

FLOWSERVE CORP  
Form 10-Q  
October 24, 2013

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q  
(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2013  
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 No. 1-13179

FLOWSERVE CORPORATION  
(Exact name of registrant as specified in its charter)

New York 31-0267900  
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

5215 N. O'Connor Blvd., Suite 2300, Irving, Texas 75039  
(Address of principal executive offices) (Zip Code)

(972) 443-6500

(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 requirements for the past 90 days.  Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  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 definitions of "accelerated filer," "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

As of October 21, 2013, there were 139,468,604 shares of the issuer's common stock outstanding.

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## PART I — FINANCIAL INFORMATION

## Item 1. Financial Statements.

## FLOWSERVE CORPORATION

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(Amounts in thousands, except per share data)

	Three Months Ended September 30,	
	2013	2012
Sales	\$1,229,057	\$1,165,923
Cost of sales	(806,318	) (776,319
Gross profit	422,739	389,604
Selling, general and administrative expense	(231,569	) (227,797
Net earnings from affiliates	2,218	3,899
Operating income	193,388	165,706
Interest expense	(13,046	) (12,144
Interest income	325	208
Other income (expense), net	1,733	(9,167
Earnings before income taxes	182,400	144,603
Provision for income taxes	(55,870	) (37,769
Net earnings, including noncontrolling interests	126,530	106,834
Less: Net earnings attributable to noncontrolling interests	(259	) (538
Net earnings attributable to Flowserve Corporation	\$126,271	\$106,296
Net earnings per share attributable to Flowserve Corporation common shareholders:		
Basic	\$0.90	\$0.70
Diluted	0.90	0.69
Cash dividends declared per share	\$0.14	\$0.12

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(Amounts in thousands)

	Three Months Ended September 30,	
	2013	2012
Net earnings, including noncontrolling interests	\$126,530	\$106,834
Other comprehensive income:		
Foreign currency translation adjustments, net of taxes of \$(23,353) and \$(19,147), respectively	38,581	31,641
Pension and other postretirement effects, net of taxes of \$(407) and \$(463), respectively	(373	) 180
Cash flow hedging activity, net of taxes of \$(74) and \$(130), respectively	152	215
Other comprehensive income	38,360	32,036
Comprehensive income, including noncontrolling interests	164,890	138,870
Comprehensive income attributable to noncontrolling interests	(29	) (700
Comprehensive income attributable to Flowserve Corporation	\$164,861	\$138,170

See accompanying notes to condensed consolidated financial statements.



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FLOWSERVE CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(Amounts in thousands, except per share data)

	Nine Months Ended September 30,	
	2013	2012
Sales	\$3,565,179	\$3,423,128
Cost of sales	(2,347,555	) (2,289,739
Gross profit	1,217,624	1,133,389
Selling, general and administrative expense	(706,278	) (673,578
Net earnings from affiliates (Note 2)	36,043	13,214
Operating income	547,389	473,025
Interest expense	(38,262	) (29,876
Interest income	877	727
Other expense, net	(8,679	) (22,151
Earnings before income taxes	501,325	421,725
Provision for income taxes	(154,998	) (112,864
Net earnings, including noncontrolling interests	346,327	308,861
Less: Net earnings attributable to noncontrolling interests	(1,878	) (2,124
Net earnings attributable to Flowserve Corporation	\$344,449	\$306,737
Net earnings per share attributable to Flowserve Corporation common shareholders:		
Basic	\$2.42	\$1.92
Diluted	2.41	1.91
Cash dividends declared per share	\$0.42	\$0.36

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(Amounts in thousands)

	Nine Months Ended September 30,	
	2013	2012
Net earnings, including noncontrolling interests	\$346,327	\$308,861
Other comprehensive (loss) income:		
Foreign currency translation adjustments, net of taxes of \$17,254 and \$(4,891), respectively	(28,505	) 8,082
Pension and other postretirement effects, net of taxes of \$(4,634) and \$(2,125), respectively	9,254	2,726
Cash flow hedging activity, net of taxes of \$(399) and \$29, respectively	627	(89
Other comprehensive (loss) income	(18,624	) 10,719
Comprehensive income, including noncontrolling interests	327,703	319,580
Comprehensive income attributable to noncontrolling interests	(1,722	) (2,173
Comprehensive income attributable to Flowserve Corporation	\$325,981	\$317,407

See accompanying notes to condensed consolidated financial statements.



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FLOWSERVE CORPORATION  
 CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(Amounts in thousands, except par value)

	September 30, 2013	December 31, 2012
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$113,751	\$304,252
Accounts receivable, net of allowance for doubtful accounts of \$25,916 and \$21,491, respectively	1,089,748	1,103,724
Inventories, net	1,184,188	1,086,663
Deferred taxes	150,760	151,093
Prepaid expenses and other	88,204	94,484
Total current assets	2,626,651	2,740,216
Property, plant and equipment, net of accumulated depreciation of \$837,476 and \$784,864, respectively	678,934	654,179
Goodwill	1,058,802	1,053,852
Deferred taxes	26,241	26,706
Other intangible assets, net	143,067	150,075
Other assets, net	162,499	185,930
Total assets	\$4,696,194	\$4,810,958
<b>LIABILITIES AND EQUITY</b>		
Current liabilities:		
Accounts payable	\$495,295	\$616,900
Accrued liabilities	822,414	906,593
Debt due within one year	268,934	59,478
Deferred taxes	7,606	7,654
Total current liabilities	1,594,249	1,590,625
Long-term debt due after one year	839,224	869,116
Retirement obligations and other liabilities	452,254	456,742
Shareholders' equity:		
Common shares, \$1.25 par value	220,991	220,991
Shares authorized – 305,000		
Shares issued – 176,793 and 176,793, respectively		
Capital in excess of par value	464,990	467,856
Retained earnings	2,863,863	2,579,308
Treasury shares, at cost – 38,357 and 32,389 shares, respectively	(1,511,768)	(1,164,496)
Deferred compensation obligation	9,359	10,870
Accumulated other comprehensive loss	(242,778)	(224,310)
Total Flowserve Corporation shareholders' equity	1,804,657	1,890,219
Noncontrolling interest	5,810	4,256
Total equity	1,810,467	1,894,475
Total liabilities and equity	\$4,696,194	\$4,810,958

See accompanying notes to condensed consolidated financial statements.

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## FLOWSERVE CORPORATION

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(Amounts in thousands)

	Nine Months Ended September 30,	
	2013	2012
Cash flows – Operating activities:		
Net earnings, including noncontrolling interests	\$346,327	\$308,861
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation	66,700	66,027
Amortization of intangible and other assets	11,884	14,751
Loss on early extinguishment of debt	—	1,293
Net gain on disposition of assets	(248	) (10,461
Gain on sale of equity investment in affiliate	(12,995	) —
Gain on remeasurement of acquired assets	(15,315	) —
Excess tax benefits from stock-based compensation arrangements	(10,104	) (11,056
Stock-based compensation	24,395	25,942
Net earnings from affiliates, net of dividends received	(3,397	) (5,798
Change in assets and liabilities:		
Accounts receivable, net	10,828	(45,566
Inventories, net	(101,745	) (149,254
Prepaid expenses and other	(6,870	) (8,968
Other assets, net	(12,574	) (11,609
Accounts payable	(126,976	) (75,169
Accrued liabilities and income taxes payable	(61,139	) 26,057
Retirement obligations and other liabilities	(8,512	) (6,737
Net deferred taxes	8,629	4,251
Net cash flows provided by operating activities	108,888	122,564
Cash flows – Investing activities:		
Capital expenditures	(94,702	) (84,180
Proceeds from disposal of assets	969	11,473
Payments for acquisitions, net of cash acquired	(10,143	) (3,996
Proceeds from (contributions to) equity investments in affiliates	46,240	(3,825
Net cash flows used by investing activities	(57,636	) (80,528
Cash flows – Financing activities:		
Excess tax benefits from stock-based compensation arrangements	10,104	11,056
Payments on long-term debt	(15,000	) (475,000
Proceeds from issuance of senior notes	—	498,075
Proceeds from issuance of long-term debt	—	400,000
Proceeds from short-term financing, net	196,000	—
(Payments) borrowings under other financing arrangements, net	(571	) 294
Repurchases of common shares	(370,127	) (533,864
Payments of dividends	(57,337	) (55,569
Payment of deferred loan costs	—	(9,657
Other	(78	) (248

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Net cash flows used by financing activities	(237,009	) (164,913	)
Effect of exchange rate changes on cash	(4,744	) 2,941	)
Net change in cash and cash equivalents	(190,501	) (119,936	)
Cash and cash equivalents at beginning of period	304,252	337,356	)
Cash and cash equivalents at end of period	\$ 113,751	\$ 217,420	)

See accompanying notes to condensed consolidated financial statements.

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FLOWSERVE CORPORATION

(Unaudited)

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation and Accounting Policies

Basis of Presentation

The accompanying condensed consolidated balance sheet as of September 30, 2013, the related condensed consolidated statements of income and comprehensive income for the three and nine months ended September 30, 2013 and 2012, and the condensed consolidated statements of cash flows for the nine months ended September 30, 2013 and 2012, of Flowserve Corporation are unaudited. In management's opinion, all adjustments comprising normal recurring adjustments necessary for a fair presentation of such condensed consolidated financial statements have been made.

The accompanying condensed consolidated financial statements and notes in this Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2013 ("Quarterly Report") are presented as permitted by Regulation S-X and do not contain certain information included in our annual financial statements and notes thereto. Accordingly, the accompanying condensed consolidated financial information should be read in conjunction with the consolidated financial statements presented in our Annual Report on Form 10-K for the year ended December 31, 2012 ("2012 Annual Report").

On May 23, 2013, our certificate of incorporation was amended to increase the number of authorized shares of common stock from 120.0 million to 305.0 million and enable a three-for-one stock split approved by the Board of Directors on February 7, 2013 in the form of a 200% common stock dividend. The record date for the stock split was June 7, 2013, and additional shares were distributed on June 21, 2013. Shareholders' equity and all share data, including treasury shares and stock-based compensation award shares, and per share data presented herein have been retrospectively adjusted to reflect the impact of the increase in authorized shares and the stock split, as appropriate. Venezuela – As previously disclosed in our 2012 Annual Report, effective February 13, 2013, the Venezuelan government devalued its currency (bolivar) from 4.3 to 6.3 bolivars to the United States ("U.S.") dollar. Our operations in Venezuela generally consist of a service center that performs service and repair activities. In addition, certain of our operations in other countries sell equipment and parts that are typically denominated in U.S. dollars directly to Venezuelan customers. Our Venezuelan subsidiary's sales for the three and nine months ended September 30, 2013 and total assets at September 30, 2013 represented less than 1% of consolidated sales and total assets for the same periods.

As a result of the devaluation, we recognized a loss of \$4.0 million in the first quarter of 2013. The loss was reported in other expense, net in our condensed consolidated statements of income and resulted in no tax benefit. We have evaluated the carrying value of related assets and concluded that there is no current impairment. We are continuing to assess and monitor the ongoing impact of the currency devaluation on our Venezuelan operations and imports into the market, including our Venezuelan subsidiary's ability to remit cash for dividends and other payments at the official rate, as well as further actions of the Venezuelan government and economic conditions that may adversely impact our future consolidated financial condition or results of operations.

Accounting Policies

Significant accounting policies, for which no significant changes have occurred in the nine months ended September 30, 2013, are detailed in Note 1 to our consolidated financial statements included in our 2012 Annual Report.

Accounting Developments

Pronouncements Implemented

In December 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2011-11, "Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities," which

requires enhanced disclosures about financial instruments and derivative instruments that are either (1) offset in accordance with either Accounting Standards Codification ("ASC") 210-20-45, "Balance Sheet - Offsetting," or ASC 815-10-45, "Derivatives and Hedging - Overall," or (2) subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset in accordance with either ASC 210-20-45 or ASC 815-10-45. The disclosure requirements shall be applied retrospectively for all periods presented. Our adoption of ASU No. 2011-11, effective January 1, 2013, had no impact on our consolidated financial condition and results of operations.

In January 2013, the FASB issued ASU No. 2013-01, "Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities," which limits the scope of ASU 2011-11 to derivatives, repurchase agreements and securities lending transactions to the extent that they are (1) offset in the financial statements or (2) subject to an enforceable master netting arrangement or similar agreement. The disclosure requirements shall be applied retrospectively for all periods presented. Our

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adoption of ASU No. 2013-01, effective January 1, 2013, had no impact on our consolidated financial condition and results of operations.

In July 2012, the FASB issued ASU No. 2012-02, "Intangibles-Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment," which specifies that an entity has the option to first assess qualitative factors to determine whether it is more likely than not that the asset is impaired. Unless an entity determines that it is more likely than not that the fair value of such an asset is less than its carrying amount, it would not need to calculate the fair value of the asset in that year. Our adoption of ASU No. 2012-02, effective January 1, 2013, had no impact on our consolidated financial condition and results of operations.

In February 2013, the FASB issued ASU No. 2013-02, "Comprehensive Income (Topic 220) - Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income," which requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income, but only if the amount reclassified is required under U.S. Generally Accepted Accounting Principles ("GAAP") to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional detail about those amounts. Our adoption of ASU No. 2013-02, effective January 1, 2013, had no impact on our consolidated financial condition and results of operations.

In March 2013, the FASB issued ASU No. 2013-05, "Foreign Currency Matters (Topic 830) - Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity," which specifies that a cumulative translation adjustment should be released into earnings when an entity ceases to have a controlling financial interest in a subsidiary or group of assets within a consolidated foreign entity and the sale or transfer results in the complete or substantially complete liquidation of the foreign entity. ASU No. 2013-05 is effective for fiscal years, and interim periods within those years, beginning on or after December 15, 2013. We early adopted this ASU effective January 1, 2013 and it did not have a material impact on our consolidated financial condition and results of operations.

In July 2013, the FASB issued ASU No. 2013-10, "Derivatives and Hedging (Topic 815) - Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes," which allows the use of the Fed Funds Effective Swap Rate as a U.S. benchmark interest rate for fair value and cash flow hedges under Topic 815, in addition to interest rates on direct Treasury obligations of the U.S. government and the London Interbank Offered Rate swap rate. This ASU also removes the restriction on using different benchmark rates for similar hedges. ASU No. 2013-10 is effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. Our adoption of ASU No. 2013-10 did not have a material impact on our consolidated financial condition and results of operations.

