FARMERS & MERCHANTS BANCORP
Form 10-K
March 14, 2014

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

FORM 10-K

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

For the fiscal year ended December 31, 2013

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the transition period from _________ to __________.

Commission File Number: 000-26099

FARMERS & MERCHANTS BANCORP
(Exact name of registrant as specified in its charter)

Delaware	94-3327828
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
111 W. Pine Street, Lodi, California	95240
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (209) 367-2300

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: Common Stock, $0.01 Par Value Per Share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No x

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 x No o

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 x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant’s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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 definition of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer o	Accelerated filer x	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller Reporting Company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act) Yes o No x

The aggregate market value of the Registrant's common stock held by non-affiliates on June 30, 2013 (based on the last reported trade on June 28, 2013) was $311,161,000.

The number of shares of Common Stock outstanding as of February 28, 2014: 777,882

Documents Incorporated by Reference:
Portions of the definitive Proxy Statement for the 2014 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission pursuant to Regulation 14A are incorporated by reference in Part III, Items 10 through 14.

FARMERS & MERCHANTS BANCORP
FORM 10-K

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Introduction – Forward Looking Statements

This Form 10-K contains various forward-looking statements, usually containing the words “estimate,” “project,” “expect,” “objective,” “goal,” or similar expressions and includes assumptions concerning Farmers & Merchants Bancorp’s (together with its subsidiaries, the “Company” or “we”) operations, future results, and prospects. These forward-looking statements are based upon current expectations and are subject to risks and uncertainties. In connection with the “safe-harbor” provisions of the Private Securities Litigation Reform Act of 1995, the Company provides the following cautionary statement identifying important factors which could cause the actual results of events to differ materially from those set forth in or implied by the forward-looking statements and related assumptions.

Such factors include the following: (1) continuing economic sluggishness in the Central Valley of California; (2) significant changes in interest rates and prepayment speeds; (3) credit risks of lending and investment activities; (4) changes in federal and state banking laws or regulations; (5) competitive pressure in the banking industry; (6) changes in governmental fiscal or monetary policies; (7) uncertainty regarding the economic outlook resulting from the continuing war on terrorism, as well as actions taken or to be taken by the U.S. or other governments as a result of further acts or threats of terrorism; and (8) other factors discussed in Item 1A. Risk Factors.

Readers are cautioned not to place undue reliance on these forward-looking statements which speak only as of the date hereof. The Company undertakes no obligation to update any forward-looking statements to reflect events or circumstances arising after the date on which they are made.

PART I

Item 1. Business

General Development of the Business

August 1, 1916, marked the first day of business for Farmers & Merchants Bank. The Bank was incorporated under the laws of the State of California and licensed as a state-chartered bank. Farmers & Merchants’ first venture out of Lodi occurred when the Galt office opened in 1948. Since then the Bank has opened full-service branches in Linden, Modesto, Sacramento, Elk Grove, Turlock, Hilmar, Stockton and Merced.

In addition to 21 full-service branches and 2 loan production offices, the Bank serves the needs of its customers through two stand-alone ATM’s located on the grounds of the Lodi Grape Festival and California State University-Stanislaus. In 2007, the Bank began offering certain products over the internet at www.fmbonline.com.

During 2013 the Bank: (1) closed one of its four Modesto branches, consolidating those accounts into the Modesto Main office, which is in close proximity to the closed branch; (2) initiated efforts to establish loan production offices in Irvine, CA and Walnut Creek, CA; and (3) established equipment leasing operations under the Bank.

On March 10, 1999, the Company, pursuant to a reorganization, acquired all of the voting stock of Farmers & Merchants Bank of Central California (the “Bank”). The Company is a bank holding company incorporated in the State of Delaware and registered under the Bank Holding Company Act of 1956, as amended. The Company’s outstanding securities as of December 31, 2013, consisted of 777,882 shares of common stock, $0.01 par value and no shares of preferred stock issued. The Bank is the Company’s principal asset.

The Bank’s two wholly owned subsidiaries are Farmers & Merchants Investment Corporation and Farmers/Merchants Corp. Farmers & Merchants Investment Corporation is currently dormant and Farmers/Merchants Corp. acts as trustee on deeds of trust originated by the Bank.

F & M Bancorp, Inc. was created in March 2002 to protect the name “F & M Bank.” During 2002, the Company completed a fictitious name filing in California to begin using the streamlined name, “F & M Bank” as part of a larger effort to enhance the Company’s image and build brand name recognition. Since 2002, the Company has converted all of its daily operating and image advertising to the “F & M Bank” name and the Company’s logo, slogan and signage were redesigned to incorporate the trade name, “F & M Bank.”

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During 2003, the Company formed a wholly owned Connecticut statutory business trust, FMCB Statutory Trust I, for the sole purpose of issuing trust-preferred securities. See Note 13 located in "Item 8. Financial Statements and Supplementary Data."

During the 2nd quarter of 2013, the Bank entered the equipment leasing business. Equipment leasing is a form of asset-backed financing which typically preserves cash more optimally than other financial products by advancing 100% of the installed equipment cost and allowing for customized payment terms. Leases fall into one of two broad categories: (1) "finance leases", where the lessee retains the tax benefits of ownership but obtains 100% financing on their equipment purchases; and (2) "true tax leases", where the lessor places reliance on residual value and in so doing obtains the tax benefits of ownership.

The Company's principal business is to serve as a holding company for the Bank and for other banking or banking related subsidiaries, which the Company may establish or acquire. As a legal entity separate and distinct from its subsidiary, the Company's principal source of funds is, and will continue to be, dividends paid by and other funds from the Bank. Legal limitations are imposed on the amount of dividends that may be paid and loans that may be made by the Bank to the Company. See "Supervision and Regulation - Dividends and Other Transfer of Funds."

The Bank's deposit accounts are insured under the Federal Deposit Insurance Act up to applicable limits. See "Supervision and Regulation – Deposit Insurance."

As a bank holding company, the Company is subject to regulation and examination by the Board of Governors of the Federal Reserve System ("FRB"). The Bank is a California state-chartered non-FRB member bank subject to the regulation and examination of the California Department of Business Oversight ("DBO") and the Federal Deposit Insurance Corporation ("FDIC").

Service Area

During 2013, the Company initiated efforts to broaden its geographic footprint by establishing loan production offices ("LPO") in Irvine, CA and Walnut Creek, CA. Both LPO's were opened in January 2014. Experienced lending and equipment leasing professionals have been hired to staff these offices. The Company intends to convert these LPO's to full service branches. Both of these areas have strong local economies, and will help diversify some of the concentration risks that the Company now has to the Central Valley and the agricultural industry. The Irvine location will also be the headquarters for the Company's equipment leasing activities.

At the present time the Company's primary service area remains the mid Central Valley of California, including Sacramento, San Joaquin, Stanislaus and Merced counties, where we operate 21 full-service branches and two stand-alone ATM's. This area encompasses:

- Sacramento Metropolitan Statistical Area ("MSA"), with branches in Sacramento, Elk Grove and Galt. This MSA has a Population of 2.2 million and a Per Capita Income of approximately $42,000. The MSA includes significant employment in the following sectors: state and local government; agriculture; and trade, transportation and utilities. Unemployment currently stands at 8.0%.

- Stockton MSA, with branches in Lodi, Linden and Stockton. This MSA has a Population of 0.7 million and a Per Capita Income of approximately $33,000. The MSA includes significant employment in the following sectors: state and local government; agriculture; trade, transportation, and utilities; and education and health services. Unemployment currently stands at 12.2%.

- Modesto MSA, with branches in Modesto and Turlock. This MSA has a Population of 0.5 million and a Per Capita Income of approximately $33,000. The MSA includes significant employment in the following sectors: agriculture;

trade, transportation and utilities; state and local government; and education and health services. Unemployment currently stands at 12.1%.

- Merced MSA with branches in Hilmar and Merced. This MSA has a Population of 0.3 million and a Per Capita Income of approximately $29,000. The MSA includes significant employment in the following sectors: agriculture; state and local government; and trade, transportation and utilities. Unemployment currently stands at 13.6%.

