

FLOWSERVE CORP
Form 10-Q
October 27, 2011

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**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, 2011
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)

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, 2011, there were 55,557,695 shares of the issuer's common stock outstanding.

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| (Amounts in thousands, except per share data) | Three Months Ended September | |
|---|-------------------------------------|-------------|
| | 2011 | 2010 |
| | | 30, |
| Sales | \$ 1,121,813 | \$ 971,681 |
| Cost of sales | (745,227) | (638,183) |
| Gross profit | 376,586 | 333,498 |
| Selling, general and administrative expense | (225,996) | (207,741) |
| Net earnings from affiliates | 4,367 | 3,439 |
| Operating income | 154,957 | 129,196 |
| Interest expense | (8,544) | (8,266) |
| Interest income | 216 | 430 |
| Other (expense) income, net | (6,621) | 18,578 |
| Earnings before income taxes | 140,008 | 139,938 |
| Provision for income taxes | (32,052) | (35,713) |
| Net earnings, including noncontrolling interests | 107,956 | 104,225 |
| Less: Net earnings attributable to noncontrolling interests | (185) | (306) |
| Net earnings attributable to Flowserve Corporation | \$ 107,771 | \$ 103,919 |
| Net earnings per share attributable to Flowserve Corporation common shareholders: | | |
| Basic | \$ 1.94 | \$ 1.86 |
| Diluted | 1.92 | 1.84 |
| Cash dividends declared per share | \$ 0.32 | \$ 0.29 |

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

| (Amounts in thousands) | Three Months Ended September | |
|--|-------------------------------------|-------------|
| | 2011 | 2010 |
| | | 30, |
| Net earnings, including noncontrolling interests | \$ 107,956 | \$ 104,225 |
| Other comprehensive (expense) income: | | |
| Foreign currency translation adjustments, net of tax | (107,740) | 96,435 |
| Pension and other postretirement effects, net of tax | 2,797 | (906) |
| Cash flow hedging activity, net of tax | (516) | 342 |
| Other comprehensive (expense) income | (105,459) | 95,871 |

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| | | |
|--|----------|------------|
| Comprehensive income, including noncontrolling interests | 2,497 | 200,096 |
| Comprehensive loss (income) attributable to noncontrolling interests | 110 | (495) |
| Comprehensive income attributable to Flowserve Corporation | \$ 2,607 | \$ 199,601 |

See accompanying notes to condensed consolidated financial statements.

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FLOWSERVE CORPORATION
(Unaudited)
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

| (Amounts in thousands, except per share data) | Nine Months Ended September 30, | |
|---|--|--------------|
| | 2011 | 2010 |
| Sales | \$ 3,244,772 | \$ 2,891,683 |
| Cost of sales | (2,151,153) | (1,866,510) |
| Gross profit | 1,093,619 | 1,025,173 |
| Selling, general and administrative expense | (681,618) | (620,311) |
| Net earnings from affiliates | 13,314 | 12,537 |
| Operating income | 425,315 | 417,399 |
| Interest expense | (26,684) | (25,942) |
| Interest income | 1,100 | 1,170 |
| Other income (expense), net | 7,852 | (15,259) |
| Earnings before income taxes | 407,583 | 377,368 |
| Provision for income taxes | (103,908) | (101,133) |
| Net earnings, including noncontrolling interests | 303,675 | 276,235 |
| Less: Net earnings attributable to noncontrolling interests | (191) | (448) |
| Net earnings attributable to Flowserve Corporation | \$ 303,484 | \$ 275,787 |
| Net earnings per share attributable to Flowserve Corporation common shareholders: | | |
| Basic | \$ 5.45 | \$ 4.94 |
| Diluted | 5.40 | 4.89 |
| Cash dividends declared per share | \$ 0.96 | \$ 0.87 |

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

| (Amounts in thousands) | Nine Months Ended September 30, | |
|--|--|-------------|
| | 2011 | 2010 |
| Net earnings, including noncontrolling interests | \$ 303,675 | \$ 276,235 |
| Other comprehensive (expense) income: | | |
| Foreign currency translation adjustments, net of tax | (31,625) | (1,922) |
| Pension and other postretirement effects, net of tax | 3,256 | 3,255 |
| Cash flow hedging activity, net of tax | (945) | 2,126 |
| Other comprehensive (expense) income | (29,314) | 3,459 |
| Comprehensive income, including noncontrolling interests | 274,361 | 279,694 |

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|---|------------|------------|
| Comprehensive income attributable to noncontrolling interests | (322) | (600) |
| Comprehensive income attributable to Flowserve Corporation | \$ 274,039 | \$ 279,094 |

See accompanying notes to condensed consolidated financial statements.

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FLOWSERVE CORPORATION
(Unaudited)
CONDENSED CONSOLIDATED BALANCE SHEETS

| | September 30, 2011 | December 31, 2010 |
|---|-----------------------------------|----------------------------------|
| (Amounts in thousands, except per share data) | | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 227,885 | \$ 557,579 |
| Accounts receivable, net of allowance for doubtful accounts of \$21,146 and \$18,632, respectively | 1,022,897 | 839,566 |
| Inventories, net | 1,076,704 | 886,731 |
| Deferred taxes | 128,909 | 131,996 |
| Prepaid expenses and other | 121,071 | 107,872 |
| Total current assets | 2,577,466 | 2,523,744 |
| Property, plant and equipment, net of accumulated depreciation of \$719,720 and \$682,715, respectively | 564,759 | 581,245 |
| Goodwill | 1,013,526 | 1,012,530 |
| Deferred taxes | 21,383 | 24,343 |
| Other intangible assets, net | 139,811 | 147,112 |
| Other assets, net | 163,560 | 170,936 |
| Total assets | \$ 4,480,505 | \$ 4,459,910 |
| LIABILITIES AND EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 459,900 | \$ 571,021 |
| Accrued liabilities | 769,620 | 817,837 |
| Debt due within one year | 50,033 | 51,481 |
| Deferred taxes | 18,513 | 16,036 |
| Total current liabilities | 1,298,066 | 1,456,375 |
| Long-term debt due after one year | 457,855 | 476,230 |
| Retirement obligations and other liabilities | 417,715 | 414,272 |
| Shareholders' equity: | | |
| Common shares, \$1.25 par value | 73,664 | 73,664 |
| Shares authorized 120,000 | | |
| Shares issued 58,931 and 58,931, respectively | | |
| Capital in excess of par value | 612,744 | 613,861 |
| Retained earnings | 2,098,054 | 1,848,680 |
| | 2,784,462 | 2,536,205 |
| Treasury shares, at cost 3,927 and 3,872 shares, respectively | (315,389) | (292,210) |
| Deferred compensation obligation | 9,582 | 9,533 |
| Accumulated other comprehensive loss | (179,951) | (150,506) |

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| | | |
|---|--------------|--------------|
| Total Flowserve Corporation Shareholders Equity | 2,298,704 | 2,103,022 |
| Noncontrolling interest | 8,165 | 10,011 |
| Total equity | 2,306,869 | 2,113,033 |
| Total liabilities and equity | \$ 4,480,505 | \$ 4,459,910 |

See accompanying notes to condensed consolidated financial statements.

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FLOWSERVE CORPORATION
(Unaudited)
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

| (Amounts in thousands) | Nine Months Ended September 30, | |
|---|--|---------------|
| | 2011 | 2010 |
| Cash flows Operating activities: | | |
| Net earnings, including noncontrolling interests | \$ 303,675 | \$ 276,235 |
| Adjustments to reconcile net earnings to net cash used by operating activities: | | |
| Depreciation | 67,166 | 64,727 |
| Amortization of intangible and other assets | 10,206 | 7,192 |
| Amortization of deferred loan costs | 2,179 | 2,699 |
| Net gain on disposition of assets | (484) | (97) |
| Gain on sale of investment | - | (2,618) |
| Excess tax benefits from stock-based compensation arrangements | (5,201) | (9,971) |
| Stock-based compensation | 23,655 | 24,295 |
| Net earnings from affiliates, net of dividends received | 472 | (5,869) |
| Change in assets and liabilities: | | |
| Accounts receivable, net | (201,636) | (47,883) |
| Inventories, net | (206,079) | (112,528) |
| Prepaid expenses and other | (21,606) | (17,034) |
| Other assets, net | (2,019) | 5,812 |
| Accounts payable | (101,671) | (61,960) |
| Accrued liabilities and income taxes payable | (43,648) | (138,420) |
| Retirement obligations and other liabilities | 13,635 | (31,632) |
| Net deferred taxes | 11,271 | 30,433 |
| Net cash flows used by operating activities | (150,085) | (16,619) |
| Cash flows Investing activities: | | |
| Capital expenditures | (71,164) | (46,429) |
| Proceeds from disposal of assets | 3,530 | 6,748 |
| Payments for acquisitions, net of cash acquired | (890) | (199,396) |
| Affiliate investing activity, net | - | 4,326 |
| Net cash flows used by investing activities | (68,524) | (234,751) |
| Cash flows Financing activities: | | |
| Excess tax benefits from stock-based compensation arrangements | 5,201 | 9,971 |
| Payments on long-term debt | (18,750) | (4,261) |
| Net (payments) borrowings under other financing arrangements | (1,747) | 438 |
| Repurchase of common shares | (41,088) | (34,074) |
| Payments of dividends | (51,794) | (47,419) |
| Proceeds from stock option activity | 310 | 5,576 |
| Dividends paid to noncontrolling interests | (2,168) | (259) |

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|--|------------|------------|
| Sale of shares to noncontrolling interests | - | 1,654 |
| Net cash flows used by financing activities | (110,036) | (68,374) |
| Effect of exchange rate changes on cash | (1,049) | (23,963) |
| Net change in cash and cash equivalents | (329,694) | (343,707) |
| Cash and cash equivalents at beginning of period | 557,579 | 654,320 |
| Cash and cash equivalents at end of period | \$ 227,885 | \$ 310,613 |

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, 2011, the related condensed consolidated statements of income and comprehensive income for the three and nine months ended September 30, 2011 and 2010, and the condensed consolidated statements of cash flows for the nine months ended September 30, 2011 and 2010, 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, 2011 (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, 2010 (2010 Annual Report).

Ongoing Events in North Africa, Middle East and Japan Ongoing political and economic conditions in North Africa have caused us to experience shipment delays to this region. We estimate that the shipments to this region that have been delayed resulted in lost or delayed opportunities for operating income of \$3.9 million and \$9.0 million for the three months and nine months ended September 30, 2011, respectively. We are closely monitoring the conditions in the Middle East and North Africa, and, while there are many potential outcomes in each individual country that are difficult to estimate, based on current facts and circumstances as we understand them, it is possible that delayed shipments and bookings could continue throughout the remainder of the year. If the current conditions in North Africa persist, we estimate that the unfavorable impact on bookings for 2011 could approximate \$25 million. The preponderance of our physical assets in the region are located in the Kingdom of Saudi Arabia and the United Arab Emirates and have, to date, not been significantly affected by the unrest elsewhere in the region.

We continue to assess the conditions and potential adverse impacts of the earthquake and tsunami in Japan earlier in the year, in particular as they relate to our customers and suppliers in the impacted regions, as well as announced and potential regulatory impacts to the global nuclear power market. During the nine months ended September 30, 2011, we did not experience any significant adverse impacts due to shipment delays, collection issues or supply chain disruptions. We are also closely monitoring the effects of the Japan crisis on the global nuclear power industry. While it is difficult to estimate the effect of the Fukushima plant shutdown on the global nuclear power market, we have continued to ship nuclear orders in our backlog without significant disruption. We believe that there has been a related reduction in nuclear orders that could continue in the near term, though other parts of our overall power generation business could benefit as nuclear priorities are reevaluated.

Venezuela As previously disclosed in our 2009 and 2010 Annual Reports, effective January 11, 2010, the Venezuelan government devalued its currency (Bolivar) and moved to a two-tier exchange structure. The official exchange rate moved from 2.15 to 4.30 Bolivars to the United States (U.S.) dollar for non-essential items and to 2.60 Bolivars to the U.S. dollar for essential items. Additionally, effective January 1, 2010, Venezuela was designated as hyperinflationary, and as a result, we began to use the U.S. dollar as our functional currency in Venezuela. On December 30, 2010, the Venezuelan government announced its intention to eliminate the favorable essential items rate effective January 1, 2011. Our operations in Venezuela generally consist of a service center that both imports equipment and parts from certain of our other locations for resale to third parties within Venezuela and performs service and repair activities. Our Venezuelan subsidiary's sales for the nine months ended September 30, 2011 and 2010 and total assets at September 30, 2011 represented approximately 1% or less of our consolidated sales and total assets for the same periods.

Although approvals by Venezuela's Commission for the Administration of Foreign Exchange have slowed, we have historically been able to remit dividends and other payments at the official rate, and we currently anticipate doing so

in the future. Accordingly, we used the official rate of 4.30 Bolivars to the U.S. dollar for re-measurement of our Venezuelan financial statements into U.S. dollars for all periods presented. As a result of the currency devaluation, we recognized a net loss of \$8.4 million during the nine months ended September 30, 2010. The loss was reported in other income (expense), net in our condensed consolidated statement of income and resulted in no tax benefit. The elimination of the favorable essential items rate, effective January 1, 2011, had no impact on our consolidated financial position or results of operations for the three and nine months ended September 30, 2011.

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,

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including the 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 in Venezuela that may adversely impact our future consolidated financial condition or results of operations.