**Pronouncements Not Yet Implemented**

In February 2013, the FASB issued ASU No. 2013-04, "Liabilities (Topic 405) - Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date," which requires a reporting entity that is jointly and severally liable to measure the obligation as the sum of the amount the entity has agreed with co-obligors to pay and any additional amount it expects to pay on behalf of one or more co-obligors. The scope of this ASU excludes obligations addressed by existing guidance. ASU No. 2013-04 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The ASU shall be applied retrospectively for arrangements existing at the beginning of the year of adoption. Our adoption of ASU No. 2013-04 will not have an impact on our consolidated financial condition and results of operations.

In April 2013, the FASB issued ASU No. 2013-07, "Presentation of Financial Statements (Topic 205) - Liquidation Basis of Accounting," which requires an entity to prepare its financial statements using the liquidation basis of

accounting when liquidation is imminent. Liquidation is imminent when the likelihood is remote that the entity will return from liquidation and either (a) a plan for liquidation is approved by the person or persons with the authority to make such a plan effective and the likelihood is remote that the execution of the plan will be blocked by other parties or (b) a plan for liquidation is being imposed by other forces (for example, involuntary bankruptcy). ASU No. 2013-07 is effective for entities that determine liquidation is imminent during annual reporting periods beginning after December 15, 2013, and interim reporting periods therein. The ASU shall be applied prospectively from the day that liquidation becomes imminent. Our adoption of ASU No. 2013-07 will not have an impact on our consolidated financial condition and results of operations.

In July 2013, the FASB issued ASU No. 2013-11, "Income Taxes (Topic 740) - Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists," which provides guidance on the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. ASU No. 2013-11 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2013.

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The ASU shall be applied prospectively to all unrecognized tax benefits that exist at the effective date. The adoption of ASU No. 2013-11 will not have a material impact on our consolidated financial condition and results of operations.

## 2. Exit of Joint Venture

Effective March 28, 2013, we and our joint venture partner agreed to exit our joint venture, Audco India, Limited ("AIL"), which manufactures integrated industrial valves in India. To effect the exit, in two separate transactions, Flow Control Division ("FCD") acquired 100% ownership of AIL's plug valve manufacturing business in an asset purchase for cash of \$10.1 million and sold its 50% equity interest in AIL to the joint venture partner for \$46.2 million in cash. We remeasured to fair value our previously held equity interest in the purchased net assets of the plug valve manufacturing business resulting in net assets acquired of approximately \$25 million and a pre-tax gain of \$15.3 million. The sale of our equity interest in AIL resulted in a pre-tax gain of \$13.0 million. In the first quarter of 2013, both of the above gains were recorded in net earnings from affiliates in the condensed consolidated statements of income. No pro forma information has been provided due to immateriality. Prior to these transactions, our 50% interest in AIL was recorded using the equity method of accounting.

## 3. Stock-Based Compensation Plans

We maintain the Flowserve Corporation Equity and Incentive Compensation Plan (the "2010 Plan"), which is a shareholder-approved plan authorizing the issuance of up to 8,700,000 shares of our common stock in the form of incentive stock options, non-statutory stock options, restricted shares, restricted share units and performance-based units (collectively referred to as "Restricted Shares"), stock appreciation rights and bonus stock. Of the 8,700,000 shares of common stock authorized under the 2010 Plan, 5,668,704 were available for issuance as of September 30, 2013. In addition to the 2010 Plan, we also maintain the Flowserve Corporation 2004 Stock Compensation Plan (the "2004 Plan"). The 2004 Plan authorizes the issuance of up to 10,500,000 shares of common stock through grants of Restricted Shares, stock options and other equity-based awards. Of the 10,500,000 shares of common stock authorized under the 2004 Plan, 827,835 were available for issuance as of September 30, 2013. No stock options have been granted since 2006.

Restricted Shares – Awards of Restricted Shares are valued at the closing market price of our common stock on the date of grant. The unearned compensation is amortized to compensation expense over the vesting period of the restricted shares. We had unearned compensation of \$37.0 million and \$30.4 million at September 30, 2013 and December 31, 2012, respectively, which is expected to be recognized over a weighted-average period of approximately one year. These amounts will be recognized into net earnings in prospective periods as the awards vest. The total fair value of Restricted Shares vested during the three months ended September 30, 2013 and 2012 was \$0.1 million and \$0.1 million, respectively. The total fair value of Restricted Shares vested during the nine months ended September 30, 2013 and 2012 was \$34.9 million and \$36.4 million, respectively.

We recorded stock-based compensation expense of \$5.3 million (\$8.1 million pre-tax) and \$6.9 million (\$10.5 million pre-tax) for the three months ended September 30, 2013 and 2012, respectively. We recorded stock-based compensation expense of \$16.1 million (\$24.4 million pre-tax) and \$17.1 million (\$25.9 million pre-tax) for the nine months ended September 30, 2013 and 2012, respectively.

The following table summarizes information regarding Restricted Shares:

	Nine Months Ended September 30, 2013	
	Shares	Weighted Average Grant-Date Fair Value
Number of unvested shares:		
Outstanding - January 1, 2013	2,376,300	\$37.70
Granted	701,913	52.33
Vested	(1,018,465	) 34.22

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Cancelled	(172,420	) 42.70
Outstanding - September 30, 2013	1,887,328	\$44.56

Unvested Restricted Shares outstanding as of September 30, 2013, includes approximately 900,000 units with performance-based vesting provisions. Performance-based units are issuable in common stock and vest upon the achievement of pre-defined performance targets, primarily based on our average annual return on net assets over a three-year period as compared with the same measure for a defined peer group for the same period. Most units were granted in three annual grants since January 1, 2011 and have a vesting percentage between 0% and 200% depending on the achievement of the specific performance targets. Compensation expense is recognized ratably over a cliff-vesting period of 36 months, based on the fair market value of our common stock on the date of grant, as adjusted for anticipated forfeitures. During the performance period, earned and unearned compensation

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expense is adjusted based on changes in the expected achievement of the performance targets. Vesting provisions range from 0 to approximately 1,800,000 shares based on performance targets. As of September 30, 2013, we estimate vesting of approximately 1,140,000 shares based on expected achievement of performance targets.

#### 4. Derivative Instruments and Hedges

Our risk management and derivatives policy specifies the conditions under which we may enter into derivative contracts. See Notes 1 and 6 to our consolidated financial statements included in our 2012 Annual Report and Note 7 of this Quarterly Report for additional information on our derivatives. We enter into forward exchange contracts to hedge our cash flow risks associated with transactions denominated in currencies other than the local currency of the operation engaging in the transaction. We have not elected to apply hedge accounting to our forward exchange contracts. At September 30, 2013 and December 31, 2012, we had \$666.6 million and \$608.9 million, respectively, of notional amount in outstanding forward exchange contracts with third parties. At September 30, 2013, the length of forward exchange contracts currently in place ranged from one day to 20 months. Also as part of our risk management program, we enter into interest rate swap agreements to hedge exposure to floating interest rates on certain portions of our debt. At September 30, 2013 and December 31, 2012, we had \$170.0 million and \$275.0 million, respectively, of notional amount in outstanding interest rate swaps with third parties. All interest rate swaps are highly effective. At September 30, 2013, the maximum remaining length of any interest rate swap contract in place was approximately 21 months.

We are exposed to risk from credit-related losses resulting from nonperformance by counterparties to our financial instruments. We perform credit evaluations of our counterparties under forward exchange contracts and interest rate swap agreements and expect all counterparties to meet their obligations. If necessary, we would adjust the values of our derivative contracts for our or our counterparties' credit risks. We have not experienced credit losses from our counterparties.

The fair value of forward exchange contracts not designated as hedging instruments are summarized below:

(Amounts in thousands)	September 30, 2013	December 31, 2012
Current derivative assets	\$5,097	\$6,104
Noncurrent derivative assets	424	104
Current derivative liabilities	4,822	7,814
Noncurrent derivative liabilities	6	12

The fair value of interest rate swaps in cash flow hedging relationships are summarized below:

(Amounts in thousands)	September 30, 2013	December 31, 2012
Current derivative liabilities	\$635	\$1,417
Noncurrent derivative liabilities	36	316

Current and noncurrent derivative assets are reported in our condensed consolidated balance sheets in prepaid expenses and other and other assets, net, respectively. Current and noncurrent derivative liabilities are reported in our condensed consolidated balance sheets in accrued liabilities and retirement obligations and other liabilities, respectively.

The impact of net changes in the fair values of forward exchange contracts not designated as hedging instruments are summarized below:

(Amounts in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Gain (loss) recognized in income	\$3,817	\$(855)	\$(3,714)	\$(6,496)

Gains and losses recognized in our condensed consolidated statements of income for forward exchange contracts are classified as other income (expense), net.

The impact of net changes in the fair values of interest rate swaps in cash flow hedging relationships are summarized in Note 16.

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## 5. Debt

Debt, including capital lease obligations, consisted of:

(Amounts in thousands, except percentages)	September 30, 2013	December 31, 2012
3.50% Senior Notes due September 15, 2022 (net of unamortized discount)	\$498,247	\$498,124
Term Loan Facility, interest rate of 1.50% at September 30, 2013 and 1.81% at December 31, 2012	380,000	395,000
Revolving Credit Facility, interest rate of 1.49% at September 30, 2013	196,000	—
Capital lease obligations and other borrowings	33,911	35,470
Debt and capital lease obligations	1,108,158	928,594
Less amounts due within one year	268,934	59,478
Total debt due after one year	\$839,224	\$869,116

## Senior Notes

On September 11, 2012, we completed a public offering of \$500.0 million in aggregate principal amount of senior notes due September 15, 2022 ("Senior Notes"). The Senior Notes bear an interest rate of 3.50% per year, payable on March 15 and September 15 of each year, commencing on March 15, 2013. The Senior Notes were priced at 99.615% of par value, reflecting a discount to the aggregate principal amount.

## Senior Credit Facility

On October 4, 2013 we amended our existing credit agreement that provided for a \$400.0 million term loan ("Term Loan Facility") and a revolving credit facility ("Revolving Credit Facility" and, together with the Term Loan Facility, the "Senior Credit Facility"). The significant amendments extend the maturity of our Senior Credit Facility by one year to October 4, 2018, increase the Revolving Credit Facility from \$850.0 million to \$1.0 billion and remove the \$300.0 million sublimit for the issuance of performance letters of credit. The Revolving Credit Facility retains its \$30.0 million sublimit for swing line loans and all other significant existing terms under the credit agreement remained unchanged. As of September 30, 2013 we had \$196.0 million outstanding under the Revolving Credit Facility. We had outstanding letters of credit of \$118.4 million and \$152.2 million at September 30, 2013 and December 31, 2012, respectively, which when included with the outstanding Revolving Credit Facility, reduced our borrowing capacity to \$535.6 million and \$697.8 million, respectively. Under our amended credit agreement and subject to certain conditions, we have the right to increase the amount of the Term Loan Facility or the Revolving Credit Facility by an aggregate amount not to exceed \$400.0 million. Our obligations under the Senior Credit Facility are guaranteed by certain of our 100% owned domestic subsidiaries. Such guarantees are released if we achieve certain credit ratings. We had not achieved these ratings as of September 30, 2013. Our compliance with applicable financial covenants under the Senior Credit Facility is tested quarterly, and we complied with all covenants at September 30, 2013. We may prepay loans under our Senior Credit Facility in whole or in part, without premium or penalty, at any time. A commitment fee, which is payable quarterly on the daily unused portions of the Senior Credit Facility, was 0.175% (per annum) during the period ended September 30, 2013. During the nine months ended September 30, 2013, we made scheduled repayments of \$15.0 million under our Term Loan Facility. We have scheduled repayments of \$10.0 million due in each of the next four quarters on our Senior Credit Facility. Our Senior Credit Facility bears a floating rate of interest, and we have entered into \$170.0 million of notional amount of interest rate swaps at September 30, 2013 to hedge exposure to floating interest rates.

## European Letter of Credit Facility

Due to the increased capacity and the removal of the performance letters of credit sublimit of the amended Revolving Credit Facility, we elected not to renew our 364-day unsecured, committed €125.0 million European Letter of Credit Facility ("European LOC Facility") used for contingent obligations in respect of surety and performance bonds, bank guarantees and similar obligations with maturities up to five years. The European LOC Facility will expire in October 2013. The remaining outstanding letters of credit will mature over the next five years. We had outstanding letters of credit drawn on the European LOC Facility of €74.3 million (\$100.5 million) and €63.1 million (\$83.3 million) as of September 30, 2013 and December 31, 2012, respectively.

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## 6. Supplemental Guarantor Financial Information

On September 11, 2012, we completed a public offering of Senior Notes that are fully and unconditionally and jointly and severally guaranteed by certain of our 100% owned domestic subsidiaries. The following condensed consolidating financial statements present the financial position, results of operations and cash flows of Flowserve Corporation (referred to as “Parent” for the purpose of this note only) on a Parent-only (Issuer) basis, the combined guarantor subsidiaries on a guarantor-only basis, the combined non-guarantor subsidiaries on a non-guarantor-only basis and elimination adjustments necessary to arrive at the information for the Parent, guarantor subsidiaries and non-guarantor subsidiaries on a condensed consolidated basis. Investments in subsidiaries have been accounted for using the equity method for this presentation.

