

DATA I/O CORP
Form 10-K
March 31, 2009

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, 2008**

or

- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number. **0-10394**

DATA I/O CORPORATION

(Exact name of registrant as specified in its charter)

Washington
(State or other jurisdiction of incorporation)

91-0864123
(I.R.S. Employer Identification No.)

6464 185th Ave NE, Suite 101, Redmond, Washington, 98052

(425) 881-6444

(Address, including zip code, of registrant's principle executive offices and telephone number, including area code)

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

Title of each class

Name of each exchange on which registered

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Common Stock (No Par Value)

Nasdaq Capital Market

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 (§229.405 of this chapter) 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. Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

Aggregate market value of voting and non-voting common equity held
by non-affiliates of the registrant as of June 30, 2008:

\$48,898,970

Shares of Common Stock, no par value, outstanding as of March 16, 2009:

8,873,051

Documents incorporated by reference

Portions of the registrant's Proxy Statement relating to its May 14, 2009 Annual Meeting of Shareholders are incorporated into Part III of this Annual Report on Form 10-K.

DATA I/O CORPORATION

FORM 10-K

For the Fiscal Year Ended December 31, 2008

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PART I

Item 1. Business

This Annual Report on Form 10-K and the documents incorporated herein by reference contain forward-looking statements based on current expectations, estimates and projections about Data I/O® Corporation's industry, management's beliefs and certain assumptions made by management. See "Management's Discussion and Analysis of Financial Condition and Results of Operations – Forward Looking Statements."

General

Data I/O Corporation ("Data I/O") designs, manufactures, and sells programming systems for electronic device manufacturers, specifically targeting high growth areas such as flash and microcontrollers. Virtually every electronic product today incorporates one or more programmable semiconductor devices that contain data and operating instructions essential for the proper operation of the product. Data I/O was incorporated in the State of Washington in 1969 and its business was founded in 1972.

Data I/O's mission is to deliver high-value systems and services to the rapidly expanding programmable semiconductor market by providing a software-rich programming platform for content delivery. These programmable solutions are used in devices such as smart phones, MP3 players, gaming systems and automobile electronics. These solutions, some of which include intellectual property protection, secure content management and flash media duplication, enable Data I/O to address the demanding requirements for the electronic device market, where applications and intellectual property protection are essential to our customer's success. Data I/O's largest customers are heavy users of programmable semiconductor devices and include original equipment manufacturers ("OEMs") in wireless and consumer electronics and automotive electronics, and their electronic manufacturing service ("EMS") contract manufacturers.

Business Restructuring. The business shift to focusing on manufacturing and automation, the geographic shifts in high volume electronics manufacturing, and the economic volatility we have experienced have resulted in ongoing restructuring efforts. During 2004 changes were made to control costs in North America and Europe and address the need to build staff serving China and Eastern Europe. During 2005, we aligned management operations with those changes. We responded to declining margins and operating results during the first half of 2006 with actions to further reduce expenses and improve margins.

The restructuring activities started during the second half of 2006 were continued during the first and second quarters of 2007 to further improve our operating results and the effectiveness of our sales and marketing organization and sales channels. These actions included re-engineering some internal processes, integrating some activities, transferring some activities to our lower cost base of operations in China, reducing resources applied to declining legacy products, moving some engineering positions to production, reducing the number of taxable entities, outsourcing some functions such as payroll, combining some positions, eliminating some functions, and shifting some responsibilities and resources to our sales channels.

As a result of the business downturn we were experiencing in the fourth quarter of 2008 and the uncertain business outlook, we took additional actions to reduce expenses. This resulted in a restructuring charge during the fourth quarter primarily related to severance of \$535,000, with a total of \$542,000 for the year 2008. Restructuring charges were \$725,000 in 2007, \$191,000 in 2006, \$96,000 in 2005 and \$562,000 in 2004.

Industry Background

Data I/O enables companies to improve productivity and reduce costs by providing device programming solutions that allow our customers to take intellectual property (design and data files) and program it into memory, microcontroller and logic devices. Data I/O also provides services related to hardware support, system installation and repair, and device programming. Companies that design and manufacture electronic products that utilize programmable devices purchase these solutions from us.

Our automated programming systems integrate programming and handling functions into one product solution. Quality conscious customers continue to drive this portion of our business, which includes high-volume manufacturing and high-volume programming center customers.

Traditionally, the programming market opportunity focused on the number of semiconductor devices to be programmed but because of the rapid increase in the density of devices, the focus is shifting to the number of bits to be programmed as described in the following table:

| Market Characteristics | Data I/O's Traditional Market Model | Data I/O's New Market Model |
|---------------------------------------|--|------------------------------------|
| Primary driver of demand | Number of devices | Number of bits |
| Primary measure of performance | Devices programmed per hour | Bits programmed per hour |
| Primary device type | Microcontrollers – 60% of devices | NAND Flash – 71% of content |
| DAIO business focus | Device programming | Content programming and management |
| Demand growth | ~12% growth in devices | ~90% growth in content |

Products

In order to accommodate the expanding variety and quantities of programmable devices being manufactured today, Data I/O offers multiple solutions for the numerous types of device mix and volume usage by our customers in the various market segments and applications. We work closely with leading manufacturers of programmable devices to develop our products to meet the requirements of a particular device.

Data I/O's line of programming systems includes a broad range of products, systems, modules, and accessories, which we group into two general categories: automated programming systems and non-automated programming systems. We provide two main categories of automated programming systems: off-line and in-line. Data I/O's automated programming systems and FlashPAK™ share a common programming platform, FlashCORE™ and Data I/O's universal job setup tool, Tasklink®. In addition, we provide device support and service on all of our products. Device support is a critical aspect of our business and consists of writing software algorithms for devices and developing socket adapters to hold and connect to the device for programming.

Data I/O's key product and the customer benefits/key features Data I/O believes are important are described in the following table:

| Products | Customer Benefits | Key Features |
|---|--|---|
| RoadRunner Series: In-line, (Automated) | <ul style="list-style-type: none"> • Dramatic reduction in inventory carrying and rework costs • “Zero” footprint • Rapid return on investment (“ROI”) realized in a matter of months | <ul style="list-style-type: none"> • Just-in-time inline programming • Direct integration with placement machine supporting Siemens, Fuji, Panasonic, Assembleon and Universal • Parallel programming • Average Selling Price (“ASP”) of \$78,000 to \$119,000K |
| PS Series: Off-line Medium/High Volume, High Mix (Automated) | <ul style="list-style-type: none"> • High throughput/lowest cost-of ownership for high density Flash programming | <ul style="list-style-type: none"> • Up to 48 programming sites • Supports multiple media types • Superior throughput |

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FLX500: Off-line, Moderate Volume
(Automated)

- High flexibility with respect to I/O options (tube, tray, tape), marking labeling, and vision inspection for coplanarity
- Affordable automation
- Modular, easy to configure
- Small footprint
- ASP of \$160,000 to \$522,000
- Industry's fastest changeover times
- Self-learning "plug-and-play" operation
- Language-independent graphic user interface
- ASP of \$83,000 to \$116,000

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Products

FLX-FMD: Off-line, Flash Media Duplication

(Automated)

Customer Benefits

- Secure Data Management automating access to customer data files, serial-number handling, and inventory tracking
- Eliminates need for dedicated operator

Key Features

- Programs up to 750 cards per hour
- Reduces cost
- Improves quality
- Provides secure data (content) management
- ASP of \$79,000 to \$110,000
- Scalability
- Network control via Ethernet
- Stand-alone operation or PC compatible
- Parallel programming
- ASP of \$9,000
- Breadth of device coverage
- ASP of \$9,000 to \$32,000

FlashPAK I/II: Off-line, Low Mix, Low Volume

(Non-Automated)

- Validate designs before moving down the firmware supply chain
- Unmatched ease of use in manual production systems

Sprint/Unifamily: Off-line, Low Volume, and Engineering (Non-Automated)

- Universal programmer

Customers

Data I/O sells our products to customers worldwide in a broad range of industries, as described in the following table:

Customer Types

| | OEMs | Automotive Electronics | Industrial & Control Electronics | EMS Contract Manufacturers | Programming Centers |
|----------------------------------|--|---|--|--|--|
| Notable end customers | Nokia, LG, Motorola, RIM, Sony, HTC, Microsoft, Vestel | TRW, Lear, Delphi, Bosch, Blaupunkt, Continental, Siemens | Allen-Bradley, Square D, ABB, Trane, Grundig, Danfoss, Philips | Flextronics, Celestica, Elcoteq, Jabil, Wistron, Foxconn | Arrow, Avnet, BTW, MSC, HTV, CPS, Liberty, Synchronworks |
| Programmable devices used | 5 billion NOR & NAND flash devices annually; | 5 billion microcontrollers annually; use of flash growing | 2 billion microcontrollers | Same as OEMs they serve | Same as OEMs they serve, and lines they distribute |
| Business drivers | 5 billion microcontrollers | | | | |

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| | | | | | |
|--------------------------------------|---|--|--|--|---|
| | GPS, Digital Rights Management, security, flash media, video, 3G, drive-by-wire features & functionality of converged devices | Safety, navigation, infotainment, | Higher functionality driven by increasing electronic content | Acquisition of OEM factories, production logistics contract wins | Value-adds services, logistics |
| Programming equipment drivers | Rollout of new products that incorporate higher functionality, more memory, and new technology, e.g. eSD, eMMC | Process improvement and simplification as well as new product rollouts | Process improvement and simplification as well as new product rollouts | New contracts from OEMs, programming solutions specified by OEMs | Capacity utilization of their installed base of equipment |

Customer Types

| | OEMs Wireless & Consumer Electronics | Automotive Electronics | Industrial & Control Electronics | EMS Contract Manufacturers | Programming Centers |
|------------------------|--|--|--|---|---|
| Buying criteria | Throughput, technical capability to support evolving technology, global support, intellectual property protection, robust algorithms | Quality, reliability configuration control, traceability, global support, intellectual property protection | Quality, reliability configuration control, traceability | Lowest equipment procurement cost, global support | Flexibility, lowest life-cycle cost-per programmed-part, low changeover time; use of multiple vendors provides negotiating leverage |

Data I/O's solutions address a large growing market. In 2007, there were 17 billion programmable devices shipped and of that 17 billion, NAND and NOR flash and microcontrollers represented 23%, 31%, and 40%, respectively.

Addressing High Growth, High Volume Markets. Data I/O's device programming solutions currently target two high growth, high volume markets: flash for mobile devices and microcontrollers for automotive electronics.

Growth drivers of NAND flash in Mobile Devices

- Flash unit volume experiencing explosive growth
- Increasing usage of NAND; replacing NOR due to its lower cost per bit
- Densities continue to increase beyond 8GB driving the need for more advanced and secure programming capabilities
- Higher densities driving new usage models such as the Blackberry and other smart phones

Growth drivers of microcontrollers in Automotive

- Consumers desire advanced car features requiring higher levels of sophistication (e.g., infotainment: audio, radio, satellite, navigation, wireless connectivity, increased safety features and optimized engine functionality)
- ~60 microcontrollers per vehicle
- Proliferation of programmable microcontrollers to support the next-generation electronic car systems
- Increasing use of high-density flash to provide memory for advanced applications that need to be programmed

Increasingly, OEMs are outsourcing their device programming needs to EMS contract manufacturers to reduce capital expense and maximize profit margins. At the same time, these OEMs are also increasing their proprietary software content to accelerate new product introductions, with more feature-rich, application-specific features. While the outsourcing of manufacturing processes is essential to maximizing an OEM's profit margin, maintaining the integrity and control of the software, the OEM's core intellectual property, is increasingly complex in this outsourced environment, especially given the global nature of the manufacturing supply chain. This need drove Data I/O to develop its comprehensive programming solution that can manage, monitor, audit and secure the software supply chain.

During 2008, we sold products to over 958 customers throughout the world. During 2008, there were no customers that accounted for more than 10% of our 2008 net sales. In 2007, there were no customers that accounted for more than 10% of our 2007 net sales. In 2006 there was one customer, Bright Faith Global Limited (our former sales agents in China), that represented approximately 10.6% of our 2006 net sales. As of December 31, 2008 the combined subsidiaries accounts receivable of one customer represented 13.3% of our total consolidated accounts receivable balance and there were no other customers that represented 10% or more. In 2007, there were no customers that represented 10% or more of our total consolidated accounts receivable balance as of December 31, 2007. In 2006, there were three customers, two of which were distributors, that represented 10.1%, 10.2%, and 12.0% of our total consolidated accounts receivable balance at December 31, 2006, respectively.

Geographic Markets and Distribution

Data I/O markets and sells our products through a combination of direct sales, internal telesales, and indirect sales representatives and distributors. We continually evaluate our sales channels against our evolving markets and customers.

U.S. Sales

We market our products throughout the U.S. using a variety of sales channels, including our own field sales management personnel, independent sales representatives, and a direct telesales organization. Our U.S. independent sales representatives obtain orders on an agency basis, with shipments made directly to the customer by Data I/O. Net sales in the United States for 2008, 2007, and 2006 were \$4,070,000, \$4,925,000, and \$6,407,000, respectively.

Foreign Sales

Foreign sales represented approximately 85%, 82%, and 78%, of net sales of our programming systems in 2008, 2007, and 2006, respectively (see Note 14 of "Notes to Consolidated Financial Statements"). We make foreign sales through our wholly-owned subsidiaries in Germany, China, and Canada, as well as through independent distributors and sales representatives located in 35 other countries. Our independent foreign distributors purchase Data I/O products in U.S. Dollars for resale and we recognize the sale at the time of shipment to the distributor. As with U.S. sales representatives, sales made by international sales representatives are on an agency basis with shipments made directly to the customer by us.

Net foreign sales for 2008, 2007, and 2006 were \$23,527,000, \$21,827,000, and \$22,386,000, respectively. We determine total foreign sales by the international geographic area into which the products are sold and delivered, and include not only sales by foreign subsidiaries but also export sales from the U.S. to our foreign distributors and to our representatives' customers. Foreign sales do not include transfers between Data I/O and our foreign subsidiaries. Export sales are subject to U.S. Department of Commerce regulations. We have not, however, experienced difficulties to date as a result of these requirements.

Fluctuating exchange rates and other factors beyond our control, such as international monetary stability, tariff and trade policies, and U.S. and foreign tax and economic policies, affect the level and profitability of foreign sales. We cannot predict the effect of such factors on our business, but we try to consider and respond to changes in these factors, particularly as the majority of our costs are USA based while the vast majority of our sales are international.

Competition

The competition in the programming systems market is highly fragmented with a large number of smaller organizations offering inexpensive solutions. While we are not aware of any published industry market information covering the programming systems market, according to our inside analysis of competitors, we estimate that for the 2007 and 2008 that Data I/O has had revenues at least twice the size of the next largest direct competitor and approximately five times the size of the second largest direct competitor.

Data I/O primarily focuses on automated programming solutions and believes its solutions offer numerous advantages over alternative solutions as described in the following table:

| Benefit Comparison | Data I/O | Alternative Solutions |
|---------------------------|-----------------|------------------------------|
|---------------------------|-----------------|------------------------------|

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| | Automated Solutions | In-System Programming with ATE | Outsourced Programming | Manual Programming* |
|--|----------------------------|---------------------------------------|-------------------------------|----------------------------|
| Eliminates production bottlenecks | x | | x | |
| Requires few internal engineering resources | x | | x | x |
| Programs large files quickly | x | | x | |
| Supports multiple devices per board easily | x | | x | x |
| Supports multiple boards per panel easily | x | | x | x |
| Ensures minimum yield loss | x | x | | |
| Enables intellectual property protections | x | x | | |
| Automates quality tracking | x | x | | |
| Ensures traceability and configuration control | x | x | | |
| Minimize risk of human error | x | x | | |
| No inventory at risk from software changes | x | x | | |
| Just-in-time programming | x | x | | |

* Data I/O also offers manual programming solutions.

Manufacturing, Raw Materials, and Backlog

Data I/O primarily assembles and tests our products at our principal facility in Redmond, Washington and we outsource our circuit board manufacturing and fabrication. We have transferred most of our FlashCORE adapter production to China. We use a combination of standard components, proprietary custom ICs and fabricated parts manufactured to Data I/O specifications. Two significant outside suppliers of Data I/O proprietary products are located in Germany: Haberer Electronic manufactures our Sprint non-automated programming systems and Yamaichi manufactures specialty sockets. Most components used are available from a number of different suppliers and subcontractors but certain items, such as some handler and programmer subassemblies, custom integrated circuits, hybrid circuits and connectors, are purchased from single sources. We believe that additional sources can be developed for present single-source components without significant difficulties in obtaining supplies. We cannot be sure that single-source components will always continue to be readily available. If we cannot develop alternative sources for these components, or if we experience deterioration in relationships with these suppliers, there may be delays or reductions in product introductions or shipments, which may materially adversely affect our operating results.

In accordance with industry practices, generally all orders are subject to cancellation prior to shipment without penalty, except for contracts calling for custom configuration. To date, such cancellations have not had a material effect on our sales volume. To meet customers' delivery requirements, we manufacture certain products based upon a combination of backlog and anticipated orders. Most orders are scheduled for delivery within 1 to 60 days after receipt of the order. Our backlog of pending orders was approximately \$2 million, \$2.1 million, and \$2.2 million, as of December 31, 2008, 2007, and 2006, respectively. The size of backlog at any particular date is not necessarily a meaningful indicator of the trend of our business.

Research and Development

Data I/O believes that continued investment in research and development is critical to our future success. We continue to develop new technologies and products and enhance existing products. Future growth is to a large extent dependent upon the timely development and introduction of new products, as well as the development of algorithms to support the latest programmable devices. We are currently focusing our research and development efforts on strategic growth markets, namely new programming technology and automated handling systems for the manufacturing environment, including new programmer technologies, support for the latest FLASH memories and microcontrollers, additional platforms and improvements for ProLINE-RoadRunner, and enhancements for the FLX500. We continue to also focus on increasing our capacity and responsiveness for new device support requests from customers and programmable integrated circuit manufacturers by revising and enhancing our internal processes and tools. During this past year, our research and development resulted in our newest product ProLINE-RoadRunner XLF.

During 2008, 2007, and 2006, we made expenditures for research and development of \$4,464,000, \$4,716,000, and \$5,577,000, respectively, representing 16.2%, 17.6%, and 19.4%, of net sales, respectively. Research and development costs are expensed as incurred.

Patents, Copyrights, Trademarks, and Licenses

Data I/O relies on a combination of patents, copyrights, trade secrets and trademarks to protect our intellectual property, as well as product development and marketing skill, to establish and protect our market position. We have continued to add new patents to our patent portfolio over the past few years as we developed strategic technologies like the FLX500 that are critical to our Connected Strategy.

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In March 2008 we closed the sale of selected patents and patent applications to Leannoux Properties AG L.L.C. for net proceeds of approximately \$3.3 million and reported a net gain of approximately \$2.1 million. The patents and patent applications sold relate primarily to technology used in Data I/O's ProLINE-RoadRunner product line. Data I/O retains a non-exclusive, royalty-free license to use the technology covered by these patents and applications. Additional payments are due to Data I/O upon license or transfer of these patents and patent applications to certain third parties. However, Data I/O does not currently anticipate receiving any such payments.

Most of the patents sold relate to technology that Data I/O has been using for a number of years. The sale monetizes the value of these patents, avoids future annual maintenance and patent defense expenses, and allows Data I/O royalty-free use of these patents. The sale does not include technology related to the firm's most recent development programs.

We attempt to protect our rights in proprietary software products, including TaskLink and other software products, by retaining the title to and copyright of the software and documentation, by including appropriate contractual restrictions on use and disclosure in our licenses, and by requiring our employees to execute non-disclosure agreements. Our software products are not normally sold separately from sales of programming systems. However, on those occasions where software is sold separately, revenue is recognized when a sales

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agreement exists, when delivery has occurred, when the fee is fixed or determinable, and when collectibility is probable.

Because of the rapidly changing technology in the semiconductor, electronic equipment and software industries, portions of our products might possibly infringe upon existing patents or copyrights, and we may, be required to obtain licenses or discontinue the use of the infringing technology. We believe that any exposure we may have regarding possible infringement claims is a reasonable business risk similar to that assumed by other companies in the electronic equipment and software industries. However, any claim of infringement, with or without merit, could be costly and a diversion of management's attention, and an adverse determination could adversely affect our reputation, preclude us from offering certain products, and subject us to substantial liability.

Employees

As of December 31, 2008, we had a total of 93 employees, of which 38 were located outside the U.S. and 6 of which are part time. We also utilize independent contractors for specialty work, primarily in research and development, and utilize temporary workers to adjust capacity to fluctuating demand or for special projects. Many of our employees are highly skilled and our continued success will depend in part upon our ability to attract and retain employees who can be in great demand within the industry. None of our employees are represented by a collective bargaining unit and we believe relations with our employees are favorable. In foreign countries we have employment agreements or, in China, the Shanghai Foreign Services Co., Ltd. ("FSCO") labor agreement.

Environmental Compliance

Our facilities are subject to numerous laws and regulations concerning the discharge of materials or otherwise relating to the environment. Compliance with environmental laws has not had, nor is it expected to have, a material effect on our capital expenditures, financial position, results of operations or competitive position. However, see Item 3, Legal Proceedings, regarding the Rowley Properties, Inc. claim.

Executive Officers of the Registrant

Set forth below is certain information concerning the executive officers of Data I/O as of March 16, 2009:

| <u>Name</u> | <u>Age</u> | <u>Position</u> |
|--------------------|------------|---|
| Frederick R. Hume | 66 | President and Chief Executive Officer |
| Joel S. Hatlen | 50 | Vice President, Finance Chief Financial Officer Secretary and Treasurer |
| Gordon B. Bluechel | 46 | Vice President, Operations and Administration |

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Frederick R. Hume joined Data I/O as President and Chief Executive Officer in February 1999. He was appointed to the Board of Directors of Data I/O in January 1999. From 1988 until his retirement in 1998, Mr. Hume served as Vice President and General Manager of Keithley Instruments in Cleveland, Ohio. From 1972 to 1988, he held various management positions at Fluke Corporation, including Group Vice President for Manufacturing and Research and Development.

Joel S. Hatlen joined Data I/O in September 1991 and became Chief Accounting Officer and Corporate Controller in February 1997. In January 1998, he was promoted to Vice President of Finance and Chief Financial Officer, Secretary and Treasurer. He began his career at Data I/O as a Senior Tax Accountant and became Tax Manager in December 1992 and Corporate Controller in December 1993. From September 1981 until joining Data I/O, Mr. Hatlen was employed by Ernst & Young LLP, where his most recent position was Senior Manager.

