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GARDNER DENVER INC  
Form 10-Q  
November 12, 2003

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2003

OR

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

Commission File Number 1-13215

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

DELAWARE

76-0419383

(State or Other Jurisdiction of  
Incorporation or Organization)

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

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

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

Indicate by check mark whether the registrant (1) has filed all  
reports required to be filed by Section 13 or 15(d) of the  
Securities Exchange Act of 1934 during the preceding 12 months (or  
for such shorter period that the registrant was required to file  
such reports), and (2) has been subject to such filing requirement  
for the past 90 days.

Yes        X        No  
-----

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

Yes        X        No  
-----

Number of shares outstanding of the issuer's Common Stock, par  
value \$.01 per share, as of October 27, 2003: 16,098,426 shares.

=====

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PART I  
FINANCIAL INFORMATION

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

|  | THREE MONTHS ENDED<br>SEPTEMBER 30, |           | NINE<br>SEP |
|--|-------------------------------------|-----------|-------------|
|  | 2003                                | 2002      | 2003        |
| Revenues   | \$112,061                           | \$102,791 | \$322,940   |
| Costs and Expenses:  |                                     |           |             |
| Cost of sales (excluding depreciation<br>and amortization) | 78,198                              | 70,261    | 225,123     |
| Depreciation and amortization                              | 3,740                               | 3,718     | 11,053      |
| Selling and administrative expenses                        | 21,063                              | 19,897    | 62,421      |
| Interest expense   | 1,070                               | 1,566     | 3,411       |
| Other expense (income), net                                | 230                                 | 32        | 133         |
| Income before income taxes                                 | 7,760                               | 7,317     | 20,799      |
| Provision for income taxes                                 | 2,483                               | 2,488     | 6,656       |
| Net income   | \$ 5,277                            | \$ 4,829  | \$ 14,143   |
| Basic earnings per share                                   | \$ 0.33                             | \$ 0.30   | \$ 0.88     |
| Diluted earnings per share                                 | \$ 0.32                             | \$ 0.30   | \$ 0.87     |

The accompanying notes are an integral part of this statement.

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

|                 | (UNAUDITED)<br>SEPTEMBER 30,<br>2003 | DECEMBE<br>200 |
|-----------------|--------------------------------------|----------------|
| ASSETS          |                                      |                |
| Current assets: |                                      |                |

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|  |           |        |
|--|-----------|--------|
| Cash and equivalents   | \$ 24,623 | \$ 25, |
| Receivables, net   | 78,257    | 74,    |
| Inventories, net   | 70,351    | 67,    |
| Deferred income taxes  | 5,812     | 5,     |
| Other  | 3,493     | 4,     |
|  | -----     | -----  |
| Total current assets   | 182,536   | 177,   |
|  | -----     | -----  |
| Property, plant and equipment, net   | 75,750    | 76,    |
| Goodwill   | 203,927   | 201,   |
| Other intangibles, net   | 9,461     | 9,     |
| Deferred income taxes  | --        | 3,     |
| Other assets   | 4,282     | 3,     |
|  | -----     | -----  |
| Total assets   | \$475,956 | \$472, |
|  | =====     | =====  |
| LIABILITIES AND STOCKHOLDERS' EQUITY   |           |        |
| Current liabilities:   |           |        |
| Short-term borrowings and current maturities<br>of long-term debt  | \$ 13,750 | \$ 7,  |
| Accounts payable and accrued liabilities   | 65,747    | 70,    |
|  | -----     | -----  |
| Total current liabilities  | 79,497    | 77,    |
|  | -----     | -----  |
| Long-term debt, less current maturities  | 88,514    | 112,   |
| Postretirement benefits other than pensions  | 32,750    | 34,    |
| Deferred income taxes  | 518       |        |
| Other long-term liabilities  | 28,050    | 24,    |
|  | -----     | -----  |
| Total liabilities  | 229,329   | 249,   |
|  | -----     | -----  |
| Stockholders' equity:  |           |        |
| Common stock, \$0.01 par value; 50,000 shares<br>authorized; 16,094 shares issued and<br>outstanding at September 30, 2003 | 178       |        |
| Capital in excess of par value   | 173,906   | 171,   |
| Treasury stock at cost, 1,720 shares at<br>September 30, 2003  | (25,909)  | (25,   |
| Retained earnings  | 95,807    | 81,    |
| Accumulated other comprehensive income (loss)  | 2,645     | (4,    |
|  | -----     | -----  |
| Total stockholders' equity   | 246,627   | 222,   |
|  | -----     | -----  |
| Total liabilities and stockholders' equity   | \$475,956 | \$472, |
|  | =====     | =====  |

The accompanying notes are an integral part of this statement.

