

FLOWSERVE CORP  
Form 10-Q  
October 28, 2009

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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, 2009  
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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated  
filer ☐

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting  
company ☐

(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 23, 2009, there were 55,849,075 shares of the issuer's common stock outstanding.



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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements.****FLOWSERVE CORPORATION****(Unaudited)****CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

	<b>Three Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
(Amounts in thousands, except per share data)		
Sales	\$ 1,051,064	\$ 1,153,592
Cost of sales	(665,859)	(748,668)
Gross profit	385,205	404,924
Selling, general and administrative expense	(227,265)	(243,799)
Net earnings from affiliates	3,265	3,389
Operating income	161,205	164,514
Interest expense	(10,119)	(13,105)
Interest income	562	2,152
Other income (expense), net	6,997	(8,690)
Earnings before income taxes	158,645	144,871
Provision for income taxes	(42,006)	(26,948)
Net earnings, including noncontrolling interests	116,639	117,923
Less: Net loss (earnings) attributable to noncontrolling interests	305	(874)
Net earnings of Flowserve Corporation	\$ 116,944	\$ 117,049
Net earnings per share of Flowserve Corporation common shareholders:		
Basic	\$ 2.10	\$ 2.05
Diluted	2.07	2.04
Cash dividends declared per share	\$ 0.27	\$ 0.25

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

	<b>Three Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
(Amounts in thousands)		
Net earnings	\$ 116,944	\$ 117,049
Other comprehensive income (expense):		
Foreign currency translation adjustments, net of tax	34,927	(105,060)
Pension and other postretirement effects, net of tax	836	2,665
Cash flow hedging activity, net of tax	731	901
Other comprehensive income (expense)	36,494	(101,494)

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Comprehensive income	\$	153,438	\$	15,555
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See accompanying notes to condensed consolidated financial statements.

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**FLOWSERVE CORPORATION**  
**(Unaudited)**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

	<b>Nine Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
(Amounts in thousands, except per share data)		
Sales	\$ 3,166,189	\$ 3,304,516
Cost of sales	(2,026,890)	(2,135,776)
Gross profit	1,139,299	1,168,740
Selling, general and administrative expense	(683,920)	(726,453)
Net earnings from affiliates	11,718	13,873
Operating income	467,097	456,160
Interest expense	(30,159)	(38,695)
Interest income	2,094	6,612
Other (expense) income, net	(2,369)	8,365
Earnings before income taxes	436,663	432,442
Provision for income taxes	(118,593)	(102,212)
Net earnings, including noncontrolling interests	318,070	330,230
Less: Net earnings attributable to noncontrolling interests	(601)	(2,249)
Net earnings of Flowserve Corporation	\$ 317,469	\$ 327,981
Net earnings per share of Flowserve Corporation common shareholders:		
Basic	\$ 5.68	\$ 5.72
Diluted	5.63	5.68
Cash dividends declared per share	\$ 0.81	\$ 0.75

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

	<b>Nine Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
(Amounts in thousands)		
Net earnings	\$ 317,469	\$ 327,981
Other comprehensive income (expense):		
Foreign currency translation adjustments, net of tax	70,124	(70,535)
Pension and other postretirement effects, net of tax	(2,763)	1,952
Cash flow hedging activity, net of tax	2,567	531
Other comprehensive income (expense)	69,928	(68,052)
Comprehensive income	\$ 387,397	\$ 259,929

See accompanying notes to condensed consolidated financial statements.



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**FLOWSERVE CORPORATION**  
**(Unaudited)**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

	<b>September 30, 2009</b>	<b>December 31, 2008</b>
(Amounts in thousands, except per share data)		
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 291,225	\$ 472,056
Accounts receivable, net of allowance for doubtful accounts of \$21,091 and \$23,667, respectively	841,251	808,522
Inventories, net	884,422	834,612
Deferred taxes	136,553	126,890
Prepaid expenses and other	114,342	90,345
Total current assets	2,267,793	2,332,425
Property, plant and equipment, net of accumulated depreciation of \$663,900 and \$594,991, respectively	561,679	547,235
Goodwill	865,437	828,395
Deferred taxes	32,105	32,561
Other intangible assets, net	127,834	121,919
Other assets, net	162,179	161,159
Total assets	\$ 4,017,027	\$ 4,023,694
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 398,507	\$ 598,498
Accrued liabilities	869,659	967,099
Debt due within one year	27,786	27,731
Deferred taxes	20,390	14,668
Total current liabilities	1,316,342	1,607,996
Long-term debt due after one year	541,151	545,617
Retirement obligations and other liabilities	438,959	495,883
Shareholders' equity:		
Common shares, \$1.25 par value	73,547	73,477
Shares authorized 120,000		
Shares issued 58,838 and 58,781, respectively		
Capital in excess of par value	602,669	586,371
Retained earnings	1,431,507	1,159,634
	2,107,723	1,819,482
Treasury shares, at cost 3,787 and 3,566 shares, respectively	(261,739)	(248,073)
Deferred compensation obligation	8,564	7,678
Accumulated other comprehensive loss	(141,392)	(211,320)
Noncontrolling interest	7,419	6,431

Total shareholders' equity	1,720,575	1,374,198
Total liabilities and shareholders' equity	\$ 4,017,027	\$ 4,023,694

See accompanying notes to condensed consolidated financial statements.

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**FLOWSERVE CORPORATION**  
**(Unaudited)**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>Nine Months Ended September 30,</b>	
(Amounts in thousands)	<b>2009</b>	<b>2008</b>
<b>Cash flows    Operating activities:</b>		
Net earnings, including noncontrolling interests	\$ 318,070	\$ 330,230
Adjustments to reconcile net earnings to net cash used by operating activities:		
Depreciation	63,527	54,414
Amortization of intangible and other assets	7,288	7,519
Amortization of deferred loan costs	1,312	1,265
Net loss (gain) on disposition of assets	666	(6,200)
Gain on bargain purchase		(3,400)
Excess tax benefits from stock-based compensation arrangements	(1,040)	(16,414)
Stock-based compensation	31,393	23,981
Net earnings from affiliates, net of dividends received	(3,805)	(5,911)
Change in assets and liabilities:		
Accounts receivable, net	8,141	(280,343)
Inventories, net	(8,084)	(190,292)
Prepaid expenses and other	(20,881)	(26,763)
Other assets, net	4,130	7,571
Accounts payable	(209,247)	(32,599)
Accrued liabilities and income taxes payable	(117,151)	212,336
Retirement obligations and other liabilities	(75,712)	(48,283)
Net deferred taxes	5,934	(31,914)
Net cash flows provided (used) by operating activities	4,541	(4,803)
<b>Cash flows    Investing activities:</b>		
Capital expenditures	(87,067)	(72,506)
Proceeds from disposal of assets		7,556
Payments for acquisitions, net of cash acquired	(30,750)	
Net cash flows used by investing activities	(117,817)	(64,950)
<b>Cash flows    Financing activities:</b>		
Excess tax benefits from stock-based compensation arrangements	1,040	16,414
Payments on long-term debt	(4,261)	(4,261)
Borrowings under other financing arrangements	88	9,644
Repurchase of common shares	(27,527)	(134,997)
Payments of dividends	(44,151)	(37,348)
Proceeds from stock option activity	2,496	11,214
Net cash flows used by financing activities	(72,315)	(139,334)

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Effect of exchange rate changes on cash	4,760	(10,201)
Net change in cash and cash equivalents	(180,831)	(219,288)
Cash and cash equivalents at beginning of year	472,056	373,238
Cash and cash equivalents at end of period	\$ 291,225	\$ 153,950

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, 2009, and the related condensed consolidated statements of income and comprehensive income for the three and nine months ended September 30, 2009 and 2008, and the condensed consolidated statements of cash flows for the nine months ended September 30, 2009 and 2008, 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, 2009 ( 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, 2008 ( 2008 Annual Report ).

Certain reclassifications and retrospective adjustments have been made to prior period information to conform to current period presentation. These reclassifications and retrospective adjustments primarily result from our adoption of guidance related to (1) noncontrolling interest under Accounting Standards Codification ( ASC ) 810, Consolidation, and (2) guidance related to the two-class method of calculating Earnings Per Share ( EPS ) under ASC 260, Earnings Per Share.

**Accounting Policies**

Significant accounting policies, for which no significant changes have occurred in the nine months ended September 30, 2009, are detailed in Note 1 of our 2008 Annual Report.

*Subsequent Events* - We evaluate subsequent events through the date of filing of our interim and annual reports.

**Accounting Developments**

***Pronouncements Implemented***

In September 2006, the Financial Accounting Standards Board ( FASB ) issued guidance under ASC 820, Fair Value Measurements and Disclosures, which establishes a single definition of fair value and a framework for measuring fair value under accounting principles generally accepted in the United States ( GAAP ), and expands disclosures about fair value measurements. This guidance applies under other accounting pronouncements that require or permit fair value measurements; however, it does not require any new fair value measurements. In February 2008, the FASB issued additional guidance, which delayed the adoption for our nonfinancial assets and nonfinancial liabilities, except those items recognized or disclosed at fair value on an annual or more frequently recurring basis, until January 1, 2009. Our adoption of this guidance, effective January 1, 2009, did not have a material impact on our consolidated financial condition or results of operations.

In December 2007, the FASB issued guidance related to business combinations under ASC 805, Business Combinations, which established principles and requirements for how the acquirer in a business combination recognizes and measures identifiable assets acquired, liabilities assumed, noncontrolling interest in the acquiree and goodwill acquired, and expands disclosures about business combinations. This guidance requires the acquirer to recognize changes in valuation allowances on acquired deferred tax assets in operations. These changes in deferred tax benefits were previously recognized through a corresponding reduction to goodwill. With the exception of the provisions regarding acquired deferred taxes and tax contingencies, which are applicable to all business combinations, the guidance applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Our adoption of this guidance, effective January 1, 2009, did not have a material impact on our consolidated financial condition or results of operations.

In December 2007, the FASB issued guidance related to consolidation under ASC 810, which establishes accounting and reporting standards that require:

the ownership interests in subsidiaries held by parties other than the parent to be clearly identified, labeled and presented in

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the consolidated balance sheet within equity, but separate from the parent's equity;  
the amount of consolidated net income attributable to the parent and to the noncontrolling interest to be clearly identified and presented on the face of the consolidated statement of income;

changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary to be accounted for consistently;

when a subsidiary is deconsolidated, any retained noncontrolling equity investment in the former subsidiary to be initially measured at fair value; and

entities to provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners.

Our adoption of this guidance, effective January 1, 2009, which has been applied retrospectively for all periods presented, did not have a material impact on our consolidated financial condition or results of operations.

In March 2008, the FASB issued guidance related to derivatives and hedging under ASC 815, *Derivatives and Hedging*, which enhances the disclosure framework, by requiring entities to provide detailed disclosures about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for and how derivative instruments and related hedged items affect an entity's financial condition, results of operations and cash flows. Our adoption of this guidance, effective January 1, 2009, did not impact our consolidated financial condition or results of operations.

In April 2008, the FASB issued guidance related to intangibles and business combinations under ASC 350, *Intangibles—Goodwill and Other*, and ASC 805, respectively, which amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. This guidance is intended to improve the consistency between the useful life of a recognized intangible asset and the period of expected cash flows used to measure the fair value of the asset. Our adoption of this guidance, effective January 1, 2009, did not impact our consolidated financial condition or results of operations.

In June 2008, the FASB issued guidance related to EPS under ASC 260, which concluded that all outstanding unvested share-based payment awards that contain rights to nonforfeitable dividends participate in undistributed earnings with common shareholders and, therefore, are considered participating securities for purposes of computing earnings per share. Entities that have participating securities are required to use the two-class method of computing earnings per share. The two-class method is an earnings allocation formula that determines earnings per share for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings. Our adoption of this guidance, effective January 1, 2009, which has been applied retrospectively for all periods presented, did not have a material impact on our consolidated financial condition or results of operations (see Note 10).

In April 2009, the FASB issued guidance related to business combinations under ASC 805, which amended and clarified guidance to address application on initial recognition and measurement, subsequent measurement and accounting and disclosure of assets and liabilities arising from contingencies in a business combination. This additional guidance applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Our adoption of this guidance, effective January 1, 2009, did not have a material impact on our consolidated financial condition or results of operations.

In April 2009, the FASB issued guidance related to interim disclosures about fair value of financial instruments under ASC 825, *Financial Instruments*, which requires disclosures about fair value of financial instruments for interim reporting periods of publicly-traded companies, as well as in annual financial statements. Our adoption of this guidance, effective April 1, 2009, did not impact our consolidated financial condition or results of operations.

In April 2009, the FASB issued guidance related to investments in debt and equity securities under ASC 320, *Investments—Debt and Equity Securities*, which amended the other-than-temporary impairment guidance in GAAP for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments of debt and equity securities in the financial statements. This guidance does not

amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. Our adoption of this guidance, effective April 1, 2009, did not have a material impact on our consolidated financial condition or results of operations.



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In May 2009, the FASB issued guidance related to subsequent events under ASC 855, *Subsequent Events*, which clarified and codified guidance previously issued by the American Institute of Certified Public Accountants. The guidance established the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. Our adoption of this guidance, effective April 1, 2009, did not have a material impact on our consolidated financial condition or results of operations.

***Pronouncements Not Yet Implemented***

In December 2008, the FASB issued guidance related to retirement benefits compensation under ASC 715, *Compensation - Retirement Benefits*, which amends guidance on an employer's disclosures about plan assets of a defined benefit pension or other postretirement plan. The disclosure requirements of this guidance are effective for fiscal years ending after December 15, 2009. Our adoption of this guidance will not have a material impact on our consolidated financial condition or results of operations.

In June 2009, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 166, *Accounting for Transfers of Financial Assets* an amendment of FASB Statement No. 140, which has not yet been codified. This guidance removes the concept of a qualifying special-purpose entity (QSPE) and clarifies the determination of whether a transferor and all of the entities included in the transferor's financial statements being presented have surrendered control over transferred financial assets. It also defines the term *participating interest* to establish specific conditions for reporting a transfer of a portion of a financial asset as a sale and removes special provisions for guaranteed mortgage securitizations. This guidance requires that a transferor recognize and initially measure at fair value all assets obtained (including a transferor's beneficial interest) and liabilities incurred as a result of a transfer of financial assets accounted for as a sale. Enhanced disclosures are required to provide financial statement users with greater transparency about transfers of financial assets and a transferor's continuing involvement with transferred financial assets. The new requirements are effective for fiscal years beginning after November 15, 2009. We do not expect our adoption to have a material impact on our consolidated financial condition or results of operations.