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All of the Company’s Central Valley service areas are heavily influenced by the agricultural industry, however, with the exception of the State of California in the Sacramento MSA, no single employer represents a material concentration of jobs in any of our service areas.

See “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations – Overview” and “Financial Condition – Loans & Leases” for additional discussion regarding the Company’s market conditions.

Through its network of banking offices, the Company emphasizes personalized service along with a broad range of banking services to businesses and individuals located in the service areas of its offices. Although the Company focuses on marketing its services to small and medium sized businesses, a broad range of retail banking services are made available to the local consumer market.

The Company offers a wide range of deposit instruments. These include checking, savings, money market, time certificates of deposit, individual retirement accounts and online banking services for both business and personal accounts.

The Company provides a broad complement of lending products, including commercial, real estate construction, agribusiness, consumer, credit card, real estate loans, and equipment leases. Commercial products include term loans, lines of credit and other working capital financing and letters of credit. Financing products for individuals include automobile financing, lines of credit, residential real estate, home improvement and home equity lines of credit.

The Company also offers a wide range of specialized services designed for the needs of its commercial accounts. These services include a credit card program for merchants, collection services, account reconciliation, investment sweep, on-line account access, and electronic funds transfers by way of domestic and international wire and automated clearinghouse.

The Company makes investment products available to customers, including mutual funds and annuities. These investment products are offered through a third party, which employs investment advisors to meet with and provide investment advice to the Company’s customers.

Employees

At December 31, 2013, the Company employed 299 full time equivalent employees. The Company believes that its employee relations are satisfactory.

Competition

The banking and financial services industry in California generally, and in the Company’s market areas specifically, is highly competitive. The increasingly competitive environment is a result primarily of changes in regulation, changes in technology and product delivery systems, and the accelerating pace of consolidation among financial service providers. The Company competes with other major commercial banks, diversified financial institutions, credit unions, savings and loan associations, money market and other mutual funds, mortgage companies, and a variety of other non-banking financial services and advisory companies. Federal legislation encourages competition between different types of financial service providers and has fostered new entrants into the financial services market. It is anticipated that this trend will continue. Using the financial holding company structure, insurance companies and securities firms may compete more directly with banks and bank holding companies.

Many of our competitors are much larger in total assets and capitalization, have greater access to capital markets and offer a broader range of financial services than the Company. In order to compete with other financial service providers, the Company relies upon personal contact by its officers, directors, employees, and stockholders, along

with various promotional activities and specialized services. In those instances where the Company is unable to accommodate a customer’s needs, the Company may arrange for those services to be provided through its correspondents.

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Government Policies

The Company's profitability, like most financial institutions, is primarily dependent on interest rate differentials. The difference between the interest rates paid by the Company on interest-bearing liabilities, such as deposits and other borrowings, and the interest rates received by the Company on its interest-earning assets, such as loans & leases extended to its customers and securities held in its investment portfolio, comprise the major portion of the Company's earnings. These rates are highly sensitive to many factors that are beyond the control of the Company and the Bank, such as inflation, recession and unemployment. The impact that changes in economic conditions might have on the Company and the Bank cannot be predicted.

The business of the Company is also influenced by the monetary and fiscal policies of the federal government and the policies of regulatory agencies, particularly the FRB. The FRB implements national monetary policies (with objectives such as curbing inflation and combating recession) through its open-market operations in U.S. Government securities by adjusting the required level of reserves for depository institutions subject to its reserve requirements, and by varying the target federal funds and discount rates applicable to borrowings by depository institutions. The actions of the FRB in these areas influence the growth of bank loans & leases, investments, and deposits and also affect interest rates earned on interest-earning assets and paid on interest-bearing liabilities. The nature and impact on the Company of any future changes in monetary and fiscal policies cannot be predicted.

From time to time, legislative acts, as well as regulations, are enacted which have the effect of increasing the cost of doing business, limiting or expanding permissible activities, or affecting the competitive balance between banks and other financial services providers. Proposals to change the laws and regulations governing the operations and taxation of banks, bank holding companies, and other financial institutions and financial services providers are frequently made in the U.S. Congress, in the state legislatures, and before various regulatory agencies. This legislation may change banking statutes and the operating environment of the Company and its subsidiaries in substantial and unpredictable ways. If enacted, such legislation could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance among banks, savings associations, credit unions, and other financial institutions. The Company cannot predict whether any of this potential legislation will be enacted, and if enacted, the effect that it, or any implemented regulations, would have on the financial condition or results of operations of the Company or any of its subsidiaries.

Supervision and Regulation

General

Bank holding companies and banks are extensively regulated under both federal and state law. The regulation is intended primarily for the protection of depositors and the deposit insurance fund and not for the benefit of stockholders of the Company. Set forth below is a summary description of the material laws and regulations, which relate to the operations of the Company and the Bank. This description does not purport to be complete and is qualified in its entirety by reference to the applicable laws and regulations.

The Company

The Company is a registered bank holding company and is subject to regulation under the Bank Holding Company Act of 1956 ("BHCA"), as amended. Accordingly, the Company's operations are subject to extensive regulation and examination by the FRB. The Company is required to file with the FRB quarterly and annual reports and such additional information as the FRB may require pursuant to the BHCA. The FRB conducts periodic examinations of the Company.

The FRB may require that the Company terminate an activity or terminate control of or liquidate or divest certain subsidiaries of affiliates when the FRB believes the activity or the control of the subsidiary or affiliate constitutes a significant risk to the financial safety, soundness or stability of any of its banking subsidiaries. The FRB also has the

authority to regulate provisions of certain bank holding company debt. Under certain circumstances, the Company must file written notice and obtain approval from the FRB prior to purchasing or redeeming its equity securities.

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Under the BHCA and regulations adopted by the FRB, a bank holding company and its non-banking subsidiaries are prohibited from requiring certain tie-in arrangements in connection with an extension of credit, lease or sale of property, or furnishing of services. For example, with certain exceptions, a bank may not condition an extension of credit on a promise by its customer to obtain other services provided by it, its holding company or other subsidiaries, or on a promise by its customer not to obtain other services from a competitor. In addition, federal law imposes certain restrictions on transactions between Farmers & Merchants Bancorp and its subsidiaries. Further, the Company is required by the FRB to maintain certain levels of capital. See "Capital Standards."

The Company is prohibited by the BHCA, except in certain statutorily prescribed instances, from acquiring direct or indirect ownership or control of more than 5% of the outstanding voting shares of any company that is not a bank or bank holding company and from engaging directly or indirectly in activities other than those of banking, managing or controlling banks, or furnishing services to its subsidiaries. However, the Company, subject to the prior notice and/or approval of the FRB, may engage in any, or acquire shares of companies engaged in, activities that are deemed by the FRB to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

Under FRB regulations, a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks and may not conduct its operations in an unsafe or unsound manner. In addition, it is the FRB's policy that in serving as a source of strength to its subsidiary banks, a bank holding company should stand ready to use available resources to provide adequate capital funds to its subsidiary banks during periods of financial stress or adversity and should maintain the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks. This support may be required at times when a bank holding company may not be able to provide such support. A bank holding company's failure to meet its obligations to serve as a source of strength to its subsidiary banks will generally be considered by the FRB to be an unsafe and unsound banking practice or a violation of the FRB's regulations or both.

The Company is not a financial holding company for purposes of the FRB.

The Company is also a bank holding company within the meaning of the California Financial Code. As such, the Company and its subsidiaries are subject to examination by, and may be required to file reports with, the DBO.

The Company's securities are registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). As such, the Company is subject to the reporting, proxy solicitation and other requirements and restrictions of the Exchange Act.

