Many people talk about how fast the world is changing. At Eaton, we’re doing something about it.

We continue to evolve—and expand our capabilities—to help our customers move ahead faster, smarter and more responsibly.

We provide solutions for a world that won’t wait.

Eaton Corporation is a diversified industrial manufacturer with 2007 sales of $13.0 billion. Eaton is a global leader in electrical systems and components for power quality, distribution and control; fluid power systems and services for industrial, mobile and aircraft equipment; intelligent truck drivetrain systems for safety and fuel economy; and automotive engine air management systems, powertrain solutions and specialty controls for performance, fuel economy and safety. Eaton has 64,000 employees and sells products to customers in more than 140 countries. For more information, visit www.eaton.com.
To Our Shareholders:

Eaton’s integrated diversification strategy is working, helping us to deliver record revenues and earnings for the seventh year in a row. We are tremendously proud of that accomplishment, especially given the challenges of a business environment in which financial and economic volatility have become household words. We entered 2007 facing a stiff headwind, as North American heavy-duty truck markets were projected to decline by more than 40 percent due to the changes in the U.S. diesel emissions standards. That management challenge became even tougher as the year went on as generally upbeat economic forecasts fell under the dark cloud of a credit crisis in global markets.

Despite these hurdles, Eaton continued to deliver outstanding performance, demonstrating the effectiveness of our business model throughout all phases of the economic cycle. As the world continues to change, the implications are clear: Businesses must become more nimble and have a broad base of diversification. At Eaton, that’s exactly the kind of company we’ve become.

OUR RESULTS SPEAK FOR THEMSELVES

We continued to significantly outgrow our end markets in 2007, setting new all-time records in both revenues and profitability. For the first time in Eaton’s modern history, Eaton’s profits increased in a year in which the North American heavy-duty truck business declined. During the year, North American heavy-duty truck markets declined by a whopping 44 percent while our fully diluted EPS grew by 6 percent.

Among the year’s financial and operating highlights:

- Our sales surpassed $13 billion for the first time in our history, growing by 7 percent.
- We delivered a 22 percent return on shareholders’ equity, again placing our return near the top of diversified industrial companies.
- And our all-in shareholder return was 31.5 percent!
- Our sales surpassed $13 billion for the first time in our history, growing by 7 percent.
- We delivered a 22 percent return on shareholders’ equity, again placing our return near the top of diversified industrial companies.
- And our all-in shareholder return was 31.5 percent!

This performance is not the result of a one-time event or a simple turn of good fortune. It is the product of a long-term strategy— and the hard work and dedication of a team of employees who live and breathe that strategy every day.

The above graph compares the cumulative total shareholder return for the five years ending December 31, 2007 for Eaton Common Shares, the S&P 1500 Industrial Machinery Index, and the S&P 500 Index. These figures assume all dividends are reinvested when received, and are based on $100 invested in Eaton Common Shares on December 31, 2002.
As a result of our organic growth initiatives and success with targeted acquisitions, approximately 70 percent of our revenues are now concentrated in the higher-growth electrical and fluid power industries. Our announced acquisitions of The Moeller Group and Phoenixtec, which are expected to close in early 2008, will move this balance ever closer to 75 percent of total revenues in 2008.

**DIVERSIFICATION IS PAYING OFF**

Since this decade began, Eaton has been on a mission to achieve diversification across three key dimensions: business balance, geographic balance and balance through the three phases of the economic cycle. That difficult groundwork paid off handsomely in 2007 as we continued to move closer to our targets.

**Business Balance**

As a result of our organic growth initiatives and success with targeted acquisitions, approximately 70 percent of our revenues are now concentrated in the higher-growth electrical and fluid power industries. Our announced acquisitions of The Moeller Group and Phoenixtec, which are expected to close in early 2008, will move this balance ever closer to 75 percent of total revenues in 2008.

**In 2007, for the first time, approximately 50 percent of Eaton’s revenues were driven by economies outside the United States. Never before has this global balance been more important.**

**Geographic Balance**

During 2008, when the U.S. economy is expected to underperform, continuing environment of high energy prices, the increased focus upon sustainable business strategies and the pace of global growth make our progress in each of these dimensions all the more important for our customers.