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GARDNER DENVER, INC.  
CONSOLIDATED STATEMENT OF CASH FLOWS

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(in thousands)  
(Unaudited)

|   | NINE MONTHS ENDED<br>SEPTEMBER 30, |         |
|---|------------------------------------|---------|
|   | 2003                               | 2002    |
| Cash flows from operating activities:   |                                    |         |
| Net income  | \$ 14,143                          | \$ 14,9 |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                    |         |
| Depreciation and amortization   | 11,053                             | 10,8    |
| Net gain on asset dispositions  | (359)                              | (       |
| Stock issued for employee benefit plans   | 1,904                              | 1,6     |
| Deferred income taxes   | 4,189                              | 2       |
| Changes in assets and liabilities:  |                                    |         |
| Receivables   | (2,518)                            | 9,0     |
| Inventories   | (543)                              | 3,9     |
| Accounts payable and accrued liabilities  | (5,568)                            | (13,2   |
| Other assets and liabilities, net   | 1,432                              | (       |
| Net cash provided by operating activities   | 23,733                             | 27,3    |
| Cash flows from investing activities:   |                                    |         |
| Capital expenditures  | (8,194)                            | (7,4    |
| Business acquisitions, net of cash acquired                                       | (2,402)                            | (       |
| Disposals of property, plant and equipment  | 940                                | 1       |
| Other   | --                                 | --      |
| Net cash used in investing activities   | (9,656)                            | (7,3    |
| Cash flows from financing activities:   |                                    |         |
| Principal payments on long-term debt  | (44,899)                           | (48,8   |
| Proceeds from long-term debt  | 27,000                             | 12,0    |
| Proceeds from stock options   | 956                                | 2,2     |
| Purchase of treasury stock  | (90)                               | (2      |
| Other   | (2)                                | (7      |
| Net cash used in financing activities   | (17,035)                           | (35,4   |
| Effect of exchange rate changes on cash and equivalents                           | 1,914                              | 1,6     |
| Decrease in cash and equivalents  | (1,044)                            | (13,7   |
| Cash and equivalents, beginning of period   | 25,667                             | 29,9    |
| Cash and equivalents, end of period   | \$ 24,623                          | \$ 16,1 |

The accompanying notes are an integral part of this statement.

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

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES.

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

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

These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto incorporated by reference in Gardner Denver's Annual Report on Form 10-K for the year ended December 31, 2002.

The results of operations for the three and nine months ended September 30, 2003 are not necessarily indicative of the results to be expected for the full year.

Certain prior year amounts have been reclassified to conform with current year presentation.

NOTE 2. STOCK-BASED COMPENSATION PLANS.

As allowed under Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation," the Company measures its compensation cost of equity instruments issued under employee compensation plans using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. Stock options granted during the three and nine months ended September 30, 2003 and 2002 were exercisable at prices equal to the fair market value of the Company's common stock on the dates the options were granted; accordingly, no compensation expense has been recognized. If the Company had accounted for stock-based compensation using the fair value recognition provisions of SFAS No. 123 and related amendments, net income and basic and diluted earnings per share would have been as follows:

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|  | THREE MONTHS<br>ENDED<br>SEPTEMBER 30, |          |      |
|--|--|----------|------|
|  | 2003                                   | 2002     |      |
| Net income, as reported  | \$ 5,277                               | \$ 4,829 | \$14 |
| Less: Total stock-based employee compensation expense determined under fair value method, net of related tax effects | 292                                    | 332      |      |
| Pro forma net income   | \$ 4,985                               | \$ 4,497 | \$13 |
| Basic earnings per share, as reported  | \$ 0.33                                | \$ 0.30  | \$   |
| Basic earnings per share, pro forma  | \$ 0.31                                | \$ 0.28  | \$   |
| Diluted earnings per share, as reported  | \$ 0.32                                | \$ 0.30  | \$   |
| Diluted earnings per share, pro forma  | \$ 0.30                                | \$ 0.28  | \$   |

Compensation costs charged against income (net of tax) for restricted stock issued under the Company's Incentive Plan totaled \$0.2 million in the nine months ended September 30, 2003.

NOTE 3. INVENTORIES.

|  | SEPTEMBER 30,<br>2003 | DECEMBER 31,<br>2002 |
|--|-----------------------|----------------------|
| Raw materials, including parts and subassemblies | \$ 35,522             | \$ 35,675            |
| Work-in-process                                  | 10,593                | 9,077                |
| Finished goods                                   | 26,750                | 25,355               |
| Perishable tooling and supplies                  | 2,456                 | 2,456                |
|  | 75,321                | 72,563               |
| Excess of current costs over LIFO costs          | (4,970)               | (5,115)              |
| Inventories, net                                 | \$ 70,351             | \$ 67,448            |

NOTE 4. GOODWILL AND OTHER INTANGIBLE ASSETS.