The Bank

The Bank, as a California chartered non-FRB member bank, is subject to primary supervision, periodic examination and regulation by the DBO and the FDIC. If, as a result of an examination of the Bank, the FDIC should determine that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity, or other aspects of the Bank's operations are unsatisfactory, or that the Bank or its management is violating or has violated any law or regulation, various remedies are available to the FDIC. Such remedies include the power to enjoin "unsafe or unsound" practices, to require affirmative action to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in capital, to restrict the growth of the Bank, to assess civil monetary penalties, to remove officers and directors, and ultimately to terminate the Bank's deposit insurance, which for a California chartered bank would result in a revocation of the Bank's charter. The DBO has many of the same remedial powers.

Various requirements and restrictions under the laws of the State of California and the United States affect the operations of the Bank. State and federal statutes and regulations relate to many aspects of the Bank's operations, including reserves against deposits, ownership of deposit accounts, interest rates payable on deposits, loans & leases, investments, mergers and acquisitions, borrowings, dividends, locations of branch offices, and capital requirements.

Further, the Bank is required to maintain certain levels of capital. See “Capital Standards.”

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The USA Patriot Act

Title III of the United and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the "USA Patriot Act") includes numerous provisions for fighting international money laundering and blocking terrorism access to the U.S. financial system. The USA Patriot Act requires certain additional due diligence and record keeping practices, including, but not limited to, new customers, correspondent, and private banking accounts.

Part of the USA Patriot Act requires covered financial institutions to: (i) establish an anti-money laundering program; (ii) establish appropriate anti-money laundering policies, procedures and controls; (iii) appoint a Bank Secrecy Act officer responsible for day-to-day compliance; and (iv) conduct independent audits. The Patriot Act also expands penalties for violation of the anti-money laundering laws, including expanding the circumstances under which funds in a bank account may be forfeited. The Patriot Act also requires covered financial institutions to respond, under certain circumstances, to requests for information from federal banking agencies within 120 hours.

Privacy Restrictions

The GLBA, in addition to the previous described changes in permissible, non-banking activities permitted to banks, bank holding companies, and financial holding companies, also requires financial institutions in the U.S. to provide certain privacy disclosures to customers and consumers, to comply with certain restrictions on the sharing and usage of personally identifiable information, and to implement and maintain commercially reasonable customer information safeguarding standards.

The Company believes that it complies with all provisions of the GLBA and all implementing regulations and the Bank has developed appropriate policies and procedures to meet its responsibilities in connection with the privacy provisions of GLBA.

Dividends and Other Transfer of Funds

Dividends from the Bank constitute the principal source of income to the Company. The Company is a legal entity separate and distinct from the Bank. The Bank is subject to various statutory and regulatory restrictions on its ability to pay dividends to the Company. Under such restrictions, the amount available for payment of dividends to the Company by the Bank totaled $40.3 million at December 31, 2013. During 2013, the Bank paid $10.5 million in dividends to the Company.

The FDIC and the DBO also have authority to prohibit the Bank from engaging in activities that, in their opinion, constitute unsafe or unsound practices in conducting its business. It is possible, depending upon the financial condition of the bank in question and other factors, that the FDIC or the DBO could assert that the payment of dividends or other payments might, under some circumstances, be an unsafe or unsound practice. Further, the FRB and the FDIC have established guidelines with respect to the maintenance of appropriate levels of capital by banks or bank holding companies under their jurisdiction. Compliance with the standards set forth in such guidelines and the restrictions that are or may be imposed under the prompt corrective action provisions of federal law could limit the amount of dividends that the Bank or the Company may pay. An insured depository institution is prohibited from paying management fees to any controlling persons or, with certain limited exceptions, making capital distributions if after such transaction the institution would be undercapitalized. The DBO may impose similar limitations on the Bank. See "Prompt Corrective Regulatory Action and Other Enforcement Mechanisms" and "Capital Standards" for a discussion of these additional restrictions on capital distributions.

Transactions with Affiliates

The Bank is subject to certain restrictions imposed by federal law on any extensions of credit to, or the issuance of a guarantee or letter of credit on behalf of the Company or other affiliates, the purchase of, or investments in stock or other securities thereof, the taking of such securities as collateral for loans & leases, and the purchase of assets of the Company or other affiliates. Such restrictions prevent the Company and other affiliates from borrowing from the Bank

unless the loans are secured by marketable obligations of designated amounts. Further, such secured loans and investments by the Bank to or in the Company or to or in any other affiliates are limited, individually, to 10% of the Bank's capital and surplus (as defined by federal regulations), and such secured loans and investments are limited, in the aggregate, to 20% of the Bank's capital and surplus (as defined by federal regulations).

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In addition, the Company and its operating subsidiaries generally may not purchase a low-quality asset from an affiliate, and other specified transactions between the Company or its operating subsidiaries and an affiliate must be on terms and conditions that are consistent with safe and sound banking practices.

Also, the Company and its operating subsidiaries may engage in transactions with affiliates only on terms and under conditions that are substantially the same, or at least as favorable to the Company or its subsidiaries, as those prevailing at the time for comparable transactions with (or that in good faith would be offered to) non-affiliated companies.

California law also imposes certain restrictions with respect to transactions with affiliates. Additionally, limitations involving the transactions with affiliates may be imposed on the Bank under the prompt corrective action provisions of federal law. See “Prompt Corrective Action and Other Enforcement Mechanisms.”

Capital Standards

The FRB and the FDIC have established risk-based capital guidelines with respect to the maintenance of appropriate levels of capital by United States banking organizations. These guidelines are intended to provide a measure of capital that reflects the risk associated with a banking organization’s operations for both transactions reported on the balance sheet as assets and transactions, such as letters of credit and recourse arrangements, which are recorded as off balance sheet items. Under these guidelines, nominal dollar amounts of assets and credit equivalent amounts of off balance sheet items are multiplied by one of several risk adjustment percentages, which range from 0% for assets with low credit risk, such as certain U.S. Treasury securities, to 100% for assets with relatively high credit risk, such as commercial loans.

The federal banking agencies currently require a minimum ratio of qualifying total capital to risk-weighted assets of 8% and a minimum ratio of Tier 1 capital to risk-weighted assets of 4%. In addition to the risk-based guidelines, federal banking regulators require banking organizations to maintain a minimum amount of Tier 1 capital to total assets, referred to as the leverage ratio. For a banking organization rated in the highest of the five categories used by regulators to rate banking organizations, the minimum leverage ratio of Tier 1 capital to total assets must be 4%. In addition to these uniform risk-based capital guidelines and leverage ratios that apply across the industry, the regulators have the discretion to set individual minimum capital requirements for specific institutions at rates significantly above minimum guidelines and ratios. For further information on the Company and the Bank’s risk-based capital ratios see Note 14 located in “Item 8. Financial Statements and Supplementary Data.”

On July 2, 2013, the FRB approved final rules and the FDIC subsequently adopted interim final rules that would substantially amend the regulatory risk-based capital rules applicable to the Company and the Bank. These rules would implement the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act as hereinafter defined.

The final rules include new minimum risk-based capital and leverage ratios, which would be phased in over time. The new minimum capital level requirements applicable to the Company and the Bank under the final rules will be: (i) a common equity Tier 1 capital ratio of 4.5% of risk weighted assets (“RWA”); (ii) a Tier 1 capital ratio of 6% of RWA; (iii) a total capital ratio of 8% of RWA; and (iv) a Tier 1 leverage ratio of 4% of total assets. The final rules also establish a "capital conservation buffer" of 2.5% above each of the new regulatory minimum capital ratios, which would result in the following minimum ratios: (i) a common equity Tier 1 capital ratio of 7.0% of RWA; (ii) a Tier 1 capital ratio of 8.5% of RWA, and (iii) a total capital ratio of 10.5% of RWA. An institution will be subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. The final rules also permit the Company’s subordinated debentures to continue to be counted as Tier 1 capital.

