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GARDNER DENVER INC  
Form 10-Q  
November 09, 2004

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2004

OR

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

Commission File Number 1-13215

GARDNER DENVER, INC.  
(Exact name of Registrant as Specified in its Charter)

DELAWARE

76-0419383

(State or Other Jurisdiction of  
Incorporation or Organization)

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

1800 GARDNER EXPRESSWAY  
QUINCY, ILLINOIS 62301  
(Address of Principal Executive Offices and Zip Code)

(217) 222-5400  
(Registrant's Telephone Number, Including Area Code)

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 requirement for the past 90 days.

Yes X No  
--- ---

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes X No  
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Number of shares outstanding of the issuer's Common Stock, par value \$0.01 per share, as of October 31, 2004: 19,858,503 shares.

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PART I  
FINANCIAL INFORMATION

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GARDNER DENVER, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
 (dollars in thousands, except per share amounts)  
 (Unaudited)

	THREE MONTHS ENDED SEPTEMBER 30,		NINE SEP
	2004	2003	2004
Revenues	\$182,616	\$112,061	\$498,341
Costs and Expenses:			
Cost of sales (excluding depreciation and amortization)	123,296	78,198	336,457
Depreciation and amortization	5,925	3,740	16,074
Selling and administrative expenses	37,461	21,063	106,031
Interest expense	2,491	1,070	5,949
Other expense (income), net	332	230	(1,756)
Income before income taxes	13,111	7,760	35,586
Provision for income taxes	4,457	2,483	12,099
Net income	\$ 8,654	\$ 5,277	\$ 23,487
Basic earnings per share	\$ 0.44	\$ 0.33	\$ 1.26
Diluted earnings per share	\$ 0.43	\$ 0.32	\$ 1.23

The accompanying notes are an integral part of this statement.

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GARDNER DENVER, INC.  
 CONDENSED CONSOLIDATED BALANCE SHEETS  
 (in thousands, except per share amounts)

	(UNAUDITED) SEPTEMBER 30, 2004	DECEMBER 200
ASSETS		
Current assets:		
Cash and equivalents	\$ 48,055	\$132,
Receivables, net	152,459	81,
Inventories, net	141,977	64,
Deferred income taxes	8,144	3,
Other	10,339	5,

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Total current assets	360,974	287,
	-----	-----
Property, plant and equipment, net	142,029	75,
Goodwill	359,153	205,
Other intangibles, net	127,319	10,
Deferred income taxes	--	5,
Other assets	10,495	5,
	-----	-----
Total assets	\$999,970	\$589,
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Short-term borrowings and current maturities of long-term debt	\$ 28,964	\$ 16,
Accounts payable and accrued liabilities	171,609	84,
	-----	-----
Total current liabilities	200,573	100,
	-----	-----
Long-term debt, less current maturities	309,564	165,
Postretirement benefits other than pensions	30,936	32,
Deferred income taxes	30,783	
Other long-term liabilities	52,003	25,
	-----	-----
Total liabilities	623,859	323,
	-----	-----
Stockholders' equity:		
Common stock, \$0.01 par value; 50,000 shares authorized; 19,850 shares issued and outstanding at September 30, 2004	216	
Capital in excess of par value	259,236	174,
Treasury stock at cost, 1,736 shares at September 30, 2004	(26,345)	(25,
Retained earnings	125,794	102,
Accumulated other comprehensive income	17,210	14,
	-----	-----
Total stockholders' equity	376,111	265,
	-----	-----
Total liabilities and stockholders' equity	\$999,970	\$589,
	=====	=====

The accompanying notes are an integral part of this statement.

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GARDNER DENVER, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(in thousands)  
(Unaudited)

NINE MONTHS ENDED  
SEPTEMBER 30,

-----  
2004

-----  
2003

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Cash flows from operating activities:		
Net income	\$ 23,487	\$ 14,1
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	16,074	11,0
Foreign currency transaction gain	(1,235)	
Net gain on asset dispositions	(11)	(3
Stock issued for employee benefit plans	1,768	1,9
Deferred income taxes	1,291	4,1
Changes in assets and liabilities:		
Receivables	(638)	(2,5
Inventories	(8,324)	(5
Accounts payable and accrued liabilities	(8,746)	(5,5
Other assets and liabilities, net	(1,413)	1,4
Net cash provided by operating activities	22,253	23,7
Cash flows from investing activities:		
Business acquisitions, net of cash acquired	(292,108)	(2,4
Capital expenditures	(12,301)	(8,1
Disposals of property, plant and equipment	315	9
Other	(126)	
Net cash used in investing activities	(304,220)	(9,6
Cash flows from financing activities:		
Principal payments on long-term debt	(200,998)	(44,8
Proceeds from long-term debt	315,959	27,0
Proceeds from issuance of common stock	79,557	
Proceeds from stock options	3,475	9
Purchase of treasury stock	(399)	(
Other	(1,846)	
Net cash provided by (used in) financing activities	195,748	(17,0
Effect of exchange rate changes on cash and equivalents	1,471	1,9
Decrease in cash and equivalents	(84,748)	(1,0
Cash and equivalents, beginning of period	132,803	25,6
Cash and equivalents, end of period	\$ 48,055	\$ 24,6

The accompanying notes are an integral part of this statement.

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NOTES TO CONDENSED FINANCIAL STATEMENTS  
(in thousands, except per share amounts)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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### BASIS OF PRESENTATION

The accompanying condensed consolidated financial statements include the accounts of Gardner Denver, Inc. and its subsidiaries ("Gardner Denver" or the "Company"). All significant intercompany transactions and accounts have been eliminated.

The financial information presented as of any date other than December 31 has been prepared from the books and records without audit. The accompanying condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and footnotes required by generally accepted accounting principles for complete statements. In the opinion of management, all adjustments, consisting only of normal recurring adjustments necessary for a fair presentation of such financial statements, have been included.

These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto incorporated by reference in Gardner Denver's Annual Report on Form 10-K for the year ended December 31, 2003.

The results of operations for the three and nine months ended September 30, 2004 are not necessarily indicative of the results to be expected for the full year.

### STOCK-BASED COMPENSATION PLANS

As allowed under Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation," the Company measures its compensation cost of equity instruments issued under employee compensation plans using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. Stock options granted during the three and nine months ended September 30, 2004 and 2003 were exercisable at prices equal to the fair market value of the Company's common stock on the dates the options were granted; and accordingly, no compensation expense has been recognized. If the Company had accounted for stock-based compensation using the fair value recognition provisions of SFAS No. 123 and related amendments, net income and basic and diluted earnings per share would have been as follows:

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	THREE MONTHS ENDED SEPTEMBER 30,	
	2004	2003
	-----	-----
Net income, as reported	\$ 8,654	\$ 5,277
Less: Total stock-based employee compensation expense determined under fair value method, net of related tax effects	(363)	(292)
	-----	-----
Pro forma net income	\$8,291	\$4,985
	=====	=====
Basic earnings per share, as reported	\$ 0.44	\$ 0.33

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Basic earnings per share, pro forma	\$ 0.42	\$ 0.31
Diluted earnings per share, as reported	\$ 0.43	\$ 0.32
Diluted earnings per share, pro forma	\$ 0.41	\$ 0.30

Compensation costs charged against income (net of tax) for restricted stock issued under the Company's Incentive Plan totaled \$0.2 million in the nine months ended September 30, 2003. There was no restricted stock issued in the current year.