Accounting Policies

Effective January 1, 2011, we adopted Accounting Standards Update (ASU) No. 2009-13, Revenue Recognition (Accounting Standards Codification (ASC) 605): Multiple-Deliverable Revenue Arrangements—a consensus of the Financial Accounting Standards Board (FASB) Emerging Issues Task Force, which resulted in expanded disclosure requirements regarding our revenue recognition policy (see Revenue Recognition below). Our adoption of ASU No. 2009-13, effective January 1, 2011, had no impact on our consolidated financial condition or results of operations.

Except for the incremental revenue recognition policy disclosure included below, no other changes have occurred to our significant accounting policies in the nine months ended September 30, 2011. Our significant accounting policies are detailed in Note 1 to our consolidated financial statements included in our 2010 Annual Report.

Revenue Recognition

Revenues for product sales are recognized when the risks and rewards of ownership are transferred to the customers, which is typically based on the contractual delivery terms agreed to with the customer and fulfillment of all but inconsequential or perfunctory actions. In addition, our policy requires persuasive evidence of an arrangement, a fixed or determinable sales price and reasonable assurance of collectability. We defer the recognition of revenue when advance payments are received from customers before performance obligations have been completed and/or services have been performed. Freight charges billed to customers are included in sales and the related shipping costs are included in cost of sales in our consolidated statements of income. Our contracts typically include cancellation provisions that require customers to reimburse us for costs incurred up to the date of cancellation, as well as any contractual cancellation penalties.

We enter into certain contracts with multiple deliverables that may include any combination of designing, developing, manufacturing, modifying, installing and commissioning of flow management equipment and providing services related to the performance of such products. Delivery of these products and services typically occurs within a one to two-year period, although many arrangements, such as book and ship type orders, have a shorter timeframe for delivery. We aggregate or separate deliverables into units of accounting based on whether the deliverable(s) have standalone value to the customer and when no general right of return exists. Contract value is allocated ratably to the units of accounting in the arrangement based on their relative selling prices determined as if the deliverables were sold separately.

Revenues for long-term contracts, including separate units of accounting from multiple-deliverable contracts, that exceed certain internal thresholds regarding the size, complexity and duration of the project and provide for the receipt of progress billings from the customer are recorded on the percentage of completion method with progress measured on a cost-to-cost basis. Percentage of completion revenue represented approximately 7% and 9% of our consolidated sales for the nine months ended September 30, 2011 and 2010, respectively.

Revenue on service and repair contracts is recognized after services have been agreed to by the customer and rendered. Revenues generated under fixed fee service and repair contracts are recognized on a ratable basis over the term of the contract. These contracts can range in duration, but generally extend for up to five years. Revenue on fixed fee service contracts represented approximately 1% of our consolidated sales for the three and nine months ended September 30, 2011 and 2010.

In certain instances, we provide guaranteed completion dates under the terms of our contracts. Failure to meet contractual delivery dates can result in late delivery penalties or non-recoverable costs. In instances where the payment of such costs are deemed to be probable, we perform a project profitability analysis, accounting for such costs as a reduction of realizable revenues, which could potentially cause estimated total project costs to exceed projected total revenues realized from the project. In such instances, we would record reserves to cover such excesses in the period they are determined. In circumstances where the total projected revenues still exceed total projected costs, the incurrence of unrealized incentive fees or non-recoverable costs generally reduces profitability of the project at the time of subsequent revenue recognition. Our reported results would change if different estimates were used for contract costs or if different estimates were used for contractual contingencies.

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In January 2010, the FASB issued ASU No. 2010-06, Fair Value Measurements and Disclosures (ASC 820): Improving Disclosures about Fair Value Measurements, which requires additional disclosures on transfers in and out of Level I and Level II and on activity for Level III fair value measurements. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures of Level III activity, which are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. Our adoption of ASU No. 2010-06 had no material impact on our consolidated financial condition or results of operations.

In September 2009, the FASB issued ASU No. 2009-13, Revenue Recognition (ASC 605): Multiple-Deliverable Revenue Arrangements a consensus of the FASB Emerging Issues Task Force, which addresses the accounting for multiple-deliverable arrangements to enable vendors to account for products or services separately rather than as a combined unit and requires expanded revenue recognition policy disclosures. This amendment addresses how to separate deliverables and how to measure and allocate arrangement consideration to one or more units of accounting. As noted above, our adoption of ASU No. 2009-13, effective January 1, 2011, had no impact on our consolidated financial condition or results of operations.

In December 2010, the FASB issued ASU No. 2010-28, Intangibles Goodwill and Other (ASC 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts a consensus of the FASB Emerging Issues Task Force, which modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. This amendment requires an entity to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists and to consider whether there are any adverse qualitative factors indicating that an impairment may exist. Our adoption of ASU No. 2010-28, effective January 1, 2011, had no impact on our consolidated financial condition or results of operations.

In December 2010, the FASB issued ASU No. 2010-29, Business Combinations (ASC 805): Disclosure of Supplementary Pro Forma Information for Business Combinations a consensus of the FASB Emerging Issues Task Force, which specifies that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. This amendment also expands the supplemental pro forma disclosures under ASC 805 to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. Our adoption of ASU No. 2010-29, effective January 1, 2011, had no material impact on our consolidated financial condition or results of operations.

Pronouncements Not Yet Implemented

In June 2011, the FASB issued ASU No. 2011-05, Comprehensive Income (ASC 220): Presentation of Comprehensive Income, which specifies that an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This amendment requires an entity to present on the face of the financial statements reclassification adjustments for items that are reclassified from other comprehensive income to net income. ASU No. 2011-05 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The presentation and disclosure requirements shall be applied retrospectively for all periods presented. The adoption of ASU No. 2011-05 will not have an impact on our consolidated financial condition and results of operations.

In September 2011, the FASB issued ASU No. 2011-08, Intangibles Goodwill and Other (ASC 350): Testing Goodwill 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 fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. An entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. ASU No. 2011-08 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. We do not expect the adoption of ASU No. 2011-08 to have a material impact on

our consolidated financial condition and results of operations.

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As discussed in Note 2 to our consolidated financial statements included in our 2010 Annual Report, effective July 16, 2010, we acquired for inclusion in Flow Control Division (FCD), Valbart Srl (Valbart), a privately-owned Italian valve manufacturer, for \$199.4 million, which included \$33.8 million of existing Valbart net debt (third party debt less cash on hand) that was repaid at closing. Valbart manufactures trunnion-mounted ball valves used primarily in upstream and midstream oil and gas applications, and its acquisition is to improve our ability to provide a more complete valve portfolio to oil and gas projects. Prior to acquisition, Valbart generated approximately 81 million (\$104 million, at then-current exchange rates) in sales (unaudited) during its fiscal year ended May 31, 2010. No pro forma information was provided due to immateriality.

3. Stock-Based Compensation Plans

We established the Flowserve Corporation Equity and Incentive Compensation Plan (the 2010 Plan) effective January 1, 2010. This shareholder-approved plan authorizes the issuance of up to 2,900,000 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 2,900,000 shares of common stock authorized under the 2010 Plan, 2,432,259 remain available for issuance as of September 30, 2011. In addition to the 2010 Plan, we also maintain the Flowserve Corporation 2004 Stock Compensation Plan (the 2004 Plan), which was established on April 21, 2004. The 2004 Plan authorized the issuance of up to 3,500,000 shares of common stock through grants of Restricted Shares, stock options and other equity-based awards. No stock options have been granted in recent years. Of the 3,500,000 shares of common stock authorized under the 2004 Plan, 482,265 remain available for issuance as of September 30, 2011.

We recorded stock-based compensation expense of \$4.9 million (\$7.4 million pre-tax) and \$6.2 million (\$9.2 million pre-tax) for the three months ended September 30, 2011 and 2010, respectively. We recorded stock-based compensation expense of \$15.9 million (\$23.7 million pre-tax) and \$16.4 million (\$24.3 million pre-tax) for the nine months ended September 30, 2011 and 2010, respectively.

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 \$33.1 million and \$31.6 million at September 30, 2011 and December 31, 2010, 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 both the three months ended September 30, 2011 and 2010 was \$0.2 million. The total fair value of Restricted Shares vested during the nine months ended September 30, 2011 and 2010 was \$35.0 million and \$31.8 million, respectively.

The following table summarizes information regarding Restricted Shares:

| | Nine Months Ended September 30, 2011 | |
|----------------------------------|---|---|
| | Shares | Weighted Average Grant-Date Fair Value |
| Number of unvested shares: | | |
| Outstanding - January 1, 2011 | 1,259,377 | \$ 77.05 |
| Granted | 216,644 | 130.51 |
| Vested | (394,849) | 88.73 |
| Cancelled | (49,742) | 84.52 |
| Outstanding - September 30, 2011 | 1,031,430 | \$ 83.45 |

Unvested Restricted Shares outstanding as of September 30, 2011, includes 427,000 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, 2009 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 expense is adjusted based on changes in the expected achievement of the performance targets. Vesting provisions range from 0 to 829,000 shares based on performance targets. As of September 30, 2011, we estimate vesting of approximately 734,000 shares based on expected achievement of performance targets.

Table of Contents**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 2010 Annual Report and Note 7 of this Quarterly Report for additional information on our purpose for entering into derivatives not designated as hedging instruments and our overall risk management strategies. 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. At September 30, 2011 and December 31, 2010, we had \$506.6 million and \$358.5 million, respectively, of notional amount in outstanding forward exchange contracts with third parties. At September 30, 2011, the length of forward exchange contracts currently in place ranged from 7 days to 22 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, 2011 and December 31, 2010, we had \$335.0 million and \$350.0 million, respectively, of notional amount in outstanding interest rate swaps with third parties. All interest rate swaps are highly effective. At September 30, 2011, the maximum remaining length of any interest rate swap contract in place was approximately 33 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 material, 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, 2011 | December 31, 2010 |
|-----------------------------------|-----------------------------------|----------------------------------|
| Current derivative assets | \$ 5,181 | \$ 4,397 |
| Noncurrent derivative assets | - | 50 |
| Current derivative liabilities | 8,657 | 2,949 |
| Noncurrent derivative liabilities | 1,130 | 473 |

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

| (Amounts in thousands) | September 30, 2011 | December 31, 2010 |
|-----------------------------------|-----------------------------------|----------------------------------|
| Current derivative assets | \$ 3 | \$ - |
| Noncurrent derivative assets | 49 | 608 |
| Current derivative liabilities | 1,220 | 1,232 |
| Noncurrent derivative liabilities | 941 | 3 |

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, | |
|----------------------------------|---|-------------|--|-------------|
| | 2011 | 2010 | 2011 | 2010 |
| (Loss) gain recognized in income | \$ (9,892) | \$ 18,467 | \$ 211 | \$ (7,787) |

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The impact of net changes in the fair values of interest rate swaps in cash flow hedging relationships are summarized below:

| (Amounts in thousands) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|----------|------------------------------------|------------|
| | 2011 | 2010 | 2011 | 2010 |
| Loss reclassified from accumulated other comprehensive income into income for settlements, net of tax | \$ (396) | \$ (930) | \$ (1,203) | \$ (3,603) |
| Loss recognized in other comprehensive income, net of tax | (912) | (588) | (2,149) | (1,476) |

Gains and losses recognized in our condensed consolidated statements of income for forward exchange contracts and interest rate swaps are classified as other income (expense), net, and interest expense, respectively. At September 30, 2011, we estimate that approximately \$1.1 million of net losses on interest rate swaps designated as cash flow hedges will be reclassified from accumulated other comprehensive income to earnings during the next twelve months.

5. Debt

Debt, including capital lease obligations, consisted of:

| (Amounts in thousands) | September 30, 2011 | December 31, 2010 |
|---|--------------------------|-------------------------|
| Term Loan, interest rate of 2.39% and 2.30% at September 30, 2011 and December 31, 2010, respectively | \$ 481,250 | \$ 500,000 |
| Capital lease obligations and other borrowings | 26,638 | 27,711 |
| Debt and capital lease obligations | 507,888 | 527,711 |
| Less amounts due within one year | 50,033 | 51,481 |
| Total debt due after one year | \$ 457,855 | \$ 476,230 |

Credit Facilities

Our credit facilities are comprised of a \$500.0 million term loan facility with a maturity date of December 14, 2015 and a \$500.0 million revolving credit facility with a maturity date of December 14, 2015 (collectively referred to as the Credit Facilities). The revolving credit facility includes a \$300.0 million sublimit for the issuance of letters of credit. Subject to certain conditions, we have the right to increase the amount of the revolving credit facility by an aggregate amount not to exceed \$200.0 million. We had outstanding letters of credit of \$144.8 million and \$133.9 million at September 30, 2011 and December 31, 2010, respectively, which reduced our borrowing capacity to \$355.2 million and \$366.1 million, respectively.

Borrowings under our Credit Facilities, other than in respect of swingline loans, bear interest at a rate equal to, at our option, either (1) London Interbank Offered Rate (LIBOR) plus 1.75% - 2.50%, as applicable, depending on our consolidated leverage ratio (2) the base rate (which is based on greater of the prime rate most recently announced by the administrative agent under our New Credit Facilities or the Federal Funds rate plus 0.50% or (3) a daily rate equal to the one month LIBOR plus 1.0% plus, as applicable, an applicable margin of 0.75% - 1.50% determined by reference to the ratio of our total debt to consolidated earnings before interest, taxes, depreciation and amortization (EBITDA). The applicable interest rate as of September 30, 2011 was 2.39% for borrowings under our Credit Facilities. In connection with our Credit Facilities, we have entered into \$335.0 million of notional amount of interest rate swaps at September 30, 2011 to hedge exposure to floating interest rates.