Prompt Corrective Action and Other Enforcement Mechanisms

The Federal Deposit Insurance Corporation Improvement Act of 1991 (“FDICIA”), among other things, identifies five capital categories for insured depository institutions (well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized) and requires the respective Federal regulatory agencies to implement systems for “prompt corrective action” for insured depository institutions that do not meet minimum capital requirements within such categories. FDICIA imposes progressively more restrictive constraints on operations, management, and capital distributions, depending on the category in which an institution is classified. Failure to meet the capital guidelines could also subject a banking institution to capital raising requirements. An “undercapitalized” institution must develop a capital restoration plan. At December 31, 2013, the Bank exceeded all of the required ratios for classification as “well capitalized.” It should be noted; however, that the Bank’s capital category is determined solely for the purpose of applying the federal banking agencies’ prompt corrective action regulations and the capital category may not constitute an accurate representation of the Bank’s overall financial condition or prospects.

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An institution that, based upon its capital levels, is classified as well capitalized, adequately capitalized, or undercapitalized may be treated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for hearing, determines that an unsafe or unsound condition or practice warrants such treatment. At each successive lower capital category, an insured depository institution is subject to more restrictions.

Banking agencies have also adopted regulations which mandate that regulators take into consideration: (i) concentrations of credit risk; (ii) interest rate risk (when the interest rate sensitivity of an institution’s assets does not match the sensitivity of its liabilities or its off-balance-sheet position); and (iii) risks from non-traditional activities, as well as an institution’s ability to manage those risks, when determining the adequacy of an institution’s capital. That evaluation will be made as a part of the institution’s regular safety and soundness examination. In addition, the banking agencies have amended their regulatory capital guidelines to incorporate a measure for market risk. In accordance with the amended guidelines, any company with significant trading activity must incorporate a measure for market risk in its regulatory capital calculations.

In addition to measures taken under the prompt corrective action provisions, commercial banking organizations may be subject to potential enforcement actions by the federal banking agencies for unsafe or unsound practices in conducting their businesses or for violations of any law, rule, regulation, any condition imposed in writing by the agency, or any written agreement with the agency. Enforcement actions may include the imposition of a conservator or receiver, the issuance of a cease-and-desist order that can be judicially enforced, the termination of insurance of deposits (in the case of a depository institution), the imposition of civil money penalties, the issuance of directives to increase capital, the issuance of formal and informal agreements, the issuance of removal and prohibition orders against institution-affiliated parties and the enforcement of such actions through injunctions or restraining orders based upon a judicial determination that the agency would be harmed if such equitable relief was not granted. Additionally, a holding company's inability to serve as a source of strength to its subsidiary banking organizations could serve as an additional basis for a regulatory action against the holding company.

Federal banking regulators have also issued final guidance regarding commercial real estate (“CRE”) lending. This guidance suggests that institutions that are potentially exposed to significant CRE concentration risk will be subject to increased regulatory scrutiny. Institutions that have experienced rapid growth in CRE lending, have notable exposure to a specific type of CRE lending, or are approaching or exceed certain supervisory criteria that measure an institution’s CRE portfolio against its capital levels, may be subject to such increased regulatory scrutiny. The Company’s CRE portfolio may be viewed as falling within one or more of the foregoing categories, and accordingly may become subject to increased regulatory scrutiny because of the CRE portfolio. Institutions that are determined by their regulator to have an undue concentration in CRE lending may be required to maintain levels of capital in excess of the statutory minimum requirements and/or be required to reduce their concentration in CRE loans. The FDIC has determined that the Company does not have any undue concentrations in CRE lending.

Safety and Soundness Standards

The federal banking agencies have adopted guidelines designed to assist in identifying and addressing potential safety and soundness concerns before capital becomes impaired. The guidelines set forth operational and managerial standards relating to: (i) internal controls, information systems, and internal audit systems; (ii) loan & lease documentation; (iii) credit underwriting; (iv) asset growth; (v) earnings; and (vi) compensation, fees, and benefits. In addition, the federal banking agencies have also adopted safety and soundness guidelines with respect to asset quality and earnings standards. These guidelines provide six standards for establishing and maintaining a system to identify problem assets and prevent those assets from deteriorating. Under these standards, any insured depository institution should: (i) conduct periodic asset quality reviews to identify problem assets; (ii) estimate the inherent losses in problem assets and establish reserves that are sufficient to absorb estimated losses; (iii) compare problem asset totals to capital; (iv) take appropriate corrective action to resolve problem assets; (v) consider the size and potential risks of material asset concentrations; and (vi) provide periodic asset quality reports with adequate information for

management and the Board of Directors to assess the level of asset risk. These guidelines also set forth standards for evaluating and monitoring earnings and for ensuring that earnings are sufficient for the maintenance of adequate capital and reserves.

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Deposit Insurance

After the passage of the Dodd-Frank act, the deposits of the Bank are now insured by the FDIC up to $250,000 per insured depositor.

The Federal Deposit Insurance Reform Act of 2005 provided the FDIC Board of Directors the authority to set the designated reserve ratio for the Deposit Insurance Fund (“DIF”) between 1.15% and 1.50%. The FDIC must adopt a restoration plan when the reserve ratio falls below 1.15% and begin paying dividends when the reserve ratio exceeds 1.35%.

Through the later part of 2008 and into 2009, the number of bank failures began to rise significantly. This placed considerable strain on the DIF. As a result, on September 29, 2009 the FDIC adopted an Amended Restoration Plan to allow the DIF to return to a ratio of 1.15% within eight years. The FDIC also adopted risk-based assessment rates beginning in January of 2011. On November 12, 2009, the FDIC also adopted a final rule amending the assessment regulations to require insured depository institutions to prepay their quarterly risk-based assessments for the fourth quarter of 2009, and for all of 2010, 2011 and 2012, on December 30, 2009, except for those institutions where the FDIC grants an exemption. The prepaid assessment was collected December 30, 2009, and resulted in a prepayment by the Bank of $7,258,000. Since December 2009, the Company has expensed $4,362,000 of this prepaid assessment. The FDIC prepaid assessment program ended March 29, 2013, and resulted in a $2,896,000 refund of unused assessment credits to the Bank on July 1, 2013.

Under the Dodd-Frank Act, the minimum designated reserve ratio of the DIF increased from 1.15% to 1.35% of estimated insured deposits. Additionally, the Dodd-Frank Act revised the assessment base against which an insured depository institution’s deposit insurance premiums paid to the DIF will be calculated. On February 7, 2011, the FDIC approved a final rule, as mandated by Dodd-Frank, changing the deposit insurance assessment system from one that is based on total domestic deposits to one that is based on average consolidated total assets minus average tangible equity. The new rule took effect for the quarter beginning April 1, 2011.

The Bank’s FDIC premiums were $981,000 in 2013 compared to $968,000 in 2012. Future increases in insurance premiums could have adverse effects on the operating expenses and results of operations of the Company. Management cannot predict what insurance assessment rates will be in the future.

Insurance of deposits may be terminated by the FDIC upon a finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order, or condition imposed by the FDIC or the Bank’s primary regulator. Management of the Company is not aware of any practice, condition or violation that might lead to termination of the Company’s deposit insurance.

Community Reinvestment Act (“CRA”) and Fair Lending

The Bank is subject to certain fair lending requirements involving lending, investing, and other CRA activities. CRA requires each insured depository institution to identify the communities served by the institution’s offices and to identify the types of credit and investments the institution is prepared to extend within such communities including low and moderate-income neighborhoods. It also requires the institution’s regulators to assess the institution’s performance in meeting the credit needs of its community and to take such assessment into consideration in reviewing applications for mergers, acquisitions, relocation of existing branches, opening of new branches, and other transactions. A bank may be subject to substantial penalties and corrective measures for a violation of certain fair lending laws.

A bank’s compliance with the Community Reinvestment Act is assessed using an evaluation system, which bases CRA ratings on an institution’s lending, service and investment performance. An unsatisfactory rating may be the basis for denying a merger application. The Bank’s latest CRA examination was completed by the Federal Deposit Insurance

Corporation in July 2010 and the Bank received an overall Satisfactory rating in complying with its CRA obligations.

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The Sarbanes-Oxley Act of 2002(Sarbanes-Oxley Act)

This legislation addresses certain accounting oversight and corporate governance matters, including but not limited to:

- required executive certification of financial presentations;
- increased requirements for board audit committees and their members;
- enhanced disclosure of controls and procedures and internal control over financial reporting;
- enhanced controls over, and reporting of, insider trading; and
- increased penalties for financial crimes and forfeiture of executive bonuses in certain circumstances.