### NEW ACCOUNTING STANDARDS

In May 2004, the FASB issued Staff Position SFAS No. 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003," ("FSP 106-2"). FSP 106-2 supersedes FSP 106-1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003," and provides guidance on the accounting, disclosure, effective date and transition related to the Prescription Drug Act. FSP 106-2 was effective for the third quarter of 2004. According to an actuarial assessment, the Company currently provides prescription drug benefits, which are actuarially equivalent to the Medicare-prescription drug benefit, to certain retired and other employees and will therefore qualify for the subsidy. As a result, the Company accounted for the federal subsidy attributable to past services as an actuarial gain, which reduced the accumulated post-retirement benefit obligation. This actuarial gain will then be amortized in future periods in accordance with SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions." The federal subsidy attributable to employee service rendered in current and future periods will reduce future net periodic postretirement benefit cost as those employees provide service. The favorable impact to diluted earnings per share from adopting FSP 106-2 is expected to be \$0.01 in 2004 and \$0.02 in 2005.

### NOTE 2. ACQUISITIONS

On September 1, 2004, the Company acquired nash\_elmo Holdings, LLC ("Nash Elmo"). Nash Elmo is a leading global manufacturer of industrial vacuum pumps. Prior to the acquisition, Nash Elmo was primarily split between two businesses, liquid ring pumps and side channel blowers. Both businesses' products are complementary to the Compressor and Vacuum Products segment's existing product portfolio. The purchase price of \$221.6 million including assumed bank debt (net of cash acquired) was paid in the form of cash (\$208.5 million), the assumption of certain of Nash Elmo's debt (\$10.4 million) and the assumption of other liabilities stemming

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from the transaction (\$2.7 million), which will be paid in the fourth quarter of 2004. There are no additional contingent payments or commitments related to this acquisition.

This acquisition has been accounted for by the purchase method and accordingly, its results are included in the Company's consolidated financial statements from the date of acquisition. Net of cash acquired, \$210.0 million in cash was used to fund the Nash Elmo acquisition (and related direct acquisition costs) during the third quarter. The aggregate purchase price (including direct acquisition costs) has been allocated

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primarily to receivables (\$35,719); inventory (\$45,749); property, plant and equipment (\$34,461); intangible assets (\$178,835); other assets (\$7,205); accounts payable and accrued liabilities (\$45,975); net deferred income tax liabilities (\$28,031) and other long-term liabilities (\$3,398), based on their estimated fair values at the date of acquisition. This allocation reflects the Company's preliminary estimates of the purchase price allocation and is subject to change upon completion of appraisals in 2005. Further, other assets and liabilities may be identified to which a portion of the purchase price could be allocated.

The following table summarizes the preliminary fair values of the intangible assets acquired in the Nash Elmo acquisition:

Amortized intangible assets:	
Customer lists and relationships	\$ 44,000
Other	12,245
Unamortized intangible assets:	
Goodwill	94,590
Trademarks	28,000
	-----
Total intangible assets	\$178,835
	=====

The preliminary weighted average amortization period for customer lists and relationships and other amortized intangible assets is 20 years and 5 years, respectively.

The total amount of goodwill that is expected to be deductible for tax purposes is not anticipated to be significant given the stock nature of the acquisition. The assignment of goodwill has been allocated to the Compressor and Vacuum Products segment. This allocation is preliminary and subject to change upon completion of appraisals. See Note 13 for additional segment information.

On January 2, 2004, the Company effectively acquired the outstanding shares of Syltone plc ("Syltone"), previously a publicly traded company listed on the London Stock Exchange. Syltone, headquartered in Bradford, United Kingdom ("U.K."), is one of the world's largest manufacturers of equipment used for loading and unloading liquid and dry bulk products on commercial transportation vehicles. This equipment includes compressors, blowers and other ancillary products that are complementary to the Company's product line. Syltone is also one of the world's largest manufacturers of fluid transfer equipment (including loading arms, swivel joints, couplers and valves) used to load and unload ships, tank trucks and rail cars. The purchase price of (pounds)61.1 million including assumed bank debt (net of cash acquired) was paid in the form of cash ((pounds)44.4 million), new loan notes ((pounds)5.2 million) and the assumption of Syltone's existing bank debt, net of cash acquired ((pounds)11.5 million). There are no additional contingent payments or commitments related to this acquisition.

This acquisition has been accounted for by the purchase method and accordingly, its results are included in the Company's consolidated financial statements from the date of acquisition. Net of

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cash acquired, \$81.3 million in cash was used to fund the Syltone acquisition (and related direct acquisition costs) during the first quarter. The aggregate purchase price (including direct acquisition costs) has been allocated primarily to receivables (\$30,410); inventory (\$22,413); property,

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plant and equipment (\$33,297); intangible assets (\$92,316); accounts payable and accrued liabilities (\$41,586); bank debt, net of cash acquired (\$20,570); net deferred income tax liabilities (\$2,308) and other long-term liabilities (\$21,993), based on their estimated fair values at the date of acquisition. This allocation reflects the Company's preliminary estimates of the purchase price allocation and is subject to change upon completion of appraisals in 2004. Further, other assets and liabilities may be identified to which a portion of the purchase price could be allocated.

The following table summarizes the preliminary fair values of the intangible assets acquired in the Syltone acquisition:

Amortized intangible assets:

Customer lists and relationships	\$19,646
Other	5,394
Unamortized intangible assets:	
Goodwill	58,346
Trademarks	8,930
	-----
Total intangible assets	\$92,316 =====

The preliminary weighted average amortization period for customer lists and relationships and other amortized intangible assets is 20 years and 5 years, respectively.

The total amount of goodwill that is expected to be deductible for tax purposes is not anticipated to be significant given the stock nature of the acquisition. The assignment of goodwill has been allocated to the Compressor and Vacuum Products segment (\$40,842) and the Fluid Transfer Products segment (\$17,504). This allocation is preliminary and subject to change upon completion of appraisals in 2004. See Note 13 for additional segment information.

The following table summarizes supplemental pro forma information as if the Nash Elmo and Syltone acquisition had been completed on January 1, 2003:

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MO SEPTE
	2004	2003	2004
Revenues	\$228,607	\$202,445	\$654,658
Net Income	10,912	4,480	28,087
Diluted earnings per share	\$ 0.54	\$ 0.27	\$ 1.48

The pro forma net income above for the three months ended September 30, 2003 reflects the negative impact of a one-time adjustment on cost of sales of approximately \$0.6 million stemming from recording Nash Elmo's inventory at fair value. The pro forma net income above for the nine months ended September 30, 2003 reflects the negative impact of a one-time adjustment on cost of sales of approximately \$3.6 million stemming from recording Syltone's and Nash Elmo's inventory at fair value.