Our Electrical Group has emerged as Eaton’s largest business, notching a successful year in many dimensions. We completed or announced eight acquisitions:

- Power Products Ltd., bolstering our service capabilities in the Czech Republic.
- SMC Electrical Products, Inc.’s industrial medium-voltage-drive business to expand our power distribution and control assemblies portfolio.
- Apfel and Pulz to expand our capabilities in power distribution units for the power-quality market.
- MGE’s small systems business to strengthen our low-end uninterruptible power supply (UPS) products capabilities and expand our European distribution channels.

**Balance Through the Economic Cycle**

We have balanced our business portfolio to ensure that we have large globally capable businesses that afford Eaton the opportunity for consistent performance throughout the economic cycle. In 2007, we achieved balance in our portfolio with approximately one-third of our businesses being early-cycle, one-third mid-cycle and one-third late-cycle businesses.

**INTEGRATED POWER**

Diversification is not enough to build an enterprise capable of sustainable earnings growth on its own. And that is where the Eaton Business System provides unique value in our overall strategy. Now in its eighth year of implementation, EBS continues to provide the disciplined set of processes and tools that ensure organization-wide alignment and compliance, rapid recognition and transfer of best practices, the framework for successful and rapid integration of acquisitions, and the framework and resources to help our employees focus upon continuing learning and career development.

In a global environment of higher energy costs, rising emissions standards and the search for alternative energy sources, Eaton remains focused upon power management—the efficient, safe and sustainable applications of electrical, fluid and mechanical power. From a technology point of view, Eaton is increasingly well-positioned in the sweet spot of activity with our customers.

**BUILDING ON STRENGTHS**

We made exciting progress in enriching our technological strengths and extending our geographic reach during 2007. The continued environment of high energy prices, the increased focus upon sustainable business strategies and the pace of global growth make our progress in each of these dimensions all the more important for our customers.

**MAINTAINING OUR VALUES**

Eaton’s rapid and steady growth brings with it exciting new challenges and opportunities for our customers, our employees, our suppliers and the communities in which we do business. While change is an undeniable partner to growth, we remain fully committed to our overall philosophy of doing business right.

Every day the 64,000 Eaton employees around the world make individual decisions that strengthen our reputation and send an important and consistent message to our partners about doing business right—everywhere we do business. This demonstration of our core values is as fundamental to Eaton as our name, and will continue to be one of the strongest ways we differentiate our company to our many stakeholders and the world.

As you read this year’s annual report and reflect on its title, “The World Won’t Wait,” know that you have our commitment that we will continue to move forward swiftly, responsibly and in a more focused manner than ever on delivering superior performance to our customers and shareholders alike. On behalf of our entire Eaton team, thank you for your continued support.

**CONCLUSION**

Convinced of our plan—and confident in our people—we concluded that December 2007 was the right time for Eaton to take the next significant step in our evolution. That step was the bold simultaneous announcement to commit $2.5 billion to acquire The Moeller Group and Phoenixtec Power Company. These two acquisitions fundamentally reposition our electrical business as a leader in both global distribution and control and power quality, with a significantly enhanced product portfolio and geographic reach. The addition of approximately $1.9 billion of incremental revenues in 2008 and some 14,000 new employees also dramatically changes the size of our enterprise.

**OUR BUSINESSES ARE BALANCED THROUGH THE ECONOMIC CYCLE**

<table>
<thead>
<tr>
<th>Sector</th>
<th>2000 Sales</th>
<th>2007 Sales</th>
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<tbody>
<tr>
<td>Residential Electric</td>
<td>31%</td>
<td>37%</td>
</tr>
<tr>
<td>Nonresidential Electric</td>
<td>33%</td>
<td>34%</td>
</tr>
<tr>
<td>Commercial &amp; Industrial</td>
<td>19%</td>
<td>17%</td>
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<tr>
<td>Defense</td>
<td>11%</td>
<td>10%</td>
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<td>Total</td>
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**WE’RE EXPANDING OUR GLOBAL PRESENCE**

**RAISING THE STAKES**

Volatility opens new opportunities but at the same time can cause hesitation—the understandable hesitation that emerges from a lack of certainty in the environment around us. While we appreciate the increased risk that accompanies volatility, we remain confident of the fundamental capabilities of our enterprise and our strategy for success.
Eaton helps customers manage power, so buildings, airplanes, trucks, cars and machinery can do more while consuming fewer resources. We deliver the power inside hundreds of products that are helping to answer the demands of today’s fast-changing world.