As a public reporting company, the Company is subject to the requirements of this legislation and related rules and regulations issued by the Securities and Exchange Commission (the "SEC"). Compliance with the Sarbanes-Oxley Act did not have a material impact upon its business. However, other non-interest expense items, including professional expenses and other costs related to compliance with the reporting requirements of the securities laws have significantly increased and can be expected to continue to increase.

Consumer Protection Regulations

The Company's lending activities are subject to a variety of statutes and regulations designed to protect consumers, including the Fair Credit Reporting Act, Equal Credit Opportunity Act, the Fair Housing Act, and the Truth-in-Lending Act. Deposit operations are also subject to laws and regulations that protect consumer rights including Funds Availability, Truth in Savings, and Electronic Funds Transfers. Additional rules govern check writing ability on certain interest earning accounts and prescribe procedures for complying with administrative subpoenas of financial records. Additionally, a provision of the Federal Reserve Regulation E has been changed effective July 1, 2010 that puts restrictions on institutions assessing overdraft fees on consumer's accounts relating to debit card usage or other forms of transfers.

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")

On July 21, 2010, President Obama signed into law the sweeping financial regulatory reform, Dodd-Frank Act, that implements significant changes to the regulation of the financial services industry, including provisions that, among other things:

- Centralize responsibility for consumer financial protection by creating a new agency within the Federal Reserve Board, the Bureau of Consumer Financial Protection, with broad rulemaking, supervision and enforcement authority for a wide range of consumer protection laws that would apply to all banks and thrifts.
- Apply the same leverage and risk-based capital requirements that apply to insured depository institutions to bank holding companies.
- Require the FDIC to seek to make its capital requirements for banks countercyclical so that the amount of capital required to be maintained increases in times of economic expansion and decreases in times of economic contraction.
- Change the assessment base for federal deposit insurance from the amount of insured deposits to consolidated assets less tangible capital.
- Implement corporate governance revisions, including executive compensation and proxy access by stockholders.

- Make permanent the $250,000 limit for federal deposit insurance and increase the cash limit of Securities Investor Protection Corporation protection from $100,000 to $250,000, and provide unlimited federal deposit insurance until January 1, 2013 for non-interest bearing demand transaction accounts at all insured depository institutions.

- Repeal the federal prohibitions on the payment of interest on demand deposits effective July 21, 2011, thereby permitting depository institutions to pay interest on business transaction and other accounts.

Many aspects of the Dodd-Frank Act are subject to rulemaking by various regulatory agencies and will take effect over several years, making it difficult to anticipate the overall financial impact on the Company, its customers or the financial industry more om" width="1%"> 50,207   53,428

Property, plant and equipment, net
93,060   92,090
Goodwill
168,060   165,530
Intangible assets, net
12,553   13,516
Long-term asbestos insurance asset
376,676   277,542
Deferred loan costs, pension and other assets
16,594   16,113 $1,025,204 $913,076
LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES:

Current portion of long-term debt and capital leases
$7,698 $5,420
Accounts payable
37,991   52,138
Accrued asbestos liability
36,696   28,574
Accrued payroll
20,562   19,162
Accrued taxes
5,115   11,457
Other accrued liabilities
46,678   37,535
Total current liabilities
154,740   154,286
Long-term debt, less current portion
85,236   91,701
Long-term asbestos liability
418,885   328,684
Pension and accrued post-retirement benefits
129,663   130,188
Deferred income tax liability
8,170   7,685
Other liabilities
31,885   33,601
Total liabilities
828,579   746,145

Shareholders' equity:

Common stock: $0.001 par value; authorized 200,000,000; issued and

outstanding 43,229,104 and 43,211,026	43	43
Additional paid-in capital	402,229	400,259
Retained deficit	(96,699)	(113,301)
Accumulated other comprehensive loss	(108,948)	(120,070)
Total shareholders' equity	196,625	166,931
	$1,025,204	$913,076

See accompanying notes to condensed consolidated financial statements.

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COLFAX CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
Dollars in thousands
(unaudited)

	Nine Months Ended	
	October 2, 2009	September 26, 2008
Cash flows from operating activities:		
Net income (loss)	$ 16,602	$ (10,950)
Adjustments to reconcile net income (loss) to cash provided by (used in) operating activities:		
Depreciation, amortization and fixed asset impairment charges	11,240	11,345
Noncash stock-based compensation	1,970	10,814
Write off of deferred loan costs	-	4,614
Amortization of deferred loan costs	507	769
(Gain) loss on sale of fixed assets	(33)	47
Deferred income taxes	1,731	(18,063)
Changes in operating assets and liabilities:		
Trade receivables	15,885	(14,839)
Inventories	5,777	(17,290)
Accounts payable and accrued liabilities, excluding asbestos-related accrued expenses	(14,821)	5,814
Other current assets	984	(1,996)
Change in asbestos liability and asbestos-related accrued expenses, net of asbestos insurance asset and receivable	(5,384)	(5,464)
Changes in other operating assets and liabilities	(456)	4,508
Net cash provided by (used in) operating activities	34,002	(30,691)
Cash flows from investing activities:		
Purchases of fixed assets	(7,779)	(13,329)
Acquisitions, net of cash received	(1,260)	-
Proceeds from sale of fixed assets	238	23
Net cash used in investing activities	(8,801)	(13,306)
Cash flows from financing activities:		
Borrowings under term credit facility	-	100,000
Payments under term credit facility	(3,750)	(207,778)
Proceeds from borrowings on revolving credit facilities	-	28,185
Repayments of borrowings on revolving credit facilities	-	(28,158)
Payments on capital leases	(447)	(197)
Payments for deferred loan costs	-	(3,249)
Proceeds from the issuance of common stock, net of offering costs	-	193,020
Dividends paid to preferred shareholders	-	(38,546)
Net cash (used in) provided by financing activities	(4,197)	43,277
Effect of exchange rates on cash	1,067	556

Increase (decrease) in cash and cash equivalents		22,071		(164)
Cash and cash equivalents, beginning of period		28,762		48,093
Cash and cash equivalents, end of period	$	50,833	$	47,929

See accompanying notes to condensed consolidated financial statements.

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COLFAX CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Dollars in thousands, unless otherwise noted

1. Organization and Nature of Operations

Colfax Corporation (the "Company", "Colfax", "we" or "us") is a global supplier of a broad range of fluid handling products, including pumps, fluid handling systems and controls, and specialty valves. We believe that we are a leading manufacturer of rotary positive displacement pumps, which include screw pumps, gear pumps and progressive cavity pumps. We have a global manufacturing footprint, with production facilities in Europe, North America and Asia, as well as worldwide sales and distribution channels. Our products serve a variety of applications in five strategic markets: commercial marine, oil and gas, power generation, global navy and general industrial. We design and engineer our products to high quality and reliability standards for use in critical fluid handling applications where performance is paramount. We also offer customized fluid handling solutions to meet individual customer needs based on our in-depth technical knowledge of the applications in which our products are used. Our products are marketed principally under the Allweiler, Fairmount, Houttuin, Imo, LSC, Portland Valve, Tushaco, Warren, and Zenith brand names. We believe that our brands are widely known and have a premium position in our industry. Allweiler, Houttuin, Imo and Warren are among the oldest and most recognized brands in the fluid handling industry, with Allweiler dating back to 1860.

2. General

The unaudited condensed consolidated financial statements included in this quarterly report have been prepared by the Company according to the rules and regulations of the Securities and Exchange Commission ("SEC") and according to accounting principles generally accepted in the United States of America ("GAAP") for interim financial statements. The accompanying balance sheet information as of December 31, 2008 is derived from our audited financial statements. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been omitted in accordance with the SEC's rules and regulations for interim financial statements. The unaudited condensed consolidated financial statements included herein should be read in conjunction with the audited financial statements and related footnotes included in our Annual Report on Form 10-K for the year ended December 31, 2008 filed with the SEC on March 6, 2009. Subsequent events were evaluated through November 16, 2009, the date these financial statements were issued.

