers in lower-cost regions. The areas impacted are supply chain, service delivery, general and administrative expense, as well as marketing and sales support functions.
- Focusing consumer segment marketing and sales efforts into countries or geographic regions that have the highest supplies usage.

The 2007 Restructuring Plan is expected to impact approximately 1,650 positions by the end of 2008. Most of the impacted positions are being moved to lower-cost countries. The Company expects the 2007 Restructuring Plan will result in pre-tax charges of approximately \$55 million, of which \$40 million will require cash. The Company expects the 2007 Restructuring Plan to be substantially completed by the end of 2008.

For the year ended December 31, 2007, the Company incurred \$30.8 million for the 2007 Restructuring Plan as follows:

Accelerated depreciation charges	\$ 5.1
Employee termination benefit charges	25.7
Total restructuring-related charges	\$30.8

The accelerated depreciation charges were determined in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. The accelerated depreciation charges are included in *Cost of revenue* on the Consolidated Statements of Earnings.

Employee termination benefit charges were accrued in accordance with SFAS No. 112, *Employers' Accounting for Postemployment Benefits* and SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, as appropriate. Employee termination benefit charges include severance, medical and other benefits and are included in *Restructuring and other, net* on the Consolidated Statements of Earnings.

The following table presents a rollforward of the liability incurred for employee termination benefits in connection with the 2007 Restructuring Plan. The liability is included in *Accrued liabilities* on the Company's Consolidated Statements of Financial Position.

	Employee Termination Benefits
Balance at January 1, 2007	\$ —
Costs incurred	25.7
Payments & other ⁽¹⁾	(4.6)
Balance at December 31, 2007	\$21.1

⁽¹⁾ Other consists of pension related items that will be settled through the Company's pension plans.

For the year ended December 31, 2007, the Company incurred restructuring-related charges of \$6.5 million in its Business segment, \$13.9 million in its Consumer segment and \$10.4 million in All other. The Company expects to incur charges related to the 2007 Restructuring Plan of approximately \$14 million in its Business segment, approximately \$19 million in its Consumer segment and approximately \$22 million in All other.

2006 Restructuring

During the first quarter of 2006, the Company approved a plan to restructure its workforce, consolidate some manufacturing capacity and make certain changes to its U.S. retirement plans (collectively referred to as the "2006 actions"). The workforce restructuring eliminated or transferred over 1,400 positions from various business functions and job classes, with over 850 positions being eliminated, and over 550 positions being transferred from various locations primarily to low-cost countries. Lexmark consolidated its manufacturing capacity to reduce manufacturing costs, including the closure of its Rosyth, Scotland inkjet cartridge manufacturing facility and Orleans, France laser toner facilities, and reduced its operating expenses, particularly in the areas of supply chain, general and administrative and marketing and sales support. Lexmark also froze pension benefits in its defined benefit pension plan for U.S. employees, effective April 3, 2006, and at the same time changed from a maximum Company matching contribution of three percent of eligible compensation to an automatic Company contribution of one percent and a maximum Company matching contribution of five percent to Lexmark's existing 401(k) plan. Except for approximately 100 positions that were eliminated in 2007, activities related to the 2006 actions were substantially completed at the end of 2006.

For the year ended December 31, 2006, the Company incurred pre-tax charges of \$121.1 million related to the 2006 actions which were partially offset by a \$9.9 million pension curtailment gain. Of the \$111.2 million of net pre-tax charges incurred, \$40.0 million is included in *Cost of revenue* and \$71.2 million in *Restructuring and other, net* on the Company's Consolidated Statements of Earnings. For the year ended December 31, 2006, the Company incurred total pre-tax restructuring-related charges of \$35.2 million in its Business segment, \$54.7 million in its Consumer segment and \$31.2 million in All other. All other operating income also included the \$9.9 million pension curtailment gain.

The following table presents a rollforward of the liability incurred for employee termination benefit and contract termination and lease charges in connection with the 2006 actions. The liability is included in *Accrued liabilities* on the Company's Consolidated Statements of Financial Position.

	Employee Termination Benefit Charges	Contract Termination & Lease Charges	Total
Balance at January 1, 2006	\$ —	\$ —	\$ —
Costs incurred	75.9	5.2	81.1
Payments	(46.2)	(0.4)	(46.6)
Other ⁽¹⁾	(4.4)	—	(4.4)
Balance at December 31, 2006	25.3	4.8	30.1
Payments & other ⁽²⁾	(14.0)	(1.7)	(15.7)
Reversals	(0.9)	(1.7)	(2.6)
Balance at December 31, 2007	\$ 10.4	\$ 1.4	\$ 11.8

⁽¹⁾ Other consists primarily of special termination benefits that are paid out of the U.S. pension plan.

⁽²⁾ Other consists of additions due to positions being eliminated in 2007 and changes in the liability balance due to foreign currency translations.

During the first quarter of 2007, the Company sold its Rosyth, Scotland facility for \$8.1 million and recognized a \$3.5 million pre-tax gain on the sale.

During the second quarter of 2007, the Company substantially liquidated the remaining operations of its Scotland entity and recognized an \$8.1 million pre-tax gain from the realization of the entity's accumulated foreign currency translation adjustment generated on the investment in the entity during its operating life. This gain is included in *Other (income) expense, net* on the Company's Consolidated Statements of Earnings.

2005 Workforce Reduction

In order to optimize the Company's expense structure, the Company approved a plan during the third quarter of 2005 that would reduce its workforce by approximately 275 employees worldwide from various business functions and job classes. The separation of the affected employees was completed by December 31, 2005.

As of December 31, 2005, the Company incurred one-time termination benefit charges of \$10.4 million related to the plan that is included in *Restructuring and other, net* on the Consolidated Statements of Earnings. For the \$10.4 million of one-time termination benefit charges, the Company recorded \$6.5 million in its Business segment, \$2.6 million in its Consumer segment and \$1.3 million in All other.

4. STOCK-BASED COMPENSATION

Lexmark has various stock incentive plans to encourage employees and nonemployee directors to remain with the Company and to more closely align their interests with those of the Company's stockholders. As of December 31, 2007, awards under the programs consisted of stock options, restricted stock units ("RSUs") and deferred stock units ("DSUs"). The Company currently issues the majority of shares related to its stock incentive plans from the Company's authorized and unissued shares of Class A Common Stock. Approximately 47.9 million shares of Class A Common Stock have been authorized for these stock incentive plans.

For the years ended December 31, 2007 and 2006, the Company incurred pre-tax stock-based compensation expense under SFAS 123R of \$41.3 million and \$43.2 million, respectively, in the Consolidated Statements of Earnings. The Company recorded pre-tax compensation expense of \$2.9 million in 2005 related to its stock incentive plans prior to the adoption of SFAS 123R.

The following table presents a breakout of the stock-based compensation expense recognized for the years ended December 31:

	2007	2006
Cost of revenue	\$ 3.4	\$ 6.0
Research and development	6.2	6.9
Selling, general and administrative	31.7	30.3
Stock-based compensation expense before income taxes	41.3	43.2
Income tax benefit	(15.9)	(16.5)
Stock-based compensation expense after income taxes	\$ 25.4	\$ 26.7

Under the Company's stock incentive plans, awards granted to certain employees who meet age and/or service requirements prescribed in the plan will continue to vest after the employees' retirement with no additional service requirements. Prior to the adoption of SFAS 123R, the Company recognized cost, on a pro forma basis, over the stipulated vesting period of these awards. Per SEC guidance, the Company is continuing to account for these awards in this manner subsequent to the adoption of SFAS 123R. For any awards granted after the adoption of SFAS 123R to employees who meet the age and/or service requirements, the Company is recognizing the cost of these awards over the period that the employee is required to provide service until the employee may retire and continue to vest in these awards. The change in method of accounting for these awards is not material for any periods presented.

On December 31, 2005, Lexmark accelerated the vesting of certain unvested "out-of-the-money" stock options with exercise prices equal to or greater than \$80.00 per share. These options, which were previously awarded to its employees under the Company's equity compensation plans, would have otherwise vested in the years 2006 through 2008. The vesting was effective for approximately 2.4 million unvested options, or 39% of the Company's total outstanding unvested options as of December 31, 2005. Acceleration of options held by non-employee directors and executive officers were not included in the vesting acceleration. The acceleration of these options eliminated future compensation expense the Company would otherwise have recognized in its income statement with respect to these accelerated options upon the adoption of SFAS 123R. As a result of the acceleration, the Company recognized an additional \$25 million (pre-tax) of stock-based employee compensation expense in the 2005 pro forma disclosure information provided further in this note.

Stock Options

Generally, options expire ten years from the date of grant. Options granted during 2007, 2006 and 2005, vest in approximately equal annual installments over a three-year period based upon continued employment or service on the board of directors.

For the year ended December 31, 2007, 2006 and 2005, the weighted average fair value of options granted were \$18.52, \$13.62 and \$16.78, respectively. The fair value of each option award on the grant date was estimated using the Black-Scholes option-pricing model with the following assumptions:

	2007	2006	2005
Expected dividend yield	—	—	—
Expected stock price volatility	30%	32%	24%
Weighted average risk-free interest rate	4.7%	4.7%	3.4%
Weighted average expected life of options (years)	4.0	3.1	2.9

A summary of the status of the Company's stock-based compensation plans as of December 31, 2007 and 2006, and changes during the years then ended is presented below:

	Options	Weighted Average Exercise Price (Per Share)	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
Outstanding at December 31, 2005	12.8	\$66.30	6.1	\$ 23.6
Granted	0.9	50.09		
Exercised	(1.4)	38.63		
Forfeited or canceled	(0.9)	77.43		
Outstanding at December 31, 2006	11.4	\$67.65	5.6	\$138.2
Granted	0.6	60.39		
Exercised	(0.3)	34.02		
Forfeited or canceled	(0.5)	78.39		
Outstanding at December 31, 2007	11.2	\$67.82	4.9	\$ 2.2
Exercisable at December 31, 2006	8.8	\$69.12	5.3	\$ 99.9
Exercisable at December 31, 2007	9.5	\$68.52	4.5	\$ 2.2

For the years ended December 31, 2007 and 2006, the total intrinsic value of options exercised was \$7.7 million and \$34.2 million, respectively. As of December 31, 2007, the Company had \$8.2 million of total unrecognized compensation expense, net of estimated forfeitures, related to unvested stock options that will be recognized over the weighted average period of 1.3 years.

A summary of the status of the Company's stock option plans as of December 31, 2005, and changes during the year then ended is presented below:

	Options	Weighted Average Exercise Price
Outstanding at December 31, 2004	12.3	\$60.73
Granted	2.2	81.96
Exercised	(1.2)	35.61
Forfeited or canceled	(0.5)	71.36
Outstanding at December 31, 2005	12.8	\$66.30

As of December 31, 2005, there were 9.0 million options exercisable.

Restricted Stock and Deferred Stock Units

Lexmark has granted RSUs with various vesting periods and generally these awards vest based upon continued employment with the Company. As of December 31, 2007, the Company has issued DSUs to certain members of management who elected to defer all or a portion of their annual bonus into such units and to certain nonemployee directors who elected to defer all or a portion of their annual retainer, chair retainer and/or meeting fees into such units. These DSUs are 100% vested when issued. The Company has also issued supplemental DSUs to certain members of management upon the election to defer all or a portion of an annual bonus into DSUs. These supplemental DSUs vest at the end of five years based upon continued employment with the Company. The cost of the RSUs and supplemental DSUs, generally determined to be the fair market value of the shares at the date of grant, is charged to compensation expense ratably over the vesting period of the award.

A summary of the status of the Company's RSU and DSU grants as of December 31, 2007 and 2006, and changes during the year then ended is presented below:

	Units	Weighted Average Grant Date Fair Value (Per Share)	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
RSUs and DSUs at December 31, 2005	0.4	\$54.55	4.2	\$18.4
Granted	0.6	48.75		
Vested	(0.1)	35.52		
Forfeited or canceled	(0.1)	54.89		
RSUs and DSUs at December 31, 2006	0.8	\$52.84	3.5	\$61.9
Granted	0.5	56.08		
Vested	(0.1)	58.62		
Forfeited or canceled	—	54.43		
RSUs and DSUs at December 31, 2007	1.2	\$53.79	2.6	\$42.6

For the years ended December 31, 2007 and 2006, the total fair value of RSUs and DSUs that vested was \$3.2 million and \$4.9 million, respectively. As of December 31, 2007, the Company had \$33.7 million of total unrecognized compensation expense, net of estimated forfeitures, related to RSUs and DSUs that will be recognized over the weighted average period of 3.1 years.