In June 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)*, which has not yet been codified. This guidance eliminates the exclusion of QSPEs from consideration for consolidation and revises the determination of the primary beneficiary of a variable interest entity (VIE) to require a qualitative assessment of whether a company has a controlling financial interest through (1) the power to direct the activities that most significantly impact the VIE's economic performance and (2) the right to receive benefits from or obligation to absorb losses of the VIE that could potentially be significant to the VIE. The determination of the primary beneficiary must be reconsidered on an ongoing basis. The new requirements are effective for fiscal years beginning after January 1, 2010. We do not expect our adoption to have a material impact on our consolidated financial condition or results of operations.

In August 2009, the FASB issued Accounting Standards Update (ASU) No. 2009-05, *Fair Value Measurements and Disclosures (ASC 820): Measuring Liabilities at Fair Value*, which provides amendments to ASC Subtopic 820-10, *Fair Value Measurements and Disclosures - Overall*, for the fair value measurement of liabilities. ASU No. 2009-05 clarifies that in circumstances in which a quoted market price for an identical liability is not available, a reporting entity is required to measure fair value using one of the following techniques: a valuation technique that uses the quoted market price of the identical liability when traded as an asset, quoted prices for similar liabilities or similar liabilities when traded as assets, or another valuation technique that is consistent with the principles of ASC 820. ASU No. 2009-05 is effective for interim and annual periods beginning after August 2009. We do not expect the adoption of ASU No. 2009-05 to have a 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 addressed the accounting for multiple-deliverable arrangements to enable vendors to account for products or services separately rather than as a combined unit. This amendment addresses how to separate deliverables and how to measure and allocate arrangement consideration to one or more units of accounting. ASU No. 2009-13 is effective prospectively for revenue

arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. We do not expect the adoption of ASU No. 2009-13 to have a material impact on our consolidated financial condition or results or operations.

## **2. Acquisition**

Effective April 21, 2009, Flowserve Pump Division acquired Calder AG, a private Swiss company and a supplier of energy recovery technology for use in the global desalination market, for up to \$44.1 million, net of cash acquired. Of the total purchase price, \$28.4 million was paid at closing and \$2.4 million was paid after the working capital valuation was completed in early July 2009. The remaining \$13.3 million of the total purchase price is contingent upon Calder AG achieving certain performance metrics

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within a specified time frame after closing, and, to the extent achieved, is expected to be paid in cash within 12 months of the acquisition date. We recognized a liability of \$4.4 million as an estimate of the acquisition date fair value of the contingent consideration, which is based on the weighted probability of achievement of the performance metrics as of the date of the acquisition. Failure to meet the performance metrics would reduce this liability to \$0, while complete achievement would increase this liability to the full remaining purchase price of \$13.3 million. Any change in the fair value of the acquisition-related contingent consideration subsequent to the acquisition date is recognized in earnings in the period the estimated fair value changes.

During the third quarter of 2009, the estimated fair value of the contingent consideration was reduced to \$2.2 million based on third quarter 2009 results and an updated weighted probability of achievement of the performance metrics within the specified time frame. The resulting gain is included in selling, general and administrative expense ( SG&A ) in our condensed consolidated statements of income. The purchase price was allocated to the assets acquired and liabilities assumed based on estimates of fair values at the date of acquisition. The allocation of the purchase price is summarized below:

(Amounts in millions)

Purchase price, net of cash acquired	\$ 30.8
Fair value of contingent consideration (recorded as a liability)	4.4
Total expected purchase price at date of acquisition	\$ 35.2
Current assets	\$ 4.7
Intangible assets (expected useful life of approximately 10 years)	10.5
Property, plant and equipment	0.1
Current liabilities	(4.2)
Noncurrent liabilities	(1.1)
Net tangible and intangible assets	10.0
Goodwill	25.2
	\$ 35.2

The excess of the acquisition date fair value of the total purchase price over the estimated fair value of the net tangible and intangible assets was recorded as goodwill. No pro forma information has been provided due to immateriality.

Flowserve Pump Division acquired the remaining 50% interest in Niigata Worthington Company, Ltd. ( Niigata ), a Japanese manufacturer of pumps and other rotating equipment, effective March 1, 2008, for \$2.4 million in cash. The incremental interest acquired was accounted for as a step acquisition and Niigata's results of operations have been consolidated since the date of acquisition. Prior to this transaction, our 50% interest in Niigata was recorded using the equity method of accounting. The purchase price was allocated to the assets acquired and liabilities assumed based on estimates of fair values at the date of the acquisition. The estimate of the fair value of the net assets acquired exceeded the cash paid and, accordingly, no goodwill was recognized. This acquisition was accounted for as a bargain purchase, resulting in a gain of \$3.4 million recorded in the first quarter of 2008, which was reduced by \$0.6 million to \$2.8 million in the fourth quarter of 2008 when the purchase accounting was finalized. This gain is included in other income, net in the consolidated statement of income due to immateriality. No pro forma information has been provided due to immateriality.

### **3. Stock-Based Compensation Plans**

The Flowserve Corporation 2004 Stock Compensation Plan (the 2004 Plan ), which was established on April 21, 2004, authorized the issuance of up to 3,500,000 shares of common stock through grants of stock options, restricted

shares and other equity-based awards. Of the 3,500,000 shares of common stock that have been authorized under the 2004 Plan, 669,102 shares remain available for issuance as of September 30, 2009. We recorded stock-based compensation as follows:

(Amounts in millions)	Three Months Ended September 30,					
		2009			2008	
	Stock	Restricted	Total	Stock	Restricted	Total
	Options	Shares		Options	Shares	
Stock-based compensation expense	\$ 0.1	\$ 9.8	\$ 9.9	\$ 0.3	\$ 7.3	\$ 7.6
Related income tax benefit		(3.8)	(3.8)	(0.1)	(2.2)	(2.3)
Net stock-based compensation expense	\$ 0.1	\$ 6.0	\$ 6.1	\$ 0.2	\$ 5.1	\$ 5.3

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(Amounts in millions)	Nine Months Ended September 30,					
	2009			2008		
	Stock Options	Restricted Shares	Total	Stock Options	Restricted Shares	Total
Stock-based compensation expense	\$ 0.3	\$ 31.1	\$ 31.4	\$ 1.2	\$ 22.8	\$ 24.0
Related income tax benefit	(0.1)	(10.3)	(10.4)	(0.3)	(6.9)	(7.2)
Net stock-based compensation expense	\$ 0.2	\$ 20.8	\$ 21.0	\$ 0.9	\$ 15.9	\$ 16.8

*Stock Options* Information related to stock options issued to officers, other employees and directors under all plans described in Note 7 to our consolidated financial statements included in our 2008 Annual Report is presented in the following table:

		Nine Months Ended September 30, 2009			
		Shares	Weighted Average Exercise Price	Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in millions)
Number of shares under option:					
Outstanding	January 1, 2009	303,100	\$ 39.58		
Exercised		(81,968)	32.32		
Outstanding	September 30, 2009	221,132	\$ 42.28	5.7	\$ 12.4
Exercisable	September 30, 2009	190,132	\$ 40.65	5.5	\$ 11.0

No options were granted during the nine months ended September 30, 2009 or 2008. The total fair value of stock options vested during the three months ended September 30, 2009 and 2008 was \$0.1 million and \$1.3 million, respectively. The total fair value of stock options vested during the nine months ended September 30, 2009 and 2008 was \$2.0 million and \$3.9 million, respectively. The fair value of each option award was estimated on the date of grant using the Black-Scholes option pricing model.

As of September 30, 2009, we had less than \$0.1 million of unrecognized compensation cost related to outstanding unvested stock option awards, which is expected to be recognized over a weighted-average period of less than 1 year. The total intrinsic value of stock options exercised during the three months ended September 30, 2009 and 2008 was \$2.8 million and \$4.9 million, respectively. The total intrinsic value of stock options exercised during the nine months ended September 30, 2009 and 2008 was \$4.0 million and \$27.0 million, 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 \$42.7 million and \$34.1 million at September 30, 2009 and December 31, 2008, respectively, which is expected to be recognized over a weighted-average period of approximately 1 year. These amounts will be recognized into net earnings in prospective periods as the awards vest. The total fair value of restricted shares vested during the three months ended September 30, 2009 and 2008 was \$0.1 million and \$4.1 million, respectively. The total fair value of restricted shares vested during the nine months ended both September 30, 2009 and 2008 was \$14.9 million.

The following table summarizes information regarding restricted share activity:

		<b>Nine Months Ended September 30, 2009</b>	
		<b>Shares</b>	<b>Weighted Average Grant-Date Fair Value</b>
Number of unvested shares:			
Outstanding	January 1, 2009	1,080,237	\$ 71.11
Granted		804,341	54.72
Vested		(230,461)	64.84
Cancelled		(70,352)	68.72
Unvested restricted shares	September 30, 2009	1,583,765	\$ 63.80

Unvested restricted shares outstanding as of September 30, 2009, includes a total of 540,000 shares with performance-based vesting provisions granted in three annual grants since January 1, 2007. Performance-based restricted shares vest upon the achievement of pre-defined performance targets, and are issuable in common stock. Our performance targets are based on our average annual return on net assets over a rolling three-year period as compared with the same measure for a defined peer group for the same

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period. Compensation expense is recognized ratably over a 36-month cliff vesting period 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 1,030,000 shares based on performance targets. As of September 30, 2009, we estimate vesting of 1,030,000 shares based on expected achievement of performance targets.

**4. Derivative Instruments and Hedges**

Our risk management and derivatives policy specifies the conditions under which we may enter into derivative contracts. See Notes 1 and 8 to our consolidated financial statements included in our 2008 Annual Report and Note 5 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, 2009 and December 31, 2008, we had \$342.8 million and \$555.7 million, respectively, of notional amount in outstanding forward exchange contracts with third parties. At September 30, 2009, the length of forward exchange contracts currently in place ranged from one day to 17 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 both September 30, 2009 and December 31, 2008, we had \$385.0 million of notional amount in outstanding interest rate swaps with third parties. All interest rate swaps are 100% effective. At September 30, 2009, the maximum remaining length of any interest rate swap contract in place was approximately 24 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 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:

	<b>September 30, 2009</b>	<b>December 31, 2008</b>
(Amounts in thousands)		
Current derivative assets	\$ 12,045	\$ 12,172
Noncurrent derivative assets	89	264
Current derivative liabilities	2,708	15,350
Noncurrent derivative liabilities	232	314

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

	<b>September 30, 2009</b>	<b>December 31, 2008</b>
(Amounts in thousands)		
Current derivative assets	\$ 4	\$
Noncurrent derivative assets	485	
Current derivative liabilities	7,000	8,213
Noncurrent derivative liabilities	168	2,407

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)	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Gain (loss) recognized in income	\$ 7,824	\$ (19,049)	\$ 10,030	\$ (399)
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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,	
	2009	2008	2009	2008
(Loss) gain reclassified from accumulated other comprehensive income into income for settlements, net of tax	\$ (1,799)	\$ 1,194	\$ (4,466)	\$ 2,450
(Loss) gain recognized in other comprehensive income, net of tax	(1,068)	2,196	(1,898)	2,933

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.

**5. 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 condensed consolidated financial position and results of operations.

As discussed in Note 2 above, a liability of \$4.4 million was initially recognized as an estimate of the acquisition date fair value of the contingent consideration. This liability is classified as Level III under the fair value hierarchy as it is based on the weighted probability as of the date of the acquisition of achievement of performance metrics, which is not observable in the market. As of September 30, 2009, this liability was reduced to \$2.2 million based on an updated weighted probability of achievement of performance metrics.

**6. Debt**

Debt, including capital lease obligations, consisted of:

(Amounts in thousands)	September 30, 2009	December 31, 2008
Term Loan, interest rate of 1.81% in 2009 and 2.99% in 2008	\$ 545,436	\$ 549,697
Capital lease obligations and other	23,501	23,651
Debt and capital lease obligations	568,937	573,348
Less amounts due within one year	27,786	27,731
Total debt due after one year	\$ 541,151	\$ 545,617

**Credit Facilities**

Our credit facilities, as amended, are comprised of a \$600.0 million term loan expiring on August 10, 2012 and a \$400.0 million revolving line of credit, which can be utilized to provide up to \$300.0 million in letters of credit, expiring on August 10, 2012. We hereinafter refer to these credit facilities collectively as our Credit Facilities. At both September 30, 2009 and December 31, 2008, we had no amounts outstanding under the revolving line of credit. We had outstanding letters of credit of \$114.3 million and \$104.2 million at September 30, 2009 and December 31, 2008, respectively, which reduced borrowing capacity to \$285.7 million and \$295.8 million, respectively. The carrying amount of our term loan approximated fair value at September 30, 2009. The interbank market for our term loan implied a fair value of approximately \$495 million at December 31, 2008, as compared with a carrying value of \$549.7 million.

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Borrowings under our Credit Facilities bear interest at a rate equal to, at our option, either (1) the base rate (which is based on the greater of the prime rate most recently announced by the administrative agent under our Credit Facilities or the Federal Funds rate plus 0.50%) or (2) London Interbank Offered Rate ( LIBOR ) plus an applicable margin determined by reference to the ratio of our total debt to consolidated Earnings Before Interest, Taxes, Depreciation and Amortization ( EBITDA ), which as of September 30, 2009 was 0.875% and 1.50% for borrowings under our revolving line of credit and term loan, respectively.

We may prepay loans under our Credit Facilities in whole or in part, without premium or penalty. During the three and nine months ended September 30, 2009, we made scheduled repayments under our Credit Facilities of \$1.4 million and \$4.3 million, respectively. We have scheduled repayments under our Credit Facilities of \$1.4 million due in each of the next four quarters.

### **European Letter of Credit Facility**

As previously disclosed, our 364-day unsecured European Letter of Credit Facility ( European rLOC Facility ), which has a commitment of 110.0 million, was extended beyond its September 11, 2009 expiration date through November 9, 2009. The European LOC Facility is used for contingent obligations solely in respect of surety and performance bonds, bank guarantees and similar obligations. We had outstanding letters of credit drawn on the European LOC Facility of 81.7 million (\$119.6 million) and 104.0 million (\$145.2 million) as of September 30, 2009 and December 31, 2008, respectively. We pay certain fees for the letters of credit written against the European LOC Facility based upon the ratio of our total debt to consolidated EBITDA. As of September 30, 2009, the annual fees equaled 0.875% plus a fronting fee of 0.1%.