Gordon Bluechel joined Data I/O in November 1992 and was named an executive officer on November 17, 2008. He currently serves as the Vice President of Operations and Administration. Prior to his current role he served as Vice President/ Director of Operations since 2007, Director of Operations during 2005-2007, General Manager of In-System Programming during 2004-2005, Director of Americas Sales and Service during 2002-2004, Director of Worldwide Service during 2001-2002, General Manager of Sprint Operations in Germany during 2000-2001 and prior management and staff positions.

Item 1A. Risk Factors

Cautionary Factors That May Affect Future Results

Data I/O's disclosure and analysis in this Annual Report contains some forward-looking statements. Forward-looking statements include our current expectations or forecasts of future events. The reader can identify these statements by the fact that they do not relate strictly to historical or current facts. In particular, these include statements relating to future action, prospective products, new technologies, establishing foreign operations, future performance or results of current and anticipated products, sales efforts, expenses, outsourcing of functions, outcome of contingencies, impact of regulatory requirements, restructure actions and financial results.

Any or all of the forward-looking statements in this Annual Report or in any other public statement made may turn out to be wrong. They can be affected by inaccurate assumptions we might make, or known or unknown risks and uncertainties can affect these forward-looking statements. Many factors -- for example, product competition and product development -- will be important in determining future results. Moreover, neither Data I/O nor anyone else assumes responsibility for the accuracy and completeness of these forward-looking statements. Actual future results may materially vary.

We undertake no obligation to publicly update any forward-looking statements after the date of this Annual Report, whether as a result of new information, future events or otherwise. The reader should not unduly rely on our forward-looking statements. The reader is advised, however, to consult any future disclosures Data I/O makes on related subjects in our 10-Q, 8-K and 10-K reports to the SEC and press releases. Also, note that Data I/O provides the following cautionary discussion of risks, uncertainties and possible inaccurate assumptions relevant to our business. These are factors that we think could cause Data I/O's actual results to differ materially from expected and historical results. Other factors besides those listed here could also adversely affect Data I/O. This discussion is permitted by the Private Securities Litigation Reform Act of 1995.

RISK FACTORS

A decline in economic and market conditions may result in decreased capital spending by delayed/non payments from our customers.

Our business is highly impacted by capital spending plans and other economic cycles that affect the users and manufacturers of integrated circuits. These industries are highly cyclical and are characterized by rapid technological change, short product life cycles, and fluctuations in manufacturing capacity and pricing and gross margin pressures. As we experienced in recent years and are currently experiencing, our operations may in the future reflect substantial fluctuations from period-to-period as a consequence of these industry patterns, general economic conditions affecting the timing of orders from major customers, and other factors affecting capital spending. In addition, in the current difficult economic climate it may take us longer to receive payments from our customers and some of our customers' business may fail, resulting in non-payment. These factors could have a material adverse effect on our business and financial condition.

Delays in development, introduction and shipment of new products or services may result in a decline in sales.

Data I/O develops new engineering and automated programming systems and services. Significant technological, supplier, manufacturing or other problems may delay the development, introduction or production of these products or services.

For example, we may encounter these problems:

- technical problems in the development of a new programming system platform or the robotics for new automated handling systems
- inability to hire qualified personnel
- delays or failures to perform by third parties involved in our development projects
- development of new services that are not accepted by the market

Delays in the development, completion and shipment of new products or services, or failure of customers to accept new products, may result in a decline in sales.

Quarterly fluctuations in our operating results may adversely affect our stock price.

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Data I/O's operating results tend to vary from quarter to quarter. Our revenue in each quarter substantially depends upon orders received within that quarter. Conversely, our expenditures are based on investment plans and estimates of future revenues. We may, therefore, be unable to quickly reduce our spending if our revenues

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decline in a given quarter. As a result, operating results for that quarter will suffer. Our results of operations for any one quarter are not necessarily indicative of results for any future periods.

Other factors, which may cause our quarterly operating results to fluctuate, include:

- increased competition
- timing of new product announcements
- product or service releases and pricing changes by us or our competitors
- market acceptance or delays in the introduction of new products or services
- production constraints
- quality issues
- labor or material shortages
- the timing of significant orders
- the sales channel mix of direct vs. indirect distribution
- war or terrorism
- health issues (such as SARS)
- customers' budgets
- adverse movements in exchange rates, interest rates or tax rates
- cyclical nature of demand for our customers' products
- general economic conditions in the countries where we sell products
- expenses and obtaining authorizations in setting up new operations or locations

Due to all of the foregoing factors, it is possible that in some future quarters, our operating results will be below expectations of analysts and investors.

Failure to adapt to technology trends in our industry may hinder our competitiveness and financial results.

Product and service technology in Data I/O's industry evolves rapidly, making timely product innovation essential to success in the marketplace. Introducing products and services with improved technologies or features may render our existing products obsolete and unmarketable. Technological advances that may negatively impact our business include:

- new device package types, densities, and technologies requiring hardware and software changes in order to be programmed by our products
- electronics equipment manufacturing practices, such as widespread use of in-circuit programming
- customer software platform preferences different from those on which our products operate
- more rigid industry standards, which would decrease the value-added element of our products and support services

If we cannot develop products or services in a timely manner in response to industry changes, or if our products or services do not perform well, our business and financial condition may be adversely affected. Also, our new products or services may contain defects or errors that give rise to product liability claims against us or cause our products to fail to gain market acceptance. Our future success depends on our ability to successfully compete with other technology firms in attracting and retaining key technical personnel.

We have a history of recent operating losses and may be unable to generate enough revenue to achieve and maintain profitability.

We have incurred operating losses in two of the last five years. We will continue to examine our level of operating expense based upon our projected revenues. Any planned increases in operating expenses may result in larger losses in future periods if projected revenues are not achieved. As a result, we may need to generate greater revenues than we have recently to achieve and maintain profitability. However, we cannot provide assurance that our revenues will increase and our strategy may not be successful, resulting in future losses.

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Our restructuring activities may have a negative impact on our future operations.

Our restructuring plans may yield unanticipated consequences, such as increased burden on our administrative, operational, and financial resources and increased responsibilities for our management personnel. As a result, our ability to respond to unexpected challenges may be impaired and we may be unable to take advantage of new opportunities.

In addition, many of the employees that were terminated as a part of our restructuring possessed specific knowledge or expertise, and that knowledge or expertise may prove to have been important to our operations. In that case, their absence may create significant difficulties, particularly if our business experiences significant growth. Also, the reduction in workforce related to our restructuring may subject us to the risk of litigation, which could result in substantial cost. Any failure by us to properly manage this rapid change in workforce could impair our ability to efficiently manage our business, to maintain and develop important relationships with third-parties, and to attract and retain customers. It could also cause us to incur higher operating cost and delays in the execution of our business plan or in the reporting or tracking of our financial results.

We may need to raise additional capital and our future access to capital is uncertain.

Our past revenues have been and our future revenues may continue to be insufficient to support the expense of our operations and any expansion of our business. We may therefore need additional equity or debt capital to finance our operations. If we are unable to generate sufficient cash flows from operations or to obtain funds through additional debt or equity financing, we may have to reduce some or all of our development and sales and marketing efforts and limit the expansion of our business.

We believe our existing cash and cash equivalents will be sufficient to meet our working capital requirements for at least the next twelve months. Thereafter, depending on the development of our business, we may need to raise additional cash for working capital or other expenses. We may also encounter opportunities for acquisitions or other business initiatives that require significant cash commitments, or unanticipated problems or expenses that could result in a requirement for additional cash before that time.

Therefore, we may seek additional funding through public or private debt or equity financing or from other sources. We have no commitments for additional financing, and given the current economic climate may experience difficulty in obtaining funding on favorable terms, if at all. Any financing we obtain may contain covenants that restrict our freedom to operate our business or may require us to issue securities that have rights, preferences or privileges senior to our Common Stock and may dilute your ownership interest.

We may face increased competition and may not be able to compete successfully with current and future competitors.

Technological advances have reduced the barriers of entry into the programming systems market. We expect competition to increase from both established and emerging companies. If we fail to compete successfully against current and future sources of competition, our profitability and financial performance will be adversely impacted.

If our relationship with semiconductor manufacturers deteriorates, our business may be adversely affected.

We work closely with most semiconductor manufacturers to ensure that our programming systems comply with their requirements. In addition, many semiconductor manufacturers recommend our programming systems for use by users of their programmable devices. These working relationships enable us to keep our programming systems product lines up to date and provide end-users with broad and current programmable device support. Our business may be adversely affected if our relationships with semiconductor manufacturers deteriorate.

Our reliance on a small number of suppliers may result in a shortage of key components, which may adversely affect our business, and our suppliers may experience financial difficulties which could effect their ability to service Data I/O's needs.

Certain parts used in our products are currently available from either a single supplier or from a limited number of suppliers. If we cannot develop alternative sources of these components, if sales of parts are discontinued by the supplier, if we experience deterioration in our relationship with these suppliers, or if these suppliers require financing which is not available there may be delays or reductions in product introductions or shipments, which may materially adversely affect our operating results.

Because we rely on a small number of suppliers for certain parts, we are subject to possible price increases by these suppliers. Also, we may be unable to accurately forecast our production schedule. If we underestimate our production schedule, suppliers may be unable to meet our demand for components. This delay in the supply of key components may materially adversely affect our business. Over estimation of demand will lead to excess inventories that may become obsolete.

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The non-automated programming system products we acquired when we acquired SMS in November 1998 are currently manufactured to our specifications by a third-party foreign contract manufacturer. We may not be able to obtain a sufficient quantity of these products if and when needed, which may result in lost sales.

If we are unable to attract and retain qualified third-party distributors, our business may be adversely affected.

Data I/O has an internal sales force and also utilizes third-party representatives, and distributors. Therefore, the financial stability of these representatives and distributors is important: Their ability to timely pay Data I/O and to acquire any necessary financing may be affected by the current economic climate. Highly skilled professional engineers use most of our products. To be effective, third-party distributors must possess significant technical, marketing and sales resources and must devote their resources to sales efforts, customer education, training and support. These required qualities limit the number of potential third-party distributors. Our business will suffer if we cannot attract and retain a sufficient number of qualified third-party distributors to market our products.

Our international operations may expose us to additional risks that may adversely affect our business.

International sales represented 85% and 82% of our net revenue for the fiscal year ended December 31, 2008 and December 31, 2007, respectively. We expect that international sales will continue to be a significant portion of our net revenue. International sales may fluctuate due to various factors, including:

- migration of manufacturing to low cost geographies
- unexpected changes in regulatory requirements
- tariffs and taxes
- difficulties in establishing, staffing and managing foreign operations
- longer average payment cycles and difficulty in collecting accounts receivable
- fluctuations in foreign currency exchange rates
- compliance with applicable export licensing requirements
- product safety and other certification requirements
- difficulties in integrating foreign and outsourced operations
- political and economic instability

Because we have customers located throughout the world, we have significant foreign receivables. We may experience difficulties in collecting these amounts due to payment practices of certain foreign customers, the availability and reliability of foreign credit information, and potential difficulties in enforcing collection terms.

The European Community and European Free Trade Association (“EU”) has established certain electronic emission and product safety requirements (“CE”). Although our products currently meet these requirements, failure to obtain either a CE certification or a waiver for any product may prevent us from marketing that product in Europe. The EU also has directives concerning the Reduction of Hazardous Substances (“RoHS”) from which Data I/O is relying on an exemption for test and measurement companies. China is implementing similar requirements. Failure to meet applicable directives or qualifying exemption may prevent us from marketing certain products in Europe or other territories with similar requirements.

We have subsidiaries in Germany, China, Hong Kong, Brazil, and Canada. Our business and financial condition is sensitive to currency exchange rates or any other restrictions imposed on their currencies. Currency exchange fluctuations in Canada, China, Hong Kong, Brazil and Germany may adversely affect our investment in our subsidiaries.

If we are unable to protect our intellectual property, we may not be able to compete effectively or operate profitably.

Data I/O relies on patents, copyrights, trade secrets and trademarks to protect our intellectual property, as well as product development and marketing skill to establish and protect our market position. We attempt to protect our rights in proprietary software products, including TaskLink our intellectual property software and other software products, by retaining the title to and copyright of the software and documentation, by including appropriate contractual restrictions on use and disclosure in our licenses, and by requiring our employees to execute non-disclosure agreements.

Because of the rapidly changing technology in the semiconductor, electronic equipment and software industries, portions of our products might possibly infringe upon existing patents or copyrights, and we may be required to obtain licenses or discontinue the use of the infringing technology. We believe that any exposure we may have regarding possible infringement claims is a reasonable business risk similar to that assumed by other companies

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in the electronic equipment and software industries. However, any claim of infringement, with or without merit, could be costly and a diversion of management's attention, and an adverse determination could adversely affect our reputation, preclude us from offering certain products, and subject us to substantial liability.

We may pursue business acquisitions that could impair our financial position and profitability.

We may pursue acquisitions of complementary technologies, product lines or businesses. Future acquisitions may include risks, such as:

- burdening management and our operating teams during the integration of the acquired entity
- diverting management's attention from other business concerns
- failing to successfully integrate the acquired products
- lack of acceptance of the acquired products by our sales channels or customers
- entering markets where we have no or limited prior experience
- potential loss of key employees of the acquired company
- additional burden of support for an acquired programmer architecture

Future acquisitions may also impact Data I/O's financial position. For example, we may use significant cash or incur additional debt, which would weaken our balance sheet. We may also capitalize goodwill and intangible assets acquired, the impairment of which would reduce our profitability. We cannot guarantee that future acquisitions will improve our business or operating results.

The loss of key employees may adversely affect our operations.

We have employees located in the U.S., Germany, and China. We also utilize independent contractors for specialty work, primarily in research and development, and utilize temporary workers to adjust capacity to fluctuating demand. Many of our employees are highly skilled and our continued success will depend in part upon our ability to attract and retain employees who can be in great demand within the industry. None of our employees are represented by a collective bargaining unit and we believe relations with our employees are favorable though no assurance can be made that this will be the case in the future. In China, our workers are "leased" with the arrangements made under the Shanghai Foreign Services Co., Ltd. ("FSCO") labor agreement and we could be adversely affected if we were unable to continue that arrangement. Refer to the section captioned "Our restructuring activities may have a negative impact on our future operations" above.

Failure to comply with regulatory requirements may adversely affect our stock price and business.

As a public company, we are subject to numerous governmental and stock exchange requirements, with which we believe we are in compliance. The Sarbanes-Oxley Act of 2002 and the Securities and Exchange Commission (SEC) have requirements that we may fail to meet by the required deadlines or we may fall out of compliance with, such as the internal controls auditor attestation required under Section 404 of the Sarbanes-Oxley Act of 2002, with which we are not yet required to comply as we are not an accelerated filer. Data I/O assumes it will continue to have the status of a smaller reporting company based on the aggregate market value of the voting and non-voting shares held as of June 30, 2008. During the course of our testing we may identify deficiencies which we may not be able to remediate in time to meet the deadline imposed by the Sarbanes-Oxley Act of 2002 for compliance with the requirements of Section 404. We may also incur additional costs in order to comply with Section 404. In addition, if we fail to achieve and maintain the adequacy of our internal controls, as such standards are modified, supplemented or amended from time to time, we may not be able to ensure that we can conclude on an ongoing basis that we have effective internal controls over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act of 2002. Moreover, effective internal controls, particularly those related to revenue recognition, are necessary for us to produce reliable financial reports and are important to help prevent financial fraud. If we cannot provide reliable financial reports or prevent fraud, our business and operating results could be harmed, investors could lose confidence in our reported financial information, and the trading price of our stock could drop significantly. Our failure to meet regulatory requirements and exchange listing standards may result in actions such as the delisting of our stock impacting our stock's liquidity; SEC enforcement actions; and securities claims and litigation.

Our stock price may be volatile and, as a result, you may lose some or all of your investment.

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The stock prices of technology companies tend to fluctuate significantly. We believe factors such as announcements of new products or services by us or our competitors and quarterly variations in financial results may cause the market price of Data I/O's Common Stock to fluctuate substantially. In addition, overall volatility in the stock market, particularly in the technology company sector, is often unrelated to the operating

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performance of companies. If these market fluctuations continue in the future, they may adversely affect the price of Data I/O's Common Stock.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

On February 28, 2006, Data I/O entered into a termination agreement for the Redmond headquarters facility lease and entered into a five year lease agreement for a 40,000 square foot office space also located in Redmond, Washington. The lease commenced and the move occurred during the third quarter of 2006. The lease base annual rental payments during 2008 were approximately \$556,000. The new lease requires base annual rental payments of approximately \$573,000 for 2009. See Note 8 of "Notes to Consolidated Financial Statements." We also entered into a new lease agreement during the second quarter of 2006 for our offices in Shanghai, China. During the fourth quarter of 2007, Data I/O terminated the leases for two China sales offices and moved to a new location for one, as a result of the restructure actions to lower costs.

In addition to the Redmond facility, approximately 14,000 square feet is leased at four foreign locations, including our German sales, service and engineering operations located in Munich, Germany, and two sales, service, and engineering offices located in China.

Item 3. Legal Proceedings

As of December 31, 2008, Data I/O was not a party to any legal proceedings, the adverse outcome of which in management's opinion, individually or in the aggregate, would have a material adverse effect on our results of operations or financial position.

From time to time, we may be involved in litigation relating to claims arising out of our operations in the normal course of business.

As previously disclosed, on January 22, 2008, our former landlord, (now known as Rowley Properties, Inc.), filed a Complaint in the Superior Court of Washington for King County (No. 08-2-03518-2 SEA) against Data I/O, Robert/Barbara Hiester and Steven/Jane Doe Hiester. The claims against Data I/O include breach of agreement, waste, and an environmental remediation claim for contribution under RCW 70.105D.080. No claim amount was specified in the Complaint. The claims relate to a former circuit board fabrication business that Data I/O operated from 1978 to October 1988. We sold that business to Circuit Partners whose officers and principal shareholders were Robert and Barbara Hiester. In March 2009, we agreed to settle this case with Rowley Properties, Inc with the settlement amount to be paid by our insurer. Rowley Properties, Inc. and Data I/O expect to enter into a mutual release and settlement agreement in which they release each other from claims related to this case and Rowley Properties, Inc indemnifies Data I/O against any claims from the other defendants related to this case.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted for a vote of shareholders of Data I/O during the fourth quarter of the fiscal year ended December 31, 2008.

PART II**Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

The following table shows, for the periods indicated, the high and low price information for Data I/O's Common Stock as reported by the NASDAQ Capital Market (NASDAQ symbol is DAIO). The closing price was \$2.40 on December 31, 2008.

| | <u>Period</u> | <u>High</u> | <u>Low</u> |
|------|----------------|-------------|------------|
| 2008 | Fourth Quarter | \$4.46 | \$1.87 |
| | Third Quarter | 6.90 | 3.00 |
| | Second Quarter | 6.16 | 4.25 |
| | First Quarter | 6.65 | 3.87 |
| 2007 | Fourth Quarter | \$6.74 | \$3.97 |
| | Third Quarter | 3.71 | 3.12 |
| | Second Quarter | 4.41 | 3.22 |
| | First Quarter | 4.09 | 3.52 |

The approximate number of shareholders of record as of March 16, 2009 was 589.

Except for a special cash dividend of \$4.15 per share paid on March 8, 1989, Data I/O has not paid cash dividends on our Common Stock and does not anticipate paying regular cash dividends in the foreseeable future.

No sales of unregistered securities were made by Data I/O during the periods ended December 31, 2008, December 31, 2007 and December 31, 2006.

See Item 12 for the Equity Compensation Plan Information.

SHARE REPURCHASE PROGRAM

On December 16, 2008, Data I/O's board of directors authorized a stock repurchase program of up to 1 million shares of common stock. The shares will be purchased in the open market, by block purchases or in private transactions, based on prevailing market conditions and price limits, and the stock repurchase program is authorized for the year 2009. The program may be suspended or discontinued at any time. The shares repurchased will be available for re-issuance to satisfy employee stock plans and for other corporate purposes. The board also approved entering into a Rule 10b5-1 trading plan, which allows the company to repurchase the company's common stock in the open market during periods in which stock trading is otherwise closed for the company. The discretionary repurchase provisions and the 10b5-1 provisions of the program will be effective starting January 5, 2009. As of December 31, 2008 no shares have been repurchased under this program.

Item 6. Selected Financial Data

Not applicable.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. This Act provides a "safe harbor" for forward-looking statements to encourage companies to provide prospective information about themselves as long as they identify these statements as forward-looking and provide meaningful cautionary statements identifying important factors that could cause actual results to differ from the projected results. All statements other than statements of historical fact made in this Annual Report on Form 10-K are forward-looking. In particular, statements herein regarding economic outlook, industry prospects and trends; future results of operations or financial position; breakeven revenue point; integration of acquired products and operations; market acceptance of our newly introduced or upgraded products or services; development, introduction and shipment of new products or services; changing foreign operations; and any other guidance on future periods are forward-looking statements. Forward-looking statements reflect management's current expectations and are inherently uncertain. Although Data I/O believes that the expectations reflected in these forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance, achievements, or other future events. Moreover, neither Data I/O nor anyone else assumes responsibility for the accuracy and completeness of these forward-looking statements. Data I/O is under no duty to update any of these forward-looking statements after the date of this Annual Report. The Reader should not place undue reliance on these forward-looking statements. The following discussions and the section entitled "Risk Factors – Cautionary Factors That May Affect Future Results" describes some, but not all, of the factors that could cause these differences.

OVERVIEW

We continued to focus on our primary goal of managing the business to achieve profitable operations, while developing, launching and enhancing products to drive revenue and earnings growth. Our challenge continues to be operating in a cyclical and challenging industry environment.

In response to losses in the first half of 2006, we launched an initiative during the third quarter of 2006 to lower the quarterly revenue breakeven point. We again experienced losses during the first half of 2007 with declining revenues and gross margins and, as such, we decided to take additional expense reductions to lower our expected quarterly revenue breakeven point to below \$5.3 million when fully implemented during 2007. During the fourth quarter of 2007, we successfully completed these actions consisting of a combination of margin improvements and expense reductions. We have taken actions to improve the effectiveness of our sales and marketing organization. We have reduced expenses by reducing personnel costs, re-engineering some internal processes, and transferring some activities to our lower cost base of operations in China. These restructuring actions taken in the first half of 2007, resulted in our financial operation for the five following quarters at approximately our business model.

We experienced in the fourth quarter of 2008 a significant decline in business, which together with an uncertain economic outlook caused us to determine that additional cost and expense reduction measures were necessary. We took a restructuring charge of \$535,000 in the fourth quarter of 2008, primarily related to severance, to further lower the revenue breakeven point for Data I/O. We are continuing our efforts to balance business geography shifts, increasing costs and strategic investments in our business with the level of demand and mix of business we expect. Tempering these efforts is the current economic uncertainty regarding forecast business in certain geographic and customer segments.