Employee Stock Purchase Plan

The Company's Employee Stock Purchase Plan ("ESPP") enables substantially all regular employees to purchase full or fractional shares of Lexmark Class A Common Stock through payroll deductions of up to 10% of eligible compensation. Effective January 1, 2006, the ESPP was amended whereby the share price paid by an employee is 85% of the closing market price on the last business day of the respective offering period. Prior to January 1, 2006, the share price paid by an employee was 85% of the lesser of the closing market price on (i) the last business day immediately preceding the first day of the respective offering period and (ii) the last business day of the respective offering period. The ESPP provides semi-annual offering periods beginning each January 1 and July 1. During the years ended December 31, 2007, 2006 and 2005, employees paid the Company \$5.6 million, \$6.2 million and \$8.6 million, respectively, to purchase approximately 0.1 million shares during each of these years. During 2007 and 2006, the Company recognized approximately \$0.9 million and \$1.9 million of compensation expense related to this ESPP activity due to the adoption of SFAS 123R mentioned earlier. Compensation expense was calculated using the fair value of the employees' purchase rights under the Black-Scholes model.

The Company discontinued the ESPP as of December 31, 2007. Employees enrolled in the ESPP during the offering period that ended December 31, 2007, qualified for the final ESPP purchase executed according to the plan provisions described above.

Pro Forma Information for Periods Prior to Adopting SFAS 123R

Prior to the adoption of SFAS 123R on January 1, 2006, the Company accounted for its stock-based employee compensation plans under APB 25 and related interpretations. Under APB 25, compensation cost was not recognized for substantially all options granted because the exercise price was at least equal to the market value of the underlying common stock on the date of grant.

The following table illustrates the effect on net earnings and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*, to stock-based employee compensation:

	2005
Net earnings, as reported	\$356.3
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(52.3) ⁽¹⁾
Pro forma net income	\$304.0
Net earnings per share:	
Basic — as reported	\$ 2.94
Basic — pro forma	2.51
Diluted — as reported	\$ 2.91
Diluted — pro forma	2.48

⁽¹⁾ 2005 stock-based employee compensation expense includes the \$25 million (pre-tax) impact of the acceleration of certain unvested "out-of-the-money" stock options performed in December 2005.

5. MARKETABLE SECURITIES

The Company evaluates its marketable securities in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and has determined that all of its investments in marketable securities should be classified as available-for-sale and reported at fair value, with unrealized gains and losses recorded in *Accumulated other comprehensive earnings (loss)*. The fair values of the Company's available-for-sale marketable securities are based on quoted market prices or other observable market data, or in some cases, the Company's amortized cost, which approximates fair value due to the frequent resetting of interest rates resulting in repricing of the investments.

As of December 31, 2007, the Company had gross unrealized losses and gross unrealized gains of \$1.5 million and \$1.5 million, respectively, related to its marketable securities. Substantially all of the unrealized losses as of December 31, 2007, have been in a loss position for less than 12 months. As of December 31, 2006, the Company had immaterial gross unrealized losses related to its marketable securities. The Company assesses its marketable securities for other-than-temporary declines in value by considering various factors that include, among other things, any events that may affect the creditworthiness of a security's issuer, the length of time the security has been in a loss position, and the Company's ability and intent to hold the security until a forecasted recovery of fair value that may include holding the security to maturity.

At December 31, 2007, the Company's available-for-sale *Marketable securities* consisted of the following:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Municipal debt securities	\$ 78.9	\$ —	\$ —	\$ 78.9
Corporate debt securities	147.6	0.1	(0.7)	147.0
U.S. gov't and agency debt securities	65.6	0.3	—	65.9
Asset-backed and mortgage-backed securities	246.8	1.1	(0.8)	247.1
Total debt securities	538.9	1.5	(1.5)	538.9
Preferred securities	0.5	—	—	0.5
Total security investments	539.4	1.5	(1.5)	539.4
Cash equivalents	(20.3)	—	—	(20.3)
Total marketable securities	\$519.1	\$1.5	\$(1.5)	\$519.1

At December 31, 2006, the Company's available-for-sale *Marketable securities* consisted of the following:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Municipal debt securities	\$172.2	\$ —	\$ —	\$172.2
Corporate debt securities	220.7	—	—	220.7
U.S. gov't and agency debt securities	10.6	—	—	10.6
Asset-backed and mortgage-backed securities	31.1	—	—	31.1
Total security investments	434.6	—	—	434.6
Cash equivalents	(28.3)	—	—	(28.3)
Total marketable securities	\$406.3	\$ —	\$ —	\$406.3

Although contractual maturities of the Company's debt securities may be greater than one year, the investments are classified as current assets in the Consolidated Statements of Financial Position due to the Company's expected holding period of less than one year. The contractual maturities of the Company's available-for-sale marketable debt securities noted above were as follows:

	2007		2006	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in less than one year	\$111.3	\$111.2	\$211.2	\$211.2
Due in 1-5 years	210.9	211.1	41.3	41.3
Due after 5 years	217.2	217.1	182.1	182.1
Total available-for-sale marketable debt securities	\$539.4	\$539.4	\$434.6	\$434.6

Proceeds from the sales and maturities of the Company's available-for-sale marketable securities were \$855.3 million in 2007, \$1,721.0 million in 2006 and \$1,824.7 million in 2005. The Company recognized immaterial gross realized gains and losses from these sales in 2007, 2006 and 2005. The Company uses the specific identification method when accounting for the costs of its available-for-sale marketable securities sold.

6. TRADE RECEIVABLES

The Company's trade receivables are reported in the Consolidated Statements of Financial Position net of allowances for doubtful accounts and product returns. *Trade receivables* consisted of the following at December 31:

	2007	2006
Gross trade receivables	\$615.3	\$622.3
Allowances	(36.5)	(38.0)
Trade receivables, net	\$578.8	\$584.3

In the U.S., the Company transfers a majority of its receivables to its wholly-owned subsidiary, Lexmark Receivables Corporation ("LRC"), which then may transfer the receivables on a limited recourse basis to an unrelated third party. The financial results of LRC are included in the Company's consolidated financial results. LRC is a separate legal entity with its own separate creditors who, in a liquidation of LRC, would be entitled to be satisfied out of LRC's assets prior to any value in LRC becoming available for equity claims of the Company.

In October 2004, the Company entered into an amended and restated agreement to sell a portion of its trade receivables on a limited recourse basis. The amended agreement allows for a maximum capital availability of \$200 million under this facility. The primary purpose of the amendment was to extend the term of the facility to October 16, 2007, with required annual renewal of commitments.

During the first quarter of 2007, the Company amended the facility to allow LRC to repurchase receivables previously transferred to the unrelated third party. Prior to the 2007 amendment, the Company accounted for the transfer of receivables from LRC to the unrelated third party as sales of receivables. As a result of the 2007 amendment, the Company accounts for the transfers of receivables from LRC to the unrelated third party as a secured borrowing with a pledge of its receivables as collateral. The amendment became effective in the second quarter of 2007. In October 2007, the facility was renewed until October 3, 2008.

This facility contains customary affirmative and negative covenants as well as specific provisions related to the quality of the accounts receivables transferred. As collections reduce previously transferred receivables, the Company may replenish these with new receivables. Lexmark bears a limited risk of bad debt losses on the trade receivables transferred, since the Company over-collateralizes the receivables transferred with additional eligible receivables. Lexmark addresses this risk of loss in its allowance for doubtful accounts. Receivables transferred to the unrelated third-party may not include amounts over 90 days past due or concentrations over certain limits with any one customer.

At December 31, 2007, there were no secured borrowings under the facility. At December 31, 2006, there were no trade receivables outstanding under the facility.

Expenses incurred under this program totaling \$0.6 million, \$0.9 million and \$1.0 million in 2007, 2006 and 2005, respectively, are included in *Other (income) expense, net*, on the Consolidated Statements of Earnings.

7. INVENTORIES

Inventories consisted of the following at December 31:

	2007	2006
Work in process	\$127.2	\$119.7
Finished goods	337.2	338.1
Inventories	\$464.4	\$457.8

8. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consisted of the following at December 31:

	Useful Lives (Years)	2007	2006
Land and improvements	20	\$ 37.7	\$ 35.7
Buildings and improvements	10-35	512.7	502.6
Machinery and equipment	2-10	1,023.3	992.8
Information systems	3-4	136.7	121.4
Internal use software	3-5	192.9	178.8
Furniture and other	3-7	91.7	71.4
		1,995.0	1,902.7
Accumulated depreciation		(1,126.0)	(1,055.9)
Property, plant and equipment, net		\$ 869.0	\$ 846.8

Depreciation expense was \$191.0 million, \$199.5 million and \$157.1 million in 2007, 2006 and 2005, respectively.

9. ACCRUED LIABILITIES AND OTHER LIABILITIES

Accrued liabilities, in the current liabilities section of the balance sheet, consisted of the following at December 31:

	2007	2006
Copyright fees	\$117.5	\$ 97.8
Compensation	111.0	132.3
Deferred revenue	84.1	81.9
Marketing programs	67.1	72.9
Warranty	62.3	62.7
Other	268.5	276.1
Accrued liabilities	\$710.5	\$723.7

In accordance with the disclosure requirements of FIN 45, changes in the Company's aggregate warranty liability, which includes both warranty and extended warranty (deferred revenue), are presented below:

	2007	2006
Balance at January 1	\$ 212.4	\$ 195.0
Accruals for warranties issued	284.9	231.5
Accruals related to pre-existing warranties (including amortization of deferred revenue for extended warranties and changes in estimates)	(57.9)	(53.0)
Settlements made (in cash or in kind)	(188.2)	(161.1)
Balance at December 31	\$ 251.2	\$ 212.4

Both warranty and the short-term portion of extended warranty are included in *Accrued liabilities* on the Consolidated Statements of Financial Position. The long-term portion of extended warranty is included in *Other liabilities* on the Consolidated Statements of Financial Position.

Other liabilities, in the noncurrent liabilities section of the balance sheet, consisted of the following at December 31:

	2007	2006
Deferred revenue	\$124.3	\$ 85.5
Pension/Postretirement	117.9	119.6
Other	103.3	134.9
Other liabilities	\$345.5	\$340.0

10. DEBT

Senior Notes — Long-term Debt and Current Portion of Long-term Debt

Lexmark has outstanding \$150.0 million principal amount of 6.75% senior notes due May 15, 2008, which was initially priced at 98.998%, to yield 6.89% to maturity. A balance of \$149.9 million (net of the unamortized discount of \$0.1 million) was outstanding at December 31, 2007. At December 31, 2006, the balance was \$149.8 million (net of the unamortized discount of \$0.2 million). As the notes mature in May 2008, the senior notes were reclassified from *Long-term debt* to *Current portion of long-term debt* during 2007.

The senior notes contain typical restrictions on liens, sale leaseback transactions, mergers and sales of assets. There are no sinking fund requirements on the senior notes and they may be redeemed at any time at the option of the Company, at a redemption price as described in the related indenture agreement, as supplemented and amended, in whole or in part.

During October 2003, the Company entered into interest rate swap contracts to convert its \$150.0 million principal amount of 6.75% senior notes from a fixed interest rate to a variable interest rate. Interest rate

swaps with a notional amount of \$150.0 million were executed whereby the Company will receive interest at a fixed rate of 6.75% and pay interest at a variable rate of approximately 2.76% above the six-month London Interbank Offered Rate ("LIBOR"). These interest rate swaps have a maturity date of May 15, 2008, which is equivalent to the maturity date of the senior notes.

Credit Facility

Effective January 20, 2005, Lexmark entered into a \$300 million 5-year senior, unsecured, multi-currency revolving credit facility with a group of banks. Under the credit facility, the Company may borrow in dollars, euros, British pounds sterling and Japanese yen. Under certain circumstances, the aggregate amount available under the facility may be increased to a maximum of \$500 million. As of December 31, 2007 and 2006, there were no amounts outstanding under the credit facility.

Lexmark's credit agreement contains usual and customary default provisions, leverage and interest coverage restrictions and certain restrictions on secured and subsidiary debt, disposition of assets, liens and mergers and acquisitions. The \$300 million credit facility has a maturity date of January 20, 2010.

Interest on all borrowings under the facility depends upon the type of loan, namely alternative base rate loans, swingline loans or eurocurrency loans. Alternative base rate loans bear interest at the greater of the prime rate or the federal funds rate plus one-half of one percent. Swingline loans (limited to \$50 million) bear interest at an agreed upon rate at the time of the borrowing. Eurocurrency loans bear interest at the sum of (i) a LIBOR for the applicable currency and interest period and (ii) an interest rate spread based upon the Company's debt ratings ranging from 0.18% to 0.80%. In addition, Lexmark is required to pay a facility fee on the \$300 million line of credit of 0.07% to 0.20% based upon the Company's debt ratings. The interest and facility fees are payable at least quarterly.

Short-term Debt

Lexmark's Brazilian operation has a short-term, uncommitted line of credit. The interest rate on this line of credit varies based upon the local prevailing interest rates at the time of borrowing. The interest rate averaged approximately 15% and 19% during 2007 and 2006, respectively. As of December 31, 2007 and 2006, there were no amounts outstanding under the credit facility.

Other

Total cash paid for interest on the debt facilities amounted to \$12.6 million, \$12.7 million and \$10.8 million in 2007, 2006 and 2005, respectively.