### **7. Realignment Program**

In February 2009, we announced our plan to incur up to \$40 million in costs 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 (the Realignment Program ). The Realignment Program consists of both restructuring and non-restructuring costs. Restructuring charges represent charges associated with the relocation of certain business activities, outsourcing of some business activities and facility closures. Non-restructuring charges, which represent the majority of the Realignment Program, are charges incurred to improve operating efficiency and reduce redundancies and primarily represent employee severance. All expenses under the Realignment Program are expected to be recognized during 2009. Expenses are reported in cost of sales ( COS ) or SG&A, as applicable, in our condensed consolidated statement of income.

### **Restructuring Charges**

Restructuring charges include costs related to employee severance at closed facilities, contract termination costs, asset write-downs and other exit costs. Severance costs primarily include costs associated with involuntary termination benefits. Contract termination costs include costs related to termination of operating leases or other contract termination costs. Asset write-downs include accelerated depreciation of fixed assets, accelerated amortization of intangible assets and inventory write-downs. Other includes costs related to employee relocation, asset relocation, vacant facility costs (i.e., taxes and insurance) and other charges.

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Restructuring charges incurred for the three and nine months ended September 30, 2009 and total restructuring charges expected to be incurred are as follows:

(Amounts in thousands)	<b>Severance</b>	<b>Contract termination</b>	<b>Asset write-downs</b>	<b>Other</b>	<b>Total</b>
<b>Three Months Ended September 30, 2009</b>					
COS					
Flowserve Pump Division	\$ 25	\$	\$ 206	\$ 544	\$ 775
Flow Control Division					
Flow Solutions Division				111	111
SG&A					
Flowserve Pump Division				16	16
Flow Control Division	4				4
Flow Solutions Division					
Total	\$ 29	\$	\$ 206	\$ 671	\$ 906

**Nine Months Ended September 30, 2009 (1)**

COS					
Flowserve Pump Division	\$ 3,515	\$	\$ 4,606	\$ 877	\$ 8,998
Flow Control Division	122		360		482
Flow Solutions Division	575	33		152	760
SG&A					
Flowserve Pump Division	215			16	231
Flow Control Division	155				155
Flow Solutions Division	127				127
Total	\$ 4,709	\$ 33	\$ 4,966	\$ 1,045	\$ 10,753

**Total Expected Restructuring Charges for 2009**

COS					
Flowserve Pump Division	\$ 3,544	\$ 1,115	\$ 4,826	\$ 4,097	\$ 13,582
Flow Control Division	122		360		482
Flow Solutions Division	576	264		415	1,255
SG&A					
Flowserve Pump Division	215			16	231
Flow Control Division	155				155
Flow Solutions Division	127				127
Total	\$ 4,739	\$ 1,379	\$ 5,186	\$ 4,528	\$ 15,832

(1) Charges for the  
nine months

ended  
September 30,  
2009 are equal  
to charges  
incurred from  
inception of the  
program as the  
program began  
in 2009.

The following represents the activity related to the restructuring reserve:

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(Amounts in thousands)	<b>Severance</b>	<b>Contract Termination</b>	<b>Other</b>	<b>Total</b>
Balance at December 31, 2008	\$	\$	\$	\$
Charges	1,878			1,878
Balance at March 31, 2009	1,878			1,878
Charges	2,802	33	375	3,210
Cash expenditures	(1,067)	(33)	(289)	(1,389)
Balance at June 30, 2009	3,613		86	3,699
Charges	29		671	700
Cash expenditures	(1,406)		(564)	(1,970)
Other non-cash adjustments, including currency	125			125
Balance at September 30, 2009	\$ 2,361	\$	\$ 193	\$ 2,554

**Total Realignment Program Charges**

The following is a summary of total charges incurred related to the Realignment Program:

**Three Months Ended September 30, 2009**

	<b>Flowserve</b>	<b>Flow</b>	<b>Flow</b>	<b>Subtotal Reportable</b>		<b>Consolidated</b>
(Amounts in millions)	<b>Pump</b>	<b>Control</b>	<b>Solutions</b>	<b>Segments</b>	<b>All Other</b>	<b>Total</b>
<b>Restructuring Charges</b>						
COS	\$ 0.8	\$	\$ 0.1	\$ 0.9	\$	\$ 0.9
SG&A	\$ 0.8	\$	\$ 0.1	\$ 0.9	\$	\$ 0.9
<b>Non-Restructuring Charges</b>						
COS	\$ 0.4	\$ 0.6	\$ 0.2	\$ 1.2	\$	\$ 1.2
SG&A	0.2		0.7	0.9	0.6	1.5
	\$ 0.6	\$ 0.6	\$ 0.9	\$ 2.1	\$ 0.6	\$ 2.7
<b>Total Realignment Program Charges</b>						
COS	\$ 1.2	\$ 0.6	\$ 0.3	\$ 2.1	\$	\$ 2.1
SG&A	0.2		0.7	0.9	0.6	1.5
	\$ 1.4	\$ 0.6	\$ 1.0	\$ 3.0	\$ 0.6	\$ 3.6

**Nine Months Ended September 30, 2009**

	Flowserve	Flow	Flow	Subtotal Reportable		Consolidated
(Amounts in millions)	Pump	Control	Solutions	Segments	All Other	Total
<b>Restructuring Charges</b>						
COS	\$ 9.0	\$ 0.5	\$ 0.8	\$ 10.3	\$	\$ 10.3
SG&A	0.2	0.2	0.1	0.5		0.5
	\$ 9.2	\$ 0.7	\$ 0.9	\$ 10.8	\$	\$ 10.8
<b>Non-Restructuring Charges</b>						
COS	\$ 2.4	\$ 3.8	\$ 3.9	\$ 10.1	\$	\$ 10.1
SG&A	2.8	3.8	4.8	11.4	0.9	12.3
	\$ 5.2	\$ 7.6	\$ 8.7	\$ 21.5	\$ 0.9	\$ 22.4
<b>Total Realignment Program Charges</b>						
COS	\$ 11.4	\$ 4.3	\$ 4.7	\$ 20.4	\$	\$ 20.4
SG&A	3.0	4.0	4.9	11.9	0.9	12.8
	\$ 14.4	\$ 8.3	\$ 9.6	\$ 32.3	\$ 0.9	\$ 33.2

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The following is a summary of total charges expected to be incurred related to the Realignment Program:

**Total Expected Charges for 2009**

	<b>Subtotal</b>					<b>Consolidated</b>
	<b>Flowserve</b>	<b>Flow</b>	<b>Flow</b>	<b>Reportable</b>	<b>All</b>	
(Amounts in millions)	<b>Pump</b>	<b>Control</b>	<b>Solutions</b>	<b>Segments</b>	<b>Other</b>	<b>Total</b>
<b>Total Expected Restructuring Charges</b>						
COS	\$ 13.6	\$ 0.4	\$ 1.3	\$ 15.3	\$	\$ 15.3
SG&A	0.2	0.2	0.1	0.5		0.5
	\$ 13.8	\$ 0.6	\$ 1.4	\$ 15.8	\$	\$ 15.8
<b>Total Expected Non-restructuring Charges</b>						
COS	\$ 3.0	\$ 5.8	\$ 3.8	\$ 12.6	\$	\$ 12.6
SG&A	2.8	4.2	4.8	11.8	0.9	12.7
	\$ 5.8	\$ 10.0	\$ 8.6	\$ 24.4	\$ 0.9	\$ 25.3
<b>Total Expected Realignment Program Charges</b>						
COS	\$ 16.6	\$ 6.2	\$ 5.1	\$ 27.9	\$	\$ 27.9
SG&A	3.0	4.4	4.9	12.3	0.9	13.2
	\$ 19.6	\$ 10.6	\$ 10.0	\$ 40.2	\$ 0.9	\$ 41.1

In the fourth quarter of 2009, we plan to commence additional realignment initiatives that will expand our efforts to optimize assets and reduce our overall cost structure. The additional initiatives are planned to occur in the remainder of 2009 and continue into 2010. We currently expect to incur approximately \$45 million in additional charges, which are not reflected above.

**8. Inventories**

Inventories are stated at lower of cost or market. Cost is determined by the first-in, first-out method. Inventories, net consisted of the following:

	<b>September 30, 2009</b>	<b>December 31, 2008</b>
(Amounts in thousands)		
Raw materials	\$ 262,095	\$ 241,953
Work in process	744,508	635,490
Finished goods	262,676	264,746
Less: Progress billings	(321,160)	(250,289)
Less: Excess and obsolete reserve	(63,697)	(57,288)
Inventories, net	\$ 884,422	\$ 834,612



**9. Equity Method Investments**

As of September 30, 2009, we had investments in seven joint ventures (one located in each of China, Japan, Korea, Saudi Arabia and the United Arab Emirates and two located in India) that were accounted for using the equity method. Summarized below is combined income statement information, based on the most recent financial information, for those investments:

(Amounts in thousands)	<b>Three Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
Revenues	\$ 46,346	\$ 71,365
Gross profit	16,426	16,318
Income before provision for income taxes	11,578	11,481
Provision for income taxes	(3,428)	(3,101)
Net income	\$ 8,150	\$ 8,380

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	<b>Nine Months Ended September 30,</b>	
(Amounts in thousands)	<b>2009</b>	<b>2008 (1)</b>
Revenues	\$ 159,368	\$ 259,187
Gross profit	57,541	70,020
Income before provision for income taxes	40,733	49,788
Provision for income taxes	(12,605)	(14,776)
Net income	\$ 28,128	\$ 35,012

(1) As discussed in Note 2, effective March 1, 2008, we purchased the remaining 50% interest in Niigata, resulting in the full consolidation of Niigata as of that date. Prior to this transaction, our 50% interest was recorded using the equity method of accounting. As a result, Niigata's income statement information presented herein includes only the first two months of 2008.

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**

As discussed in Note 1, effective January 1, 2009, we adopted the two-class method of calculating EPS. We have retrospectively adjusted earnings per common share for all prior periods presented. We now use the two-class method of computing earnings per share. The two-class method is an earnings allocation formula that determines earnings per share for each class of common stock and participating security as if all earnings for the period had been distributed. Unvested restricted share awards that earn non-forfeitable dividend rights qualify as participating securities and, accordingly, are now included in the basic computation as such. Our unvested restricted shares participate on an equal

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basis with common shares; therefore, there is no difference in undistributed earnings allocated to each participating security. Accordingly, the presentation below is prepared on a combined basis and is presented as earnings per common share. Previously, such unvested restricted shares were not included as outstanding within basic earnings per common share and were included in diluted earnings per common share pursuant to the treasury stock method. The following is a reconciliation of net earnings of Flowserve Corporation and weighted average shares for calculating basic net earnings per common share.

Earnings per weighted average common share outstanding was calculated as follows:

(Amounts in thousands, except per share data)	<b>Three Months Ended</b>	
	<b>September 30,</b>	
	<b>2009</b>	<b>2008</b>
Net earnings of Flowserve Corporation	\$ 116,944	\$ 117,049
Dividends on restricted shares not expected to vest	5	5
Earnings attributable to common and participating shareholders	\$ 116,949	\$ 117,054
Weighted average shares:		
Common stock	55,351	56,726
Participating securities	441	442
Denominator for basic earnings per common share	55,792	57,168
Effect of potentially dilutive securities	586	301
Denominator for diluted earnings per common share	56,378	57,469
Earnings per common share:		
Basic	\$ 2.10	\$ 2.05
Diluted	2.07	2.04

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	<b>Nine Months Ended September 30,</b>	
(Amounts in thousands, except per share data)	<b>2009</b>	<b>2008</b>
Net earnings of Flowserve Corporation	\$ 317,469	\$ 327,981
Dividends on restricted shares not expected to vest	18	23
Earnings attributable to common and participating shareholders	\$ 317,487	\$ 328,004
Weighted average shares:		
Common stock	55,443	56,843
Participating securities	443	526
Denominator for basic earnings per common share	55,886	57,369
Effect of potentially dilutive securities	481	340
Denominator for diluted earnings per common share	56,367	57,709
Earnings per common share:		
Basic	\$ 5.68	\$ 5.72
Diluted	5.63	5.68

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, 2009 and 2008, we had no options to purchase common stock that were excluded from the computation of potentially dilutive securities.

We have retrospectively adjusted the prior period to reflect the results that would have been reported had we applied the provisions of the two-class method for computing earnings per common share for all periods presented. The effects of the change as it relates to our earnings per common share are as follows:

	<b>Three Months Ended September 30, 2008</b>	
	<b>Basic</b>	<b>Diluted</b>
As previously reported	\$ 2.06	\$ 2.04
Effect of adoption of the two-class method	(0.01)	
As retrospectively adjusted	\$ 2.05	\$ 2.04
	<b>Nine Months Ended September 30, 2008</b>	
	<b>Basic</b>	<b>Diluted</b>
As previously reported	\$ 5.77	\$ 5.71
Effect of adoption of the two-class method	(0.05)	(0.03)
As retrospectively adjusted	\$ 5.72	\$ 5.68

## **11. Legal Matters and Contingencies**

### **Asbestos-Related Claims**

We are a defendant in a number of pending lawsuits (which include, in many cases, multiple claimants) that seek to recover damages for personal injury allegedly caused by exposure to asbestos-containing products manufactured and/or distributed by us 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 increase. Asbestos-containing materials incorporated into any such products were primarily encapsulated and used as components of process equipment, and we do not believe that any significant emission of asbestos-containing fibers occurred during the use of this equipment. We believe that a high percentage of the claims are covered by applicable insurance or indemnities from other companies.

### **Shareholder Litigation    Appeal of Dismissed Class Action Case; Derivative Case Dismissals**

In 2003, related lawsuits were filed in federal court in the Northern District of Texas, alleging that we violated federal securities laws. After these cases were consolidated, the lead plaintiff amended its complaint several times. The lead plaintiff's last pleading was

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the fifth consolidated amended complaint (the Complaint). The Complaint alleged that federal securities violations occurred between February 6, 2001 and September 27, 2002 and named as defendants our company, C. Scott Greer, our former Chairman, President and Chief Executive Officer, Renee J. Hornbaker, our former Vice President and Chief Financial Officer, PricewaterhouseCoopers LLP, our independent registered public accounting firm, and Banc of America Securities LLC and Credit Suisse First Boston LLC, which served as underwriters for our two public stock offerings during the relevant period. The Complaint asserted claims under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 (the Exchange Act), and Rule 10b-5 thereunder, and Sections 11 and 15 of the Securities Act of 1933 (the Securities Act). The lead plaintiff sought unspecified compensatory damages, forfeiture by Mr. Greer and Ms. Hornbaker of unspecified incentive-based or equity-based compensation and profits from any stock sales and recovery of costs. By orders dated November 13, 2007 and January 4, 2008, the District Court denied the plaintiffs motion for class certification and granted summary judgment in favor of the defendants on all claims. The plaintiffs appealed both rulings to the federal Fifth Circuit Court of Appeals (Court of Appeals), and on June 19, 2009, the Court of Appeals issued an opinion vacating the District Court's denial of class certification, reversing in part and vacating in part the District Court's entry of summary judgment, and remanding the case to the District Court for further proceedings consistent with the Court of Appeals' opinion. As a result of the Court of Appeals' opinion, the case will be returned to the District Court for further consideration of certain issues, including whether the plaintiffs can demonstrate that the case should be certified as a class action.