We are focusing our research and development efforts in our strategic growth markets, namely new programming technology, and automated programming systems for the manufacturing environment. We continue to focus on extending the capabilities and support for our FlashCORE architecture, and the ProLINE-RoadRunner, FLX, PS, and FlashPAK product lines. Our applications innovation strategy provides complete

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solutions to target customer's business problems. These solutions generally have a larger software element, may involve third-party components, and in many cases, will be developed to address a specific customer's requirements. We believe by adding these features to our strategic product platforms, we will be able to set ourselves apart from other product suppliers and elevate our relationships with our customers to a partner level.

Our customer focus has been on strategic high volume manufacturers in key market segments like wireless, automotive, industrial controls and programming centers and supporting NAND Flash and microcontrollers on our newer products to gain new accounts and in newer areas, such as microcontrollers for the automotive market with our new ProLINE-RoadRunner XLF. We have continued to expand our China operations to take advantage of the growth of manufacturing in China and to operate close to our customers. We continue to address the effectiveness of our sales and marketing organization and sales channels by adding and changing channels during 2007 and 2008. We recognized the need to diversify our customer base and are continuing to take steps to broaden our channels of distribution and representation to reach a greater number of customers. This decision, in regard to our China sales operations, made at the end of the first quarter of 2007, included

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eliminating some China direct selling expenses and increasing the use of agents that have established relationships with the desired customers. We have also added additional Asian sales channel management to drive Asia sales and manage this important region. We believe these changes helped us more rapidly grow our business in China and Asia during 2008 and convert some of our fixed selling expenses to variable. In the second half of 2008 and early 2009 we have further focused on broadening our sales coverage in the Americas and have added, and plan to add, additional sales representative channels again expanding the use of a variable cost model.

On March 18, 2008, the Company completed the sale of selected patents and patent applications to Leannoux Properties AG L.L.C. Net proceeds were approximately \$3.3 million with a net gain of approximately \$2.1 million.

BUSINESS RESTRUCTURING PROGRESS

The restructuring activities started during the second half of 2006 to reduce expenses and improve margins were continued during the first and second quarters of 2007, to further improve our operating results and the effectiveness of our sales and marketing organization and sales channels. During the first quarter of 2007, we recorded restructuring charges of approximately \$200,000 primarily related to severance charges. During the second quarter of 2007, we recorded an additional \$632,000 of restructuring charges. These actions included re-engineering some internal processes, integrating some activities, transferring some activities to our lower cost base of operations in China, reducing resources applied to declining legacy products, moving some engineering positions to production, reducing the number of taxable entities, outsourcing some functions such as payroll, combining some positions, eliminating some functions, and shifting some responsibilities and resources to our channels. During the third quarter of 2007, we recorded a net expense reversal of \$107,000 comprised of \$54,000 of additional expense, primarily relating to facilities, and a reversal of \$161,000 of previously accrued severance primarily because certain employees who had been scheduled for termination had their termination notice rescinded.

As a result of the business down turn we were experiencing in the fourth quarter of 2008 and the uncertain business outlook, additional actions to reduce expenses were taken. This resulted in a restructuring charge primarily related to severance during the fourth quarter of \$535,000 and total of \$542,000 for the year 2008. At December 31, 2008, \$390,000 remains accrued and is expected to be largely paid out during the first quarter of 2009.

CRITICAL ACCOUNTING POLICY JUDGMENTS AND ESTIMATES

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires that we make estimates and judgments, which affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. On an on-going basis, Data I/O evaluates our estimates, including those related to sales returns, bad debts, inventories, investments, intangible assets, income taxes, warranty obligations, restructuring charges, contingencies such as litigation, and contract terms that have multiple elements and other complexities typical in the capital equipment industry. We base our estimates on historical experience and other assumptions that we believe are reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

Data I/O believes the following critical accounting policies affect the more significant judgments and estimates used in the preparation of our financial statements:

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Revenue Recognition: Sales of Data I/O's semiconductor programming equipment requiring installation by us that is other than perfunctory were previously recorded when installation was complete, or at the later of customer acceptance or installation, if an acceptance clause is specified in the sales terms. Beginning in the third quarter of 2005, Data I/O began recognizing revenue for these products at the time of shipment. We began recognizing revenue at the time of shipment after we determined that our automated products have reached a point of maturity and stability such that product acceptance can be assured by testing at the factory prior to shipment and that the installation meets the criteria to be considered a separate element. These systems are standard products with published product specifications and are configurable with standard options. The evidence that these systems could be accepted was based upon having standardized factory production of the units, results from batteries of tests of product performance to our published specifications, quality inspections and installation standardization, as well as past product operation validation with customer and the history provided by our installed base of products upon which the current versions were based. When arrangements include multiple elements, we use objective evidence of fair value to allocate revenue to the elements pursuant to EITF 00-21, "Revenue Arrangements with Multiple Deliverables," and recognize revenue when the criteria for revenue recognition have been met for each element according to SAB 104, "Revenue Recognition." The amount of revenue recognized is affected by our judgments as to the collectability of the transaction or whether an arrangement includes multiple elements and if so, whether specific objective evidence of fair value exists for those elements. The measure of standalone fair value of the product versus the service installation value component is determined by the amount Data I/O pays to independent representative service groups or the amount of additional discount given to independent distributors, to provide the service installation. Changes to the elements in an arrangement and the ability to establish specific objective evidence for those elements could affect the timing of the revenue recognition. These conditions could be subjective and actual results could vary

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from the estimated outcome.

Installation that is considered perfunctory includes any installation that can be performed by other parties, such as distributors, other vendors, or in most cases the customer themselves. This takes into account the complexity, skill, and training needed as well as customer expectations regarding installation. The revenue related to products requiring installation that is perfunctory is recognized at the time of shipment provided that persuasive evidence of an arrangement exists, shipment has occurred, the price is fixed or determinable, and collectability is reasonably assured.

We record revenue from the sale of service and update contracts as deferred revenue and we recognize it on a straight-line basis over the contractual period, which is typically one year. We establish a reserve for sales returns based on historical trends in product returns and estimates for new items. Data I/O has a stated return policy that customers can return standard products for any reason within 30 days after delivery provided that the returned product is received in its original condition, including all packaging materials, for a refund of the price paid less a restocking charge of 30% of the total amount invoiced for the product returned, unless such restocking charge is waived in writing by Data I/O. In accordance with SFAS 48, "Revenue Recognition When Right of Return Exists," provisions for revenue recognition, the price is fixed or determinable at the date of the sale. The buyer has paid or is obligated to pay and the obligation is not contingent on resale of the product. The buyer's obligation would not be changed in the event of theft, physical destruction or damage to the product. The buyer acquiring the product for resale has economic substance apart from Data I/O. We do not have contractual obligations for future performance to directly bring about the resale of the product by the buyer.

Allowance for Doubtful Accounts: We base the allowance for doubtful accounts receivable on our assessment of the collectability of specific customer accounts and the aging of accounts receivable. If there is deterioration of a major customer's credit worthiness or actual defaults are higher than historical experience, our estimates of the recoverability of amounts due to us could be adversely affected.

Inventory: Inventories are stated at the lower of cost or market ("locom") with cost being currently adjusted at standard cost which approximates cost on a first-in, first-out basis. We estimate reductions to inventory for obsolete, slow-moving, excess and non-salable inventory by reviewing current transactions and forecasted product demand. We evaluate our inventories on an item by item basis and record locom adjustment accordingly. If there is a significant decrease in demand for our products or there is a higher risk of inventory obsolescence because of rapidly changing technology and customer requirements, Data I/O may be required to increase our inventory adjustments and our gross margin could be adversely affected.

Warranty Accruals: Data I/O accrues for warranty costs based on the expected material and labor costs to fulfill our warranty obligations. If we experience an increase in warranty claims, which are higher than our historical experience, our gross margin could be adversely affected.

Tax Valuation Allowances: Given the uncertainty created by our loss history, as well as the current uncertain economic outlook for our industry and capital spending, Data I/O expects to continue to limit the recognition of net deferred tax assets and accounting for uncertain tax positions and maintain the tax valuation allowances. We expect, therefore, that reversals of the tax valuation allowance will take place only as we are able to take advantage of the underlying tax loss or other attributes in carry forward. The transfer pricing and expense or cost sharing arrangements are complex areas where judgments, such as the determination of arms-length arrangements, can be subject to challenges by different tax jurisdictions.

Share-based Compensation: We accounted for share-based awards made to our employees and directors including employee stock option awards, employee stock purchases made under our Employee Stock Purchase Plan ("ESPP) and restricted and performance share awards using the estimated grant date fair value method of accounting in accordance with SFAS, No. 123 (revised 2004), "Share-Based Payment (SFAS No.

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123(R),” which was effective January 1, 2006 for Data I/O. We estimate the fair value using the Black-Scholes valuation model which requires the input of highly subjective assumptions, including the option’s expected life and the price volatility of the underlying stock. The expected stock price volatility assumption was determined using the historical volatility of the Company’s common stock. Changes in the subjective assumptions required in the valuation model may significantly affect the estimated value of the awards, the related stock-based compensation expense and, consequently, our results of operations. Beginning in the second quarter of 2006, restricted stock awards and performance-based stock awards were granted. The vesting of the performance-based stock awards is based on attaining a particular revenue growth target during the three year period ending December 31, 2008. However, during the third quarter of 2007, we reversed the compensation expense related to the performance-based stock awards, based upon the likelihood of not meeting the performance goal for the year ending December 31, 2008. Beginning August 2006, ESPP shares were issued under provisions that do not require expense under SFAS 123(R).

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Results of Operations

NET SALES

(in thousands)

| Net sales by product line: | 2008 | Change | 2007 |
|-----------------------------------|----------|--------|----------|
| Automated programming systems | \$16,822 | 0.7% | \$16,710 |
| Non-automated programming systems | 10,775 | 7.3% | 10,042 |
| Totals | \$27,597 | 3.2% | \$26,752 |

Net sales by location:

| | | | |
|---------------|----------|---------|----------|
| United States | \$4,070 | (17.4%) | \$4,925 |
| % of total | 14.7% | | 18.4% |
| International | \$23,527 | 7.8% | \$21,827 |
| % of total | 85.3% | | 81.6% |

For the year ended December 31, 2008 compared to the same period of 2007, sales increased by approximately \$845,000 or 3.2% with the increase occurring during the first three calendar quarters of 2008, offset by a decline in the fourth quarter. The increase relates primarily to higher sales of aftermarket adapters as well as RoadRunner, FLX, and FlashPAK product lines. Partially offsetting the increase were reduced sales of PS systems, ImageWriter, and our legacy non-automated programmers Unifamily and Sprint. The decline in sales of 11% in our legacy non-automated programmers is a continuing trend for these older product lines. Our backlog was roughly the same at \$2.0 million on December 31, 2008 compared to \$2.1 million on December 31, 2007.

International sales for the year ended 2008 were 85.3% of sales and increased by approximately 7.8% compared to the same period in 2007. During the year ended 2008, sales in Asia increased by approximately 46% compared to 2007, reflecting the improvements made in our China channels and Asian sales management during the second half of 2007 as well as what we believe to be a continued shift to international markets of manufacturing capacity related demand. The increase in Asia, especially in China, was offset in part by decreases in sales of 4% in Europe and 2% in Americas. Asia sales growth was strong in FLX, adapters, FlashPAK, and PS systems.

During 2008, our development team delivered a new version of RoadRunner the ProLINE-RoadRunner XLF aimed at large sized microcontroller users particularly in automotive electronics. We expect this to be an important product in this market, however the economic climate for capital spending is very uncertain currently in the automotive market. Our FLX-FMD had sales primarily to our initial development partner, a handset manufacturer, but has not been widely adopted at this point. During 2009, we plan to introduce additional new product solutions and product enhancements that provide both vehicles for growth as well as substantial value to our customers. We are also making changes and increasing territory coverage with new representative sales channels, especially in the U.S.A. We also expect our new products and channels to increase our revenues, however, offsetting these increases are the expected continuing trend of declining sales of our older non-automated product lines and the current market conditions for decreased spending on capital equipment.

GROSS MARGIN

(in thousands)

| 2008 | Change | 2007 |
|------|--------|------|
|------|--------|------|

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| | | | |
|-------------------------|----------|------|----------|
| Gross margin | \$16,233 | 8.2% | \$15,007 |
| Percentage of net sales | 58.8% | | 56.1% |

Gross margins increased in dollars by approximately \$1.2 million and increased as a percentage of sales by 2.6 percentage points for the year ended December 31, 2008 compared to the same period in 2007. The overall gross margin percentage increase relates primarily to savings from restructuring actions taken during the first half of 2007 to lower factory costs; more favorable factory variances including: manufacturing variances of \$309,000, and the labor and overhead variance of \$171,000; and the effect of higher sales volume relative to fixed manufacturing costs. The current economic climate implications of decreased sales volume would typically imply a resulting lower gross margin percentage. Offsetting this is the potential for new representative sales channels to add sales which typically have a higher gross margin than our sales to distributors, but have an associated selling commission expense.

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RESEARCH AND DEVELOPMENT

| (in thousands) | 2008 | Change | 2007 |
|--------------------------|---------|--------|---------|
| Research and development | \$4,464 | (5.3%) | \$4,716 |
| Percentage of net sales | 16.2 % | | 17.6% |

Research and development (“R&D”) spending for the year ended December 31, 2008 compared to the same period in 2007 decreased in both dollars and as a percentage of sales due to the decreased spending associated with the platform development especially the FLX500. R&D also decreased due to the restructure actions and the re-engineering of internal processes including shifts of engineering work to our China based operations. Data I/O’s R&D objectives continue to focus on platform enhancements and application engineering development on the FLX500, PS, ProLINE-RoadRunner and our FlashCORE programmer architecture. Our R&D spending also fluctuates based on the number and the development stage of projects. New products introduced in 2008 include the ProLINE-RoadRunner XLF, a new larger format RoadRunner version.

We believe it is essential to invest in R&D to significantly enhance our existing products and to create new products as markets develop and technologies change. In addition to product development a significant part of R&D spending is on creating software and support for new devices introduced by the semiconductor companies. We are focusing our R&D efforts in our strategic growth markets, namely new programming technology and automated programming systems for the manufacturing environment, particularly extending the capabilities and support for our FlashCORE programmer architecture and automated handling solutions.

SELLING, GENERAL AND ADMINISTRATIVE

| (in thousands) | 2008 | Change | 2007 |
|-------------------------------------|---------|--------|---------|
| Selling, general and administrative | \$8,106 | (7.9%) | \$8,801 |
| Percentage of net sales | 29.4% | | 32.9% |

For the year ended December 31, 2008 compared with the same period in 2007, SG&A expenses decreased by approximately \$695,000. The expense reduction was due primarily to lower commissions to channels of \$665,000 especially due to certain representatives becoming distributors; a decrease in net personnel costs of approximately \$307,000 related primarily to the 2008 and 2007 restructure actions; and a decrease in trade show expenses of \$148,000. Partially offsetting these expense reductions was 2008 bonus incentive compensation of \$580,000 where there was none in 2007. For 2009, increased sales channel territory coverage by new representatives is expected to add variable cost selling commissions for sales that they generate.

INTEREST

| (in thousands) | 2008 | Change | 2007 |
|------------------|--------|---------|--------|
| Interest income | \$153 | 25.4% | \$122 |
| Interest expense | (\$30) | (21.1%) | (\$38) |

Interest income increased by \$31,000 for the twelve month period ending December 31, 2008 compared to the same period in 2007 due to the increase in the cash balance. Interest expense decreased for the twelve month period ending December 31, 2008 compared to the same period in

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2007 due to paying down the equipment capital lease associated with the move to a new facility during the third quarter of 2006.

INCOME TAXES

| (in thousands) | 2008 | 2007 |
|------------------------------|--------|-------|
| Income tax (expense) benefit | (\$79) | (\$8) |

Income tax expense for 2008 relates to federal alternative minimum tax as well as foreign and state income taxes. Impacting the effective tax rate was the usage of previously reserved deferred tax assets like net operating losses in carryforward that we were able to recognize based upon the current year taxable income. For 2007, income tax expense related to foreign and state income taxes. The effective tax rate for 2007 was impacted by the valuation allowances on tax losses. We had income in 2007 in some foreign operations partially offset by losses in other countries.

For financial reporting purposes, Data I/O established tax valuation reserves against our deferred tax assets because of the uncertainty relating to the realization of such asset values. We had valuation allowances of \$8.7 million and \$9.5 million at December 31, 2008 and 2007, respectively. Given the uncertainty created by our past loss history as well as the current uncertain economic outlook for our industry and capital spending, we expect to continue to limit the recognition of net deferred tax assets and maintain the tax valuation allowances.

INFLATION AND CHANGES IN FOREIGN CURRENCY EXCHANGE RATES

Sales and expenses incurred by foreign subsidiaries are denominated in the subsidiary's local currency and translated into U.S. Dollar amounts at average rates of exchange during the year. We recognized foreign currency transaction gains and (losses) of (\$153,000) and (\$9,000) in 2008 and 2007, respectively. The transaction gains or losses resulted primarily from inter-company sales which were not hedged; sales by our German subsidiary to certain customers, which were invoiced in US dollars; and unhedged Brazilian currency balances. We hedge our foreign currency exposure on sales of inventory to our foreign subsidiaries through the use of foreign currency exchange contracts. See Note 1 of "Notes to Consolidated Financial Statements."

Financial Condition**LIQUIDITY AND CAPITAL RESOURCES**

| (in thousands) | 2008 | Change | 2007 |
|-----------------|----------|---------|----------|
| Working capital | \$18,715 | \$5,653 | \$13,062 |

At December 31, 2008, Data I/O's principal sources of liquidity consisted of existing cash and cash equivalents. Our working capital increased by \$5.7 million and our current ratio increased from 3.5 in 2007 to 4.3 in 2008.

Our cash and cash equivalents increased by \$5.7 million during the year ended December 31, 2008 primarily due to the cash received from operating activities totaling approximately \$4.6 million. Cash received from operations primarily included net income for the year, excluding the

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\$2.1 million from the patent sale, as well as adding back depreciation and amortization of approximately \$1 million.

We added approximately \$438,000 of cash from investing activities during the year ended December 31, 2008 including the \$2.1 million net proceeds from the patent sale offset by 1.7 million used to purchase property, plant and equipment. We expect that we will continue to make capital expenditures to support our business and anticipate that present working capital will be sufficient to meet our operating requirements. Capital expenditures are expected to be funded by existing and internally generated funds or lease financing.

During 2007, our cash and cash equivalents increased by \$5.2 million primarily due to cash received from operating activities totaling approximately \$6.5 million which primarily included net income for the year 2007; a \$3.5 million decrease in accounts receivable; and depreciation amortization in 2007 of approximately \$1.2 million.

As a result of our significant product development, customer support, international expansion and selling and marketing efforts, we require substantial working capital to fund our operations. Over the last several years, we restructured our operations to lower our costs and operating expenditures in certain geographic regions and to lower the level of revenue required for our net income breakeven point, to preserve our cash position and to focus on profitable operations. Offsetting these actions are our investments in expanded operations in China, equipment, and hiring new key personnel. Given our strong cash position of \$13 million as of year end, we believe that we have sufficient working capital available under our operating plan to fund our operations and capital requirements through at least December 31, 2009. Any substantial inability to achieve our current business plan could have a material adverse impact on our financial position, liquidity, or results of operations and may require us to reduce expenditures and/or seek additional financing. Given the current economic climate, additional financing may be extremely difficult to obtain.

LONG-TERM DEBT

| (in thousands) | 2008 | Change | 2007 |
|----------------|-------|---------|-------|
| Long-term debt | \$219 | (\$118) | \$337 |

During the third quarter of 2006, the Company entered into a five year capital lease agreement in the amount of \$591,145. The lease was used to fund new equipment and installation associated with our move to the new facility in July of 2006. See Note 16, "Long-Term Debt."

OFF-BALANCE SHEET ARRANGEMENTS

Except as noted in Note 8, "Operating Lease and Other Commitments," Data I/O had no off-balance sheet arrangements.

SHARE REPURCHASE PROGRAM

On December 16, 2008, Data I/O's board of directors authorized a stock repurchase program of up to 1 million shares of common stock. The shares will be purchased in the open market, by block purchases or in private transactions, based on prevailing market conditions and price limits, and the stock repurchase program is authorized for the year 2009. The program may be suspended or discontinued at any time. The shares repurchased will be available for re-issuance to satisfy employee stock plans and for other corporate purposes. The board also approved entering into a Rule 10b5-1 trading plan, which allows Data I/O to repurchase our common stock in the open market during periods in which stock trading is otherwise closed for the company. The discretionary repurchase provisions and the 10b5-1 provisions of the program will be effective starting January 5, 2009. As of December 31, 2008 no shares have been repurchased under this program.

SHARE HOLDER RIGHTS PLAN

Data I/O's Shareholder Rights Plan dated April 4, 1998 was scheduled to expire on April 4, 2008. Data I/O's Board of Directors amended and extended the Shareholder Rights Plan for an additional 10-year term on April 3, 2008.

NEW ACCOUNTING PRONOUNCEMENTS

In September 2006, the Financial Accounting Standards Board (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, and expands disclosures about fair value measurements. This statement was originally effective for financial statements issued for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued FASB Staff Position (FSP FIN) No. 157-2 which extended the effective date for certain nonfinancial assets and nonfinancial liabilities to fiscal years beginning after November 15, 2008. Data I/O adopted the effective portions of

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SFAS 157 effective December 1, 2007, which did not have a significant impact on our consolidated financial statements. We are currently evaluating the impact of the remaining portions of SFAS 157-2 on our financial statements and anticipate that the adoption of those remaining portions of the statement will not have a significant impact on the reporting of our financial position and results of operations.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities –Including an amendment of FASB Statement No. 115* (“SFAS No. 159”). SFAS No. 159 permits an entity, at specified election dates, to choose to measure certain financial instruments and other items at fair value. The objective of SFAS No. 159 is to provide entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently, without having to apply complex hedge accounting provisions. SFAS No. 159 is effective for accounting periods beginning after November 15, 2007. Data I/O’s adoption of SFAS No. 159 did not have a material impact on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007) (“SFAS 141(R)”) *Business Combinations*. SFAS 141(R) makes significant changes to the accounting and reporting standards for business acquisitions. SFAS 141(R) establishes principles and requirements for an acquirer’s financial statement recognition and measurement of the assets acquired; the liabilities assumed, including those arising from contractual contingencies; any contingent consideration; and any noncontrolling interest in the acquiree at the acquisition date. SFAS 141(R) amends SFAS No. 109, *Accounting for Income Taxes*, to require the acquirer to recognize changes in the amount of its deferred tax benefits that are recognizable as a result of a business combination either in income from continuing operations in the period of the combination or directly in contributed capital, depending on the circumstances. The statement also amends SFAS No. 142, *Goodwill and Other Intangible Assets*, to, among other things, provide guidance for the impairment testing of acquired research and development intangible assets and assets that the acquirer intends not to use. SFAS 141(R) is effective for the Company’s fiscal year beginning January 1, 2009 and may not be adopted early or applied retrospectively. The adoption of SFAS 141(R) will have an impact on the accounting for, and the effect will depend upon the nature

of, business combinations occurring on or after the adoption date.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement No. 133*, (SFAS No. 161), which requires companies to provide additional disclosures about its objectives and strategies for using derivative instruments; how the derivative instruments and related hedged items are accounted for under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and related interpretations; and how the derivative instruments and related hedged items affect our financial statements. SFAS No. 161 also requires companies to disclose information about credit risk-related contingent features in their hedged positions. SFAS No. 161 is effective for fiscal years and interim periods beginning after November 15, 2008. We do not currently believe adoption will have a material impact on our financial position or operating results.