We may prepay loans under our Credit Facilities in whole or in part, without premium or penalty, at any time. During the three and nine months ended September 30, 2011, we made scheduled repayments under our Credit Facilities of \$6.3 million and \$18.8 million, respectively. We have scheduled repayments of \$6.3 million due in each of the next four quarters.

European Letter of Credit Facilities On October 30, 2009, we entered into a new 364-day unsecured European Letter of Credit Facility (New European LOC Facility) with an initial commitment of 125.0 million. The New European LOC Facility is renewable annually and is used for contingent obligations in respect of surety and performance bonds, bank guarantees and similar obligations with maturities up to five years. We anticipate renewing the New European LOC Facility in late October 2011 consistent with its initial terms for an additional 364-day period. We pay fees of 1.35% and 0.40% for utilized and unutilized capacity, respectively, under our New European LOC Facility. We had outstanding letters of credit drawn on the New European LOC Facility of 62.4 million (\$83.5 million) and 55.7 million (\$74.5 million) as of September 30, 2011 and December 31, 2010, respectively.

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Our ability to issue additional letters of credit under our previous European Letter of Credit Facility (Old European LOC Facility), which had a commitment of 110.0 million, expired November 9, 2009. We paid annual and fronting fees of 0.875% and 0.10%, respectively, for letters of credit written against the Old European LOC Facility. We had outstanding letters of credit written against the Old European LOC Facility of 16.0 million (\$21.4 million) and 33.3 million (\$44.5 million) as of September 30, 2011 and December 31, 2010, respectively.

Certain banks are parties to both facilities and are managing their exposures on an aggregated basis. As such, the commitment under the New European LOC Facility is reduced by the face amount of existing letters of credit written against the Old European LOC Facility prior to its expiration. These existing letters of credit will remain outstanding, and accordingly offset the 125.0 million capacity of the New European LOC Facility until their maturity, which, as of September 30, 2011, was approximately one year for the majority of the outstanding existing letters of credit. After consideration of outstanding commitments under both facilities, the available capacity under the New European LOC Facility was 114.1 million as of September 30, 2011, of which 62.4 million has been utilized.

6. Realignment Programs and Industrial Product Division (IPD) Recovery Plan

Beginning in 2009, we initiated realignment programs to reduce and optimize certain non-strategic manufacturing facilities and our overall cost structure by improving our operating efficiency, reducing redundancies, maximizing global consistency and driving improved financial performance, as well as expanding our efforts to optimize assets, respond to reduced orders and drive an enhanced customer-facing organization (Realignment Programs). Most of the realignment initiatives related to these programs have been substantially completed as of September 30, 2011. We currently expect total charges related to these realignment programs will be approximately \$92 million, of which \$89.7 million has been incurred through September 30, 2011. Total expected realignment charges represent management's best estimate to date, and actual realignment charges incurred could vary from total expected charges as all initiatives are finalized.

The Realignment Programs consist of both restructuring and non-restructuring charges. Restructuring charges represent costs associated with the relocation of certain business activities, outsourcing of some business activities and facility closures. Non-restructuring charges are costs incurred to improve operating efficiency and reduce redundancies and primarily represent employee severance. Charges are reported in Cost of Sales (COS) or Selling, General & Administrative Expense (SG&A), as applicable, in our condensed consolidated statements of income, net of adjustments related to changes in estimates of previously recorded amounts.

Charges, net of adjustments, related to our Realignment Programs were \$1.2 million and \$2.1 million for the three months ended September 30, 2011 and September 30, 2010, respectively, and \$3.3 million and \$10.2 million for the nine months ended September 30, 2011 and September 30, 2010, respectively.

The restructuring reserve related to the Realignment Programs was \$1.4 million and \$7.1 million at September 30, 2011 and December 31, 2010, respectively. Other than cash payments, there was no significant activity related to the restructuring reserve during the three or nine months ended September 30, 2011.

In addition, in connection with our previously announced IPD recovery plan, in the second quarter of 2011 we initiated new activities to optimize structural parts of IPD's business. We expect charges related to this program to be non-restructuring in nature and will approximate \$9 million, of which \$7.1 million was incurred and recorded in COS for the nine months ended September 30, 2011, all of which were incurred in the second quarter of 2011.

7. Fair Value

Our financial instruments are presented at fair value in our condensed consolidated balance sheets. 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 based upon the level of judgment associated with the inputs used to measure their fair values. Hierarchical levels are directly related to the amount of subjectivity associated with the inputs to fair valuation of these assets and liabilities. Recurring fair value measurements are limited to investments in derivative instruments and some 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 above in Note 4. The fair value measurements of our investments in equity securities are determined using quoted market prices. The fair values of our investments in equity securities, and changes thereto, are immaterial to our consolidated financial position and results of operations.

Table of Contents**8. Inventories**

Certain reclassifications have been made to prior period information to conform to current year presentation. Inventories, net consisted of the following:

| (Amounts in thousands) | September 30, 2011 | December 31, 2010 |
|-----------------------------------|-----------------------------------|----------------------------------|
| Raw materials | \$ 326,241 | \$ 265,742 |
| Work in process | 764,525 | 688,710 |
| Finished goods | 339,293 | 306,083 |
| Less: Progress billings | (279,968) | (305,541) |
| Less: Excess and obsolete reserve | (73,387) | (68,263) |
| Inventories, net | \$ 1,076,704 | \$ 886,731 |

9. Equity Method Investments

As of September 30, 2011, we had investments in eight joint ventures (one located in each of Japan, Saudi Arabia, South Korea, and the United Arab Emirates and two located in each of China and India) that were accounted for using the equity method. Summarized below is combined income statement information, based on the most recent financial information (unaudited), for those investments:

| (Amounts in thousands) | Three Months Ended September 30, | |
|--|---|-------------|
| | 2011 | 2010 |
| Revenues | \$ 91,832 | \$ 60,597 |
| Gross profit | 21,356 | 17,561 |
| Income before provision for income taxes | 14,772 | 12,494 |
| Provision for income taxes | (4,189) | (3,570) |
| Net income | \$ 10,583 | \$ 8,924 |

| (Amounts in thousands) | Nine Months Ended September 30, | |
|--|--|-------------|
| | 2011 | 2010 |
| Revenues | \$ 243,688 | \$ 174,517 |
| Gross profit | 68,966 | 57,819 |
| Income before provision for income taxes | 47,607 | 42,237 |
| Provision for income taxes | (14,237) | (11,524) |
| Net income | \$ 33,370 | \$ 30,713 |

The provision for income taxes is based on the tax laws and rates in the countries in which our investees operate. The tax jurisdictions vary not only by their nominal rates, but also by the allowability of deductions, credits and other benefits. Our share of net income is reflected in our condensed consolidated statements of income.

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:

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| | Three Months Ended September 30, | |
|--|---|-------------|
| (Amounts in thousands, except per share data) | 2011 | 2010 |
| Net earnings of Flowserve Corporation | \$ 107,771 | \$ 103,919 |
| Dividends on restricted shares not expected to vest | 4 | 4 |
| Earnings attributable to common and participating shareholders | \$ 107,775 | \$ 103,923 |
| Weighted average shares: | | |
| Common stock | 55,381 | 55,499 |
| Participating securities | 262 | 311 |
| Denominator for basic earnings per common share | 55,643 | 55,810 |
| Effect of potentially dilutive securities | 518 | 576 |
| Denominator for diluted earnings per common share | 56,161 | 56,386 |
| Earnings per common share: | | |
| Basic | \$ 1.94 | \$ 1.86 |
| Diluted | 1.92 | 1.84 |
| | | |
| | Nine Months Ended September 30, | |
| (Amounts in thousands, except per share data) | 2011 | 2010 |
| Net earnings of Flowserve Corporation | \$ 303,484 | \$ 275,787 |
| Dividends on restricted shares not expected to vest | 11 | 12 |
| Earnings attributable to common and participating shareholders | \$ 303,495 | \$ 275,799 |
| Weighted average shares: | | |
| Common stock | 55,407 | 55,448 |
| Participating securities | 275 | 338 |
| Denominator for basic earnings per common share | 55,682 | 55,786 |
| Effect of potentially dilutive securities | 565 | 667 |
| Denominator for diluted earnings per common share | 56,247 | 56,453 |
| Earnings per common share: | | |
| Basic | \$ 5.45 | \$ 4.94 |
| Diluted | 5.40 | 4.89 |

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, 2011 and 2010, 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 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

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probable and not otherwise in dispute. While unfavorable rulings, judgments or settlement terms regarding these claims could have a material adverse impact on our business, financial condition, results of operations and cash flows, we currently believe the likelihood is remote. In one asbestos insurance related matter, we have a claim in litigation against relevant insurers substantially in excess of the recorded receivable. If our claim is resolved more favorably than reflected in this receivable, we would benefit from a one-time gain in the amount of such excess. We are currently unable to estimate the impact, if any, of unasserted asbestos-related claims, although future claims would also be subject to 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 our French subsidiary was included, concerning suspected inappropriate activities conducted in connection with the United Nations Oil for Food Program. As anticipated and as previously disclosed, the French investigation of our French subsidiary was formally opened in the first quarter of 2010, and our French subsidiary has filed a formal response with the French court. 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 effect 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. There have been no material developments in this case since it was initially filed. We intend to vigorously contest the suit, and we believe that we have valid defenses to the claims asserted. While we cannot predict the outcome of the suit at the present time, we do not currently believe the resolution of this suit will have a material adverse financial impact on our company.

Export Compliance

As previously reported, in March 2006, we initiated a voluntary systematic process to determine our compliance with respect to U.S. export control and economic sanctions laws and regulations. Our process included the onsite review of approximately 40 sites globally and addressed the period of October 1, 2002 through October 1, 2007. At the end of 2008, we completed comprehensive disclosures to the Commerce Department's Bureau of Industry and Security (BIS) and the Treasury Department's Office of Foreign Assets Control (OFAC) regarding the results of our review process. Following the initial disclosures to BIS and OFAC, we continued to work closely with authorities to supplement and clarify specific aspects of our voluntary disclosures.

In late September 2011, we entered into settlement agreements with both BIS and OFAC that resolved in full all matters contained in our voluntary disclosures. Under the settlements, we agreed to pay a combined civil penalty of approximately \$3 million to these federal agencies and also agreed to conduct a one-time, post-settlement compliance audit of certain company sites. The full amount of the civil penalty and the expected cost of the audit approximate the reserve previously established for this matter.

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 exposure for existing disposal sites will not be material.

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 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 absolute certainty except as otherwise indicated above, we have established reserves covering exposures relating to contingencies, to the extent believed to be reasonably estimable

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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.

12. Retirement and Postretirement Benefits

Components of the net periodic cost for retirement and postretirement benefits for the three months ended September 30, 2011 and 2010 were as follows:

| (Amounts in millions) | U.S. Defined Benefit Plans | | Non-U.S. Defined Benefit Plans | | Postretirement Medical Benefits | |
|--|-------------------------------|--------|-----------------------------------|--------|------------------------------------|----------|
| | 2011 | 2010 | 2011 | 2010 | 2011 | 2010 |
| Service cost | \$ 4.9 | \$ 5.1 | \$ 1.3 | \$ 1.3 | \$ - | \$ - |
| Interest cost | 4.3 | 4.4 | 3.3 | 3.3 | 0.5 | 0.5 |
| Expected return on plan assets | (5.4) | (5.9) | (2.1) | (1.9) | - | - |
| Curtailments/settlements | - | 0.4 | - | - | - | - |
| Amortization of prior service benefit | (0.3) | (0.3) | - | - | (0.4) | (0.5) |
| Amortization of unrecognized net loss (gain) | 2.7 | 2.3 | 0.5 | 0.6 | (0.4) | (0.7) |
| Net periodic cost (benefit) recognized | \$ 6.2 | \$ 6.0 | \$ 3.0 | \$ 3.3 | \$ (0.3) | \$ (0.7) |

Components of the net periodic cost for retirement and postretirement benefits for the nine months ended September 30, 2011 and 2010 were as follows:

| (Amounts in millions) | U.S. Defined Benefit Plans | | Non-U.S. Defined Benefit Plans | | Postretirement Medical Benefits | |
|--|-------------------------------|---------|-----------------------------------|--------|------------------------------------|----------|
| | 2011 | 2010 | 2011 | 2010 | 2011 | 2010 |
| Service cost | \$ 14.8 | \$ 15.3 | \$ 3.8 | \$ 3.7 | \$ - | \$ - |
| Interest cost | 12.9 | 13.5 | 9.9 | 9.8 | 1.4 | 1.5 |
| Expected return on plan assets | (16.3) | (18.0) | (6.1) | (5.6) | - | - |
| Curtailments/settlements | - | 0.4 | - | - | - | - |
| Amortization of prior service benefit | (0.9) | (0.9) | - | - | (1.2) | (1.5) |
| Amortization of unrecognized net loss (gain) | 8.1 | 7.2 | 1.5 | 1.8 | (1.1) | (1.8) |
| Net periodic cost (benefit) recognized | \$ 18.6 | \$ 17.5 | \$ 9.1 | \$ 9.7 | \$ (0.9) | \$ (1.8) |

See additional discussion of our retirement and postretirement benefits in Note 12 to our consolidated financial statements included in our 2010 Annual Report.