The components of *Interest (income) expense, net* in the Consolidated Statements of Earnings were as follows:

	2007	2006	2005
Interest income	\$(34.2)	\$(34.2)	\$(37.7)
Interest expense	13.0	12.1	11.2
Total	\$(21.2)	\$(22.1)	\$(26.5)

11. INCOME TAXES

Adoption of FIN 48

The Company adopted the provisions of FIN 48 and related guidance on January 1, 2007. As a result of the implementation of FIN 48, the Company reduced its liability for unrecognized tax benefits and related interest and penalties by \$7.3 million, which resulted in a corresponding increase in the Company's January 1, 2007, retained earnings balance. The Company also recorded an increase in its deferred tax assets of \$8.5 million and a corresponding increase in its liability for unrecognized tax benefits as a result of adopting FIN 48.

The amount of unrecognized tax benefits at December 31, 2007, was \$53.5 million, of which \$43.5 million would affect the Company's effective tax rate if recognized. The Company recognizes accrued interest and penalties associated with uncertain tax positions as part of its income tax provision. As of December 31, 2007, the Company had \$7.4 million of accrued interest and penalties. During 2007, releases of \$3.7 million of accrued interest and penalties were included in the Company's results of operations.

FIN 48 Additional Disclosures

It is reasonably possible that the total amount of unrecognized tax benefits will increase or decrease in the next 12 months. Such changes could occur based on the expiration of various statutes of limitations or the conclusion of ongoing tax audits in various jurisdictions around the world. If those events occur within the next 12 months, the Company estimates that its unrecognized tax benefits amount could decrease by an amount in the range of \$0 to \$18 million, the impact of which would affect the Company's effective tax rate.

Several tax years are subject to examination by major tax jurisdictions. In the U.S., federal tax years 2004 and after are subject to examination. The Internal Revenue Service ("IRS") is currently auditing tax years 2004 and 2005. In France, tax years 2006 and after are subject to examination. In Switzerland, tax years 2002 and after are subject to examination. In most of the other countries where the Company files income tax returns, 2002 is the earliest tax year that is subject to examination. The Company believes that adequate amounts have been provided for any adjustments that may result from those examinations.

A reconciliation of the total beginning and ending amounts of unrecognized tax benefits is as follows:

Balance at January 1, 2007	\$ 59.8
Increases/(decreases) in unrecognized tax benefits as a result of tax positions taken during a prior period	(5.5)
Increases/(decreases) in unrecognized tax benefits as a result of tax positions taken during the current period	10.4
Increases/(decreases) in unrecognized tax benefits relating to settlements with taxing authorities	(11.2)
Reductions to unrecognized tax benefits as a result of a lapse of the applicable statute of limitations	—
Balance at December 31, 2007	\$ 53.5

Provision for Income Taxes

The *Provision for income taxes* consisted of the following:

	2007	2006	2005
Current:			
Federal	\$ 35.4	\$ 96.0	\$143.4
Non-U.S.	34.8	37.2	61.0
State and local	6.5	9.6	15.3
	<u>76.7</u>	<u>142.8</u>	<u>219.7</u>
Deferred:			
Federal	(7.9)	(31.5)	(7.8)
Non-U.S.	(20.0)	12.3	(14.1)
State and local	(0.1)	(2.7)	(0.4)
	<u>(28.0)</u>	<u>(21.9)</u>	<u>(22.3)</u>
Provision for income taxes	\$ 48.7	\$120.9	\$197.4

Earnings before income taxes were as follows:

	2007	2006	2005
U.S.	\$135.7	\$219.4	\$339.0
Non-U.S.	213.8	239.9	214.7
Earnings before income taxes	\$349.5	\$459.3	\$553.7

The Company realized an income tax benefit from the exercise of certain stock options in 2007, 2006 and 2005 of \$3.4 million, \$11.8 million and \$15.8 million, respectively. This benefit resulted in a decrease in current income taxes payable and an increase in capital in excess of par.

A reconciliation of the provision for income taxes using the U.S. statutory rate and the Company's effective tax rate was as follows:

	2007		2006		2005	
	Amount	%	Amount	%	Amount	%
Provision for income taxes at statutory rate	\$122.3	35.0%	\$160.8	35.0%	\$193.8	35.0%
State and local income taxes, net of federal tax benefit.	6.8	2.0	7.5	1.6	12.4	2.2
Foreign tax differential	(42.2)	(12.1)	(23.9)	(5.2)	(41.2)	(7.4)
Research and development credit	(5.6)	(1.6)	(6.8)	(1.5)	(14.0)	(2.5)
Repatriation under AJCA	—	—	—	—	51.9	9.4
Tax-exempt interest, net of related expenses	(1.4)	(0.4)	(3.6)	(0.8)	(4.7)	(0.9)
Valuation allowance	0.2	0.1	7.9	1.7	2.4	0.4
Reversal of previously accrued taxes	(18.4)	(5.3)	(14.3)	(3.1)	—	—
Adjustments to previously recorded taxes	(11.2)	(3.2)	—	—	—	—
Other	(1.8)	(0.6)	(6.7)	(1.4)	(3.2)	(0.6)
Provision for income taxes	\$ 48.7	13.9%	\$120.9	26.3%	\$197.4	35.6%

The effective income tax rate was 13.9% for the year ended December 31, 2007. The 12.4 percentage point reduction YTY of the effective tax rate was primarily due to a geographic shift of earnings (6.9 percentage points) as well as reversals and adjustments of previously accrued taxes (5.4 percentage points). During 2007, the Company reversed \$18.4 million of previously accrued taxes mostly due to the settlement of a tax audit outside the U.S. and recorded \$11.2 million of adjustments to previously recorded tax amounts. Specific to the fourth quarter of 2007, the Company recorded adjustments of \$6.4 million to previously recorded tax amounts. The impact of these adjustments was insignificant to prior periods.

The effective income tax rate was 26.3% for the year ended December 31, 2006. During 2006, the IRS completed its examination of the Company's income tax returns for the years 2002 and 2003. Upon completion of that audit, the Company reversed \$2.5 million of previously accrued taxes. Additionally, the Company also reversed \$11.8 million of previously accrued taxes based on the expiration of various domestic and foreign statutes of limitation. The benefit of those two reversals was included in the 2006 tax rate.

During 2006, the Company was subject to a tax holiday in Switzerland with respect to the earnings of one of the Company's wholly-owned Swiss subsidiaries. The holiday expired at the end of 2006. The benefit derived from the tax holiday was \$1.6 million in 2006 and \$11.5 million in 2005.

The 2005 effective income tax rate was impacted by two specific events. First, due to the retroactive extension of a favorable, non-U.S. tax rate, the income tax provision was reduced by \$3.1 million. Second, on October 22, 2004, the President of the U.S. signed the American Jobs Creation Act of 2004 (the "AJCA"). The AJCA created a temporary incentive for U.S. corporations to repatriate accumulated income earned abroad by providing an 85 percent dividends-received deduction for certain dividends from

controlled foreign corporations. On April 28, 2005, the Company's board of directors approved a Domestic Reinvestment Plan ("DRP") under the AJCA. Pursuant to the DRP, the Company repatriated \$683.9 million for which it will claim the 85 percent dividends-received deduction provided by the AJCA. The Company's 2005 income tax provision included \$51.9 million to cover the Federal, State, and foreign income taxes the Company has estimated it would owe in connection with its repatriation of the \$683.9 million.

Deferred income tax assets and (liabilities)

Significant components of deferred income tax assets and (liabilities) at December 31 were as follows:

	2007	2006
Deferred tax assets:		
Tax loss carryforwards	\$ 2.6	\$ 11.6
Inventories	14.5	13.6
Pension	14.7	19.7
Warranty	11.2	10.2
Postretirement benefits	21.9	24.0
Equity compensation	28.5	16.4
Other	64.4	36.4
Deferred tax liabilities:		
Property, plant and equipment	(32.7)	(29.8)
	125.1	102.1
Valuation allowances	(0.9)	(6.1)
Net deferred tax assets	\$124.2	\$ 96.0

The Company has non-U.S. tax loss carryforwards of \$11.7 million, of which \$5.9 million is subject to a valuation allowance. The remaining \$5.8 million has an indefinite carryforward period. The Company believes that, for any tax loss carryforward where a valuation allowance has not been provided, the associated asset will be realized because there will be sufficient income in the future to absorb the loss.

Deferred income taxes have not been provided on the majority of the undistributed earnings of foreign subsidiaries. Undistributed earnings of non-U.S. subsidiaries included in the consolidated retained earnings were approximately \$1,010.6 million as of December 31, 2007. It is not practicable to estimate the amount of additional tax that may be payable on the foreign earnings. The Company does not plan to initiate any action that would precipitate the payment of income taxes.

Other

Cash paid for income taxes was \$76.1 million, \$134.4 million and \$164.2 million in 2007, 2006 and 2005, respectively.

On November 10, 2005, the FASB issued FSP No. FAS 123R-3, *Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards* ("FSP 123R-3"). The Company elected to adopt the alternative transition method provided in FSP 123R-3 for calculating the tax effects of stock-based compensation pursuant to SFAS 123R. The alternative transition method includes simplified methods to establish the beginning balance of the additional paid-in capital pool ("APIC pool") related to the tax effects of employee stock-based compensation, and to determine the subsequent impact on the APIC pool and Consolidated Statement of Cash Flows of the tax effects of employee stock-based compensation awards that are outstanding upon the adoption of SFAS 123R.

12. STOCKHOLDERS' EQUITY AND OTHER COMPREHENSIVE EARNINGS (LOSS)

The Class A Common Stock is voting and exchangeable for Class B Common Stock in very limited circumstances. The Class B Common Stock is non-voting and is convertible, subject to certain limitations, into Class A Common Stock.

At December 31, 2007, approximately 772.4 million and 1.8 million shares of Class A and Class B Common Stock were unissued and unreserved. These shares are available for a variety of general corporate purposes, including future public offerings to raise additional capital and for facilitating acquisitions.

In January 2006, the Company received authorization from the board of directors to repurchase an additional \$1.0 billion of its Class A Common Stock for a total repurchase authority of \$3.9 billion. As of December 31, 2007, there was approximately \$0.3 billion of share repurchase authority remaining. This repurchase authority allows the Company, at management's discretion, to selectively repurchase its stock from time to time in the open market or in privately negotiated transactions depending upon market price and other factors. During 2007, the Company repurchased approximately 2.7 million shares at a cost of approximately \$0.2 billion. As of December 31, 2007, since the inception of the program in April 1996, the Company had repurchased approximately 74.1 million shares for an aggregate cost of approximately \$3.6 billion. As of December 31, 2007, the Company had reissued approximately 0.5 million shares of previously repurchased shares in connection with certain of its employee benefit programs. As a result of these issuances as well as the retirement of 44.0 million and 16.0 million shares of treasury stock in 2005 and 2006, respectively, the net treasury shares outstanding at December 31, 2007, were 13.6 million.

In December 2005 and October 2006, the Company received authorization from the board of directors to retire 44.0 million and 16.0 million shares, respectively, of the Company's Class A Common Stock currently held in the Company's treasury as treasury stock. The retired shares resumed the status of authorized but unissued shares of Class A Common Stock. Refer to the Consolidated Statements of Stockholders' Equity and Comprehensive Earnings for the effects on *Common stock*, *Capital in excess of par*, *Retained earnings* and *Treasury stock* from the retirement of the 44.0 million shares of Class A Common Stock in 2005 and 16.0 million shares of Class A Common Stock in 2006.

In 1998, the Company's board of directors adopted a stockholder rights plan (the "Rights Plan") which provides existing stockholders with the right to purchase one one-thousandth (0.001) of a share of Series A Junior Participating preferred stock for each share of Class A and Class B Common Stock held in the event of certain changes in the Company's ownership. The rights will expire on January 31, 2009, unless earlier redeemed by the Company.