In May 2008, the FASB issued SFAS 162, *The Hierarchy of Generally Accepted Accounting Principles*. SFAS No. 162 identifies the sources of accounting principles and provides entities with a framework for selecting the principles used in preparation of financial statements that are presented in conformity with GAAP. The current GAAP hierarchy has been criticized because it is directed to the auditor rather than the entity, it is complex, and it ranks FASB Statements of Financial Accounting Concepts, which are subject to the same level of due process as FASB Statements of Financial Accounting Standards, below industry practices that are widely recognized as generally accepted but that are not subject to due process. The Board believes the GAAP hierarchy should be directed to entities because it is the entity (not its auditors) that is responsible for selecting accounting principles for financial statements that are presented in conformity with GAAP. The adoption of FASB 162 is not expected to have a material impact on our financial statements.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

Item 8. Financial Statements and Supplementary Data

See pages 25 through 44.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders,

Data I/O Corporation

We have audited the accompanying consolidated balance sheets of Data I/O Corporation and subsidiaries (the Company) as of December 31, 2008 and 2007 and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the two years in the period ended December 31, 2008. Our audits of the basic consolidated financial statements included the consolidated financial statement schedule (Schedule II). These consolidated financial statements and consolidated financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and consolidated financial statement schedule based on our 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes 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, 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 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Data I/O Corporation and subsidiaries as of December 31, 2008 and 2007, and the consolidated results of its operations and its consolidated cash flows for each of the two years in the period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related consolidated financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

//S//GRANT THORNTON LLP

Seattle, Washington

March 25, 2009

DATA I/O CORPORATION

CONSOLIDATED BALANCE SHEETS

December 31,

| | 2008 | 2007 |
|--|-----------------|-----------------|
| (in thousands, except share data) | | |
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$13,304 | \$7,637 |
| Trade accounts receivable, net of allowance for doubtful accounts of \$142 and \$130 | 5,659 | 5,299 |
| Inventories | 5,039 | 4,980 |
| Other current assets | 408 | 323 |
| TOTAL CURRENT ASSETS | 24,410 | 18,239 |
| Property, plant and equipment – net | 2,290 | 2,257 |
| Other assets | 111 | 124 |
| TOTAL ASSETS | \$26,811 | \$20,620 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Accounts payable | \$1,005 | \$1,204 |
| Accrued compensation | 1,476 | 1,025 |
| Deferred revenue | 1,541 | 1,715 |
| Other accrued liabilities | 1,100 | 1,104 |
| Accrued costs of business restructuring | 389 | 8 |
| Income taxes payable | 59 | 3 |
| Current portion long-term debt | 125 | 118 |
| TOTAL CURRENT LIABILITIES | 5,695 | 5,177 |
| Long-term other payables | 57 | 20 |
| Long-term debt | 219 | 337 |
| COMMITMENTS | – | – |
| STOCKHOLDERS' EQUITY | | |
| Preferred stock - | | |
| Authorized, 5,000,000 shares, including 200,000 shares of Series A Junior Participating | | |
| Issued and outstanding, none | – | – |
| Common stock, at stated value - | | |
| Authorized, 30,000,000 shares | | |
| Issued and outstanding, 8,869,245 | | |

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| | | |
|--|----------|----------|
| and 8,765,767 shares | 21,331 | 20,724 |
| Accumulated Deficit and Retained Earnings | (1,301) | (6,429) |
| Accumulated other comprehensive income | 810 | 791 |
| TOTAL STOCKHOLDERS' EQUITY | 20,840 | 15,086 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$26,811 | \$20,620 |

See notes to consolidated financial statements.

DATA I/O CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

| For the years ended December 31, (in thousands, except per share data) | 2008 | 2007 |
|---|----------|----------|
| Net sales | \$27,597 | \$26,752 |
| Cost of goods sold | 11,364 | 11,745 |
| Gross margin | 16,233 | 15,007 |
| Operating expenses: | | |
| Research and development | 4,464 | 4,716 |
| Selling, general and administrative | 8,106 | 8,801 |
| Provision for business restructuring | 542 | 725 |
| Total operating expenses | 13,112 | 14,242 |
| Gain on sale of assets - patents | 2,116 | - |
| Operating income (loss) | 5,237 | 765 |
| Non-operating income (expense): | | |
| Interest income | 153 | 122 |
| Interest expense | (30) | (38) |
| Foreign currency transaction gain (loss) | (153) | (9) |
| Total non-operating income (loss) | (30) | 75 |
| Income (loss) before income taxes | 5,207 | 840 |
| Income tax (expense) benefit | (79) | (8) |
| Net income (loss) | \$5,128 | \$832 |
| Basic earnings (loss) per share | \$0.58 | \$0.10 |
| Diluted earnings (loss) per share | \$0.57 | \$0.09 |
| Weighted-average basic shares | 8,822 | 8,592 |
| Weighted-average diluted shares | 9,053 | 8,860 |

See notes to consolidated financial statements

DATA I/O CORPORATION**CONSOLIDATED STATEMENTS OF CASH FLOWS**

| For the years ended December 31, (in thousands) | 2008 | 2007 |
|---|----------|---------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income (loss) | \$5,128 | \$832 |
| Adjustments to reconcile income (loss) to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 1,017 | 986 |
| Write off of property, plant and equipment | 0 | 58 |
| Equipment transferred to cost of goods sold | 398 | 896 |
| Gain on sale of patents | (2,115) | - |
| Share-based compensation | 401 | 316 |
| Net change in: | | |
| Trade accounts receivable | (467) | 3,492 |
| Inventories | (78) | 163 |
| Other current assets | (96) | 179 |
| Accrued cost of business restructuring | 381 | 6 |
| Accounts payable and accrued liabilities | 245 | (657) |
| Deferred revenue | (174) | 249 |
| Deposits and other long-term assets | (1) | 5 |
| Net cash provided by (used in) operating activities | 4,639 | 6,525 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Additions to property, plant and equipment | (1,677) | (1,015) |
| Net proceeds from sale of patents | 2,115 | - |
| Acquisition of intangibles | - | - |
| Proceeds from maturities of available-for-sale securities | - | - |
| Cash provided by (used in) investing activities | 438 | (1,015) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Proceeds from issuance of common stock | 206 | 355 |
| Payment of capital lease obligation | (112) | (103) |
| Cash provided by financing activities | 94 | 252 |
| Increase (decrease) in cash and cash equivalents | 5,172 | 5,762 |
| Effects of exchange rate changes on cash | 496 | (603) |
| Cash and cash equivalents at beginning of year | 7,637 | 2,478 |
| Cash and cash equivalents at end of year | \$13,304 | \$7,637 |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: | | |
| Cash paid during the year for: | | |
| Interest | \$32 | \$39 |
| Income taxes | \$23 | \$12 |

See notes to consolidated financial statements.

DATA I/O CORPORATION

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

| | Common Stock | | Retained | Accumulated | Total |
|--|--------------|----------|-----------|---------------|---------------|
| | Shares | Amount | Earnings | Other | Stockholders' |
| | | | (Deficit) | Comprehensive | Equity |
| | | | | Income (Loss) | |
| (in thousands, except share data) | | | | | |
| Balance at December 31, 2006 | 8,481,563 | \$20,053 | (\$7,261) | \$491 | \$13,283 |
| Balance at December 31, 2006 as adjusted | 8,481,563 | 20,053 | (7,261) | 491 | 13,283 |
| Stock options exercised | 273,344 | 327 | | | 327 |
| Stock awards issued net of | 1,902 | (3) | | | (3) |
| tax withholding | | | | | |
| Issuance of stock through | | | | | |
| Employee Stock | 8,958 | 31 | | | 31 |
| Purchase Plan | | | | | |
| Share-based compensation | | 316 | | | 316 |
| Comprehensive income: | | | | | |
| Net Income | | | 832 | | 832 |
| Translation adjustment | | | | 300 | 300 |
| Total comprehensive income | | | | | 1,132 |
| Balance at December 31, 2007 | 8,765,767 | 20,724 | (6,429) | 791 | 15,086 |
| Stock options exercised | 96,240 | 194 | | | 194 |
| Stock awards issued net of | 3,607 | (7) | | | (7) |
| tax withholding | | | | | |
| Issuance of stock through | | | | | |
| Employee Stock | 3,631 | 19 | | | 19 |
| Purchase Plan | | | | | |
| Share-based compensation | | 401 | | | 401 |
| Comprehensive income: | | | | | |
| Net income | | | 5,128 | | 5,128 |
| Translation adjustment | | | | 19 | 19 |
| Total comprehensive income | | | | | 5,147 |
| Balance at December 31, 2008 | 8,869,245 | \$21,331 | (\$1,301) | \$810 | \$20,840 |

See notes to consolidated financial statements.

DATA I/O CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Data I/O Corporation (“Data I/O”) designs, manufactures, and sells programming systems used by designers and manufacturers of electronic products. Our programming system products are used to program integrated circuits (“ICs” or “devices” or “semiconductors”) with the specific unique data necessary for the ICs contained in various products, and are an important tool for the electronics industry experiencing growing use of programmable ICs. Customers for our programming system products are located around the world, primarily in the United States, Europe and the Far East. Our manufacturing operations are currently located in the United States, with most of our FlashCORE adapters are manufactured in China. An outside supplier located in Germany currently manufactures our Sprint non-automated programming systems.

Principles of Consolidation

The consolidated financial statements include the accounts of Data I/O Corporation and our wholly-owned subsidiaries. Intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Foreign Currency Translation

Assets and liabilities of foreign subsidiaries are translated at the exchange rate on the balance sheet date. Revenues, costs and expenses of foreign subsidiaries are translated at average rates of exchange prevailing during the year. Translation adjustments resulting from this process are charged or credited to stockholders’ equity, net of taxes recognized. Realized and unrealized gains and losses resulting from the effects of changes in exchange rates on assets and liabilities denominated in foreign currencies are included in non-operating expense as foreign currency transaction gains and losses.

Cash and Cash Equivalents

Cash and cash equivalents are highly liquid investments with maturities of three months or less at date of purchase.

Fair Value of Financial Instruments

The carrying value of cash, cash equivalents, marketable securities and forward exchange contracts approximates fair value. The fair value of Data I/O's marketable securities is based upon the quoted market price on the last business day of the fiscal year plus accrued interest, if any.

Accounts Receivable

The majority of Data I/O's accounts receivable are due from companies in the electronics manufacturing industries. Credit is extended based on an evaluation of a customer's financial condition and, generally, collateral is not required. Accounts receivable are typically due within 30 to 60 days and are stated at amounts due from customers net of an allowance for doubtful accounts. Accounts receivable outstanding longer than the contractual payment terms are considered past due. Data I/O determines our allowance by considering a number of factors, including the length of time trade accounts receivable are past due, the industry and geographic payment practices involved, Data I/O's previous loss history, the customer's current ability to pay their obligation to Data I/O, and the condition of the general economy and the industry as a whole. Data I/O writes off accounts receivable when they become uncollectible, and payments subsequently received on such receivables are credited to the allowance for doubtful accounts. Interest may be accrued, at the discretion of management and according to our standard sales terms, beginning on the day after the due date of the receivable. However, interest income is subsequently recognized on these accounts either to the extent cash is received, or when the future collection of interest and the receivable balance is considered probable by management.

Inventories

Inventories are stated at the lower of cost or market with cost being the currently adjusted standard cost, which approximates cost on a first-in, first-out basis. We estimate changes to inventory for obsolete, slow-moving, excess and non-salable inventory by reviewing current transactions and forecasted product demand. We evaluate our inventories on an item by item basis and record locom (lower of cost or market) adjustment accordingly. See Note 5.

Property, Plant and Equipment

Property, plant and equipment, including leasehold improvements, are stated at cost and depreciation is calculated over the estimated useful lives of the related assets or lease terms on the straight-line basis. We depreciate substantially all manufacturing and office equipment over periods of three to seven years. We depreciate leasehold improvements over the remaining portion of the lease or over the expected life of the asset if less than the remaining term of the lease.

Long-lived assets are evaluated on an annual basis for impairment. Based on this evaluation, no impairment was noted for the years ended December 31, 2008 and 2007.

Intangible Assets

Intangible assets include capitalized costs, technical and product rights, patent, trademarks, and other intellectual property. Intangible assets are stated at cost and amortized to operations over their estimated useful lives or statutory lives, whichever is shorter. Capitalized intangible assets are included in other long term assets on the balance sheet. We evaluate our intangible assets for impairments whenever events or changes in circumstances indicate that the carrying amount may not be recoverable using a fair value approach. No such impairment was recognized for the years ended December 31, 2008 and 2007.

Income Taxes

Federal and state income taxes are computed at current enacted tax rates, less tax credits using the asset and liability method. Deferred taxes are adjusted both for items that do not have tax consequences and for the cumulative effect of any changes in tax rates from those previously used to determine deferred tax assets or liabilities. Tax provisions include amounts that are currently payable, changes in deferred tax assets and liabilities that arise because of temporary differences between the timing of when items of income and expense are recognized for financial reporting and income tax purposes, changes in the recognition of tax positions due to the application of Financial Accounting Standards Board, or FASB, Interpretation 48 (FIN 48), and any changes in the valuation allowance caused by a change in judgment about the realizability of the related deferred tax assets. A valuation allowance is established when necessary to reduce deferred tax assets to amounts expected to be realized.

Share-Based Compensation

On January 1, 2006, we adopted SFAS No. 123(R), "Share-Based Payment (Revised 2004)," which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors. Under this standard, the Company's stock-based compensation awards are measured based on estimated fair values on the date of grant and recognized as compensation expense on the straight-line

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method. The Company implemented SFAS No. 123(R) using the modified prospective transition method. Our share-based compensation is reduced for estimated forfeitures at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

Prior to January 1, 2006, we accounted for share-based payments under the recognition and measurement provisions of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees ("APB 25")," and related interpretations, as permitted by FASB Statement No. 123, "Accounting for Stock-Based Compensation ("SFAS 123")." In accordance with APB 25, no compensation cost was required to be recognized for options granted that had an exercise price equal to the market value of the underlying common stock on the date of grant. Under our plan, stock options are generally granted at fair market value.

Revenue Recognition

Sales of Data I/O's semiconductor programming equipment products requiring installation by us that is other than perfunctory were previously recorded when installation was complete, or at the later of customer acceptance or installation, if an acceptance clause is specified in the sales terms. Beginning in the third quarter of 2005, Data I/O began recognizing revenue for these products at the time of shipment. We began recognizing revenue at the time of shipment after we determined that our programming equipment have reached a point of maturity and stability such that product acceptance can be assured by testing at the factory prior to shipment and that the installation meets the criteria to be considered a separate element. These systems are standard products with published product specifications and are configurable with standard options. The evidence that these systems could be deemed as accepted was based upon having standardized factory production of the units, results from batteries of tests of product performance to our published specifications, quality inspections and installation standardization, as well as past product operation validation with the customer and the history provided by our installed base of products upon which the current versions were based. When arrangements include multiple elements, we use objective evidence of fair value to allocate revenue to the elements pursuant to EITF 00-21, "Revenue Arrangements with Multiple Deliverables," and recognize revenue when the criteria for revenue recognition have been met for each element according to SAB 104, "Revenue Recognition." The amount of revenue recognized is affected by our judgments as to the collectibility of the transaction or whether an arrangement includes multiple elements and if so, whether specific objective evidence of fair value exists for those elements. The measure of standalone fair value of the product versus the service installation value component is by the amount the Company pays to independent representative service groups or the amount of additional discount given to independent distributors to provide the service installation (published price).

Installation that is considered perfunctory includes any installation that can be performed by other parties, such as distributors, other vendors, or in most cases the customers themselves. This takes into account the complexity, skill, and training needed as well as customer expectations regarding installation. The revenue related to products requiring installation that is perfunctory is recognized at the time of shipment provided that persuasive evidence of an arrangement exists, shipment has occurred, the price is fixed or determinable, and collectibility is reasonably assured.

We record revenue from the sale of service and update contracts as deferred revenue and we recognize it on a straight-line basis over the contractual period, which is typically one year. We establish a reserve for sales returns based on historical trends in product returns and estimates for new items. The Company has a stated return policy that customers can return standard products for any reason within 30 days after delivery provided that the returned product is received in its original condition, including all packaging materials, for a refund of the price paid less a restocking charge of 30% of the total amount invoiced for the product returned, unless such restocking charge is waived in writing by the Company. In accordance with SFAS 48, "Revenue Recognition When Right of Return Exists," provisions for revenue recognition, the price is fixed or determinable at the date of the sale. The buyer has paid or is obligated to pay and the obligation is not contingent on resale of the product. The buyer's obligation would not be changed in the event of theft, physical destruction or damage to the product. The buyer acquiring the product for resale has economic substance apart from the Company. The Company does not have significant obligations for future performance to directly bring about the resale of the product by the buyer.

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Sales were recorded net of associated sales return reserves, which were \$197,000 and \$158,000 at December 31, 2008 and 2007, respectively.

Data I/O's software products are not normally sold separately from sales of programming systems. However, on those occasions where we sell software separately, we recognize revenue when a sales agreement exists, when delivery has occurred, when the fee is fixed or determinable, and when collection is probable.

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Data I/O transfers certain products out of service from their internal use and makes them available for sale. The products transferred are our standard products in one of the following areas: service loaners, rental or test units; engineering test units; or sales demonstration equipment. Once transferred, the equipment is sold by our regular sales channels as used equipment inventory. These product units often involve refurbishing and an equipment warranty, and are conducted as sales in our normal and ordinary course of business. The transfer amount is the product unit's net book value and the sale transaction is accounted for as revenue and cost of goods sold.

Research and Development

Research and development costs are expensed as incurred.

Advertising Expense

Data I/O expenses advertising costs as incurred. Total advertising expenses were approximately \$116,000 and \$115,000 in 2008 and 2007, respectively.

Warranty Expense

Data I/O records a liability for an estimate of costs that it expects to incur under our basic limited warranty when product revenue is recognized. Factors affecting our warranty liability include the number of units sold and historical and anticipated rates of claims and costs per claim. We periodically assess the adequacy of our warranty liability based on changes in these factors. Data I/O normally warrants our products against defects for periods ranging from ninety days to one year. The FlashPAK, which at introduction carried a three-year warranty on some components, now have a one year warranty. We provide currently for the estimated cost that may be incurred under our product warranties. Data I/O records revenues on extended warranties on a straight-line basis over the term of the related warranty contracts. Service costs are expensed as incurred.

Earnings (Loss) Per Share

Basic earnings (loss) per share exclude any dilutive effects of stock options. Basic earnings (loss) per share are computed using the weighted-average number of common shares outstanding during the period. Diluted earnings per share are computed using the weighted-average number of common shares and common stock equivalent shares outstanding during the period. The common stock equivalent shares from equity awards used in calculating diluted earnings per share were 231,974 and 268,197 for the years ended December 31, 2008 and 2007 respectively. Options to purchase 820,645 and 259,359 shares of common stock were outstanding as of December 31, 2008 and 2007, respectively, but were excluded from the computation of diluted EPS for the period then ended because the options were anti-dilutive.

Diversification of Credit Risk

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Financial instruments, which potentially subject Data I/O to concentrations of credit risk, consist primarily of trade receivables. Our cash, cash equivalents and marketable securities consist of high quality financial instruments. Data I/O maintains cash balances in financial institutions, which at times may exceed federally insured limits. We have not experienced any losses in such accounts and believe we are not exposed to any significant credit risk on cash and cash equivalents. Our trade receivables are geographically dispersed and include customers in many different industries. At December 31, 2008 the combined subsidiaries accounts receivable of one customer represented 13.3% of our total consolidated accounts receivable balance and there were no other customers that represented 10% or more. As of December 31, 2007, we had no customers that represented 10% or more of total consolidated accounts receivable balance. We believe that risk of loss is significantly reduced due to the diversity of our end-customers and geographic sales areas. We perform on-going credit evaluations of our customers' financial condition and require collateral, such as letters of credit and bank guarantees, or prepayment whenever deemed necessary.

Derivatives

Data I/O accounts for our derivatives using SFAS No. 133, "Accounting for Derivatives and Hedging Activities." This statement establishes accounting and reporting standards for derivative instruments and requires recognition of derivatives as assets or liabilities in the statement of financial position and measurement of those instruments at fair value.

Data I/O utilizes forward foreign exchange contracts to reduce the impact of foreign currency exchange rate risks where natural hedging strategies cannot be effectively employed. All of our hedging instruments are fair value hedges. Generally, these contracts have maturities less than one year and require us to exchange foreign currencies for U.S. dollars at maturity. At December 31, 2008 and 2007, we had a notional value of approximately

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\$424,000 and \$1,620,000, respectively. The estimated fair value gain (loss) of the open hedge contracts as of December 31, 2008 and 2007 is approximately (\$9,000) and (\$8,000), respectively, and is included in accounts payable on the balance sheet. Periodic changes in fair value are recorded in other income in the statement of operations. The amount of transaction gain or (loss) in other income in 2008 and 2007 was (\$153,000) and (\$9,000), respectively.

Data I/O does not hold or issue derivative financial instruments for trading purposes. The purpose of our hedging activities is to reduce the risk that the valuation of the underlying assets, liabilities and firm commitments will be adversely affected by changes in exchange rates. Our derivative activities help minimize foreign currency exchange rate risk because fluctuations in the value of the instruments used for hedging purposes are offset by fluctuations in the value of the underlying exposures being hedged. We are exposed to credit-related losses in the event of nonperformance by counterparties to forward exchange contracts. However, we have entered into these instruments with creditworthy financial institutions and consider the risk of nonperformance remote.

New Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (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, and expands disclosures about fair value measurements. This statement was originally effective for financial statements issued for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued FASB Staff Position (FSP FIN) No. 157-2 which extended the effective date for certain nonfinancial assets and nonfinancial liabilities to fiscal years beginning after November 15, 2008. Data I/O adopted the effective portions of SFAS 157 effective December 1, 2007, which did not have a significant impact on our consolidated financial statements. We are currently evaluating the impact of the remaining portions of SFAS 157-2 on our financial statements and anticipate that the adoption of those remaining portions of the statement will not have a significant impact on the reporting of our financial position and results of operations.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115* ("SFAS No. 159"). SFAS No. 159 permits an entity, at specified election dates, to choose to measure certain financial instruments and other items at fair value. The objective of SFAS No. 159 is to provide entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently, without having to apply complex hedge accounting provisions. SFAS No. 159 is effective for accounting periods beginning after November 15, 2007. Data I/O's adoption of SFAS No. 159 did not have a material impact on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007) ("SFAS 141(R)") *Business Combinations*. SFAS 141(R) makes significant changes to the accounting and reporting standards for business acquisitions. SFAS 141(R) establishes principles and requirements for an acquirer's financial statement recognition and measurement of the assets acquired; the liabilities assumed, including those arising from contractual contingencies; any contingent consideration; and any noncontrolling interest in the acquiree at the acquisition date. SFAS 141(R) amends SFAS No. 109, *Accounting for Income Taxes*, to require the acquirer to recognize changes in the amount of its deferred tax benefits that are recognizable as a result of a business combination either in income from continuing operations in the period of the combination or directly in contributed capital, depending on the circumstances. The statement also amends SFAS No. 142, *Goodwill and Other Intangible Assets*, to, among other things, provide guidance for the impairment testing of acquired research and development intangible assets and assets that the acquirer intends not to use. SFAS 141(R) is effective for the Company's fiscal year beginning January 1, 2009 and may not be adopted early or applied retrospectively. The adoption of SFAS 141(R) will have an impact on the accounting for, and the effect will depend upon the nature of, business combinations occurring on or after the adoption date.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement No. 133*, (SFAS No. 161), which requires companies to provide additional disclosures about its objectives and strategies for using

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derivative instruments; how the derivative instruments and related hedged items are accounted for under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and related interpretations; and how the derivative instruments and related hedged items affect our financial statements. SFAS No. 161 also requires companies to disclose information about credit risk-related contingent features in their hedged positions. SFAS No. 161 is effective for fiscal years and interim periods beginning after November 15, 2008. We do not currently believe adoption will have a material impact on our financial position or operating results.

In May 2008, the FASB issued SFAS 162, *The Hierarchy of Generally Accepted Accounting Principles*. SFAS No. 162 identifies the sources of accounting principles and provides entities with a framework for selecting the principles used in preparation of financial statements that are presented in conformity with GAAP. The current

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GAAP hierarchy has been criticized because it is directed to the auditor rather than the entity, it is complex, and it ranks FASB Statements of Financial Accounting Concepts, which are subject to the same level of due process as FASB Statements of Financial Accounting Standards, below industry practices that are widely recognized as generally accepted but that are not subject to due process. The Board believes the GAAP hierarchy should be directed to entities because it is the entity (not its auditors) that is responsible for selecting accounting principles for financial statements that are presented in conformity with GAAP. The adoption of FASB 162 is not expected to have a material impact on our financial statements.

NOTE 2 – CLASSIFICATIONS

Certain prior periods' balances have been reclassified to conform to the presentation used in the current period.

NOTE 3 – PROVISION FOR BUSINESS RESTRUCTURING

The restructuring activities started during the second half of 2006 to reduce expenses and improve margins were continued during the first and second quarters of 2007, to further improve our operating results and the effectiveness of our sales and marketing organization and sales channels. During the first quarter of 2007, we recorded restructuring charges of approximately \$200,000 primarily related to severance charges. During the second quarter of 2007, we recorded an additional \$632,000 of restructuring charges. These actions included re-engineering some internal processes, integrating some activities, transferring some activities to our lower cost base of operations in China, reducing resources applied to declining legacy products, moving some engineering positions to production, reducing the number of taxable entities, outsourcing some functions such as payroll, combining some positions, eliminating some functions, and shifting some responsibilities and resources to our channels. During the third quarter of 2007, we recorded a net expense reversal of \$107,000 comprised of \$54,000 of additional expense, primarily relating to facilities, and a reversal of \$161,000 of previously accrued severance primarily because certain employees who had been scheduled for termination had their termination notice rescinded.

As a result of the business down turn we were experiencing in the fourth quarter of 2008 and the uncertain business outlook, additional actions to reduce expenses were taken. This resulted in a restructuring charge primarily related to severance during the fourth quarter of \$535,000 and total of \$542,000 for the year 2008. At December 31, 2008, \$390,000 remains accrued and is expected to be largely paid out during the first quarter of 2009.

An analysis of the restructuring is as follows (in thousands):

| Description | Reserve | 2007 Payments/ | | Reserve | 2008 Payments/ | | Reserve |
|---------------------------|------------|----------------|------------|------------|----------------|------------|------------|
| | Balance at | 2007 | Write-offs | Balance at | 2008 | Write-offs | Balance at |
| | 12/31/2006 | Expenses | | 12/31/2007 | Expenses | | 12/31/2008 |
| Downsizing US Operations: | | | | | | | |
| Employee severance | \$2 | \$411 | \$413 | \$- | \$162 | \$82 | \$80 |
| Facility & other costs | - | 5 | 5 | - | 18 | 11 | 7 |
| Downsizing | | | | | | | |

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| | | | | | | | |
|------------------------|-----|-------|-------|-----|-------|-------|-------|
| foreign operations: | | | | | | | |
| Employee severance | - | 204 | 199 | 5 | 347 | 63 | 289 |
| Facility & other costs | - | 105 | 102 | 3 | 15 | 4 | 14 |
| Total | \$2 | \$725 | \$719 | \$8 | \$542 | \$160 | \$390 |

NOTE 4 –ACCOUNTS RECEIVABLE, NET

Receivables consist of the following (in thousands):

| | Dec. 31, 2008 | Dec. 31, 2007 |
|---|------------------|------------------|
| | \$5,801 | \$5,429 |
| Trade accounts receivable | | |
| Less allowance for doubtful receivables | 142 | 130 |
| Trade accounts receivable, net | \$5,659 | \$5,299 |

Trade receivables relate to sales to Data I/O customers, for which credit is extended based on the customer’s credit history.

Changes in Data I/O’s allowance for doubtful accounts are as follows (in thousands):

| | Dec. 31, 2008 | Dec. 31, 2007 |
|-----------------------------|------------------|------------------|
| Beginning balance | \$130 | \$199 |
| Bad debt expense (reversal) | 36 | 11 |
| Accounts written-off | (24) | (80) |
| Recoveries | - | - |
| Ending balance | \$142 | \$130 |

NOTE 5 – INVENTORIES

Net inventories consisted of the following components (in thousands):

| | Dec. 31, 2008 | Dec. 31, 2007 |
|--------------|------------------|------------------|
| Raw material | \$2,631 | \$3,047 |

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| | | |
|-----------------|---------|---------|
| Work-in-process | 1,155 | 1,125 |
| Finished goods | 1,253 | 808 |
| Inventories | \$5,039 | \$4,980 |

NOTE 6 – PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment consisted of the following (in thousands):

| | Dec. 31, 2008 | Dec. 31, 2007 |
|------------------------------------|------------------|------------------|
| Leasehold improvements | \$393 | \$389 |
| Equipment | 8,931 | 8,853 |
| | 9,324 | 9,242 |
| Less accumulated depreciation | 7,034 | 6,985 |
| Property, plant and equipment, net | \$2,290 | \$2,257 |

Total depreciation recorded for 2008 and 2007 was \$832,000 and \$1,054,000 respectively.

NOTE 7 – OTHER ACCRUED LIABILITIES

Other accrued liabilities consisted of the following components (in thousands):

| | Dec. 31, 2008 | Dec. 31, 2007 |
|----------------------------|------------------|------------------|
| Product warranty liability | \$400 | \$401 |
| Sales return reserve | 197 | 158 |
| Deferred rent | 156 | 187 |
| Other taxes | 186 | 65 |
| Other | 161 | 293 |
| Other accrued liabilities | \$1,100 | \$1,104 |

The changes in Data I/O's product warranty liability are as follows (in thousands):

| | Dec. 31, 2008 | Dec. 31, 2007 |
|------------------------------|------------------|------------------|
| Liability, beginning of year | \$401 | \$467 |
| Net expenses | 717 | 782 |
| Warranty claims | (719) | (782) |
| Accrual revisions | 1 | (66) |
| Liability, end of year | \$400 | \$401 |

NOTE 8 – OPERATING LEASE AND OTHER COMMITMENTS

Data I/O has purchase obligations for inventory and production costs as well as other obligations such as capital expenditures, service contracts, marketing, and development agreements. Arrangements are considered purchase obligations if a contract specifies all significant terms, including fixed or minimum quantities to be purchased, a pricing structure and approximate timing of the transaction. Most arrangements are cancelable without a significant penalty, and with short notice, typically less than 90 days. At December 31, 2008, the purchase and other obligations totaled \$493,000 all of which are 2009 commitments. Any amounts reflected on the balance sheet as accounts payable, accrued liabilities, and notes payable are excluded from the below table. Data I/O has commitments under non-cancelable operating leases and other agreements, primarily for factory and office space, with initial or remaining terms of one year or more as follows:

For the years ending December 31, (in thousands):

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Operating
leases

| | |
|---------------------|---------|
| 2009 | \$1,092 |
| 2010 | 876 |
| 2011 | 491 |
| 2012 and thereafter | 1 |
| Total | \$2,460 |

Lease and rental expense was \$1,209,000 and \$1,200,000 in 2008 and 2007, respectively. Rent expense is recorded on a straight line basis, over the term of the lease, for leases that contain fixed escalation clauses. Data I/O has renewal options on substantially all of our major leases. Data I/O entered into a headquarters facility lease for a five year period for an approximately 40,000 square foot office space located in Redmond, Washington and it commenced during the third quarter of 2006. We also entered into a new lease agreement during the second quarter of 2006 for our offices in Shanghai, China. During the third quarter of 2008, we entered into a new lease agreement for our office in Hong Kong, China.

NOTE 9 – CONTINGENCIES

As of December 31, 2008, Data I/O was not a party to any legal proceedings, the adverse outcome of which in management's opinion, individually or in the aggregate, would have a material adverse effect on our results of operations or financial position.

As previously disclosed, on January 22, 2008, our former landlord, (now known as Rowley Properties, Inc.), filed a Complaint in the Superior Court of Washington for King County (No. 08-2-03518-2 SEA) against Data I/O, Robert/Barbara Hiester and Steven/Jane Doe Hiester. The claims against Data I/O include breach of agreement, waste, and an environmental remediation claim for contribution under RCW 70.105D.080. No claim amount was specified in the Complaint. The claims relate to a former circuit board fabrication business that Data I/O operated from 1978 to October 1988. We sold that business to Circuit Partners whose officers and principal shareholders were Robert and Barbara Hiester. In March 2009, we agreed to settle this case with Rowley Properties, Inc with the settlement amount to be paid by our insurer. Rowley Properties, Inc. and Data I/O expect to enter into a mutual release and settlement agreement in which they release each other from claims related to this case and Rowley Properties, Inc indemnifies Data I/O against any claims from the other defendants related to this case.

NOTE 10 – STOCK AND RETIREMENT PLANS

Stock Option Plans

At December 31, 2008, there were 1,096,473 shares of Common Stock reserved for issuance of which 192,242 shares are available for future grant under Data I/O's employee stock option plans ("Stock Plan"). Pursuant to these plans, options are granted to our officers and key employees with exercise prices equal to the fair market value of the Common Stock at the date of grant and generally vest over four years. Options granted under the plans generally have a maximum term of six years from the date of grant, except for certain options granted in January 1999, which have a maximum term of ten years. Stock awards may also be granted under the Stock Plan. Beginning in the second quarter of 2006, we granted restricted stock awards and performance-based stock awards to our officers and key employees at fair market value. The restricted stock awards are contingent upon meeting the required service period and vest in equal annual installments over four years. The performance-based stock awards vest on December 31, 2008 based on obtaining a revenue growth target of \$34,694,935 for the fiscal year ending December 31, 2008. However, during the third quarter of 2007, we reversed the compensation expense related to the performance-based stock awards, based upon the likelihood of not obtaining the performance goal for the year ending December 31, 2008. The 2008 performance goal was not met and as a result these performance-based stock awards did not vest at the end of 2008.

Employee Stock Purchase Plan

Under the Employee Stock Purchase Plan, eligible employees may purchase shares of Data I/O's Common Stock at six-month intervals at 95% of the fair market value on the last day of each six-month period. Employees may purchase shares having a value not exceeding 10% of their gross compensation during an offering period. During 2008 and 2007, a total of 3,631 and 8,958 shares, respectively, were purchased under the plan at average prices of \$5.35 and \$3.43 per share, respectively. At December 31, 2008, a total of 95,482 shares were reserved for future issuance. The 5% discount allowed under the ESPP is not considered compensatory under SFAS 123(R).

Stock Appreciation Rights Plan

Data I/O has a Stock Appreciation Rights Plan (“SAR”) under which each director, executive officer or holder of 10% or more of Data I/O’s Common Stock has a SAR with respect to each exercisable stock option. The SAR entitles the SAR holder to receive cash from Data I/O for the difference between the market value of the stock and the exercise price of the option in lieu of exercising the related option. SARs are only exercisable following a tender offer or exchange offer for Data I/O’s stock, or following approval by shareholders of Data I/O of any merger, consolidation, reorganization or other transaction providing for the conversion or exchange of more than 50% of the common shares outstanding. As no event has occurred, which would make the SARs exercisable, and no such event is deemed probable, no compensation expense has been recorded under this plan.

Director Fee Plan

Data I/O has a Director Fee Plan, not currently in use, which had provided for payment to directors who are not employees of Data I/O Corporation by delivery of shares of Data I/O’s Common Stock. No shares were issued from the plan for 2008 or 2007 board service and 151,332 shares remain available in the plan as of December 31, 2008.

Retirement Savings Plan

Data I/O has a savings plan that qualifies as a cash or deferred salary arrangement under Section 401(k) of the Internal Revenue Code. Under the plan, participating U.S. employees may defer their pre-tax salary, subject to IRS limitations. In fiscal years 2008 and 2007, Data I/O contributed one dollar for each dollar contributed by a participant, with a maximum contribution of 4% of a participant's earnings. Data I/O's matching contribution expense for the savings plan was approximately \$145,000 and \$161,000 in 2008 and 2007, respectively.

Share Repurchase Program

On December 16, 2008, Data I/O's board of directors authorized a stock repurchase program of up to 1 million shares of common stock. The shares will be purchased in the open market, by block purchases or in private transactions, based on prevailing market conditions and price limits, and the stock repurchase program is authorized for the year 2009. The program may be suspended or discontinued at any time. The shares repurchased will be available for re-issuance to satisfy employee stock plans and for other corporate purposes. The board also approved entering into a Rule 10b5-1 trading plan, which allows the company to repurchase the company's common stock in the open market during periods in which stock trading is otherwise closed for the company. The discretionary repurchase provisions and the 10b5-1 provisions of the program will be effective starting January 5, 2009. As of December 31, 2008 no shares have been repurchased under this program.

NOTE 11– SHARE-BASED COMPENSATION

Effective January 1, 2006, the Company adopted the provisions of SFAS No. 123(R) which requires the measurement and recognition of compensation expense for all share-based payment awards made to our employees and directors including employee stock options, stock awards and employee stock purchases made under our Employee Stock Purchase Plan ("ESPP") during 2006.

Data I/O adopted SFAS No. 123(R) using the modified prospective method beginning January 1, 2006. Accordingly, during the year ended December 31, 2008, 2007, and 2006, we recorded share-based compensation expense for awards granted prior to but not yet vested as of January 1, 2006 as if the fair value method required for pro forma disclosure under SFAS No. 123 were in effect for expense recognition purposes adjusted for estimated forfeitures. For share-based awards granted after January 1, 2006, we have recognized compensation expense based on the estimated grant date fair value method required under SFAS No. 123(R). For these awards we have recognized compensation expense using a straight-line amortization method and reduced for estimated forfeitures. SFAS No. 123(R) supersedes the Company's previous accounting under APB No. 25, "Accounting for Stock Issued to Employees, under which the Company did not recognize compensation expense.

The impact on our results of operations of recording share-based compensation for the year ended December 31, 2008 and 2007 was as follows (in thousands):

Year Ended

Year Ended

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| | Dec. 31, 2008 | Dec. 31, 2007 |
|--|---------------|---------------|
| Costs of goods sold | \$24 | \$14 |
| Research and development | 50 | 39 |
| Selling, general and administrative | 327 | 263 |
| Total share-based compensation expense | \$401 | \$316 |
| Impact on net income (loss) per share: | | |
| Basic and diluted | \$0.04 | \$0.04 |

Approximately \$6,600 and \$3,500 of share-based compensation was capitalized within inventory for the year ended December 31, 2008 and 2007, respectively.

The fair value of share-based awards for employee stock option awards and employee stock purchases made under our Employee Stock Purchase Plan were estimated at the date of grant using the Black-Scholes valuation model. The volatility and expected life of the options used in calculations the fair value of share-based awards excludes certain periods of historical data that we considered atypical and not likely or rare to occur in future

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periods. The following weighted average assumptions were used to calculate the fair value of options granted during the years ended December 31:

| | Employee Stock Options | | Employee Stock Purchase Plan | |
|--------------------------------------|------------------------|-------|------------------------------|------|
| | 2008 | 2007 | 2008 | 2007 |
| Risk-free interest rates | 3.08% | 4.90% | N/A | N/A |
| Volatility factors | .54 | .59 | N/A | N/A |
| Expected life of the option in years | 4.7 | 4.68 | N/A | N/A |
| Expected dividend yield | None | None | N/A | N/A |

The risk-free interest rate used in the Black-Scholes valuation method is based on the implied yield currently available in U.S. Treasury securities at maturity with an equivalent term. We have not recently declared or paid any dividends and do not currently expect to do so in the future. The expected term of options represents the period that our stock-based awards are expected to be outstanding and was determined based on historical weighted average holding periods and projected holding periods for the remaining unexercised shares. Consideration was given to the contractual terms of our stock-based awards, vesting schedules and expectations of future employee behavior. Expected volatility is based on the annualized daily historical volatility of Data I/O's stock over a representative period.

The weighted average grant date fair value of options granted under our stock option plans for the twelve month period ending December 31, 2008 and 2007 was \$2.85 and \$1.98, respectively.

The following table summarizes stock option activity under our stock option plans for the twelve months ended December 31:

| | Dec. 31, 2008 | | Dec. 31, 2007 | |
|---|---------------|---------------------------------|---------------|---------------------------------|
| | Options | Weighted-Average Exercise Price | Options | Weighted-Average Exercise Price |
| Outstanding at beginning of year | 855,925 | \$2.90 | 1,080,904 | \$2.40 |
| Granted | 187,000 | 5.91 | 166,000 | 3.71 |
| Exercised | (102,007) | 2.19 | (317,576) | 1.61 |
| Cancelled, expired or forfeited | (36,687) | 3.53 | (73,403) | 2.97 |
| Outstanding – end of year | 904,231 | \$3.58 | 855,925 | 2.90 |
| Vested or expected to vest at the end of the period | 850,793 | \$3.48 | 801,579 | \$2.85 |
| Exercisable at end of year | 602,483 | \$2.98 | 533,108 | \$2.58 |

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The stock options outstanding and exercisable for equity share-based payment awards under our stock option plans as of December 31, 2008 were in the following exercise price ranges:

| Range of Exercise Prices | Options Outstanding | | | Options Exercisable | | | |
|--------------------------|---------------------|--|-----------------------------------|---------------------------|--------------------|-----------------------------------|---------------------------|
| | Number Outstanding | Weighted – Average Remaining Contractual Life in Years | Weighted – Average Exercise Price | Aggregate Intrinsic Value | Number Exercisable | Weighted – Average Exercise Price | Aggregate Intrinsic Value |
| \$1.00 - \$1.94 | 207,036 | 1.60 | \$2.08 | | 188,920 | \$2.05 | |
| \$1.94 - \$2.49 | 229,226 | 1.61 | 2.84 | | 226,570 | 2.84 | |
| \$2.49 - \$3.13 | 152,625 | 4.37 | 3.68 | | 65,220 | 3.68 | |
| \$3.13 - \$3.69 | 141,719 | 3.52 | 3.90 | | 97,398 | 3.90 | |
| \$3.69 - \$6.07 | 173,625 | 5.38 | 5.96 | | 24,375 | 5.96 | |
| | 904,231 | 3.10 | \$3.58 | \$76,815 | 602,483 | \$2.98 | \$76,815 |

The aggregate intrinsic value in the table above represents the total pretax intrinsic value, based on the Company closing stock price of \$2.40 at December 31, 2008, which would have been received by award holders had all award holders exercised their stock options that were in-the-money as of that date. The aggregate intrinsic value of awards exercised during the twelve month period ended December 31, 2008 was \$579,380.

Restricted stock award including performance-based stock award activity under our share-based compensation plan was as follows:

| | Dec. 31, 2008 | | Dec. 31, 2007 | |
|----------------------------------|---------------|--|---------------|--|
| | Awards | Weighted-Average Grant Date Fair Value | Awards | Weighted-Average Grant Date Fair Value |
| Outstanding at beginning of year | 23,986 | \$3.80 | 21,150 | \$3.88 |
| Granted | 13,200 | 5.98 | 12,450 | 3.69 |
| Vested | (4,843) | 3.78 | (2,566) | 3.88 |
| Cancelled | (10,020) | 4.15 | (7,048) | 3.82 |
| Outstanding at end of year | 22,323 | \$4.93 | 23,986 | \$3.80 |

As of December 31, 2008 and 2007, there were \$684,834 and \$599,552, respectively, of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under our stock option plans. That cost is expected to be recognized over a weighted average period of 2.53 and 2.26 years as of December 31, 2008 and 2007, respectively.

NOTE 12 – ACCUMULATED OTHER COMPREHENSIVE INCOME

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Ending accumulated balances for each item in accumulated other comprehensive income are as follows:

| (in thousands) | Dec. 31, 2008 | Dec. 31, 2007 |
|--|------------------|------------------|
| Unrealized currency gain | \$810 | \$792 |
| Unrealized loss on marketable securities | (0) | (1) |
| Total accumulated other comprehensive income | \$810 | \$791 |

NOTE 13- INCOME TAXES

Data I/O accounts for income taxes using the liability method as prescribed by Statement of Financial Accounting Standards No.

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109, "Accounting for Income Taxes."