The financial statements reflect, in the opinion of management, all adjustments which consist solely of normal recurring adjustments necessary to present fairly the Company's financial position and results of operations as of and for the periods indicated. Significant intercompany transactions and accounts are eliminated in consolidation.

We make certain estimates and assumptions in preparing our condensed consolidated financial statements in accordance with GAAP. These estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses for the periods presented. Actual results may differ from those estimates.

Certain prior period amounts have been reclassified to conform to current year presentations.

The results of operations for the three and nine months ended October 2, 2009 are not necessarily indicative of the results of operations that may be achieved for the full year. Quarterly results are affected by seasonal variations in our fluid handling business. As our customers seek to fully utilize capital spending budgets before the end of the year, historically our shipments have peaked during the fourth quarter. Also, our European operations typically experience a slowdown during the July and August holiday season. General economic conditions as well as backlog levels may,

however, impact future seasonal variations. Our results for the nine months ended October 2, 2009 include the impact of three additional business days as compared to 2008. The third quarter of 2009 had one additional business day compared to 2008. The fourth quarter of 2009 will have four fewer business days than the fourth quarter of 2008.

3. Recent Accounting Pronouncements

In October 2009, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) No. 2009-13, Multiple-Deliverable Revenue Arrangements—a consensus of the FASB Emerging Issues Task Force. ASU No. 2009-13 addresses the unit of accounting for arrangements involving multiple deliverables and how arrangement consideration should be allocated to the separate units of accounting. The Company will be required to adopt the provisions of ASU No. 2009-13 prospectively beginning January 1, 2011. Earlier retrospective application is permitted. The Company is evaluating the effects of implementing the provisions of this new guidance.

4. Warranty Costs

Estimated expenses related to product warranties are accrued at the time products are sold to customers and recorded as part of cost of sales. Estimates are established using historical information as to the nature, frequency, and average costs of warranty claims.

Warranty activity for the nine months ended October 2, 2009 and September 26, 2008 consisted of the following:

	Nine Months Ended	
	October 2, 2009	September 26, 2008
Warranty liability at beginning of the period	$ 3,108	$ 2,971
Accrued warranty expense, net of adjustments	679	1,338
Cost of warranty service work performed	(493)	(1,128)
Foreign exchange translation effect	151	(49)
Warranty liability at end of the period	$ 3,445	$ 3,132

5. Income Taxes

For the three and nine months ended October 2, 2009, the Company earned approximately $7.6 million and $24.0 million, respectively, before taxes and had $2.2 million and $ 7.4 million, respectively, of income tax expense. The effective tax rates of 28.9% and 30.9%, respectively, for the three and nine months ended October 2, 2009 represent the estimated annual tax rate for the year applied to the current period income before tax plus the tax effect of any significant unusual items, discrete items or changes in tax law.

The effective tax rate for the three months ended October 2, 2009 differs from the U.S. statutory rate primarily due to international tax rates which are lower than the U.S. tax rate and the net effect of the realization of previously unrecognized tax benefits as well as other discrete items. The effective tax rate for the nine months ended October 2, 2009 differs from the U.S. federal statutory tax rate primarily due to international tax rates which are lower than the U.S. tax rate, including the impact of the reduction in 2009 of the Swedish tax rate from 28.0% to 26.3% that is applied to our Swedish operations offset in part by a net increase to our valuation allowance and unrecognized tax benefit liability.

For the three and nine months ended September 26, 2008, the Company had effective tax expense (benefit) rates of 28.1% and (25.6)%. The effective tax expense rate for the three months ended September 26, 2008 was lower than the U.S. federal statutory rate primarily due to expected lower effective tax rates on normal operations in Germany and other international jurisdictions compared to the U.S. tax rate plus the net effect of the realization of previously unrecognized tax benefits. The lower effective tax (benefit) rate for the nine months ended September 26, 2008

compared to the U.S. federal statutory rate is primarily due to an $11.8 payment to reimburse certain selling shareholders for underwriters discounts that are not deductible for tax purposes offset in part by an expected lower overall rate on normal operations due to reductions in the German corporate tax rates in 2008, other international tax rates that are lower than the U.S. tax rate, changes in overall profitability and the net effect of the realization of previously unrecognized tax benefits.

The Company is subject to income tax in the U.S., state and international locations. The Company's significant operations outside the U.S. are located in Germany and Sweden. In Sweden tax years from 2003 to 2008 and in Germany tax years 2003 and 2006 to 2008 remain subject to examination. In the U.S., tax years from 2005 and beyond generally remain open for examination by U.S. and state tax authorities as well as tax years ending in 1997, 1998, 2000 and 2003 that have U.S. net operating loss tax attributes that have been carried forward to open tax years or are available to be carried forward to future tax years.

Due to the difficulty in predicting with reasonable certainty when tax audits will be fully resolved and closed, the range of reasonably possible significant increases or decreases in the liability for unrecognized tax benefits that may occur within the next 12 months is difficult to ascertain. Currently, we estimate it is reasonably possible the expiration of various statutes of limitations and resolution of tax audits may reduce our tax expense in the next 12 months from zero to $1.4 million.

6. Restructuring and Other Related Charges

The Company has initiated a series of restructuring actions during 2009 in response to current and expected future economic conditions. As a result, the Company recorded pre-tax restructuring and related costs of $9.6 million and $10.8 million for the three and nine month periods ended October 2, 2009, respectively. As of October 2, 2009, we have reduced our company-wide workforce by 230 associates from December 31, 2008. Additionally, 628 associates participate in a German government-sponsored furlough program in which the government pays the wage-related costs of workers that work less than a full work week. Payroll taxes and other employee benefits related to employees' furlough time are included in restructuring costs. We expect to incur an additional $0.2 million of these costs during the fourth quarter of 2009. We are currently implementing a voluntary termination program to convert a portion of the furloughed workforce to permanent headcount reductions.

During the second quarter of 2009, we closed a repair facility in Aberdeen, NC. We recorded a non-cash impairment loss of $0.2 million to reduce the carrying value of this facility to its estimated fair value. Further, by the end of 2009, we expect to close our facility in Sanford, NC and move production to the Company's facilities in Monroe, NC and Columbia, KY. Cash expenses associated with the Sanford, NC facility closing are expected to be approximately $2.0 million of which $0.5 million was incurred in the third quarter of 2009, and the remaining costs are expected to be incurred in the fourth quarter of 2009. Of the total cash expenses, severance and other employee termination-related costs are expected to be approximately $0.9 million and employee and equipment relocation costs are expected to be approximately $1.1 million. During the three months ended October 2, 2009, we recorded $0.5 million of non-cash asset impairment charges to reduce the carrying value of the Sanford, NC facility's building and equipment that will be sold or disposed of to their estimated fair values.

We recognize the cost of involuntary termination benefits at the communication date or ratably over any remaining expected future service period. Voluntary termination benefits are recognized as a liability and a loss when employees accept the offer and the amount can be reasonably estimated. We record asset impairment charges to reduce the carrying amount of long-lived assets that will be sold or disposed of to their estimated fair values. Fair values are estimated using observable inputs including third party appraisals and quoted market prices.

A summary of restructuring activity for the nine months ended October 2, 2009 is shown below.

	Nine Months Ended October 2, 2009			
	Provisions	Payments	Foreign Currency Translation	Reserve Balance at Oct. 2, 2009
Restructuring Charges:				
Termination benefits (1)	$ 8,930	$ (1,878)	$ (5)	$ 7,047
Furlough charges (2)	959	(987)	28	-
Facility closure charges (3)	218	(218)	-	-
Total Restructuring Charges	10,107	$ (3,083)	$ 23	$ 7,047
Other Related Charges:				
Asset impairment charges (4)	648			
Total Restructuring and Other Related Charges	$ 10,755			

(1) Includes severance and other termination benefits such as outplacement services.
(2) Includes payroll taxes and other employee benefits related to German employees' furlough time.
(3) Includes the cost of relocating and training associates and relocating equipment in connection with the closing of the Sanford, NC facility.
(4) Includes asset impairment charges associated with the building and equipment at the Aberdeen, NC and Sanford, NC locations.