The changes in the carrying amount of goodwill attributable to each business segment for the nine months ended September 30, 2003, are as follows:

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|                                  | COMPRESSED<br>AIR PRODUCTS<br>----- |
|----------------------------------|-------------------------------------|
| Balance as of December 31, 2002  | \$176,230                           |
| Goodwill acquired during year    | --                                  |
| Foreign currency translation     | 2,053                               |
|                                  | -----                               |
| Balance as of September 30, 2003 | \$178,283<br>=====                  |

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Other intangible assets at September 30, 2003 consisted of the following:

|                                | GROSS CARRYING<br>AMOUNT<br>----- |
|--------------------------------|-----------------------------------|
| Amortized intangible assets:   |                                   |
| Acquired technology            | \$12,209                          |
| Other                          | 4,234                             |
| Unamortized intangible assets: |                                   |
| Trademarks                     | 3,057                             |
|                                | -----                             |
| Total other intangible assets  | \$19,500<br>=====                 |

Amortization of intangible assets for the nine months ended September 30, 2003, was \$1.1 million. Amortization of intangible assets is anticipated to be approximately \$1.5 to \$2.0 million per year for 2003 through 2007.

NOTE 5. ACCRUED PRODUCT WARRANTY.

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

|                                | THREE MONTHS ENDED<br>SEPTEMBER 30, 2003<br>----- |
|--------------------------------|---|
| Balance at beginning of period | \$ 6,695  |
| Product warranty accruals      | 1,589   |
| Settlements                    | (1,812)   |
| Other                          | 41  |
|                                | -----   |
| Balance at end of period       | \$ 6,513<br>=====                                 |

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NOTE 6. EARNINGS PER SHARE.

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

|  | THREE MONTHS ENDED<br>SEPTEMBER 30, |          | NINE MONTHS ENDED<br>SEPTEMBER 30, |
|--|-------------------------------------|----------|------------------------------------|
|  | 2003                                | 2002     | 2003                               |
| Basic EPS:   |                                     |          |                                    |
| Net income   | \$ 5,277                            | \$ 4,829 | \$ 14,143                          |
| Shares:  |                                     |          |                                    |
| Weighted average number of common shares outstanding | 16,079                              | 15,887   | 16,047                             |
| Basic earnings per common share                      | \$ 0.33                             | \$ 0.30  | \$ 0.88                            |

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|  | THREE MONTHS ENDED<br>SEPTEMBER 30, |          | NINE MONTHS ENDED<br>SEPTEMBER 30, |
|--|-------------------------------------|----------|------------------------------------|
|  | 2003                                | 2002     | 2003                               |
| Diluted EPS:   |                                     |          |                                    |
| Net income   | \$ 5,277                            | \$ 4,829 | \$ 14,143                          |
| Shares:  |                                     |          |                                    |
| Weighted average number of common shares outstanding                 | 16,079                              | 15,887   | 16,047                             |
| Assuming conversion of dilutive stock options issued and outstanding | 314                                 | 151      | 222                                |
| Weighted average number of common shares outstanding, as adjusted    | 16,393                              | 16,038   | 16,269                             |
| Diluted earnings per common share                                    | \$ 0.32                             | \$ 0.30  | \$ 0.87                            |

NOTE 7. COMPREHENSIVE INCOME.

For the three months ended September 30, 2003 and 2002, comprehensive income



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was \$6.3 million and \$5.5 million, respectively. For the nine months ended September 30, 2003 and 2002, comprehensive income was \$20.9 million and \$20.1 million, respectively. Items impacting the Company's comprehensive income, but not included in net income, consist of foreign currency translation adjustments.

### NOTE 8. CASH FLOW INFORMATION.

In the first nine months of 2003 and 2002, the Company paid \$2.8 million and \$5.3 million, respectively, to the various taxing authorities for income taxes. Interest paid for the first nine months of 2003 and 2002, was \$3.6 million and \$5.4 million, respectively.

### NOTE 9. CONTINGENCIES.

The Company is a party to various other legal proceedings, lawsuits and administrative actions, which are of an ordinary or routine nature. Due to the bankruptcies of several asbestos manufacturers and other primary defendants, the Company has been named as a defendant in an increasing number of asbestos personal injury lawsuits. We have also been named as a defendant in an increasing number of silicosis personal injury lawsuits. The plaintiffs in these suits allege exposure to asbestos or silica from multiple sources, and typically the Company is one of approximately 25 or more named defendants. In our experience, the substantial majority of the plaintiffs have not been physically impaired by the alleged exposure.

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

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

The Company has entered into a series of cost sharing agreements with multiple insurance companies to secure coverage for asbestos and silicosis lawsuits. The Company also believes some of the potential liabilities regarding these lawsuits are covered by indemnity agreements with other parties. The Company's uninsured settlement payments for past asbestos and silicosis lawsuits have been immaterial. The Company believes that the pending, and future, asbestos and silicosis lawsuits will not, in the aggregate, have a material adverse effect on its consolidated financial position, results of operations or liquidity, based on: the Company's anticipated insurance and indemnification rights to address the risks of such matters; the limited potential asbestos exposure from the components described above; the fact that the substantial majority of plaintiffs are not impaired with a disease; various potential defenses available to the Company with respect to such matters; and the Company's prior disposition of comparable matters.

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However, because future developments could cause a different outcome, there can be no assurance that the resolution of pending or future lawsuits, whether by judgment, settlement or dismissal, will not have a material adverse effect on our consolidated financial position, results of operation or liquidity.