13. Shareholders Equity

On February 21, 2011, our Board of Directors authorized an increase in the payment of quarterly dividends on our common stock from \$0.29 per share to \$0.32 per share, effective for the first quarter of 2011. On February 22, 2010, our Board of Directors authorized an increase in our quarterly cash dividend from \$0.27 per share to \$0.29 per share, effective for the first quarter of 2010. Generally, our dividend date-of-record is in the last month of the quarter, and the dividend is paid the following month.

On September 12, 2011, our Board of Directors announced the approval of a new program to repurchase up to \$300.0 million of our outstanding common stock over an unspecified time period. The program is expected to commence in the fourth quarter of 2011.

On February 27, 2008, our Board of Directors announced the approval of a program to repurchase up to \$300.0 million of our outstanding common stock over an unspecified time period, and the program commenced in the second quarter of 2008. We repurchased 168,750 shares for \$15.1 million and 112,500 shares for \$11.0 million during the three months ended September 30, 2011 and 2010, respectively. We repurchased 381,250 shares for \$41.1 million and 337,500 shares for \$34.1 million during the nine months ended September 30, 2011 and 2010, respectively. To date, we have repurchased a total of 3,116,850 shares for \$293.0 million under this program, and the program is expected to conclude in the fourth quarter of 2011.

Table of Contents**14. Income Taxes**

For the three months ended September 30, 2011, we earned \$140.0 million before taxes and provided for income taxes of \$32.1 million, resulting in an effective tax rate of 22.9%. For the nine months ended September 30, 2011, we earned \$407.6 million before taxes and provided for income taxes of \$103.9 million, resulting in an effective tax rate of 25.5%. The effective tax rate varied from the U.S. federal statutory rate for the three months ended September 30, 2011 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. The effective tax rate varied from the U.S. federal statutory rate for the nine months ended September 30, 2011 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.

For the three months ended September 30, 2010, we earned \$139.9 million before taxes and provided for income taxes of \$35.7 million, resulting in an effective tax rate of 25.5%. For the nine months ended September 30, 2010, we earned \$377.4 million before taxes and provided for income taxes of \$101.1 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 months ended September 30, 2010 primarily due to the net impact of foreign operations and resolution of tax audits and the lapse of the statute of limitations in certain jurisdictions. The effective tax rate varied from the U.S. federal statutory rate for the nine months ended September 30, 2010 primarily due to the net impact of foreign operations, including the adverse tax impact from the non-deductibility of the net losses resulting from Venezuela's currency devaluation, and a net reduction of our reserve for uncertain tax positions due to the resolution of tax audits and the lapse of the statute of limitations in certain jurisdictions.

As of September 30, 2011, the amount of unrecognized tax benefits decreased by \$1.6 million from December 31, 2010, due to the net impacts of currency translation adjustments, expiration of statutes and audit settlements. With limited exception, we are no longer subject to U.S. federal, state and local income tax audits for years through 2007 or non-U.S. income tax audits for years through 2004. We are currently under examination for various years in Austria, Belgium, Canada, Germany, India, 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 between \$17.5 million and \$27.6 million within the next 12 months.

15. Segment Information

We are principally engaged in the worldwide design, manufacture, distribution and service of industrial flow management equipment. We provide long lead-time, highly engineered pumps, shorter lead-time engineered pumps, standardized, general purpose pumps, mechanical seals, industrial valves and related automation products and solutions primarily for oil and gas, chemical, power generation, water management and other general industries requiring flow management products and services.

Our business segments, defined below, 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 which 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.

We conduct our operations through these three business segments based on type of product and how we manage the business:

Flow Solutions Group (FSG) 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;

FSG IPD for engineered and pre-configured industrial pumps and pump systems and related products and services; and

FCD for engineered and industrial valves, control valves, actuators and controls and related services.

The President of FSG reports directly to the Chief Executive Officer (CEO) and the FSG Vice President Finance reports directly to our Chief Accounting Officer (CAO). The structure of FSG consists of two reportable operating segments: EPD and IPD. FCD has a President, who reports directly to our CEO, and a Vice President Finance, who reports directly to our CAO. For decision-making purposes, our CEO and other members of senior executive management use financial information generated and reported at the reportable segment level. Our corporate headquarters does not constitute a separate division or business segment.

We evaluate segment performance and allocate resources based on each reportable segment s operating income. Amounts classified as Eliminations and All Other include corporate headquarters costs and other minor entities that do not constitute separate segments. Intersegment sales and transfers are recorded at cost plus a profit margin, with the sales and related margin on such sales eliminated in consolidation.

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

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| Three Months Ended September 30, 2011 | Flow Solutions Group | | | Subtotal Reportable Segments | Eliminations and All Other | Consolidated Total |
|--|-----------------------------|------------|------------|---|---|-------------------------------|
| | EPD | IPD | FCD | | | |
| Sales to external customers | \$ 554,708 | \$200,190 | \$ 366,915 | \$1,121,813 | \$ - | \$1,121,813 |
| Intersegment sales | 19,549 | 15,449 | 1,407 | 36,405 | (36,405) | - |
| Segment operating income | 91,921 | 16,532 | 63,769 | 172,222 | (17,265) | 154,957 |

| Three Months Ended September 30, 2010 | Flow Solutions Group | | | Subtotal Reportable Segments | Eliminations and All Other | Consolidated Total |
|--|-----------------------------|------------|------------|---|---|-------------------------------|
| | EPD | IPD | FCD | | | |
| Sales to external customers | \$ 494,912 | \$166,741 | \$ 310,028 | \$ 971,681 | \$ - | \$ 971,681 |
| Intersegment sales | 16,388 | 9,729 | 2,532 | 28,649 | (28,649) | - |
| Segment operating income | 92,785 | 9,534 | 45,690 | 148,009 | (18,813) | 129,196 |

| Nine Months Ended September 30, 2011 | Flow Solutions Group | | | Subtotal Reportable Segments | Eliminations and All Other | Consolidated Total |
|---|-----------------------------|------------|-------------|---|---|-------------------------------|
| | EPD | IPD | FCD | | | |
| Sales to external customers | \$1,593,681 | \$563,586 | \$1,087,505 | \$3,244,772 | \$ - | \$3,244,772 |
| Intersegment sales | 61,640 | 52,895 | 5,498 | 120,033 | (120,033) | - |
| Segment operating income | 270,363 | 39,225 | 171,239 | 480,827 | (55,512) | 425,315 |

| Nine Months Ended September 30, 2010 | Flow Solutions Group | | | Subtotal Reportable Segments | Eliminations and All Other | Consolidated Total |
|---|-----------------------------|------------|------------|---|---|-------------------------------|
| | EPD | IPD | FCD | | | |
| Sales to external customers | \$1,520,267 | \$539,634 | \$ 831,782 | \$2,891,683 | \$ - | \$2,891,683 |
| Intersegment sales | 47,310 | 31,610 | 5,618 | 84,538 | (84,538) | - |
| Segment operating income | 301,418 | 46,414 | 127,920 | 475,752 | (58,353) | 417,399 |

16. Subsequent Events

On October 4, 2011, we entered into an agreement to acquire for inclusion in EPD, Lawrence Pumps, Inc. (LPI), a privately-owned, U.S.-based company specializing in the design, development and manufacture of engineered centrifugal slurry pumps for critical services within the petroleum refining, petrochemical, pulp and paper and energy markets. LPI generated approximately \$44 million in sales (unaudited) and EBITDA of approximately \$8 million (unaudited) during its fiscal year ended December 31, 2010. The acquisition is expected to close in late October 2011 and is subject to customary closing conditions. Upon closing, 100% of LPI s outstanding equity will be acquired in a cash transaction valued at approximately \$89 million, subject to final adjustments. We intend to fund the transaction with cash on hand.

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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 2010 Annual Report.

EXECUTIVE OVERVIEW

Our Company

We believe that 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, management 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, on an integrated basis 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 16,000 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 and the extent to which service and maintenance is undertaken by our customers. 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 maximize our customers' investment in our offerings, as well as to provide business stability during various economic periods. The aftermarket business, which is served by more than 160 of our 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, and is generally a higher margin 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:

FSG EPD for long lead-time, custom and other highly-engineered pumps and pump systems, mechanical seals, auxiliary systems and replacement parts and related services;

FSG IPD for engineered and pre-configured industrial pumps and pump systems and related products and services; and

FCD for engineered and industrial valves, control valves, actuators and controls and related services.

The reputation of our product portfolio is built on more than 50 well-respected brand names such as Worthington, IDP, Valtek, Limitorque and Durametallc, which we believe to be one of the most comprehensive in the industry. The 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 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 this important 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 divisions 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 continue to focus 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 first nine months of 2011, we continued to experience improved bookings volume despite an environment of global macroeconomic uncertainty. The oil and gas industry experienced improved conditions, as the developing regions economic growth plans

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rekindled projections of demand growth for oil and gas. While large project business remained competitive, short cycle and small project activity improved, primarily in the chemical, general, and oil and gas industries. Recovery in the chemical industry has been notable in North America and the developing regions also experienced increased chemical processing investment. In the mature regions excluding Europe, the oil and gas industries continued experiencing a moderate level of investment. Pipeline and refining investments were driven by infrastructure expansion plans in emerging regions.

During the first nine months of 2011, we continued to experience favorable conditions in our aftermarket business driven by our customers' need to maintain continuing operations across several industries and the expansion of our aftermarket capabilities provided through our new integrated solutions offerings. Our pursuit of major capital projects globally and our investment in our ability to serve the customer in a local manner remain key components of our long-term growth strategy, as well as 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 provided us with the opportunity to grow our market share in the aftermarket portion of our business.

With overall demand and the need to replace aging infrastructure, 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 challenges affecting many companies in our industry with a significant multinational presence, such as economic, political, currency and other risks.

Ongoing political and economic conditions in North Africa have caused us to experience shipment delays to this region. We estimate that the shipments to this region that have been delayed resulted in lost or delayed opportunities for operating income of \$3.9 million (\$2.0 million in EPD and \$1.9 million in IPD) and \$9.0 million (\$6.1 million in EPD and \$2.9 million in IPD) for the three months and nine months ended September 30, 2011, respectively. We are closely monitoring the conditions in the Middle East and North Africa and, while there are many potential outcomes in each individual country that are difficult to estimate, based on current facts and circumstances as we understand them, it is possible that delayed shipments and bookings could continue throughout the remainder of the year. If the current conditions in North Africa persist, we estimate that the unfavorable impact on bookings for 2011 could approximate \$25 million. The preponderance of our physical assets in the region are located in the Kingdom of Saudi Arabia and the United Arab Emirates and have, to date, not been significantly affected by the unrest elsewhere in the region.

We continue to assess the conditions and potential adverse impacts of the earthquake and tsunami in Japan earlier in the year, in particular as they relate to our customers and suppliers in the impacted regions, as well as announced and potential regulatory impacts to the global nuclear power market. During the nine months ended September 30, 2011, we did not experience any significant adverse impacts due to shipment delays, collection issues or supply chain disruptions. We are closely monitoring the effects of the Japan crisis on the global nuclear power industry. While it is difficult to estimate the effect of the Fukushima plant shutdown on the global nuclear power market, we have continued to ship nuclear orders in our backlog without significant disruption. We believe that there has been a related reduction in nuclear orders that could continue in the near term, though other parts of our overall power generation business could benefit as nuclear priorities are re-evaluated.

RESULTS OF OPERATIONS Three and nine months ended September 30, 2011 and 2010

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, we acquired for inclusion in FCD, Valbart, a privately-owned Italian valve manufacturer, effective July 16, 2010, and Valbart's results of operations have been consolidated since the date of acquisition. No pro forma information has been provided for the acquisition due to immateriality.

As discussed in Note 6 to our condensed consolidated financial statements included in this Quarterly Report, beginning in 2009, we initiated Realignment Programs to reduce and optimize certain non-strategic manufacturing facilities and our overall cost structure by improving our operating efficiency, reducing redundancies, maximizing global consistency and driving improved financial performance, as well as expanding our efforts to optimize assets,

responding to reduced orders and driving an enhanced customer-facing organization. To date, we have incurred charges related to our Realignment Programs of \$89.7 million, including \$18.3 million in 2010 and \$68.1 million in 2009. We expect to incur approximately \$2 million of additional charges resulting in total expected Realignment Programs charges of approximately \$92 million for approved plans. Total expected realignment charges represent management's best estimate to date for approved plans. As the execution of certain initiatives are still in process, the amount and nature of actual realignment charges incurred could vary from total expected charges.

The Realignment Programs consist of both restructuring and non-restructuring costs. Restructuring charges represent costs

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associated with the relocation of certain business activities, outsourcing of some business activities and facility closures. Non-restructuring charges are costs incurred to improve operating efficiency and reduce redundancies, which includes a reduction in headcount. Expenses are reported in COS or SG&A, as applicable, in our condensed consolidated statements of income.

Charges, net of adjustments, related to our Realignment Programs were \$1.2 million and \$2.1 million for the three months ended September 30, 2011 and September 30, 2010, respectively. IPD, FCD and EPD incurred \$1.0 million, \$0.1 million and \$0.1 million of realignment charges, net of adjustments, for the three months ended September 30, 2011, respectively. For the three months ended September 30, 2010, IPD, FCD, EPD and Eliminations and All Other incurred \$1.1 million, \$0.8 million, \$0.1 million and \$0.1 million of realignment charges, net of adjustments, respectively.

Charges, net of adjustments, related to our Realignment Programs were \$3.3 million and \$10.2 million for the nine months ended September 30, 2011 and September 30, 2010, respectively. IPD, FCD and EPD incurred \$3.0 million, \$0.5 million, and \$0.1 million of realignment charges, net of adjustments, for the nine months ended September 30, 2011, respectively. Eliminations and All Other incurred \$0.3 million of adjustments due to changes in estimates for the nine months ended September 30, 2011. For the nine months ended September 30, 2010, IPD, FCD, EPD and Eliminations and All Other incurred \$5.4 million, \$3.9 million, \$0.5 million and \$0.4 million of realignment charges, net of adjustments, respectively.