The world woke up this morning. And it was hungry. For more energy. For greater efficiency. For a competitive edge. Across our business lines, it’s a good thing, too. Eaton is answering the call on the first ring. Because there are only 24 hours in a day. And there’s only one world.
In the U.S., data centers consumed more than 61 billion kilowatt hours of electricity in 2007—roughly equal to 5.8 million households. New technologies from Eaton help businesses reduce this demand, while increasing power quality and reliability.

All across the world today, consumers are raising their sights—and businesses are elevating their expectations. Eaton people are responding more swiftly than ever to meet these heightened needs, helping our customers to stay out in front of their markets—and keep one step ahead of a world that won’t wait.

POWER IN G R E N E R B U I L D I N G S A N D B U S I N E S S E S
Eaton’s Electrical Group is a leading provider of power quality, distribution and control solutions that increase energy efficiency and improve power quality, safety and reliability.

Our PowerChain Management® solutions offer a growing portfolio of “green” products and services, such as energy audits and real-time energy consumption monitoring. Eaton’s Uninterruptible Power Supply (UPS), variable-speed drives and lighting controls help conserve energy and increase efficiency.

In fact, Eaton’s electrical solutions can contribute up to 40 percent of the total credit points that building owners need to achieve Leadership in Energy and Environmental Design (LEED) certification. We’re putting those same products to work in our Electrical Group’s headquarters expansion in Pittsburgh, opening in 2008.

Among our recent innovations: Eaton’s award-winning Powerware® 9395 UPS and Powerware BladeUPS® systems reduce the energy costs of data centers through industry-leading efficiency. During 2007, these systems contributed to a more than 30 percent increase in total sales in Russia and the Commonwealth of Independent States (CIS) alone.

Late in the year, we completed our purchase of Schneider Electric’s MGE Office Protection Systems business, expanding Eaton’s power quality leadership. We also announced plans to acquire The Moeller Group in Europe and Phoenixtec Power Company Ltd. in the Asia-Pacific region. These deals will enhance our Power Distribution & Control and Power Quality businesses, expand our global reach and increase our annual sales by $2.5 billion.

LISTENING TO THE VOICE OF OUR CUSTOMERS
Eaton’s Electrical Group collaborates closely with customers and industry partners to accelerate the development of new products. For example, together with leading utility, petroleum and forest products companies, we launched our new...
Eaton is driving the development of new technologies—from hybrid drivetrains and emission control systems to advanced engine components—that reduce fuel consumption and emissions in trucks and cars.

global standard FlashGard™ Motor Control Center that reduces maintenance downtime, injuries and damage from hazardous electrical arc flashes.

Working with global communications companies, we also developed a small, reliable and efficient power system that enables telecom and data services to be delivered to customers in remote geographies where power is often scarce or unstable.

EXPANDING OUR HYBRID TECHNOLOGY LEADERSHIP

Demand continues to surge for Eaton’s hybrid power system technologies, which increase the fuel efficiency of commercial vehicles up to 60 percent and significantly reduce emissions. In the U.S., we’re developing hybrid trucks for Coca-Cola, FedEx, Pepsi Bottling, UPS, Wal-Mart and others, and more than 70 percent of the vehicles at the 2007 Hybrid Truck Users Forum were all “powered by Eaton.”


Additionally, we’ve partnered with PACCAR to accelerate the development of diesel-electric hybrid technology for Class 8 heavy-duty trucks, expected to go into production in late 2009.

We’re expanding our hybrid efforts globally, too, working with vehicle manufacturers in South America, Europe and Asia. In partnership with Beiqi Foton Motor Company, we delivered 30 hybrid diesel-electric transit buses for use in Guangzhou, China, in January 2008.

During the first quarter of 2008, a fleet of 12 Peterbilt refuse trucks equipped with our HLA® hybrid hydraulic technology will go into service in Texas and Colorado. Eaton HLA systems recover energy normally wasted through braking, improving fuel efficiency by 15 to 30 percent. Commercial production is targeted for later in the year.