## FLOWSERVE CORPORATION

## CONDENSED CONSOLIDATING STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

	Three Months Ended September 30, 2013				
	Parent (Issuer)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated Total
(Amounts in thousands)					
Sales	\$—	\$483,039	\$ 842,426	\$(96,408 )	\$1,229,057
Cost of sales	—	(311,255 )	(591,471 )	96,408	(806,318 )
Gross profit	—	171,784	250,955	—	422,739
Selling, general and administrative expense	(457 )	(114,511 )	(116,601 )	—	(231,569 )
Net earnings from affiliates	—	565	1,653	—	2,218
Net earnings from consolidated subsidiaries, net of tax	131,425	93,959	—	(225,384 )	—
Operating income	130,968	151,797	136,007	(225,384 )	193,388
Interest expense, net	(7,253 )	(3,026 )	(2,442 )	—	(12,721 )
Other (expense) income, net	—	(1,822 )	3,555	—	1,733
Earnings before income taxes	123,715	146,949	137,120	(225,384 )	182,400
Provision for income taxes	2,556	(15,524 )	(42,902 )	—	(55,870 )
Net earnings, including noncontrolling interests	126,271	131,425	94,218	(225,384 )	126,530
Less: Net earnings attributable to noncontrolling interests	—	—	(259 )	—	(259 )
Net earnings attributable to Flowserve Corporation	\$126,271	\$131,425	\$ 93,959	\$(225,384 )	\$126,271
Comprehensive income attributable to Flowserve Corporation	\$164,861	\$169,865	\$ 129,539	\$(299,404 )	\$164,861



Net earnings attributable to Flowserve Corporation

Comprehensive income attributable to Flowserve Corporation	\$325,981	\$341,344	\$ 196,768	\$(538,112 )	\$325,981
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	Nine Months Ended September 30, 2012				Consolidated Total
	Parent (Issuer)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	
(Amounts in thousands)					
Sales	\$—	\$1,337,117	\$ 2,343,241	\$(257,230 )	\$3,423,128
Cost of sales	—	(880,848 )	(1,666,121 )	257,230	(2,289,739 )
Gross profit	—	456,269	677,120	—	1,133,389
Selling, general and administrative expense	(2,655 )	(290,428 )	(380,495 )	—	(673,578 )
Net earnings from affiliates	—	3,154	10,060	—	13,214
Net earnings from consolidated subsidiaries, net of tax	312,681	195,451	—	(508,132 )	—
Operating income	310,026	364,446	306,685	(508,132 )	473,025
Interest expense, net	(5,776 )	(14,334 )	(9,039 )	—	(29,149 )
Other income (expense), net	—	673	(22,824 )	—	(22,151 )
Earnings before income taxes	304,250	350,785	274,822	(508,132 )	421,725
Provision for income taxes	2,487	(38,104 )	(77,247 )	—	(112,864 )
Net earnings, including noncontrolling interests	306,737	312,681	197,575	(508,132 )	308,861
Less: Net earnings attributable to noncontrolling interests	—	—	(2,124 )	—	(2,124 )
Net earnings attributable to Flowserve Corporation	\$306,737	\$312,681	\$ 195,451	\$(508,132 )	\$306,737
Comprehensive income attributable to Flowserve Corporation	\$317,407	\$323,427	\$ 202,268	\$(525,695 )	\$317,407



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FLOWSERVE CORPORATION  
CONDENSED CONSOLIDATING BALANCE SHEETS

	September 30, 2013				
	Parent (Issuer)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated Total
(Amounts in thousands)					
<b>ASSETS</b>					
Current assets:					
Cash and cash equivalents	\$ 1,386	\$—	\$ 112,365	\$—	\$ 113,751
Accounts receivable, net	—	238,870	850,878	—	1,089,748
Intercompany receivables	6,705	146,233	51,796	(204,734 )	—
Inventories, net	—	405,711	778,477	—	1,184,188
Other current assets, net	1,701	123,259	114,004	—	238,964
Total current assets	9,792	914,073	1,907,520	(204,734 )	2,626,651
Property, plant and equipment, net	—	203,338	475,596	—	678,934
Goodwill	—	671,858	386,944	—	1,058,802
Intercompany receivables	462,500	9,503	202,495	(674,498 )	—
Investment in consolidated subsidiaries	2,409,231	1,736,471	—	(4,145,702 )	—
Other assets, net	12,603	178,996	140,208	—	331,807
Total assets	\$ 2,894,126	\$ 3,714,239	\$ 3,112,763	\$ (5,024,934)	\$ 4,696,194
<b>LIABILITIES AND EQUITY</b>					
Current liabilities:					
Accounts payable	\$—	\$ 143,513	\$ 351,782	\$—	\$ 495,295
Intercompany payables	69	58,432	146,233	(204,734 )	—
Accrued liabilities	6,999	229,263	586,152	—	822,414
Debt due within one year	236,000	10	32,924	—	268,934
Deferred taxes	—	—	7,606	—	7,606
Total current liabilities	243,068	431,218	1,124,697	(204,734 )	1,594,249
Long-term debt due after one year	838,247	—	977	—	839,224
Intercompany payables	1,144	663,850	9,504	(674,498 )	—
Retirement obligations and other liabilities	7,010	209,940	235,304	—	452,254
Total liabilities	1,089,469	1,305,008	1,370,482	(879,232 )	2,885,727
Total Flowserve Corporation shareholders' equity	1,804,657	2,409,231	1,736,471	(4,145,702 )	1,804,657
Noncontrolling interest	—	—	5,810	—	5,810
Total equity	1,804,657	2,409,231	1,742,281	(4,145,702 )	1,810,467
Total liabilities and equity	\$ 2,894,126	\$ 3,714,239	\$ 3,112,763	\$ (5,024,934)	\$ 4,696,194



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	December 31, 2012				Consolidated Total
	Parent (Issuer)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	
(Amounts in thousands)					
<b>ASSETS</b>					
Current assets:					
Cash and cash equivalents	\$2,609	\$—	\$ 301,643	\$—	\$304,252
Accounts receivable, net	—	255,164	848,560	—	1,103,724
Intercompany receivables	—	157,447	42,836	(200,283 )	—
Inventories, net	—	382,360	704,303	—	1,086,663
Other current assets, net	1,967	123,152	120,458	—	245,577
Total current assets	4,576	918,123	2,017,800	(200,283 )	2,740,216
Property, plant and equipment, net	—	204,032	450,147	—	654,179
Goodwill	—	671,858	381,994	—	1,053,852
Intercompany receivables	462,500	10,363	85,316	(558,179 )	—
Investment in consolidated subsidiaries	2,321,597	1,604,462	—	(3,926,059 )	—
Other assets, net	14,879	175,771	172,061	—	362,711
Total assets	\$2,803,552	\$3,584,609	\$ 3,107,318	\$(4,684,521)	\$4,810,958
<b>LIABILITIES AND EQUITY</b>					
Current liabilities:					
Accounts payable	\$—	\$158,028	\$ 458,872	\$—	\$616,900
Intercompany payables	35	42,801	157,447	(200,283 )	—
Accrued liabilities	11,610	314,162	580,821	—	906,593
Debt due within one year	25,000	5	34,473	—	59,478
Deferred taxes	—	—	7,654	—	7,654
Total current liabilities	36,645	514,996	1,239,267	(200,283 )	1,590,625
Long-term debt due after one year	868,124	20	972	—	869,116
Intercompany payables	1,144	546,672	10,363	(558,179 )	—
Retirement obligations and other liabilities	7,420	201,324	247,998	—	456,742
Total liabilities	913,333	1,263,012	1,498,600	(758,462 )	2,916,483
Total Flowserve Corporation shareholders' equity	1,890,219	2,321,597	1,604,462	(3,926,059 )	1,890,219
Noncontrolling interest	—	—	4,256	—	4,256
Total equity	1,890,219	2,321,597	1,608,718	(3,926,059 )	1,894,475
Total liabilities and equity	\$2,803,552	\$3,584,609	\$ 3,107,318	\$(4,684,521)	\$4,810,958



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## FLOWSERVE CORPORATION

## CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS

	Nine Months Ended September 30, 2013				Consolidated Total
	Parent (Issuer)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	
(Amounts in thousands)					
Net cash flows provided (used) by operating activities	\$245,150	\$138,849	\$ (26,091 )	\$ (249,020 )	\$108,888
Cash flows — Investing activities:					
Capital expenditures	—	(27,827 )	(66,875 )	—	(94,702 )
Payments for acquisitions, net of cash acquired	—	—	(10,143 )	—	(10,143 )
Intercompany loan proceeds	—	911	56,333	(57,244 )	—
Intercompany loan payments	—	(52 )	(173,511 )	173,563	—
Proceeds from disposition of assets	—	93	876	—	969
Affiliate investment activity, net	—	—	46,240	—	46,240
Net cash flows used by investing activities	—	(26,875 )	(147,080 )	116,319	(57,636 )
Cash flows — Financing activities:					
Excess tax benefits from stock-based payment arrangements	—	8,265	1,839	—	10,104
Payments on long-term debt	(15,000 )	—	—	—	(15,000 )
Short-term financing, net	196,000	—	—	—	196,000
Borrowings under other financing arrangements, net	—	(15 )	(556 )	—	(571 )
Repurchases of common shares	(370,127 )	—	—	—	(370,127 )
Payments of dividends	(57,337 )	—	—	—	(57,337 )
Intercompany loan proceeds	—	173,511	52	(173,563 )	—
Intercompany loan payments	—	(56,333 )	(911 )	57,244	—
Intercompany dividends	—	(237,402 )	(11,618 )	249,020	—
All other financing, net	91	—	(169 )	—	(78 )
Net cash flows used by financing activities	(246,373 )	(111,974 )	(11,363 )	132,701	(237,009 )
Effect of exchange rate changes on cash	—	—	(4,744 )	—	(4,744 )
Net change in cash and cash equivalents	(1,223 )	—	(189,278 )	—	(190,501 )
Cash and cash equivalents at beginning of period	2,609	—	301,643	—	304,252
Cash and cash equivalents at end of period	\$1,386	\$—	\$ 112,365	\$—	\$113,751

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	Nine Months Ended September 30, 2012				Consolidated Total
	Parent (Issuer)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	
(Amounts in thousands)					
Net cash flows provided by operating activities	\$49,256	\$74,283	\$ 50,767	\$(51,742 )	\$122,564
Cash flows — Investing activities:					
Capital expenditures	—	(25,366 )	(58,814 )	—	(84,180 )
Payments for acquisitions, net of cash acquired	—	—	(3,996 )	—	(3,996 )
Intercompany loan proceeds	—	7,869	—	(7,869 )	—
Intercompany loan payments	—	(26,648 )	—	26,648	—
Intercompany return of capital	—	1,982	—	(1,982 )	—
Intercompany capital contribution	—	(483 )	—	483	—
Proceeds from disposition of assets	—	87	11,386	—	11,473
Affiliate investment activity, net	—	—	(3,825 )	—	(3,825 )
Net cash flows used by investing activities	—	(42,559 )	(55,249 )	17,280	(80,528 )
Cash flows — Financing activities:					
Excess tax benefits from stock-based payment arrangements	—	8,837	2,219	—	11,056
Payments on long-term debt	(475,000 )	—	—	—	(475,000 )
Proceeds from issuance of senior notes	498,075	—	—	—	498,075
Proceeds from issuance of long-term debt	400,000	—	—	—	400,000
Borrowings under other financing arrangements, net	9	171	114	—	294
Repurchases of common shares	(533,864 )	—	—	—	(533,864 )
Payments of dividends	(55,569 )	—	—	—	(55,569 )
Payment of deferred loan costs	(9,657 )	—	—	—	(9,657 )
Intercompany loan proceeds	—	—	26,648	(26,648 )	—
Intercompany loan payments	—	—	(7,869 )	7,869	—
Intercompany distributions of capital	—	—	(1,982 )	1,982	—
Intercompany capital contribution	—	—	483	(483 )	—
Intercompany dividends	—	(40,732 )	(11,010 )	51,742	—
All other financing, net	250	—	(498 )	—	(248 )
Net cash flows (used) provided by financing activities	(175,756 )	(31,724 )	8,105	34,462	(164,913 )
Effect of exchange rate changes on cash	—	—	2,941	—	2,941
Net change in cash and cash equivalents	(126,500 )	—	6,564	—	(119,936 )
Cash and cash equivalents at beginning of period	150,308	—	187,048	—	337,356
Cash and cash equivalents at end of period	\$23,808	\$—	\$ 193,612	\$—	\$217,420

## 7. Fair Value

Our financial instruments are presented at fair value in our condensed consolidated balance sheets, with the exception of our long-term debt. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Where available, fair value is based on observable market prices or parameters or derived from such prices or parameters. Where observable prices

or inputs are not available, valuation models may be applied. Assets and liabilities recorded at fair value in our condensed consolidated balance sheets are categorized by hierarchical levels based upon the level of judgment associated with the inputs used to measure their fair values. Recurring fair value measurements are limited to investments in derivative instruments and certain equity securities. The fair value measurements of our derivative instruments are determined using models that maximize the use of the observable market inputs including interest rate curves and both forward and spot prices for currencies, and are classified as Level II under the fair value hierarchy. The fair values of our derivatives are included in Note 4. The fair value measurements of our investments in equity securities are determined

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using quoted market prices and are classified as Level I. The fair values of our investments in equity securities, and changes thereto, are immaterial to our consolidated financial position and results of operations.

The fair value of our debt, excluding the Senior Notes, was estimated using interest rates on similar debt recently issued by companies with credit metrics similar to ours and is classified as Level II under the fair value hierarchy. The carrying value of our debt is included in Note 5 and, except for the Senior Notes, approximates fair value. The estimated fair value of our Senior Notes at September 30, 2013 was \$473.1 million compared to the carrying value of \$498.2 million. The estimated fair value of the Senior Notes is based on Level I quoted market rates. The carrying amounts of our other financial instruments (i.e., cash and cash equivalents, accounts receivable, net and accounts payable) approximated fair value due to their short-term nature at September 30, 2013 and December 31, 2012.

## 8. Inventories

Inventories, net consisted of the following:

(Amounts in thousands)	September 30, 2013	December 31, 2012
Raw materials	\$379,993	\$351,705
Work in process	858,773	798,662
Finished goods	314,122	288,160
Less: Progress billings	(288,678)	(275,611)
Less: Excess and obsolete reserve	(80,022)	(76,253)
Inventories, net	\$1,184,188	\$1,086,663

## 9. Equity Method Investments

We occasionally enter into joint venture arrangements with local country partners as our preferred means of entry into countries where barriers to entry may exist. Similar to our consolidated subsidiaries, these unconsolidated joint ventures generally operate within our primary businesses of designing, manufacturing, assembling and distributing fluid motion and control products and services. We have agreements with certain of these joint ventures that restrict us from otherwise entering the respective market and certain joint ventures produce and/or sell our products as part of their broader product offering. Net earnings from investments in unconsolidated joint ventures is reported in net earnings from affiliates in our condensed consolidated statements of income. Given the integrated role of the unconsolidated joint ventures in our business, net earnings from affiliates is presented as a component of operating income.

As discussed in Note 2, effective March 28, 2013, we and our joint venture partner agreed to exit our AIL joint venture, a manufacturer of integrated industrial valves in India. Prior to these transactions, our 50% interest was recorded using the equity method of accounting. As of September 30, 2013, we had investments in seven joint ventures (one located in each of India, Japan, Saudi Arabia, South Korea and the United Arab Emirates and two located in China) that were accounted for using the equity method.