Comprehensive earnings (loss) for the years ended December 31, net of taxes, consists of the following:

	2007	2006	2005
Net earnings	\$300.8	\$338.4	\$356.3
Other comprehensive earnings (loss):			
Foreign currency translation adjustment	22.5	22.3	(19.3)
Cash flow hedging, net of reclassifications (net of tax benefit (liability) of \$0.1 in 2007, \$0.2 in 2006 and \$(4.6) in 2005)	(0.7)	(6.4)	35.9
Minimum pension liability adjustments (net of tax (liability) benefit of \$(16.5) in 2006 and \$8.2 in 2005)	—	26.9	(14.8)
SFAS 158 pension or other postretirement benefits, net of reclassifications (net of tax (liability) of \$(2.8) in 2007)	17.5	—	—
Net unrealized gain (loss) on marketable securities (net of tax (liability) benefit of \$(0.0) in 2007, \$(0.1) in 2006 and \$(0.0) in 2005)	—	0.6	0.2
Comprehensive earnings	\$340.1	\$381.8	\$358.3

Accumulated other comprehensive (loss) earnings for the years ended December 31 consists of the following:

	Foreign Currency Translation Adjustment	Cash Flow Hedges	Minimum Pension Liability	Pension or Other Postretirement Benefits	Net Unrealized (Loss) Gain on Marketable Securities	Accumulated Other Comprehensive (Loss) Earnings
Balance at 12/31/04	\$ 4.1	\$(28.8)	\$(139.8)	\$ —	\$(0.8)	\$(165.3)
2005 Change	(19.3)	35.9	(14.8)	—	0.2	2.0
Balance at 12/31/05	(15.2)	7.1	(154.6)	—	(0.6)	(163.3)
2006 Change	22.3	(6.4)	26.9	—	0.6	43.4
Adoption of SFAS 158 ...	—	—	127.7	(138.7)	—	(11.0)
Balance at 12/31/06	7.1	0.7	—	(138.7)	—	(130.9)
2007 Change	22.5	(0.7)	—	17.5	—	39.3
Balance at 12/31/07	\$ 29.6	\$ —	\$ —	\$(121.2)	\$ —	\$ (91.6)

13. EARNINGS PER SHARE ("EPS")

The following table presents a reconciliation of the numerators and denominators of the basic and diluted net EPS calculations for the years ended December 31:

	2007	2006	2005
Numerator:			
Net earnings	\$300.8	\$338.4	\$356.3
Denominator:			
Weighted average shares used to compute basic EPS	95.3	102.8	121.0
Effect of dilutive securities — employee stock plans	0.5	0.7	1.3
Weighted average shares used to compute diluted EPS	95.8	103.5	122.3
Basic net EPS	\$ 3.16	\$ 3.29	\$ 2.94
Diluted net EPS	\$ 3.14	\$ 3.27	\$ 2.91

RSUs and stock options totaling an additional 5.1 million, 5.3 million and 3.3 million of Class A Common Stock in 2007, 2006 and 2005, respectively, were outstanding but were not included in the computation of diluted net earnings per share because the effect would have been antidilutive.

14. PENSION AND OTHER POSTRETIREMENT PLANS

Lexmark and its subsidiaries have defined benefit and defined contribution pension plans that cover certain of its regular employees, and a supplemental plan that covers certain executives. Medical, dental and life insurance plans for retirees are provided by the Company and certain of its non-U.S. subsidiaries.

Effective April 3, 2006, Lexmark froze pension benefits in its defined benefit pension plan for U.S. employees and at the same time changed from a maximum Company matching contribution of three percent of eligible compensation to an automatic Company contribution of one percent and a maximum Company matching contribution of five percent to Lexmark's existing 401(k) plan. As a result, during 2006, the Company recognized a \$9.9 million pension curtailment gain due to the freeze of benefit accruals in the U.S. Additionally, in 2006 and 2007, the Company made a maximum Company matching contribution of six percent to a nonqualified deferred compensation plan on compensation amounts in excess of IRS qualified plan limits.

Effective December 31, 2006, the Company adopted SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R)* ("SFAS 158"). SFAS 158 required recognition of the funded status of a benefit plan in the statement of financial position and recognition in other comprehensive earnings of certain gains and losses that arise during the period, but are deferred under pension accounting rules.

The Pension Protection Act of 2006 ("the Act") was enacted on August 17, 2006. Most of its provisions will become effective in 2008. The Act significantly changes the funding requirements for single-employer defined benefit pension plans. The funding requirements will now largely be based on a plan's calculated funded status, with faster amortization of any shortfalls or surpluses. The Act directs the U.S. Treasury Department to develop a new yield curve to discount pension obligations for determining the funded status of a plan when calculating the funding requirements.

Defined Benefit Plans

The non-U.S. pension plans are not significant and use economic assumptions similar to the U.S. pension plan and therefore are not shown separately in the following disclosures.

Obligations and funded status at December 31:

	Pension Benefits		Other Postretirement Benefits	
	2007	2006	2007	2006
Change in Benefit Obligation:				
Benefit obligation at beginning of year	\$777.1	\$797.9	\$ 46.6	\$ 58.3
Service cost	2.6	7.9	1.7	1.8
Interest cost	42.3	42.0	2.5	2.5
Contributions by plan participants	3.4	1.6	4.2	3.5
Actuarial gain	(19.4)	(25.7)	(1.1)	(0.3)
Benefits paid	(53.3)	(52.3)	(6.5)	(5.9)
Foreign currency exchange rate changes	7.6	16.5	—	—
Plan amendments and adjustments	0.6	0.5	—	(13.6)
Settlement, curtailment or special termination losses	1.3	(11.3)	0.4	0.3
Benefit obligation at end of year	762.2	777.1	47.8	46.6
Change in Plan Assets:				
Fair value of plan assets at beginning of year	718.5	678.4	—	—
Actual return on plan assets	34.5	78.3	—	—
Contributions by the employer	4.0	4.0	2.3	2.4
Benefits paid	(53.3)	(52.3)	(6.5)	(5.9)
Foreign currency exchange rate changes	7.3	15.8	—	—
Plan amendments and adjustments	0.5	(2.8)	—	—
Contributions by plan participants	3.4	1.6	4.2	3.5
Settlements	(0.5)	(4.5)	—	—
Fair value of plan assets at end of year	714.4	718.5	—	—
Unfunded status at end of year	(47.8)	(58.6)	(47.8)	(46.6)
Net loss	203.5	226.3	12.1	14.1
Prior service cost (credit)	0.3	0.3	(15.7)	(20.0)
Net amount recognized	\$156.0	\$168.0	\$(51.4)	\$(52.5)
Amounts Recognized in the Consolidated Statements of Financial Position:				
Noncurrent assets	\$ 19.1	\$ 9.0	\$ —	\$ —
Current liabilities	(1.3)	(1.2)	(3.5)	(3.3)
Noncurrent liabilities	(65.6)	(66.4)	(44.3)	(43.3)
Accumulated other comprehensive loss (earnings), net of tax	123.3	142.4	(2.2)	(3.7)
Deferred tax assets	82.5	85.9	—	—
Deferred tax liabilities	(2.0)	(1.7)	(1.4)	(2.2)
Net amount recognized	\$156.0	\$168.0	\$(51.4)	\$(52.5)

The adoption of SFAS 158 in 2006 did not have a material impact on the Company's results of operations and cash flows. The following table illustrates the incremental effect of applying SFAS 158 on individual line items on the Consolidated Statement of Financial Position as of December 31, 2006:

	Before	SFAS 158 Adjustment	After
Other assets	\$ 338.7	\$(166.5)	\$ 172.2
Accrued liabilities	719.1	4.6	723.7
Other noncurrent liabilities	500.1	(160.1)	340.0
Accumulated other comprehensive loss	(119.9)	(11.0)	(130.9)

The accumulated benefit obligation for all of the Company's defined benefit pension plans was \$756.0 million and \$771.4 million at December 31, 2007 and 2006, respectively.

Pension plans with a benefit obligation in excess of plan assets at December 31:

	2007		2006	
	Benefit Obligation	Plan Assets	Benefit Obligation	Plan Assets
Plans with projected benefit obligation in excess of plan assets	\$664.6	\$597.7	\$673.9	\$606.2
Plans with accumulated benefit obligation in excess of plan assets	659.9	597.5	665.3	601.7

Components of net periodic benefit cost:

	Pension Benefits			Other Postretirement Benefits		
	2007	2006	2005	2007	2006	2005
Net Periodic Benefit Cost:						
Service cost	\$ 2.6	\$ 7.9	\$ 16.9	\$ 1.7	\$ 1.8	\$ 1.8
Interest cost	42.3	42.0	41.9	2.5	2.5	3.1
Expected return on plan assets	(48.8)	(49.2)	(51.2)	—	—	—
Amortization of prior service cost (credit)	—	—	(1.3)	(4.0)	(3.8)	(1.8)
Amortization of net loss	15.1	17.2	16.4	0.9	1.0	0.9
Settlement, curtailment or special termination (gains) losses	2.0	(5.4)	3.4	0.1	(0.1)	0.1
Net periodic benefit cost	\$ 13.2	\$ 12.5	\$ 26.1	\$ 1.2	\$ 1.4	\$ 4.1

Other changes in plan assets and benefit obligations recognized in accumulated other comprehensive income ("AOCI") (pre-tax) for the year ended December 31, 2007:

	Pension Benefits	Other Postretirement Benefits
Net (gain) arising during the period	\$ (8.1)	\$(1.1)
Effect of foreign currency exchange rate changes on amounts included in AOCI	0.6	—
Less amounts recognized as a component of net periodic benefit cost:		
Amortization of net loss	(15.1)	(0.9)
Amortization or curtailment recognition of prior service cost (credit)	—	4.3
Total amount recognized in AOCI for the period	(22.6)	2.3
Total amount recognized in net periodic benefit cost and AOCI for the period	\$ (9.4)	\$ 3.5

The estimated net loss for the defined benefit pension plans that will be amortized from *Accumulated other comprehensive earnings (loss)* into net periodic benefit cost over the next fiscal year is \$11 million. The estimated prior service credit and net loss for the other defined benefit postretirement plans that will be amortized from *Accumulated other comprehensive earnings (loss)* into net periodic benefit cost over the next fiscal year are \$4 million and \$1 million, respectively.

Assumptions:

	Pension Benefits		Other Postretirement Benefits	
	2007	2006	2007	2006
Weighted-Average Assumptions Used to Determine Benefit Obligations at December 31:				
Discount rate	6.2%	5.7%	6.0%	5.7%
Rate of compensation increase	3.5%	2.9%	4.0%	4.0%

	Pension Benefits			Other Postretirement Benefits		
	2007	2006	2005	2007	2006	2005
Weighted-Average Assumptions Used to Determine Net Periodic Benefit Cost for Years Ended December 31:						
Discount rate	5.7%	5.5%	5.6%	5.7%	5.6%	5.8%
Expected long-term return on plan assets	7.6%	7.6%	7.7%	—	—	—
Rate of compensation increase	2.9%	3.9%	3.9%	4.0%	4.0%	4.0%

Plan assets:

Plan assets are invested in equity securities, government and agency securities, mortgage-backed securities, corporate debt, annuity contracts and real estate investments. The U.S. defined benefit plan comprises a significant portion of the assets and liabilities relating to the defined benefit plans. The investment goal of the U.S. defined benefit plan is to achieve an adequate net investment return in order to provide for future benefit payments to its participants. The target asset allocation percentages approved by the compensation and pension committee of the Company's board of directors are 75% equity investments and 25% fixed income investments. The plan currently employs professional investment managers to invest in two asset classes: U.S. equity and U.S. fixed income. Each investment manager operates under an investment management contract that includes specific investment guidelines, requiring among other actions, adequate diversification, prudent use of derivatives and standard risk management practices such as portfolio constraints relating to established benchmarks. The plan currently uses a combination of both active management and passive index funds to achieve its investment goals.

Lexmark's U.S. pension plan's weighted-average asset allocations at December 31, 2007 and 2006, by asset category were as follows:

	2007	2006
Equity investments	75%	76%
Fixed income investments	25%	24%
Total	100%	100%

Defined Contribution Plans

Lexmark also sponsors defined contribution plans for employees in certain countries. Company contributions are generally based upon a percentage of employees' contributions. The Company's expense under these plans was \$25.8 million, \$20.5 million and \$13.6 million in 2007, 2006 and 2005, respectively.

Additional Information

Other postretirement benefits:

For measurement purposes, a 7.5% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2008. The rate is assumed to decrease gradually to 5.25% in 2013 and remain at that level thereafter. A one-percentage-point change in the health care cost trend rate would have a de minimus effect on the benefit cost and obligation since preset caps have been met for the net employer cost of postretirement medical benefits.

Related to Lexmark's acquisition of the Information Products Corporation from IBM in 1991, IBM agreed to pay for its pro rata share (currently estimated at \$30.5 million) of future postretirement benefits for all the Company's U.S. employees based on pro rated years of service with IBM and the Company.

Cash flows:

In 2008, the Company is currently expecting to contribute approximately \$7.5 million to its pension and other postretirement plans.

Lexmark estimates that the future benefits payable for the pension and other postretirement plans are as follows:

	Pension Benefits	Other Postretirement Benefits
2008	\$ 49.7	\$ 3.5
2009	49.6	4.0
2010	49.5	4.3
2011	49.8	4.7
2012	50.1	4.7
2013-2017	261.8	24.7

15. DERIVATIVES, FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Derivative Instruments and Hedging Activities

Lexmark's activities expose it to a variety of market risks, including the effects of changes in foreign currency exchange rates and interest rates. The Company's risk management program seeks to reduce the potentially adverse effects that market risks may have on its operating results.