POWERING CLEANER, MORE EFFICIENT VEHICLES

Eaton is also working with customers to manufacture more environmentally friendly cars and trucks through a variety of other means:

• We’re developing exhaust aftertreatment technology to help commercial vehicle makers meet stricter global emissions requirements. Eaton’s unique Selective Catalytic Reduction process does not use urea, eliminating the industry’s need to build a costly infrastructure system.

Leading the way to cleaner, more efficient vehicles.
• Working with vehicle makers in Brazil, we’ve designed engine valves that optimize the performance of flexible-fuel engines, helping to speed the adoption of biofuel-powered vehicles.

• Eaton superchargers continue to win support from Toyota, Volkswagen, General Motors and other manufacturers who seek to pack more power into smaller engines.

• We’re designing next-generation valves for new energy-efficient engines, including direct-engine gas and consumer diesel models. Eaton Crutonite® valves save money and resources by halving the nickel content of traditional designs.

"MORE ON BOARD" FUELS AEROSPACE GROWTH
In today’s global economy, businesses depend on efficient air transportation. In fact, one of the world’s leading aerospace companies predicts that air passenger traffic will rise 5 percent—and cargo traffic will rise 6.1 percent—annually for the next two decades, creating significant demand for new planes.

Eaton continues to excel in this arena by collaborating with major aerospace manufacturers and providing integrated systems solutions for their needs. We help our customers design more efficient aircraft, accelerate their manufacturing processes, and provide service and maintenance support. We enhance their speed and efficiency through cooperative programs such as Europe’s SPACE supply-chain alliance.

Sales in our aerospace business grew by more than 23 percent in 2007, driven in part by growing contracts for hydraulic power generation, fluid, fuel, air conveyance and other systems on both the Airbus A380® and Boeing 787 Dreamliner™, the commercial airline industry’s two largest programs.

Our light jet and very light jet business also grew, propelled by the increasing demand for personal business jet travel and “air taxi” services. Our major customers in this market include Bombardier, Cessna, Eclipse and Embraer. The four-seat Embraer Phenom 100™ is scheduled to launch commercially in 2008, and we’ve also been selected to provide hydraulic power for the nine-passenger Phenom 300™.

STRATEGIC ACQUISITIONS EXPAND OPPORTUNITIES
Key acquisitions have enabled us to diversify our Aerospace Operations—and accelerate our growth. In 2005, we significantly enlarged our fuel system business by acquiring Cobham Aerospace’s
Fluid and Air Division. We expanded our presence in 2007 by purchasing Argo-Tech, enabling us to provide complete aerospace fuel system solutions—moving fuel from underground fuel tanks to aircraft engine combustion chambers.

As a result of this capability, we were selected in 2007 to supply the integrated fuel system for the new Sikorsky® CH-53K military heavy-lift helicopter, adding to hydraulic power generation and fluid conveyance system contracts we had won earlier in the year. Combined, these contracts are expected to exceed $160 million in business over approximately 12 years.

ENHANCING OUR SPEED AND RESPONSIVENESS
Eaton’s hydraulic systems move the world, delivering efficient and reliable fluid power for hundreds of growing applications.

Our broad geographic reach and wide-ranging expertise enable us to respond quickly to customer needs anywhere in the world—from providing cost-effective control of mobile cement mixers in China to designing sophisticated diagnostic hydraulic valves for a leading European wind-power manufacturer.

JCB India, which manufactures construction equipment, recognized Eaton’s responsiveness and technical innovation in 2007 by awarding us its “Best Supplier Award for Outstanding Efforts in Cost Reduction” for designing customized steering control units for its heavyweight loader backhoes, manufactured in Delhi NCR.

During the year, our hydraulics business also demonstrated its ability to respond quickly to market trends, combining the right products and manufacturing capacity to meet the surging demand for agricultural machinery, driven in part by the use of biofuels as an alternative fuel source.

We’ve been equally responsive at sea, supplying the large-bore cylinders needed for offshore oil and gas exploration. Eaton’s Synflex® specialty tubing products are also being used to explore for oil resources deeper than ever before—safely, efficiently and expediently.

SHARPENING OUR COMPETITIVE EDGE WORLDWIDE
To increase Eaton’s speed and responsiveness, we are building two new technical centers in Pune, India, and Suzhou, China. These centers will not only enhance our ability to design and develop products geared specifically for Asian markets, but they will also support the growth of our operations worldwide.