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## 10. Earnings Per Share

The following is a reconciliation of net earnings of Flowserve Corporation and weighted average shares for calculating net earnings per common share. Earnings per weighted average common share outstanding was calculated as follows:

(Amounts in thousands, except per share data)	Three Months Ended September 30,	
	2013	2012
Net earnings of Flowserve Corporation	\$ 126,271	\$ 106,296
Dividends on restricted shares not expected to vest	3	4
Earnings attributable to common and participating shareholders	\$ 126,274	\$ 106,300
Weighted average shares:		
Common stock	139,689	152,119
Participating securities	676	792
Denominator for basic earnings per common share	140,365	152,911
Effect of potentially dilutive securities	720	944
Denominator for diluted earnings per common share	141,085	153,855
Earnings per common share:		
Basic	\$0.90	\$0.70
Diluted	0.90	0.69
	Nine Months Ended September 30,	
	2013	2012
Net earnings of Flowserve Corporation	\$344,449	\$306,737
Dividends on restricted shares not expected to vest	10	11
Earnings attributable to common and participating shareholders	\$344,459	\$306,748
Weighted average shares:		
Common stock	141,641	158,650
Participating securities	708	786
Denominator for basic earnings per common share	142,349	159,436
Effect of potentially dilutive securities	850	1,145
Denominator for diluted earnings per common share	143,199	160,581
Earnings per common share:		
Basic	\$2.42	\$1.92
Diluted	2.41	1.91

Diluted earnings per share above is based upon the weighted average number of shares as determined for basic earnings per share plus shares potentially issuable in conjunction with stock options, restricted share units and performance share units.

For the three and nine months ended both September 30, 2013 and 2012, no options to purchase common stock were excluded from the computation of potentially dilutive securities.

## 11. Legal Matters and Contingencies

## Asbestos-Related Claims

We are a defendant in a substantial number of lawsuits that seek to recover damages for personal injury allegedly caused by exposure to asbestos-containing products manufactured and/or distributed by our heritage companies in the past. While the overall number of asbestos-related claims has generally declined in recent years, there can be no assurance that this trend will continue, or that the average cost per claim will not further increase. Asbestos-containing materials incorporated into any such products were primarily encapsulated and used as internal components of process

equipment, and we do not believe that any significant emission of asbestos fibers occurred during the use of this equipment.

Our practice is to vigorously contest and resolve these claims, and we have been successful in resolving a majority of claims with little or no payment. Historically, a high percentage of resolved claims have been covered by applicable insurance or

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indemnities from other companies, and we believe that a substantial majority of existing claims should continue to be covered by insurance or indemnities. Accordingly, we have recorded a liability for our estimate of the most likely settlement of asserted claims and a related receivable from insurers or other companies for our estimated recovery, to the extent we believe that the amounts of recovery are probable and not otherwise in dispute. Although infrequent, from time to time we have tried cases, one of which resulted in an unfavorable ruling during the quarter. The impact of the verdict is not material, and we intend to vigorously contest the ruling. We established a loss reserve and related insurance receivable based on the reasonably estimable and probable outcome of the case. While unfavorable rulings, judgments or settlement terms regarding these matters could have a material adverse impact on our business, financial condition, results of operations and cash flows, we currently believe the likelihood is remote.

Additionally, we have claims pending against certain insurers that, if resolved more favorably than reflected in the recorded receivables, would result in discrete gains in the applicable quarter. We are currently unable to estimate the impact, if any, of unasserted asbestos-related claims, although future claims would also be subject to then existing indemnities and insurance coverage.

United Nations Oil-for-Food Program

In mid-2006, French authorities began an investigation of over 170 French companies, of which one of our French subsidiaries was included, concerning suspected inappropriate activities conducted in connection with the United Nations Oil-for-Food Program. As previously disclosed, the French investigation of our French subsidiary was formally opened in the first quarter of 2010, and our French subsidiary filed a formal response with the French Court. In July 2012, the French Court ruled against our procedural motions to challenge the constitutionality of the charges and quash the indictment. While the French Court ruling is currently proceeding through a formal review process, we currently do not expect to incur additional case resolution costs of a material amount in this matter. However, if the French authorities take enforcement action against our French subsidiary regarding its investigation, we may be subject to monetary and non-monetary penalties, which we currently do not believe will have a material adverse financial impact on our company.

In addition to the governmental investigation referenced above, on June 27, 2008, the Republic of Iraq filed a civil suit in federal court in New York against 93 participants in the United Nations Oil-for-Food Program, including us and our two foreign subsidiaries that participated in the program. On February 6, 2013 the U.S. District Court for the Southern District of New York issued a ruling that dismissed the suit with prejudice. On February 15, 2013 the plaintiff appealed the District Court's ruling. We will continue to vigorously contest the suit, and we believe that we have valid defenses to the claims asserted. We do not currently believe the resolution of this suit will have a material adverse financial impact on our company.

Other

We are currently involved as a potentially responsible party at six former public waste disposal sites in various stages of evaluation or remediation. The projected cost of remediation at these sites, as well as our alleged "fair share" allocation, will remain uncertain until all studies have been completed and the parties have either negotiated an amicable resolution or the matter has been judicially resolved. At each site, there are many other parties who have similarly been identified. Many of the other parties identified are financially strong and solvent companies that appear able to pay their share of the remediation costs. Based on our information about the waste disposal practices at these sites and the environmental regulatory process in general, we believe that it is likely that ultimate remediation liability costs for each site will be apportioned among all liable parties, including site owners and waste transporters, according to the volumes and/or toxicity of the wastes shown to have been disposed of at the sites. We believe that our financial exposure for existing disposal sites will not be materially in excess of accrued reserves.

We are also a defendant in a number of other lawsuits, including product liability claims, that are insured, subject to the applicable deductibles, arising in the ordinary course of business, and we are also involved in other uninsured routine litigation, including contract disputes, incidental to our business. We currently believe none of such litigation,

either individually or in the aggregate, is material to our business, operations or overall financial condition. However, litigation is inherently unpredictable, and resolutions or dispositions of claims or lawsuits by settlement or otherwise could have an adverse impact on our financial position, results of operations or cash flows for the reporting period in which any such resolution or disposition occurs.

Although none of the aforementioned potential liabilities can be quantified with certainty, we have established reserves covering exposures relating to contingencies, to the extent believed to be reasonably estimable and probable based on past experience and available facts. While additional exposures beyond these reserves could exist, they currently cannot be estimated. We will continue to evaluate and update the reserves as necessary and appropriate.

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## 12. Retirement and Postretirement Benefits

Components of the net periodic cost for retirement and postretirement benefits for the three months ended September 30, 2013 and 2012 were as follows:

(Amounts in millions)	U.S. Defined Benefit Plans		Non-U.S. Defined Benefit Plans		Postretirement Medical Benefits	
	2013	2012	2013	2012	2013	2012
Service cost	\$5.4	\$5.3	\$1.7	\$1.2	\$—	\$—
Interest cost	3.7	4.1	3.3	3.4	0.3	0.4
Expected return on plan assets	(4.8 )	(5.3 )	(2.4 )	(2.1 )	—	—
Amortization of prior service benefit	—	(0.3 )	0.1	—	—	—
Amortization of unrecognized net loss (gain)	3.8	3.1	1.7	0.9	(0.4 )	(0.4 )
Net periodic cost (benefit) recognized	\$8.1	\$6.9	\$4.4	\$3.4	\$(0.1 )	\$—

Components of the net periodic cost for retirement and postretirement benefits for the nine months ended September 30, 2013 and 2012 were as follows:

(Amounts in millions)	U.S. Defined Benefit Plans		Non-U.S. Defined Benefit Plans		Postretirement Medical Benefits	
	2013	2012	2013	2012	2013	2012
Service cost	\$17.6	\$15.9	\$5.1	\$3.5	\$—	\$—
Interest cost	11.3	12.3	10.1	10.1	0.8	1.1
Expected return on plan assets	(15.0 )	(15.9 )	(7.1 )	(6.3 )	—	—
Amortization of prior service benefit	—	(0.9 )	0.1	—	—	—
Amortization of unrecognized net loss (gain)	10.7	9.2	5.0	2.9	(1.0 )	(1.2 )
Net periodic cost (benefit) recognized	\$24.6	\$20.6	\$13.2	\$10.2	\$(0.2 )	\$(0.1 )

## 13. Shareholders' Equity

**Stock Split** – On May 23, 2013, our certificate of incorporation was amended to increase the number of authorized shares of common stock from 120.0 million to 305.0 million and enable a three-for-one stock split approved by the Board of Directors on February 7, 2013 in the form of a 200% common stock dividend. The record date for the stock split was June 7, 2013, and additional shares were distributed on June 21, 2013. As a result of the three-for-one stock split, 117,861,772 shares of common stock were issued. The par value of the common stock remained unchanged at \$1.25 per share, which required \$147.3 million to be retrospectively reclassified from capital in excess of par value to common shares all within the shareholders' equity section of our condensed consolidated balance sheets. Shareholders' equity and all share data, including treasury shares and stock-based compensation award shares, and per share data presented herein have been retrospectively adjusted to reflect the impact of the increase in authorized shares and the stock split, as appropriate.

**Dividends** – On February 19, 2013, our Board of Directors authorized an increase in the payment of quarterly dividends on our common stock from \$0.12 per share to \$0.14 per share, as adjusted for the stock split, payable quarterly beginning on April 12, 2013. Generally, our dividend date-of-record is in the last month of the quarter and the dividend is paid the following month. Any subsequent dividends will be reviewed by our Board of Directors and declared in its discretion dependent on its assessment of our financial situation and business outlook at the applicable time.

**Share Repurchase Program** – On February 19, 2013, our Board of Directors approved a \$750 million share repurchase authorization, which included approximately \$193 million of remaining capacity under the prior \$1.0 billion share

repurchase authorization. Our share repurchase program does not have an expiration date, and we reserve the right to limit or terminate the repurchase program at any time without notice.

On a post-split basis, we repurchased 1,115,276 shares of our outstanding common stock for \$63.8 million, and 2,478,246 shares for \$101.0 million, during the three months ended September 30, 2013 and 2012, respectively. We repurchased 6,876,380 shares of our outstanding common stock for \$370.1 million, and 12,954,255 shares for \$473.9 million, during the nine months ended September 30, 2013 and 2012, respectively. As of September 30, 2013, we have \$472.6 million of remaining capacity under our current share repurchase program.

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## 14. Income Taxes

For the three months ended September 30, 2013, we earned \$182.4 million before taxes and provided for income taxes of \$55.9 million, resulting in an effective tax rate of 30.6%. For the nine months ended September 30, 2013, we earned \$501.3 million before taxes and provided for income taxes of \$155.0 million resulting in an effective tax rate of 30.9%. The effective tax rate varied from the U.S. federal statutory rate for the three months ended September 30, 2013 primarily due to the net impact of foreign operations. The effective tax rate varied from the U.S. federal statutory rate for the nine months ended September 30, 2013, primarily due to the net impact of foreign operations, partially offset by taxes incurred on the exit of our equity investment in the AIL joint venture discussed in Note 2.

For the three months ended September 30, 2012, we earned \$144.6 million before taxes and provided for income taxes of \$37.8 million, resulting in an effective tax rate of 26.1%. For the nine months ended September 30, 2012, we earned \$421.7 million before taxes and provided for income taxes of \$112.9 million, resulting in an effective tax rate of 26.8%. The effective tax rate varied from the U.S. federal statutory rate for the three and nine months ended September 30, 2012 primarily due to the net impact of foreign operations and a net reduction of our reserve for uncertain tax positions due to the lapse of the statute of limitations in certain jurisdictions.

As of September 30, 2013, the amount of unrecognized tax benefits increased by \$0.5 million from December 31, 2012. With limited exception, we are no longer subject to U.S. federal income tax audits for years through 2011, state and local income tax audits for years through 2009 or non-U.S. income tax audits for years through 2007. We are currently under examination for various years in Austria, Canada, Finland, Germany, India, Italy, Singapore, the U.S. and Venezuela.

It is reasonably possible that within the next 12 months the effective tax rate will be impacted by the resolution of some or all of the matters audited by various taxing authorities. It is also reasonably possible that we will have the statute of limitations close in various taxing jurisdictions within the next 12 months. As such, we estimate we could record a reduction in our tax expense of approximately \$14 million within the next 12 months.

## 15. Segment Information

The following is a summary of the financial information of the reportable segments reconciled to the amounts reported in the condensed consolidated financial statements:

## Three Months Ended September 30, 2013

(Amounts in thousands)	Engineered Product Division	Industrial Product Division	Flow Control Division	Subtotal—Reportable Segments	Eliminations and All Other	Consolidated Total
Sales to external customers	\$634,402	\$201,914	\$392,741	\$ 1,229,057	\$—	\$1,229,057
Intersegment sales	16,949	20,510	1,617	39,076	(39,076 )	—
Segment operating income	114,004	25,234	76,700	215,938	(22,550 )	193,388

## Three Months Ended September 30, 2012

(Amounts in thousands)	Engineered Product Division	Industrial Product Division	Flow Control Division	Subtotal—Reportable Segments	Eliminations and All Other	Consolidated Total
Sales to external customers	\$551,589	\$221,787	\$392,547	\$ 1,165,923	\$—	\$1,165,923
Intersegment sales	15,898	21,770	2,160	39,828	(39,828 )	—
Segment operating income	87,019	26,615	68,313	181,947	(16,241 )	165,706





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## Nine Months Ended September 30, 2013

(Amounts in thousands)	Engineered Product Division	Industrial Product Division	Flow Control Division	Subtotal—Reportable Segments	Eliminations and All Other	Consolidated Total
Sales to external customers	\$1,765,783	\$615,094	\$1,184,302	\$ 3,565,179	\$—	\$3,565,179
Intersegment sales	50,209	57,514	5,257	112,980	(112,980 )	—
Segment operating income	296,794	77,070	236,736	610,600	(63,211 )	547,389

## Nine Months Ended September 30, 2012

(Amounts in thousands)	Engineered Product Division	Industrial Product Division	Flow Control Division	Subtotal—Reportable Segments	Eliminations and All Other	Consolidated Total
Sales to external customers	\$1,641,925	\$627,522	\$1,153,681	\$ 3,423,128	\$—	\$3,423,128
Intersegment sales	47,027	60,900	6,457	114,384	(114,384 )	—
Segment operating income	274,249	67,796	184,359	526,404	(53,379 )	473,025

Engineered Product Division's ("EPD") operating income for the nine months ended September 30, 2012, included a \$10.4 million gain from the sale of a manufacturing facility in Rio de Janeiro, Brazil, in preparation for opening a new manufacturing facility there later in 2012.