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NOTE 3. INVENTORIES

	SEPTEMBER 30, 2004	DECEMBER 31, 2003
	-----	-----
Raw materials, including parts and subassemblies	\$ 63,094	\$33,850
Work-in-process	23,252	7,850
Finished goods	58,104	24,731
Perishable tooling and supplies	2,274	2,429
	-----	-----
	146,724	68,860
Excess of FIFO costs over LIFO costs	(4,747)	(4,533)
	-----	-----
Inventories, net	\$141,977	\$64,327
	=====	=====

NOTE 4. GOODWILL AND OTHER INTANGIBLE ASSETS

The changes in the carrying amount of goodwill attributable to each business segment for the nine months ended September 30, 2004, are as follows:

	COMPRESSOR & VACUUM PRODUCTS	FLUID TRANSFER PRODUCTS
	-----	-----
Balance as of December 31, 2003	\$179,854	\$25,634
Goodwill acquired during the period	135,432	17,504
Foreign currency translation	472	257
	-----	-----
Balance as of September 30, 2004	\$315,758	\$43,395
	=====	=====

Other intangible assets at September 30, 2004 consisted of the following:

	COST	ACCUMULATED AMORTIZATION
	-----	-----
Amortized intangible assets:		
Acquired technology	\$ 23,687	\$ (12,328)
Customer lists and relationships	66,136	(2,137)
Other	14,080	(2,237)
	-----	-----
Unamortized intangible assets:		
Trademarks	40,118	--
	-----	-----
Total other intangible assets	\$144,021	\$ (16,702)
	=====	=====

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Amortization of intangible assets for the three and nine months ended September 30, 2004, was \$1.3 million and \$3.3 million, respectively. Amortization of intangible assets is anticipated to be approximately \$5.5 million in 2004 and \$8.0 to \$9.0 million per year for 2005 through 2008.

### NOTE 5. ACCRUED PRODUCT WARRANTY

The following is a rollforward of the Company's warranty accrual for the three and nine months ended September 30, 2004 and 2003.

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	THREE MONTHS ENDED SEPTEMBER 30,		NINE S
	2004	2003	2004
Balance at beginning of period	\$ 7,808	\$ 6,695	\$ 6,635
Product warranty accruals	2,284	1,589	6,012
Settlements	(1,948)	(1,812)	(5,978)
Other (acquisitions and foreign currency translation)	3,059	41	4,534
	\$11,203	\$ 6,513	\$11,203
	=====	=====	=====

### NOTE 6. DEBT

On September 1, 2004, the Company entered into a \$375.0 million amended and restated credit agreement (the "Credit Agreement"). The Credit Agreement provided the Company with access to senior secured credit facilities including a \$150.0 million five-year Term Loan and a \$225.0 million five-year Revolving Line of Credit (the "Credit Line"). Proceeds from the Credit Agreement were used to fund the Nash Elmo acquisition and retire debt outstanding under its previously existing Credit Line and Term Loan.

The Credit Line has a borrowing capacity of \$225.0 million and the total debt balance is due upon final maturity on September 1, 2009. Loans under this facility may be denominated in U.S. Dollars or several foreign currencies. The interest rate varies with prime, federal funds and/or LIBOR for the applicable currency and was 3.8% as of September 30, 2004. On September 30, 2004, the Credit Line had an outstanding principal balance of \$127.0 million, leaving \$98.0 million available for letters of credit or future use, subject to the terms of the Credit Line.

The \$150.0 million Term Loan has a final maturity of September 1, 2009. The Term Loan requires quarterly principal payments totaling \$7.5 million, \$15.0 million, \$22.5 million, \$37.5 million and \$67.5 million in years one through five, respectively. The interest rate varies with prime, federal funds and/or LIBOR and was 3.8% as of September 30, 2004. On September 30, 2004, the Term Loan had an outstanding principal balance of \$150.0 million.

### NOTE 7. PENSION AND OTHER POSTRETIREMENT BENEFITS

The following table provides the components of net periodic expense for the Company's defined benefit pension plans and other postretirement benefit plans for the three and nine months ended September 30, 2004 and 2003:

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	THREE MONTHS ENDED SEPTEMBER			
	Pension Benefits			
	U.S. Plans		Non-U.S. Plans	
	2004	2003	2004	2003
Service cost	\$ 528	\$ 494	\$ 858	\$ 385
Interest cost	831	850	1,453	362
Expected return on plan assets	(925)	(817)	(1,328)	(369)
Amortization of transition liability	--	1	--	--
Amortization of prior-service cost	(20)	(22)	5	--
Amortization of net loss (gain)	57	105	61	57
Net periodic expense	\$ 471	\$ 611	\$ 1,049	\$ 435

	NINE MONTHS ENDED SEPTEMBER			
	Pension Benefits			
	U.S. Plans		Non-U.S. Plans	
	2004	2003	2004	2003
Service cost	\$ 1,583	\$ 1,483	\$ 2,424	\$ 1,154
Interest cost	2,493	2,550	4,057	1,085
Expected return on plan assets	(2,776)	(2,452)	(3,885)	(1,106)
Amortization of transition liability	--	4	--	--
Amortization of prior-service cost	(61)	(65)	15	--
Amortization of net loss (gain)	170	316	183	172
Net periodic expense	\$ 1,409	\$ 1,836	\$ 2,794	\$ 1,305

NOTE 8. STOCKHOLDERS' EQUITY

Pursuant to its previously filed shelf registration with the Securities and Exchange Commission, the Company completed an offering of 3.45 million shares of its common stock for net proceeds of approximately \$79.6 million during March 2004. These proceeds were used to repay borrowings under the Company's previously existing Credit Line. See Note 6 for additional information regarding the Company's debt.

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NOTE 9. EARNINGS PER SHARE

The following table details the calculation of basic and diluted earnings per share:

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	THREE MONTHS ENDED SEPTEMBER 30,		2003
	2004	2003	
Basic EPS:			
Net income	\$ 8,654	\$ 5,277	\$23,
Shares:			
Weighted average number of common shares outstanding	19,806	16,079	18,
Basic earnings per common share	\$ 0.44	\$ 0.33	\$ 1
Diluted EPS:			
Net income	\$ 8,654	\$ 5,277	\$23,
Shares:			
Weighted average number of common shares outstanding	19,806	16,079	18,
Assuming conversion of dilutive stock options issued and outstanding	382	314	
Weighted average number of common shares outstanding, as adjusted	20,188	16,393	19,
Diluted earnings per common share	\$ 0.43	\$ 0.32	\$ 1

NOTE 10. COMPREHENSIVE INCOME

For the three months ended September 30, 2004 and 2003, comprehensive income was \$11.9 million and \$6.3 million, respectively. For the nine months ended September 30, 2004 and 2003, comprehensive income was \$25.8 million and \$20.9 million, respectively. Items impacting the Company's comprehensive income, but not included in net income, consist of foreign currency translation adjustments.

NOTE 11. CASH FLOW INFORMATION

In the first nine months of 2004 and 2003, the Company paid \$11.5 million and \$2.8 million, respectively, to the various taxing authorities for income taxes. Interest paid for the first nine months of 2004 and 2003 was \$5.4 million and \$3.6 million, respectively.