BUILDING ON OUR STRENGTHS
Our hydraulics business combines localized service and support with an innovative portfolio of fluid power solutions to answer the needs of global infrastructure projects, including locks, canals and dams.
Fostering a Sustainable Business and Culture

At Eaton, sustainability isn’t an autonomous program or initiative. It’s how we do business—and it’s an increasing part of our business success. That’s why we’re proud to share our progress with you in our annual report.

Throughout our company, Eaton people are developing solutions to drive sustainable growth for our company—as we deliver more sustainable products and services to our customers. This cycle of responsible innovation continues to distinguish Eaton across our businesses and within the communities in which we live and work.

Fostering a Sustainable Business and Culture

While we’ve gone about this quietly, we’re honored that a growing number of organizations have recognized Eaton’s social responsibility leadership. Over the past year, this list has included:

- “The World’s Most Ethical Companies” (Ethisphere magazine)
- No. 1 in our category, “10 Best Corporate Citizens by Industry” (Corporate Responsibility Officer magazine)
- “Most Committed Multi-National Award” for Social Responsibility in China (Foreign Investment in China magazine)

We will continue to work hard to earn the trust of our many stakeholders as we pursue our vision of becoming the most admired company in every market we serve.
Committed to World-Class EHS Performance

Protecting the environment and our people is among Eaton’s highest priorities. It is a deep responsibility shared throughout our organization, as we strive to achieve world-class environmental, health and safety (EHS) performance.

We don’t believe in regional trade-offs or ethical compromises. Applying the principles of MESH—a global Management System of Environment, Safety, Security and Health launched in 2005—we adhere to the same high standard of excellence at all our facilities across the globe. These requirements include mandatory ISO 14001 certification, an international environmental management standard that we have successfully pursued at all our manufacturing plants, including those we acquire, since 2000. Our Truck business has also earned OHSAS 18001 certification for health and safety excellence.

During 2007, we expanded our EHS programs and participation, helping to drive improvements across all of our key metrics (see pages 20 and 21 for data and discussion). Among the year’s achievements:

- Consistent with our goals, we decreased global greenhouse gas (GHG) emissions by 9.2 percent, indexed for sales. As a member of the Business Roundtable’s Climate RESOLVE initiative, Eaton has pledged to reduce our GHG emissions by 18 percent, indexed for sales, by 2012.

- Through aggressive waste management—including integrating EHS into our Lean Six Sigma process improvement efforts—we reduced the amount of total waste generated by our global operations by 10.5 percent, indexed for sales, compared to 2006 levels.

- We improved our employee health and safety performance, reducing both the number of work-related injuries or illnesses at our facilities (Total Recordable Case Rate) by 25 percent, as well as the number of injuries or illnesses that required one or more days away from work (Days Away Case Rate) by 16 percent.

In addition, we expanded our involvement in voluntary government programs designed to promote leadership in environmental, health and safety. Four Eaton plants are enrolled in the U.S. EPA’s Performance Track program. Eleven of our plants in the U.S. and Mexico participate in OSHA’s Voluntary Protection Program (VPP), 10 of which have achieved STAR recognition.

EVENmEryWHERE THE WIND BLoW S. As the wind moves across the globe, Eaton is committed to meeting the needs of our customers—both today and tomorrow—with sustainable technologies. For example, Eaton’s hydraulic systems help keep wind turbines turning—and generating clean, renewable energy—in the harshest environments. The proven reliability of our products combined with our global manufacturing capabilities enable us to keep pace with the fast-growing supply demands of wind turbine manufacturers all over the world, as we provide the local service they need to maximize uptime for their customers.

EnvironmenTal, HEALTH & SAFETY PERFORMANCE

Eaton’s Vision for Carbon-Neutral Manufacturing

For many years, Eaton’s electrical business has been helping the world to design and build more energy-efficient workplaces and office buildings (see “Powering Greener Buildings and Businesses” on page 8). Applying that expertise, we’ve set out to achieve an even more ambitious goal—to design a carbon-neutral manufacturing plant.

The program, known as the Vision Project, is part of Eaton’s commitment to the Business Roundtable’s S.E.E. (Social, Environmental, Economic) Initiative, which seeks to promote understanding and adoption of sustainable growth strategies throughout the business community.