## 16. Accumulated Other Comprehensive Loss

The following table presents the changes in accumulated other comprehensive loss by component for the three months ended September 30, 2013:

(Amounts in thousands)	Foreign currency translation items(1)	Pension and other postretirement effects	Cash flow hedging activity(2)	Total(1)
Balance - July 1, 2013	\$(128,169 )	\$(152,130 )	\$221	\$(280,078 )
Other comprehensive income (loss) before reclassifications, net of taxes	38,581	(3,824 )	172	34,929
Amounts reclassified from accumulated other comprehensive loss, net of taxes	—	3,451	(20 )	3,431
Net current-period other comprehensive income (loss), net of taxes	38,581	(373 )	152	38,360
Balance - September 30, 2013	\$(89,588 )	\$(152,503 )	\$373	\$(241,718 )

(1) Includes foreign currency translation adjustments attributable to noncontrolling interests of \$1.3 million and \$1.1 million at July 1, 2013 and September 30, 2013, respectively. Amounts in parentheses indicate debits.

(2) Other comprehensive loss before reclassifications, net of taxes was \$22,000 and amounts reclassified from accumulated other comprehensive loss, net of taxes was \$237,000 for the three months ended September 30, 2012 for cash flow hedging activity.

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The following table presents the reclassifications out of accumulated other comprehensive loss for the three months ended September 30, 2013:

(Amounts in thousands)	Amount reclassified from accumulated other comprehensive loss (1)	Affected line item in the statement of income
<b>Cash flow hedging activity</b>		
Interest rate swaps	\$ 32	Interest expense
	(12)	) Tax benefit
	\$ 20	Net of tax
<b>Pension and other postretirement effects</b>		
Amortization of actuarial losses	\$ (5,108)	) (2)
	1,657	Tax benefit
	\$ (3,451)	) Net of tax

(1) Amounts in parentheses indicate decreases to income. None of the reclass amounts have a noncontrolling interest component.

(2) These accumulated other comprehensive loss components are included in the computation of net periodic pension cost. See Note 12 for additional details.

The following table presents the changes in accumulated other comprehensive loss by component for the nine months ended September 30, 2013:

(Amounts in thousands)	Foreign currency translation items(1)	Pension and other postretirement effects	Cash flow hedging activity(2)	Total(1)
Balance - January 1, 2013	\$ (61,083	) \$ (161,757	) \$ (254	) \$ (223,094
Other comprehensive (loss) income before reclassifications, net of taxes	(29,722	) (699	) 373	(30,048
Amounts reclassified from accumulated other comprehensive loss, net of taxes	1,217	9,953	254	11,424
Net current-period other comprehensive (loss) income, net of taxes	(28,505	) 9,254	627	(18,624
Balance - September 30, 2013	\$ (89,588	) \$ (152,503	) \$ 373	\$ (241,718

(1) Includes foreign currency translation adjustments attributable to noncontrolling interests of \$1.2 million and \$1.1 million at January 1, 2013 and September 30, 2013, respectively. Amounts in parentheses indicate debits.

Other comprehensive loss before reclassifications, net of taxes was \$725,000 and amounts reclassified from (2) accumulated other comprehensive loss, net of taxes was \$636,000 for the nine months ended September 30, 2012 for cash flow hedging activity.



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The following table presents the reclassifications out of accumulated other comprehensive loss for the nine months ended September 30, 2013:

(Amounts in thousands)	Amount reclassified from accumulated other comprehensive loss (1)	Affected line item in the statement of income
Foreign currency translation items		
Release of cumulative translation adjustments upon sale of equity method investment	\$(1,217)	) Net earnings from affiliates
	—	) Tax (expense) benefit
	\$(1,217)	) Net of tax
Cash flow hedging activity		
Interest rate swaps	\$(406)	) Interest expense
	152	) Tax benefit
	\$(254)	) Net of tax
Pension and other postretirement effects		
Amortization of actuarial losses	\$(14,709)	) (2)
	4,756	) Tax benefit
	\$(9,953)	) Net of tax

(1) Amounts in parentheses indicate decreases to income. None of the reclass amounts have a noncontrolling interest component.

(2) These accumulated other comprehensive loss components are included in the computation of net periodic pension cost. See Note 12 for additional details.

At September 30, 2013, we expect to recognize losses of \$0.4 million, net of deferred taxes, into earnings in the next twelve months related to interest rate swap agreements based on their fair values at September 30, 2013.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements, and notes thereto, and the other financial data included elsewhere in this Quarterly Report. The following discussion should also be read in conjunction with our audited consolidated financial statements, and notes thereto, and "Management's Discussion and Analysis of Financial Condition and Results of Operations" ("MD&A") included in our 2012 Annual Report.

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EXECUTIVE OVERVIEW

Our Company

We are a world-leading manufacturer and aftermarket service provider of comprehensive flow control systems. We develop and manufacture precision-engineered flow control equipment integral to the movement, control and protection of the flow of materials in our customers' critical processes. Our product portfolio of pumps, valves, seals, automation and aftermarket services supports global infrastructure industries, including oil and gas, chemical, power generation and water management, as well as general industrial markets where our products and services add value. Through our manufacturing platform and global network of Quick Response Centers ("QRCs"), we offer a broad array of aftermarket equipment services, such as installation, advanced diagnostics, repair and retrofitting. We currently employ approximately 18,000 employees in more than 50 countries.

Our business model is significantly influenced by the capital spending of global infrastructure industries for the placement of new products into service and aftermarket services for existing operations. The worldwide installed base of our products is an important source of aftermarket revenue, where products are expected to ensure the maximum operating time of many key industrial processes. Over the past several years, we have significantly invested in our aftermarket strategy to provide local support to drive customer investments in our offerings and use of our services to replace or repair installed products. The aftermarket portion of our business also helps provide business stability during various economic periods. The aftermarket business, which is served by our network of 177 QRCs located around the globe, provides a variety of service offerings for our customers including spare parts, service solutions, product life cycle solutions and other value-added services. It is generally a higher margin business compared to our original equipment business and a key component of our profitable growth strategy.

Our operations are conducted through three business segments that are referenced throughout this MD&A:

- Engineered Product Division ("EPD") for long lead-time, custom and other highly-engineered pumps and pump systems, mechanical seals, auxiliary systems and replacement parts and related services;
- Industrial Product Division ("IPD") for engineered and pre-configured industrial pumps and pump systems and related products and services; and
- Flow Control Division ("FCD") for engineered and industrial valves, control valves, actuators and controls and related services.

Our business segments share a focus on industrial flow control technology and have a high number of common customers. These segments also have complementary product offerings and technologies that are often combined in applications that provide us a net competitive advantage. Our segments also benefit from our global footprint and our economies of scale in reducing administrative and overhead costs to serve customers more cost effectively. For example, our segment leadership reports to our Chief Operating Officer ("COO"), and the segments share leadership for operational support functions such as research and development, marketing and supply chain.

The reputation of our product portfolio is built on more than 50 well-respected brand names such as Worthington, IDP, Valtek, Limitorque, Durco, Edward, Anchor/Darling and Durametallc, which we believe to be one of the most comprehensive in the industry. Our products and services are sold either directly or through designated channels to more than 10,000 companies, including some of the world's leading engineering, procurement and construction ("EPC") firms, original equipment manufacturers, distributors and end users.

We continue to build on our geographic breadth through our QRC network with the goal to be positioned as near to customers as possible for service and support in order to capture valuable aftermarket business. Along with ensuring that we have the local capability to sell, install and service our equipment in remote regions, it is equally imperative to continuously improve our global operations. We continue to expand our global supply chain capability to meet global customer demands and ensure the quality and timely delivery of our products. We continue to devote resources to improving the supply chain processes across our business segments to find areas of synergy and cost reduction and to improve our supply chain management capability to ensure it can meet global customer demands. We also remain

focused on improving on-time delivery and quality, while managing warranty costs as a percentage of sales across our global operations, through the assistance of a focused Continuous Improvement Process ("CIP") initiative. The goal of the CIP initiative, which includes lean manufacturing, six sigma business management strategy and value engineering, is to maximize service fulfillment to customers through on-time delivery, reduced cycle time and quality at the highest internal productivity.

During the third quarter of 2013, we experienced an increase in bookings despite continuing to operate in a competitive economic environment with global macroeconomic uncertainty. Although the markets produced no large original equipment project orders in the quarter, the original equipment market showed strength, particularly in the power generation and chemical industries. From a geographical standpoint, we saw continued strengthening in North America, Europe and Asia Pacific.

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Although some of our refining customers have deferred some scheduled maintenance since late in 2012 due to strong margins, we continue to experience favorable conditions in our aftermarket business, which has been driven by our customers' need to maintain continuing operations across several industries and the expansion of our aftermarket capabilities through our integrated solutions offerings. Our pursuit of major capital projects globally and our investments in localized customer service remain key components of our long-term growth strategy, and also provide stability during various economic periods. We believe that our commitment to localize service support capabilities close to our customers' operations through our QRC network has enabled us to grow our market share in the aftermarket portion of our business.

We believe that with our customer relationships, global presence and highly-regarded technical capabilities, we will continue to have opportunities in our core industries; however, we face ongoing challenges affecting many companies in our industry with a significant multinational presence, such as economic, political, currency and other risks.

**RESULTS OF OPERATIONS** — Three and nine months ended September 30, 2013 and 2012

Throughout this discussion of our results of operations, we discuss the impact of fluctuations in foreign currency exchange rates. We have calculated currency effects on operations by translating current year results on a monthly basis at prior year exchange rates for the same periods.

As discussed in Note 2 to our condensed consolidated financial statements included in this Quarterly Report, FCD sold its equity interest in the AIL joint venture and acquired AIL's plug valve manufacturing business in an asset purchase for cash, effective March 28, 2013. No pro forma information has been provided for the acquisition due to immateriality.

## Consolidated Results

## Bookings, Sales and Backlog

(Amounts in millions)	Three Months Ended September 30,	
	2013	2012
Bookings	\$1,229.8	\$1,186.1
Sales	1,229.1	1,165.9
(Amounts in millions)	Nine Months Ended September 30,	
	2013	2012
Bookings	\$3,635.4	\$3,635.4
Sales	3,565.2	3,423.1

We define a booking as the receipt of a customer order that contractually engages us to perform activities on behalf of our customer with regard to manufacturing, service or support. Bookings recorded and subsequently canceled within the year-to-date period are excluded from year-to-date bookings. Bookings for the three months ended September 30, 2013 increased by \$43.7 million, or 3.7%, as compared with the same period in 2012. The increase included currency benefits of approximately \$3 million and included the impact of orders in the third quarter of 2012 in excess of \$90 million to supply offshore oil and gas platform equipment, primarily to an end customer in Latin America. The nonrecurrence of large orders of similar size in the third quarter of 2013 resulted in decreased customer bookings in the oil and gas industry, which were more than offset by an increase in the power generation and chemical industries. The overall increase was primarily driven by original equipment bookings.

Bookings for the nine months ended September 30, 2013 were consistent with the same period in 2012 and included negative currency effects of approximately \$16 million. Increases in the chemical industry were offset by decreases in the oil and gas and water management industries. An increase in aftermarket bookings was offset by a decrease in original equipment bookings.

Sales for the three months ended September 30, 2013 increased by \$63.2 million, or 5.4%, as compared with the same period in 2012. The increase included negative currency effects of approximately \$11 million. Increased sales into Latin America, North America and Europe were partially offset by a decrease into the Middle East. Net sales to international customers, including export sales from the U.S., were approximately 70% and 71% of total sales for the three months ended September 30, 2013 and 2012, respectively.

Sales for the nine months ended September 30, 2013 increased by \$142.1 million, or 4.2%, as compared with the same period in 2012. The increase included negative currency effects of approximately \$25 million. Increased sales into North America, Europe and Latin America were partially offset by a decrease into the Middle East. Net sales to international customers, including export sales from the U.S., were approximately 70% of total sales for both the nine months ended September 30, 2013 and 2012.



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Backlog represents the aggregate value of booked but uncompleted customer orders and is influenced primarily by bookings, sales, cancellations and currency effects. Backlog of \$2,700.1 million at September 30, 2013 increased by \$51.2 million, or 1.9%, as compared with December 31, 2012. Currency effects provided a decrease of approximately \$19 million. Approximately 25% of the backlog at September 30, 2013 was related to aftermarket orders.

## Gross Profit and Gross Profit Margin

(Amounts in millions, except percentages)	Three Months Ended September 30,			
	2013	2012		
Gross profit	\$422.7	\$389.6		
Gross profit margin	34.4	% 33.4		%

  

(Amounts in millions, except percentages)	Nine Months Ended September 30,			
	2013	2012		
Gross profit	\$1,217.6	\$1,133.4		
Gross profit margin	34.2	% 33.1		%

Gross profit for the three months ended September 30, 2013 increased by \$33.1 million, or 8.5%, as compared with the same period in 2012. Gross profit margin for the three months ended September 30, 2013 of 34.4% increased from 33.4% for the same period in 2012. The increase was primarily attributed to the effects of lower costs as a result of operational improvements and disciplined selectivity of customer bookings, as compared with the same period in 2012. The increase was partially offset by a sales mix shift to original equipment sales. As a result of the sales mix shift, aftermarket sales decreased to approximately 38% of total sales, as compared with approximately 39% of total sales for the same period in 2012.

Gross profit for the nine months ended September 30, 2013 increased by \$84.2 million, or 7.4%, as compared with the same period in 2012. Gross profit margin for the nine months ended September 30, 2013 of 34.2% increased from 33.1% for the same period in 2012. The increase was primarily attributable to our execution of operational improvements and disciplined selectivity of customer bookings. Aftermarket sales as a percent of total sales remained consistent as compared with the same period in 2012.

## Selling, General and Administrative Expense ("SG&amp;A")

(Amounts in millions, except percentages)	Three Months Ended September 30,			
	2013	2012		
SG&A	\$231.6	\$227.8		
SG&A as a percentage of sales	18.8	% 19.5		%

  

(Amounts in millions, except percentages)	Nine Months Ended September 30,			
	2013	2012		
SG&A	\$706.3	\$673.6		
SG&A as a percentage of sales	19.8	% 19.7		%

SG&A for the three months ended September 30, 2013 increased by \$3.8 million, or 1.7%, as compared with the same period in 2012. Currency effects yielded a decrease of less than \$1 million. SG&A as a percentage of sales for the three months ended September 30, 2013 decreased 70 basis points as compared with the same period in 2012 due primarily to the favorable impact of improved SG&A leverage and continued focus on cost containment, partially offset by a gain from certain legal matters in 2012 that did not recur in 2013.

SG&A for the nine months ended September 30, 2013 increased by \$32.7 million, or 4.9%, as compared with the same period in 2012. Currency effects yielded a decrease of approximately \$3 million. SG&A as a percentage of sales for the nine months ended September 30, 2013 increased 10 basis points as compared with the same period in 2012 due primarily to a \$10.4 million gain from the sale of our manufacturing facility in Brazil and a gain from certain legal matters both in 2012, neither of which recurred in 2013, substantially offset by the favorable impact of improved SG&A leverage and continued focus on cost containment.