Based on actions under our Realignment Programs, we have realized additional savings of approximately \$4 million and \$23 million for the three and nine months ended September 30, 2011, respectively, as compared with the same period in 2010, and we expect to realize total savings in 2011 of approximately \$116 million. Upon completion of our Realignment Programs, we expect annual run rate cost savings of approximately \$120 million at current exchange rates. Approximately two-thirds of savings from the Realignment Programs were and will be realized in COS and the remainder in SG&A. Actual savings realized could vary from expected savings, which represent management's best estimate to date.

Generally, the aforementioned charges were or will be paid in cash, except for asset write-downs, which are non-cash charges. Asset write-down charges of \$2.3 million and \$3.1 million were recorded during the nine months ended September 30, 2011 and 2010, respectively. The majority of remaining cash payments related to our Realignment Programs will be incurred by the end of 2012.

In addition, in connection with our previously announced IPD recovery plan, in the second quarter of 2011 we initiated new activities to optimize structural parts of IPD's business. We expect charges related to this program to be non-restructuring in nature and will approximate \$9 million, of which \$7.1 million was incurred and recorded in COS for the nine months ended September 30, 2011, all of which were incurred in the second quarter of 2011.

Consolidated Results**Bookings, Sales and Backlog**

| (Amounts in millions) | Three Months Ended September 30, | |
|-----------------------|---|-------------|
| | 2011 | 2010 |
| Bookings | \$ 1,159.7 | \$ 1,000.3 |
| Sales | 1,121.8 | 971.7 |
| | Nine Months Ended September 30, | |
| (Amounts in millions) | 2011 | 2010 |
| Bookings | \$ 3,526.6 | \$ 3,202.2 |
| Sales | 3,244.8 | 2,891.7 |

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 cancelled within the year-to-date period are excluded from year-to-date bookings. Bookings for the three months ended

September 30, 2011 increased by \$159.4 million, or 15.9%, as compared with the same period in 2010. The increase included currency benefits of approximately \$57 million. The increase is primarily attributable to increased original equipment bookings in FCD, due to growth in the oil and gas, chemical and general industries, and increased aftermarket bookings in EPD.

Bookings for the nine months ended September 30, 2011 increased by \$324.4 million, or 10.1%, as compared with the same period in 2010. The increase included currency benefits of approximately \$157 million. The increase was primarily attributable to increased original equipment bookings in FCD and IPD, coupled with increased aftermarket bookings in EPD. These increases were partially offset by decreased original equipment bookings in EPD. The increase was also attributable to strength in the oil and gas and

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chemical industries in FCD and general industries in both FCD and IPD, partially offset by a decrease in the oil and gas industry in EPD.

Sales for the three months ended September 30, 2011 increased by \$150.1 million, or 15.4%, as compared with the same period in 2010. The increase included currency benefits of approximately \$54 million. Sales increased for all business segments, primarily due to increased original equipment sales in FCD and aftermarket sales in EPD and FCD. Net sales to international customers, including export sales from the U.S., were approximately 73% of total sales for the three months ended September 30, 2011, as compared with approximately 74% for the same period in 2010.

Sales for the nine months ended September 30, 2011 increased by \$353.1 million, or 12.2%, as compared with the same period in 2010. The increase included currency benefits of approximately \$152 million. The increase was primarily due to increased original equipment sales in FCD and aftermarket sales in EPD and FCD, partially offset by decreased original equipment sales in EPD. Net sales to international customers, including export sales from the U.S., were approximately 72% of total sales for both the nine months ended September 30, 2011 and 2010.

Backlog represents the aggregate value of booked but uncompleted customer orders and is influenced primarily by bookings, sales, cancellations and currency effects. Backlog of \$2,812.7 million at September 30, 2011 increased by \$218.0 million, or 8.4%, as compared with December 31, 2010. Currency effects provided a decrease of approximately \$43 million. Approximately 25% of the backlog at September 30, 2011 was related to aftermarket uncompleted orders.

Gross Profit and Gross Profit Margin

| (Amounts in millions) | Three Months Ended September 30, | |
|-----------------------|---|-------------|
| | 2011 | 2010 |
| Gross profit | \$ 376.6 | \$ 333.5 |
| Gross profit margin | 33.6% | 34.3% |

| (Amounts in millions) | Nine Months Ended September 30, | |
|-----------------------|--|-------------|
| | 2011 | 2010 |
| Gross profit | \$ 1,093.6 | \$ 1,025.2 |
| Gross profit margin | 33.7% | 35.5% |

Gross profit for the three months ended September 30, 2011 increased by \$43.1 million, or 12.9%, as compared with the same period in 2010. The increase included the effect of approximately \$2 million in increased savings realized from our Realignment Programs as compared with the same period in 2010. Gross profit margin for the three months ended September 30, 2011 of 33.6% decreased from 34.3% for the same period in 2010. The decrease was primarily attributable to lower margins on certain large projects in EPD, partially offset by improved margins in FCD and a mix shift to higher margin aftermarket sales in all divisions. As a result of the sales mix shift, aftermarket sales increased to approximately 41% of total sales, as compared with approximately 39% of total sales for the same period in 2010.

Gross profit for the nine months ended September 30, 2011 increased by \$68.4 million, or 6.7%, as compared with the same period in 2010. The increase included the effect of approximately \$13 million in increased savings realized from our Realignment Programs as compared with the same period in 2010. Gross profit margin for the nine months ended September 30, 2011 of 33.7% decreased from 35.5% for the same period in 2010. The decrease was primarily attributable to lower margins on certain large projects in EPD and charges related to the IPD recovery plan, partially offset by improved margins in FCD and a mix shift to higher margin aftermarket sales in all divisions. As a result of the sales mix shift, aftermarket sales increased to approximately 41% of total sales, as compared with approximately 39% of total sales for the same period in 2010.

Selling, General and Administrative Expense

| (Amounts in millions) | Three Months Ended September | |
|-------------------------------|------------------------------|----------|
| | 2011 | 2010 |
| SG&A | \$ 226.0 | \$ 207.7 |
| SG&A as a percentage of sales | 20.1% | 21.4% |

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| | Nine Months Ended September 30, | |
|-------------------------------|--|-------------|
| (Amounts in millions) | 2011 | 2010 |
| SG&A | \$ 681.6 | \$ 620.3 |
| SG&A as a percentage of sales | 21.0% | 21.5% |

SG&A for the three months ended September 30, 2011 increased by \$18.3 million, or 8.8%, as compared with the same period in 2010. Currency effects yielded an increase of approximately \$10 million. The increase included the effect of approximately \$2 million in increased savings from our Realignment Programs as compared with the same period in 2010. The increase was primarily attributable to increased selling and marketing related expenses in FCD and EPD. SG&A as a percentage of sales for the three months ended September 30, 2011 was lower as compared with the same period in 2010.

SG&A for the nine months ended September 30, 2011 increased by \$61.3 million, or 9.9%, as compared with the same period in 2010. Currency effects yielded an increase of approximately \$26 million. The increase included the effect of approximately \$10 million in increased savings from our Realignment Programs as compared with the same period in 2010. The increase was primarily attributable to increased selling and marketing related expenses in FCD and EPD, as well as a \$3.9 million penalty that was assessed by a Spanish regulatory commission in the second quarter of 2011. SG&A as a percentage of sales for the nine months ended September 30, 2011 was slightly lower as compared with the same period in 2010.

Net Earnings from Affiliates

| | Three Months Ended September 30, | |
|------------------------------|---|-------------|
| (Amounts in millions) | 2011 | 2010 |
| Net earnings from affiliates | \$ 4.4 | \$ 3.4 |

| | Nine Months Ended September 30, | |
|------------------------------|--|-------------|
| (Amounts in millions) | 2011 | 2010 |
| Net earnings from affiliates | \$ 13.3 | \$ 12.5 |

Net earnings from affiliates represents our net income from investments in eight joint ventures (one located in each of Japan, Saudi Arabia, South Korea and the United Arab Emirates and two located in each of China and India) that are accounted for using the equity method of accounting. Net earnings from affiliates for the three months ended September 30, 2011 increased by \$1.0 million, or 29.4%, as compared with the same period in 2010, primarily due to increased earnings of our FCD joint venture in India.

Net earnings from affiliates for the nine months ended September 30, 2011 increased by \$0.8 million, or 6.4%, as compared with the same period in 2010, primarily due to increased earnings of our FCD joint venture in India.

Operating Income and Operating Margin

| | Three Months Ended September 30, | |
|---|---|-------------|
| (Amounts in millions) | 2011 | 2010 |
| Operating income | \$ 155.0 | \$ 129.2 |
| Operating income as a percentage of sales | 13.8% | 13.3% |

| | Nine Months Ended September 30, | |
|-----------------------|--|-------------|
| (Amounts in millions) | 2011 | 2010 |
| Operating income | \$ 425.3 | \$ 417.4 |

Operating income as a percentage of sales 13.1% 14.4%

Operating income for the three months ended September 30, 2011 increased by \$25.8 million, or 20.0%, as compared with the same period in 2010. The increase included currency benefits of approximately \$6 million. The increase included the effect of approximately \$4 million in increased savings realized from our Realignment Programs as compared with the same period in 2010. The increase is primarily a result of the \$43.1 million increase in gross profit as discussed above, partially offset by the \$18.3 million increase in SG&A, as discussed above. The increase in operating income as a percentage of sales is primarily due to SG&A as a percentage of sales decreasing to 20.1% from 21.4% for the same period in 2010.

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Operating income for the nine months ended September 30, 2011 increased by \$7.9 million, or 1.9%, as compared with the same period in 2010. The increase included currency benefits of approximately \$19 million. The increase included the effect of approximately \$23 million in increased savings realized from our Realignment Programs as compared with the same period in 2010. The increase is primarily a result of the \$68.4 million increase in gross profit as discussed above, partially offset by the \$61.3 million increase in SG&A. The decrease in operating income as a percentage of sales is primarily due to gross profit margin decreasing to 33.7% from 35.5% for the same period in 2010.

Interest Expense and Interest Income

| (Amounts in millions) | Three Months Ended September 30, | |
|-----------------------|---|-------------|
| | 2011 | 2010 |
| Interest expense | \$ (8.5) | \$ (8.3) |
| Interest income | 0.2 | 0.4 |

| (Amounts in millions) | Nine Months Ended September 30, | |
|-----------------------|--|-------------|
| | 2011 | 2010 |
| Interest expense | \$ (26.7) | \$ (25.9) |
| Interest income | 1.1 | 1.2 |

Interest expense for the three and nine months ended September 30, 2011 increased by \$0.2 million and \$0.8 million, respectively, as compared with the same periods in 2010. Interest expense increased in 2011 primarily due to increased interest expense on local borrowings to fund short-term cash needs in support of growth in emerging markets. Approximately 70% of our term loan was at fixed rates at September 30, 2011, including the effects of \$335.0 million of notional interest rate swaps.

Interest income for the three and nine months ended September 30, 2011 decreased by \$0.2 million and \$0.1 million, respectively as compared with the same periods in 2010. These decreases are primarily attributable to lower average cash balances in 2011 as compared with the same periods in 2010.

Other Income (Expense), Net

| (Amounts in millions) | Three Months Ended September 30, | |
|-----------------------------|---|-------------|
| | 2011 | 2010 |
| Other (expense) income, net | \$ (6.6) | \$ 18.6 |

| (Amounts in millions) | Nine Months Ended September 30, | |
|-----------------------------|--|-------------|
| | 2011 | 2010 |
| Other income (expense), net | \$ 7.9 | \$ (15.3) |

Other (expense) income, net for the three months ended September 30, 2011 decreased \$25.2 million to other expense, net of \$6.6 million as compared with the same period in 2010, primarily due to a \$28.4 million decrease in gains (due to a \$9.9 million loss in the current period as compared with an \$18.5 million gain in the prior period) on foreign exchange contracts, partially offset by a \$8.2 million increase in gains arising from transactions in currencies other than our sites functional currencies, which reflect the relative strengthening of the U.S. dollar versus the Euro during the three months ended September 30, 2011 as compared with the same period in 2010. The three months ended September 30, 2010 included a \$2.6 million gain on the sale of a small, non-core investment in a joint venture that was accounted for under the cost method that did not recur for the comparable period in 2011.

Other income (expense), net for the nine months ended September 30, 2011 increased \$23.2 million to other income, net of \$7.9 million as compared with the same period in 2010. This was primarily due to a \$21.9 million

increase in gains (due to a \$7.7 million gain in the current period as compared with a \$14.2 million loss in the prior period) arising from transactions in currencies other than our sites' functional currencies, which reflect the relative strengthening of the U.S. dollar versus the Euro during the nine months ended September 30, 2011 as compared with the same period in 2010. The above mentioned currency losses in 2010 included the impact of the \$8.4 million net loss recorded as a result of Venezuela's currency devaluation effective January 11, 2010. The nine months ended September 30, 2010 included a \$2.6 million gain on the sale of a small, non-core investment in a joint venture that was accounted for under the cost method that did not recur for the comparable period in 2011.