NOTE 12. CONTINGENCIES

The Company is a party to various legal proceedings, lawsuits and administrative actions, which are of an ordinary or routine nature. In addition, due to the bankruptcies of several asbestos manufacturers and other primary defendants, the Company has been named as a defendant in an increasing number of asbestos personal injury lawsuits. The Company has also been named as a defendant in an increasing number of silicosis personal injury lawsuits. The plaintiffs in these

suits allege exposure to asbestos or silica from multiple sources and typically the Company is one of approximately 25 or more named defendants. In the Company's experience, the vast majority of the plaintiffs are not impaired with a disease for which the Company bears any responsibility.

Predecessors to the Company manufactured, distributed and sold products allegedly at issue in the pending asbestos and silicosis litigation lawsuits (the "Products"). The Company has potential responsibility for certain of these Products, namely: (a) air compressors which used asbestos containing components manufactured and supplied by third parties; and (b) portable air compressors used in sandblasting operations as a component of sandblasting equipment manufactured and sold by others. The sandblasting equipment is alleged to have caused the silicosis disease plaintiffs claim in these cases.

Neither the Company nor its predecessors ever mined, manufactured, mixed, produced or distributed asbestos fiber. The asbestos-containing components used in the Products were completely encapsulated in a protective non-asbestos binder and enclosed within the subject Products. Furthermore, the Company has never manufactured or distributed portable air compressors.

The Company has entered into a series of cost sharing agreements with multiple insurance companies to secure coverage for asbestos and silicosis lawsuits. The Company also believes some of the potential liabilities regarding these lawsuits are covered by indemnity agreements with other parties. The Company's uninsured settlement payments for past asbestos and silicosis lawsuits have been immaterial.

The Company believes that the pending and future asbestos and silicosis lawsuits will not, in the aggregate, have a material adverse effect on its consolidated financial position, results of operations or liquidity, based on: the Company's anticipated insurance and indemnification rights to address the risks of such matters; the limited potential asbestos exposure from the components described above; the Company's experience that the vast majority of plaintiffs are not impaired with a disease attributable to alleged exposure to asbestos or silica from or relating to the Products; various potential defenses available to the Company with respect to such matters; and the Company's prior disposition of comparable matters. However, due to inherent uncertainties of litigation and because future developments could cause a different outcome, there can be no assurance that the resolution of pending or future lawsuits, whether by judgment, settlement or dismissal, will not have a material adverse effect on its consolidated financial position, results of operations or liquidity.

The Company has also been identified as a potentially responsible party with respect to several sites designated for environmental cleanup under various state and federal laws. The Company does not own any of these sites. The Company does not believe that the future potential costs related to these sites will have a material adverse effect on its consolidated financial position, results of operations or liquidity.

NOTE 13. SEGMENT INFORMATION

Subsequent to the acquisition of Nash Elmo and Syltone, the Company continues to be organized based upon the products and services it offers and has four operating divisions: Compressor, Blower, Liquid Ring Pump and Fluid Transfer. These divisions comprise two reportable segments, Compressor and Vacuum Products (formerly Compressed Air Products) and Fluid Transfer Products. The Compressor, Blower (which now includes the Syltone

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transportation-

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related activities and Nash Elmo's side channel blower business) and Liquid Ring Pump (consisting of Nash Elmo's liquid ring pump business) Divisions are aggregated into one reportable segment (Compressor and Vacuum Products) since the long-term financial performance of these businesses are affected by similar economic conditions, coupled with the similar nature of their products, manufacturing processes and other business characteristics. During the third quarter, the Company's former Pump and Fluid Transfer (which consisted of the Syltone fluid transfer-related activities) Divisions were combined into one division, Fluid Transfer. These two divisions were previously aggregated into one reportable segment (Fluid Transfer Products) primarily due to the same factors as noted above, and thus, there has been no change to the Fluid Transfer Products segment.

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2004	2003	2004	2003
Revenues:				
Compressor and Vacuum Products	\$147,148	\$ 91,554	\$396,170	\$271,170
Fluid Transfer Products	35,468	20,507	102,171	51,170
Total	\$182,616	\$112,061	\$498,341	\$322,340
Operating Earnings:				
Compressor and Vacuum Products	\$ 13,519	\$ 7,089	\$ 32,422	\$ 21,170
Fluid Transfer Products	2,415	1,971	7,357	2,415
Total	15,934	9,060	39,779	23,585
Interest expense	2,491	1,070	5,949	3,140
Other expense (income), net	332	230	(1,756)	1,140
Income before income taxes	\$ 13,111	\$ 7,760	\$ 35,586	\$ 20,475

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

RECENT DEVELOPMENTS.

On September 1, 2004, the Company acquired the outstanding shares of nash\_elmo Holdings, LLC ("Nash Elmo"). Nash Elmo is a leading global manufacturer of industrial vacuum pumps. Prior to the acquisition, Nash Elmo was primarily split between two businesses, liquid ring pumps and side channel blowers. Both businesses' products are complementary to the Compressor and Vacuum Products segment's existing product portfolio. Nash

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Elmo, headquartered in Trumbull, CT, has primary manufacturing facilities located in Bad Neustadt and Nuremberg, Germany; Zibo, China; and Campinas, Brazil. The purchase price of \$221.6 million, including assumed bank debt (net of cash acquired), was paid in the form of cash (\$208.5 million), the assumption of certain of Nash Elmo's debt (\$10.4 million) and the assumption of other liabilities stemming from the transaction (\$2.7 million), which will be paid in the fourth quarter of 2004. There are no additional contingent payments or commitments related to this acquisition.

For the year ended December 31, 2003, Nash Elmo's revenues and earnings before income taxes were \$212.4 million and \$7.8 million, respectively. Nash Elmo's largest markets are in Europe, North America, South America and Asia. Approximately 70% of Nash Elmo's revenues are generated from liquid ring pump products (including related engineered systems and aftermarket services), while the remaining 30% are derived from side channel blower products (including aftermarket services).

On January 2, 2004, the Company effectively acquired the outstanding shares of Syltone plc ("Syltone"), previously a publicly traded company listed on the London Stock Exchange. Syltone, headquartered in Bradford, United Kingdom ("U.K."), is one of the world's largest manufacturers of equipment used for loading and unloading liquid and dry bulk products on commercial transportation vehicles. This equipment includes compressors, blowers and other ancillary products that are complementary to the Company's product lines. Syltone is also one of the world's largest manufacturers of fluid transfer equipment (including loading arms, swivel joints, couplers and valves) used to load and unload ships, tank trucks and rail cars. The purchase price of (pounds)61.1 million, including assumed bank debt (net of cash acquired), was paid in the form of cash ((pounds)44.4 million), new loan notes ((pounds)5.2 million) and the assumption of Syltone's existing bank debt, net of cash ((pounds)11.5 million). There are no additional contingent payments or commitments related to this acquisition.

Syltone generated revenues and operating profit (in accordance with accounting principles generally accepted in the U.K.) of (pounds)84.4 million and (pounds)6.3 million, respectively (approximately \$151.1 million and \$11.3 million, respectively as calculated using the December 31, 2003 exchange rate of \$1.79/(pounds)) for the twelve months ended September 30, 2003. Syltone's largest markets are Europe and North America, which represent approximately 67% and 20% of its revenues, respectively. Approximately 70% of Syltone's revenues are generated through transportation-related activities while the remaining 30% are derived from fluid transfer-related activities.