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

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NOTE 10. SEGMENT INFORMATION.

|                             | THREE MONTHS ENDED<br>SEPTEMBER 30, |            | NINE MONTHS ENDED<br>SEPTEMBER 30, |            |
|-----------------------------|-------------------------------------|------------|------------------------------------|------------|
|                             | 2003                                | 2002       | 2003                               | 2002       |
| Revenues:                   |                                     |            |                                    |            |
| Compressed Air Products     | \$ 91,554                           | \$ 85,496  | \$ 271,183                         | \$ 256,757 |
| Pump Products               | 20,507                              | 17,295     | 51,757                             | 48,757     |
| Total                       | \$ 112,061                          | \$ 102,791 | \$ 322,940                         | \$ 305,514 |
| Operating Earnings:         |                                     |            |                                    |            |
| Compressed Air Products     | \$ 7,089                            | \$ 7,375   | \$ 21,364                          | \$ 21,364  |
| Pump Products               | 1,971                               | 1,540      | 2,979                              | 2,979      |
| Total                       | 9,060                               | 8,915      | 24,343                             | 24,343     |
| Interest expense            | 1,070                               | 1,566      | 3,411                              | 3,411      |
| Other expense (income), net | 230                                 | 32         | 133                                | 133        |
| Income before income taxes  | \$ 7,760                            | \$ 7,317   | \$ 20,799                          | \$ 20,799  |

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

RESULTS OF OPERATIONS.

PERFORMANCE IN THE QUARTER ENDED SEPTEMBER 30, 2003 COMPARED WITH THE QUARTER ENDED SEPTEMBER 30, 2002

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### Revenues

Revenues increased \$9.3 million to \$112.1 million for the three months ended September 30, 2003, compared to \$102.8 million in the same period of 2002 due to increased order activity in both reportable segments and changes in currency exchange rates.

For the three months ended September 30, 2003, revenues for the Compressed Air Products segment increased \$6.1 million (7%) to \$91.6 million, compared to the same period of 2002. Revenues in this segment increased \$3.1 million (4%) primarily due to improved orders for industrial products, particularly from Europe and Asia and \$3.0 million (3%) from changes in currency exchange rates. Pump Products segment revenues increased \$3.2 million (19%) to \$20.5 million for the three months ended September 30, 2003, compared to the same period of 2002, primarily as a result of increased demand for well stimulation pumps and petroleum pump parts.

### Costs and Expenses

Gross margin (defined as sales less cost of sales excluding depreciation and amortization) for the three months ended September 30, 2003 increased \$1.3 million (4%) to \$33.9 million compared to the same period of 2002. Gross margin as a percentage of revenues (gross margin percentage) decreased to 30.2% in the three-month period of 2003 from 31.6% in the same period of 2002. The decrease in gross margin percentage was principally attributable to unfavorable sales mix (including lower centrifugal blower and drilling pump sales and higher compressor package sales) combined with higher warranty expense (due to unusually low warranty expense in the third quarter of 2002, as a result of favorable claims experience). These negative factors were partially offset by cost reduction efforts, including continued acquisition integration.

Selling and administrative expenses increased in the three-month period of 2003 by 6% to \$21.1 million from \$19.9 million in the same period of 2002. Selling and administrative expenses increased 3% primarily due to higher compensation and fringe benefit expense and 3% due to changes in currency exchange rates. Selling and administrative expenses as a percentage of revenues decreased to 18.8% for the three-month period of 2003 compared to 19.4% in 2002 primarily as a result of the increase in revenues.

The Compressed Air Products segment generated operating margins (defined as revenues, less cost of sales, depreciation and amortization, and selling and administrative expenses) of 7.7% for the three-month period ended September 30, 2003, a decrease from 8.6% for the same period of 2002. This decrease was primarily attributable to the higher warranty, compensation and fringe benefit expense discussed above. These negative factors were partially offset by cost reductions, including continued acquisition integration, combined with revenue and operating margin improvement on compressor packages.

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The Pump Products segment generated operating margins of 9.6% of revenues for the three-month period ended September 30, 2003, compared to an operating margin of 8.9% for the same period in 2002. This increase was primarily attributable to the positive impact of increased leverage of the segment's fixed and semi-fixed costs over a higher revenue base.

Interest expense decreased \$0.5 million (32%) to \$1.1 million for the three

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months ended September 30, 2003, compared to \$1.6 million for the same period of 2002 due to lower average borrowings and interest rates. The average interest rate for the three-month period of 2003 was 4.0% compared to 4.6% in the prior year period.

Other expense, net increased \$0.2 million compared to the prior year period primarily due to lower interest income and higher foreign currency transaction losses generated from U.S. dollar denominated balances of foreign subsidiaries in 2003.

Income before income taxes increased \$0.4 million (6%) to \$7.8 million for the three months ended September 30, 2003, compared to the same period of 2002. This increase was primarily the result of the positive impact of increased leverage of the Pump Products segment's fixed and semi-fixed costs over a higher revenue base, cost reduction efforts (including continued acquisition integration), lower interest expense and changes in currency exchange rates. These positive factors were partially offset by the negative factors driving the changes in the Compressed Air Products segment operating margins and other expense as discussed above.