The parties have engaged in discussions following the issuance of the Court of Appeals' opinion in furtherance of an amicable resolution of the case. These discussions have yielded tentative settlement terms, which remain contingent upon resolution of certain closure issues. As a result, a charge of \$7.5 million was recognized in the third quarter of 2009 related to increased fees and accrued resolution costs. That charge, along with a smaller earlier accrual, represents our current determination of our exposure relating to the tentative settlement amount. If the closure issues are not resolved and the litigation proceeds, we continue to believe we have valid defenses to the claims asserted, and we will continue to vigorously defend this case.

In 2005, a shareholder derivative lawsuit was filed purportedly on our behalf in the 193rd Judicial District of Dallas County, Texas. The lawsuit originally named as defendants Mr. Greer, Ms. Hornbaker, and former and current board members Hugh K. Coble, George T. Haymaker, Jr., William C. Rusnack, Michael F. Johnston, Charles M. Rampacek, Kevin E. Sheehan, Diane C. Harris, James O. Rollans and Christopher A. Bartlett. We were named as a nominal defendant. Based primarily on the purported misstatements alleged in the above-described federal securities case, the original lawsuit in this action asserted claims against the defendants for breach of fiduciary duty, abuse of control, gross mismanagement, waste of corporate assets and unjust enrichment. The plaintiff alleged that these purported violations of state law occurred between April 2000 and the date of suit. The plaintiff sought on our behalf an unspecified amount of damages, injunctive relief and/or the imposition of a constructive trust on defendants' assets, disgorgement of compensation, profits or other benefits received by the defendants from us and recovery of attorneys fees and costs. We filed a motion seeking dismissal of the case, and the court thereafter ordered the plaintiffs to replead. On October 11, 2007, the plaintiffs filed an amended petition adding new claims against the following additional defendants: Kathy Giddings, our former Vice-President and Corporate Controller; Bernard G. Rethore, our former Chairman and Chief Executive Officer; Banc of America Securities, LLC and Credit Suisse First Boston, LLC, which served as underwriters for our public stock offerings in November 2001 and April 2002, and PricewaterhouseCoopers, LLP, our independent registered public accounting firm. On April 2, 2008, the lawsuit was dismissed by the court without prejudice at the plaintiffs' request.

On March 14, 2006, a shareholder derivative lawsuit was filed purportedly on our behalf in federal court in the Northern District of Texas. The lawsuit named as defendants Mr. Greer, Ms. Hornbaker, and former and current board members Mr. Coble, Mr. Haymaker, Mr. Lewis M. Kling, Mr. Rusnack, Mr. Johnston, Mr. Rampacek, Mr. Sheehan, Ms. Harris, Mr. Rollans and Mr. Bartlett. We were named as a nominal defendant. Based primarily on certain of the purported misstatements alleged in the above-described federal securities case, the plaintiff asserted claims against the defendants for breaches of fiduciary duty that purportedly occurred between 2000 and 2004. The plaintiff sought on our behalf an unspecified amount of damages, disgorgement by Mr. Greer and Ms. Hornbaker of salaries, bonuses, restricted stock and stock options and recovery of attorneys' fees and costs. Pursuant to a motion filed by us, the

federal court dismissed that case on March 14, 2007, primarily on the basis that the case was not properly filed in federal court. On or about March 27, 2007, the same plaintiff re-filed essentially the same lawsuit naming the same defendants in the Supreme Court of the State of New York. We believed that this new lawsuit was improperly filed in the Supreme Court of the State of New York and filed a motion seeking dismissal of the case. On January 2, 2008, the court entered an order granting our motion to dismiss all claims and allowed the plaintiffs an opportunity to replead. A notice of entry of the dismissal order was served on the plaintiff on January 15, 2008.

**United Nations Oil-for-Food Program**

We have entered into and disclosed previously in our SEC filings the material details of settlements with the SEC, the Department of Justice (the DOJ ) and the Dutch authorities relating to products that two of our foreign subsidiaries delivered to Iraq from 1996 through 2003 under the United Nations Oil-for-Food Program. We believe that a confidential French investigation may still be ongoing, and, accordingly, we cannot predict the outcome of the French investigation at this time. We currently do not expect to incur

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additional case resolution costs of a material amount in this matter; however, if the French authorities take enforcement action against us regarding its investigation, we may be subject to additional monetary and non-monetary penalties.

In addition to the settlements and 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 Flowserve and our two foreign subsidiaries that participated in the program. We intend to vigorously contest the suit, and we believe that we have valid defenses to the claims asserted. However, we cannot predict the outcome of the suit at the present time or whether the resolution of this suit will have a material adverse financial impact on our company.

### **Export Compliance**

In March 2006, we initiated a voluntary process to determine our compliance posture with respect to United States ( U.S. ) export control and economic sanctions laws and regulations. Upon initial investigation, it appeared that some product transactions and technology transfers were not handled in full compliance with U.S. export control laws and regulations. As a result, in conjunction with outside counsel, we conducted a voluntary systematic process to further review, validate and voluntarily disclose export violations discovered as part of this review process. We completed our comprehensive disclosures to the appropriate U.S. government regulatory authorities at the end of 2008, although these disclosures may be refined or supplemented. Based on our review of the data collected, during the self-disclosure period of October 1, 2002 through October 1, 2007, a number of process pumps, valves, mechanical seals and parts related thereto were exported, in limited circumstances, without required export or reexport licenses or without full compliance with all applicable rules and regulations to a number of different countries throughout the world, including certain U.S. sanctioned countries. The foregoing information is subject to revision as we further review this submittal with applicable U.S. regulatory authorities.

We have taken a number of actions to increase the effectiveness of our global export compliance program. This has included increasing the personnel and resources dedicated to export compliance, providing additional export compliance tools to employees, improving our export transaction screening processes and enhancing the content and frequency of our export compliance training programs.

Any self-reported violations of U.S. export control laws and regulations may result in civil or criminal penalties, including fines and/or other penalties. We are currently engaged in discussions with U.S. regulators about such penalties as part of our effort to resolve this matter; however, we are currently unable to definitively determine the full extent or nature or total amount of penalties to which we might be subject as a result of any such self-reported violations of the U.S. export control laws and regulations.

### **Other**

We are currently involved as a potentially responsible party at three former public waste disposal sites that may be subject to remediation under pending government procedures. The sites are in various stages of evaluation by federal and state environmental authorities. 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 ordinary routine litigation incidental to our business, none of which, either individually or in the aggregate, we believe to be 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 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 these potential contingent loss exposures and, if they develop, recognize expense as soon as such losses become probable and can be reasonably estimated.

**Table of Contents****12. Retirement and Postretirement Benefits**

Components of the net periodic cost for retirement and postretirement benefits for the three months ended September 30, 2009 and 2008 were as follows:

	<b>U.S. Defined Benefit Plans</b>		<b>Non-U.S. Defined Benefit Plans</b>		<b>Postretirement Medical Benefits</b>	
(Amounts in millions)	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Service cost	\$ 4.6	\$ 4.3	\$ 0.9	\$ 0.9	\$	\$ 0.1
Interest cost	4.8	4.5	2.9	3.4	0.7	0.6
Expected return on plan assets	(5.5)	(5.1)	(1.0)	(1.4)		
Amortization of unrecognized net loss (gain)	1.6	1.0	0.6	0.1	(0.7)	
Amortization of prior service benefit	(0.3)	(0.3)			(0.5)	(0.6)
Net periodic cost (benefit) recognized	\$ 5.2	\$ 4.4	\$ 3.4	\$ 3.0	\$ (0.5)	\$ 0.1

Components of the net periodic cost for retirement and postretirement benefits for the nine months ended September 30, 2009 and 2008 were as follows:

	<b>U.S. Defined Benefit Plans</b>		<b>Non-U.S. Defined Benefit Plans</b>		<b>Postretirement Medical Benefits</b>	
(Amounts in millions)	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Service cost	\$ 13.8	\$ 12.9	\$ 2.9	\$ 2.7	\$	\$ 0.1
Interest cost	14.4	13.4	8.7	10.3	1.9	2.6
Expected return on plan assets	(16.6)	(15.2)	(3.1)	(4.3)		
Amortization of unrecognized net loss (gain)	4.9	3.2	1.8	0.3	(2.2)	0.1
Amortization of prior service benefit	(0.9)	(1.0)			(1.5)	(1.9)
Net periodic cost (benefit) recognized	\$ 15.6	\$ 13.3	\$ 10.3	\$ 9.0	\$ (1.8)	\$ 0.9

See additional discussion of our retirement and postretirement benefits in Note 13 to our consolidated financial statements included in our 2008 Annual Report.

**13. Shareholders Equity**

On February 23, 2009, our Board of Directors authorized an increase in our quarterly cash dividend to \$0.27 per share from \$0.25 per share, effective for the first quarter of 2009. Generally, our dividend date-of-record is in the last month of the quarter, and the dividend is paid the following month.

On February 26, 2008 our Board of Directors authorized a program to repurchase up to \$300.0 million of our outstanding common stock over an unspecified time period. The program commenced in the second quarter of 2008. We repurchased 131,500 shares for \$11.3 million and 413,000 shares for \$27.5 million during the three and nine months ended September 30, 2009, respectively. To date, we have repurchased a total of 2.2 million shares for \$192.5 million under this program.

**14. Income Taxes**

For the three months ended September 30, 2009, we earned \$158.6 million before taxes and provided for income taxes of \$42.0 million, resulting in an effective tax rate of 26.5%. For the nine months ended September 30, 2009, we earned \$436.7 million before taxes and provided for income taxes of \$118.6 million, resulting in an effective tax rate of 27.2%. The effective tax rate varied from the U.S. federal statutory rate for both the three and nine months ended September 30, 2009 primarily due to the net impact of foreign operations.

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For the three months ended September 30, 2008, we earned \$144.9 million before taxes and provided for income taxes of \$26.9 million, resulting in an effective tax rate of 18.6%. The effective tax rate varied from the U.S. federal statutory rate for the three months ended September 30, 2008 primarily due to the net impact of foreign operations, as well as a net tax benefit of \$12.4 million arising from our permanent reinvestment in foreign subsidiaries, the release of certain reserves related to the closure of the statute of limitations in various jurisdictions and repatriation of cash. For the nine months ended September 30, 2008, we earned \$432.4 million

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before taxes and provided for income taxes of \$102.2 million, resulting in an effective tax rate of 23.6%. The effective tax rate varied from the U.S. federal statutory rate for the nine months ended September 30, 2008 primarily due to the net favorable impact of foreign operations, a favorable tax ruling in Luxembourg, our permanent reinvestment in foreign subsidiaries, the release of certain reserves related to the closure of the statute of limitations in various jurisdictions and repatriation of cash.

As of September 30, 2009, the amount of unrecognized tax benefits has increased by \$9.1 million from December 31, 2008, due primarily to interest on prior year positions and currency translation adjustments. With limited exception, we are no longer subject to U.S. federal, state and local income tax audits for years through 2004 or non-U.S. income tax audits for years through 2003. We are currently under examination for various years in Argentina, Austria, France, Germany, India, Italy, Mexico, 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 \$2 million to \$29 million.

**15. Segment Information**

We are principally engaged in the worldwide design, manufacture, distribution and service of industrial flow management equipment. We provide pumps, valves and mechanical seals primarily for oil and gas, chemical, power generation, water management and other industries requiring flow management products.

We have the following three divisions, each of which constitutes a business segment:

Flowserve Pump Division ( FPD );

Flow Control Division ( FCD ); and

Flow Solutions Division ( FSD ).

Each division manufactures different products and is defined by the type of products and services provided. Each division has a President, who reports directly to our Chief Executive Officer, and a Division Vice President Finance, who reports directly to our Chief Accounting Officer. For decision-making purposes, our Chief Executive Officer and other members of senior executive management use financial information generated and reported at the division level. Our corporate headquarters does not constitute a separate division or business segment.

We evaluate segment performance and allocate resources based on each segment's operating income. Amounts classified as 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 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.

**Three Months Ended September 30, 2009**

	Flowserve Pump	Flow Control	Flow Solutions	Subtotal Reportable Segments	All Other	Consolidated Total
(Amounts in thousands)						
Sales to external customers	\$635,949	\$292,465	\$121,669	\$1,050,083	\$ 981	\$1,051,064
Intersegment sales	1,153	1,074	14,590	16,817	(16,817)	
Segment operating income	108,649	54,038	29,066	191,753	(30,548)	161,205

**Three Months Ended September 30, 2008**

	Flowserve Pump	Flow Control	Flow Solutions	Subtotal Reportable Segments	All Other	Consolidated Total
(Amounts in thousands)						
Sales to external customers	\$638,767	\$363,417	\$149,904	\$1,152,088	\$ 1,504	\$1,153,592

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Intersegment sales	398	1,778	20,966	23,142	(23,142)	
Segment operating income	99,398	61,378	33,103	193,879	(29,365)	164,514
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**Table of Contents****Nine Months Ended September 30, 2009**

(Amounts in thousands)	<b>Flowserve Pump</b>	<b>Flow Control</b>	<b>Flow Solutions</b>	<b>Subtotal Reportable Segments</b>	<b>All Other</b>	<b>Consolidated Total</b>
Sales to external customers	\$1,894,110	\$889,377	\$379,467	\$3,162,954	\$ 3,235	\$3,166,189
Intersegment sales	2,440	3,804	45,238	51,482	(51,482)	
Segment operating income	325,982	148,398	78,285	552,665	(85,568)	467,097
<b>Nine Months Ended September 30, 2008</b>						

(Amounts in thousands)	<b>Flowserve Pump</b>	<b>Flow Control</b>	<b>Flow Solutions</b>	<b>Subtotal Reportable Segments</b>	<b>All Other</b>	<b>Consolidated Total</b>
Sales to external customers	\$1,831,936	\$1,030,811	\$437,623	\$3,300,370	\$ 4,146	\$3,304,516
Intersegment sales	1,564	4,931	57,871	64,366	(64,366)	
Segment operating income	281,566	167,386	97,932	546,884	(90,724)	456,160

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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 consolidated 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 included in our 2008 Annual Report.