Subsequent to the acquisition of Nash Elmo and Syltone, the Company continues to be organized based upon the products and services it offers and has four operating divisions: Compressor, Blower, Liquid Ring Pump and Fluid Transfer. These divisions comprise two reportable

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segments, Compressor and Vacuum Products (formerly Compressed Air Products) and Fluid Transfer Products. The Compressor, Blower (which now includes the Syltone transportation-related activities and Nash Elmo's side channel blower business) and Liquid Ring Pump (consisting of Nash Elmo's liquid ring pump business) Divisions are aggregated into one reportable segment (Compressor and Vacuum Products) since the long-term financial performance of these businesses are affected by similar economic conditions, coupled with the similar nature of their products, manufacturing processes and other business characteristics. During the third quarter, the Company's former Pump and Fluid Transfer (which consisted of the Syltone fluid

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transfer-related activities) Divisions were combined into one division, Fluid Transfer. These two divisions were previously aggregated into one reportable segment (Fluid Transfer Products) primarily due to the same factors as noted above, and thus, there has been no change to the Fluid Transfer Products segment.

### RESULTS OF OPERATIONS.

#### PERFORMANCE IN THE QUARTER ENDED SEPTEMBER 30, 2004 COMPARED WITH THE QUARTER ENDED SEPTEMBER 30, 2003

##### Revenues

Revenues increased \$70.6 million (63%) to \$182.6 million for the three months ended September 30, 2004, compared to the same period of 2003. This increase was primarily due to acquisitions, which contributed \$58.8 million in revenues. Increased shipments of well stimulation pumps, compressors and blowers, combined with changes in currency exchange rates and price increases, also contributed to this increase.

For the three months ended September 30, 2004, revenues for the Compressor and Vacuum Products segment increased \$55.6 million to \$147.1 million, compared to the same period of 2003. This 61% increase is primarily due to the acquisition of Syltone and Nash Elmo (52%), increased volume of compressor and blower shipments in the U.S., Europe, South Africa and China (4%), changes in currency exchange rates (3%) and price increases (2%). Fluid Transfer Products segment revenues increased \$15.0 million to \$35.5 million for the three months ended September 30, 2004, compared to the same period of 2003. This 73% increase is primarily due to the acquisition of Syltone (53%), and increased shipments of well stimulation pumps, water jetting systems and related aftermarket (34%) and price increases (4%). These positive factors were partially offset by lower drilling pump shipments (18%).

##### Costs and Expenses

Gross margin (defined as revenues less cost of sales) for the three months ended September 30, 2004 increased \$25.5 million (75%) to \$59.3 million compared to the same period of 2003, primarily due to the increase in revenues. Gross margin as a percentage of revenues (gross margin percentage) increased to 32.5% in the three-month period of 2004 from 30.2% in the same period of 2003. This increase in gross margin percentage was principally attributable to increased volume in both segments and the related positive impact of increased leverage of fixed and semi-fixed costs over a higher revenue base. Acquisitions also positively impacted gross margin percentage as their gross margin percentage (35.4%) is higher than the Company's previously existing businesses. Favorable sales mix also contributed to the increased gross margin as the third quarter of 2004 included a higher percentage of aftermarket sales compared to the prior year.

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Depreciation and amortization for the three months ended September 30, 2004 increased \$2.2 million to \$5.9 million, compared to \$3.7 million in the same period of 2003, primarily due to the Syltone and Nash Elmo acquisitions.

Selling and administrative expenses increased in the three-month period of 2004 by 78% to \$37.5 million from \$21.1 million in the same period of 2003, primarily due to the acquisition of Syltone and Nash Elmo (\$15.1 million). Changes in currency exchange rates also contributed to this increase.

The Compressor and Vacuum Products segment generated operating earnings



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(defined as revenues, less cost of sales, depreciation and amortization, and selling and administrative expenses) as a percentage of revenues of 9.2% in the three-month period ended September 30, 2004, an increase from 7.7% for the same period of 2003. This increase was primarily attributable to the positive impact of increased leverage of the segment's fixed and semi-fixed costs over a higher revenue base. Favorable sales mix also contributed to this increase. These favorable factors were partially offset by acquisitions, as their operating margins were lower than the segment's previously existing businesses. Operating earnings as a percentage of revenues from Compressor and Vacuum Products segment businesses that existed prior to the Nash Elmo and Syltone acquisitions were 9.5% for the three-month period ended September 30, 2004.

The Fluid Transfer Products segment generated operating earnings as a percentage of revenues of 6.8% for the three-month period ended September 30, 2004, compared to 9.6% in the same period of 2003. This decrease was primarily attributable to the Syltone business included in this segment which generated an operating loss of \$0.5 million during the third quarter primarily due to a \$3.0 million shipment scheduled for the third quarter which was delayed due to a customer logistics issue. This order subsequently shipped in October 2004. This negative factor was partially offset by the positive impact of increased leverage of the segment's fixed and semi-fixed costs over a higher revenue base and operational improvements. Operating earnings as a percentage of revenues from Fluid Transfer Products segment businesses that existed prior to the Syltone acquisition were 13.0% for the three-month period ended September 30, 2004.

Interest expense increased \$1.4 million (133%) to \$2.5 million for the three months ended September 30, 2004, compared to the same period of 2003, due to higher average borrowings stemming from the Nash Elmo and Syltone acquisitions and higher average rates. The average interest rate for the three-month period ended September 30, 2004 was 5.6% compared to 4.0% in the comparable prior year period.

Income before income taxes increased \$5.4 million (69%) to \$13.1 million for the three months ended September 30, 2004. This increase is primarily due to the increased volume in both segments and the related positive impact of increased leverage of fixed and semi-fixed costs over a higher revenue base. Acquisitions also contributed \$1.5 million to this increase. These positive factors were partially offset by higher interest expense.

The provision for income taxes increased by \$2.0 million to \$4.5 million for the three-month period of 2004, compared to the prior year period, as a result of the incremental income before taxes and a higher overall effective tax rate. The Company's effective tax rate for the three months ended September 30, 2004 increased to 34.0% compared to 32.0% in the prior year period, principally due to the acquisition of Syltone.

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Net income for the three months ended September 30, 2004 increased \$3.4 million (64%) to \$8.7 million (\$0.43 diluted earnings per share), compared to \$5.3 million (\$0.32 diluted earnings per share) in same period of 2003. This increase was primarily attributable to the same factors that resulted in increased income before taxes noted above, partially offset by a higher effective tax rate in 2004. The incremental impact on diluted earnings per share from acquisitions was \$0.04.

PERFORMANCE IN THE NINE MONTHS ENDED SEPTEMBER 30, 2004 COMPARED WITH  
THE NINE MONTHS ENDED SEPTEMBER 30, 2003

Revenues

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Revenues increased \$175.4 million (54%) to \$498.3 million for the nine months ended September 30, 2004, compared to the same period of 2003. This increase was primarily due to acquisitions, which contributed \$138.6 million in revenues. Increased shipments of well stimulation pumps, pump parts, compressors and blowers combined with changes in currency exchange rates and price increases also contributed to this increase.