The provision for income taxes was \$2.5 million in both three-month periods, as higher income before taxes was offset by a lower overall effective tax rate. The Company's effective tax rate for the three months ended September 30, 2003 decreased to 32.0%, compared to 34.0% in the prior year period, principally as a result of a higher proportion of Extraterritorial Income Exclusion (EIE) benefit from U.S. export sales relative to pretax income.

Net income for the three months ended September 30, 2003 increased \$0.4 million (9%) to \$5.3 million (\$0.32 diluted earnings per share), compared to \$4.8 million (\$0.30 diluted earnings per share) for the same period of 2002. This increase in net income was primarily attributable to the same factors that resulted in increased income before taxes noted above combined with a lower effective tax rate in 2003. Changes in currency exchange rates increased net income by approximately \$0.2 million in the three months ended September 30, 2003 compared to the prior year period.

### PERFORMANCE IN THE NINE MONTHS ENDED SEPTEMBER 30, 2003 COMPARED WITH THE NINE MONTHS ENDED SEPTEMBER 30, 2002

#### Revenues

Revenues increased \$8.7 million to \$322.9 million for the nine months ended September 30, 2003, compared to the same period of 2002 primarily due to changes in currency exchange rates.

For the nine months ended September 30, 2003, revenues for the Compressed Air Products segment increased \$7.9 million (3%) to \$271.2 million, compared to the same period of 2002. Revenues in this segment increased approximately 5% due to changes in currency exchange rates. Excluding the impact of changes in currency exchange rates, revenues in this segment decreased approximately 2% due to softer industrial economic conditions in the U.S. and Europe, which was partially offset by incremental demand of compressor packages used in PET bottle

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blowing applications. Pump Products segment revenues increased \$0.8 million (1%) to \$51.8 million for the nine months ended September 30, 2003, compared to the same period of 2002. This increase is primarily attributable to

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higher shipments of well stimulation pumps and petroleum pump parts and was partially offset by lower drilling pump sales. In 2002, Pump Products segment revenues were primarily supported by drilling pump backlog carried over from 2001 orders.

### Costs and Expenses

Atchison Casting Corporation, the Company's largest supplier of iron castings in 2002, downsized and subsequently closed its LaGrange, Missouri foundry ("LaGrange Foundry") in the second half of 2002. As a result, the Company implemented its previously developed contingency plan to secure alternate supply sources. The Company does not anticipate that the closure of the LaGrange Foundry will materially impact its long-term financial performance. However, there was a negative impact (estimated at \$0.04-\$0.05 diluted earnings per share) on the Company's financial performance during the first nine months of 2003, as additional costs were incurred to expedite castings from new suppliers and accelerate depreciation expense of pattern modification charges from alternate casting suppliers who are no longer servicing the Company.

The most significant aspects of the changes related to the LaGrange Foundry closure have been completed and the Company expects to benefit going forward from reduced material costs from alternate suppliers. At the same time, the Company anticipates that it will need to address some lingering problems over the balance of the year as it re-balances its casting supply chain while dealing with suppliers that are experiencing lower volumes, high fixed cost structures and increased competitive pressures.

Gross margin for the nine months ended September 30, 2003 decreased \$0.3 million to \$97.8 million compared to the same period of 2002. The gross margin percentage decreased to 30.3% in the nine-month period of 2003 from 31.2% in the same period of 2002. This decrease in the gross margin percentage was principally attributable to unfavorable sales mix (including lower drilling pump and centrifugal blower sales and higher compressor package sales) and costs associated with the disruption in the Company's casting supply chain. These negative factors were partially offset by cost reduction efforts, including continued acquisition integration efforts.

Selling and administrative expenses increased in the nine-month period of 2003 by 4% to \$62.4 million from \$60.2 million in the same period of 2002 primarily due to changes in foreign currency exchange rates. Excluding the impact of foreign currency exchange rate changes, selling and administrative expenses decreased approximately \$0.2 million due to cost reductions, including continued acquisition integration efforts. These cost reductions were partially offset by higher compensation expense, sales commissions, fringe benefit and legal costs. Selling and administrative expenses as a percentage of revenues increased to 19.3% for the nine-month period of 2003 compared to 19.1% in 2002 primarily as a result of the factors discussed above which were partially offset by the impact of higher revenues.

The Compressed Air Products segment generated operating margins of 7.9% for the nine-month period ended September 30, 2003, a decrease from 8.9% for the same period of 2002. This decrease was primarily attributable to higher warranty, compensation and fringe benefit expense combined with costs associated with the disruption within the Company's casting supply chain. These negative factors were partially offset by cost reductions, including continued acquisition

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integration efforts, combined with revenue and operating margin improvement from compressor packages used in PET bottle blowing applications.