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| | Three Months Ended September 30, | |
|----------------------------|---|-------------|
| (Amounts in millions) | 2011 | 2010 |
| Provision for income taxes | \$ 32.1 | \$ 35.7 |
| Effective tax rate | 22.9% | 25.5% |

| | Nine Months Ended September 30, | |
|----------------------------|--|-------------|
| (Amounts in millions) | 2011 | 2010 |
| Provision for income taxes | \$ 103.9 | \$ 101.1 |
| Effective tax rate | 25.5% | 26.8% |

Our effective tax rate of 22.9% for the three months ended September 30, 2011 decreased from 25.5% for the same period in 2010. The effective tax rate varied from the U.S. federal statutory rate for the three months ended September 30, 2011 primarily due to the net impact of foreign operations. Our effective tax rate of 25.5% for the nine months ended September 30, 2011 decreased from 26.8% for the same period in 2010. The decrease is primarily due to a more favorable net impact of foreign operations as compared with the same period in 2010.

Other Comprehensive Income (Expense)

| | Three Months Ended September 30, | |
|--------------------------------------|---|-------------|
| (Amounts in millions) | 2011 | 2010 |
| Other comprehensive (expense) income | \$ (105.5) | \$ 95.9 |

| | Nine Months Ended September 30, | |
|--------------------------------------|--|-------------|
| (Amounts in millions) | 2011 | 2010 |
| Other comprehensive (expense) income | \$ (29.3) | \$ 3.5 |

Other comprehensive (expense) income for the three months ended September 30, 2011 decreased \$201.4 million to expense of \$105.5 million as compared with the same period in 2010, primarily reflecting the strengthening of the U.S. dollar versus the Euro during the three months ended September 30, 2011, as compared with the same period in 2010.

Other comprehensive (expense) income for the nine months ended September 30, 2011 decreased \$32.8 million to expense of \$29.3 million as compared with the same period in 2010, primarily reflecting the strengthening of the U.S. dollar versus the Euro during the nine months ended September 30, 2011, as compared with the same period in 2010.

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. See Note 15 to our condensed consolidated financial statements included in this Quarterly Report for further discussion of our segments. The key operating results for our three business segments, EPD, IPD and FCD, are discussed below.

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 which 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.

FSG 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 replacement 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 much 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, chemical, power generation and water management industries. EPD operates in 40 countries with 27 manufacturing facilities worldwide, nine of which are located in Europe, ten in North America, four in Asia and four in Latin America, and it has 117 QRCs, including those co-located in manufacturing facilities.

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| | Three Months Ended September 30, | |
|---|---|-------------|
| (Amounts in millions) | 2011 | 2010 |
| Bookings | \$ 567.6 | \$ 497.9 |
| Sales | 574.3 | 511.3 |
| Gross profit | 193.1 | 184.8 |
| Gross profit margin | 33.6% | 36.1% |
| Segment operating income | 91.9 | 92.8 |
| Segment operating income as a percentage of sales | 16.0% | 18.1% |

| | Nine Months Ended September 30, | |
|---|--|-------------|
| (Amounts in millions) | 2011 | 2010 |
| Bookings | \$ 1,753.7 | \$ 1,719.5 |
| Sales | 1,655.3 | 1,567.6 |
| Gross profit | 573.3 | 575.1 |
| Gross profit margin | 34.6% | 36.7% |
| Segment operating income | 270.4 | 301.4 |
| Segment operating income as a percentage of sales | 16.3% | 19.2% |

Bookings for the three months ended September 30, 2011 increased by \$69.7 million, or 14.0%, as compared with the same period in 2010. The increase included currency benefits of approximately \$24 million. Customer bookings in Europe, the Middle East and Africa (EMA), Latin America, North America and Asia Pacific increased \$28.3 million (including currency benefits of approximately \$14 million), \$18.2 million, \$13.6 million and \$13.4 million, respectively. The increase primarily consisted of an increase in the oil and gas, power generation and chemical industries. Interdivision bookings (which are eliminated and are not included in consolidated bookings as disclosed above) decreased \$3.4 million.

Bookings for the nine months ended September 30, 2011 increased by \$34.2 million, or 2.0%, as compared with the same period in 2010. The increase included currency benefits of approximately \$73 million. Customer bookings in Latin America and Asia Pacific increased \$45.8 million (including currency benefits of approximately \$9 million) and \$15.2 million (including currency benefits of approximately \$19 million), respectively. These increases were partially offset by a decrease of \$23.9 million in EMA (including currency benefits of approximately \$40 million). The overall net increase primarily consisted of an increase in the power generation and chemical industries. Interdivision bookings (which are eliminated and are not included in consolidated bookings as disclosed above) decreased by \$4.2 million.

Sales for the three months ended September 30, 2011 increased \$63.0 million, or 12.3%, as compared with the same period in 2010. The increase included currency benefits of approximately \$25 million. The increase was primarily due to increased customer sales in North America, EMA and Latin America of \$27.4 million, \$18.8 million (including currency benefits of approximately \$16 million) and \$14.3 million, respectively. These increases were primarily driven by increased aftermarket sales. Interdivision sales (which are eliminated and are not included in consolidated sales as disclosed above) increased \$3.2 million.

Sales for the nine months ended September 30, 2011 increased \$87.7 million, or 5.6%, as compared with the same period in 2010. The increase included currency benefits of approximately \$75 million. The increase was primarily due to increased customer sales in North America, Asia Pacific and Latin America of \$66.7 million, \$32.0 million (including currency benefits of approximately \$18 million) and \$17.3 million (including currency benefits of approximately \$11 million), respectively. These increases were primarily driven by increased aftermarket sales, and were partially offset by a decrease of \$34.9 million (including currency benefits of approximately \$40 million) in EMA. Interdivision sales (which are eliminated and are not included in consolidated sales as disclosed above)

increased \$14.3 million.

Gross profit for the three months ended September 30, 2011 increased by \$8.3 million, or 4.5%, as compared with the same period in 2010. Gross profit margin for the three months ended September 30, 2011 of 33.6% decreased from 36.1% for the same period in 2010. The decrease was primarily attributed to the effect on revenue of certain large projects at very low margins and the negative impact of currency on margins of U.S. dollar denominated sales produced in some of our non-U.S. facilities, partially offset by a sales mix shift towards higher margin aftermarket sales.

Gross profit for the nine months ended September 30, 2011 decreased by \$1.8 million, or 0.3%, as compared with the same period in 2010. Gross profit margin for the nine months ended September 30, 2011 of 34.6% decreased from 36.7% for the same period in 2010. The decrease was primarily attributed to the effect on revenue of certain large projects at very low margins, the negative impact of currency on margins of U.S. dollar denominated sales produced in some of our non-U.S. facilities and incremental charges associated with certain projects that have not shipped, partially offset by a sales mix shift towards higher margin aftermarket sales.

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from our supply chain initiatives and increased savings realized from our Realignment Programs as compared with the same period in 2010.

Operating income for the three months ended September 30, 2011 decreased by \$0.9 million, or 1.0%, as compared with the same period in 2010. The decrease included currency benefits of approximately \$4 million. The overall net decrease was due primarily to increased SG&A of \$8.7 million (including increases due to currency effects of approximately \$5 million), which was primarily due to increased selling and marketing related expenses, substantially offset by the increased gross profit of \$8.3 million, as discussed above.

Operating income for the nine months ended September 30, 2011 decreased by \$31.0 million, or 10.3%, as compared with the same period in 2010. The increase included currency benefits of approximately \$12 million. The overall net decrease was due primarily to increased SG&A of \$28.7 million (including increases due to currency effects of approximately \$13 million), which was primarily due to increased selling and marketing related expenses, allowance for doubtful accounts recoveries during the same period in 2010 that did not recur and a \$3.9 million penalty that was assessed by a Spanish regulatory commission in the second quarter of 2011, and the reduced gross profit of \$1.8 million, as discussed above.

Backlog of \$1,499.2 million at September 30, 2011 increased by \$63.7 million, or 4.4%, as compared with December 31, 2010. Currency effects provided a decrease of approximately \$31 million. Backlog at September 30, 2011 and December 31, 2010 included \$19.7 million and \$25.5 million, respectively, of interdivision backlog (which is eliminated and not included in consolidated backlog as disclosed above).

FSG 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 13 manufacturing facilities, three of which are located in the U.S and six in Europe, and it operates 21 QRCs worldwide, including 11 sites in Europe and four in the U.S., including those co-located in manufacturing facilities.

| | Three Months Ended September 30, | |
|---|---|-------------|
| (Amounts in millions) | 2011 | 2010 |
| Bookings | \$ 223.2 | \$ 202.9 |
| Sales | 215.6 | 176.5 |
| Gross profit | 50.9 | 42.0 |
| Gross profit margin | 23.6% | 23.8% |
| Segment operating income | 16.5 | 9.5 |
| Segment operating income as a percentage of sales | 7.7% | 5.4% |

| | Nine Months Ended September 30, | |
|---|--|-------------|
| (Amounts in millions) | 2011 | 2010 |
| Bookings | \$ 674.5 | \$ 609.5 |
| Sales | 616.5 | 571.2 |
| Gross profit | 140.4 | 146.6 |
| Gross profit margin | 22.8% | 25.7% |
| Segment operating income | 39.2 | 46.4 |
| Segment operating income as a percentage of sales | 6.4% | 8.1% |

Bookings for the three months ended September 30, 2011 increased by \$20.3 million, or 10.0%, as compared with the same period in 2010. This increase included currency benefits of approximately \$11 million. The increase was primarily driven by increased customer bookings of \$29.9 million in EMA and Australia, partially offset by decreased customer bookings in North America. Increased customer bookings, primarily in the chemical, power generation and oil and gas industries, were offset by decreased customer bookings in the general industries. Interdivision bookings (which are eliminated and are not included in consolidated bookings as disclosed above) increased by \$8.1 million.

Bookings for the nine months ended September 30, 2011 increased by \$65.0 million, or 10.7%, as compared with the same period in 2010. The increase included currency benefits of approximately \$29 million. The increase was primarily driven by increased customer bookings of \$41.8 million (including currency benefits of approximately \$20 million) in EMA and Australia partially offset

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by a decrease in customer bookings of \$3.1 million in the Americas. Increased customer bookings were driven by general and chemical industries, partially offset by decreased customer bookings in the power generation industry. Interdivision bookings (which are eliminated and are not included in consolidated bookings as disclosed above) increased \$27.9 million.

Sales for the three months ended September 30, 2011 increased by \$39.1 million, or 22.2%, as compared with the same period in 2010. The increase included currency benefits of approximately \$11 million. The increase in customer sales was driven by an increase of \$21.7 million in the Americas primarily due to original equipment sales and a \$12.5 million increase in EMA primarily driven by aftermarket sales. Interdivision sales (which are eliminated and are not included in consolidated sales as disclosed above) increased \$5.7 million.

Sales for the nine months ended September 30, 2011 increased by \$45.3 million, or 7.9%, as compared with the same period in 2010. The increase included currency benefits of approximately \$28 million. The increase in customer sales was driven by an increase of \$42.3 million in the Americas, partially offset by a decrease in EMA and Australia. The increase in the Americas was primarily driven by original equipment sales. The decline in EMA and Australia was primarily attributable to decreased original equipment sales, which resulted from lower beginning of year original equipment backlog as compared with 2010. Interdivision sales (which are eliminated and are not included in consolidated sales as disclosed above) increased \$21.3 million.

Gross profit for the three months ended September 30, 2011 increased by \$8.9 million, or 21.2%, as compared with the same period in 2010. Gross profit margin for the three months ended September 30, 2011 of 23.6% decreased from 23.8% for the same period in 2010. The decrease is primarily attributable to increased material costs, substantially offset by increased sales, which favorably impacted our absorption of fixed manufacturing costs, and a mix shift to higher margin aftermarket sales.

Gross profit for the nine months ended September 30, 2011 decreased by \$6.2 million, or 4.2%, as compared with the same period in 2010. Gross profit margin for the nine months ended September 30, 2011 of 22.8% decreased from 25.7% for the same period in 2010. The decrease is primarily attributable to less favorable pricing on projects shipped from backlog, increased material costs, charges related to the IPD recovery plan and operational efficiency issues in certain sites, partially offset by increased savings realized from our Realignment Programs, as compared with the same period in 2010, and a mix shift to higher margin aftermarket sales.

Operating income for the three months ended September 30, 2011 increased by \$7.0 million, or 73.7%, as compared with the same period in 2010. The increase included currency benefits of approximately \$1 million. The increase is due to the \$8.9 million increase in gross profit discussed above, partially offset by a \$1.9 million increase in SG&A. The increase in SG&A included increases due to currency effects of approximately \$2 million.

Operating income for the nine months ended September 30, 2011 decreased by \$7.2 million, or 15.5%, as compared with the same period in 2010. The decrease included currency benefits of approximately \$2 million. The overall net decrease is due to the \$6.2 million decrease in gross profit discussed above, coupled with a \$0.9 million increase in SG&A. The increase in SG&A included increases due to currency effects of approximately \$4 million.

Backlog of \$608.3 million at September 30, 2011 increased by \$40.3 million, or 7.1%, as compared with December 31, 2010. Currency effects provided a decrease of approximately \$3 million. Backlog at September 30, 2011 and December 31, 2010 includes \$52.2 million and \$38.5 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 51 manufacturing facilities and QRCs in 23 countries around the world, with only five of its 24 manufacturing operations located in the U.S. Based on independent industry sources, we believe that we are the fourth largest industrial valve supplier on a global basis.