For the nine months ended September 30, 2004, revenues for the Compressor and Vacuum Products segment increased \$125.0 million (46%) to \$396.2 million, compared to the same period of 2003. This increase is primarily due to acquisitions (38%), changes in currency exchange rates (4%), increased volume of compressor and blower shipments in the U.S., Europe, South Africa and China (3%) and price increases (1%). Fluid Transfer Products segment revenues increased \$50.4 million to \$102.2 million for the nine months ended September 30, 2003, compared to the same period of 2003. This 97% increase is primarily due to the acquisition of Syltone (69%), increased shipments of well stimulation pumps, water jetting systems and related aftermarket (36%) and price increases (3%). These positive factors were partially offset by a decreased volume of drilling pump shipments (11%).

### Costs and Expenses

Gross margin for the nine months ended September 30, 2004 increased \$64.1 million (66%) to \$161.9 million compared to the same period of 2003. Gross margin percentage increased to 32.5% in the nine-month period of 2004 from 30.3% in the same period of 2003. This increase in gross margin percentage was principally attributable to the increased volume in both segments and the related positive impact of increased leverage of fixed and semi-fixed costs over a higher revenue base. Acquisitions also positively impacted gross margin percentage, as their gross margin percentage (34.6%) is higher than the Company's previously existing businesses. Finally, favorable sales mix also contributed to the increased gross margin as the first nine months of 2004 included a higher percentage of aftermarket sales compared to the prior year. These positive factors were partially offset by higher warranty expense in 2004.

Depreciation and amortization for the nine months ended September 30, 2004 increased \$5.0 million to \$16.1 million compared to \$11.1 million in the same period of 2003, primarily due to the Syltone and Nash Elmo acquisitions.

Selling and administrative expenses increased \$43.6 million (70%) in the nine-month period of 2004 to \$106.0 million compared to \$62.4 million in the same period of 2003, primarily due to acquisitions (\$35.8 million). Higher compensation and fringe benefit costs and changes in currency exchange rates also contributed to this increase.

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Other income, net was \$1.8 million for the nine-month period ended September 30, 2004, compared to expense of \$0.1 million in the comparable prior year period. This change was primarily due to foreign currency transaction gains recorded in 2004. These gains included \$1.2 million in the first quarter specifically related to a portion of the proceeds from U.S. dollar borrowings, which were converted to British pounds and appreciated in U.S. dollars in 2004 prior to being used to consummate the Syltone acquisition. This change was partially offset by a \$0.4 million pretax gain on the sale of an idle manufacturing facility in Syracuse, New York in the second quarter of 2003.

The Compressor and Vacuum Products segment generated operating earnings as a

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percentage of revenues of 8.2% in the nine-month period ended September 30, 2004, an increase from 7.9% for the same period of 2003. This increase was primarily attributable to the positive impact of increased leverage of the segment's fixed and semi-fixed costs over a higher revenue base and favorable sales mix. These positive factors were partially offset by higher compensation, fringe benefit and warranty expense and acquisitions, which had lower operating earnings as a percentage of revenues than the segment's previously existing businesses. Operating earnings as a percentage of revenues from Compressor and Vacuum Products segment businesses that existed prior to the Nash Elmo and Syltone acquisitions were 8.4% for the nine-month period ended September 30, 2004.

The Fluid Transfer Products segment generated operating earnings as a percentage of revenues of 7.2% for the nine-month period ended September 30, 2004, compared to 5.8% in the same period of 2003. This improvement was primarily attributable to the positive impact of increased leverage of the segment's fixed and semi-fixed costs over a higher revenue base and operational improvements. This positive factor was partially offset by the impact of the Syltone business included in this segment which had lower operating earnings as a percentage of revenues than the segment's previously existing businesses. Operating earnings as a percentage of revenues from Fluid Transfer Products segment businesses that existed prior to the Syltone acquisition were 12.4% for the nine-month period ended September 30, 2004.

Interest expense increased \$2.5 million (74%) to \$5.9 million for the nine months ended September 30, 2004, compared to the same period of 2003, due to higher average borrowings stemming from the Syltone and Nash Elmo acquisitions and higher average rates. The average interest rate for the nine-month period ended September 30, 2004 was 4.9% compared to 4.1% in the comparable prior year period.

Income before income taxes increased \$14.8 million (71%) to \$35.6 million for the nine months ended September 30, 2004. This increase is primarily due to the increased volume in both segments and the related positive impact of increased leverage of fixed and semi-fixed costs over a higher revenue base. Acquisitions also contributed \$3.4 million to this increase. These positive factors were partially offset by higher interest expense.

The provision for income taxes increased by \$5.4 million to \$12.1 million for the nine-month period of 2004, compared to the prior year period, as a result of the incremental income before taxes and a higher overall effective tax rate. The Company's effective tax rate for the nine months ended September 30, 2004 increased to 34.0% compared to 32.0% in the prior year period, principally due to the acquisition of Syltone.

Net income for the nine months ended September 30, 2004 increased \$9.3 million (66%) to \$23.5 million (\$1.23 diluted earnings per share), compared to \$14.1 million (\$0.87 diluted

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earnings per share) in same period of 2003. This increase in net income is primarily attributable to the same factors that resulted in increased income before taxes noted above, partially offset by a higher effective tax rate in 2004. The incremental impact on diluted earnings per share from acquisitions was \$0.10.

### Outlook

In general, demand for compressor and vacuum products correlates to the rate of manufacturing capacity utilization and the rate of change of industrial

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production because compressed air is often used as a fourth utility in the manufacturing process. Over longer time periods, demand also follows the economic growth patterns indicated by the rates of change in the Gross Domestic Product. In the third quarter of 2004, orders for compressor and vacuum products were \$146.5 million, compared to \$90.3 million in the same period of 2003. Backlog for the Compressor and Vacuum Products segment was \$161.2 million as of September 30, 2004, compared to \$56.5 million as of September 30, 2003. The increase in orders and backlog compared to the prior year was primarily due to the addition of Syltone's transportation-related activities and Nash Elmo, which contributed \$44.0 million and \$93.4 million to orders and backlog, respectively. Favorable changes in foreign currency exchange rates also added approximately \$2.9 million and \$2.2 million to orders and backlog, respectively. Excluding these favorable items, the growth in orders in the three-month period for this segment was primarily driven by an improvement in industrial demand in the U.S. and Europe, combined with incremental market share gains in Europe, South Africa and China. The Company also experienced an increase in demand for positive displacement blowers and locomotive compressors due to an improved transportation market in the U.S.

Demand for fluid transfer products, the majority of which are petroleum related, has historically corresponded to market conditions and expectations for oil and natural gas prices. Orders for fluid transfer products were \$50.4 million in the third quarter of 2004, compared to \$18.9 million in the same period of 2003. Backlog for this business segment was \$51.6 million as of September 30, 2004, compared to \$8.7 million as of September 30, 2003. The increase in orders and backlog compared to the prior year was primarily due to the addition of Syltone's fluid transfer-related activities, which contributed \$15.5 million and \$23.7 million to orders and backlog, respectively. Excluding the impact of Syltone, the increase in orders for this segment was principally due to increased demand for well stimulation pumps, drilling pumps and petroleum pump parts, as a result of continued high prices for oil and natural gas. Future increases in demand for these products will likely be dependent upon oil and natural gas prices and rig counts, which the Company cannot predict.