The Pump Products segment generated operating margins of 5.8% of revenues for the nine-month period ended September 30, 2003, compared to an operating margin of 7.0% for the same period in 2002. This decrease was primarily attributable to a less favorable sales mix, which included a lower percentage of revenues from drilling pumps, which carry higher margins than other pump products. This negative factor was partially offset by lower warranty expense.

Interest expense decreased \$1.6 million (31%) to \$3.4 million for the nine months ended September 30, 2003, compared to \$5.0 million for the same period of 2002 due to lower average borrowings and interest rates. The average interest rate for the nine-month period of 2003 was 4.1% compared to 4.4% in the prior year period.

Other expense, net increased \$0.7 million compared to the prior year period primarily due to lower interest income and higher foreign currency transaction losses generated from U.S. dollar denominated balances of foreign subsidiaries in 2003. These negative factors were partially offset by a \$0.4 million (pretax) gain on the sale of an idle manufacturing facility in Syracuse, New York in the second quarter of 2003.

Income before income taxes decreased \$1.8 million (8%) to \$20.8 million for the nine months ended September 30, 2003, compared to the same period of 2002. This decrease was primarily the result of the factors driving the changes in segment operating margins and other expense noted above. These negative factors were partially offset by cost reductions, including continued acquisition integration efforts, changes in currency exchange rates and lower interest expense.

The provision for income taxes decreased by \$1.0 million (13%) to \$6.7 million for the nine-month period of 2003, compared to \$7.7 million in 2002, as a result of the lower income before taxes and a lower overall effective tax rate. The Company's effective tax rate for the nine months ended September 30, 2003 decreased to 32.0%, compared to 34.0% in the prior year period, principally as a result of a higher proportion of Extraterritorial Income Exclusion (EIE) benefit from U.S. export sales relative to pretax income.

Net income for the nine months ended September 30, 2003 decreased \$0.8 million (5%) to \$14.1 million (\$0.87 diluted earnings per share), compared to \$14.9 million (\$0.93 diluted earnings per share) for the same period of 2002. This decrease in net income was primarily attributable to the same factors that resulted in decreased income before taxes discussed above partially offset by a lower effective tax rate in 2003. Changes in currency exchange rates increased net income by approximately \$0.7 million in the nine months ended September 30, 2003 compared to the prior year period.

### Outlook

In general, demand for compressed air products correlates to the rate of manufacturing capacity utilization and the rate of change of industrial production because compressed air is often used as a fourth utility in the manufacturing process. Over longer time periods, demand also follows the economic growth patterns indicated by the rates of change in the Gross Domestic Product. In the third quarter of 2003, orders for compressed air products were \$90.3 million, compared to \$80.7 million in the same period of 2002. For the first nine months of 2003, orders for compressed air products were \$265.1 million compared to \$259.9 million in the same period of 2002.

Order

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backlog for the Compressed Air Products segment was \$56.5 million as of September 30, 2003, compared to \$56.9 million as of September 30, 2002. The favorable impact of changes in currency exchange rates was approximately \$12.1 million and \$1.7 million and for compressed air products orders and backlog, respectively, as of and for the nine months ended September 30, 2003. Excluding this impact, the decrease in orders and backlog compared to the prior year is primarily due to softer U.S. and European industrial economies.

Demand for pump products, which are primarily petroleum related, has historically corresponded to market conditions and expectations for oil and natural gas prices. Orders for pump products were \$18.9 million in the third quarter of 2003 compared to \$14.5 million in the same period of 2002. For the first nine months of 2003, pump product orders were \$53.4 million compared to \$40.7 million in the same period of 2002. The increase in orders can primarily be attributed to increasing demand for well stimulation pumps and petroleum pump parts. Compared to September 30, 2002, backlog for this business segment decreased \$1.6 million to \$8.7 million on September 30, 2003, primarily due to the significant drilling pump backlog in the third quarter of 2002, which was carried over from 2001 orders.

During the fourth quarter of 2003, the Company announced and initiated restructuring plans to eliminate redundant manufacturing capacity, streamline operations and reduce costs. These activities represent further integration of previously completed acquisitions, which the Company expects will better leverage existing manufacturing facilities. As a result of the restructuring, the Company expects to realize a net reduction in headcount of approximately 80 personnel (approximately 4% of its current workforce) by 2005. The Company also announced a detailed inventory reduction plan and its intent to establish a compressor packaging and assembly operation in China. The Company estimates the aggregate financial impact of these programs (restructuring plans, inventory reduction plan and China operations establishment) will be a reduction in diluted earnings per share of approximately \$0.10 to \$0.12 in the fourth quarter of 2003. Based upon the above and the current economic environment and activity levels in both reporting segments, the Company anticipates that diluted earnings per share will be approximately \$0.22 to \$0.26 for the fourth quarter of 2003. Diluted earnings per share is expected to be approximately \$1.09 to \$1.13 for the year, which is within the range of the Company's previous guidance after adjustment for the programs discussed above.