#### **EXECUTIVE OVERVIEW**

We are an established industry leader with a strong product portfolio of pumps, valves, seals, automation and aftermarket services in support of global infrastructure industries, including oil and gas, chemical, power generation and water management, as well as general industrial markets where our products add value. Our products are integral to the movement, control and protection of the flow of materials in our customers' critical processes. We currently employ approximately 15,000 employees in more than 55 countries who are focused on key strategies that reach across the business. Our business model is influenced by the capital spending of these industries for the placement of new products into service and aftermarket services for existing operations. The worldwide installed base of our products is an important source of aftermarket revenue, where products are expected to ensure the maximum operating time of many key industrial processes. Over the past several years, we have invested significantly 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 150 of our Quick Response Centers ( 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 to our profitable growth strategy.

The favorable conditions we experienced in much of 2008 in our key industries moderated in the last quarter of 2008 and the first quarter of 2009. In the second and third quarters of 2009, we experienced some stabilization in business conditions. Although we have experienced increased pricing pressure in 2009, the overall demand for our products and services reflects continuing investments in oil and gas, capacity expansion and upgrade projects in power generation, global infrastructure growth in desalination, chemical manufacturing expansion in certain developing regions and aftermarket opportunities, including optimization projects of continuing operations. We have not experienced a significant level of cancellations in our backlog. Overall global demand in our key industries reflected moderate growth in the developing markets offset by weakness in the mature markets.

The global demand growth during previous years provided us the opportunity to increase our installed base of new products and drive recurring aftermarket business. We continue to build on our geographic breadth through our QRC network, with the goal to be positioned as near to our customers as possible for service and support in order to capture this important aftermarket business. Despite this, we continue to face challenges affecting many companies in our industry with a significant multinational presence, such as economic, political and other risks.

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 optimize our global supply chain capability to meet global customer demands and ensure the quality and timely delivery of our products. Significant efforts are underway to improve the supply chain processes across our divisions to find areas of synergy and cost reduction. In addition, we are improving 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 reducing 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. This program is a key factor in our margin improvement plans.

Ongoing effects of global financial markets and banking systems disruptions continue to make credit and capital markets difficult for companies to access, and have generally driven up the costs of newly raised debt. We continue to monitor and evaluate the implications of these factors on our current business, our customers and suppliers and the state of the global economy. While we believe that these financial market disruptions have not directly had a

disproportionate adverse impact on our financial position, results of operations or liquidity as of September 30, 2009, continuing disruptions in the functioning of credit and capital markets could potentially materially impair our and our customers' ability to access these markets and increase associated costs. There can be no assurance that we will not be materially adversely affected by these financial market disruptions and global economic conditions as economic events and circumstances continue to evolve. Only 1% of our term loan is due to mature in each of 2009 and 2010, and after the effects of \$385.0 million of notional interest rate swaps, approximately 71% of our term debt was at fixed rates at September 30, 2009. Our revolving line of credit and our European LOC Facility are committed and are held by a diversified group of financial institutions. Our cash balance decreased by \$180.8 million to \$291.2 million as of September 30, 2009 as compared with December



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31, 2008. The cash draw was anticipated based on planned significant cash uses in the nine months ended September 30, 2009, including approximately \$115 million in long-term and broad-based annual incentive program payments related to prior period performance, \$87.1 million in capital expenditures, \$44.2 million in dividend payments, \$82.5 million in contributions to our U.S. pension plan, \$27.5 million of share repurchases and the funding of increased working capital requirements, as well as \$30.8 million for the acquisition of Calder AG. 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. See the Liquidity and Capital Resources section of this

Management's Discussion and Analysis of Financial Condition and Results of Operations for further discussion.

**RESULTS OF OPERATIONS Three and nine months ended September 30, 2009 and 2008**

Throughout this discussion of our results of operations, we discuss the impact of fluctuations in foreign currency exchange rates. We have calculated currency effects 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, FPD acquired Calder AG, a Swiss supplier of energy recovery technology, effective April 21, 2009, and Calder AG's results of operations have been consolidated since the date of acquisition. Additionally, FPD acquired the remaining 50% interest in Niigata, a Japanese manufacturer of pumps and other rotating equipment, effective March 1, 2008. The incremental interest acquired was accounted for as a step acquisition and Niigata's results of operations have been consolidated since the date of acquisition. Prior to this transaction, our 50% interest in Niigata was recorded using the equity method of accounting. No pro forma information has been provided for either acquisition due to immateriality.

As discussed in Note 7 to our condensed consolidated financial statements included in this Quarterly Report, in February 2009, we announced our Realignment Program to incur up to \$40 million in realignment costs 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. The Realignment Program consists of both restructuring and non-restructuring costs. Restructuring charges represent charges associated with the relocation of certain business activities, outsourcing of some business activities and facility closures. Non-restructuring charges, which represent the majority of the Realignment Program, are charges 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 statement of income.

The following is a summary of Realignment Program charges included in operating income for the three and nine months ended September 30, 2009:

**Three Months Ended September 30, 2009**

	Flowserve	Flow	Flow	Subtotal Reportable	All Other	Consolidated
(Amounts in millions)	Pump	Control	Solutions	Segments		Total
<b>Restructuring Charges</b>						
COS	\$ 0.8	\$	\$ 0.1	\$ 0.9	\$	\$ 0.9
SG&A	\$ 0.8	\$	\$ 0.1	\$ 0.9	\$	\$ 0.9
<b>Non-Restructuring Charges</b>						
COS	\$ 0.4	\$ 0.6	\$ 0.2	\$ 1.2	\$	\$ 1.2
SG&A	0.2		0.7	0.9	0.6	1.5
	\$ 0.6	\$ 0.6	\$ 0.9	\$ 2.1	\$ 0.6	\$ 2.7

**Total Realignment Program  
Charges**

COS	\$	1.2	\$	0.6	\$	0.3	\$	2.1	\$		\$	2.1
SG&A		0.2				0.7		0.9		0.6		1.5
	\$	1.4	\$	0.6	\$	1.0	\$	3.0	\$	0.6	\$	3.6

**Table of Contents****Nine Months Ended September 30, 2009**

	Flowserve	Flow	Flow	Subtotal Reportable		Consolidated
(Amounts in millions)	Pump	Control	Solutions	Segments	All Other	Total
<b>Restructuring Charges</b>						
COS	\$ 9.0	\$ 0.5	\$ 0.8	\$ 10.3	\$	\$ 10.3
SG&A	0.2	0.2	0.1	0.5		0.5
	\$ 9.2	\$ 0.7	\$ 0.9	\$ 10.8	\$	\$ 10.8
<b>Non-Restructuring Charges</b>						
COS	\$ 2.4	\$ 3.8	\$ 3.9	\$ 10.1	\$	\$ 10.1
SG&A	2.8	3.8	4.8	11.4	0.9	12.3
	\$ 5.2	\$ 7.6	\$ 8.7	\$ 21.5	\$ 0.9	\$ 22.4
<b>Total Realignment Program Charges</b>						
COS	\$ 11.4	\$ 4.3	\$ 4.7	\$ 20.4	\$	\$ 20.4
SG&A	3.0	4.0	4.9	11.9	0.9	12.8
	\$ 14.4	\$ 8.3	\$ 9.6	\$ 32.3	\$ 0.9	\$ 33.2

The following is a summary of total expected Realignment Program charges:

**Total Expected Charges for 2009**

	Flowserve	Flow	Flow	Subtotal Reportable		Consolidated
(Amounts in millions)	Pump	Control	Solutions	Segments	All Other	Total
<b>Total Expected Restructuring Charges</b>						
COS	\$ 13.6	\$ 0.4	\$ 1.3	\$ 15.3	\$	\$ 15.3
SG&A	0.2	0.2	0.1	0.5		0.5
	\$ 13.8	\$ 0.6	\$ 1.4	\$ 15.8	\$	\$ 15.8
<b>Total Expected Non-restructuring Charges</b>						
COS	\$ 3.0	\$ 5.8	\$ 3.8	\$ 12.6	\$	\$ 12.6
SG&A	2.8	4.2	4.8	11.8	0.9	12.7
	\$ 5.8	\$ 10.0	\$ 8.6	\$ 24.4	\$ 0.9	\$ 25.3

**Total Expected  
Realignment Program  
Charges**

COS	\$	16.6	\$	6.2	\$	5.1	\$	27.9	\$		\$	27.9
SG&A		3.0		4.4		4.9		12.3		0.9		13.2
	\$	19.6	\$	10.6	\$	10.0	\$	40.2	\$	0.9	\$	41.1

Based on actions under our Realignment Program, we have realized savings of approximately \$10 million and \$17 million for the three and nine months ended September 30, 2009, respectively, and we expect to realize savings in 2009 of approximately \$30 million. Upon completion of our Realignment Program, we expect annual cost savings of approximately \$60 million. Approximately two-thirds of savings were and will be realized in COS and the remainder in SG&A.

Most of the charges presented above are expected to be paid in cash in 2009, except for asset write-downs, which are non-cash restructuring charges. Asset write-down charges (including accelerated depreciation of fixed assets, accelerated amortization of intangible assets and inventory write-downs) of \$0.2 million and \$5.0 million were recorded during the three and nine months ended September 30, 2009, respectively. Additional asset write-down charges of \$0.2 million are expected to be recorded during the remainder of 2009.

In the fourth quarter of 2009, we plan to commence additional realignment initiatives that will expand our efforts to optimize assets and reduce our overall cost structure. The additional initiatives are planned to occur in the remainder of 2009 and continue into 2010. We currently expect to incur approximately \$45 million in additional charges, which are not reflected above, and expect to generate approximately \$50 million in additional annual cost savings. We view the additional initiatives as a long-term investment that should improve our operating platform, better support our customers and have lower execution risk with higher expected return than other investments currently available.

**Table of Contents****Consolidated Results  
Bookings, Sales and Backlog**

	<b>Three Months Ended September 30,</b>	
(Amounts in millions)	<b>2009</b>	<b>2008</b>
Bookings	\$ 975.3	\$ 1,373.5
Sales	1,051.1	1,153.6

	<b>Nine Months Ended September 30,</b>	
(Amounts in millions)	<b>2009</b>	<b>2008</b>
Bookings, net	\$ 2,946.0	\$ 4,113.4
Sales	3,166.2	3,304.5

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 manufacture, service or support. Bookings for the three months ended September 30, 2009 decreased by \$398.2 million, or 29.0%, as compared with the same period in 2008. The decrease includes negative currency effects of approximately \$37 million. The decrease is attributable to declines in original equipment bookings in FPD, including the impact of the \$85 million project to supply a variety of pumps to build the Abu Dhabi Crude Oil Pipeline recorded in the same period in 2008 that did not recur, as well as declines in original equipment bookings by FSD. These decreases are primarily related to declines in the oil and gas and general industries and reflect our customers' responses to general global economic conditions and declines in oil and gas prices as compared with 2008. The decrease is also attributable to declines in the chemical industry and distributor business in FCD, partially offset by orders of more than \$45 million in FCD to supply valves to four Westinghouse Electric Co. nuclear power units in North America.

Bookings for the nine months ended September 30, 2009 decreased by \$1,167.4 million, or 28.4%, as compared with the same period in 2008. The decrease includes negative currency effects of approximately \$264 million. The decrease is primarily attributable to declines in original equipment bookings in FPD, including the impacts of \$110.9 million of thruster orders and the impact of the \$85 million Abu Dhabi Crude Oil Pipeline order that were recorded in the same period in 2008 and did not recur, as well as declines in original equipment bookings by FSD. These decreases are primarily attributable to declines in the oil and gas and general industries and reflect our customers' responses to general global economic conditions and declines in oil and gas prices as compared with 2008. The decrease is also attributable to declines in the chemical industry and distributor business in FCD, partially offset by orders of more than \$45 million in FCD to supply valves to four Westinghouse Electric Co. nuclear power units in North America. Bookings recorded and subsequently canceled within the year-to-date period are excluded from year-to-date bookings.

Sales for the three months ended September 30, 2009 decreased by \$102.5 million, or 8.9%, as compared with the same period in 2008. The decrease includes negative currency effects of approximately \$47 million. The decrease is attributable to decreased chemical and general industries and distributor business in FCD and decreased original equipment sales by FSD. Net sales to international customers, including export sales from the U.S., were approximately 74% of consolidated sales for the three months ended September 30, 2009, as compared with approximately 72% for the same period in 2008.

Sales for the nine months ended September 30, 2009 decreased by \$138.3 million, or 4.2%, as compared with the same period in 2008. The decrease includes negative currency effects of approximately \$277 million. The overall net decrease is primarily attributable to decreased chemical and general industries and distributor business in FCD and decreased original equipment sales by FPD and FSD. Net sales to international customers, including export sales from the U.S., were approximately 72% of consolidated sales for the nine months ended September 30, 2009, as compared

with approximately 69% for the same period in 2008.

Backlog represents the value of aggregate uncompleted customer orders. Backlog of \$2,664.9 million at September 30, 2009 decreased by \$160.2 million, or 5.7%, as compared with December 31, 2008. Currency effects provided an increase of approximately \$90 million. The overall net decrease includes the impact of cancellations of \$35.4 million of orders booked during the prior year. The acquisition of Calder AG resulted in a \$4.7 million increase in backlog.

**Table of Contents****Gross Profit and Gross Profit Margin**

	<b>Three Months Ended September 30,</b>	
(Amounts in millions)	<b>2009</b>	<b>2008</b>
Gross profit	\$ 385.2	\$ 404.9
Gross profit margin	36.6%	35.1%

	<b>Nine Months Ended September 30,</b>	
(Amounts in millions)	<b>2009</b>	<b>2008</b>
Gross profit	\$ 1,139.3	\$ 1,168.7
Gross profit margin	36.0%	35.4%

Gross profit for the three months ended September 30, 2009 decreased by \$19.7 million, or 4.9%, as compared with the same period in 2008. The decrease includes the effect of \$2.1 million in charges resulting from our Realignment Program in 2009. Gross profit margin for the three months ended September 30, 2009 of 36.6% increased from 35.1% for the same period in 2008. The increase is primarily attributable to improved pricing on original equipment orders booked by FPD in 2008, a sales mix shifts toward higher margin aftermarket sales and savings realized from our Realignment Program.