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| | Three Months Ended September 30, | |
|---|---|-------------|
| (Amounts in millions) | 2011 | 2010 |
| Bookings | \$ 409.9 | \$ 335.0 |
| Sales | 368.3 | 312.6 |
| Gross profit | 131.3 | 107.4 |
| Gross profit margin | 35.7% | 34.4% |
| Segment operating income | 63.8 | 45.7 |
| Segment operating income as a percentage of sales | 17.3% | 14.6% |

| | Nine Months Ended September 30, | |
|---|--|-------------|
| (Amounts in millions) | 2011 | 2010 |
| Bookings | \$ 1,227.1 | \$ 978.7 |
| Sales | 1,093.0 | 837.4 |
| Gross profit | 378.8 | 303.2 |
| Gross profit margin | 34.7% | 36.2% |
| Segment operating income | 171.2 | 127.9 |
| Segment operating income as a percentage of sales | 15.7% | 15.3% |

Bookings for the three months ended September 30, 2011 increased \$74.9 million, or 22.4%, as compared with the same period in 2010. The increase included currency benefits of approximately \$21 million. The increase in bookings is primarily attributable to strength in the oil and gas industry in EMA and Asia Pacific, maintenance, repair and overhaul (MRO) activity in the chemical industry in North America, and a large pulp and paper project in Latin America. Increased bookings were partially offset by decreases in the power generation industry due primarily to a slowdown in global nuclear power project awards.

Bookings for the nine months ended September 30, 2011 increased \$248.4 million, or 25.4%, as compared with the same period in 2010. The increase included currency benefits of approximately \$55 million. The increase in bookings is primarily attributable to strength in the oil and gas industry, primarily in EMA and Asia Pacific, and increased bookings in the chemical and general industries. Increased bookings were partially offset by decreases in the power generation industry due primarily to a slowdown in global nuclear power projects. The increase above includes increased Valbart bookings of \$92.3 million.

Sales for the three months ended September 30, 2011 increased \$55.7 million, or 17.8%, as compared with the same period in 2010. The increase included currency benefits of approximately \$18 million. Customer sales in EMA and North America increased \$47.6 million (including currency benefits of approximately \$15 million) and \$9.6 million, respectively, reflecting continued growth in the oil and gas, chemical and general industries.

Sales for the nine months ended September 30, 2011 increased \$255.6 million, or 30.5%, as compared with the same period in 2010. The increase included currency benefits of approximately \$48 million. Customer sales in EMA increased \$171.9 million (including currency benefits of approximately \$39 million), reflecting continued recovery in the oil and gas industry and includes increased Valbart sales of \$78.3 million. North America and Asia Pacific increased \$43.2 million and \$32.1 million, respectively.

Gross profit for the three months ended September 30, 2011 increased by \$23.9 million, or 22.3%, as compared with the same period in 2010. Gross profit margin for the three months ended September 30, 2011 of 35.7% increased from 34.4% for the same period in 2010. The increase is attributable to increased sales, which positively impacted our absorption of fixed manufacturing costs, and a favorable product line and MRO mix.

Gross profit for the nine months ended September 30, 2011 increased by \$75.6 million, or 24.9%, as compared with the same period in 2010. Gross profit margin for the nine months ended September 30, 2011 of 34.7% decreased

from 36.2% for the same period in 2010. The decrease was attributable to increased material costs and the negative impact of low margins on acquired Valbart backlog, partially offset by increased sales, which favorably impacted our absorption of fixed manufacturing costs, and various CIP initiatives. The gross profit increase attributable to Valbart was \$10.7 million.

Operating income for the three months ended September 30, 2011 increased by \$18.1 million, or 39.6%, as compared with the same period in 2010. The increase included currency benefits of approximately \$2 million. The increase was principally attributable to the \$23.9 million increase in gross profit as discussed above, partially offset by \$7.2 million increase in SG&A. Increased SG&A was primarily attributable to increased selling and marketing-related expenses and increased research and development costs.

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Operating income for the nine months ended September 30, 2011 increased by \$43.3 million, or 33.9%, as compared with the same period in 2010. The increase included currency benefits of approximately \$6 million. The increase is principally attributable to the \$75.6 million increase in gross profit as discussed above, partially offset by a \$33.7 million increase in SG&A, which included increased SG&A of \$10.5 million attributable to Valbart. Increased SG&A was also attributable to increased selling and marketing-related expenses and increased research and development costs.

Backlog of \$779.8 million at September 30, 2011 increased by \$121.3 million, or 18.4%, as compared with December 31, 2010. Currency effects provided a decrease of approximately \$9 million.

LIQUIDITY AND CAPITAL RESOURCES**Cash Flow Analysis**

| (Amounts in millions) | Nine Months Ended September 30, | |
|---|--|-------------|
| | 2011 | 2010 |
| Net cash flows used by operating activities | \$ (150.1) | \$ (16.6) |
| Net cash flows used by investing activities | (68.5) | (234.8) |
| Net cash flows used by financing activities | (110.0) | (68.4) |

Existing cash, cash generated by operations and borrowings available under our existing revolving credit facility are our primary sources of short-term liquidity. Our cash balance at September 30, 2011 was \$227.9 million, as compared with \$557.6 million at December 31, 2010.

For the nine months ended September 30, 2011 our cash used by operating activities reflected additional cash used to support short-term working capital needs and a trend towards longer payment terms on project progress billings. Working capital increased for the nine months ended September 30, 2011 as compared with the same period 2010, due primarily to higher inventory of \$206.1 million and higher accounts receivable of \$201.6 million. Working capital increased for the nine months ended September 30, 2010, due primarily to lower accrued liabilities of \$138.4 million, resulting from reductions in advanced cash received from customers, lower accounts payable of \$62.0 million and increased inventories of \$112.5 million. During the nine months ended September 30, 2011, we contributed \$8.3 million to our U.S. pension plan.

Increases in accounts receivable used \$201.6 million of cash flow for the nine months ended September 30, 2011, as compared with \$47.9 million for the same period in 2010. As of September 30, 2011, our days sales receivables outstanding (DSO) was 82 days as compared with 78 days as of September 30, 2010. For reference purposes based on 2011 sales, an improvement of one day could provide approximately \$12 million in cash flow. The increase was primarily due to delays in collection of accounts receivable due to shipment delays, disputes over project documentation, slower than anticipated payments from certain Engineering, Procurement and Construction (EPC) contractors and end-customers, and contractually longer payment terms. We have not experienced a significant increase in customer payment defaults. Increases in inventory used \$206.1 million of cash flow for the nine months ended September 30, 2011 compared with \$112.5 million for the same period in 2010. The increase is primarily due to shipment delays and acceleration of short cycle orders during the nine months ended September 30, 2011, requiring higher raw material and work in process inventory to support end of period backlog. Inventory turns were 2.8 times as of September 30, 2011 and 2.7 times as of September 30, 2010. Our calculation of inventory turns does not reflect the impact of advanced cash received from our customers. For reference purposes based on 2011 data, an improvement of one-tenth of a turn could yield approximately \$29 million in cash flow. We continue to work through isolated execution issues, which have contributed to the delays mentioned above, and work with our customers to finalize collection of accounts receivable. At the end of the third quarter 2011, we began to see past due projects trend downward due to our efforts to target such projects, and we remain highly focused on further reducing past due projects by year end. Increases in prepaid expenses and other current assets used \$21.6 million of cash for the nine months ended September 30, 2011 as compared with \$17.0 million for the same period in 2010. The increase is primarily due to increased advanced payments to suppliers. Decreases in accounts payable used \$101.7 million of cash flow for the nine months ended September 30, 2011 as compared with \$62.0 million for the same period in 2010. The

decrease in 2011 is primarily due to higher accounts payable balances related to certain inventory and equipment purchases and corporate-level expenses at December 31, 2010 that required payment during the first quarter of 2011 based on contractual payment terms, as compared with the same period in 2010.

Cash flows used by investing activities during the nine months ended September 30, 2011 were \$68.5 million, as compared with \$234.8 million for the same period in 2010. Capital expenditures during the nine months ended September 30, 2011 were \$71.2 million, an increase of \$24.7 million as compared with the same period in 2010. In 2011, our cash flows for investing activities are focused on strategic initiatives to pursue new markets, geographic expansion, Enterprise Resource Planning (ERP) application upgrades, information technology infrastructure and cost reduction opportunities and are expected to be between \$125 million and \$135 million for the full year, before consideration of any acquisition activity. In the fourth quarter of 2011, we expect a use of cash

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of approximately \$89 million to acquire LPI. For the nine months ended September 30, 2010 there were \$199.4 million in cash outflows for the acquisition of Valbart and net cash inflows of \$4.3 million from affiliate investing activity that did not recur in 2011.

Cash flows used by financing activities during the nine months ended September 30, 2011 were \$110.0 million, as compared with \$68.4 million for the same period in 2010. Cash outflows during the nine months ended September 30, 2011 resulted primarily from the payment of \$51.8 million in dividends, \$41.1 million for the repurchase of common shares and \$18.8 million from the payments of long-term debt. Cash outflows for the same period in 2010 resulted primarily from the payment of \$47.4 million in dividends and \$34.1 million for the repurchase of common shares, partially offset by proceeds and excess tax benefits from stock option activity.

Considering our current debt structure and cash needs, we currently believe cash flows from operating activities combined with availability under our existing revolving credit agreement 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 *Liquidity Analysis* and *Cautionary Note Regarding Forward-Looking Statements* below.

On September 12, 2011, our Board of Directors announced the approval of a new program to repurchase up to \$300.0 million of our outstanding common stock over an unspecified time period. The program is expected to commence in the fourth quarter of 2011.

On February 27, 2008, our Board of Directors announced the approval of a program to repurchase up to \$300.0 million of our outstanding common stock over an unspecified time period, and the program commenced in the second quarter of 2008. We repurchased 168,750 shares for \$15.1 million and 112,500 shares for \$11.0 million during the three months ended September 30, 2011 and 2010, respectively. We repurchased 381,250 shares for \$41.1 million and 337,500 shares for \$34.1 million during the nine months ended September 30, 2011 and 2010, respectively. To date, we have repurchased a total of 3,116,850 shares for \$293.0 million under this program, and the program is expected to conclude in the fourth quarter of 2011. See *Item 2. Unregistered Sales of Equity Securities and Use of Proceeds* below.

On February 21, 2011, our Board of Directors authorized an increase in the payment of quarterly dividends on our common stock from \$0.29 per share to \$0.32 per share payable quarterly beginning on April 14, 2011. On February 22, 2010, our Board of Directors authorized an increase in our quarterly cash dividend from \$0.27 per share to \$0.29 per share, effective for the first quarter of 2010. Generally, our dividend date-of-record is in the last month of the quarter, and the dividend is paid the following month. While we currently intend to pay regular quarterly dividends in the foreseeable future, any future dividends will be reviewed individually and declared by our Board of Directors at its discretion, dependent on its assessment of our financial condition and business outlook at the applicable 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.

As discussed in Note 2 to our condensed consolidated financial statements included in this Quarterly Report, effective July 16, 2010, we acquired for inclusion in FCD, Valbart, a privately-owned Italian valve manufacturer, for \$199.4 million, which included \$33.8 million of existing Valbart net debt (third party debt less cash on hand) that was repaid at closing. Valbart manufactures trunnion-mounted ball valves used primarily in upstream and midstream oil and gas applications, and its acquisition is to improve our ability to provide a more complete valve portfolio to oil and gas projects. Valbart generated approximately \$81 million (\$104 million, at then-current exchange rates) in sales (unaudited) during its fiscal year ended May 31, 2010.

Effective April 11, 2011, we purchased the assets of FEDD Wireless LLC (*FEDD*), a privately-owned wireless data acquisition company based in Houston, including existing inventory and equipment and rights to the related intellectual property for inclusion in EPD. The asset purchase was less than \$1 million in cash. This acquisition is expected to allow EPD to capitalize on growth opportunities and expand existing asset management and optimization

services.

On October 4, 2011, we entered into an agreement to acquire for inclusion in EPD, LPI, a privately-owned, U.S.-based company specializing in the design, development and manufacture of engineered centrifugal slurry pumps for critical services within the petroleum refining, petrochemical, pulp and paper and energy markets. LPI generated approximately \$44 million in sales (unaudited) and EBITDA of approximately \$8 million (unaudited) during its fiscal year ended December 31, 2010. The acquisition is expected to close in late October 2011 and is subject to customary closing conditions. Upon closing, 100% of LPI's outstanding equity will be acquired in a cash transaction valued at approximately \$89 million, subject to final adjustments. We intend to fund the transaction proceeds with cash on hand.

Table of Contents**Financing*****Credit Facilities***

Our credit facilities are comprised of a \$500.0 million term loan facility with a maturity date of December 14, 2015 and a \$500.0 million revolving credit facility with a maturity date of December 14, 2015 (collectively referred to as the Credit Facilities). The revolving credit facility includes a \$300.0 million sublimit for the issuance of letters of credit. Subject to certain conditions, we have the right to increase the amount of the revolving credit facility by an aggregate amount not to exceed \$200.0 million.

At both September 30, 2011 and December 31, 2010, we had no amounts outstanding under the revolving credit facility. We had outstanding letters of credit of \$144.8 million and \$133.9 million at September 30, 2011 and December 31, 2010, respectively, which reduced our borrowing capacity to \$355.2 million and \$366.1 million, respectively.