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## Net Earnings from Affiliates

	Three Months Ended September 30,	
(Amounts in millions)	2013	2012
Net earnings from affiliates	\$2.2	\$3.9
	Nine Months Ended September 30,	
(Amounts in millions)	2013	2012
Net earnings from affiliates	\$36.0	\$13.2

Net earnings from affiliates represents our net income from investments in our joint ventures that are accounted for using the equity method of accounting. Net earnings from affiliates for the three months ended September 30, 2013 decreased \$1.7 million, or 43.6%, as compared with the same period in 2012. As discussed in Note 2 to our condensed consolidated financial statements included in this Quarterly Report, effective March 28, 2013, we sold our 50% interest in our AIL joint venture and acquired AIL's plug valve manufacturing business in India. The absence of this joint venture is the primary driver of the decrease in net earnings from affiliates for the three months ended September 30, 2013.

Net earnings from affiliates for the nine months ended September 30, 2013, increased \$22.8 million or 172.7% as compared with the same period in 2012. The increase was primarily a result of the AIL transactions, which resulted in total pre-tax gains of \$28.3 million recorded in net earnings from affiliates in the first quarter of 2013.

## Operating Income and Operating Margin

	Three Months Ended September 30,			
(Amounts in millions, except percentages)	2013	2012		
Operating income	\$193.4	\$165.7		
Operating income as a percentage of sales	15.7	% 14.2		%
	Nine Months Ended September 30,			
(Amounts in millions, except percentages)	2013	2012		
Operating income	\$547.4	\$473.0		
Operating income as a percentage of sales	15.4	% 13.8		%

Operating income for the three months ended September 30, 2013 increased by \$27.7 million, or 16.7%, as compared with the same period in 2012. The increase included negative currency effects of approximately \$4 million. The increase was primarily a result of the \$33.1 million increase in gross profit, slightly offset by the \$3.8 million increase in SG&A.

Operating income for the nine months ended September 30, 2013 increased by \$74.4 million, or 15.7%, as compared with the same period in 2012. The increase included negative currency effects of approximately \$8 million. The increase was primarily a result of the \$28.3 million in gains from our transactions concerning the AIL joint venture discussed above and the \$84.2 million increase in gross profit, partially offset by the \$32.7 million increase in SG&A, which includes a \$10.4 million gain from the sale of our manufacturing facility in Brazil recorded in SG&A in 2012 that did not recur in 2013.

## Interest Expense and Interest Income

	Three Months Ended September 30,	
(Amounts in millions)	2013	2012
Interest expense	\$(13.0	) \$(12.1

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Interest income	0.3	0.2
(Amounts in millions)	Nine Months Ended September 30,	
	2013	2012
Interest expense	\$(38.3	) \$(29.9
Interest income	0.9	0.7

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Interest expense for the three and nine months ended September 30, 2013 increased by \$0.9 million and \$8.4 million, respectively, as compared with the same periods in 2012. The increase was primarily attributable to interest expense associated with our Senior Notes, which were issued in the third quarter of 2012, and our increased short-term borrowings as compared to the same periods in 2012. Approximately 45% of our Term Loan Facility was at fixed interest rates at September 30, 2013, including the effects of \$170.0 million of notional interest rate swaps.

Interest income for the three and nine months ended September 30, 2013 was consistent with the same periods in 2012.

## Other Income (Expense), Net

(Amounts in millions)	Three Months Ended September 30,	
	2013	2012
Other income (expense), net	\$1.7	\$(9.2)
	)	
(Amounts in millions)	Nine Months Ended September 30,	
	2013	2012
Other expense, net	\$(8.7	) \$(22.2
	)	

Other income, net for the three months ended September 30, 2013 increased \$10.9 million from other expense, net of \$9.2 million for the same period in 2012, primarily due to a \$5.6 million decrease in losses arising from transactions in currencies other than our sites' functional currencies and a \$4.7 million decrease in losses on foreign exchange contracts. The change is primarily due to the foreign currency exchange rate movements of the Euro, Mexican peso and Indian rupee in relation to the U.S. dollar during the three months ended September 30, 2013, as compared with the same period in 2012.

Other expense, net for the nine months ended September 30, 2013 decreased \$13.5 million, as compared with the same period in 2012, primarily due to a \$10.3 million decrease in losses arising from transactions in currencies other than our sites' functional currencies. The change is primarily driven by the foreign exchange rate movements of the Euro, Mexican peso and Singapore dollar in relation to the U.S. dollar during the nine months ended September 30, 2013, as compared with the same period in 2012.

## Tax Expense and Tax Rate

(Amounts in millions, except percentages)	Three Months Ended September 30,	
	2013	2012
Provision for income taxes	\$55.9	\$37.8
Effective tax rate	30.6	% 26.1
	%	
(Amounts in millions, except percentages)	Nine Months Ended September 30,	
	2013	2012
Provision for income taxes	\$155.0	\$112.9
Effective tax rate	30.9	% 26.8
	%	

Our effective tax rate of 30.6% for the three months ended September 30, 2013 increased from 26.1% for the same period in 2012. The effective tax rate varied from the U.S. federal statutory rate for the three months ended September 30, 2013 primarily due to the net impact of foreign operations.

Our effective tax rate of 30.9% for the nine months ended September 30, 2013 increased from 26.8% for the same period in 2012. The effective tax rate varied from the U.S. federal statutory rate for the nine months ended

September 30, 2013 primarily due to the net impact of foreign operations, partially offset by taxes incurred on the exit of our equity investment in the AIL joint venture discussed in Note 2 to our condensed consolidated financial statements included in this Quarterly Report.

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## Other Comprehensive Income

(Amounts in millions)	Three Months Ended September 30,	
	2013	2012
Other comprehensive income	\$38.4	\$32.0
(Amounts in millions)	Nine Months Ended September 30,	
	2013	2012
Other comprehensive (loss) income	\$(18.6	) \$10.7

Other comprehensive income for the three months ended September 30, 2013 increased \$6.4 million as compared with the same period in 2012. The increase was primarily due to the increased weakening of the U.S. dollar versus the Euro during the three months ended September 30, 2013, as compared with the same period in 2012.

Other comprehensive (loss) income for the nine months ended September 30, 2013 decreased \$29.3 million to loss of \$18.6 million as compared with the same period in 2012. The decrease was primarily due to the strengthening of the U.S. dollar versus the Indian rupee, Mexican peso, Argentinian peso and British pound during the nine months ended September 30, 2013, as compared with the same period in 2012.

## Business Segments

We conduct our operations through three business segments based on type of product and how we manage the business. We evaluate segment performance and allocate resources based on each segment's operating income. The key operating results for our three business segments, EPD, IPD and FCD, are discussed below.

## Engineered Product Division Segment Results

Our largest business segment is EPD, through which we design, manufacture, distribute and service custom and other highly-engineered pumps and pump systems, mechanical seals, auxiliary systems and spare parts (collectively referred to as "original equipment"). EPD includes longer lead-time, highly-engineered pump products and shorter cycle engineered pumps and mechanical seals that are generally manufactured more quickly. EPD also manufactures replacement parts and related equipment and provides a full array of replacement parts, repair and support services (collectively referred to as "aftermarket"). EPD primarily operates in the oil and gas, power generation, chemical, water management and general industries. EPD operates in 41 countries with 29 manufacturing facilities worldwide, nine of which are located in Europe, 11 in North America, four in Asia and five in Latin America, and it has 128 QRCs, including those co-located in manufacturing facilities.

(Amounts in millions, except percentages)	Three Months Ended September 30,		
	2013	2012	
Bookings	\$665.3	\$553.7	
Sales	651.4	567.5	
Gross profit	219.2	192.3	
Gross profit margin	33.7	% 33.9	%
Segment operating income	114.0	87.0	
Segment operating income as a percentage of sales	17.5	% 15.3	%
(Amounts in millions, except percentages)	Nine Months Ended September 30,		
	2013	2012	
Bookings	\$1,845.5	\$1,818.2	
Sales	1,816.0	1,689.0	
Gross profit	617.4	571.4	
Gross profit margin	34.0	% 33.8	%
Segment operating income	296.8	274.2	

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Segment operating income as a percentage of sales	16.3	%	16.2	%
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Bookings for the three months ended September 30, 2013 increased by \$111.6 million, or 20.2%, as compared with the same period in 2012. The increase included negative currency effects of approximately \$4 million. The increase in customer bookings

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was primarily driven by the power generation, oil and gas and chemical industries. Customer bookings increased \$45.2 million into Asia Pacific, \$32.2 million into the Middle East, \$14.5 million into Europe and \$14.7 million into North America. The increase was primarily driven by customer original equipment bookings. Interdivision bookings (which are eliminated and are not included in consolidated bookings as disclosed above) increased \$4.7 million. Bookings for the nine months ended September 30, 2013 increased by \$27.3 million, or 1.5%, as compared with the same period in 2012. The increase included negative currency effects of approximately \$22 million. The increase in customer bookings was primarily driven by the power generation, general and chemical industries, partially offset by the water management industry. Increased customer bookings of \$9.7 million into North America, \$7.0 million into Latin America, and \$9.2 million into Africa were partially offset by a decrease of \$6.9 million into Asia Pacific. The increase was driven by customer original equipment bookings. Interdivision bookings (which are eliminated and are not included in consolidated bookings as disclosed above) decreased \$2.3 million.

Sales for the three months ended September 30, 2013 increased \$83.9 million, or 14.8%, as compared with the same period in 2012. The increase included negative currency effects of approximately \$17 million. The increase was primarily driven by increased original equipment sales, resulting from increased sales of \$26.9 million into North America, \$25.7 million into Asia Pacific, \$22.5 million into Europe and \$18.8 million into Latin America, partially offset by decreased sales of \$9.7 million into the Middle East. Interdivision sales (which are eliminated and are not included in consolidated sales as disclosed above) decreased \$1.1 million.

Sales for the nine months ended September 30, 2013 increased \$127.0 million, or 7.5%, as compared with the same period in 2012. The increase included negative currency effects of approximately \$28 million. The increase was primarily driven by increased original equipment sales, primarily resulting from increased customer sales of \$60.3 million into Asia Pacific, \$58.0 million into North America, \$29.1 million into Europe and \$22.9 million into Africa, partially offset by decreased sales of \$58.6 million into the Middle East. Interdivision sales (which are eliminated and are not included in consolidated sales as disclosed above) increased \$3.2 million.

Gross profit for the three months ended September 30, 2013 increased by \$26.9 million, or 14.0%, as compared with the same period in 2012. Gross profit margin for the three months ended September 30, 2013 of 33.7% decreased from 33.9% for the same period in 2012. The decrease was attributable to a less favorable sales mix between original equipment and aftermarket, partially offset by the effects of lower costs associated with operational execution improvements, and to a lesser extent, fewer lower margin projects that shipped from backlog.

Gross profit for the nine months ended September 30, 2013 increased by \$46.0 million, or 8.1%, as compared with the same period in 2012. Gross profit margin for the nine months ended September 30, 2013 of 34.0% increased from 33.8% for the same period in 2012. The increase was attributable to the effects of lower costs associated with our execution of operational improvements and to a lesser extent, fewer lower margin projects that shipped from backlog, partially offset by a sales mix shift to lower margin original equipment sales.

Operating income for the three months ended September 30, 2013 increased by \$27.0 million, or 31.0%, as compared with the same period in 2012. The increase included negative currency effects of approximately \$5 million. The increase was due primarily to the increase in gross profit. SG&A for the three months ended September 30, 2013 was comparable to the same period in 2012 due primarily to improved SG&A leverage and continued focus on cost containment.

Operating income for the nine months ended September 30, 2013 increased by \$22.6 million, or 8.2%, as compared with the same period in 2012. The increase included negative currency effects of approximately \$5 million. The increase was due primarily to the \$46.0 million increase in gross profit, partially offset by increased SG&A of \$19.6 million. The increase in SG&A was due in part to increased bad debt expense related to certain customers and included a \$10.4 million gain from the sale of our manufacturing facility in Rio de Janeiro, Brazil, in 2012 that did not recur in 2013.

Backlog of \$1,411.8 million at September 30, 2013 decreased by \$11.5 million, or 0.8%, as compared with December 31, 2012. Currency effects provided a decrease of approximately \$19.2 million. Backlog at September 30, 2013 and December 31, 2012 included \$17.6 million and \$21.4 million, respectively, of interdivision backlog (which is eliminated and not included in consolidated backlog as disclosed above).

#### Industrial Product Division Segment Results

Through IPD, we design, manufacture, distribute and service engineered, pre-configured industrial pumps and pump systems, including submersible motors (collectively referred to as "original equipment"). Additionally, IPD manufactures replacement parts and related equipment, and provides a full array of support services (collectively referred to as "aftermarket"). IPD primarily operates in the oil and gas, chemical, water management, power generation and general industries. IPD operates 12 manufacturing facilities, three of which are located in the U.S and six in Europe, and it operates 20 QRCs worldwide, including 11 sites in Europe and three in the U.S., including those co-located in manufacturing facilities.

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(Amounts in millions, except percentages)	Three Months Ended September 30,			
	2013	2012		
Bookings	\$228.5	\$283.5		
Sales	222.4	243.6		
Gross profit	56.8	59.1		
Gross profit margin	25.5	%	24.3	%
Segment operating income	25.2	26.6		
Segment operating income as a percentage of sales	11.3	%	10.9	%
(Amounts in millions, except percentages)	Nine Months Ended September 30,			
	2013	2012		
Bookings	\$643.3	\$758.1		
Sales	672.6	688.4		
Gross profit	172.0	164.6		
Gross profit margin	25.6	%	23.9	%
Segment operating income	77.1	67.8		
Segment operating income as a percentage of sales	11.5	%	9.8	%

Bookings for the three months ended September 30, 2013 decreased by \$55.0 million, or 19.4%, as compared with the same period in 2012. This decrease included currency benefits of approximately \$3 million and included the impact of orders in the third quarter of 2012 in excess of \$90 million to supply offshore oil and gas platform equipment primarily to an end customer in Latin America. The nonrecurrence of large orders of similar size in the third quarter of 2013 resulted in decreased customer bookings in the oil and gas industry, which were partially offset by an increase in the power generation industry. Decreased bookings of \$74.4 million into Latin America were partially offset by an increase of \$8.7 million into Europe and \$7.5 million into Asia Pacific. The decrease was primarily driven by customer original equipment bookings. Interdivision bookings (which are eliminated and are not included in consolidated bookings as disclosed above) remained consistent with the same period in 2012.