Gross profit for the nine months ended September 30, 2009 decreased by \$29.4 million, or 2.5%, as compared with the same period in 2008. The decrease includes the effect of \$20.4 million in charges resulting from our Realignment Program in 2009. Gross profit margin for the nine months ended September 30, 2009 of 36.0% increased from 35.4% for the same period in 2008. A sales mix shift toward higher margin aftermarket sales by FCD and FSD, improved pricing on original equipment orders booked by FPD in late 2007 and early 2008 and savings realized from our Realignment Program were partially offset by a sales mix shift toward lower margin original equipment in FPD.

**Selling, General and Administrative Expense ( SG&A )**

	<b>Three Months Ended September 30,</b>	
(Amounts in millions)	<b>2009</b>	<b>2008</b>
SG&A	\$ 227.3	\$ 243.8
SG&A as a percentage of sales	21.6%	21.1%

	<b>Nine Months Ended September 30,</b>	
(Amounts in millions)	<b>2009</b>	<b>2008</b>
SG&A	\$ 683.9	\$ 726.5
SG&A as a percentage of sales	21.6%	22.0%

SG&A for the three months ended September 30, 2009 decreased by \$16.5 million, or 6.8%, as compared with the same period in 2008. Currency effects yielded a decrease of approximately \$7 million. Recoveries of bad debts, decreased annual incentive compensation expense, commissions and travel and savings realized from our Realignment Program were partially offset by a \$7.5 million increase in legal fees and accrued costs related to the pending resolution of the 2003 shareholder class action litigation, which remains contingent upon the resolution of certain closure issues (see Note 11 to our condensed consolidated financial statements included in this Quarterly Report).

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SG&A for the nine months ended September 30, 2009 decreased by \$42.6 million, or 5.9%, as compared with the same period in 2008. The decrease includes the effect of \$12.8 million in charges resulting from our Realignment Program in 2009. Currency effects yielded a decrease of approximately \$42 million. Recoveries of bad debts, decreased annual incentive compensation expense, commissions and travel and savings realized from our Realignment Program were partially offset by an increase in legal fees and accrued resolution costs related to shareholder litigation and charges resulting from our Realignment Program.

### Net Earnings from Affiliates

(Amounts in millions)	Three Months Ended September 30,	
	2009	2008
Net earnings from affiliates	\$ 3.3	\$ 3.4

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	<b>Nine Months Ended September 30,</b>	
(Amounts in millions)	<b>2009</b>	<b>2008</b>
Net earnings from affiliates	\$ 11.7	\$ 13.9

Net earnings from affiliates represents our net income from investments in seven joint ventures (one located in each of China, Japan, Korea, Saudi Arabia and the United Arab Emirates and two located in India) that are accounted for using the equity method of accounting. Net earnings from affiliates for the three months ended September 30, 2009 was comparable to the same period in 2008.

Net earnings from affiliates for the nine months ended September 30, 2009 decreased by \$2.2 million, or 15.8%, as compared with the same period in 2008. The decrease in earnings is primarily attributable to our FCD joint venture in India and the impact of the consolidation of Niigata in the first quarter of 2008 when we purchased the remaining 50% interest. As discussed above, effective March 1, 2008, we purchased the remaining 50% interest in Niigata, resulting in the full consolidation of Niigata as of that date. Prior to this transaction, our 50% interest was recorded using the equity method of accounting.

**Operating Income and Operating Margin**

	<b>Three Months Ended September 30,</b>	
(Amounts in millions)	<b>2009</b>	<b>2008</b>
Operating income	\$ 161.2	\$ 164.5
Operating margin	15.3%	14.3%

	<b>Nine Months Ended September 30,</b>	
(Amounts in millions)	<b>2009</b>	<b>2008</b>
Operating income	\$ 467.1	\$ 456.2
Operating margin	14.8%	13.8%

Operating income for the three months ended September 30, 2009 decreased by \$3.3 million, or 2.0%, as compared with the same period in 2008. The decrease includes the effect of approximately \$10 million in savings, partially offset by \$3.6 million in charges, resulting from our Realignment Program in 2009. The decrease also includes negative currency effects of approximately \$10 million. The overall net decrease is primarily a result of the \$19.7 million decrease in gross profit, which was partially offset by the \$16.5 million decrease in SG&A, as discussed above.

Operating income for the nine months ended September 30, 2009 increased by \$10.9 million, or 2.4%, as compared with the same period in 2008. The increase includes the effect of \$33.2 million in charges, partially offset by approximately \$17 million in savings, resulting from our Realignment Program in 2009. The increase also includes negative currency effects of approximately \$58 million. The increase is primarily a result of the \$42.6 million decrease in SG&A, partially offset by the \$29.4 million decrease in gross profit, as discussed above.

**Interest Expense and Interest Income**

	<b>Three Months Ended September 30,</b>	
(Amounts in millions)	<b>2009</b>	<b>2008</b>
Interest expense	\$ (10.1)	\$ (13.1)

Interest income	0.6	2.2
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	<b>Nine Months Ended September 30,</b>	
(Amounts in millions)	<b>2009</b>	<b>2008</b>
Interest expense	\$ (30.2)	\$ (38.7)
Interest income	2.1	6.6

Interest expense for the three and nine months ended September 30, 2009 decreased by \$3.0 million and \$8.5 million, respectively, as compared with the same periods in 2008. These decreases are primarily attributable to a decrease in the average interest rate on our outstanding debt. Approximately 71% of our term debt was at fixed rates at September 30, 2009, including the effects of \$385.0 million of notional interest rate swaps.

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Interest income for the three and nine months ended September 30, 2009 decreased by \$1.6 million and \$4.5 million, respectively, as compared with the same periods in 2008. These decreases are primarily attributable to a decrease in the average interest rate on cash balances.

**Other Income (Expense), Net**

(Amounts in millions)	<b>Three Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
Other income (expense), net	\$ 7.0	\$ (8.7)

(Amounts in millions)	<b>Nine Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
Other (expense) income, net	\$ (2.4)	\$ 8.4

Other income (expense), net for the three months ended September 30, 2009 increased to net other income of \$7.0 million, as compared with net other expense of \$8.7 million for the same period in 2008, primarily due to a \$26.9 million increase in gains (due to a \$7.8 million gain in the current period as compared with a \$19.1 million loss in the prior period) on forward exchange contracts partially offset by a \$10.7 million increase in losses (due to a \$1.2 million loss in the current period as compared with a \$9.5 million gain in the prior period) arising from transactions in currencies other than our sites' functional currencies.

Other (expense) income, net for the nine months ended September 30, 2009 decreased to net other expense of \$2.4 million, as compared with net other income of \$8.4 million for the same period in 2008, primarily due to a \$16.2 million increase in losses (due to a \$13.1 million loss in the current period as compared with a \$3.1 million gain in the prior period) arising from transactions in currencies other than our sites' functional currencies and a \$3.4 million gain in 2008 on the bargain purchase of the remaining 50% interest in Niigata (as discussed in Note 2 to our condensed consolidated financial statements included in this Quarterly Report) that did not recur, partially offset by a \$10.4 million increase in gains (due to a \$10.0 million gain in the current period as compared with a \$0.4 million loss in the prior period) on forward exchange contracts.

**Tax Expense and Tax Rate**

(Amounts in millions)	<b>Three Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
Provision for income tax	\$ 42.0	\$ 26.9
Effective tax rate	26.5%	18.6%

(Amounts in millions)	<b>Nine Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
Provision for income tax	\$ 118.6	\$ 102.2
Effective tax rate	27.2%	23.6%

Our effective tax rate of 26.5% for the three months ended September 30, 2009 increased from 18.6% for the same period in 2008. Our effective tax rate of 27.2% for the nine months ended September 30, 2009 increased from 23.6% for the same period in 2008. The increases are primarily due to the impact of favorable tax items in 2008 that did not recur.

**Other Comprehensive Income (Expense)**

(Amounts in millions)	<b>Three Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
Other comprehensive income (expense)	\$ 36.5	\$ (101.5)

(Amounts in millions)	<b>Nine Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
Other comprehensive income (expense)	\$ 69.9	\$ (68.1)

Other comprehensive income (expense) for the three months ended September 30, 2009 increased to income of \$36.5 million, as compared to expense of \$101.5 million for the same period in 2008, primarily reflecting the weakening of the U.S. Dollar exchange rate versus the Euro during the three months ended September 30, 2009, as compared with the same period in 2008. Other comprehensive income (expense) for the nine months ended September 30, 2009 increased to income of \$69.9 million as compared to

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expense of \$68.1 million for the same period in 2008, primarily reflecting the weakening of the U.S. Dollar exchange rate versus the Euro during the nine months ended September 30, 2009, as compared with the same period in 2008.

**Business Segments**

We conduct our operations through three business segments:

FPD for engineered pumps, industrial pumps and related services;

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

FSD for precision mechanical seals and related products and services.

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, FPD, FCD and FSD are discussed below.

***Flowserve Pump Division***

Through FPD, we design, manufacture, distribute and service engineered and industrial pumps and pump systems and submersible motors (collectively referred to as "original equipment") primarily in the oil and gas, chemical and power generation industries. FPD also manufactures replacement parts and related equipment, and provides a full array of support services (collectively referred to as "aftermarket"). FPD has 30 manufacturing facilities worldwide, seven of which are located in North America, 13 in Europe, four in Latin America and six in Asia. FPD also has 78 service centers, including those co-located in a manufacturing facility, in 28 countries.

(Amounts in millions)	<b>Three Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
Bookings	\$ 517.8	\$ 858.3
Sales	637.1	639.2
Gross profit	206.2	194.8
Gross profit margin	32.4%	30.5%
Operating income	108.6	99.4
Operating margin	17.1%	15.6%

(Amounts in millions)	<b>Nine Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
Bookings, net	\$ 1,687.1	\$ 2,484.9
Sales	1,896.6	1,833.5
Gross profit	616.6	575.5
Gross profit margin	32.5%	31.4%
Operating income	326.0	281.6
Operating margin	17.2%	15.4%

Bookings for the three months ended September 30, 2009 decreased by \$340.5 million, or 39.7%, as compared with the same period in 2008. The decrease includes negative currency effects of approximately \$21 million. The decrease was primarily attributable to original equipment bookings, which was driven by a decline in the oil and gas, general and chemical industries, and includes the impact of the \$85 million project to supply a variety of pumps to build the Abu Dhabi Crude Oil Pipeline recorded in same period in 2008 that did not recur. Bookings in Europe, Middle East and Africa ( "EMA"), North America and Latin America decreased \$244.2 million (including negative currency effects of approximately \$14 million), \$77.6 million and \$56.6 million (including negative currency effects of approximately \$6 million), respectively. The decrease in bookings reflects lower demand and project delays due to

our customers' responses to concerns regarding global economic conditions and declines in prices as compared with the same period in the prior year.

Bookings for the nine months ended September 30, 2009 decreased by \$797.8 million, or 32.1%, as compared with the same period in 2008. The decrease includes negative currency effects of approximately \$167 million. Original equipment bookings decreased approximately 45% driven by a decline in the oil and gas and general industries, and includes the impacts of \$110.9 million of thruster orders and the \$85 million Abu Dhabi Crude Oil Pipeline order recorded in the same period in 2008 that did not recur.

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Bookings in EMA and North America decreased \$535.0 million (including negative currency effects of approximately \$107 million) and \$257.4 million, respectively. The decrease in bookings reflects lower demand and project delays due to our customers' responses to concerns regarding global economic conditions and declines in prices as compared with the same period in the prior year.

Sales for the three months ended September 30, 2009 were comparable to the same period in 2008. Sales for 2009 reflect negative currency effects of approximately \$31 million. Sales were generally comparable for all regions and for original equipment and aftermarket. Sales reflect execution against a strong order backlog, which predominantly resulted from growth in the oil and gas and power markets over the past two years.

Sales for the nine months ended September 30, 2009 increased by \$63.1 million, or 3.4%, as compared with the same period in 2008. The increase includes negative currency effects of approximately \$172 million. Original equipment sales showed continued strength, increasing approximately 7%, reflecting execution against a strong order backlog, which predominantly resulted from growth in the oil and gas and power industries over the past two years.

Gross profit for the three months ended September 30, 2009 increased by \$11.4 million, or 5.9%, as compared with the same period in 2008. Gross profit margin for the three months ended September 30, 2009 of 32.4% increased from 30.5% for the same period in 2008. The increase is attributable to improved pricing on original equipment orders booked in 2008, a sales mix shift toward higher margin aftermarket sales and savings realized from our Realignment Program. As a result of the sales mix shift, aftermarket sales increased to approximately 38% of total sales, as compared with approximately 36% of total sales in the same period in 2008.

Gross profit for the nine months ended September 30, 2009 increased by \$41.1 million, or 7.1%, as compared with the same period in 2008. The decrease includes the effect of \$11.4 million in charges resulting from our Realignment Program in 2009. Gross profit margin for the nine months ended September 30, 2009 of 32.5% increased from 31.4% for the same period in 2008. The increase is attributable to improved pricing on original equipment orders booked in late 2007 and early 2008, as well as operating efficiencies and savings realized from our Realignment Program, partially offset by a sales mix shift toward lower margin original equipment. As a result of the sales mix shift, original equipment sales increased to approximately 62% of total sales, as compared with approximately 60% of total sales in the same period in 2008.

Operating income for the three months ended September 30, 2009 increased by \$9.2 million, or 9.3%, as compared with the same period in 2008. The increase includes negative currency effects of approximately \$6 million. The increase was due primarily to improved gross profit of \$11.4 million, which includes the effect of savings realized from our Realignment Program, partially offset by a \$2.8 million increase in SG&A, which was due to an insurance recovery in the same period in 2008 that did not recur.

Operating income for the nine months ended September 30, 2009 increased by \$44.4 million, or 15.8%, as compared with the same period in 2008. The increase includes the effect of \$14.4 million in charges resulting from our Realignment Program in 2009. The increase includes negative currency effects of approximately \$36 million. The increase was due primarily to increased gross profit of \$41.1 million, which includes the effect of savings realized from our Realignment Program.

Backlog of \$2,088.5 million at September 30, 2009 decreased by \$164.6 million, or 7.3%, as compared with December 31, 2008. Currency effects provided an increase of approximately \$74 million. The overall net decrease includes the impact of cancellations of \$33.4 million of orders booked during the prior year. The acquisition of Calder AG resulted in a \$4.7 million increase in backlog.