Components of income (loss) before taxes:

| (in thousands) | Year Ended Dec. 31, | |
|--------------------|---------------------|-------|
| | 2008 | 2007 |
| U.S. operations | \$2,718 | \$127 |
| Foreign operations | 2,490 | 713 |
| | \$5,208 | \$840 |

Income tax expense (benefit) consists of:

Current tax expense (benefit):

| | | |
|--------------|------|------|
| U.S. federal | \$39 | \$ - |
| State | 12 | 4 |
| Foreign | 28 | 4 |
| | 79 | 8 |

Deferred tax expense (benefit) – U.S. federal

| | | |
|------------------------------------|------|-----|
| | - | - |
| Total income tax expense (benefit) | \$79 | \$8 |

A reconciliation of Data I/O's effective income tax and the U.S. federal tax rate is as follows:

| | Year Ended Dec. 31, | |
|---|---------------------|-------|
| | 2008 | 2007 |
| Statutory tax | \$1,770 | \$286 |
| State and foreign income tax, net of federal income tax benefit | (760) | (255) |
| Valuation allowance for deferred tax assets | (931) | (23) |
| | \$79 | \$8 |

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The tax effects of temporary differences that gave rise to significant portions of the deferred tax assets are presented below (in thousands):

| | Dec. 31, 2008 | Dec. 31, 2007 |
|--|------------------|------------------|
| Deferred income tax assets: | | |
| Allowance for doubtful accounts | \$36 | \$32 |
| Inventory and product return reserves | 657 | 623 |
| Compensation accruals | 487 | 385 |
| Accrued liabilities | 89 | 157 |
| Book-over-tax depreciation and amortization | 366 | 442 |
| Foreign net operating loss carryforwards | 456 | 546 |
| U.S. net operating loss and credit carryforwards | 6,588 | 7,359 |
| Other, net | 2 | - |
| | 8,681 | 9,544 |
| Valuation allowance | (8,681) | (9,544) |
| Total deferred income tax assets | \$ - | \$ - |

The valuation allowance for deferred tax assets decreased \$862,000 and \$165,000 during the years ended December 31, 2008 and December 31, 2007, respectively, due primarily to book net income and reversal of deferred tax assets. The net deferred tax assets have a full valuation allowance provided due to uncertainty regarding Data I/O's ability to utilize such assets in future years. Although we have had recent profitable operations, this full valuation allowance evaluation is based upon our volatile history of losses and the current uncertain economic outlook for our industry and capital spending. Credit carryforwards consist primarily of research and experimental and alternative minimum tax credits. U.S. net operating loss carryforwards expire beginning in 2020 to 2029. Utilization of net operating loss and credit carryforwards is subject to certain limitations under Section 382 of the Internal Revenue Code of 1986, as amended.

We adopted the provisions of FIN 48 on January 1, 2007. FIN 48 clarifies the accounting and disclosure for uncertainty in income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. It also provides guidance on derecognition, measurement, classification, interest and penalties, accounting for interim periods, disclosure and transition, and clearly scopes income taxes out of Financial Accounting Standards Board Statement No. 5, Accounting for Contingencies. The adoption of FIN 48 had no impact on the Company's financial statements. There were \$71,000 and \$66,000 of unrecognized tax benefits as of December 31, 2008 and 2007, respectively.

Historically, the Company has not incurred any interest or penalties associated with tax matters and no interest or penalties were recognized during 2008. However, the Company has adopted a policy whereby amounts related to interest and penalties associated with tax matters are classified as general and administrative expense when incurred.

Tax years that remain open for examination include 2005, 2006, and 2007 in the United States of America. In addition, tax years from 1999 to 2004 may be subject to examination in the event that the Company utilizes the NOL's from those years in its current or future year tax return.

NOTE 14 – SEGMENT AND GEOGRAPHIC INFORMATION

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We consider our operations to be a single operating segment, focused on the design, manufacturing, and sale of programming systems used by designers and manufacturers of electron products.

During 2008 and 2007 there were no customers that accounted for 10% of Data I/O's consolidated net revenues for that year. Major operations outside the U.S. include sales and service support subsidiaries in Germany, Canada and China. At December 31, 2008 the combined subsidiaries accounts receivable of one customer represented 13.3% of our total consolidated accounts receivable balance and there were no other customers that represented 10% or more. At December 31, 2007, there were no customers that represented 10% or more of total consolidated accounts receivable balance.

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The following table summarizes information about geographic area:

| (in thousands) | Year Ended Dec. 31, 2008 | 2007 |
|--|-----------------------------|-----------|
| Net sales: | | |
| U.S. | \$4,070 | \$4,925 |
| Europe | 11,250 | 12,304 |
| Rest of World | 12,277 | 9,523 |
| | \$27,597 | \$26,752 |
| Included in Europe and Rest of World are the following significant balances: | | |
| Germany | \$6,137 | \$5,836 |
| China | \$3,205 | \$2,136 |
| Operating income (loss): | | |
| U.S. | \$1,411 | (\$1,105) |
| Europe | 1,298 | 2,236 |
| Rest of World | 2,528 | (366) |
| | \$5,237 | \$765 |
| Identifiable assets: | | |
| U.S. | \$14,814 | \$12,358 |
| Europe | 6,185 | 5,007 |
| Rest of World | 5,812 | 3,255 |
| | \$26,811 | \$20,620 |

NOTE 15 – LONG-TERM DEBT

On September 27, 2006, the Company entered into a five year capital lease agreement in the amount of \$591,145. The imputed interest rate is 7.69%.

At December 31, 2008 scheduled maturities of the capital lease obligation for the years ending December 31 are as follows (in thousands):

| | |
|---|--------|
| 2009 | \$141 |
| 2010 | 141 |
| 2011 | 94 |
| Thereafter | 0 |
| Total minimum lease payments | 376 |
| Less: Amount representing interest | (33) |
| Present value of capital lease obligation | 343 |
| Current portion long-term debt | (125) |
| Non-current portion long-term debt | \$ 218 |

NOTE 16 – GAIN ON SALE OF PATENTS

On March 18, 2008, the Company completed the sale of selected patents and patent applications to Leannoux Properties AG L.L.C. Net proceeds were approximately \$3.3 million with a net gain of approximately \$2.1 million.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

(a) Evaluation of disclosure controls and procedures.

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, Data I/O evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) under the Exchange Act) as of the end of the period covered by this report (the "Evaluation Date"). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the Evaluation Date, our disclosure controls and procedures were effective at the reasonable level of assurance level. Disclosure Controls are controls and procedures designed to reasonably assure that information required to be disclosed in our reports filed under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms. Disclosure Controls are also designed to reasonably assure that such information is accumulated and communicated to our management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

(b) Management's Report on Internal Control Over Financial Reporting.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control systems was designed to provide reasonable assurance to the Company's management and board of directors regarding the preparation and fair presentation of published financial statements. Internal control over financial reporting is defined in Rule 13a-15(f) promulgated under the Securities Exchange Act of 1934 and 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.

All internal controls, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statements preparation and presentation.

Our management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2008. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in Internal

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Control – Integrated Framework. Based on this assessment we concluded that, as of December 31, 2008, our internal control over financial reporting was effective.

This annual report does not include an attestation report of the company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the company's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the company to provide only management's report in this annual report.

(c) Changes in internal controls.

There were no changes made in our internal controls during the period covered by this report that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

Our continued restructuring actions decreased the number of personnel and reallocated tasks. We did not change our internal controls, however, these restructure actions may have an impact on our internal controls' operation which we will continue to monitor and evaluate.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

Information regarding the Registrant's directors is set forth under "Election of Directors" in Data I/O's Proxy Statement relating to Data I/O's annual meeting of shareholders to be held on May 14, 2009 and is incorporated herein by reference. Such Proxy Statement will be filed within 120 days of Data I/O's year-end. Information regarding the Registrant's executive officers is set forth in Item 1 of Part I herein under the caption "Executive Officers of the Registrant."

Code of Ethics

We have adopted an updated Code of Ethics that applies to all directors, officers and employees of Data I/O, including the Chief Executive Officer and Chief Financial Officer. The key principles of the Code of Ethics are to act legally and with integrity in all work for Data I/O. The Code of Ethics is posted on the corporate governance page of our website at <http://www.dataio.com/corporate/governance.asp>. We will post any amendments to our Code of Ethics on our website. In the unlikely event that the Board of Directors approves any sort of waiver to the Code of Ethics for our executive officers or directors, information concerning such waiver will also be posted on our website. In addition to posting information regarding amendments and waivers on our website, the same information will be included in a Current Report on Form 8-K within four business days following the date of the amendment or waiver, unless website posting of such amendments or waivers is permitted by the rules of The Nasdaq Stock Market, Inc.

Item 11. Executive Compensation

Information called for by Part III, Item 11, is included in Data I/O's Proxy Statement relating to Data I/O's annual meeting of shareholders to be held on May 14, 2009 and is incorporated herein by reference. The information appears in the Proxy Statement under the caption "Executive Compensation." Such Proxy Statement will be filed within 120 days of Data I/O's year-end.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information called for by Part III, Item 12, is included in Data I/O's Proxy Statement relating to Data I/O's annual meeting of shareholders to be held on May 14, 2009 and is incorporated herein by reference. The information appears in the Proxy Statement under the caption "Voting Securities and Principal Holders." Such Proxy Statement will be filed within 120 days of Data I/O's year-end.

Equity Compensation Plan Information

The following table gives information about our Common Stock that may be issued upon the exercise of options and rights under all of our existing equity compensation plans as of December 31, 2008. See Notes 10 and 11 of "Notes to Consolidated Financial Statements."

| | (a) Number of securities to be issued upon the exercise of outstanding options, warrants and rights | (b) Weighted-average exercise price of outstanding options, warrants and rights | (c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) |
|--|---|---|---|
| Equity compensation plans approved by security holders (1) (2) | 907,803 | \$3.57 | 435,484 |
| Equity compensation plans not approved by security holders | - | \$ - | - |
| Total | 907,803 | \$3.57 | 435,484 |

- (1) Represents shares of Data I/O's Common Stock issuable pursuant to our 2000 Stock Incentive Compensation Plan, 1986 Stock Option Plan, 1982 Employee Stock Purchase Plan, and 1996 Director Fee Plan.
- (2) Stock Appreciation Rights Plan ("SAR") provides that directors, executive officers or holders of 10% or more of Data I/O's Common Stock have an accompanying SAR with respect to each exercisable option. While the plan has been approved by the security holders, no amounts are included in columns (a), (b), or (c) relating to the SAR.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this item is contained in, and incorporated by reference from, the Proxy Statement for the Company's 2009 Annual Meeting of Shareholders under the caption "Certain Relationships and Related Transactions."

Item 14. Principle Accounting Fees and Services

The information required by this Item with respect to principal accountant fees and services is incorporated by reference to the section captioned "Principal Accountant's Fees and Services" in the Proxy Statement relating to Data I/O's annual meeting of shareholders to be held on May 14, 2009. Such Proxy Statement will be filed within 120 days of Data I/O's year-end.

PART IV

Item 15. Exhibits, Financial Statement Schedules

Executive Compensation Plans and Arrangements

The following list is a subset of the list of exhibits described below and contains all compensatory plans, contracts or arrangements in which any director or executive officer of Data I/O is a participant, unless the method of allocation of benefits thereunder is the same for management and non-management participants:

- (1) Amended and Restated 1982 Employee Stock Purchase Plan. See Exhibit 10.7.
- (2) Data I/O Corporation Tax Deferral Retirement Plan and Trust with Orchard Trust Company. See Exhibit 10.19 and 10.20.
- (3) Summary of Amended and Restated Management Incentive Compensation Plan. See Exhibit 10.2.
- (4) Amended and Restated 1983 Stock Appreciation Rights Plan. See Exhibit 10.1.
- (5) Amended and Restated 1986 Stock Option Plan. See Exhibit 10.5.
- (6) Form of Change in Control Agreements. See Exhibit 10.10 and 10.11.
- (7) 1996 Director Fee Plan. See Exhibit 10. 4.
- (8) Letter Agreement with Frederick R. Hume. See Exhibit 10. 6.
- (9) Amended and Restated 2000 Stock Compensation Incentive Plan. See Exhibit 10.8.

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- (10) Form of Option Agreement. See Exhibit 10.9.
- (11) Form of Performance Share Award Agreement. See Exhibit 10.15.
- (12) Harald Weigelt Employment Agreement. See Exhibit 10.23.

| | | |
|-----|--|--------------------|
| (a) | <u>List of Documents Filed as a Part of This Report:</u> | <u>Page</u> |
| (1) | <u>Index to Financial Statements:</u> | |
| | Report of Independent Registered Public Accounting Firm | 25 |
| | Consolidated Balance Sheets as of December 31, 2008 and 2007 | 26 |
| | Consolidated Statements of Operations for each of the two years ended December 31, 2008 | 27 |
| | Consolidated Statements of Cash Flows for each of the two years ended December 31, 2008 | 28 |
| | Consolidated Statement of Stockholders' Equity for each of the two years ended December 31, 2008 | 29 |
| | Notes to Consolidated Financial Statements | 30 |

(2) Index to Financial Statement Schedules:

Schedule II – Consolidated Valuation and Qualifying Accounts

All other schedules not listed above have been omitted because the required information is included in the consolidated financial statements or the notes thereto, or is not applicable or required.

(3) Index to Exhibits:

3 **Articles of Incorporation:**

- 3.1 Data I/O's restated Articles of Incorporation filed November 2, 1987 (Incorporated by reference to Exhibit 3.1 of Data I/O's 1987 Annual Report on Form 10-K (File No. 0-10394)).
- 3.2 Data I/O's Bylaws as amended and restated as of February 2006 (Incorporated by reference to Exhibit 3.2 of Data I/O's 2005 Annual Report on Form 10-K (File No. 0-10394)).
- 3.3 Certification of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock (Incorporated by reference to Exhibit 1 of Data I/O's Registration Statement on Form 8-A filed March 13, 1998 (File No. 0-10394)).

4 **Instruments Defining the Rights of Security Holders, Including Indentures:**

- 4.1 Rights Agreement, dated as of April 4, 1998, between Data I/O Corporation and ChaseMellon Shareholder Services, L.L.C. as Rights Agent, which includes: as Exhibit A thereto, the Form of Right Certificate; and, as Exhibit B thereto, the Summary of Rights to Purchase Series A Junior Participating Preferred Stock (Incorporated by reference to Data I/O's Current Report on Form 8-K filed on March 13, 1998).
- 4.2 Rights Agreement, dated as of March 31, 1988, between Data I/O Corporation and First Jersey National Bank, as Rights Agent, as amended by Amendment No. 1 thereto, dated as of May 28, 1992 and Amendment No. 2 thereto, dated as of July 16, 1997 (Incorporated by reference to Data I/O's Report on Form 8-K filed on March 13, 1998).
- 4.3 Amendment No. 1, dated as of February 10, 1999, to Rights Agreement, dated as of April 4, 1998, between Data I/O Corporation and ChaseMellon Shareholder Services, L.L.C. as Rights Agent (Incorporated by reference to Exhibit 4.1 of Data I/O's Form 8-A/A dated February 10, 1999).
- 4.4 Amendment No. 2 to Rights Agreement, dated as of April 3, 2008, between Data I/O Corporation and Mellon Investor Services LLC (formerly ChaseMellon Shareholder Services, L.L.C.). (Incorporated by reference to Exhibit 4.3 of Data I/O's Form 8-K dated April 3, 2008).

10 **Material Contracts:**

- 10.1 Amended and Restated 1983 Stock Appreciation Rights Plan dated February 3, 1993 (Incorporated by reference to Exhibit 10.23 of Data I/O's 1992 Annual Report on Form 10-K (File No. 0-10394)).

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- 10.2 Amended and Restated Management Incentive Compensation Plan dated January 1, 1997 (Incorporated by reference to Exhibit 10.25 of Data I/O's 1997 Annual Report on Form 10-K (File No. 0-10394)).
- 10.3 Amended and Restated Performance Bonus Plan dated January 1, 1997 (Incorporated by reference to Exhibit 10.26 of Data I/O's 1997 Annual Report on Form 10-K (File No. 0-10394)).
- 10.4 Amended and Restated Data I/O Corporation 1996 Director Fee Plan (Incorporated by reference to Exhibit 10.32 of Data I/O's 1997 Annual Report on Form 10-K (File No. 0-10394)).
- 10.5 Amended and Restated 1986 Stock Option Plan dated May 12, 1998 (Incorporated by reference to Exhibit 10.37 of Data I/O's 1998 Annual Report on Form 10-K (File No. 0-10394)).
- 10.6 Letter Agreement with Fred R. Hume dated January 29, 1999. (Incorporated by reference to Exhibit 10.35 of Data I/O's 1999 Annual Report on Form 10-K (File No. 0-10394)).
- 10.7 Amended and Restated 1982 Employee Stock Purchase Plan dated May 16, 2003
(Incorporated by reference to Data I/O's 2003 Proxy Statement dated March 31, 2003).
- 10.8 Amended and Restated 2000 Stock Compensation Incentive Plan dated May 20, 2004 (Incorporated by reference to Data I/O's 2004 Proxy Statement dated April 12, 2004).
- 10.9 Form of Option Agreement (Incorporated by reference to Data I/O's 2004 Annual Report on Form 10-K (File No. 0-10394)).
- 10.10 Change in Control Agreement with Fred R. Hume dated December 31, 2008
- 10.11 Change in Control Agreement with Joel S. Hatlen dated December 31, 2008
- 10.12 Harald Weigelt Employment Agreement (Incorporated by reference to Data I/O's 2005 Annual Report on Form 10-K (File No. 0-10394)).
- 10.13 Lease, Redmond East Business Campus between Data I/O Corporation and Carr Redmond PLCC dated February 28, 2006 (Incorporated by reference to Data I/O's 2005 Annual Report on Form 10K (File No. 0-10394)).
- 10.14 Amended and Restated 2000 Stock Compensation Incentive Plan dated May 24, 2006 (Incorporated by reference to Data I/O's 2006 Proxy Statement dated April 6, 2006).
- 10.15 Form of Performance Award Agreement (incorporated by reference to Exhibit 10.28 of Data I/O's June 30, 2006 Quarterly Report on Form 10-Q (File No. 0-10394)).

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10.16 Form of Restricted Stock Award Agreement (Incorporated by reference to Exhibit 10.29 of Data I/O's June 30, 2006 Quarterly Report on Form 10-Q (File No. 0-10394)).

10.17 Patent Purchase Agreement (Incorporated by reference to Data I/O's Current Report on Form 8-K filed on March 25, 2008).

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- 10.18 First Amendment to the Patent Purchase Agreement (Incorporated by reference to Data I/O's Current Report on Form 8-K filed on March 25, 2008).

- 10.19 Orchard Trust Company Defined Contribution Prototype Plan and Trust (Incorporated by reference to Data I/O's 2007 Annual Report on Form 10K (File No. 0-10394)).

- 10.20 Orchard Trust Company Non-standardized 401(k) Plan (Incorporated by reference to Data I/O's 2007 Annual Report on Form 10K (File No. 0-10394)).

- 21.1 Subsidiaries of the Registrant

- 23.1 Consent of Independent Registered Public Accounting Firm

31 **Certification – Section 302:**

- 31.1 Chief Executive Officer Certification
- 31.2 Chief Financial Officer Certification

32 **Certification – Section 906:**

- 32.1 Chief Executive Officer Certification
- 32.2 Chief Financial Officer Certification

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DATA I/O CORPORATION
(REGISTRANT)

DATED: March 27, 2009

By: //S//Frederick R. Hume
Frederick R. Hume
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| NAME & DATE | TITLE |
|--|--|
| By: <u>//S//Frederick R. Hume</u> Frederick R. Hume | President and Chief Executive Officer (Principal Executive Officer) |
| By: <u>//S//Joel S. Hatlen</u> Joel S. Hatlen (Principal Financial and Accounting Officer) | Chief Financial Officer Vice President of Finance Secretary, Treasurer |
| By: <u>//S//Paul A. Gary</u> Paul A. Gary | Director |
| By: <u>//S//Edward D. Lazowska</u> Edward D. Lazowska | Director |
| By: <u>//S//Daniel A. DiLeo</u> Daniel A. DiLeo | Director |

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By: //S//Steven M. Quist
Steven M. Quist

Director

By: //S//William R. Walker
William R. Walker

Director

DATA I/O CORPORATION

SCHEDULE II – CONSOLIDATED VALUATION AND QUALIFYING ACCOUNTS

| (in thousands) | Balance at Beginning of Period | Charged/ (Credited) to Costs and Expenses | Deductions- Describe | Balance at End of Period |
|--------------------------------|--------------------------------------|---|-------------------------|--------------------------------|
| Year Ended December 31, 2007 : | | | | |
| Allowance for bad debts | \$199 | \$11 | (\$80) ⁽¹⁾ | \$130 |
| Year Ended December 31, 2008: | | | | |
| Allowance for bad debts | \$130 | \$36 | (\$24) ⁽¹⁾ | \$142 |

⁽¹⁾ Uncollectable accounts written off, net of recoveries.

EXHIBIT 21.1**DATA I/O CORPORATION****SUBSIDIARIES OF THE REGISTRANT**

The following table indicates the name, jurisdiction of incorporation and basis of ownership of each of Data I/O's subsidiaries:

| <u>Name of Subsidiary</u> | <u>State or Jurisdiction of Organization</u> | <u>Percentage of Voting Securities Owned</u> |
|---|--|--|
| Data I/O International, Inc. | Washington | 100% |
| Data I/O FSC International, Inc. | Territory of Guam | 100% |
| Data I/O Canada Corporation | Canada | 100% |
| Data I/O China, Ltd | Hong Kong, China | 100% |
| Data I/O GmbH | Germany | 100% |
| RTD, Inc. (formerly Reel-Tech, Inc.) | Washington | 100% |
| Data I/O Electronics (Shanghai) Co. Ltd | China | 100% |
| Data I/O Programacao de Sistemas Ltda | Brazil | 100% |

EXHIBIT 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We have issued our report dated March 25, 2009, accompanying the consolidated financial statements and schedule included in the Annual Report of Data I/O Corporation on Form 10-K for the year ended December 31, 2008. We hereby consent to the incorporation by reference of said report in the Registration Statements of Data I/O Corporation on Form S-8 (File Nos. 002-76164, 002-86785, 002-98115, 002-78394, 33-95608, 33-66824, 33-42010, 33-26472, 33-54422, 333-20657, 333-55911, 33-02254, 33-03958, 333-107543, 333-81986, 333-48595, 333-121861 and 333-151006) and on Form S-3 (File No. 333-121566).