7. Earnings per Share

The following table presents the computation of basic and diluted earnings (loss) per share:

	Three Months Ended		Nine Months Ended	
	October 2, 2009	September 26, 2008	October 2, 2009	September 26, 2008
Numerator:				
Net income (loss)	$ 5,375	$ 13,651	$ 16,602	$ (10,950)
Dividends on preferred stock	-	-	-	(3,492)
Income (loss) available to common shareholders	$ 5,375	$ 13,651	$ 16,602	$ (14,442)
Denominator:				
Weighted-average shares of common stock outstanding - basic	43,229,104	44,006,026	43,220,492	33,601,388
Net income (loss) per share - basic	$ 0.12	$ 0.31	$ 0.38	$ (0.43)
Weighted-average shares of common stock outstanding - basic	43,229,104	44,006,026	43,220,492	33,601,388
Net effect of potentally dilutive securities (1)	95,891	60,892	53,685	-
Weighted-average shares of common stock outstanding - diluted	43,324,995	44,066,918	43,274,177	33,601,388
Net income (loss) per share - diluted	$ 0.12	$ 0.31	$ 0.38	$ (0.43)

(1) Potentially dilutive securities consist of options and restricted stock units.

In the three and nine months ended October 2, 2009, respectively, approximately 0.5 million and 0.6 million potentially dilutive stock options, restricted stock units and deferred stock units were excluded from the calculation of diluted earnings per share, since their effect would have been anti-dilutive. In the nine months ended September 26, 2008, 0.7 million potentially dilutive stock options and restricted stock units were excluded from the calculation of diluted earnings per share, since their effect would have been anti-dilutive.

8. Comprehensive Income (Loss)

	Three Months Ended		Nine Months Ended	
	October 2, 2009	September 26, 2008	October 2, 2009	September 26, 2008
Net income (loss)	$ 5,375	$ 13,651	$ 16,602	$ (10,950)
Other comprehensive income (loss):				
Foreign currency translation, net of tax	6,472	(8,033)	8,093	(3,976)
Unrecognized pension and post-retirement benefit plan costs, net of tax	583	(871)	1,799	(9)
Unrecognized gains (losses) on hedging activities, net of tax	29	(119)	1,230	(841)
Other comprehensive income (loss)	7,084	(9,023)	11,122	(4,826)
Comprehensive income (loss)	$ 12,459	$ 4,628	$ 27,724	$ (15,776)

9. Inventories

Inventories consisted of the following:

	October 2, 2009	December 31, 2008
Raw materials	$ 31,942	$ 34,074
Work in process	36,216	33,691
Finished goods	21,895	21,600
	90,053	89,365
Less-Customer progress billings	(4,197)	(2,115)
Less-Allowance for excess, slow-moving and obsolete inventory	(8,487)	(6,923)
	$ 77,369	$ 80,327

10. Net Periodic Benefit Cost – Defined Benefit Plans

The following sets forth the components of net periodic benefit cost of the non-contributory defined benefit pension plans and the Company's other post-retirement employee benefit plans for periods presented.

	Three Months Ended		Nine Months Ended	
	October 2, 2009	September 26, 2008	October 2, 2009	September 26, 2008
Pension Benefits - U.S. Plans				
Service cost	$ -	$ -	$ -	$ -
Interest cost	3,470	3,576	10,410	10,727
Expected return on plan assets	(4,566)	(4,774)	(13,698)	(14,323)
Amortization	702	585	2,106	1,755
Net periodic benefit credit	$ (394)	$ (613)	$ (1,182)	$ (1,841)
Pension Benefits - Non U.S. Plans				
Service cost	$ 285	$ 267	$ 855	$ 809
Interest cost	1,145	959	3,306	2,893
Expected return on plan assets	(277)	(232)	(816)	(710)
Amortization	187	87	537	313
Net periodic benefit cost	$ 1,340	$ 1,081	$ 3,882	$ 3,305
Other Post-retirement Benefits				
Service cost	$ -	$ -	$ -	$ -
Interest cost	132	108	394	323
Amortization	88	37	264	112
Net periodic benefit cost	$ 220	$ 145	$ 658	$ 435

11. Financial Instruments

The carrying values of financial instruments, including accounts receivable, accounts payable and other accrued liabilities, approximate their fair values due to their short-term maturities. The fair value of long-term debt is estimated to approximate the carrying amount based on current interest rates for similar types of borrowings. The estimated fair values may not represent actual values of the financial instruments that could be realized as of the balance sheet date or that will be realized in the future.

The Company periodically enters into foreign currency, interest rate swap, and commodity derivative contracts. The Company uses interest rate swaps to manage exposure to interest rate fluctuations. Foreign currency contracts are used to manage exchange rate fluctuations and generally hedge transactions between the Euro and the U.S. dollar. Commodity futures contracts are used to manage costs of raw materials used in the Company's production processes.

The Company enters into such contracts with financial institutions of good standing, and the total credit exposure related to non-performance by those institutions is not material to the operations of the Company. The Company does not enter into contracts for trading purposes.

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We designate a portion of our derivative instruments as cash flow hedges for accounting purposes. For all derivatives designated as hedges, we formally document the relationship between the hedging instrument and the hedged item, as well as the risk management objective and the strategy for using the hedging instrument. We assess whether the hedging relationship between the derivative and the hedged item is highly effective at offsetting changes in the cash flows both at inception of the hedging relationship and on an ongoing basis. Any change in the fair value of the derivative that is not effective at offsetting changes in the cash flows or fair values of the hedged item is recognized currently in earnings.

Interest rate swaps and other derivative contracts are recognized on the balance sheet as assets and liabilities, measured at fair value on a recurring basis using significant observable inputs, which is Level 2 as defined in the fair value hierarchy. For transactions in which we are hedging the variability of cash flows, changes in the fair value of the derivative are reported in accumulated other comprehensive income (loss) (AOCI), to the extent they are effective at offsetting changes in the hedged item, until earnings are affected by the hedged item. Changes in the fair value of derivatives not designated as hedges are recognized currently in earnings.

On June 24, 2008, the Company entered into an interest rate swap with an aggregate notional value of $75 million whereby it exchanged its LIBOR-based variable rate interest for a fixed rate of 4.1375%. The notional value decreases to $50 million and then $25 million on June 30, 2010 and June 30, 2011, respectively, and expires on June 29, 2012. The fair values of the swap agreement were liabilities of $3.7 million at October 2, 2009 and $5.0 million at December 31, 2008, and are recorded in “Other long-term liabilities” on the consolidated balance sheets. The swap agreement has been designated as a cash flow hedge, and therefore changes in its fair value are recorded as an adjustment to other comprehensive income. There has been no ineffectiveness related to this arrangement since its inception. During the three and nine months ended October 2, 2009, $0.7 million and $2.1 million of losses on the swap were reclassified from AOCI to interest expense. At October 2, 2009, the Company expects to reclassify $2.5 million of net losses on the interest rate swap from accumulated other comprehensive income to earnings during the next twelve months.

The Company had copper and nickel futures contracts with notional values of $0.6 million at October 2, 2009 and $3.6 million at December 31, 2008. The fair values of the contracts were liabilities of $0.1 million at October 2, 2009 and $2.1 million at December 31, 2008, and are recorded in “Other accrued liabilities” on the consolidated balance sheets. The Company has not elected hedge accounting for these contracts, and therefore changes in the fair value are recognized in earnings. For the three and nine months ended October 2, 2009, respectively, the consolidated statements of operations include $0.3 million and $1.9 million of unrealized gains as a result of changes in the fair value of these commodity contracts. For the three and nine months ended September 26, 2008, respectively, the consolidated statements of operations include $0.8 million and $0.4 million of unrealized losses as a result of changes in the fair value of these commodity contracts. Realized losses on these commodity contracts of $0.2 million and $0.9 million were recognized in the three and nine months ended October 2, 2009, respectively, and less than $0.1 million of realized gains were recognized in the both the three and nine months ended September 26, 2008.