In the future we will work to incorporate many of our own products, as well as other feasible leading-edge technologies—such as renewable solar and wind energy—into our plant designs to help reduce energy consumption and greenhouse gas emissions. We will share the blueprint with our customers and other companies to advance a model for sustainable manufacturing worldwide.

The first phase of the Vision Project, scheduled for completion in early 2008, will include a preliminary template for sustainable manufacturing plant design. This template will become one of the foundations of our future EHS efforts, and help us to shape our implementation strategy for meeting our Business Roundtable Climate RESOLVE goal of reducing GHG emissions by 18 percent, indexed for sales, by 2012.

EHS Success Story: Shenandoah, Iowa

To help us meet our Climate RESOLVE goal, we’ve been conducting exhaustive energy audits of our existing facilities—and identifying conservation opportunities—working in tandem with Eaton’s Electrical Solutions Center, and external consultants such as Summit Energy in Latin America and Europe and Carbon Trust in the U.K.

In addition, we’ve integrated EHS into Eaton’s Lean Six Sigma process-improvement program. This “sustainable mindset” has created significant new opportunities at each of our plants for waste and energy reduction, cost savings and other business efficiencies. When uncovered, these opportunities are shared across our businesses, multiplying the benefits.

These efforts—combined with training and education of plant personnel—have contributed to significant performance improvements at many of our facilities. Our truck transmission plant in Shenandoah, Iowa, was an EHS leader in 2007, demonstrating the social, environmental and economic potential of our programs. Among the plant’s initiatives and results:

- By replacing high-pressure sodium lighting with new, reduced-wattage metal halide bulbs and ballasts, the plant was able to improve lighting efficiency in the facility, creating a cleaner, brighter working environment, and saving more than 480,000 kilowatt hours of electricity per year. In addition to eliminating an estimated 400 metric tons of GHG emissions, the lighting upgrade will save the plant approximately $28,000 a year.

- Introducing new endothermic gas injection technology and equipment, our Shenandoah Lean-EHS team eliminated process-gas venting from a manufacturing process, saving approximately 20 million cubic feet of natural gas per year, and reducing GHG emissions by an estimated 549 metric tons. The program is also expected to save $96,500 a year, lowering our production costs. As a result of this success, we’re evaluating applying the technology at other Eaton plants.

- By modifying its exhaust ductwork, the facility was able to divert and recover “lost” heated air generated by the building’s compressors, redirecting that heat back into the plant and its loading dock area in colder weather. The project will reduce the facility’s GHG emissions by an estimated 385 metric tons annually, and decrease its heating costs by $50,000 or more a year.

Sustainability has always been at the heart of Eaton’s products, since we help our customers use electrical, fluid and mechanical power more efficiently. Increasingly, that heritage and reputation have become a marketing advantage as customers seek to partner with us to develop more efficient—and productive—products and services. For example, Eaton has a long relationship with the EPA and other governmental agencies in developing hybrid technologies to increase efficiency and reduce emissions in commercial vehicles.

In late 2007, we announced a new partnership with Western Michigan University to contribute in adapting hydraulic hybrid drive system technology for use in U.S. Army vehicles, enabling them to be in the field longer without refueling. Development is being led by Eaton’s Innovation Center, which is dedicated to identifying and developing advanced technologies and applications to address customer needs.

Increasingly our customers are involved in this design process, joining us in innovation summits and other collaborative working sessions, leveraging our joint knowledge. Working with top retailers, for example, we continue to deliver new electrical products and solutions to increase energy efficiency and reduce their environmental footprints. Among these: Our Integrated Facilities Systems (IFS) decrease the floor space required for in-store electrical systems by 40 percent—and dramatically reduce the time, cost, raw materials (including copper and steel), packaging and waste associated with traditional electrical system installations.
In just six months, the program has helped us to eliminate the plant’s water consumption by 33 percent and curtailing GHG emissions by an estimated 816 metric tons per year. The action also will save the plant more than $300,000 a year in operating costs. This same process improvement is currently being evaluated at Eaton’s other truck transmission plants.

To eliminate waste, the facility is working with suppliers to reduce packaging and create reusable containers that would otherwise be discarded. New balers and education programs have helped increase recycling of paper, cardboard and plastic at the plant, reducing its landfill waste by approximately 35 percent in 2007.