Bookings for the nine months ended September 30, 2013 decreased by \$114.8 million, or 15.1%, as compared with the same period in 2012. This decrease included currency benefits of approximately \$2 million. The decrease included the impact of orders in the third quarter of 2012 in excess of \$90 million to supply offshore oil and gas platform equipment primarily to an end customer in Latin America. The nonrecurrence of large orders of similar size in 2013 resulted in decreased customer bookings in the oil and gas and general industries, partially offset by an increase in the power generation industry. Bookings decreased \$85.9 million into Latin America, \$16.3 million into Asia Pacific and \$6.7 million into the Middle East. The decrease was driven primarily by customer original equipment bookings. Interdivision bookings (which are eliminated and are not included in consolidated bookings as disclosed above) decreased \$9.3 million.

Sales for the three months ended September 30, 2013 decreased by \$21.2 million, or 8.7%, as compared with the same period in 2012. The decrease included currency benefits of approximately \$2 million. The decrease was primarily driven by decreased customer original equipment sales. Decreased sales of \$11.1 million into the Middle East, \$9.6 million into Asia Pacific and \$7.5 million into North America were partially offset by increased sales of \$9.7 million into Latin America. Interdivision sales (which are eliminated and are not included in consolidated sales as disclosed above) decreased \$1.3 million.

Sales for the nine months ended September 30, 2013 decreased by \$15.8 million, or 2.3%, as compared with the same period in 2012. The decrease included currency benefits of less than \$1 million. The decrease in customer sales was primarily driven by aftermarket sales. Decreased sales of \$17.7 million into the Middle East, \$17.3 million into Asia Pacific and \$14.3 million into Europe were partially offset by increased sales of \$30.6 million into Latin America and

\$4.1 million into Africa. Interdivision sales (which are eliminated and are not included in consolidated sales as disclosed above) decreased \$3.4 million.

Gross profit for the three months ended September 30, 2013 decreased by \$2.3 million, or 3.9%, as compared with the same period in 2012. Gross profit margin for the three months ended September 30, 2013 of 25.5% increased from 24.3% for the same period in 2012. The increase was primarily attributable to lower manufacturing costs resulting from our execution of operational improvements.

Gross profit for the nine months ended September 30, 2013 increased by \$7.4 million, or 4.5%, as compared with the same period in 2012. Gross profit margin for the nine months ended September 30, 2013 of 25.6% increased from 23.9% for the same period in 2012. The increase was primarily attributable to lower manufacturing costs resulting from our execution of operational improvements, partially offset by a sales mix shift to lower margin customer original equipment.

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Operating income for the three months ended September 30, 2013 decreased by \$1.4 million, or 5.3%, as compared with the same period in 2012. The decrease included currency benefits of approximately \$1 million. The decrease was primarily due to the \$2.3 million decrease in gross profit, partially offset by a decrease in SG&A of less than \$1 million.

Operating income for the nine months ended September 30, 2013 increased by \$9.3 million, or 13.7%, as compared with the same period in 2012. The increase included currency benefits of approximately \$1 million. The increase was due to the \$7.4 million increase in gross profit and a \$1.9 million decrease in SG&A.

Backlog of \$561.5 million at September 30, 2013 decreased by \$31.5 million, or 5.3%, as compared with December 31, 2012. Currency effects provided an increase of approximately \$3 million. Backlog at September 30, 2013 and December 31, 2012 included \$33.8 million and \$40.7 million, respectively, of interdivision backlog (which is eliminated and not included in consolidated backlog as disclosed above).

**Flow Control Division Segment Results**

Our second largest business segment is FCD, which designs, manufactures and distributes a broad portfolio of engineered-to-order and configured-to-order isolation valves, control valves, valve automation products, boiler controls and related services. FCD leverages its experience and application know-how by offering a complete menu of engineered services to complement its expansive product portfolio. FCD has a total of 59 manufacturing facilities and QRCs in 25 countries around the world, with five of its 26 manufacturing operations located in the U.S. and 13 located in Europe. Based on independent industry sources, we believe that we are the fourth largest industrial valve supplier on a global basis.

(Amounts in millions, except percentages)	Three Months Ended September 30,			
	2013	2012		
Bookings	\$373.2	\$381.4		
Sales	394.4	394.7		
Gross profit	147.4	139.6		
Gross profit margin	37.4	%	35.4	%
Segment operating income	76.7	68.3		
Segment operating income as a percentage of sales	19.4	%	17.3	%
(Amounts in millions, except percentages)	Nine Months Ended September 30,			
	2013	2012		
Bookings	\$1,250.8	\$1,173.0		
Sales	1,189.6	1,160.1		
Gross profit	428.4	399.1		
Gross profit margin	36.0	%	34.4	%
Segment operating income	236.7	184.4		
Segment operating income as a percentage of sales	19.9	%	15.9	%

Bookings for the three months ended September 30, 2013 decreased \$8.2 million, or 2.1%, as compared with the same period in 2012. The decrease included currency benefits of approximately \$4 million. The decrease in customer bookings was primarily attributable to the oil and gas and general industries, partially offset by an increase in the chemical industry. Decreased customer bookings of \$8.8 million into Europe, \$6.6 million into Asia Pacific and \$2.7 million into North America were partially offset by an increase of \$9.7 million into Africa. The decrease was primarily driven by decreased customer aftermarket bookings.

Bookings for the nine months ended September 30, 2013 increased \$77.8 million, or 6.6%, as compared with the same period in 2012. The increase included currency benefits of approximately \$4 million. The increase in customer bookings was primarily attributable to the oil and gas, general and chemical industries, partially offset by a decrease in

the power generation industry. Increased customer bookings of \$40.4 million into Latin America, \$32.1 million into North America, \$17.1 million into Europe, \$8.5 million into Africa and \$5.6 million in to Asia Pacific were partially offset by a decrease of \$22.4 million into the Middle East. The increase was primarily driven by increased customer original equipment bookings.

Sales for the three months ended September 30, 2013 decreased \$0.3 million, or 0.1%, as compared with the same period in 2012. The decrease included currency benefits of approximately \$4 million. Decreased sales of \$18.8 million into Asia Pacific were mostly offset by an increase of \$10.2 million into North America and \$7.5 million into Europe.

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Sales for the nine months ended September 30, 2013 increased \$29.5 million, or 2.5%, as compared with the same period in 2012. The increase included currency benefits of approximately \$2 million. The increase was primarily driven by customer aftermarket sales and growth in the oil and gas and power generation industries. Increased sales of \$26.6 million into the Middle East, \$25.8 million into North America and \$10.8 million into Europe were partially offset by a decrease of \$22.3 million into Asia Pacific and \$14.0 million into Latin America.

Gross profit for the three months ended September 30, 2013 increased \$7.8 million, or 5.6%, as compared with the same period in 2012. Gross profit margin for the three months ended September 30, 2013 of 37.4% increased from 35.4% for the same period in 2012. The increase was attributable to a shift in product line mix, continued traction of low cost sourcing and cost control initiatives.

Gross profit for the nine months ended September 30, 2013 increased by \$29.3 million, or 7.3%, as compared with the same period in 2012. Gross profit margin for the nine months ended September 30, 2013 of 36.0% increased from 34.4% for the same period in 2012. The increase was attributable to a more favorable sales mix between original equipment and aftermarket, a shift in product line mix and continued traction of low cost sourcing and cost control initiatives.

Operating income for the three months ended September 30, 2013 increased by \$8.4 million, or 12.3%, as compared with the same period in 2012. The increase included negative currency effects of less than \$1 million. The increase was primarily attributable to the \$7.8 million improved gross profit.

Operating income for the nine months ended September 30, 2013 increased by \$52.3 million, or 28.4%, as compared with the same period in 2012. The increase included negative currency effects of approximately \$4 million. The increase was primarily attributable to the \$28.3 million in pre-tax gains realized from transactions concerning the AIL joint venture, as discussed in Note 2 to our condensed consolidated financial statements included in this Quarterly Report, and the \$29.3 million increase in gross profit, partially offset by a \$3.7 million increase in SG&A.

Backlog of \$781.1 million at September 30, 2013 increased by \$57.2 million, or 7.9%, as compared with December 31, 2012. Currency effects provided a decrease of approximately \$3 million.

**LIQUIDITY AND CAPITAL RESOURCES****Cash Flow and Liquidity Analysis**

(Amounts in millions)	Nine Months Ended September 30,	
	2013	2012
Net cash flows provided by operating activities	\$108.9	\$122.6
Net cash flows used by investing activities	(57.6)	(80.5)
Net cash flows used by financing activities	(237.0)	(164.9)

Existing cash, cash generated by operations and borrowings available under our existing revolving credit facility are our primary sources of short-term liquidity. We monitor the depository institutions that hold our cash and cash equivalents on a regular basis, and we believe that we have placed our deposits with creditworthy financial institutions. Our sources of operating cash generally include the sale of our products and services and the conversion of our working capital, particularly accounts receivable and inventories. Our cash balance at September 30, 2013 was \$113.8 million, as compared with \$304.3 million at December 31, 2012.

Our cash balance decreased by \$190.5 million to \$113.8 million as of September 30, 2013 as compared with December 31, 2012. The cash used in the first nine months of 2013 included \$370.1 million of share repurchases, \$94.7 million in capital expenditures and \$57.3 million in dividend payments, partially offset by \$196.0 million in net proceeds from our short-term credit facilities.

For the nine months ended September 30, 2013, our cash provided by operating activities was \$108.9 million as compared with \$122.6 million for the same period in 2012, and provided cash used to support short-term and cyclical working capital needs. Working capital increased for the nine months ended September 30, 2013, due primarily to

higher inventory of \$101.7 million and lower accounts payable of \$127.0 million. Working capital increased for the nine months ended September 30, 2012, due primarily to higher inventory of \$149.3 million and lower accounts payable of \$75.2 million.

Decreases in accounts receivable provided \$10.8 million of cash flow for the nine months ended September 30, 2013 as compared with a cash use of \$45.6 million for the same period in 2012. As of September 30, 2013, our days' sales outstanding ("DSO") was 80 days as compared with 85 days as of September 30, 2012. For reference purposes based on 2013 sales, an improvement of one day could provide approximately \$17 million in cash flow. Increases in inventory used \$101.7 million of cash flow for the nine months ended September 30, 2013 as compared with a cash use of \$149.3 million for the same period in 2012.



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Inventory turns were 2.7 times as of both September 30, 2013 and 2012. Our calculation of inventory turns does not reflect the impact of advanced cash received from our customers. For reference purposes based on 2013 data, an improvement of one-tenth of a turn could yield approximately \$32 million in cash flow. Decreases in accounts payable used \$127.0 million of cash flow for the nine months ended September 30, 2013 as compared with a cash use of \$75.2 million for the same period in 2012.

Cash flows used by investing activities during the nine months ended September 30, 2013 were \$57.6 million as compared with \$80.5 million for the same period in 2012. Capital expenditures during the nine months ended September 30, 2013 were \$94.7 million, an increase of \$10.5 million as compared with the same period in 2012. In 2013, our capital expenditures are focused on strategic initiatives to pursue new markets, geographic and capacity expansion, information technology infrastructure and cost reduction opportunities, and total capital expenditures are expected to be between \$120 million and \$130 million, before consideration of any acquisition activity. As discussed in Note 2 to our condensed consolidated financial statements included in this Quarterly Report, during the first quarter of 2013, we sold our 50% equity interest in AIL to our joint venture partner for \$46.2 million in cash and acquired 100% ownership of AIL's plug valve manufacturing business in an asset purchase for cash of \$10.1 million.

Cash flows used by financing activities during the nine months ended September 30, 2013 were \$237.0 million as compared with \$164.9 million for the same period in 2012. Cash outflows during the nine months ended September 30, 2013 resulted primarily from the repurchase of \$370.1 million of common shares and \$57.3 million of dividend payments, partially offset by \$196.0 million in net proceeds from short-term financing. Cash outflows for the same period in 2012 resulted primarily from the repurchase of \$533.9 million of common shares, \$75.0 million in net payments on long-term debt and \$55.6 million of dividend payments, partially offset by net proceeds of \$498.1 million from the issuance of Senior Notes.

Approximately 3% of our term loan is due to mature in 2013 and approximately 11% in 2014. Our Senior Credit Facility, as amended, matures in October 2018. After the effects of \$170.0 million of notional interest rate swaps, approximately 45% of our term loan was at fixed rates at September 30, 2013. As of September 30, 2013, we had available capacity of \$535.6 million on our \$850.0 million Revolving Credit Facility. Our Revolving Credit Facility is committed and held by a diversified group of financial institutions. On October 4, 2013 our Senior Credit Facility was amended. Note 5 to our condensed consolidated financial statements included in this Quarterly Report describes the impacts of the amendment.

During the nine months ended September 30, 2013 and 2012, we contributed \$20.0 million and \$7 million, respectively, to our U.S. pension plan. At December 31, 2012, as a result of increases in values of the plan's assets and our contributions to the plan, our U.S. pension plan was fully funded as defined by applicable law. After consideration of our funded status, we currently do not anticipate making any additional contributions to the U.S. pension plan in 2013. We continue to maintain an asset allocation consistent with our strategy to maximize total return, while reducing portfolio risks through asset class diversification.

At September 30, 2013, \$111.7 million of our total cash balance of \$113.8 million was held by foreign subsidiaries, \$68.1 million of which we consider permanently reinvested outside the U.S. Based on the expected near-term liquidity needs of our various geographies and our currently available sources of domestic short-term liquidity, we currently do not anticipate the need to repatriate any permanently reinvested cash to fund domestic operations. However, in the event this cash is needed to fund domestic operations, we estimate the full \$68.1 million could be repatriated without resulting in a material tax liability.

Considering our current debt structure and cash needs, we currently believe cash flows from operating activities combined with availability under our Revolving Credit Facility and our existing cash balance will be sufficient to meet our cash needs for the next 12 months. Cash flows from operations could be adversely affected by economic, political and other risks associated with sales of our products, operational factors, competition, fluctuations in foreign exchange rates and fluctuations in interest rates, among other factors. See "Cautionary Note Regarding

Forward-Looking Statements" below.