On October 22, 2004, the President of the United States signed into law the "American Jobs Creation Act of 2004." The Company is currently analyzing this tax legislation to determine its impact, if any, on the Company's future income tax accounting and consolidated financial statements.

### LIQUIDITY AND CAPITAL RESOURCES

#### Operating Working Capital

During the nine months ended September 30, 2004, operating working capital (defined as receivables plus inventories, less accounts payable and accrued liabilities) increased \$61.2 million, primarily due to incremental operating working capital from the Nash Elmo and Syltone

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acquisitions and higher inventory and receivable balances stemming from increased activity levels.

#### Cash Flows

During the first nine months of 2004, the Company generated cash from operations totaling \$22.3 million, compared to \$23.7 million in the prior year period. This change was primarily due to the unfavorable change in operating working capital due to increased activity levels, partially offset

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by higher net income and cash from operations provided by acquisitions. Net of cash acquired, \$292.1 million in cash was used to fund the Nash Elmo and Syltone acquisitions (and related direct acquisition costs) during the first nine months of 2004. This use of cash was primarily funded by net borrowings (\$115.0 million), the sale of 3.45 million shares of common stock in March 2004 (\$79.6 million) and excess cash reserves. The cash flows provided by operating and financing activities and used in investing activities, combined with the effect of exchange rate changes, resulted in a net cash decrease of \$84.7 million during the first nine months of 2004.

### Capital Expenditures and Commitments

Capital projects designed to increase operating efficiency and flexibility, expand production capacity and bring new products to market resulted in expenditures of \$12.3 million in the first nine months 2004. This was \$4.1 million higher than the level of capital expenditures in the comparable period in 2003, primarily due to the timing of capital projects and spending at acquisitions. Commitments for capital expenditures at September 30, 2004 were approximately \$10 million. Capital expenditures related to environmental projects have not been significant in the past and are not expected to be significant in the foreseeable future.

In October 1998, Gardner Denver's Board of Directors authorized the repurchase of up to 1,600,000 shares of the Company's common stock to be used for general corporate purposes. Approximately 200,000 shares remain available for repurchase under this program. The Company has also established a Stock Repurchase Program for its executive officers to provide a means for them to sell Gardner Denver common stock and obtain sufficient funds to meet income tax obligations which arise from the exercise or vesting of incentive stock options, restricted stock or performance shares. The Gardner Denver Board has authorized up to 400,000 shares for repurchase under this program and of this amount approximately 200,000 shares remain available for repurchase. As of September 30, 2004, a total of 1,572,542 shares have been repurchased at a cost of \$22.8 million under both repurchase programs.

### Liquidity

On September 1, 2004, the Company entered into a \$375.0 million amended and restated credit agreement (the "Credit Agreement"). The Credit Agreement provided the Company with access to senior secured credit facilities including a \$150.0 million five-year Term Loan and a \$225.0 million five-year Revolving Line of Credit (the "Credit Line"). Proceeds from the Credit Agreement were used to fund the Nash Elmo acquisition and retire debt outstanding under its previously existing Credit Line and Term Loan.

The Credit Line has a borrowing capacity of \$225.0 million and the total debt balance is due upon final maturity on September 1, 2009. Loans under this facility may be denominated in U.S. Dollars or several foreign currencies. The interest rate varies with prime, federal funds and/or

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LIBOR for the applicable currency and was 3.8% as of September 30, 2004. On September 30, 2004, the Credit Line had an outstanding principal balance of \$127.0 million, leaving \$98.0 million available for letters of credit or for future use, subject to the terms of the Credit Line.

The \$150.0 million Term Loan has a final maturity of September 1, 2009. The Term Loan requires quarterly principal payments totaling \$7.5 million, \$15.0 million, \$22.5 million, \$37.5 million and \$67.5 million in years one through

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five, respectively. The interest rate varies with prime, federal funds and/or LIBOR and was 3.8% as of September 30, 2004. On September 30, 2004, the Term Loan had an outstanding principal balance of \$150.0 million.

Pursuant to its previously filed shelf registration with the Securities and Exchange Commission, the Company completed an offering of 3.45 million shares of its common stock for net proceeds of approximately \$79.6 million during March 2004. These proceeds were used to repay borrowings under its previously existing Credit Line.

The Company's borrowing arrangements permit certain investments and dividend payments and are generally unsecured with the exception of the Credit Agreement, which requires the pledge of certain subsidiaries' stock. There are no material restrictions on the Company as a result of its credit agreements, other than customary covenants regarding certain earnings, liquidity and capital ratios.

Management currently expects the Company's future cash flows to be sufficient to fund its scheduled debt service and provide required resources for working capital and capital investments for at least the next twelve months.

### CONTINGENCIES

The Company is a party to various legal proceedings, lawsuits and administrative actions, which are of an ordinary or routine nature. In addition, due to the bankruptcies of several asbestos manufacturers and other primary defendants, the Company has been named as a defendant in an increasing number of asbestos personal injury lawsuits. The Company has also been named as a defendant in an increasing number of silicosis personal injury lawsuits. The plaintiffs in these suits allege exposure to asbestos or silica from multiple sources and typically the Company is one of approximately 25 or more named defendants. In the Company's experience, the vast majority of the plaintiffs are not impaired with a disease for which the Company bears any responsibility.

Predecessors to the Company manufactured, distributed and sold products allegedly at issue in the pending asbestos and silicosis litigation lawsuits (the "Products"). The Company has potential responsibility for certain of these Products, namely: (a) air compressors which used asbestos containing components manufactured and supplied by third parties; and (b) portable air compressors used in sandblasting operations as a component of sandblasting equipment manufactured and sold by others. The sandblasting equipment is alleged to have caused the silicosis disease plaintiffs claim in these cases.

Neither the Company nor its predecessors ever mined, manufactured, mixed, produced or distributed asbestos fiber. The asbestos-containing components used in the Products were completely encapsulated in a protective non-asbestos binder and enclosed within the subject Products. Furthermore, the Company has never manufactured or distributed portable air compressors.

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The Company has entered into a series of cost sharing agreements with multiple insurance companies to secure coverage for asbestos and silicosis lawsuits. The Company also believes some of the potential liabilities regarding these lawsuits are covered by indemnity agreements with other parties. The Company's uninsured settlement payments for past asbestos and silicosis lawsuits have been immaterial.

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The Company believes that the pending and future asbestos and silicosis lawsuits will not, in the aggregate, have a material adverse effect on its consolidated financial position, results of operations or liquidity, based on: the Company's anticipated insurance and indemnification rights to address the risks of such matters; the limited potential asbestos exposure from the components described above; the Company's experience that the vast majority of plaintiffs are not impaired with a disease attributable to alleged exposure to asbestos or silica from or relating to the Products; various potential defenses available to the Company with respect to such matters; and the Company's prior disposition of comparable matters. However, due to inherent uncertainties of litigation and because future developments could cause a different outcome, there can be no assurance that the resolution of pending or future lawsuits, whether by judgment, settlement or dismissal, will not have a material adverse effect on its consolidated financial position, results of operations or liquidity.