#### LIQUIDITY AND CAPITAL RESOURCES

##### Operating Working Capital

During the nine months ended September 30, 2003, operating working capital (defined as receivables plus inventories, less accounts payable and accrued liabilities) increased \$11.1 million due to higher receivables and inventories and lower accounts payable and accrued liabilities. Additions to inventory resulted primarily from positioning long lead-time orders in backlog and changes in currency exchange rates. The increase in receivables is primarily due to timing of shipments and changes in currency exchange rates. The lower accounts payable and accrued liabilities are primarily due to timing of payments and were partially offset by changes in currency exchange rates.

#### Cash Flows

During the first nine months of 2003, the Company generated cash flows from operating activities totaling \$23.7 million, compared to \$27.4 million in the prior year period. This unfavorable comparison is primarily due to an increase in operating working capital and lower net income in 2003, as discussed above. During the first nine months of 2003, cash from operating activities supported the Company's ability to invest in capital expenditures (\$8.2 million), reduce total debt (\$17.9 million) and acquire a small machine shop in Odessa, Texas (\$2.4 million). The cash flows provided by operating activities and used in investing and financing activities, combined with the effect of changes in currency exchange rates, resulted in a net cash decrease of \$1.0 million for the first nine months of 2003.

#### Capital Expenditures and Commitments

Capital projects designed to increase operating efficiency and flexibility, expand production capacity and increase product quality resulted in expenditures of \$8.2 million in the first nine months of 2003. This was \$0.7 million higher than the level of capital expenditures in the comparable period in 2002, primarily due to the timing of capital projects. Commitments for capital expenditures at September 30, 2003 approximated \$10 million. Capital expenditures related to environmental projects have not been significant in the past and are not expected to be significant in the foreseeable future.

In October 1998, the Company's Board of Directors authorized the repurchase of up to 1,600,000 shares of the Company's common stock to be used for general corporate purposes. Approximately 200,000 shares remain available for repurchase under this program. The Company has also established a Stock Repurchase Program for its executive officers to provide a means for them to sell Gardner Denver common stock and obtain sufficient funds to meet tax obligations which arise from the exercise or vesting of incentive stock options, restricted stock or performance shares. The Board has authorized up to 400,000 shares for repurchase under this program and, of this amount, approximately 200,000 shares remain available for repurchase. No shares were repurchased under these repurchase programs during 2002 or 2003. As of September 30, 2003, a total of 1,572,542 shares have been repurchased at a cost of \$22.8 million under both repurchase programs. During the nine months ended September 30, 2003, the Company also acquired 3,983 shares of its common stock, valued at \$0.1 million, which were tendered for the exercise of stock options.

#### Liquidity

The Company's amended and restated Revolving Line of Credit Agreement (the "Credit Line") has a borrowing capacity of \$150.0 million and matures on March 6, 2005. Subject to approval by lenders holding more than 75% of the debt, the Company may request up to two, one-year extensions. The total debt balance will be due upon final maturity. On September 30, 2003, the Credit Line had an outstanding principal balance of \$33.0 million, leaving \$117.0 million available for future use or for letters of credit, subject to the terms of the Credit Line.

The Credit Line also provided for an additional \$50 million Term Loan which



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was used to retire debt outstanding under a previous interim credit agreement. The five-year Term Loan requires principal payments of \$2.5 million in years one and two, and \$15.0 million in years three through five. On September 30, 2003, the Term Loan had an outstanding principal balance of \$46.3 million.

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

On September 24, 2003, the Company filed with the Securities and Exchange Commission ("SEC") a shelf registration statement regarding \$150 million of its securities. The registration statement has since been declared effective by the SEC and allows the Company to complete one or more offerings of its common stock, preferred stock, debt securities or warrants. The Company intends to use the net proceeds from any offering for acquisitions, capital expenditures, repayment of borrowings, working capital and other general corporate purposes.

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

### CONTINGENCIES

The Company is a party to various other legal proceedings, lawsuits and administrative actions, which are of an ordinary or routine nature. Due to the bankruptcies of several asbestos manufacturers and other primary defendants, the Company has been named as a defendant in an increasing number of asbestos personal injury lawsuits. We have also been named as a defendant in an increasing number of silicosis personal injury lawsuits. The plaintiffs in these suits allege exposure to asbestos or silica from multiple sources, and typically the Company is one of approximately 25 or more named defendants. In our experience, the substantial majority of the plaintiffs have not been physically impaired by the alleged exposure.

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

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

The Company has entered into a series of cost sharing agreements with multiple insurance companies to secure coverage for asbestos and silicosis lawsuits. The Company also believes some of the potential liabilities

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regarding these lawsuits are covered by indemnity agreements with other parties. The Company's uninsured settlement payments for past asbestos and silicosis lawsuits have been immaterial.

The Company believes that the pending, and future, asbestos and silicosis lawsuits will not, in the aggregate, have a material adverse effect on its consolidated financial position, results of operations or liquidity, based on: the Company's anticipated insurance and indemnification rights

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to address the risks of such matters; the limited potential asbestos exposure from the components described above; the fact that the substantial majority of plaintiffs are not impaired with a disease; various potential defenses available to the Company with respect to such matters; and the Company's prior disposition of comparable matters.