On May 31, 2012, we announced that our Board of Directors endorsed a capital structure strategy designed to make our financial structure more efficient. This capital structure strategy includes: (i) targeting a long-term gross leverage ratio of 1.0x-2.0x total debt to EBITDA through the business cycle; and (ii) an expanded share repurchase program of \$1.0 billion which has subsequently been completed. Our previously-announced policy of annually returning 40% to 50% of running two-year average net earnings to shareholders has been maintained following attainment of the announced target leverage ratio. On February 19, 2013, our Board of Directors approved a \$750.0 million share repurchase authorization, which included approximately \$193 million of remaining capacity under the previous \$1.0 billion share repurchase authorization. As of September 30, 2013, we have \$472.6 million of remaining capacity under our current share repurchase program. While we intend to adhere to this policy for the foreseeable future, any future returns of cash through dividends and/or share repurchases, will be reviewed individually, declared by our Board of Directors and implemented by management at its discretion, depending on our financial condition, business opportunities and market conditions at such time.

#### Acquisitions and Dispositions

We regularly evaluate acquisition opportunities of various sizes. The cost and terms of any financing to be raised in conjunction with any acquisition, including our ability to raise economical capital, is a critical consideration in any such evaluation.

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Note 2 to our condensed consolidated financial statements included in this Quarterly Report contains a discussion of the exit of our AIL joint venture in India.

Financing

Credit Facilities

On October 4, 2013 we amended our existing credit agreement that provided for a \$400.0 million term loan ("Term Loan Facility") and a revolving credit facility ("Revolving Credit Facility" and, together with the Term Loan Facility, the "Senior Credit Facility"). A discussion of our Senior Credit Facility and our European LOC facility is included in Note 5 to our condensed consolidated financial statements included in this Quarterly Report.

We have entered into interest rate swap agreements to hedge our exposure to variable interest payments related to our Senior Credit Facility. These agreements are more fully described in Note 4 to our condensed consolidated financial statements included in this Quarterly Report, and in "Item 3. Quantitative and Qualitative Disclosures about Market Risk" below.

See Note 10 to our consolidated financial statements included in our 2012 Annual Report and Note 5 to our condensed consolidated financial statements included in this Quarterly Report for a discussion of covenants related to our European LOC and Senior Credit Facilities. We complied with all covenants through September 30, 2013.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Management's discussion and analysis of financial condition and results of operations are based on our condensed consolidated financial statements and related footnotes contained within this Quarterly Report. Our critical accounting policies used in the preparation of our condensed consolidated financial statements were discussed in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" of our 2012 Annual Report. These critical policies, for which no significant changes have occurred in the nine months ended September 30, 2013, include:

Revenue Recognition;

Deferred Taxes, Tax Valuation Allowances and Tax Reserves;

Reserves for Contingent Loss;

Retirement and Postretirement Benefits; and

Valuation of Goodwill, Indefinite-Lived Intangible Assets and Other Long-Lived Assets.

The process of preparing condensed consolidated financial statements in conformity with U.S. GAAP requires the use of estimates and assumptions to determine certain of the assets, liabilities, revenues and expenses. These estimates and assumptions are based upon what we believe is the best information available at the time of the estimates or assumptions. The estimates and assumptions could change materially as conditions within and beyond our control change. Accordingly, actual results could differ materially from those estimates. The significant estimates are reviewed quarterly with the Audit Committee of our Board of Directors.

Based on an assessment of our accounting policies and the underlying judgments and uncertainties affecting the application of those policies, we believe that our condensed consolidated financial statements provide a meaningful and fair perspective of our consolidated financial condition and results of operations. This is not to suggest that other general risk factors, such as changes in worldwide demand, changes in material costs, performance of acquired businesses and others, could not adversely impact our consolidated financial condition, results of operations and cash flows in future periods. See "Cautionary Note Regarding Forward-Looking Statements" below.

ACCOUNTING DEVELOPMENTS

We have presented the information about pronouncements not yet implemented in Note 1 to our condensed consolidated financial statements included in this Quarterly Report.

#### Cautionary Note Regarding Forward-Looking Statements

This Quarterly Report includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, as amended. Words or phrases such as, "may," "should," "expects," "could," "intends," "plans," "anticipates," "estimates," "believes," "predicts" or other similar expressions are intended to identify forward-looking statements, which include, without limitation, statements concerning our future financial performance, future debt and financing levels, investment objectives, implications of litigation and regulatory investigations and other management plans for future operations and performance.

The forward-looking statements included in this Quarterly Report are based on our current expectations, projections, estimates and assumptions. These statements are only predictions, not guarantees. Such forward-looking statements are subject to numerous risks and uncertainties that are difficult to predict. These risks and uncertainties may cause actual results to differ materially from what is forecast in such forward-looking statements, and include, without limitation, the following:

- a portion of our bookings may not lead to completed sales, and our ability to convert bookings into revenues at acceptable profit margins;

- changes in the global financial markets and the availability of capital and the potential for unexpected cancellations or delays of customer orders in our reported backlog;

- our dependence on our customers' ability to make required capital investment and maintenance expenditures;

- risks associated with cost overruns on fixed fee projects and in accepting customer orders for large complex custom engineered products;

- the substantial dependence of our sales on the success of the oil and gas, chemical, power generation and water management industries;

- the adverse impact of volatile raw materials prices on our products and operating margins;

- economic, political and other risks associated with our international operations, including military actions or trade embargoes that could affect customer markets, particularly North African and Middle Eastern markets and global oil and gas producers, and non-compliance with U.S. export/reexport control, foreign corrupt practice laws, economic sanctions and import laws and regulations;

- our exposure to fluctuations in foreign currency exchange rates, particularly the Euro and British pound and in hyperinflationary countries such as Venezuela;

- our furnishing of products and services to nuclear power plant facilities and other critical applications;

- potential adverse consequences resulting from litigation to which we are a party, such as litigation involving asbestos-containing material claims;

- a foreign government investigation regarding our participation in the United Nations Oil-For-Food Program;

- expectations regarding acquisitions and the integration of acquired businesses;

- our relative geographical profitability and its impact on our utilization of deferred tax assets, including foreign tax credits;

- the potential adverse impact of an impairment in the carrying value of goodwill or other intangible assets;
- our dependence upon third-party suppliers whose failure to perform timely could adversely affect our business operations;
- the highly competitive nature of the markets in which we operate;
- environmental compliance costs and liabilities;
- potential work stoppages and other labor matters;
- access to public and private sources of debt financing;
- our inability to protect our intellectual property in the U.S., as well as in foreign countries; and
- obligations under our defined benefit pension plans.

These and other risks and uncertainties are more fully discussed in the risk factors identified in "Item 1A. Risk Factors" in Part I of our 2012 Annual Report, and may be identified in our Quarterly Reports on Form 10-Q and our other filings with the U.S. Securities and Exchange Commission ("SEC") and/or press releases from time to time. All forward-looking statements included in this document are based on information available to us on the date hereof, and we assume no obligation to update any forward-looking statement.

#### Item 3. Quantitative and Qualitative Disclosures about Market Risk.

We have market risk exposure arising from changes in interest rates and foreign currency exchange rate movements. We are exposed to credit-related losses in the event of non-performance by counterparties to financial instruments, including interest rate swaps and forward exchange contracts, but we currently expect our counterparties will continue to meet their obligations given their current creditworthiness.

##### Interest Rate Risk

Our earnings are impacted by changes in short-term interest rates as a result of borrowings under our Senior Credit Facility, which bear interest based on floating rates. At September 30, 2013, after the effect of interest rate swaps, we had \$210.0 million of variable rate debt obligations outstanding under our Senior Credit Facility with a weighted average interest rate of 1.50%. A hypothetical change of 100 basis points in the interest rate for these borrowings, assuming constant variable rate debt levels, would have changed interest expense by \$1.6 million for the nine months ended September 30, 2013. At September 30, 2013 and December 31, 2012, we had \$170.0 million and \$275.0 million, respectively, of notional amount in outstanding interest rate swaps with third parties with varying maturities through May 2015.

##### Foreign Currency Exchange Rate Risk

A substantial portion of our operations are conducted by our subsidiaries outside of the U.S. in currencies other than the U.S. dollar. Almost all of our non-U.S. subsidiaries conduct their business primarily in their local currencies, which are also their functional currencies. Foreign currency exposures arise from translation of foreign-denominated assets and liabilities into U.S. dollars and from transactions, including firm commitments and anticipated transactions, denominated in a currency other than a non-U.S. subsidiary's functional currency. Generally, we view our investments in foreign subsidiaries from a long-term perspective and, therefore, do not hedge these investments. We use capital structuring techniques to manage our investment in foreign subsidiaries as deemed necessary. We realized net income associated with foreign currency translation of \$38.6 million and \$31.6 million for the three months ended September 30, 2013 and 2012, respectively, and net (losses) income of \$(28.5) million and \$8.1 million for the nine months ended September 30, 2013 and 2012, respectively, which are included in other comprehensive income (loss). We employ a foreign currency risk management strategy to minimize potential changes in cash flows from unfavorable foreign currency exchange rate movements. The use of forward exchange contracts allows us to mitigate transactional exposure to exchange rate fluctuations as the gains or losses incurred on the forward exchange contracts

will offset, in whole or in part, losses or gains on the underlying foreign currency exposure. Our policy allows foreign currency coverage only for identifiable foreign currency exposures. As of September 30, 2013, we had a U.S. dollar equivalent of \$666.6 million in aggregate notional amount outstanding in forward exchange contracts with third parties, as compared with \$608.9 million at December 31, 2012. Transactional currency gains and losses arising from transactions outside of our sites' functional currencies and changes in fair value of certain forward exchange contracts are included in our consolidated results of operations. We recognized foreign currency net gains (losses) of \$1.8 million and \$(8.5) million for the three months ended September 30, 2013 and 2012, respectively, and \$(8.5) million and \$(21.6) million for the nine months ended September 30, 2013 and 2012, respectively, which are included in other income (expense), net in the accompanying condensed consolidated statements of income.

Based on a sensitivity analysis at September 30, 2013, a 10% change in the foreign currency exchange rates for the nine months ended September 30, 2013 would have impacted our net earnings by approximately \$25 million, due primarily to the Euro, Indian Rupee and Singapore Dollar. This calculation assumes that all currencies change in the same direction and proportion relative to the U.S. dollar and that there are no indirect effects, such as changes in non-U.S. dollar sales volumes or prices. This calculation does not take into account the impact of the foreign currency forward exchange contracts discussed above.

Item 4. Controls and Procedures.

Disclosure Controls and Procedures

Disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) are controls and other procedures that are designed to ensure that the information that we are required to disclose in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and

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forms, and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure. In connection with the preparation of this Quarterly Report, our management, under the supervision and with the participation of our principal executive officer and principal financial officer, carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2013. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of September 30, 2013.

**Changes in Internal Control Over Financial Reporting**

There have been no changes in our internal control over financial reporting during the quarter ended September 30, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II — OTHER INFORMATION**

**Item 1. Legal Proceedings.**

We are party to the legal proceedings that are described in Note 11 to our condensed consolidated financial statements included in "Item 1. Financial Statements" of this Quarterly Report, and such disclosure is incorporated by reference into this "Item 1. Legal Proceedings." In addition to the foregoing, we and our subsidiaries are named defendants in certain other ordinary routine lawsuits incidental to our business and are involved from time to time as parties to governmental proceedings, all arising in the ordinary course of business. Although the outcome of lawsuits or other proceedings involving us and our subsidiaries cannot be predicted with certainty, and the amount of any liability that could arise with respect to such lawsuits or other proceedings cannot be predicted accurately, management does not currently expect the amount of any liability that could arise with respect to these matters, either individually or in the aggregate, to have a material adverse effect on our financial position, results of operations or cash flows.

**Item 1A. Risk Factors**

There are numerous factors that affect our business and results of operations, many of which are beyond our control. In addition to other information set forth in this Quarterly Report, careful consideration should be given to "Item 1A. Risk Factors" in Part I and "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" in Part II of our 2012 Annual Report, which contain descriptions of significant factors that might cause the actual results of operations in future periods to differ materially from those currently expected or desired.

There have been no material changes in the risk factors discussed in our 2012 Annual Report and subsequent SEC filings. The risks described in this Quarterly Report, our 2012 Annual Report and in our other SEC filings or press releases from time to time are not the only risks we face. Additional risks and uncertainties are currently deemed immaterial based on management's assessment of currently available information, which remains subject to change; however, new risks that are currently unknown to us may surface in the future that materially adversely affect our business, financial condition, results of operations or cash flows.

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

Note 13 to our condensed consolidated financial statements included in this Quarterly Report includes a discussion of our share repurchase program and payment of quarterly dividends on our common stock. The number of shares repurchased and price paid per share below have been adjusted to reflect the three-for-one stock split discussed in Notes 1 and 13 to our condensed consolidated financial statements included in this Quarterly Report.

During the quarter ended September 30, 2013, we repurchased a total of 1,115,276 shares of our common stock for \$63.8 million (representing an average cost of \$57.21 per share). As of September 30, 2013, we have \$472.6 million of remaining capacity under our current share repurchase program. The following table sets forth the repurchase data for each of the three months during the quarter ended September 30, 2013:

Total Number of

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Period	Total Number of Shares Purchased	Average Price Paid per Share	Shares Purchased as Part of Publicly Announced Program	Maximum Number of Shares (or Approximate Dollar Value) That May Yet Be Purchased Under the Program (in millions)
July 1 - 31	387,165	\$55.62	387,165	\$514.9
August 1 - 31	417,025 (1)	56.72	414,111	491.4
September 1 - 30	314,000	59.84	314,000	472.6
Total	1,118,190	\$57.22	1,115,276	

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Includes 120 shares that were tendered by employees to satisfy minimum tax withholding amounts for Restricted Shares at an average price per share of \$56.75, and includes 2,794 shares purchased at a price of \$56.84 per share (1) by a rabbi trust that we established in connection with our director deferral plans, pursuant to which non-employee directors may elect to defer directors' quarterly cash compensation to be paid at a later date in the form of common stock.

Item 6. Exhibits.

A list of exhibits filed or furnished as part of this Quarterly Report on Form 10-Q is set forth on the Exhibits Index immediately following the signature page of this report and is incorporated herein by reference.



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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

FLOWSERVE CORPORATION

Date: October 24, 2013

/s/ Mark A. Blinn  
Mark A. Blinn  
President and Chief Executive Officer  
(Principal Executive Officer)

Date: October 24, 2013

/s/ Michael S. Taff  
Michael S. Taff  
Senior Vice President and Chief Financial  
Officer  
(Principal Financial Officer)

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Exhibits Index

Exhibit No.	Description
3.1	Restated Certificate of Incorporation of Flowserve Corporation (incorporated by reference to Exhibit 3.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2013).
3.2	Flowserve Corporation By-Laws, as amended and restated effective August 13, 2013 (incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K dated August 15, 2013).
31.1+	Certification of Principal Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2+	Certification of Principal Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1++	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2++	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document

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+ Filed herewith.

++ Furnished herewith.