The Company has also been identified as a potentially responsible party with respect to several sites designated for environmental cleanup under various state and federal laws. The Company does not own any of these sites. The Company does not believe that the future potential costs related to these sites will have a material adverse effect on its consolidated financial position, results of operations or liquidity.

### NEW ACCOUNTING STANDARDS

In May 2004, the FASB issued Staff Position SFAS No. 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003," ("FSP 106-2"). FSP 106-2 supersedes FSP 106-1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003," and provides guidance on the accounting, disclosure, effective date and transition related to the Prescription Drug Act. FSP 106-2 was effective for the third quarter of 2004. According to an actuarial assessment, the Company currently provides prescription drug benefits, which are actuarially equivalent to the Medicare-prescription drug benefit to certain retired and other employees and will therefore qualify for the subsidy. As a result, the Company accounted for the federal subsidy attributable to past services as an actuarial gain, which reduced the accumulated post-retirement benefit obligation. This actuarial gain will then be amortized in future periods in accordance with SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions." The federal subsidy attributable to employee service rendered in current and future periods will reduce future net periodic postretirement benefit cost as those employees provide service. The favorable impact to diluted earnings per share from adopting FSP 106-2 is expected to be \$0.01 in 2004 and \$0.02 in 2005.

### CRITICAL ACCOUNTING POLICIES

Management has evaluated the accounting policies used in the preparation of the Company's financial statements and related notes and believes those policies to be reasonable and appropriate. Certain of these accounting policies require the application of significant judgment by management in selecting appropriate assumptions for calculating financial estimates. By their

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nature, these judgments are subject to an inherent degree of uncertainty. These judgments are based on historical experience, trends in the industry, information provided by customers and information available from other outside sources, as appropriate. The most significant areas involving

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management judgments and estimates may be found in our 2003 Annual Report on Form 10-K, filed on March 10, 2004, in the Critical Accounting Policies section of Management's Discussion and Analysis and in Note 1 to the Consolidated Financial Statements contained in our 2003 Annual Report to Stockholders filed as Exhibit 13.0 thereto.

### CAUTIONARY STATEMENTS REGARDING FORWARD-LOOKING STATEMENTS

All of the statements in this Management's Discussion and Analysis, other than historical facts, are forward-looking statements made in reliance upon the safe harbor of the Private Securities Litigation Reform Act of 1995, including, without limitation, statements made under the caption "Outlook." As a general matter, forward-looking statements are those focused upon anticipated events or trends and expectations and beliefs relating to matters that are not historical in nature. Such forward-looking statements are subject to uncertainties and factors relating to the Company's operations and business environment, all of which are difficult to predict and many of which are beyond the control of the Company. These uncertainties and factors could cause actual results to differ materially from those matters expressed in or implied by such forward-looking statements.

The following uncertainties and factors, among others, could affect future performance and cause actual results to differ materially from those expressed in or implied by forward-looking statements: (1) the ability to identify, negotiate and complete possible future acquisitions; (2) the speed with which the Company is able to integrate acquisitions and realize the related financial benefits; (3) the ability to maintain and to enter into key purchasing, supply and outsourcing relationships; (4) purchased material cost changes, including metal surcharges; (5) the ability to effectively manage the transition of iron casting supply to alternate sources and the skill, commitment and availability of such alternate sources; (6) the successful implementation of other strategic initiatives, including, without limitation, restructuring plans, inventory reduction programs and other cost reduction efforts; (7) the domestic and/or worldwide level of oil and natural gas prices and oil and gas drilling and production, which affect demand for the Company's petroleum products; (8) changes in domestic and/or worldwide industrial production and industrial capacity utilization rates, which affect demand for the Company's compressor and vacuum products; (9) pricing of the Company's products; (10) the degree to which the Company is able to penetrate niche and international markets; (11) changes in currency exchange rates (primarily between the U.S. dollar, the euro and the British pound); (12) changes in interest rates; (13) the ability to attract and retain quality management personnel; (14) market performance of pension plan assets and changes in discount rates used for actuarial assumptions in pension and other postretirement obligation and expense calculations; (15) the continued ability to effectively manage and defend litigation matters pending, or asserted in the future, against the Company; (16) the development and acceptance of the Company's new product offerings; (17) the continued successful implementation and utilization of the Company's electronic services; and (18) changes in laws and regulations, including accounting standards and tax requirements.

The Company does not undertake, and hereby disclaims, any duty to update these forward-looking statements, even though its situation and circumstances may change in the future.

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### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risk related to changes in interest rates



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as well as European and other foreign currency exchange rates, and selectively uses derivative financial instruments, including forwards and swaps, to manage these risks. The Company does not hold derivatives for trading purposes. The value of market-risk sensitive derivatives and other financial instruments is subject to change as a result of movements in market rates and prices. Sensitivity analysis is one technique used to evaluate these impacts. Based on a hypothetical ten percent change in interest rates or ten percent change in the U.S. dollar across relevant foreign currencies, principally the euro and British pound, the potential changes in future earnings, fair value and cash flows are not material to the Company.

### ITEM 4. CONTROLS AND PROCEDURES

As required by Rule 13a-15 of the Exchange Act, the Company has carried out an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the period covered by this report. This evaluation was carried out under the supervision and with the participation of the Company's management, including the Chairman, President and Chief Executive Officer and the Vice President, Finance and Chief Financial Officer. Based upon that evaluation, the Chairman, President and Chief Executive Officer and Vice President, Finance and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed in the Company's periodic SEC reports is recorded, processed, summarized, and reported as and when required. In addition, they concluded that there were no changes in the Company's internal control over financial reporting that occurred during the period covered by this report that have materially affected, or that are reasonably likely to materially affect, the Company's internal control over financial reporting.

In designing and evaluating the disclosure controls and procedures, the Company's management recognized that any controls and procedures, no matter how well designed, can provide only reasonable assurances of achieving the desired control objectives and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

The Company completed the acquisition of Nash Elmo on September 1, 2004. For the year ended December 31, 2003, Nash Elmo's revenues were \$212.4 million. Total assets for this business were \$323.0 million as of September 30, 2004. This business is a separate control environment. The evaluation of disclosure controls and procedures referred to in the paragraph above included Nash Elmo. However, the Company will exclude this business from management's report on internal control over financial reporting, as permitted by SEC guidance, to be included in our Form 10-K for the year ended December 31, 2004.

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## PART II - OTHER INFORMATION

### ITEM 2. CHANGES IN SECURITIES, USE OF PROCEEDS AND ISSUER PURCHASES OF EQUITY SECURITIES

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TOTAL NUMBER OF  
SHARES PURCHASED AS

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PERIOD	TOTAL NUMBER OF SHARES PURCHASED (1)	AVERAGE PRICE PAID PER SHARE	PART OF PUBLICLY ANNOUNCED PLANS OR PROGRAMS (2)	T
July 1, 2004 - July 31, 2004	--	--	--	
August 1, 2004 - August 31, 2004	--	--	--	
September 1, 2004 - September 30, 2004	--	--	--	
Total	--	--	--	