However, because future developments could cause a different outcome, there can be no assurance that the resolution of pending or future lawsuits, whether by judgment, settlement or dismissal, will not have a material adverse effect on our consolidated financial position, results of operation or liquidity.

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

### CRITICAL ACCOUNTING POLICIES

Management has evaluated the accounting policies used in the preparation of the Company's financial statements and related notes and believes those policies to be reasonable and appropriate. Certain of these accounting policies require the application of significant judgment by management in selecting appropriate assumptions for calculation of financial estimates. By their nature, these judgments are subject to an inherent degree of uncertainty. These judgments are based on historical experience, trends in the industry, information provided by customers and information available from other outside sources, as appropriate. The most significant areas involving management judgments and estimates may be found in our 2002 Annual Report on Form 10-K, filed on March 26, 2003, in the Critical Accounting Policies Section of Management's Discussion and Analysis and in Note 1 to the Consolidated Financial Statements contained in our 2002 Annual Report to Stockholders filed as Exhibit 13.0 thereto.

### CAUTIONARY STATEMENTS REGARDING FORWARD-LOOKING STATEMENTS

All of the statements in this Management's Discussion and Analysis, other than historical facts, are forward-looking statements made in reliance upon the safe harbor of the Private Securities Litigation Reform Act of 1995, including, without limitation, statements made under the caption "Outlook." As a general matter, forward-looking statements are those focused upon anticipated events or trends and expectations and beliefs relating to matters that are not historical in nature. Such forward-looking statements are subject to uncertainties and factors relating to Gardner Denver's operations and business environment, all of which are difficult to predict

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and many of which are beyond the control of the Company. These uncertainties and factors could cause actual results to differ materially from those matters expressed in or implied by such forward-looking statements. The following uncertainties and factors, among others, could affect future performance and cause actual results to differ materially from those expressed in or implied by forward-looking statements: (1) the ability to maintain and to enter into key purchasing, supply and outsourcing relationships; (2) the ability to effectively manage the transition of iron casting supply to alternate sources and the skill, commitment and availability of such alternate sources; (3) the ability to identify, negotiate and complete future acquisitions; (4) the speed with which the Company is able to integrate acquisitions and realize the related financial benefits; (5) the successful implementation of other strategic initiatives, including, without limitation, restructuring plans, inventory reduction programs and other cost reduction efforts; (6) the domestic and/or

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worldwide level of oil and natural gas prices and oil and gas drilling and production, which affect demand for the Company's petroleum products; (7) changes in domestic and/or worldwide industrial production and industrial capacity utilization rates, which affect demand for the Company's compressed air products; (8) pricing of Gardner Denver products; (9) the degree to which the Company is able to penetrate niche and international markets; (10) the ability to attract and retain quality management personnel; (11) market performance of pension plan assets and changes in discount rates used for actuarial assumptions in pension and other post-employment obligation and expense calculations; (12) the continued ability to effectively manage and defend litigation matters pending, or asserted in the future, against the Company; (13) the development and acceptance of the Company's new product offerings; and (14) the continued successful implementation and utilization of the Company's electronic services.

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

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

There were no material changes in the Company's exposure to market risk between December 31, 2002 and September 30, 2003.

### ITEM 4. CONTROLS AND PROCEDURES

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

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reasonably likely to materially affect the Company's internal control over financial reporting.

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

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### PART II - OTHER INFORMATION

#### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

#### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) List of Exhibits:

- 10.10 Form of Gardner Denver, Inc. Nonemployee Director Stock Option Agreement, as amended July 29, 2003.
- 12 Calculation of Ratio of Earnings to Fixed Charges.
- 31.1 Certification of Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a).
- 31.2 Certification of Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a).
- 32 Certification pursuant to 18 U.S.C. Section 1350 and Exchange Act Rule 13a-14(b).

(b) Reports on Form 8-K

On October 20, 2003, Gardner Denver, Inc. filed a Current Report on Form 8-K to furnish its press release announcing the Company's earnings for the third quarter and nine months ended September 30, 2003, certain recent activities, and guidance as to certain future results.

On September 17, 2003, Gardner Denver, Inc. filed a Current Report on Form 8-K to report a temporary suspension of trading under its employee benefits plans.

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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

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by the undersigned thereunto duly authorized.

GARDNER DENVER, INC.

Date: November 12, 2003

By: /s/Ross J. Centanni

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Ross J. Centanni  
Chairman, President & CEO

Date: November 12, 2003

By: /s/Philip R. Roth

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Philip R. Roth  
Vice President, Finance & CFO

Date: November 12, 2003

By: /s/Daniel C. Rizzo, Jr.

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Daniel C. Rizzo, Jr.  
Vice President and Corporate  
Controller (Chief Accounting Officer)

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GARDNER DENVER, INC.

EXHIBIT INDEX

| EXHIBIT<br>NO. | DESCRIPTION  |
|----------------|--|
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