//s//GRANT THORNTON LLP

Seattle, Washington

March 25, 2009

Exhibit 10.10

AMENDED AND RESTATED

EXECUTIVE AGREEMENT

FOR

DATA I/O CORPORATION

This Amended and Restated Agreement (the "Agreement") is entered into this 31 day of December, 2008, by and between DATA I/O CORPORATION ("the Company") and Frederick R. Hume ("Executive"). Executive is an at-will employee of the Company. The Agreement was originally entered into March 22, 2007 and is being amended and restated to reflect revisions required by the provisions of Section 409A of the Internal Revenue Code, in addition to other amendments. The parties wish to provide Executive with severance benefits if Executive's employment is terminated in connection with a change in control in the Company and other payments in connection with a change of control. At the time of the execution of the original agreement, the Executive entered into the Company's form of Confidentiality and Non-Competition Agreement for executive officers.

NOW, THEREFORE, in consideration of the foregoing recitals and the covenants and conditions contained herein, the parties hereby agree as follows:

1. Change of Control.

(a) If, within the period commencing 80 days prior to the date of occurrence (the "Event Date") of a Control Event and ending on the first anniversary of the Event Date (the "Window"), the Company terminates Executive's employment (other than for Cause) or Executive resigns for Good Reason, the Company shall pay to Executive (1) the Severance Payment in immediately available funds and (2) expenses incurred, up to Twenty Thousand Dollars (\$20,000) for outplacement services or other job search expenses. If such termination occurs prior to the Control Event, the Severance Payment is due on the fifth day following the Event Date; if such termination occurs on or subsequent to the Event Date, the Severance Payment is due on the twentieth business day following the date of termination (the "Termination Date") or at a later date in order to comply with the provisions of Section 409A of the Internal Revenue Code. Outplacement expenses under Section 1(a)(2) above must be incurred and shall be paid no later than December 31st of the second calendar year following the calendar year of the Executive's termination of employment. For purposes of this Agreement, termination from employment shall mean a "separation from service" as defined under the default rules under the final Section 409A regulations.

(b) The Severance Payment shall be determined pursuant to the following formula:

$$[(B-A)/365] \times (C + D) \quad \text{where}$$

A = the number of days of continued full-time employment of Executive by the Company following the Event Date

B = 1 x 365

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C = Executive's annual base salary as of the Termination Date

D = the average of all cash bonuses that Executive received or is entitled to receive regarding the three most recent fiscal years of the Company during which Executive was employed by the Company in his or her current position for the entire year;

provided however, that unless the Company, its successors or assigns gives Executive six (6) months advance written notice of termination, the Severance Payment shall not be less than the amount computed as follows: $(0.5) \times (C + D)$.

(c) In addition to any payments which may be required pursuant to Section 1(a), upon the occurrence of a Control Event, the Company shall pay to Executive the Control Event Payment in immediately available funds. The Control Event Payment is due on the closing of the Control Event. The Control Even Payment shall equal the product of (1) 0.5 and (2) Executive's annual base salary as of the date immediately prior to the Control Event.

(d) Each of the following shall constitute a "Control Event":

(1) the acquisition of Common Stock of the Company (the "Common Stock") by any "Person" (as such term is defined in Section 1.21 of the Rights Agreement dated as of April 4, 1998 between the Corporation and Chase Mellon Shareholder Services L.L.C. (the "Rights Plan"), together with all Affiliates and Associates (as such terms are defined in Section 1.5 of the Rights Plan) of such Person, such that such Person becomes, after

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the date of this Agreement, the Beneficial Owner (as defined in the Rights Plan) of a majority of the shares of Common Stock then outstanding, but shall not include the Company, any subsidiary of the Company, any employee benefit plan of the Company or of any subsidiary of the Company, or any Person or entity organized, appointed or established by the Company for or pursuant to the terms of any such employee benefit plan; or

(2) the approval by the Company's shareholders (or, if later, approval by the shareholders of any Person) of any merger, consolidation, reorganization or other transaction providing for the conversion or exchange of more than fifty percent (50%) of the outstanding shares of Common Stock into securities of any Person, or cash, or property, or a combination of any of the foregoing; and

(e) Each of the following shall constitute "Good Reason", provided that it occurs during the Window, and provided further that Executive must provide notice to the Company within sixty (60) days of the existence of such condition and the Company will have thirty (30) days from receipt of such notice to remedy the condition. If the condition is not remedied within such 30 day period, the following conditions will constitute "Good Reason":

(1) the material diminution of Executive's position, duties, responsibilities or status with the Company or its successor, as compared with the position, duties, responsibilities or status of Executive with the Company immediately prior to the Event Date, except in connection with the termination of Executive for Cause;

(2) the Company's assignment of Executive on a substantially full-time basis to work at a location where the distance between the new location and Executive's principal residence is at least 35 miles greater than the distance between the former location and such residence; provided, however, that this paragraph shall not apply to travel in the furtherance of the Company's business to an extent substantially consistent with Executive's business travel obligations as of the date hereof;

(3) the Company's failure to obtain an assumption of the obligations of the Company to perform this Agreement by any successor to the Company;

(4) any material reduction in Executive's base salary, or a material reduction in benefits payable to Executive or failure of the Company to pay Executive any earned salary, bonus or benefits except with the prior written consent of Executive;

(5) the exclusion or limitation of Executive from participating in some form of variable compensation plan which provides the Executive the opportunity to achieve a level of total compensation (base salary plus variable compensation) consistent with what the Executive had the opportunity to earn at the Event Date; or

(6) any demand by any director or officer of the Company that Executive take any action or refrain from taking any action where such action or inaction, as the case may be, would violate any law, rule, regulation or other governmental pronouncement, court order, decree or judgment, or breach any agreement or fiduciary duty.

(f) Each of the following shall constitute "Cause":

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- (1) any violation by Executive of any material obligation under this Agreement or the attached Confidentiality and Non-Disclosure Agreement;
- (2) any action or failure to act by Executive which causes the Company to incur significant monetary damages;
- (3) conviction for commitment of a felony;
- (4) any violation of law which has a material, adverse effect on the Company;
- (5) habitual abuse of alcohol or a controlled substance;
- (6) theft or embezzlement from the Company;
- (7) repeated unexcused absence from work for reasons unrelated to short-term illnesses;
- (8) the failure by Executive substantially to achieve personal performance goals reasonably established by the board of directors or any officer to whom he/she reports other than where such failure is substantially attributable to factors beyond control of Executive;

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(9) Disability of Executive (as defined below); and

(10) repeated failure or refusal by Executive to carry out the reasonable directives, orders or resolutions of the Company's Board of Directors or any officer to whom he/she reports.

(g) "Disability" shall mean any physical, mental or other health condition which substantially impairs Executive's ability to perform his/her assigned duties for 90 days or more in any 180 day period or that can be expected to result in death. Any disagreement as to whether Executive is disabled shall be resolved by a physician selected by the Company after an examination of Executive. Executive hereby consents to such physical examination and to the examination of all medical records of Executive necessary, in the judgment of the examining physician, to make the determination of disability.

(h) Notwithstanding any other provision of this Agreement to the contrary, in the event that any severance or other payment, benefit or right payable or accruing to Executive hereunder or under the Company's 2000 Stock Compensation Incentive Plan or Amended and Restated 1986 Stock Option Plan ("Option Plan") would constitute a "parachute payment" as defined in Section 280G(b)(2) of the Internal Revenue Code of 1986, as amended (the "Code"), then the total amount of severance and other payments or benefits payable to Executive hereunder and under the Option Plan which is deemed to constitute a "parachute payment" shall not exceed and shall, if necessary, be reduced to an amount (the "Revised Severance Payment") equal to 2.99 times Executive's "base amount" as defined in Code Section 28G(b)(3). In the event of a disagreement between the Company and Executive as to whether the provisions of Code section 280G are applicable or the amount of the Revised Severance Payment, such determination shall be made by the Company's independent public accountants or, if such firm is unable or unwilling to render such a determination, then by a law firm mutually acceptable to Executive and the Company. All costs relating to such determination shall be borne by the Company. The Company and the Executive shall cooperate in good faith to make the determination required by this Section 1(h) by mutual agreement not later than the later of: (i) the fifth day preceding the date that the Severance Payment is or would be due or (ii) the earlier of (x) the tenth day following the expiration of any period of accelerated vesting of options to purchase the Company's Common Stock provided by Section 5(n) of the Option Plan or (y) the tenth day following the date of exercise by Executive of his or her last remaining option which was exercisable solely due to the application of Section 5(n) of the Option Plan. Pending the final calculation of the Severance Payment or Revised Severance Payment, the Company shall pay the amounts described under subsection (b) above at the time and in the manner provided herein; provided that, pending such determination, such payments shall be reduced by such amounts as the Company estimates in good faith to be necessary to satisfy its tax (including excise tax) withholding obligations and effect the reduction in the amount of the Severance Payment, as contemplated by this Subsection 1(h). The aggregate amount of any compensation actually paid or provided to Executive under the terms of this Agreement and in excess of the Revised Severance Payment shall be deemed, to the extent of such excess, a loan to Executive payable upon demand and bearing interest at the rate of 8% per annum.

2. Confidentiality and Non-Competition Agreement. In consideration of the obligations undertaken by the Company pursuant to this Agreement, contemporaneously with the execution of this Agreement, Executive and the Company have entered into the form of Confidentiality and Non-Competition Agreement attached hereto as Exhibit A and each agreement shall be effective only if both agreements have been executed.

3. Term of Agreement.

The Company's obligations under Section 1 of this Agreement shall expire with respect to Control Events occurring on or after the third anniversary of the date of this Agreement unless the term hereof is extended by the Board of Directors of the Company by a majority vote of those members of the Board who are not parties to this or a similar agreement.

4. At Will Employment. Unless and to the extent otherwise agreed by the Company and Executive in a separate written employment agreement, Executive's employment shall be "at will", with either party permitted to terminate the employment at any time, with or without cause. No term of any employment agreement between the Company and Executive shall be construed to conflict with, lessen or expand the

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obligations of the parties under this Agreement.

5. Notices. All notices and other communications called for or required by this Agreement shall be in writing and shall be addressed to the parties at their respective addresses stated below or to such other address as a party may subsequently specify by written notice and shall be deemed to have been received (i) upon delivery in person, (ii) five days after mailing it by U.S. certified or registered mail, return receipt requested and postage prepaid, or (iii) two days after depositing it with a commercial overnight carrier which provides written verification of delivery:

To the Company: 6464 185th Ave NE, Suite 101
 Redmond, Washington 98052
 Attention: General Counsel or Corporate Secretary

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To Executive: Frederick R. Hume
11415 178th Place NE
Redmond, WA 98052

6. Withholding. Except as described in subsection 1(h) of this Agreement, all payments due to and all benefits to be provided to Executive hereunder shall be subject to reduction for any applicable withholding taxes, including excise taxes.

7. Assignment. Executive's rights and duties hereunder are personal to Executive and are not assignable to others, but Executive's obligations hereunder will bind his/her heirs, successors, and assigns. The Company may assign its rights under this Agreement in connection with any merger or consolidation of the Company or any sale of all or any portion of the Company's assets (including, without limitation, any division or product line), provided that any such successor or assignee expressly assumes in writing the Company's obligations hereunder.

8. No Duty to Mitigate. Executive shall not be required to mitigate the amount of any payment made or benefit provided hereunder. The Company may offset any payment due hereunder by the amount of damages to the Company resulting from any breach of this Agreement by Executive.

9. General. This Agreement constitutes the exclusive agreement of the parties with respect to the subject matter hereof and supersedes all prior agreements or understandings of the parties. No waiver of or forbearance to enforce any right or provision hereof shall be binding unless in writing and signed by the party to be bound, and no such waiver or forbearance in any instance shall apply to any other instance or to any other right or provision. This Agreement will be governed by the local laws of the State of Washington without regard to its conflicts of laws rules to the contrary. The parties hereby consent to the exclusive jurisdiction and venue of the state and federal courts sitting in King County, Washington for all matters and actions arising under this Agreement. The prevailing party shall be entitled to reasonable attorneys' fees and costs incurred in connection with such litigation. No term hereof shall be construed to limit or supersede any other right or remedy of the Company under applicable law with respect to the protection of trade secrets or otherwise. If any provision of this Agreement is held to be invalid or unenforceable to any extent in any context, it shall nevertheless be enforced to the fullest extent allowed by law in that and other contexts, and the validity and force of the remainder of this Agreement shall not be affected thereby.

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IN WITNESS WHEREOF, the parties have caused this Agreement to be signed as of the date first above written.

DATA I/O CORPORATION

EXECUTIVE:

By: _____
Name: Joel Hatlen
Its: Vice President / CFO

Signature: _____
Name: Frederick R. Hume

Exhibit A

**CONFIDENTIALITY AND NON-COMPETITION AGREEMENT
FOR
DATA I/O CORPORATION**

This Agreement is entered into this 22nd day of March, 2007, by and between DATA I/O CORPORATION ("the Company") and Frederick R. Hume ("Executive"). Executive is an at-will employee of the Company. In consideration of entering into an agreement to provide Executive with severance benefits if Executive's employment is terminated in connection with a change in control in the Company, Executive promises, on the terms set forth herein, at all times to protect the Company's proprietary information and to not compete with the Company following termination of Executive's employment in connection with a change in control.

NOW, THEREFORE, in consideration of the foregoing recitals and the covenants and conditions contained herein, the parties hereby agree as follows:

1. Intellectual Properties.

(a) All ownership, copyright, patent, trade secrecy, and other rights in all works, programs, software, fixes, routines, inventions, ideas, designs, manuals, improvements, discoveries, processes, customer lists or other properties (the "Intellectual Properties") made or conceived by Executive during the term of his/her employment by the Company shall be the rights and property solely of the Company, whether developed independently by Executive or jointly with others, and whether or not developed or conceived during regular working hours or at the Company's facilities, and whether or not the Company uses, registers, or markets the same.

(b) In accordance with the Company's policy and Washington law, this Agreement (other than Subsection 1(c)) does not apply to, and Executive has no obligation to assign to the Company, any invention for which no Company trade secrets and no equipment, supplies, or facilities of the Company were used and which was developed entirely on Executive's own time, unless: (i) the invention relates directly to the business of the Company, (ii) the invention relates to actual or demonstrably anticipated research or development work of the Company, or (iii) the invention results from any work performed by Executive for the Company.

(c) If and to the extent that Executive makes use, in the course of his/her employment, of any items or Intellectual Properties previously developed by Executive or developed by Executive outside of the scope of this Agreement, Executive hereby grants the Company a nonexclusive, royalty-free, perpetual, irrevocable, worldwide license (with right to sublicense) to make, use, sell, copy, distribute, modify, and otherwise to practice and exploit any and all such items and Intellectual Properties.

(d) Executive will assist the Company as reasonably requested during and after the term of his/her employment to further evidence and perfect, and to enforce, the Company's rights in and ownership of the Intellectual Properties covered hereby, including without limitation, the execution of additional instruments of conveyance and assisting the Company with applications for patents or copyright or other registrations.

2. Trade Secrets and Confidential Information.

(a) Executive acknowledges that the Company's business and future success depends on the preservation of the trade secrets and other confidential information of the Company and its suppliers and customers (the "Secrets"). The Secrets may include, without limitation, existing and to-be-developed or acquired product designs, new product plans or ideas, market surveys, the identities of past, present or potential customers, business and financial information, pricing methods or data, terms of contracts with present or past customers, proposals or bids, marketing plans, personnel information, procedural and technical manuals and practices, servicing routines, and parts and supplier lists proprietary to the Company or its customers or suppliers, and any other sorts of items or information of the Company or its customers or suppliers which are not generally known to the public at large. Executive agrees to protect and to preserve as confidential during and after the term of his/her employment all of the Secrets at any time known to Executive or in his/her possession or control (whether wholly or partially developed by Executive or provided to Executive, and whether embodied in a tangible medium or merely remembered).

(b) Executive shall mark all items containing any of the Secrets with prominent confidentiality notices acceptable to the Company. Executive shall neither use nor allow any other person to use any of the Secrets in any way, except for the benefit of the Company and as directed by Executive's supervisor. All material containing or disclosing any portion of the Secrets shall be and remain the property of the Company, shall not be removed from the Company's premises without specific consent from an officer of the Company, and shall be returned to the Company upon the termination of Executive's employment or the earlier request Executive's supervisor. At such time, Executive shall also assemble all materials in his possession or control which contain

any of the Secrets, and promptly deliver such items to the Company.

3. Authority and Non-Infringement. Executive warrants that any and all items, technology, and Intellectual Properties of any nature developed or provided by Executive under this Agreement and in any way for or related to the Company will be original to Executive and will not, as provided to the Company or when used and exploited by the Company and its contractors and customers and its and their successors and assigns, infringe in any respect on the rights or property of Executive or any third party. Executive will not, without the prior written approval of the Company, use any equipment, supplies, facilities, or proprietary information of any other party. Executive warrants that Executive is fully authorized to enter into employment with the Company and to perform under this Agreement, without conflicting with any of Executive's other commitments, agreements, understandings or duties, whether to prior employers or otherwise. Executive will indemnify the Company for all losses, claims, and expenses (including reasonable attorneys' fees) arising from any breach of by him/her of this Agreement.

4. Non-competition and Non-solicitation.

(a) Executive agrees that during the term of his/her employment with the Company and, if Executive receives the Severance Payment (as defined below), until the first anniversary of the Termination Date (as defined below), he/she will not in any capacity directly or indirectly engage in, assist others to engage in or own a material interest in any business or activity that is, or is preparing to be, in competition with the Company with respect to any product or service sold or service provided by the Company up to the time of termination of employment in any geographical area in which at the time of termination of employment such product or service is sold or actively is engaged in. For the purposes of this Agreement, the terms "Severance Payment" and "Termination Date" shall have the meanings assigned to them in the Executive Agreement (as defined in Section 6 below).

(b) Executive further agrees that during the period stated above, he/she will not directly or indirectly call on, reveal the name of, or otherwise solicit, accept business from or attempt to entice away from the Company any actual or identified potential customer of the Company, nor will he/she assist others in doing so. Executive further agrees that he/she will not, during the period stated above, encourage or solicit any other employee or consultant of the Company to leave such employment for any reason, nor will he/she assist others to do so.

(c) Executive acknowledges that the covenants in this section are necessary and reasonable to protect the Company in the conduct of its business and that compliance with such covenants will not prevent him/her from pursuing his/her livelihood. However, should any court find that any provision of such covenants is unreasonable, invalid or unenforceable, whether in period of time, geographical area, or otherwise, then in that event the parties hereby agree that such covenants shall be interpreted and enforced to the maximum extent which the court deems reasonable.

5. Remedies. The harm to the Company from any breach of Executive's obligations under this Agreement may be difficult to determine and may be wholly or partially irreparable, and Executive agrees that such obligations may be enforced by injunctive relief and other appropriate remedies, as well as by damages. If any bond from the Company is required in connection with such enforcement, the parties agree that a reasonable value of such bond shall be \$5,000. Any amounts received by Executive or by any other through Executive in breach of this Agreement shall be held in constructive trust for the benefit of the Company.

6. Executive Agreement. In consideration of the obligations undertaken by Executive pursuant to this Agreement, contemporaneously with the execution of this Agreement, Executive and the Company shall enter into the form of Executive Agreement to which this Agreement is attached (the "Executive Agreement"), and each agreement shall be effective only if both agreements have been executed.

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7. At Will Employment. Unless and to the extent otherwise agreed by the Company and Executive in a separate written employment agreement, Executive's employment shall be "at will", with either party permitted to terminate the employment at any time, with or without cause. No term of any employment agreement between the Company and Executive shall be construed to conflict with or lessen Executive's obligations under this Agreement.

8. Notices. All notices and other communications called for or required by this Agreement shall be in writing and shall be addressed to the parties at their respective addresses stated below or to such other address as a party may subsequently specify by written notice and shall be deemed to have been received (i) upon delivery in person, (ii) five days after mailing it by U.S. certified or registered mail, return receipt requested and postage prepaid, or (iii) two days after depositing it with a commercial overnight carrier which provides written verification of delivery:

To the Company: 6464 185th Ave NE, Suite 101
 Redmond, Washington 98052
 Attention: General Counsel and Corporate Secretary

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To Executive: 11415 178th Place NE
Redmond, WA 98052

9. Assignment. Executive's rights and duties hereunder are personal to Executive and are not assignable to others, but Executive's obligations hereunder will bind his/her heirs, successors, and assigns. The Company may assign its rights under this Agreement in connection with any merger or consolidation of the Company or any sale of all or any portion of the Company's assets (including, without limitation, any division or product line), provided that any such successor or assignee expressly assumes in writing the Company's obligations under the Executive Agreement.

10. General. This Agreement constitutes the exclusive agreement of the parties with respect to the subject matter hereof and supersedes all prior agreements or understandings of the parties. No waiver of or forbearance to enforce any right or provision hereof shall be binding unless in writing and signed by the party to be bound, and no such waiver or forbearance in any instance shall apply to any other instance or to any other right or provision. This Agreement will be governed by the local laws of the State of Washington without regard to its conflicts of laws rules to the contrary. The parties hereby consent to the exclusive jurisdiction and venue of the state and federal courts sitting in King County, Washington for all matters and actions arising under this Agreement. The prevailing party shall be entitled to reasonable attorneys' fees and costs incurred in connection with such litigation. No term hereof shall be construed to limit or supersede any other right or remedy of the Company under applicable law with respect to the protection of trade secrets or otherwise. If any provision of this Agreement is held to be invalid or unenforceable to any extent in any context, it shall nevertheless be enforced to the fullest extent allowed by law in that and other contexts, and the validity and force of the remainder of this Agreement shall not be affected thereby.

IN WITNESS WHEREOF, the parties have caused this Agreement to be signed as of the date first above written.

DATA I/O CORPORATION

EXECUTIVE:

By: _____
Its: Vice President / CFO

Signature: _____
Name, printed: Frederick R. Hume

Exhibit 10.11

AMENDED AND RESTATED

EXECUTIVE AGREEMENT

FOR

DATA I/O CORPORATION

This Amended and Restated Agreement (the "Agreement") is entered into this 31 day of December, 2008, by and between DATA I/O CORPORATION ("the Company") and Joel S. Hatlen ("Executive"). Executive is an at-will employee of the Company. The Agreement was originally entered into March 22, 2007 and is being amended and restated to reflect revisions required by the provisions of Section 409A of the Internal Revenue Code, in addition to other amendments. The parties wish to provide Executive with severance benefits if Executive's employment is terminated in connection with a change in control in the Company and other payments in connection with a change of control. At the time of the execution of the original agreement, the Executive entered into the Company's form of Confidentiality and Non-Competition Agreement for executive officers.