Lexmark maintains a foreign currency risk management strategy that uses derivative instruments to protect its interests from unanticipated fluctuations in earnings and cash flows caused by volatility in currency exchange rates. The Company does not hold or issue financial instruments for trading purposes nor does it hold or issue leveraged derivative instruments. Lexmark maintains an interest rate risk management strategy that may, from time to time use derivative instruments to minimize significant, unanticipated earnings fluctuations caused by interest rate volatility. By using derivative financial instruments to hedge exposures to changes in exchange rates and interest rates, the Company exposes itself to credit risk and market risk. Lexmark manages exposure to counterparty credit risk by entering into derivative financial instruments with highly rated institutions that can be expected to fully perform under the terms of the agreement. Market risk is the adverse effect on the value of a financial instrument that results from a change in currency exchange rates or interest rates. The Company manages

exposure to market risk associated with interest rate and foreign exchange contracts by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken.

Lexmark uses the following hedging strategies to reduce the potentially adverse effects that market volatility may have on its operating results:

Fair Value Hedges: Fair value hedges are hedges of recognized assets or liabilities. Lexmark enters into forward exchange contracts to hedge accounts receivable, accounts payable and other monetary assets and liabilities. The forward contracts used in this program generally mature in three months or less, consistent with the underlying asset and liability. Foreign exchange option contracts, as well as forward contracts, may be used as fair value hedges in situations where derivative instruments, for which hedge accounting has been discontinued, expose earnings to further change in exchange rates. The Company is using interest rate swaps to convert its fixed rate financing activities to variable rates.

Cash Flow Hedges: Cash flow hedges are hedges of forecasted transactions or of the variability of cash flows to be received or paid related to a recognized asset or liability. From time to time, Lexmark enters into foreign exchange options and forward exchange contracts, generally expiring within twelve months, as hedges of anticipated purchases and sales that are denominated in foreign currencies. These contracts are entered into to protect against the risk that the eventual cash flows resulting from such transactions will be adversely affected by changes in exchange rates. The Company also enters into currency swap contracts to hedge foreign currency risks that result from the transfer of various currencies within the Company. The currency swap contracts entered into generally expire within one month.

Accounting for Derivatives and Hedging Activities

All derivatives are recognized in the Consolidated Statements of Financial Position at their fair value. Fair values for Lexmark's derivative financial instruments are based on pricing models or formulas using current market data, or where applicable, quoted market prices. On the date the derivative contract is entered into, the Company designates the derivative as either a fair value or cash flow hedge. Changes in the fair value of a derivative that is highly effective as — and that is designated and qualifies as — a fair value hedge, along with the loss or gain on the hedged asset or liability are recorded in current period earnings in *Cost of revenue* on the Consolidated Statements of Earnings. Changes in the fair value of a derivative that is highly effective as — and that is designated and qualifies as — a cash flow hedge are recorded in *Accumulated other comprehensive earnings (loss)* on the Consolidated Statements of Financial Position, until the underlying transactions occur, at which time the loss or gain on the derivative is recorded in current period earnings in *Cost of revenue* on the Consolidated Statements of Earnings. Derivatives qualifying as hedges are included in the same section of the Consolidated Statements of Cash Flows as the underlying assets and liabilities being hedged.

As of December 31, 2007, the Company had derivative assets of \$0.7 million recorded in *Prepaid expenses and other current assets* on the Consolidated Statements of Financial Position. As of December 31, 2006, the Company had derivative assets of \$11.2 million recorded in *Prepaid expenses and other current assets* as well as derivative liabilities of \$9.8 million recorded in *Accrued liabilities* on the Consolidated Statements of Financial Position. As of December 31, 2007, there were no deferred gains or losses on derivative instruments recorded in *Accumulated other comprehensive earnings (loss)*. As of December 31, 2006, a total of \$0.7 million of deferred net gains on derivative instruments was recorded in *Accumulated other comprehensive earnings (loss)*, of which \$0.7 million was reclassified to earnings during 2007.

Lexmark formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge items. This process includes linking all derivatives that are designated as fair value and cash flow to specific assets and liabilities on the balance sheet or to forecasted transactions. The Company also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair value or cash flows of hedged items. When it is determined that a

derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge, the Company discontinues hedge accounting prospectively, as discussed below.

Lexmark discontinues hedge accounting prospectively when (1) it is determined that a derivative is no longer effective in offsetting changes in the fair value or cash flows of a hedged item; (2) the derivative expires or is sold, terminated, or exercised or (3) the derivative is discontinued as a hedge instrument, because it is unlikely that a forecasted transaction will occur. When hedge accounting is discontinued because it is determined that the derivative no longer qualifies as an effective fair value hedge, the derivative will continue to be carried on the Consolidated Statements of Financial Position at its fair value. When hedge accounting is discontinued because it is probable that a forecasted transaction will not occur, the derivative will continue to be carried on the Consolidated Statements of Financial Position at its fair value, and gains and losses that were recorded in *Accumulated other comprehensive earnings (loss)* are recognized immediately in earnings. In all other situations in which hedge accounting is discontinued, the derivative will be carried at its fair value on the Consolidated Statements of Financial Position, with changes in its fair value recognized in current period earnings. A fair value hedge is entered into when the derivative instrument, for which hedge accounting has been discontinued, exposes earnings to further change in exchange rates. An immaterial portion of the Company's cash flow hedges was determined to be ineffective, and recognized in current period earnings, during 2007, 2006 and 2005.

Lexmark recorded \$8.2 million, \$4.6 million and \$3.0 million of aggregate net foreign currency transaction losses in 2007, 2006 and 2005, respectively. The aggregate foreign currency transaction net loss amounts include the gains/losses on the Company's foreign currency fair value hedges for all periods presented.

Financial Instruments

As of December 31, 2007 and 2006, the carrying value of Lexmark's \$150.0 million of senior note debt was \$149.9 million and \$149.8 million, respectively, and the fair value was \$150.3 million and \$152.0 million, respectively. The fair value of the debt was estimated based on current rates available to the Company for debt with similar characteristics. As the notes mature in May 2008, the senior notes were reclassified from *Long-term debt* to *Current portion of long-term debt* during 2007. As of December 31, 2007 and 2006, the Company had no short-term debt outstanding.

During October 2003, Lexmark entered into interest rate swap contracts to convert its \$150.0 million principal amount of 6.75% senior notes from a fixed interest rate to a variable interest rate. The interest rate swaps are designated as a fair value hedge of the Company's \$150.0 million long-term debt. The interest rate swaps are recorded at their fair value and the Company's long-term debt is adjusted by the same corresponding value in accordance with the short-cut method of SFAS 133. The fair value of the interest rate swaps is combined with the fair value adjustment of the Company's senior note debt due to immateriality and was presented in *Long-term debt* at December 31, 2006, and in *Current portion of long-term debt* at December 31, 2007, on the Consolidated Statements of Financial Position. As of December 31, 2007 and 2006, the fair value of the interest rate swap contracts was an asset of \$0.1 million and a liability of \$2.2 million, respectively.

Concentrations of Risk

Lexmark's main concentrations of credit risk consist primarily of short-term cash investments, marketable securities and trade receivables. Short-term cash and marketable securities investments are made in a variety of high quality securities with prudent diversification requirements. The Company seeks diversification among its cash investments by limiting the amount of cash investments that can be made with any one obligor. Credit risk related to trade receivables is dispersed across a large number of customers located in various geographic areas. Collateral such as letters of credit and bank guarantees is required in certain circumstances. Lexmark sells a large portion of its products through third-party distributors and resellers and original equipment manufacturer ("OEM") customers. If the financial condition or operations of these distributors, resellers and OEM customers were to deteriorate substantially, the Company's operating results could be adversely affected. The three largest

distributor, reseller and OEM customer trade receivable balances collectively represented \$281 million or approximately 46% of total trade receivables at December 31, 2007, and \$259 million or approximately 42% of total trade receivables at December 31, 2006, of which Dell receivables were \$207 million or approximately 34% of total trade receivables at December 31, 2007, and \$170 million or approximately 27% of total trade receivables at December 31, 2006. However, Lexmark performs ongoing credit evaluations of the financial position of its third-party distributors, resellers and other customers to determine appropriate credit limits.

Lexmark generally has experienced longer accounts receivable cycles in its emerging markets, in particular, Latin America, when compared to its U.S. and European markets. In the event that accounts receivable cycles in these developing markets lengthen further, the Company could be adversely affected.

Lexmark also procures a wide variety of components used in the manufacturing process. Although many of these components are available from multiple sources, the Company often utilizes preferred supplier relationships to better ensure more consistent quality, cost and delivery. The Company also sources some printer engines and finished products from OEMs. Typically, these preferred suppliers maintain alternate processes and/or facilities to ensure continuity of supply. Although Lexmark plans in anticipation of its future requirements, should these components not be available from any one of these suppliers, there can be no assurance that production of certain of the Company's products would not be disrupted.

16. COMMITMENTS AND CONTINGENCIES

Commitments

Lexmark is committed under operating leases (containing various renewal options) for rental of office and manufacturing space and equipment. Rent expense (net of rental income) was \$55.1 million, \$49.9 million and \$52.0 million in 2007, 2006 and 2005, respectively. Future minimum rentals under terms of non-cancelable operating leases (net of sublease rental income commitments) as of December 31, 2007, were as follows:

	2008	2009	2010	2011	2012	Thereafter
Minimum lease payments (net of sublease rental income)	\$38.1	\$26.5	\$19.0	\$12.7	\$10.2	\$8.0

Contingencies

In accordance with SFAS No. 5, *Accounting for Contingencies*, Lexmark records a provision for a loss contingency when management believes that it is both probable that a liability has been incurred and the amount of loss can be reasonably estimated. The Company believes it has adequate provisions for any such matters.

Legal proceedings

On December 30, 2002 ("02 action") and March 16, 2004 ("04 action"), the Company filed claims against Static Control Components, Inc. ("SCC") in the U.S. District Court for the Eastern District of Kentucky (the "District Court") alleging violation of the Company's intellectual property and state law rights. At various times in 2004, Pendl Companies, Inc. ("Pendl"), Wazana Brothers International, Inc. ("Wazana") and NER Data Products, Inc. ("NER"), were added as additional defendants to the claims brought by the Company in the 02 action and/or the 04 action. The Company entered into separate settlement agreements with each of NER, Pendl and Wazana pursuant to which the Company released each party, and each party released the Company, from any and all claims, and at various times in May 2007 the District Court entered orders dismissing with prejudice all such litigation. Similar claims in a separate action were filed by the Company in the District Court against David Abraham and Clarity Imaging Technologies, Inc. ("Clarity") on October 8, 2004. SCC and Clarity have filed counterclaims against the Company in the District Court alleging that the Company engaged in anti-competitive and monopolistic conduct and unfair and deceptive trade practices

in violation of the Sherman Act, the Lanham Act and state laws. SCC has stated in its legal documents that it is seeking approximately \$17.8 million to \$19.5 million in damages for the Company's alleged anticompetitive conduct and approximately \$1 billion for Lexmark's alleged violation of the Lanham Act. Clarity has not stated a damage dollar amount. SCC and Clarity are seeking treble damages, attorney fees, costs and injunctive relief. On September 28, 2006, the District Court dismissed the counterclaims filed by SCC alleging that the Company engaged in anti-competitive and monopolistic conduct and unfair and deceptive trade practices in violation of the Sherman Act, the Lanham Act and state laws. On October 13, 2006, SCC filed a Motion for Reconsideration of the District Court's Order dismissing SCC's claims, or in the alternative, to amend its pleadings, which the District Court denied on June 1, 2007. On October 13, 2006, the District Court issued an order to stay the action brought against David Abraham and Clarity until a final judgment or settlement are entered into in the consolidated 02 and 04 actions. On June 20, 2007, the District Court Judge ruled that SCC directly infringed one of Lexmark's patents-in-suit. On June 22, 2007, the jury returned a verdict that SCC did not induce infringement of Lexmark's patents-in-suit. As to SCC's defense that the Company has committed patent misuse, in an advisory, non-binding capacity, the jury did find some Company conduct constituted misuse. In the jury's advisory, non-binding findings, the jury also found that the relevant market was the cartridge market rather than the printer market and that the Company had unreasonably restrained competition in that market. The misuse defense will be decided by the District Court Judge at a later date. A final judgment for the 02 action and the 04 action has not yet been entered by the District Court. SCC filed an appeal of the 02 action and the 04 action with the United States Court of Appeals for the Sixth Circuit Court ("Sixth Circuit") on November 14, 2007. On December 21, 2007, the Clerk of the Sixth Circuit ordered that SCC show cause why its appeal should not be dismissed for lack of appellate jurisdiction since a final judgment has not been entered by the District Court. On January 18, 2008, SCC amended its civil appeals statement to confine its appeal to orders entered in the 02 action. The question of lack of appellate jurisdiction is pending before the Sixth Circuit.

The Company is also party to various litigation and other legal matters, including claims of intellectual property infringement and various purported consumer class action lawsuits alleging, among other things, various product defects and false and deceptive advertising claims, that are being handled in the ordinary course of business. In addition, various governmental authorities have from time to time initiated inquiries and investigations, some of which are ongoing, concerning the activities of participants in the markets for printers and supplies. The Company intends to cooperate fully with those governmental authorities in these matters.