The facility reduced its injury rate by 35 percent in 2007 through a variety of programs, including an awareness campaign on hand safety. The Shenandoah plant ranks near the top of its industry in employee safety, and strives to create a “zero injury” working environment.

As a result of these and other improvements, our Shenandoah facility has reduced its GHG emissions, lowered its operating costs, improved manufacturing cycle times and enhanced product quality. Together, these benefits demonstrate the tremendous social and economic potential of incorporating EHS into the Eaton Business System throughout our value chain.

A Team of 64,000 EHS Specialists

People across Eaton have embraced our commitment to sustainability and are taking action. Every individual has a voice and an opportunity to make a difference by identifying opportunities for EHS improvements, big and small.

During 2007, for example, a manager in our electrical business drove the creation of an innovative “trash into cash” program in which we recapture, refurbish or recycle electrical components that were previously discarded after being returned to us by our customers. In just six months, the program has helped us to eliminate more than 180,000 pounds of waste—including copper, aluminum and steel—from being sent to landfills, while generating more than $135,000 in revenue. We are currently evaluating rolling out the program to other Eaton businesses and to customers to help them to recycle used electrical equipment in an environmentally responsible way.

It all began when one employee saw a pallet of components ready to be scrapped and asked, “Why?” Throughout Eaton, we are building a culture of responsibility that encourages every employee to ask the same question about processes and practices in their own workplaces every day.

• Energy Consumption Data reported represent a majority of Eaton’s energy consumption at manufacturing plants worldwide. Of the sites reporting, 12% were in Asia/Pacific; 24% in Europe, the Middle East and Africa; 17% in Latin America; and 47% in North America.

• Emission rates are generated using World Resources Institute (WRI) recommended CO2 conversion factors, which account for the variations by region. These conversion factors are based on typical energy generation methods, such as those using fossil fuels or other means.

• Waste Generation Data reported represent a majority of Eaton’s waste generation at manufacturing plants worldwide. Of the sites reporting, 13% were in Asia/Pacific; 25% in Europe, the Middle East and Africa; 15% in Latin America; and 47% in North America.

• Hazardous waste and non-hazardous waste weights were reported consistent with local regulatory definitions of each waste type for the reporting location.

• Water Consumption Data reported represent a majority of Eaton’s water consumption at manufacturing plants worldwide. Of the sites reporting, 13% were in Asia/Pacific; 25% in Europe, the Middle East and Africa; 15% in Latin America; and 47% in North America.
That's why we encourage the managers and employees at Eaton to get involved. This process not only bolsters participation, but it also builds pride, as employees can directly experience the benefits of their community involvement as part of every location's Eaton Business Excellence assessment. We also reward outstanding achievements by individual employees through our annual Stover Volunteerism Awards.

Local Decisions, Life-Changing Results

Every community in which we work has different needs. That’s why we encourage the managers and employees at our facilities to choose which local programs to support. This process not only bolsters participation, but it also builds pride, as employees can directly experience the benefits of their volunteer efforts and contributions.

Wherever we expand, we take this culture with us. In Changzhou, China, for example, employees at Eaton Senyuan Switch Co., Ltd., acquired in late 2006, quickly demonstrated their commitment to the community by helping to fund the education of 100 low-income college and middle-school students from the area.

During 2007, we funded hundreds of similar employee-driven initiatives. Here are a few:

• In Kearney, Nebraska, we helped the S.A.F.E. Center secure a new and anonymous location to provide shelter for local victims of sexual violence.

• In São José dos Campos, Brazil, we supported a local recycling cooperative, helping to create jobs and income for 35 families, while keeping more than 200 tons of waste out of area landfills.

• In China, we provided support to both the World Special Olympics in Shanghai, and the China Lifeline Express Foundation, which helps cataclysm sufferers in rural regions of the country.

• In Bielsko-Biała, Poland, our employees contribute to supply fresh bread daily to a childcare facility that Eaton funding is helping to renovate.

• In India, we’re working to stop the spread of HIV/AIDS by funding organizations that educate truck drivers about the deadly virus and provide care to women and children who have contracted it.

To reinforce the importance of these activities, we evaluate community involvement as part of every location’s Eaton Business Excellence assessment. We also reward outstanding achievements by individual employees through our annual Stover Volunteerism Awards.