Borrowings under our Credit Facilities, other than in respect of swingline loans, bear interest at a rate equal to, at our option, either (1) LIBOR plus 1.75% - 2.50%, as applicable, depending on our consolidated leverage ratio (2) the base rate (which is based on greater of the prime rate most recently announced by the administrative agent under our New Credit Facilities or the Federal Funds rate plus 0.50% or (3) a daily rate equal to the one month LIBOR plus 1.0% plus, as applicable, an applicable margin of 0.75% - 1.50% determined by reference to the ratio of our total debt to consolidated EBITDA. The applicable interest rate as of September 30, 2011 was 2.39% for borrowings under our Credit Facilities. In connection with our Credit Facilities, we have entered into \$335.0 million of notional amount of interest rate swaps at September 30, 2011 to hedge exposure to floating interest rates.

We may prepay loans under our Credit Facilities in whole or in part, without premium or penalty, at any time. During the three and nine months ended September, 2011, we made scheduled repayments under our Credit Facilities of \$6.3 million and \$18.8 million, respectively. We have scheduled repayments of \$6.3 million due in each of the next four quarters.

Our obligations under the Credit Agreement are unconditionally guaranteed, jointly and severally, by substantially all of our existing and subsequently acquired or organized domestic subsidiaries and 65% of the capital stock of certain foreign subsidiaries, subject to certain controlled company and materiality exceptions. The Lenders have agreed to release the collateral if we achieve an Investment Grade Rating (as defined in the Credit Agreement) by both Moody's Investors Service, Inc. and Standard & Poor's Ratings Services for our senior unsecured, non-credit-enhanced, long-term debt (in each case, with an outlook of stable or better), with the understanding that identical collateral will be required to be pledged to the Lenders anytime following a release of the collateral that an Investment Grade Rating is not maintained. In addition, prior to our obtaining and maintaining investment grade credit ratings, our and the guarantors' obligations under the Credit Agreement are collateralized by substantially all of our and the guarantors' assets. We have not achieved these ratings as of September 30, 2011.

Additional discussion of our Credit Facilities, including amounts outstanding and applicable interest rates, 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 Credit Facilities. 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.

European Letter of Credit Facilities

On October 30, 2009, we entered into a new 364-day unsecured European Letter of Credit Facility (New European LOC Facility) with an initial commitment of \$125.0 million. The New European LOC Facility is renewable annually and is used for contingent obligations in respect of surety and performance bonds, bank guarantees and similar obligations with maturities up to five years. We anticipate renewing the New European LOC Facility in late October 2011 consistent with its initial terms for an additional 364-day period. We pay fees of 1.35% and 0.40% for utilized and unutilized capacity, respectively, under our New European LOC Facility. We had outstanding letters of credit utilized on the New European LOC Facility of \$62.4 million (\$83.5 million) and \$55.7 million (\$74.5 million) as of September 30, 2011 and December 31, 2010, respectively.

Our ability to issue additional letters of credit under our previous European Letter of Credit Facility (Old European LOC Facility), which had a commitment of 110.0 million, expired November 9, 2009. We paid annual and fronting fees of 0.875% and 0.10%, respectively, for letters of credit written against the Old European LOC Facility. We had outstanding letters of credit written against the Old European LOC Facility of 16.0 million (\$21.4 million) and 33.3 million (\$44.5 million) as of September 30, 2011 and December 31, 2010, respectively.

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Certain banks are parties to both facilities and are managing their exposures on an aggregated basis. As such, the commitment under the New European LOC Facility is reduced by the face amount of existing letters of credit written against the Old European LOC Facility prior to its expiration. These existing letters of credit will remain outstanding, and accordingly offset the 125.0 million capacity of the New European LOC Facility until their maturity, which, as of September 30, 2011, was approximately one year for the majority of the outstanding existing letters of credit. After consideration of outstanding commitments under both facilities, the available capacity under the New European LOC Facility was 114.1 million as of September 30, 2011, of which 62.4 million has been utilized.

See Note 11 to our consolidated financial statements included in our 2010 Annual Report for a discussion of covenants related to our Credit Facilities and our New European LOC Facility. We complied with all covenants through September 30, 2011.

Liquidity Analysis

Our cash balance decreased by \$329.7 million to \$227.9 million as of September 30, 2011 as compared with December 31, 2010. The cash draw in the first nine months of 2011, included the funding of increased working capital requirements, broad-based annual employee incentive compensation program payments related to prior period performance, reductions in advanced cash received from customers, \$71.2 million in capital expenditures, \$51.8 million in dividend payments, and \$41.1 million of share repurchases. 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.

Approximately 1% of our term loan is due to mature in 2011 and 5% in 2012. As noted above, our term loan and our revolving line of credit both mature in December 2015. After the effects of \$335.0 million of notional interest rate swaps, approximately 70% of our term debt was at fixed rates at September 30, 2011. As of September 30, 2011, we had a borrowing capacity of \$355.2 million on our \$500.0 million revolving line of credit, and we had outstanding letters of credit utilized on the both of the European LOC Facilities of 78.4 million as of September 30, 2011. Our revolving line of credit and our European LOC Facility are committed and are held by a diversified group of financial institutions.

At December 31, 2010, 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. After consideration of our intent to maintain fully funded status, as defined by the U.S. Pension Protection Act, we contributed \$8.3 million to our U.S. pension plan in 2011, which includes \$5.3 million contributed in the current quarter, excluding direct benefits paid. We do not anticipate making any additional contributions to the U.S pension plan in 2011. We continue to maintain an asset allocation consistent with our strategy to maximize total return, while reducing portfolio risks through asset class diversification.

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 our 2010 Annual Report.

Effective January 1, 2011, we adopted ASU No. 2009-13, Revenue Recognition (ASC 605): Multiple-Deliverable Revenue Arrangements—a consensus of the FASB Emerging Issues Task Force, which resulted in expanded disclosure requirements regarding our revenue recognition policy (see Revenue Recognition below). Our adoption of ASU No. 2009-13, effective January 1, 2011, had no impact on our consolidated financial condition or results of operations. Except for the incremental revenue recognition policy disclosure included below, we believe that there were no significant changes in those critical accounting policies and estimates during the nine months ended September 30, 2011.

Revenue Recognition

Revenues for product sales are recognized when the risks and rewards of ownership are transferred to the customers, which is typically based on the contractual delivery terms agreed to with the customer and fulfillment of all but inconsequential or perfunctory actions. In addition, our policy requires persuasive evidence of an arrangement, a fixed or determinable sales price and reasonable assurance of collectability. We defer the recognition of revenue when advance payments are received from customers before performance obligations have been completed and/or services

have been performed. Freight charges billed to customers are included in sales and the related shipping costs are included in cost of sales in our consolidated statements of income. Our contracts typically include cancellation provisions that require customers to reimburse us for costs incurred up to the date of cancellation, as well as any contractual cancellation penalties.

We enter into certain contracts with multiple deliverables that may include any combination of designing, developing,

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manufacturing, modifying, installing and commissioning of flow control equipment and providing services related to the performance of such products. Delivery of these products and services typically occurs within a one to two-year period, although many arrangements, such as book and ship type orders, have a shorter timeframe for delivery. We aggregate or separate deliverables into units of accounting based on whether the deliverable(s) have standalone value to the customer and when no general right of return exists. Contract value is allocated ratably to the units of accounting in the arrangement based on their relative selling prices determined as if the deliverables were sold separately.

Revenues for long-term contracts, including separate units of accounting from multiple-deliverable contracts, that exceed certain internal thresholds regarding the size, complexity and duration of the project and provide for the receipt of progress billings from the customer are recorded on the percentage of completion method with progress measured on a cost-to-cost basis. Percentage of completion revenue represented approximately 7% and 9% of our consolidated sales for the nine months ended September 30, 2011 and 2010, respectively.

Revenue on service and repair contracts is recognized after services have been agreed to by the customer and rendered. Revenues generated under fixed fee service and repair contracts are recognized on a ratable basis over the term of the contract. These contracts can range in duration, but generally extend for up to five years. Fixed fee service contracts represent approximately 1% of our consolidated sales for the three and nine months ended both September 30, 2011 and 2010.

In certain instances, we provide guaranteed completion dates under the terms of our contracts. Failure to meet contractual delivery dates can result in late delivery penalties or non-recoverable costs. In instances where the payment of such costs are deemed to be probable, we perform a project profitability analysis accounting for such costs as a reduction of realizable revenues, which could potentially cause estimated total project costs to exceed projected total revenues realized from the project. In such instances, we would record reserves to cover such excesses in the period they are determined. In circumstances where the total projected reduced revenues still exceed total projected costs, the incurrence of unrealized incentive fees or non-recoverable costs generally reduces profitability of the project at the time of subsequent revenue recognition. Our reported results would change if different estimates were used for contract costs or if different estimates were used for contractual contingencies.

Other critical policies, for which no significant changes have occurred in the nine months ended September 30, 2011, include:

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 accounting principles generally accepted in the U.S. 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.

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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;

- our ability to execute and realize the expected financial benefits from our strategic realignment initiatives;

- 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;

- expectations regarding acquisitions and the integration of acquired businesses;

- risks associated with certain of our foreign subsidiaries autonomously conducting limited business operations and sales in certain countries identified by the U.S. State Department as state sponsors of terrorism;

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

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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;

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 2010 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.

Table of Contents**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 all 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 Credit Facilities, which bear interest based on floating rates. At September 30, 2011, after the effect of interest rate swaps, we had \$146.3 million of variable rate debt obligations outstanding under our Credit Facilities with a weighted average interest rate of 2.39%. 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 \$1.1 million for the nine months ended September 30, 2011. At September 30, 2011 and December 31, 2010, we had \$335.0 and \$350.0 million, respectively, of notional amount in outstanding interest rate swaps with third parties with varying maturities through June 2014.

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 (losses) gains associated with foreign currency translation of \$(107.7) million and \$96.4 million for the three months ended September 30, 2011 and 2010, respectively, and \$(31.7) million and \$(1.9) million for the nine months ended September 30, 2011 and 2010, respectively, which are included in other comprehensive (expense) income.

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, 2011, we had a U.S. dollar equivalent of \$506.6 million in aggregate notional amount outstanding in forward exchange contracts with third parties, as compared with \$358.5 million at December 31, 2010. 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 (losses) gains of \$(6.1) million and \$14.1 million for the three months ended September 30, 2011 and 2010, respectively, and \$7.9 million and \$(22.0) million for the nine months ended September 30, 2011 and 2010, respectively, which are included in other income (expense), net in the accompanying condensed consolidated statements of income. As discussed in more detail in Note 1 to our condensed consolidated financial statements included in this Quarterly Report, during the nine months ended September 30, 2010 we recognized an \$8.4 million net loss as a result of Venezuela's currency devaluation.

Based on a sensitivity analysis at September 30, 2011, a 10% change in the foreign currency exchange rates for the nine months ended September 30, 2011 would have impacted our net earnings by approximately \$18 million, due primarily to the Euro. 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.

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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 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, 2011. 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, 2011.

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, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents**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 these matters, either individually or in the aggregate, to have a material 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 2010 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 2010 Annual Report and subsequent SEC filings. The risks described in this Quarterly Report, our 2010 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.

On September 12, 2011, our Board of Directors announced the approval of a new program to repurchase up to \$300.0 million of our outstanding common stock over an unspecified time period. The program is expected to commence in the fourth quarter of 2011. The 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 February 27, 2008, our Board of Directors announced the approval of a program to repurchase up to \$300.0 million of our outstanding common stock, which commenced in the second quarter of 2008. During the quarter ended September 30, 2011, we repurchased a total of 168,750 shares of our common stock under the prior program for approximately \$15.1 million (representing an average cost of \$89.26 per share). Since the adoption of the prior program, we have repurchased a total of 3,116,850 million shares of our common stock under the program for \$293.0 million (representing an average cost of \$94.01 per share). We may repurchase up to an additional \$7.0 million of our common stock under the prior share repurchase program. The following table sets forth the repurchase data for each of the three months during the quarter ended September 30, 2011:

| Period | Total Number of | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly | Maximum Number of Shares (or Approximate Dollar Value) That May Yet Be Purchased Under the |
|--------|--------------------|------------------------------------|---|---|
| | | | | |

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| | Shares Purchased | | | Announced Plan | Plans (in millions) |
|-----------------|-----------------------------|-----------|--------------|---------------------------|--------------------------------|
| July 1 - 31 | 64(1) | \$ | 111.05 | | \$ 22.1 |
| August 1 -31 | 113,878(2) | | 90.42 | 112,500 | 11.9 |
| September 1 -30 | 56,417(3) | | 87.02 | 56,250 | 307.0 |
| Total | 170,359 | \$ | 89.30 | 168,750 | |

(1) Represents shares that were tendered by employees to satisfy minimum tax withholding amounts for restricted stock awards at an average price per share of \$111.05.

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- (2) Includes 234 shares that were tendered by employees to satisfy minimum tax withholding amounts for restricted stock awards at an average price per share of \$88.91, and includes 1,144 shares purchased at a price of \$95.43 per share 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.
- (3) Includes 167 shares that were tendered by employees to satisfy minimum tax withholding amounts for restricted stock awards at an average price per share of \$82.02.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. (Removed and Reserved)

Item 5. Other Information.

None.

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Item 6. Exhibits.

| Exhibit No. | Description |
|-------------|--|
| 3.1+ | Restated Certificate of Incorporation of Flowserve Corporation. |
| 3.2 | Flowserve Corporation By-Laws, as amended and restated on May 19, 2011 (incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K dated May 23, 2011). |
| 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. |
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| 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 |

+ Filed herewith.

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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 27, 2011

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

Date: October 27, 2011

/s/ Richard J. Gultinan, Jr.
Richard J. Gultinan, Jr.
Senior Vice President, Finance and Chief Accounting Officer
(Principal Financial Officer)

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