**Table of Contents*****Flow Control Division***

Our second largest business segment is FCD, through which we design, manufacture and distribute a broad portfolio of engineered and industrial valves, control valves, actuators, 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 47 manufacturing facilities and QRCs in 22 countries around the world, with only five of its 19 manufacturing operations located in the U.S. Based on independent industry sources, we believe that we are the third largest industrial valve supplier on a global basis.

(Amounts in millions)	<b>Three Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
Bookings	\$ 333.1	\$ 367.6
Sales	293.5	365.2
Gross profit	112.0	132.5
Gross profit margin	38.2%	36.3%
Operating income	54.0	61.4
Operating margin	18.4%	16.8%

(Amounts in millions)	<b>Nine Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
Bookings, net	\$ 907.2	\$ 1,187.0
Sales	893.2	1,035.7
Gross profit	328.3	371.6
Gross profit margin	36.8%	35.9%
Operating income	148.4	167.4
Operating margin	16.6%	16.2%

Bookings for the three months ended September 30, 2009 decreased \$34.5 million, or 9.4%, as compared with the same period in 2008. This decrease includes negative currency effects of approximately \$11 million. Bookings decreased approximately \$33 million and \$26 million, in EMA and Asia Pacific, respectively, driven by an overall decrease in chemical industry and distributor business and delayed large projects in the chemical industry, respectively. The distributor market channel has not restocked to offset earlier inventory destocking. This decrease was partially offset by orders of more than \$45 million to supply valves to four Westinghouse Electric Co. nuclear power units in North America.

Bookings for the nine months ended September 30, 2009 decreased \$279.8 million, or 23.6%, as compared with the same period in 2008. This decrease includes negative currency effects of approximately \$68 million. The decrease in bookings is primarily attributable to EMA and North America, which decreased approximately \$150 million and \$50 million, respectively, driven by an overall decrease in chemical industry and distributor business due to inventory destocking and delays in large projects in the chemical and oil and gas markets. These decreases were partially offset by orders recorded in the third quarter of 2009 of more than \$45 million to supply valves to four Westinghouse Electric Co. nuclear power units in North America. Bookings in Asia Pacific decreased approximately \$59 million, attributable to delayed large projects in the chemical industry, and bookings in Latin America decreased approximately \$23 million due to large pulp and paper projects in the first quarter of 2008 that did not recur.

Sales for the three months ended September 30, 2009 decreased \$71.7 million, or 19.6%, as compared with the same period in 2008. The decrease includes negative currency effects of approximately \$11 million. Decreased sales in EMA and North America were attributable to the chemical and general industries and an overall decline in distributor business. Asia Pacific and Latin America sales decreased due to large project sales in the second quarter of



2008 that did not recur.

Sales for the nine months ended September 30, 2009 decreased \$142.5 million, or 13.8%, as compared with the same period in 2008. This decrease includes negative currency effects of approximately \$74 million. Sales in EMA and North America decreased approximately \$90 million and \$43 million, respectively, attributable to the chemical and general industries and an overall decline in distributor business.

Gross profit for the three months ended September 30, 2009 decreased by \$20.5 million, or 15.5%, as compared with the same period in 2008. Gross profit margin for the three months ended September 30, 2009 of 38.2% increased from 36.3% for the same period in 2008. The increase is attributable to materials cost savings, favorable product mix, various CIP initiatives, improved utilization of low cost regions and savings realized from our Realignment Program, partially offset by the impact of decreased sales, which negatively impacts our absorption of fixed manufacturing costs.

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Gross profit for the nine months ended September 30, 2009 decreased by \$43.3 million, or 11.7%, as compared with the same period in 2008. The decrease includes the effect of \$4.3 million in charges resulting from our Realignment Program in 2009. Gross profit margin for the nine months ended September 30, 2009 of 36.8% increased from 35.9% for the same period in 2008. The increase is attributable to materials cost savings, favorable product mix, various CIP initiatives, improved utilization of low cost regions and savings realized from our Realignment Program, partially offset by the impact of decreased sales, which negatively impacts our absorption of fixed manufacturing costs.

Operating income for the three months ended September 30, 2009 decreased by \$7.4 million, or 12.1%, as compared with the same period in 2008. The decrease includes negative currency effects of approximately \$2 million. The decrease is principally attributable to the \$20.5 million decrease in gross profit, which includes the effect of savings realized from our Realignment Program, partially offset by a \$13.9 million decrease in SG&A. The decrease in SG&A was attributable to decreased selling and marketing-related expenses, decreased incentive compensation and savings realized from our Realignment Program.

Operating income for the nine months ended September 30, 2009 decreased by \$19.0 million, or 11.4%, as compared with the same period in 2008. The decrease includes the effect of \$8.3 million in charges resulting from our Realignment Program in 2009. The decrease includes negative currency effects of approximately \$13 million. The decrease is principally attributable to the \$43.3 million decrease in gross profit, which includes the effect of savings realized from our Realignment Program, partially offset by a \$27.0 million decrease in SG&A. The decrease in SG&A was attributable to decreased selling and marketing-related expenses, decreased incentive compensation, \$4.3 million in bad debt recoveries and savings realized from our Realignment Program.

Backlog of \$506.2 million at September 30, 2009 increased by \$23.3 million, or 4.8%, as compared with December 31, 2008. Currency effects provided an increase of approximately \$11 million.

***Flow Solutions Division***

Through FSD, we engineer, manufacture and sell mechanical seals, auxiliary systems and parts, and provide related services, principally to process industries and general industrial markets, with similar products sold internally in support of FPD. FSD has ten manufacturing operations, four of which are located in the U.S. FSD operates 79 QRCs worldwide (including five that are co-located in a manufacturing facility), including 24 sites in North America, 21 in EMA, 19 in Latin America and 15 in Asia. Our ability to rapidly deliver mechanical sealing technology through global engineering tools, locally sited QRCs and on-site engineers represents a significant competitive advantage. This business model has enabled FSD to establish a large number of alliances with multi-national customers. Based on independent industry sources, we believe that we are the second largest mechanical seal supplier on a global basis.

	<b>Three Months Ended September 30,</b>	
(Amounts in millions)	<b>2009</b>	<b>2008</b>
Bookings	\$ 141.4	\$ 173.0
Sales	136.3	170.9
Gross profit	66.9	77.7
Gross profit margin	49.1%	45.5%
Operating income	29.1	33.1
Operating margin	21.3%	19.4%

  

	<b>Nine Months Ended September 30,</b>	
(Amounts in millions)	<b>2009</b>	<b>2008</b>
Bookings, net	\$ 406.2	\$ 513.7
Sales	424.7	495.5

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Gross profit	196.3	223.3
Gross profit margin	46.2%	45.1%
Operating income	78.3	97.9
Operating margin	18.4%	19.8%

Bookings for the three months ended September 30, 2009 decreased by \$31.6 million, or 18.3%, as compared with the same period in 2008. This decrease includes negative currency effects of approximately \$6 million. A decrease in customer bookings of original equipment and aftermarket was primarily attributable to North America and EMA, driven by the oil and gas and general

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industries. Interdivision bookings (which are eliminated and are not included in consolidated bookings as disclosed above) decreased \$2.9 million.

Bookings for the nine months ended September 30, 2009 decreased by \$107.5 million, or 20.9%, as compared with the same period in 2008. This decrease includes negative currency effects of approximately \$29 million. A decrease in customer bookings of original equipment and aftermarket was primarily attributable to North America and EMA, driven by the oil and gas and general industries, as well as a slight decrease in Latin America. Interdivision bookings (which are eliminated and are not included in consolidated bookings as disclosed above) decreased \$11.7 million.

Sales for the three months ended September 30, 2009 decreased by \$34.6 million, or 20.2%, as compared with the same period in 2008. This decrease includes negative currency effects of approximately \$5 million. The decrease was driven by declines in customer sales in all regions. Interdivision sales (which are eliminated and are not included in consolidated sales as disclosed above) decreased \$6.4 million.

Sales for the nine months ended September 30, 2009 decreased by \$70.8 million, or 14.3%, as compared with the same period in 2008. This decrease includes negative currency effects of approximately \$31 million. The decrease was driven by declines in customer sales in North America and EMA. Interdivision sales (which are eliminated and are not included in consolidated sales as disclosed above) decreased \$12.6 million.

Gross profit for the three months ended September 30, 2009 decreased by \$10.8 million, or 13.9%, as compared with the same period in 2008. Gross profit margin for the three months ended September 30, 2009 of 49.1% increased from 45.5% for the same period in 2008. The increase is primarily attributable to a sales mix shift toward more profitable aftermarket sales and savings realized from our Realignment Program, partially offset by the impact of decreased sales, which negatively impacts our absorption of fixed manufacturing costs.

Gross profit for the nine months ended September 30, 2009 decreased by \$27.0 million, or 12.1%, as compared with the same period in 2008. The decrease includes the effect of \$4.7 million in charges resulting from our Realignment Program in 2009. Gross profit margin for the nine months ended September 30, 2009 of 46.2% increased from 45.1% for the same period in 2008. The increase is primarily attributable to a sales mix shift toward more profitable aftermarket sales and savings realized from our Realignment Program, partially offset by the impact of decreased sales, which negatively impacts our absorption of fixed manufacturing costs.

Operating income for the three months ended September 30, 2009 decreased by \$4.0 million, or 12.1%, as compared with the same period in 2008. The decrease includes negative currency effects of approximately \$2 million. The decrease is due to the \$10.8 million decrease in gross profit discussed above, which includes the effect of savings realized from our Realignment Program, partially offset by a \$6.7 million decrease in SG&A. The decrease in SG&A was due to strict cost control actions in 2009 and savings realized from our Realignment Program.

Operating income for the nine months ended September 30, 2009 decreased by \$19.6 million, or 20.0%, as compared with the same period in 2008. The decrease includes the effect of \$9.6 million in charges resulting from our Realignment Program in 2009. The decrease includes negative currency effects of approximately \$10 million. The decrease is due to the \$27.0 million decrease in gross profit mentioned above, which includes the effect of savings realized from our Realignment Program, partially offset by an \$8.0 million decrease in SG&A. The decrease in SG&A was due to strict cost control actions in 2009 and savings realized from our Realignment Program.

Backlog of \$104.0 million at September 30, 2009 decreased by \$14.2 million, or 12.0%, as compared with December 31, 2008. The decrease includes currency benefits of approximately \$5 million. Backlog at September 30, 2009 and December 31, 2008 includes \$21.8 million and \$18.6 million, respectively, of interdivision backlog (which is eliminated and not included in consolidated backlog as disclosed above).

**Table of Contents****LIQUIDITY AND CAPITAL RESOURCES*****Cash Flow Analysis***

(Amounts in millions)	<b>Nine Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
Net cash flows provided (used) by operating activities	\$ 4.5	\$ (4.8)
Net cash flows used by investing activities	(117.8)	(65.0)
Net cash flows used by financing activities	(72.3)	(139.3)

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, 2009 was \$291.2 million, as compared with \$472.1 million at December 31, 2008.

Working capital increased for the nine months ended September 30, 2009 due primarily to lower accounts payable of \$209.2 million and lower accrued liabilities of \$117.2 million resulting primarily from reductions in accruals for long-term and broad-based annual incentive program payments and reductions in advanced cash received from customers. During the nine months ended September 30, 2009, we contributed \$82.5 million to our U.S. pension plan. Working capital increased for the nine months ended September 30, 2008 due primarily to higher inventory of \$280.3 million, especially project-related inventory required to support future shipments of products in backlog, and higher accounts receivable of \$190.3 million, resulting primarily from higher sales and a \$67.4 million reduction in factored receivables resulting from the discontinuation of our factoring program in early 2008. During the nine months ended September 30, 2008, we contributed \$50.4 million to our U.S. pension plan.

Decreases in accounts receivable provided \$8.1 million of cash flow for the nine months ended September 30, 2009 compared with \$280.3 million cash flow used for the same period in 2008. As of September 30, 2009, we achieved a days sales receivables outstanding ( DSO ) of 72 days as compared with 71 days as of September 30, 2008. For reference purposes based on 2009 sales, an improvement of one day could provide approximately \$12 million in cash flow. Increases in inventory used \$8.1 million of cash flow for the nine months ended September 30, 2009 compared with \$190.3 million for the same period in 2008. Inventory turns were 3.0 times as of September 30, 2009 and 3.5 times as of September 30, 2008. Our calculation of inventory turns does not reflect the impact of advanced cash received from our customers. For reference purposes based on 2009 data, an improvement of one turn could yield approximately \$220 million in cash flow.

Cash flows used by investing activities during the nine months ended September 30, 2009 were \$117.8 million, as compared with \$65.0 million for the same period in 2008 and include \$30.8 million for the acquisition of Calder AG, as discussed below in Acquisitions and Dispositions. Capital expenditures during the nine months ended September 30, 2009 were \$87.1 million, an increase of \$14.6 million as compared with the same period in 2008, reflecting, in part, payments made during the first quarter of 2009 on strategic projects committed to during 2008. Capital expenditures in 2009 and 2008 have focused on: capacity expansion, including expansion of our QRC network, nuclear capabilities and low-cost sourcing; enterprise resource planning application upgrades; information technology infrastructure; and cost reduction opportunities. For the full year 2009, our capital expenditures are expected to be between \$100 million and \$110 million.

Cash flows used by financing activities during the nine months ended September 30, 2009 were \$72.3 million, as compared with \$139.3 million for the same period in 2008. Cash outflows during the nine months ended September 30, 2009 resulted primarily from the payment of \$44.2 million in dividends and \$27.5 million for the repurchase of common shares. Cash outflows for the same period in 2008 resulted primarily from \$135.0 million for the repurchase of shares and the payment of \$37.3 million in dividends, slightly offset by \$11.2 million in proceeds from the exercise of stock options.

The general credit and capital markets have continued to experience disruptions. Continuing volatility in these markets could potentially impair our ability to access these markets and increase associated costs. Notwithstanding these adverse market conditions, 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 enable us to meet our cash flow 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 February 26, 2008, our Board of Directors authorized a program to repurchase up to \$300.0 million of our outstanding common stock over an unspecified time period. The program commenced in the second quarter of 2008. We repurchased 131,500 shares for \$11.3 million and 413,000 shares for \$27.5 million during the three and nine months ended September 30, 2009,

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respectively. To date, we have repurchased a total of 2.2 million shares for \$192.5 million under this program. See Item 2. Unregistered Sales of Equity Securities and Use of Proceeds. below.