Although it is not reasonably possible to estimate whether a loss will occur as a result of these legal matters, or if a loss should occur, the amount of such loss, the Company does not believe that any legal matters to which it is a party is likely to have a material adverse effect on the Company's financial position, results of operations and cash flows. However, there can be no assurance that any pending legal matters or any legal matters that may arise in the future would not have a material adverse effect on the Company's financial position, results of operations or cash flows.

Copyright fees

Certain countries (primarily in Europe) and/or collecting societies representing copyright owners' interests have taken action to impose fees on devices (such as scanners, printers and multifunction devices) alleging the copyright owners are entitled to compensation because these devices enable reproducing copyrighted content. Other countries are also considering imposing fees on certain devices. The amount of fees, if imposed, would depend on the number of products sold and the amounts of the fee on each product, which will vary by product and by country. The Company has accrued amounts that it believes are adequate to address the risks related to the copyright fee issues currently pending. The financial impact on the Company, which will depend in large part upon the outcome of local legislative processes, the Company's and other industry participants' outcome in contesting the fees and the Company's ability to mitigate that impact by increasing prices, which ability will depend upon competitive market conditions, remains uncertain. As of December 31, 2007 and 2006, the Company has accrued approximately

\$117 million and \$98 million, respectively, for the pending copyright fee issues, including litigation proceedings, local legislative initiatives and/or negotiations with the parties involved.

As of December 31, 2007, approximately \$58.1 million of the \$117 million accrued for the copyright fee issues was related to single function printer devices sold in Germany prior to December 31, 2007. On December 6, 2007, the Bundesgerichtshof (the "German Federal Supreme Court") issued a judgment in litigation brought by Verwertungsgesellschaft Wort ("VG Wort"), a collection society representing certain copyright holders, against Hewlett-Packard Company ("HP"), finding that single function printer devices sold in Germany prior to December 31, 2007 were not subject to the law authorizing the German copyright fee levy (German Federal Supreme Court, file reference I ZR 94/05). The Company and VG Wort entered into an agreement pursuant to which both VG Wort and the Company agreed to be bound by the outcome of the VG Wort/HP litigation. The Company was informed that the formal written decision(s) of the German Federal Supreme Court supporting the judgment rendered on December 6, 2007 was served on VG Wort on January 24, 2008. VG Wort has until February 25, 2008 to file a claim with the German Federal Constitutional Court (Bundesverfassungsgericht, the "Constitutional Court") challenging the decision(s) of the German Federal Supreme Court, and VG Wort has indicated it is considering such a claim. Pending a review of any arguments VG Wort or HP may make if VG Wort should decide to challenge the German Federal Supreme Court's decision(s) in the Constitutional Court, the Company believes the amount accrued represents its best estimate of the copyright fee issues currently pending.

As of December 31, 2007, approximately \$0.4 million of the \$117 million accrued for copyright fee issues was related to all-in-one and/or multifunction devices ("AIO/MFDs") sold in Germany prior to December 31, 2001. At an oral hearing on January 30, 2008, the German Federal Supreme Court issued a judgment in litigation brought by VG Wort against HP seeking to impose copyright levies, at the statutory rates published for photocopier devices, on AIO/MFDs, which judgment confirmed the claim of VG Wort that the statutory copyright rates for photocopier devices shall be applied to AIO/MFDs sold prior to December 31, 2001 without any reduction (German Federal Supreme Court, file reference I ZR 131/05). The Company is not a party to this litigation and has not agreed to be bound by the outcome of this litigation. The German Federal Supreme Court has not yet issued its formal written decision(s) supporting the judgment. HP will have 30 days from receipt of the German Federal Supreme Court's formal written decision(s) to file a claim with the Constitutional Court challenging the decision(s) of the German Federal Supreme Court. Pending a review of the German Federal Supreme Court's formal written decision as well as any arguments HP or VG Wort may make if HP should decide to challenge the German Federal Supreme Court's ruling(s), the Company believes the amount accrued represents its best estimate of the copyright fee issues currently pending.

For those AIO/MFDs sold in Germany after December 31, 2001 through December 31, 2007, VG Wort instituted non-binding arbitration proceedings against the Company in December 2006 before the arbitration board of the Patent and Trademark Office relating to whether and to what extent copyright levies should be imposed on such AIO/MFDs.

The Company believes the amounts accrued represent its best estimate of the copyright fee issues currently pending and these accruals are included in *Accrued liabilities* on the Consolidated Statements of Financial Position.

17. SEGMENT DATA

Lexmark manufactures and sells a variety of printing and multifunction products and related supplies and services and is primarily managed along Business and Consumer market segments. The Company evaluates the performance of its segments based on revenue and operating income, and does not include segment assets or other income and expense items for management reporting purposes. Segment operating income (loss) includes: selling, general and administrative; research and development; restructuring and other, net; and other expenses, certain of which are allocated to the respective segments based on internal measures and may not be indicative of amounts that would be incurred on a stand alone basis or may not be indicative of results of other enterprises in similar businesses. All other operating income (loss) includes significant expenses that are managed outside of the reporting segments. These unallocated costs include such items as information technology expenses, occupancy costs, stock-based compensation and certain other corporate and regional general and administrative expenses such as finance, legal and human resources.

The following table includes information about the Company's reportable segments for the year ended December 31:

	2007	2006	2005
Revenue:			
Business	\$2,999.2	\$2,869.1	\$2,774.8
Consumer	1,974.7	2,239.0	2,446.7
Total revenue	\$4,973.9	\$5,108.1	\$5,221.5
Operating income (loss):			
Business	\$ 612.0	\$ 600.1	\$ 661.0
Consumer	93.4	246.0	232.1
All other	(384.1)	(403.6)	(359.4)
Total operating income (loss)	\$ 321.3	\$ 442.5	\$ 533.7

In connection with the 2007 Restructuring Plan, operating income (loss) noted above for the year ended December 31, 2007, includes employee termination benefit charges of \$13.9 million in its Consumer segment, \$6.5 million in its Business segment and \$10.4 million in All other.

In connection with the 2006 restructuring, operating income (loss) noted above for the year ended December 31, 2006, included restructuring-related charges of \$54.7 million in its Consumer segment, \$35.2 million in its Business segment and \$31.2 million in All other. All other operating income also included a \$9.9 million pension plan freeze benefit.

In connection with the 2005 workforce reduction, operating income (loss) noted above for the year ended December 31, 2005, included one-time termination benefit charges of \$6.5 million in its Business segment, \$2.6 million in its Consumer segment and \$1.3 million in All other.

During 2007, 2006 and 2005, one customer, Dell, accounted for \$717 million or approximately 14%, \$744 million or approximately 15% and \$782 million or approximately 15%, of the Company's total revenue, respectively. Sales to Dell are included in both the Business and Consumer segments.

The following is revenue by geographic area for the year ended December 31:

	2007	2006	2005
Revenue:			
United States	\$2,140.3	\$2,245.3	\$2,360.5
EMEA (Europe, the Middle East & Africa)	1,827.2	1,843.1	1,853.8
Other International	1,006.4	1,019.7	1,007.2
Total revenue	\$4,973.9	\$5,108.1	\$5,221.5

Sales are attributed to geographic areas based on the location of customers. Other International revenue includes exports from the U.S. and Europe.

The following is long-lived asset information by geographic area as of December 31:

	2007	2006	2005
Long-lived assets:			
United States	\$416.9	\$422.0	\$420.9
EMEA (Europe, the Middle East & Africa)	34.3	45.0	103.2
Other International	417.8	379.8	308.1
Total long-lived assets	\$869.0	\$846.8	\$832.2

Long-lived assets include property, plant and equipment, net of accumulated depreciation.

The following is revenue by product category for the year ended December 31:

	2007	2006	2005
Revenue:			
Laser and inkjet printers	\$1,498.3	\$1,663.0	\$1,799.4
Laser and inkjet supplies	3,248.6	3,211.6	3,117.2
Other	227.0	233.5	304.9
Total revenue	\$4,973.9	\$5,108.1	\$5,221.5

18. QUARTERLY FINANCIAL DATA (UNAUDITED)

<i>(In Millions, Except Per Share Amounts)</i>	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2007:				
Revenue	\$1,260.6	\$1,208.2	\$1,195.4	\$1,309.7
Gross profit ⁽¹⁾	422.8	370.2	332.6	438.0
Operating income ⁽¹⁾	121.1	65.6	20.5	114.1
Net earnings ⁽¹⁾	92.4	64.2	45.2	99.0
Basic EPS* ⁽¹⁾	\$ 0.96	\$ 0.68	\$ 0.48	\$ 1.04
Diluted EPS* ⁽¹⁾	0.95	0.67	0.48	1.04
Stock prices:				
High	\$ 73.20	\$ 62.01	\$ 49.73	\$ 43.80
Low	57.81	48.93	35.71	32.85
2006:				
Revenue	\$1,275.3	\$1,229.0	\$1,234.6	\$1,369.2
Gross profit ⁽²⁾	403.8	417.7	402.4	422.1
Operating income ⁽²⁾	120.5	103.6	115.1	103.3
Net earnings ⁽²⁾	86.2	76.7	85.6	89.9
Basic EPS* ⁽²⁾	\$ 0.79	\$ 0.74	\$ 0.86	\$ 0.92
Diluted EPS* ⁽²⁾	0.78	0.74	0.85	0.91
Stock prices:				
High	\$ 51.08	\$ 57.25	\$ 59.00	\$ 74.13
Low	44.83	45.01	50.00	57.66

* The sum of the quarterly earnings per share amounts does not necessarily equal the annual earnings per share due to changes in average share calculations. This is in accordance with prescribed reporting requirements.

(1) Net earnings for the first quarter of 2007 included \$5.7 million of pre-tax project costs in connection with the Company's 2006 actions and a \$3.5 million pre-tax gain on the sale of the Company's Scotland facility.

Net earnings for the second quarter of 2007 included \$5.1 million of pre-tax project costs in connection with the 2006 actions, an \$8.1 million pre-tax foreign exchange gain realized upon the substantial liquidation of the Company's Scotland entity and adjustments of \$4.8 million to previously recorded tax amounts.

Net earnings for the third quarter of 2007 included \$6.6 million of pre-tax restructuring-related charges in connection with the 2007 Restructuring Plan, \$8.0 million of pre-tax project costs in connection with the 2006 actions and a \$13 million tax benefit due to the settlement of a tax audit outside the U.S.

Net earnings for the fourth quarter of 2007 included \$24.2 million and \$3.4 million of pre-tax restructuring-related charges and project costs, respectively, in connection with the 2007 Restructuring Plan, \$2.5 million of pre-tax project costs in connection with the 2006 actions and adjustments of \$6.4 million to previously recorded tax amounts.

(2) Net earnings for the first quarter of 2006 included \$49.6 million of pre-tax restructuring-related charges and project costs and a \$9.8 million pre-tax pension curtailment benefit.

Net earnings for the second quarter of 2006 included \$53.4 million of pre-tax restructuring-related charges and project costs and a \$2.5 million income tax benefit from the resolution of income tax matters for the years 2002 and 2003.

Net earnings for the third quarter of 2006 included \$13.3 million of pre-tax restructuring-related charges and project costs.

Net earnings for the fourth quarter of 2006 included \$18.8 million of pre-tax restructuring-related charges and project costs and an \$11.8 million income tax benefit from the expiration of various domestic and foreign statutes of limitation.

19. SUBSEQUENT EVENTS

Refer to Part II, Item 8, Note 16 of the Notes to Consolidated Financial Statements for discussion of recent developments regarding copyright fees.

In January 2008, a fire occurred in one of the Company's sub-contracted distribution centers. While the Company is still assessing what can be recovered, the Company believes it suffered a loss of inventory on inkjet products in the range of \$18 million to \$25 million, substantially all of which was inkjet hardware. Management believes that except for a \$1 million deductible, this loss will be covered by insurance. Although there could be some impact to the Company's revenue in the first quarter of 2008 as it works to restock the inventory, management currently does not believe that there will be a material adverse impact to earnings in the first quarter due to this disruption.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Lexmark International, Inc.:

In our opinion, the accompanying consolidated statements of financial position and the related consolidated statements of earnings, cash flows and stockholders' equity and comprehensive earnings present fairly, in all material respects, the financial position of Lexmark International, Inc. and its subsidiaries at December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2007 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the Index appearing under Item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in "Management's Report on Internal Control Over Financial Reporting" appearing under Item 9A. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 2 to the consolidated financial statements, the company changed the manner in which it accounts for share-based compensation in 2006, for defined benefit pension and other postretirement plans in 2006, and for uncertain tax positions in 2007.

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

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

/s/ PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Lexington, Kentucky
February 22, 2008

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

Item 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

The Company's management, with the participation of the Company's Chairman and Chief Executive Officer and Executive Vice President and Chief Financial Officer, have evaluated the effectiveness of the Company's disclosure controls and procedures as of December 31, 2007. Based upon that evaluation, the Company's Chairman and Chief Executive Officer and Executive Vice President and Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective in providing reasonable assurance that the information required to be disclosed by the Company in the reports that it files under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and were effective as of December 31, 2007 to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the Company's management including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Management's Report on Internal Control Over Financial Reporting

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of our management, including the Chairman and Chief Executive Officer and Executive Vice President and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based upon the framework in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in Internal Control-Integrated Framework, our management concluded that our internal control over financial reporting was effective as of December 31, 2007. The effectiveness of the Company's internal control over financial reporting as of December 31, 2007 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report appearing on pages 94-95.