Employee Relations and Development

Eaton aims to become known as a top employer everywhere we do business. Our employees across the world take pride in the fact that our company is known not only for its performance, but also for its values. We have developed a culture that respects the unique, individual differences of every employee. This diversity of perspectives drives our creativity and innovation.

Our workplace thrives on openness and candor. Ninety-six percent of our global workforce participated in our annual employee survey in 2007, providing confidential feedback to strengthen our company and its practices and policies. Every employee—at every level—has a voice. During 2007, we intensified our focus on attracting, retaining and developing a workforce that reflects the growing diversity of our global business. Among key initiatives: We expanded our experienced talent acquisition programs and university recruiting capabilities across the U.S., Europe, Latin America, China and India.

Additionally, we opened regional Eaton University “hubs” in China and India to facilitate the creation of training and career development programs specific to the needs of each region. The University is rapidly becoming a gateway for knowledge sharing among Eaton employees, suppliers and partners, helping to foster global collaboration and accelerate product development across all our businesses.

Global Ethics and Office of the Ombuds

Eaton is a values-based organization. We won’t compromise our integrity to win business, because Eaton’s integrity is our business. This dedication to doing business right helped us become recognized as one of the world’s most ethical companies by Ethisphere magazine in 2007.

Our Global Ethics office provides training and support to help employees make the right decisions when faced with ethical challenges. During 2007, we expanded those efforts by creating a new manager-led “Ethics in Practice” training video and providing customized training to help our people identify the specific risks, laws and challenges of their business environments.

Employees globally are showing a greater awareness of the Ethics Office as a resource for advice on doing business the right way. This was demonstrated, in part, by a significant increase in the number of calls to our Ethics and Financial Integrity Help Line for advice and guidance.

Independently, Eaton also operates an Office of the Ombuds—a confidential resource to help employees identify and resolve work-related issues or problems. During 2007, we completed our first full year of providing these services to our employees in Latin America and the Caribbean. We now offer Ombuds support to approximately 70 percent of our employees worldwide, and we plan to expand our coverage to all of our employees over time.
Approximately 50 percent of Eaton’s revenues were driven by economies outside the United States in 2007.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders
Eaton Corporation

We have audited the accompanying consolidated balance sheets of Eaton Corporation as of December 31, 2007 and 2006, and the related statements of consolidated income, shareholders’ equity, and cash flows for each of the three years in the period ended December 31, 2007. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Eaton Corporation at December 31, 2007 and 2006, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2007, in conformity with United States generally accepted accounting principles.

MANAGEMENT’S REPORT ON FINANCIAL STATEMENTS

We have prepared the accompanying consolidated financial statements and related information of Eaton Corporation included herein for the three years ended December 31, 2007. The primary responsibility for the integrity of the financial information included in this annual report rests with management. The financial information included in this annual report has been prepared in accordance with accounting principles generally accepted in the United States based on our best estimates and judgments and giving due consideration to materiality. The opinion of Ernst & Young LLP, Eaton’s independent registered public accounting firm, on these financial statements is included herein.

Eaton has high standards of ethical business practices supported by the Eaton Code of Ethics and corporate policies. Careful attention is given to selecting, training and developing personnel, to ensure that management’s objectives of establishing and maintaining adequate internal controls and unbiased, uniform reporting standards are attained. Our policies and procedures provide reasonable assurance that operations are conducted in conformity with applicable laws and with the Company’s commitment to a high standard of business conduct.

The Board of Directors pursues its responsibility for the quality of Eaton’s financial reporting primarily through its Audit Committee, which is composed of five independent directors. The Audit Committee meets regularly with management, the internal auditors and the independent registered public accounting firm to ensure that they are meeting their responsibilities and to discuss matters concerning accounting, control, audits and financial reporting. The internal auditors and independent registered public accounting firm have full and free access to senior management and the Audit Committee. 

Cleveland, Ohio
February 20, 2008
Ernst & Young LLP

Chairman and Chief Executive Officer
February 20, 2008
Alexander M. Cutler
Chairman and Chief Executive Officer
Executive Vice President—Chief Financial and Planning Officer
Richard H. Fearon
Vice President and Controller
February 20, 2008
Billie K. Rawot