On February 23, 2009, our Board of Directors authorized an increase in our quarterly cash dividend to \$0.27 per share from \$0.25 per share, effective for the first quarter of 2009. 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 April 21, 2009, FPD acquired Calder AG, a private Swiss company, for up to \$44.1 million, net of cash acquired. Calder AG is a supplier of energy recovery technology for use in the global desalination market, and we expect its acquisition will enable us to expand the products and advanced technologies we offer to the growing desalination markets. Of the total purchase price, \$28.4 million was paid at closing, and \$2.4 million was paid after the working capital valuation was completed in early July 2009. The remaining \$13.3 million of the total purchase price is contingent upon Calder AG achieving certain performance metrics within a specified time frame after closing, and, to the extent achieved, is expected to be paid in cash within 12 months of the acquisition date. During the third quarter of 2009, the estimated fair value of the contingent consideration was reduced from \$4.4 million to \$2.2 million based on third quarter 2009 results and an updated weighted probability of achievement of the performance metrics within the specified time frame. The resulting gain is included in SG&A in our condensed consolidated statements of income.

Effective March 1, 2008, we acquired the remaining 50% interest in Niigata for \$2.4 million in cash.

### **Financing**

#### ***Credit Facilities***

Our credit facilities, as amended, are comprised of a \$600.0 million term loan expiring on August 10, 2012 and a \$400.0 million revolving line of credit, which can be utilized to provide up to \$300.0 million in letters of credit, expiring on August 10, 2012. We hereinafter refer to these credit facilities collectively as our Credit Facilities. At both September 30, 2009 and December 31, 2008, we had no amounts outstanding under the revolving line of credit. We had outstanding letters of credit of \$114.3 million and \$104.2 million at September 30, 2009 and December 31, 2008, respectively, which reduced borrowing capacity to \$285.7 million and \$295.8 million, respectively.

Borrowings under our Credit Facilities bear interest at a rate equal to, at our option, either (1) the base rate (which is based on the greater of the prime rate most recently announced by the administrative agent under our Credit Facilities or the Federal Funds rate plus 0.50%) or (2) London Interbank Offered Rate ( LIBOR ) plus an applicable margin determined by reference to the ratio of our total debt to consolidated Earnings Before Interest, Taxes, Depreciation and Amortization ( EBITDA ), which as of September 30, 2009 was 0.875% and 1.50% for borrowings under our revolving line of credit and term loan, respectively.

We may prepay loans under our Credit Facilities in whole or in part, without premium or penalty. During the three and nine months ended September 30, 2009, we made scheduled repayments under our Credit Facilities of \$1.4 million and \$4.3 million, respectively. We have scheduled repayments of \$1.4 million due in the each of the next four quarters.

Our obligations under the Credit Facilities 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. In addition, prior to our obtaining and maintaining investment grade credit ratings, our and the guarantors' obligations under the Credit Facilities are collateralized by substantially all of our and the guarantors' assets.

Additional discussion of our Credit Facilities, including amounts outstanding and applicable interest rates, is included in Note 6 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.



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### ***European Letter of Credit Facility***

As previously disclosed, our 364-day unsecured European Letter of Credit Facility ( European LOC Facility ), which has a commitment of 110.0 million, was extended beyond its September 11, 2009 expiration date through November 9, 2009. The European LOC Facility is used for contingent obligations solely in respect of surety and performance bonds, bank guarantees and similar obligations. We had outstanding letters of credit drawn on the European LOC Facility of 81.7 million (\$119.6 million) and 104.0 million (\$145.2 million) as of September 30, 2009 and December 31, 2008, respectively. We pay certain fees for the letters of credit written against the European LOC Facility based upon the ratio of our total debt to consolidated EBITDA. As of September 30, 2009, the annual fees equaled 0.875% plus a fronting fee of 0.1%. We are in the process of finalizing a comparable replacement facility.

See Note 12 to our consolidated financial statements included in our 2008 Annual Report for a discussion of covenants related to our Credit Facilities and our European LOC Facility. We complied with all covenants through September 30, 2009.

### ***Liquidity Analysis***

Ongoing effects of global financial markets and banking systems disruptions continue to make credit and capital markets difficult for companies to access, and have generally driven up the costs of newly raised debt. We continue to monitor and evaluate the implications of these factors on our current business, our customers and suppliers and the state of the global economy. While we believe that these financial market disruptions have not directly had a disproportionate adverse impact on our financial position, results of operations or liquidity, continuing disruptions in the functioning of credit and capital markets could potentially materially impair our and our customers' ability to access these markets and increase associated costs, as well as our customers' ability to pay in full and/or on a timely basis. There can be no assurance that we will not be materially adversely affected by the financial market disruptions and global economic conditions as economic events and circumstances continue to evolve.

Only 1% of our term loan is due to mature in each of 2009 and 2010. As noted above, our term loan and our revolving line of credit both mature in August 2012. After the effects of \$385.0 million of notional interest rate swaps, approximately 71% of our term debt was at fixed rates at September 30, 2009. As of September 30, 2009, we had a borrowing capacity of \$285.7 million on our \$400.0 million revolving line of credit, and we had outstanding letters of credit drawn on the European LOC Facility of 81.7 million as of September 30, 2009. Our revolving line of credit and our European LOC Facility are committed and are held by a diversified group of financial institutions.

Our cash balance decreased by \$180.8 million to \$291.2 million as of September 30, 2009 as compared with December 31, 2008. The cash draw was anticipated based on planned significant cash uses in 2009, including approximately \$115 million in long-term and broad-based annual incentive program payments related to prior period performance, \$87.1 million in capital expenditures, \$44.2 million in dividend payments, \$82.5 million in contributions to our U.S. pension plan, \$27.5 million of share repurchases and the funding of increased working capital requirements, as well as \$30.8 million for the acquisition of Calder AG. 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.

We utilize a variety of insurance carriers for a wide range of insurance coverage and continuously monitor their creditworthiness. Based on current credit ratings by industry rating experts, we currently believe that our carriers have the ability to pay on claims.

We experienced significant declines in the values of our U.S. pension plan assets in 2008 resulting primarily from declines in global equity markets, and we contributed \$82.5 million to our U.S. pension plan in 2009 to maintain our pension funding at or above the fully-funded threshold prescribed by the Employee Retirement Income Security Act of 1974, as amended. 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 more critical accounting policies used in the preparation of the consolidated financial statements were discussed in our 2008 Annual Report. These critical policies, for which no significant changes have occurred in the nine months ended

September 30, 2009, include:

Revenue Recognition;

Deferred Taxes, Tax Valuation Allowances and Tax Reserves;

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

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

### **ACCOUNTING DEVELOPMENTS**

We have presented the information about accounting 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;

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

the highly competitive nature of the markets in which we operate;

risks associated with cost overruns on fixed fee projects and in taking customer orders for large complex custom engineered products requiring sophisticated program management skills and technical expertise for completion;

the substantial dependence of our sales on the success of the petroleum, chemical, power and water industries;

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

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

our furnishing of products and services to nuclear power plant facilities;

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

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

risks associated with certain of our foreign subsidiaries conducting business operations and sales in certain countries that have been 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, and tax liabilities that could result from audits of our tax returns by regulatory authorities in various tax jurisdictions;

the potential adverse impact of an impairment in the carrying value of goodwill or other intangibles;

our dependence upon third-party suppliers whose failure to perform timely could adversely affect our business operations;

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;

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 2008 Annual Report, and may be identified in our other filings with the SEC and/or press releases from time to time. All forward-looking statements included in this document are based on information available to us on the date hereof, and we assume no obligation to update any forward-looking statement.

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

We have market risk exposure arising from changes in interest rates and foreign currency exchange rate movements. We are exposed to credit-related losses in the event of non-performance by counterparties to financial instruments, including interest rate swaps and forward exchange contracts, but we currently expect 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, 2009, after the effect of interest rate swaps, we had \$160.4 million of variable rate debt obligations outstanding under our Credit Facilities with a weighted average interest rate of 1.81%. 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 \$1.2 million for the nine months ended September 30, 2009. At both September 30, 2009 and December 31, 2008, we had \$385.0 million of notional amount in outstanding interest rate swaps with third parties with varying maturities through June 2011.

**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 gains (losses) associated with foreign currency translation of \$34.9 million and \$(105.1) million for the three months ended September 30, 2009 and 2008, respectively, and \$70.1 million and \$(70.5) million for the nine months ended September 30, 2009 and 2008, respectively, which are included in other comprehensive income (expense).

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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, 2009, we had a U.S. dollar equivalent of \$342.8 million in aggregate notional amount outstanding in forward exchange contracts with third parties, compared with \$555.7 million at December 31, 2008. Transactional currency gains and losses arising from transactions outside of our sites functional currencies and changes in fair value of certain forward exchange contracts are included in our consolidated results of operations. We recognized foreign currency net gains (losses) of \$6.6 million and \$(9.6) million for the three months ended September 30, 2009 and 2008, respectively, and \$(3.0) million and \$2.8 million for the nine months ended September 30, 2009 and 2008, respectively, which are included in other (expense) income, net in the accompanying condensed consolidated statements of income.

Based on a sensitivity analysis at September 30, 2009, a 10% change in the foreign currency exchange rates for the nine months ended September 30, 2009 would have impacted our net earnings by approximately \$32 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.

### **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, 2009. 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, 2009.

#### **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, 2009 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, 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 2008 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, should be carefully read and considered.

With the exception of the risk factors set forth below, there have been no additional material changes in the risk factors discussed in our 2008 Annual Report and subsequent SEC filings. The risks described in this Quarterly Report, our 2008 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.

***We are currently subject to pending securities class action litigation, the unfavorable outcome of which could have a material adverse effect on our financial condition, results of operations and cash flows.***

A number of putative class action lawsuits were filed against us, certain of our former officers, our independent auditors and the lead underwriters of our most recent public stock offerings, alleging securities laws violations. By orders dated November 13, 2007 and January 4, 2008, the trial court denied the plaintiffs' request for class certification and also granted summary judgment in favor of us and all other defendants on all of the plaintiffs' claims. The plaintiffs appealed both rulings to the federal Fifth Circuit Court of Appeals, and on June 19, 2009, the Fifth Circuit issued an opinion vacating the trial court's denial of class certification, reversing in part and vacating in part the trial court's entry of summary judgment, and remanding the case to the trial court for further proceedings. As a result, the case will be returned to the trial court for further consideration of certain issues, including whether the plaintiffs can demonstrate that the case should be certified as a class action.

Following the issuance of the Court of Appeals' opinion, we have engaged in discussions among the parties in furtherance of an amicable resolution of the case. These discussions have resulted in tentative settlement terms among the parties that are subject to certain contingencies that may not be resolved, and we must therefore be prepared to continue the case if no final agreement is reached due to the inability to resolve the remaining contingencies. If the litigation proceeds, we continue to strongly believe that we have valid defenses to the claims asserted, and we will continue to vigorously defend this case. Under these circumstances, we cannot determine with certainty the outcome or resolution of the plaintiff's claims or the timing for their resolution. In addition to the significant expense and burden we could then incur in further defending this litigation and any damages that we could suffer, our management's attention and resources could then be further diverted from ordinary business operations in order to address these claims. If the final resolution of this litigation is then unfavorable to us and our existing insurance coverage is either unavailable or inadequate to resolve the matter, our financial condition, results of operations and cash flows could be materially adversely affected.

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



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. 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. During the quarter ended September 30, 2009, we repurchased a total of 131,500 shares of our common stock under the program for approximately \$11.3 million (representing an average cost of \$86.49 per share). Since the adoption of this program, we have repurchased a total of 2,154,100 shares of our common stock under the program for \$192.5 million (representing an average cost of \$89.35 per share). We

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may repurchase up to an additional \$107.5 million of our common stock under the stock repurchase program. The following table sets forth the repurchase data for each of the three months during the quarter ended September 30, 2009:

<b>Period</b>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plan</b>	<b>Maximum Number of Shares (or Approximate Dollar Value) That May Yet Be Purchased Under the Plan (in millions)</b>
July 1 - 31	65(1)	\$ 73.00		\$ 118.8
August 1 - 31	133,094(2)	86.47	131,500	107.5
September 1 - 30	91(3)	97.85		107.5
Total	133,250	\$ 86.47	131,500	

(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 \$73.00.

(2) Includes 59 shares that were tendered by employees to satisfy minimum tax withholding amounts for restricted stock awards at an average price

per share of  
\$87.34, and  
includes 1,535  
shares  
purchased at a  
price of \$85.35  
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) Represents  
shares that were  
tendered by  
employees to  
satisfy  
minimum tax  
withholding  
amounts for  
restricted stock  
awards at an  
average price  
per share of  
\$97.85.

**Item 3. Defaults Upon Senior Securities.**

None.

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

None.

**Item 5. Other Information.**

None.

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**Item 6. Exhibits.**

Exhibit No.	Description
3.1	Restated Certificate of Incorporation of Flowserve Corporation (incorporated by reference to Exhibit 3(i) to the Registrant's Current Report on Form 8-K/A dated August 16, 2006).
3.2	Flowserve Corporation By-Laws, as amended and restated on August 31, 2009 (incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K dated August 31, 2009).
10.1	Letter Agreement, dated August 31, 2009, between Mark A. Blinn and Flowserve Corporation (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated August 31, 2009).
10.2	Letter Agreement, dated August 31, 2009, between Lewis M. Kling and Flowserve Corporation (incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K dated August 31, 2009).
10.3	Second Amendment to Letter of Credit Agreement, dated as of September 9, 2009 among Flowserve Corporation, Flowserve B.V. and other subsidiaries of the Company party thereto, ABN AMRO Bank, N.V., as Administrative Agent and an Issuing Bank, and the other financial institutions party thereto (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated September 11, 2009).
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
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101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document

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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 28, 2009

/s/ Mark A. Blinn  
Mark A. Blinn  
President, Chief Executive Officer and Director

Date: October 28, 2009

/s/ Richard J. Guiltinan, Jr.  
Richard J. Guiltinan, Jr.  
Vice President Finance and Chief Accounting  
Officer

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**Exhibits Index**

Exhibit No.	Description
3.1	Restated Certificate of Incorporation of Flowserve Corporation (incorporated by reference to Exhibit 3(i) to the Registrant's Current Report on Form 8-K/A dated August 16, 2006).
3.2	Flowserve Corporation By-Laws, as amended and restated on August 31, 2009 (incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K dated August 31, 2009).
10.1	Letter Agreement, dated August 31, 2009, between Mark A. Blinn and Flowserve Corporation (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K dated August 31, 2009).
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