NOW, THEREFORE, in consideration of the foregoing recitals and the covenants and conditions contained herein, the parties hereby agree as follows:

1. Change of Control.

(a) If, within the period commencing 80 days prior to the date of occurrence (the "Event Date") of a Control Event and ending on the first anniversary of the Event Date (the "Window"), the Company terminates Executive's employment (other than for Cause) or Executive resigns for Good Reason, the Company shall pay to Executive (1) the Severance Payment in immediately available funds and (2) expenses incurred, up to Twenty Thousand Dollars (\$20,000) for outplacement services or other job search expenses. If such termination occurs prior to the Control Event, the Severance Payment is due on the fifth day following the Event Date; if such termination occurs on or subsequent to the Event Date, the Severance Payment is due on the twentieth business day following the date of termination (the "Termination Date") or at a later date in order to comply with the provisions of Section 409A of the Internal Revenue Code. Outplacement expenses under Section 1(a)(2) above must be incurred and shall be paid no later than December 31st of the second calendar year following the calendar year of the Executive's termination of employment. For purposes of this Agreement, termination from employment shall mean a "separation from service" as defined under the default rules under the final Section 409A regulations.

(b) The Severance Payment shall be determined pursuant to the following formula:

$$[(B-A)/365] \times (C + D) \quad \text{where}$$

A = the number of days of continued full-time employment of Executive by the Company following the Event Date

B = 1 x 365

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C = Executive's annual base salary as of the Termination Date

D = the average of all cash bonuses that Executive received or is entitled to receive regarding the three most recent fiscal years of the Company during which Executive was employed by the Company in his or her current position for the entire year;

provided however, that unless the Company, its successors or assigns gives Executive six (6) months advance written notice of termination, the Severance Payment shall not be less than the amount computed as follows: $(0.5) \times (C + D)$.

(c) In addition to any payments which may be required pursuant to Section 1(a), upon the occurrence of a Control Event, the Company shall pay to Executive the Control Event Payment in immediately available funds. The Control Event Payment is due on the closing of the Control Event. The Control Even Payment shall equal the product of (1) 0.5 and (2) Executive's annual base salary as of the date immediately prior to the Control Event.

(d) Each of the following shall constitute a "Control Event":

(1) the acquisition of Common Stock of the Company (the "Common Stock") by any "Person" (as such term is defined in Section 1.21 of the Rights Agreement dated as of April 4, 1998 between the Corporation and Chase Mellon Shareholder Services L.L.C. (the "Rights Plan"), together with all Affiliates and Associates (as such terms are defined in Section 1.5 of the Rights Plan) of such Person, such that such Person becomes, after the date of this Agreement, the Beneficial Owner (as defined in the Rights Plan) of a majority of the shares

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of Common Stock then outstanding, but shall not include the Company, any subsidiary of the Company, any employee benefit plan of the Company or of any subsidiary of the Company, or any Person or entity organized, appointed or established by the Company for or pursuant to the terms of any such employee benefit plan; or

(2) the approval by the Company's shareholders (or, if later, approval by the shareholders of any Person) of any merger, consolidation, reorganization or other transaction providing for the conversion or exchange of more than fifty percent (50%) of the outstanding shares of Common Stock into securities of any Person, or cash, or property, or a combination of any of the foregoing; and

(e) Each of the following shall constitute "Good Reason", provided that it occurs during the Window, and provided further that Executive must provide notice to the Company within sixty (60) days of the existence of such condition and the Company will have thirty (30) days from receipt of such notice to remedy the condition. If the condition is not remedied within such 30 day period, the following conditions will constitute "Good Reason":

(1) the material diminution of Executive's position, duties, responsibilities or status with the Company or its successor, as compared with the position, duties, responsibilities or status of Executive with the Company immediately prior to the Event Date, except in connection with the termination of Executive for Cause;

(2) the Company's assignment of Executive on a substantially full-time basis to work at a location where the distance between the new location and Executive's principal residence is at least 35 miles greater than the distance between the former location and such residence; provided, however, that this paragraph shall not apply to travel in the furtherance of the Company's business to an extent substantially consistent with Executive's business travel obligations as of the date hereof;

(3) the Company's failure to obtain an assumption of the obligations of the Company to perform this Agreement by any successor to the Company;

(4) any material reduction in Executive's base salary, or a material reduction in benefits payable to Executive or failure of the Company to pay Executive any earned salary, bonus or benefits except with the prior written consent of Executive;

(5) the exclusion or limitation of Executive from participating in some form of variable compensation plan which provides the Executive the opportunity to achieve a level of total compensation (base salary plus variable compensation) consistent with what the Executive had the opportunity to earn at the Event Date; or

(6) any demand by any director or officer of the Company that Executive take any action or refrain from taking any action where such action or inaction, as the case may be, would violate any law, rule, regulation or other governmental pronouncement, court order, decree or judgment, or breach any agreement or fiduciary duty.

(f) Each of the following shall constitute "Cause":

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- (1) any violation by Executive of any material obligation under this Agreement or the attached Confidentiality and Non-Disclosure Agreement;

- (2) any action or failure to act by Executive which causes the Company to incur significant monetary damages;

- (3) conviction for commitment of a felony;

- (4) any violation of law which has a material, adverse effect on the Company;

- (5) habitual abuse of alcohol or a controlled substance;

- (6) theft or embezzlement from the Company;

- (7) repeated unexcused absence from work for reasons unrelated to short-term illnesses;

- (8) the failure by Executive substantially to achieve personal performance goals reasonably established by the board of directors or any officer to whom he/she reports other than where such failure is substantially attributable to factors beyond control of Executive;

- (9) Disability of Executive (as defined below); and

(10) repeated failure or refusal by Executive to carry out the reasonable directives, orders or resolutions of the Company's Board of Directors or any officer to whom he/she reports.

(g) "Disability" shall mean any physical, mental or other health condition which substantially impairs Executive's ability to perform his/her assigned duties for 90 days or more in any 180 day period or that can be expected to result in death. Any disagreement as to whether Executive is disabled shall be resolved by a physician selected by the Company after an examination of Executive. Executive hereby consents to such physical examination and to the examination of all medical records of Executive necessary, in the judgment of the examining physician, to make the determination of disability.

(h) Notwithstanding any other provision of this Agreement to the contrary, in the event that any severance or other payment, benefit or right payable or accruing to Executive hereunder or under the Company's 2000 Stock Compensation Incentive Plan or Amended and Restated 1986 Stock Option Plan ("Option Plan") would constitute a "parachute payment" as defined in Section 280G(b)(2) of the Internal Revenue Code of 1986, as amended (the "Code"), then the total amount of severance and other payments or benefits payable to Executive hereunder and under the Option Plan which is deemed to constitute a "parachute payment" shall not exceed and shall, if necessary, be reduced to an amount (the "Revised Severance Payment") equal to 2.99 times Executive's "base amount" as defined in Code Section 28G(b)(3). In the event of a disagreement between the Company and Executive as to whether the provisions of Code section 280G are applicable or the amount of the Revised Severance Payment, such determination shall be made by the Company's independent public accountants or, if such firm is unable or unwilling to render such a determination, then by a law firm mutually acceptable to Executive and the Company. All costs relating to such determination shall be borne by the Company. The Company and the Executive shall cooperate in good faith to make the determination required by this Section 1(h) by mutual agreement not later than the later of: (i) the fifth day preceding the date that the Severance Payment is or would be due or (ii) the earlier of (x) the tenth day following the expiration of any period of accelerated vesting of options to purchase the Company's Common Stock provided by Section 5(n) of the Option Plan or (y) the tenth day following the date of exercise by Executive of his or her last remaining option which was exercisable solely due to the application of Section 5(n) of the Option Plan. Pending the final calculation of the Severance Payment or Revised Severance Payment, the Company shall pay the amounts described under subsection (b) above at the time and in the manner provided herein; provided that, pending such determination, such payments shall be reduced by such amounts as the Company estimates in good faith to be necessary to satisfy its tax (including excise tax) withholding obligations and effect the reduction in the amount of the Severance Payment, as contemplated by this Subsection 1(h). The aggregate amount of any compensation actually paid or provided to Executive under the terms of this Agreement and in excess of the Revised Severance Payment shall be deemed, to the extent of such excess, a loan to Executive payable upon demand and bearing interest at the rate of 8% per annum.

2. Confidentiality and Non-Competition Agreement. In consideration of the obligations undertaken by the Company pursuant to this Agreement, contemporaneously with the execution of this Agreement, Executive and the Company have entered into the form of Confidentiality and Non-Competition Agreement attached hereto as Exhibit A and each agreement shall be effective only if both agreements have been executed.

3. Term of Agreement.

The Company's obligations under Section 1 of this Agreement shall expire with respect to Control Events occurring on or after the third anniversary of the date of this Agreement unless the term hereof is extended by the Board of Directors of the Company by a majority vote of those members of the Board who are not parties to this or a similar agreement.

4. At Will Employment. Unless and to the extent otherwise agreed by the Company and Executive in a separate written employment agreement, Executive's employment shall be "at will", with either party permitted to terminate the employment at any time, with or without cause. No term of any employment agreement between the Company and Executive shall be construed to conflict with, lessen or expand the obligations of the parties under this Agreement.

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5. Notices. All notices and other communications called for or required by this Agreement shall be in writing and shall be addressed to the parties at their respective addresses stated below or to such other address as a party may subsequently specify by written notice and shall be deemed to have been received (i) upon delivery in person, (ii) five days after mailing it by U.S. certified or registered mail, return receipt requested and postage prepaid, or (iii) two days after depositing it with a commercial overnight carrier which provides written verification of delivery:

To the Company: 6464 185th Ave NE, Suite 101
 Redmond, Washington 98052
 Attention: General Counsel or Corporate Secretary

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To Executive: Joel S. Hatlen
3011 197th Ave SE
Sammamish, WA 98075

6. Withholding. Except as described in subsection 1(h) of this Agreement, all payments due to and all benefits to be provided to Executive hereunder shall be subject to reduction for any applicable withholding taxes, including excise taxes.

7. Assignment. Executive's rights and duties hereunder are personal to Executive and are not assignable to others, but Executive's obligations hereunder will bind his/her heirs, successors, and assigns. The Company may assign its rights under this Agreement in connection with any merger or consolidation of the Company or any sale of all or any portion of the Company's assets (including, without limitation, any division or product line), provided that any such successor or assignee expressly assumes in writing the Company's obligations hereunder.

8. No Duty to Mitigate. Executive shall not be required to mitigate the amount of any payment made or benefit provided hereunder. The Company may offset any payment due hereunder by the amount of damages to the Company resulting from any breach of this Agreement by Executive.

9. General. This Agreement constitutes the exclusive agreement of the parties with respect to the subject matter hereof and supersedes all prior agreements or understandings of the parties. No waiver of or forbearance to enforce any right or provision hereof shall be binding unless in writing and signed by the party to be bound, and no such waiver or forbearance in any instance shall apply to any other instance or to any other right or provision. This Agreement will be governed by the local laws of the State of Washington without regard to its conflicts of laws rules to the contrary. The parties hereby consent to the exclusive jurisdiction and venue of the state and federal courts sitting in King County, Washington for all matters and actions arising under this Agreement. The prevailing party shall be entitled to reasonable attorneys' fees and costs incurred in connection with such litigation. No term hereof shall be construed to limit or supersede any other right or remedy of the Company under applicable law with respect to the protection of trade secrets or otherwise. If any provision of this Agreement is held to be invalid or unenforceable to any extent in any context, it shall nevertheless be enforced to the fullest extent allowed by law in that and other contexts, and the validity and force of the remainder of this Agreement shall not be affected thereby.

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IN WITNESS WHEREOF, the parties have caused this Agreement to be signed as of the date first above written.

DATA I/O CORPORATION

EXECUTIVE:

By: _____
Name: Frederick R. Hume
Its: President / CEO

Signature: _____
Name: Joel S. Hatlen

Exhibit A

**CONFIDENTIALITY AND NON-COMPETITION AGREEMENT
FOR
DATA I/O CORPORATION**

This Agreement is entered into this 22nd day of March, 2007, by and between DATA I/O CORPORATION ("the Company") and Joel S. Hatlen ("Executive"). Executive is an at-will employee of the Company. In consideration of entering into an agreement to provide Executive with severance benefits if Executive's employment is terminated in connection with a change in control in the Company, Executive promises, on the terms set forth herein, at all times to protect the Company's proprietary information and to not compete with the Company following termination of Executive's employment in connection with a change in control.

NOW, THEREFORE, in consideration of the foregoing recitals and the covenants and conditions contained herein, the parties hereby agree as follows:

1. Intellectual Properties.

(a) All ownership, copyright, patent, trade secrecy, and other rights in all works, programs, software, fixes, routines, inventions, ideas, designs, manuals, improvements, discoveries, processes, customer lists or other properties (the "Intellectual Properties") made or conceived by Executive during the term of his/her employment by the Company shall be the rights and property solely of the Company, whether developed independently by Executive or jointly with others, and whether or not developed or conceived during regular working hours or at the Company's facilities, and whether or not the Company uses, registers, or markets the same.

(b) In accordance with the Company's policy and Washington law, this Agreement (other than Subsection 1(c)) does not apply to, and Executive has no obligation to assign to the Company, any invention for which no Company trade secrets and no equipment, supplies, or facilities of the Company were used and which was developed entirely on Executive's own time, unless: (i) the invention relates directly to the business of the Company, (ii) the invention relates to actual or demonstrably anticipated research or development work of the Company, or (iii) the invention results from any work performed by Executive for the Company.

(c) If and to the extent that Executive makes use, in the course of his/her employment, of any items or Intellectual Properties previously developed by Executive or developed by Executive outside of the scope of this Agreement, Executive hereby grants the Company a nonexclusive, royalty-free, perpetual, irrevocable, worldwide license (with right to sublicense) to make, use, sell, copy, distribute, modify, and otherwise to practice and exploit any and all such items and Intellectual Properties.

(d) Executive will assist the Company as reasonably requested during and after the term of his/her employment to further evidence and perfect, and to enforce, the Company's rights in and ownership of the Intellectual Properties covered hereby, including without limitation, the execution of additional instruments of conveyance and assisting the Company with applications for patents or copyright or other registrations.

2. Trade Secrets and Confidential Information.

(a) Executive acknowledges that the Company's business and future success depends on the preservation of the trade secrets and other confidential information of the Company and its suppliers and customers (the "Secrets"). The Secrets may include, without limitation, existing and to-be-developed or acquired product designs, new product plans or ideas, market surveys, the identities of past, present or potential customers, business and financial information, pricing methods or data, terms of contracts with present or past customers, proposals or bids, marketing plans, personnel information, procedural and technical manuals and practices, servicing routines, and parts and supplier lists proprietary to the Company or its customers or suppliers, and any other sorts of items or information of the Company or its customers or suppliers which are not generally known to the public at large. Executive agrees to protect and to preserve as confidential during and after the term of his/her employment all of the Secrets at any time known to Executive or in his/her possession or control (whether wholly or partially developed by Executive or provided to Executive, and whether embodied in a tangible medium or merely remembered).

(b) Executive shall mark all items containing any of the Secrets with prominent confidentiality notices acceptable to the Company. Executive shall neither use nor allow any other person to use any of the Secrets in any way, except for the benefit of the Company and as directed by Executive's supervisor. All material containing or disclosing any portion of the Secrets shall be and remain the property of the Company, shall not be removed from the Company's premises without specific consent from an officer of the Company, and shall be returned to the Company upon the termination of Executive's employment or the earlier request Executive's supervisor. At such time, Executive shall also assemble all materials in his possession or control which contain

any of the Secrets, and promptly deliver such items to the Company.

3. Authority and Non-Infringement. Executive warrants that any and all items, technology, and Intellectual Properties of any nature developed or provided by Executive under this Agreement and in any way for or related to the Company will be original to Executive and will not, as provided to the Company or when used and exploited by the Company and its contractors and customers and its and their successors and assigns, infringe in any respect on the rights or property of Executive or any third party. Executive will not, without the prior written approval of the Company, use any equipment, supplies, facilities, or proprietary information of any other party. Executive warrants that Executive is fully authorized to enter into employment with the Company and to perform under this Agreement, without conflicting with any of Executive's other commitments, agreements, understandings or duties, whether to prior employers or otherwise. Executive will indemnify the Company for all losses, claims, and expenses (including reasonable attorneys' fees) arising from any breach of by him/her of this Agreement.

4. Non-competition and Non-solicitation.

(a) Executive agrees that during the term of his/her employment with the Company and, if Executive receives the Severance Payment (as defined below), until the first anniversary of the Termination Date (as defined below), he/she will not in any capacity directly or indirectly engage in, assist others to engage in or own a material interest in any business or activity that is, or is preparing to be, in competition with the Company with respect to any product or service sold or service provided by the Company up to the time of termination of employment in any geographical area in which at the time of termination of employment such product or service is sold or actively is engaged in. For the purposes of this Agreement, the terms "Severance Payment" and "Termination Date" shall have the meanings assigned to them in the Executive Agreement (as defined in Section 6 below).

(b) Executive further agrees that during the period stated above, he/she will not directly or indirectly call on, reveal the name of, or otherwise solicit, accept business from or attempt to entice away from the Company any actual or identified potential customer of the Company, nor will he/she assist others in doing so. Executive further agrees that he/she will not, during the period stated above, encourage or solicit any other employee or consultant of the Company to leave such employment for any reason, nor will he/she assist others to do so.

(c) Executive acknowledges that the covenants in this section are necessary and reasonable to protect the Company in the conduct of its business and that compliance with such covenants will not prevent him/her from pursuing his/her livelihood. However, should any court find that any provision of such covenants is unreasonable, invalid or unenforceable, whether in period of time, geographical area, or otherwise, then in that event the parties hereby agree that such covenants shall be interpreted and enforced to the maximum extent which the court deems reasonable.

5. Remedies. The harm to the Company from any breach of Executive's obligations under this Agreement may be difficult to determine and may be wholly or partially irreparable, and Executive agrees that such obligations may be enforced by injunctive relief and other appropriate remedies, as well as by damages. If any bond from the Company is required in connection with such enforcement, the parties agree that a reasonable value of such bond shall be \$5,000. Any amounts received by Executive or by any other through Executive in breach of this Agreement shall be held in constructive trust for the benefit of the Company.

6. Executive Agreement. In consideration of the obligations undertaken by Executive pursuant to this Agreement, contemporaneously with the execution of this Agreement, Executive and the Company shall enter into the form of Executive Agreement to which this Agreement is attached (the "Executive Agreement"), and each agreement shall be effective only if both agreements have been executed.

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7. At Will Employment. Unless and to the extent otherwise agreed by the Company and Executive in a separate written employment agreement, Executive's employment shall be "at will", with either party permitted to terminate the employment at any time, with or without cause. No term of any employment agreement between the Company and Executive shall be construed to conflict with or lessen Executive's obligations under this Agreement.

8. Notices. All notices and other communications called for or required by this Agreement shall be in writing and shall be addressed to the parties at their respective addresses stated below or to such other address as a party may subsequently specify by written notice and shall be deemed to have been received (i) upon delivery in person, (ii) five days after mailing it by U.S. certified or registered mail, return receipt requested and postage prepaid, or (iii) two days after depositing it with a commercial overnight carrier which provides written verification of delivery:

To the Company: 6464 185th Ave NE, Suite 101
 Redmond, Washington 98052
 Attention: General Counsel and Corporate Secretary

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To Executive: 3011 197th Ave SE
Sammamish, WA 98075

9. Assignment. Executive's rights and duties hereunder are personal to Executive and are not assignable to others, but Executive's obligations hereunder will bind his/her heirs, successors, and assigns. The Company may assign its rights under this Agreement in connection with any merger or consolidation of the Company or any sale of all or any portion of the Company's assets (including, without limitation, any division or product line), provided that any such successor or assignee expressly assumes in writing the Company's obligations under the Executive Agreement.

10. General. This Agreement constitutes the exclusive agreement of the parties with respect to the subject matter hereof and supersedes all prior agreements or understandings of the parties. No waiver of or forbearance to enforce any right or provision hereof shall be binding unless in writing and signed by the party to be bound, and no such waiver or forbearance in any instance shall apply to any other instance or to any other right or provision. This Agreement will be governed by the local laws of the State of Washington without regard to its conflicts of laws rules to the contrary. The parties hereby consent to the exclusive jurisdiction and venue of the state and federal courts sitting in King County, Washington for all matters and actions arising under this Agreement. The prevailing party shall be entitled to reasonable attorneys' fees and costs incurred in connection with such litigation. No term hereof shall be construed to limit or supersede any other right or remedy of the Company under applicable law with respect to the protection of trade secrets or otherwise. If any provision of this Agreement is held to be invalid or unenforceable to any extent in any context, it shall nevertheless be enforced to the fullest extent allowed by law in that and other contexts, and the validity and force of the remainder of this Agreement shall not be affected thereby.

IN WITNESS WHEREOF, the parties have caused this Agreement to be signed as of the date first above written.

DATA I/O CORPORATION

EXECUTIVE:

By: _____
Its: President / CEO

Signature: _____
Name, printed: Joel S. Hatlen

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Exhibit 31.1

Certification by Chief Executive Officer

Pursuant to 18 U.S.C. Section 1350

As Adopted Pursuant to

Section 302(a) of the Sarbanes-Oxley Act of 2002

I, Frederick R. Hume, certify that:

- 1) I have reviewed this annual report on Form 10-K of Data I/O Corporation;
- 2) Based upon my knowledge, this annual report does not contain any untrue statement of material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
- 4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) for the registrant and we have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this annual report based on such evaluation; and
 - d) Disclosed in this annual report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
- 5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: March 27, 2009

/s/ Frederick R. Hume

Frederick R. Hume

Chief Executive Officer

(Principal Executive Officer)

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Exhibit 31.2

Certification by Chief Financial Officer

Pursuant to 18 U.S.C. Section 1350

As Adopted Pursuant to

Section 302(a) of the Sarbanes-Oxley Act of 2002

I, Joel S. Hatlen, certify that:

- 1) I have reviewed this annual report on Form 10-K of Data I/O Corporation;
- 2) Based upon my knowledge, this annual report does not contain any untrue statement of material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
- 4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) for the registrant and we have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purpose in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this annual report based on such evaluation; and
 - d) Disclosed in this annual report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
- 5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: March 27, 2009

/s/ Joel S. Hatlen

Joel S. Hatlen

Chief Financial Officer

(Principal Financial Officer)

Exhibit 32.1

Certification by Chief Executive Officer

Pursuant to 18 U.S.C. Section 1350

As Adopted Pursuant to

Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the annual report of Data I/O Corporation (the "Company") on Form 10-K for the period ended December 31, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Frederick R. Hume, Chief Executive Officer of the Company, certify, that pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Frederick R. Hume

Frederick R. Hume

Chief Executive Officer

(Principal Executive Officer)

March 27, 2009

Exhibit 32.2

Certification by Chief Financial Officer

Pursuant to 18 U.S.C. Section 1350

As Adopted Pursuant to

Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the annual report of Data I/O Corporation (the "Company") on Form 10-K for the period ended December 31, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Joel S. Hatlen, Chief Financial Officer of the Company, certify, that pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Joel S. Hatlen

Joel S. Hatlen

Chief Financial Officer

(Principal Financial Officer)

March 27, 2009