Changes in Internal Control Over Financial Reporting

Beginning in the third quarter of 2006 and continuing through the fourth quarter of 2007, the Company continued its process of centralizing certain of its accounting and other finance functions and order-to-cash functions from various countries to shared service centers. As a result, certain changes in basic processes and internal controls and procedures for day-to-day accounting functions and financial reporting were made. In the second quarter of 2007, the Company migrated the majority of the transaction processing for after-sales service activities in the United States to a new software system. While management believes the changed controls along with additional compensating controls relating to financial reporting for affected processes are adequate and effective, management is continuing to evaluate and monitor the changes in controls and procedures as processes in each of these areas evolve.

Except for implementing the changes noted above, there has been no change in the Company's internal control over financial reporting that occurred during the quarter ended December 31, 2007, that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9B. OTHER INFORMATION

None

Part III

Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Except with respect to information regarding the executive officers of the Registrant and the Company's code of ethics, the information required by Part III, Item 10 of this Form 10-K is incorporated by reference herein, and made part of this Form 10-K, from the Company's definitive Proxy Statement for its 2008 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission, pursuant to Regulation 14A, not later than 120 days after the end of the fiscal year. The required information is included in the definitive Proxy Statement under the headings "Election of Directors" and "Report of the Finance and Audit Committee." The information with respect to the executive officers of the Registrant is included under the heading "Executive Officers of the Registrant" in Item 1 above. The Company has adopted a code of business conduct and ethics for directors, officers (including the Company's principal executive officer, principal financial officer and controller) and employees, known as the Code of Business Conduct. The Code of Business Conduct, as well as the Company's Corporate Governance Principles and the charters of each of the committees of the board of directors, is available on the Corporate Governance section of the Company's Investor Relations website at <http://investor.lexmark.com>. The Company also intends to disclose on the Corporate Governance section of its Investor Relations website any amendments to the Code of Business Conduct and any waivers from the provisions of the Code of Business Conduct that apply to the principal executive officer, principal financial officer or controller, and that relate to any elements of the code of ethics enumerated by the applicable regulation of the Securities and Exchange Commission (Item 406(b) of Regulation S-K). Anyone may request a free copy of the Corporate Governance Principles, the charters of each of the committees of the board of directors or the Code of Business Conduct from:

Lexmark International, Inc.
Attention: Investor Relations
One Lexmark Centre Drive
740 West New Circle Road
Lexington, Kentucky 40550
(859) 232-5568

The New York Stock Exchange ("NYSE") requires that the Chief Executive Officer of each listed Company certify annually to the NYSE that he or she is not aware of any violation by the Company of NYSE corporate governance listing standards as of the date of such certification. The Company submitted the certification of its Chairman and Chief Executive Officer, Paul J. Curlander, for 2007 with its Annual Written Affirmation to the NYSE on May 18, 2007.

The Securities and Exchange Commission requires that the principal executive officer and principal financial officer of the Company make certain certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 and file the certifications as exhibits with each Annual Report on Form 10-K. In connection with this Annual Report on Form 10-K filed with respect to the year ended December 31, 2007, these certifications were made by Paul J. Curlander, Chairman and Chief Executive Officer, and John W. Gamble, Jr., Executive Vice President and Chief Financial Officer, of the Company and are included as Exhibits 31.1 and 31.2 to this Annual Report on Form 10-K.

Item 11. EXECUTIVE COMPENSATION

Information required by Part III, Item 11 of this Form 10-K is incorporated by reference from the Company's definitive Proxy Statement for its 2008 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission, pursuant to Regulation 14A, not later than 120 days after the end of the fiscal year, and of which information is hereby incorporated by reference in, and made part of, this Form 10-K. The required information is included in the definitive Proxy Statement under the headings

"Compensation Discussion & Analysis," "Executive Compensation," "Director Compensation" and "Compensation Committee Report."

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Information required by Part III, Item 12 of this Form 10-K is incorporated by reference from the Company's definitive Proxy Statement for its 2008 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission, pursuant to Regulation 14A, not later than 120 days after the end of the fiscal year, and of which information is hereby incorporated by reference in, and made part of, this Form 10-K. The required information is included in the definitive Proxy Statement under the headings "Security Ownership by Management and Principal Stockholders" and "Equity Compensation Plan Information."

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Information required by Part III, Item 13 of this Form 10-K is incorporated by reference from the Company's definitive Proxy Statement for its 2008 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission, pursuant to Regulation 14A, not later than 120 days after the end of the fiscal year, and of which information is hereby incorporated by reference in, and made part of, this Form 10-K. The required information is included in the definitive Proxy Statement under the headings "Composition of Board and Committees," "Executive Compensation" and "Director Compensation."

Item 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Information required by Part III, Item 14 of this Form 10-K is incorporated by reference from the Company's definitive Proxy Statement for its 2008 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission, pursuant to Regulation 14A, not later than 120 days after the end of the fiscal year, and of which information is hereby incorporated by reference in, and made part of, this Form 10-K. The required information is included in the definitive Proxy Statement under the heading "Ratification of the Appointment of Independent Auditors."

Part IV

Item 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) (1) Financial Statements:

Financial statements filed as part of this Form 10-K are included under Part II, Item 8.

(2) Financial Statement Schedule:

	<u>Pages In Form 10-K</u>
Report of Independent Registered Public Accounting Firm	94
For the years ended December 31, 2005, 2006 and 2007:	
Schedule II — Valuation and Qualifying Accounts	99

All other schedules are omitted as the required information is inapplicable or the information is presented in the Consolidated Financial Statements or related Notes.

(3) Exhibits

Exhibits for the Company are listed in the Index to Exhibits beginning on page E-1.

LEXMARK INTERNATIONAL, INC. AND SUBSIDIARIES
SCHEDULE II — VALUATION AND QUALIFYING ACCOUNTS
For the Years Ended December 31, 2005, 2006 and 2007
(In Millions)

(A) Description	(B) Balance at Beginning of Period	(C) Additions		(D) Deductions	(E) Balance at End of Period
		Charged to Costs and Expenses	Charged to Other Accounts		
2005:					
Accounts receivable allowances . . .	\$40.5	\$ 1.7	\$—	\$(4.8)	\$37.4
Deferred tax asset valuation allowances	—	—	—	—	—
2006:					
Accounts receivable allowances . . .	\$37.4	\$ 1.6	\$—	\$(1.0)	\$38.0
Deferred tax asset valuation allowances	—	6.1	—	—	6.1
2007:					
Accounts receivable allowances . . .	\$38.0	\$ 1.5	\$—	\$(3.0)	\$36.5
Deferred tax asset valuation allowances	6.1	(5.2)	—	—	0.9

Index to Exhibits

<u>Number</u>	<u>Description of Exhibits</u>
2	Agreement and Plan of Merger, dated as of February 29, 2000, by and between Lexmark International, Inc. (the "Company") and Lexmark International Group, Inc. ("Group").(1)
3.1	Restated Certificate of Incorporation of the Company.(2)
3.2	Company By-Laws, as Amended and Restated June 22, 2000.(2)
3.3	Amendment No. 1 to Company By-Laws, as Amended and Restated June 22, 2000.(3)
3.4	Amendment No. 2 to Company By-Laws, as Amended and Restated June 22, 2000.(4)
4.1	Form of the Company's 6.75% Senior Notes due 2008.(5)
4.2	Indenture, dated as of May 11, 1998, by and among the Company, as Issuer, and Group, as Guarantor, to The Bank of New York, as Trustee.(5)
4.3	First Supplemental Indenture, dated as of June 22, 2000, by and among the Company, as Issuer, and Group, as Guarantor, to The Bank of New York, as Trustee.(2)
4.4	Second Supplemental Indenture, dated as of March 26, 2007, by the Company, as Issuer, to The Bank of New York Trust Company, N.A., as Trustee.(6)
4.5	Amended and Restated Rights Agreement, dated as of December 2, 2003, between the Company and The Bank of New York, as Rights Agent.(7)
4.6	Specimen of Class A common stock certificate.(2)
10.1	Agreement, dated as of May 31, 1990, between the Company and Canon Inc., and Amendment thereto.(8)*
10.2	Agreement, dated as of March 26, 1991, between the Company and Hewlett-Packard Company.(8)*
10.3	Patent Cross-License Agreement, effective October 1, 1996, between Hewlett-Packard Company and the Company.(9)*
10.4	Amended and Restated Lease Agreement, dated as of January 1, 1991, between IBM and the Company, and First Amendment thereto.(10)
10.5	Third Amendment to Lease, dated as of December 28, 2000, between IBM and the Company.(11)
10.6	Credit Agreement, dated as of January 20, 2005, by and among the Company, as Borrower, the Lenders party thereto, JPMorgan Chase Bank, N.A., as Administrative Agent, Fleet National Bank and Citibank, N.A., as Co-Syndication Agents, and KeyBank National Association and SunTrust Bank, as Co-Documentation Agents.(12)
10.7	Amendment No. 1, dated as of December 22, 2006, to Credit Agreement, dated as of January 20, 2005, by and among the Company, as Borrower, the Lenders party thereto, JPMorgan Chase Bank, N.A., as Administrative Agent, Bank of America, N.A. (as successor by merger to Fleet National Bank) and Citibank, N.A., as Co-Syndication Agents, and KeyBank National Association and SunTrust Bank, as Co-Documentation Agents.(6)
10.8	Amendment No. 2, dated as of May 23, 2007, to Credit Agreement, dated as of January 20, 2005, by and among the Company, as Borrower, the Lenders party thereto, JPMorgan Chase Bank, N.A., as Administrative Agent, Bank of America, N.A. (as successor by merger to Fleet National Bank) and Citibank, N.A., as Co-Syndication Agents, and KeyBank National Association and SunTrust Bank, as Co-Documentation Agents.(13)
10.9	Amended and Restated Receivables Purchase Agreement, dated as of October 8, 2004, by and among Lexmark Receivables Corporation, as Seller, CIESCO, LLC and Gotham Funding Corporation, as the Investors, Citibank, N.A. and The Bank of Tokyo-Mitsubishi, Ltd., New York Branch, as the Banks, Citicorp North America, Inc. and The Bank of Tokyo-Mitsubishi, Ltd., New York Branch, as the Investor Agents, Citicorp North America, Inc., as Program Agent for the Investors and Banks, and the Company, as Collection Agent and Originator.(14)

<u>Number</u>	<u>Description of Exhibits</u>
10.10	Amendment No. 1 to Receivables Purchase Agreement, dated as of October 7, 2005, by and among Lexmark Receivables Corporation, as Seller, CIESCO, LLC, Gotham Funding Corporation, Citibank, N.A., The Bank of Tokyo-Mitsubishi, Ltd., New York Branch ("BTM"), Citicorp North America, Inc. ("CNAI"), as Program Agents, CNAI and BTM, as Investor Agents, and the Company, as Collection Agent and Originator.(15)
10.11	Amendment No. 2 to Receivables Purchase Agreement, dated as of October 6, 2006, by and among Lexmark Receivables Corporation, as Seller, CIESCO, LLC and Gotham Funding Corporation, as the Investors, Citibank, N.A. and The Bank of Tokyo-Mitsubishi UFJ, Ltd., New York Branch ("BTMUFJ"), CNAI, as Program Agent, CNAI and BTMUFJ, as Investor Agents, and the Company, as Collection Agent and Originator.(16)
10.12	Amendment No. 3 to Receivables Purchase Agreement, dated as of March 30, 2007, by and among Lexmark Receivables Corporation, as Seller, CIESCO, LLC and Gotham Funding Corporation, as the Investors, Citibank, N.A. and BTMUFJ, CNAI, as Program Agent, CNAI and BTMUFJ, as Investor Agents, and the Company, as Collection Agent and Originator.(6)
10.13	Amendment No. 4 to Receivables Purchase Agreement, dated as of October 5, 2007, by and among Lexmark Receivables Corporation, as Seller, CIESCO, LLC and Gotham Funding Corporation, as the Investors, Citibank, N.A. and BTMUFJ, CNAI, as Program Agent, CNAI and BTMUFJ, as Investor Agents, and the Company, as Collection Agent and Originator.(17)
10.14	Purchase and Contribution Agreement, dated as of October 22, 2001, by and between the Company, as Seller, and Lexmark Receivables Corporation, as Purchaser.(3)
10.15	Amendment to Purchase and Contribution Agreement, dated as of October 17, 2002, by and between the Company, as Seller, and Lexmark Receivables Corporation, as Purchaser.(18)
10.16	Amendment No. 2 to Purchase and Contribution Agreement, dated as of October 20, 2003, by and between the Company, as Seller, and Lexmark Receivables Corporation, as Purchaser.(19)
10.17	Amendment No. 3 to Purchase and Contribution Agreement, dated as of October 8, 2004, by and between the Company, as Seller, and Lexmark Receivables Corporation, as Purchaser.(14)
10.18	Amendment No. 4 to Purchase and Contribution Agreement, dated as of October 7, 2005, by and between the Company, as Seller, and Lexmark Receivables Corporation, as Purchaser.(15)
10.19	Amendment No. 5 to Purchase and Contribution Agreement, dated as of October 5, 2007, by and between the Company, as Seller, and Lexmark Receivables Corporation, as Purchaser.(17)
10.20	Lexmark International, Inc. Stock Incentive Plan, as Amended and Restated, effective April 30, 2003. (20)+
10.21	Form of Stock Option Agreement pursuant to the Lexmark International, Inc. Stock Incentive Plan, as Amended and Restated, effective April 30, 2003. (21)+
10.22	Form of Restricted Stock Unit Agreement pursuant to the Lexmark International, Inc. Stock Incentive Plan, as Amended and Restated, effective April 30, 2003. (21)+
10.23	Lexmark International Group, Inc. Nonemployee Director Stock Plan, Amended and Restated, effective April 30, 1998.(5)+
10.24	Amendment No. 1 to the Lexmark International Group, Inc. Nonemployee Director Stock Plan, dated as of February 11, 1999. (22)+
10.25	Amendment No. 2 to the Lexmark International Group, Inc. Nonemployee Director Stock Plan, dated as of April 29, 1999. (23)+
10.26	Amendment No. 3 to the Lexmark International Group, Inc. Nonemployee Director Stock Plan, dated as of July 24, 2003. (24)+
10.27	Amendment No. 4 to the Lexmark International, Inc. Nonemployee Director Stock Plan, dated as of April 22, 2004. (25)+
10.28	Form of Stock Option Agreement, pursuant to the Lexmark International, Inc. Nonemployee Director Stock Plan, Amended and Restated, effective April 30, 1998. (26)+
10.29	Lexmark International, Inc. 2005 Nonemployee Director Stock Plan. (27)+
10.30	Form of Stock Option Agreement pursuant to the Lexmark International, Inc. 2005 Nonemployee Director Stock Plan. (16)+

<u>Number</u>	<u>Description of Exhibits</u>
10.31	Form of Restricted Stock Unit Agreement pursuant to the Lexmark International, Inc. 2005 Nonemployee Director Stock Plan. (16)+
10.32	Form of Agreement pursuant to the Company's 2005-2007 Long-Term Incentive Plan. (28)+
10.33	Form of Agreement pursuant to the Company's 2006-2008 Long-Term Incentive Plan. (29)+
10.34	Form of Agreement pursuant to the Company's 2007-2009 Long-Term Incentive Plan. (30)+
10.35	Lexmark International, Inc. Senior Executive Incentive Compensation Plan. (31)+
10.36	Lexmark Supplemental Savings and Deferred Compensation Plan. (16)+
10.37	Amendment No. 1 to the Lexmark Supplemental Savings and Deferred Compensation Plan, dated as of February 27, 2007.(6)+
10.38	Form of Employment Agreement, entered into as of June 1, 2003, by and between the Company and each of Paul J. Curlander, Paul A. Rooke, Vincent J. Cole and Martin S. Canning; and entered into as of September 6, 2005 by and between the Company and John W. Gamble, Jr. (24)+
10.39	Endorsement to the Employment Contract of Najib Bahous entered into as of September 25, 2007, by and between Lexmark Europe SARL and Najib Bahous.+
10.40	Employment Agreement, entered into as of September 26, 2007, by and between Lexmark International Technology, S.A. and Najib Bahous.+
10.41	Form of Change in Control Agreement entered into as of April 30, 1998, by and among the Company, Group and each of Paul J. Curlander, Paul A. Rooke and Vincent J. Cole; and entered into as of September 6, 2005 by and between the Company and John W. Gamble, Jr. (26)+
10.42	Form of Indemnification Agreement entered into as of April 30, 1998, by and among the Company, Group and each of Paul J. Curlander, Paul A. Rooke and Vincent J. Cole; and entered into as of September 6, 2005 by and between the Company and John W. Gamble, Jr. (26)+
10.43	Description of Compensation Payable to Nonemployee Directors. (30)+
21	Subsidiaries of the Company as of December 31, 2007.
23	Consent of PricewaterhouseCoopers LLP.
24	Power of Attorney.
31.1	Certification of Chairman and Chief Executive Officer Pursuant to Rule 13a-14(a) and 15d-14(a), As Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Executive Vice President and Chief Financial Officer Pursuant to Rule 13a-14(a) and 15d-14(a), As Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chairman and Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Executive Vice President and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Confidential treatment previously granted by the Securities and Exchange Commission.

+ Indicates management contract or compensatory plan, contract or arrangement.

(1) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2000 (Commission File No. 1-14050).

(2) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2000 (Commission File No. 1-14050).

(3) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2001 (Commission File No. 1-14050).

(4) Incorporated by reference to the Company's Current Report on Form 8-K filed with the Commission on December 20, 2006 (Commission File No. 1-14050).

- (5) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1998 (Commission File No. 1-14050).
- (6) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2007 (Commission File No. 1-14050).
- (7) Incorporated by reference to the Company's Amended Registration Statement on Form 8-A filed with the Commission on December 22, 2003 (Commission File No. 1-14050).
- (8) Incorporated by reference to the Company's Form S-1 Registration Statement, Amendment No. 2 (Registration No. 33-97218) filed with the Commission on November 13, 1995.
- (9) Incorporated by reference to the Company's Quarterly Report on Form 10-Q/A for the quarter ended September 30, 1996 (Commission File No. 1-14050).
- (10) Incorporated by reference to the Company's Form S-1 Registration Statement (Registration No. 33-97218) filed with the Commission on September 22, 1995.
- (11) Incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2001 (Commission File No. 1-14050).
- (12) Incorporated by reference to the Company's Current Report on Form 8-K filed with the Commission on January 20, 2005 (Commission File No. 1-14050).
- (13) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2007 (Commission File No. 1-14050).
- (14) Incorporated by reference to the Company's Current Report on Form 8-K filed with the Commission on October 13, 2004 (Commission File No. 1-14050).
- (15) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2005 (Commission File No. 1-14050).
- (16) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2006 (Commission File No. 1-14050).
- (17) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2007 (Commission File No. 1-14050).
- (18) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002 (Commission File No. 1-14050).
- (19) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2003 (Commission File No. 1-14050).
- (20) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2003 (Commission File No. 1-14050).
- (21) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2006 (Commission File No. 1-14050).
- (22) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1999 (Commission File No. 1-14050).
- (23) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1999 (Commission File No. 1-14050).
- (24) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2003 (Commission File No. 1-14050).
- (25) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2004 (Commission file No. 1-14050).
- (26) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 1998 (Commission File No. 1-14050).
- (27) Incorporated by reference to Exhibit A of the Company's Proxy Statement filed with the Commission on March 14, 2005 (Commission File No. 1-14050).

- (28) Incorporated by reference to the Company's Current Report on Form 8-K filed with the Commission on February 15, 2005 (Commission File No. 1-14050).
- (29) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2006 (Commission File No. 1-14050).
- (30) Incorporated by reference to the Company's Current Report on Form 8-K filed with the Commission on February 27, 2007 (Commission File No. 1-14050).
- (31) Incorporated by reference to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2004 (Commission File No. 1-14050).

Board of Directors

Paul J. Curlander, chairman and chief executive officer of Lexmark
 Teresa Beck, former president of American Stores Co.
 William R. Fields, chairman of Intersource Co. Ltd.
 Ralph E. Gomory, president emeritus of the Alfred P. Sloan Foundation
 Stephen R. Hardis, former chairman and chief executive officer of Eaton Corp.
 James F. Hardymon, former chairman and chief executive officer of Textron, Inc.
 Robert Holland Jr., former general partner of Williams Capital Partners
 Marvin L. Mann, chairman emeritus and former chairman
 and chief executive officer of Lexmark
 Michael J. Maples, former executive vice president and member
 of the Office of the President of Microsoft Corp.
 Jean-Paul L. Montupet, executive vice president of Emerson Electric Co.
 Kathi P. Seifert, former executive vice president of Kimberly-Clark Corporation

Executive Officers

Paul J. Curlander, chairman and chief executive officer
 John W. Gamble Jr., executive vice president and chief financial officer
 Paul A. Rooke, executive vice president and president of the Consumer Printer Division
 Martin S. Canning, vice president and president of the Printing Solutions and Services Division
 Vincent J. Cole, Esq., vice president, general counsel and secretary
 Jeri L. Isbell, vice president, human resources
 Gary D. Stromquist, vice president and corporate controller

Annual Meeting

Lexmark International, Inc., will hold its annual meeting of stockholders at 8 a.m. EDT, Thursday, April 24, 2008, at the Embassy Suites Hotel, 1801 Newtown Pike, Lexington, Kentucky.

Transfer Agent

BNY Mellon Shareowner Services
 P.O. Box 358015
 Pittsburgh, PA 15252-8015

or

480 Washington Boulevard
 Jersey City, NJ 07310-1900

(800) 524-4458

TDD for Hearing Impaired: 800-231-5469

Foreign Shareowners: 201-680-6578

TDD Foreign Shareowners: 201-680-6610

Web Site Address: www.bnymellon.com/shareowner/isd

Investor Relations

John W. Morgan
 Lexmark International, Inc.
 One Lexmark Centre Drive
 Lexington, Kentucky 40550
 (859) 232-5568
irinfo@lexmark.com
<http://investor.lexmark.com>

Independent Registered Public Accounting Firm

PricewaterhouseCoopers LLP
 201 East Main Street
 Suite 1400
 Lexington, Kentucky 40507
 (859) 255-3366

"Safe harbor" statement under the Private Securities Litigation Reform Act of 1995:

The Annual Report on Form 10-K contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements, other than statements of historical fact, are forward-looking statements. Forward-looking statements are made based upon information that is currently available or management's current expectations and beliefs concerning future developments and their potential effects upon the Company, speak only as of the date hereof, and are subject to certain risks and uncertainties. We assume no obligation to update or revise any forward-looking statements contained or incorporated by reference herein to reflect any change in events, conditions or circumstances, or expectations with regard thereto, on which any such forward-looking statement is based, in whole or in part. There can be no assurance that future developments affecting the Company will be those anticipated by management, and there are a number of factors that could adversely affect the Company's future operating results or cause the Company's actual results to differ materially from the estimates or expectations reflected in such forward-looking statements, including, without limitation, the inability to be successful in the higher-usage segments of the inkjet market, market acceptance of new products and pricing programs, weak economic conditions, periodic variations affecting revenue and profitability, the inability to meet customer product requirements on a cost competitive basis, failure to execute planned cost reduction measures, aggressive pricing from competitors and resellers, entrance into the market of additional competitors focused on printing solutions, the financial failure or loss of business with a key customer, reseller or supplier, increased investment to support product development and marketing, inability to perform under managed print services contracts, decreased supplies consumption, increased competition in the aftermarket supplies business, failure to successfully outsource the infrastructure support of information technology systems, failure to manage inventory levels or production capacity, unforeseen cost impacts as a result of new legislation, fees on the Company's products or litigation costs required to protect the Company's rights, inability to obtain and protect the Company's intellectual property and defend against claims of infringement and/or anticompetitive conduct, reliance on international production facilities, manufacturing partners and certain key suppliers, disruptions at important points of exit and entry and distribution centers, changes in a country's political or economic conditions, conflicts among sales channels, the failure of information technology systems, changes in the Company's tax provisions or tax liabilities, business disruptions, currency fluctuations, terrorist acts, acts of war or other political conflicts, or the outbreak of a communicable disease, each as described in greater detail under the title "Risk Factors" in Item 1A of the Annual Report. The information referred to above should be considered by investors when reviewing any forward-looking statements contained in the Annual Report, in any of the Company's public filings or press releases or in any oral statements made by the Company or any of its officers or other persons acting on its behalf. The important factors that could affect forward-looking statements are subject to change, and the Company does not intend to update the factors set forth in the "Risk Factors" section of the Annual Report. By means of this cautionary note, the Company intends to avail itself of the safe harbor from liability with respect to forward-looking statements that is provided by Section 27A and Section 21E referred to above.

© 2008 Lexmark International, Inc. All rights reserved. Printed in the United States of America, March 2008. Lexmark and Lexmark with diamond design are trademarks of Lexmark International, Inc., registered in the United States and/or other countries. All other trademarks are the property of their respective owners.

This is recycled paper.

LEXMARKTM

75% OF THE TOP BANKS,
RETAILERS AND
PHARMACIES
USE LEXMARK

Put Lexmark to work for you

www.lexmark.com

Lexmark Centre Drive, Lexington, KY 40550 USA
859.232.2000

END