The Company had foreign currency contracts with notional values of $8.5 million at October 2, 2009 and $16.5 million at December 31, 2008. The fair values of the contracts were assets of $0.2 million at October 2, 2009 and $1.1 million at December 31, 2008, and are recorded in “Other current assets” on the consolidated balance sheets. The Company has not elected hedge accounting for these contracts, and therefore changes in the fair value are recognized in earnings. For the three and nine months ended October 2, 2009, respectively, the consolidated statements of operations include less than $0.1 million of unrealized gains and $0.8 million of unrealized losses as a result of changes in the fair value of these contracts. The consolidated statements of operations include $0.1 million of unrealized losses for both the three and nine months ended September 26, 2008, respectively, as a result of changes in the fair value of these contracts. Realized gains on these contracts of $0.4 million and $0.8 million were recognized in the three and nine months ended October 2, 2009, respectively. Realized losses of $0.1 million and $0.2 million were

recognized in the three and nine months ended September 26, 2008, respectively.

12. Commitments and Contingencies

Asbestos Liabilities and Insurance Assets

Two of our subsidiaries are each one of many defendants in a large number of lawsuits that claim personal injury as a result of exposure to asbestos from products manufactured with components that are alleged to have contained asbestos. Such components were acquired from third-party suppliers, and were not manufactured by any of our subsidiaries nor were the subsidiaries producers or direct suppliers of asbestos. The manufactured products that are alleged to have contained asbestos generally were provided to meet the specifications of the subsidiaries' customers, including the U.S. Navy. Of the 26,391 pending claims, approximately 4,800 of such claims have been brought in various federal and state courts in Mississippi; approximately 3,100 of such claims have been brought in the Supreme Court of New York County, New York; approximately 200 of such claims have been brought in the Superior Court, Middlesex County, New Jersey; and approximately 1,100 claims have been filed in state courts in Michigan and the U.S. District Court, Eastern and Western Districts of Michigan. The remaining pending claims have been filed in state and federal courts in Alabama, California, Kentucky, Louisiana, Pennsylvania, Rhode Island, Texas, Virginia, the U.S. Virgin Islands and Washington.

In most instances, the subsidiaries settle asbestos claims for amounts management considers reasonable given the facts and circumstances of each claim. The annual average settlement payment per asbestos claimant has fluctuated during the past several years. Management expects such fluctuations to continue in the future based upon, among other things, the number and type of claims settled in a particular period and the jurisdictions in which such claims arise. To date, the majority of settled claims have been dismissed for no payment.

Claims activity related to asbestos is as follows(1):

	Nine Months Ended	
	October 2, 2009	September 26, 2008
Claims unresolved at the beginning of the period	35,357	37,554
Claims filed(2)	2,512	3,282
Claims resolved(3)	(11,478)	(4,229)
Claims unresolved at the end of the period	26,391	36,607

(1) Excludes claims filed by one legal firm that have been "administratively dismissed."
(2) Claims filed include all asbestos claims for which notification has been received or a file has been opened.
(3) Claims resolved include asbestos claims that have been settled or dismissed or that are in the process of being settled or dismissed based upon agreements or understandings in place with counsel for the claimants.

The Company has projected each subsidiary's future asbestos-related liability costs with regard to pending and future unasserted claims based upon the Nicholson methodology. The Nicholson methodology is the standard approach used by most experts and has been accepted by numerous courts. It is the Company's policy to record a liability for asbestos-related liability costs for the longest period of time that it can reasonably estimate. The Company believes that it can reasonably estimate the asbestos-related liability for pending and future claims that will be resolved in the next 15 years and has recorded that liability as its best estimate. While it is reasonably possible that the subsidiaries will incur costs after this period, the Company does not believe the reasonably possible loss or range of reasonably possible loss is estimable at the current time. Accordingly, no accrual has been recorded for any costs which may be paid after the next 15 years. Defense costs, not expected to be recovered from insurers, associated with

asbestos-related liabilities as well as costs incurred related to litigation against the subsidiaries’ insurers are expensed as incurred.

A quarterly analysis of claims data including filing and dismissal rates, alleged disease mix, filing jurisdiction, as well as settlement values performed during the third quarter of 2009 resulted in the determination that the Company should revise its 15 year estimate of asbestos-related liability for pending and future claims. As a result, the Company recorded an $11.6 million pretax charge in the third quarter of 2009, which was comprised of an increase to its asbestos-related liabilities of $111.3 million offset by expected insurance recoveries of $99.7 million.

Each subsidiary has separate, substantial insurance coverage resulting from the independent corporate history of each entity. In its evaluation of the insurance asset, the Company used different insurance allocation methodologies for each subsidiary based upon the applicable law pertaining to the affected subsidiary.

For one of the subsidiaries, on October 14, 2009, the Delaware Court of Chancery ruled that asbestos-related costs should be allocated among excess insurers using an "all sums" allocation (which allows an insured to collect all sums paid in connection with a claim from any insurer whose policy is triggered, up to the policy's applicable limits) and that the subsidiary has rights to excess insurance policies purchased by a former owner of the business. Based upon this ruling mandating an "all sums" allocation, as well as the language of the underlying insurance policies and the determination that defense costs are outside policy limits, the Company as of October 2, 2009, increased its future expected recovery percentage from 67% to 90% of asbestos-related costs following the exhaustion in the future of its primary and umbrella layers of insurance and recorded a pretax gain of $17.3 million. Presently, this subsidiary is having all of its liability and defense costs covered in full by its primary and umbrella insurance carrier, whose coverage may exhaust as early as the first quarter of 2010. Presently no cost sharing or allocation agreement is in place with the Company's excess insurers. In addition to the primary and umbrella insurance coverage, the subsidiary has a substantial amount of excess insurance coverage available to it from solvent carriers.

In 2003, the other subsidiary brought legal action against a large number of its insurers and its former parent to resolve a variety of disputes concerning insurance for asbestos bodily injury claims asserted against it. Although none of the insurance companies contested coverage, they disputed the timing, reasonableness and allocation of payments. For this subsidiary it was determined by court ruling in the fourth quarter of 2007, that the allocation methodology mandated by the New Jersey courts will apply. Based upon this ruling and upon a series of other favorable rulings regarding interpretation of certain policy provisions related to deductibles, the number of occurrences, the Company expects to recover approximately 88.5% of all liability and defense costs.

Certain insurance carriers have agreed to settle with this subsidiary by reimbursing the subsidiary for amounts it paid for liability and defense costs as well as entering into formal agreements detailing the payments of future liability and defense costs in an agreed to allocation. In addition, a number of non-settling insurance carriers have paid significant amounts for liability and defense costs paid by the subsidiary in the past and continue to pay a share of costs as they are incurred. Presently, certain insurers are paying approximately 22.7% of costs for current asbestos-related liability and defense costs as they are incurred.

The Company has established reserves of $455.6 million and $357.3 million as of October 2, 2009 and December 31, 2008, respectively, for the probable and reasonably estimable asbestos-related liability cost it believes the subsidiaries will pay through the next 15 years. It has also established recoverables of $410.4 million and $304.0 million as of October 2, 2009 and December 31, 2008, respectively, for the insurance recoveries that are deemed probable during the same time period. Net of these recoverables, the Company's expected cash outlay on a non-discounted basis for asbestos-related bodily injury claims over the next 15 years was $45.2 million and $53.3 million as of October 2, 2009 and December 31, 2008, respectively. In addition the Company has recorded a receivable for liability and defense costs it had previously paid in the amount of $35.0 million and $36.4 million as of October 2, 2009 and December 31, 2008, respectively, for which insurance recovery is deemed probable. The Company has recorded the reserves for the asbestos liabilities as "Accrued asbestos liability" and "Long-term asbestos liability" and the related insurance recoveries as "Asbestos insurance asset" and "Long-term asbestos insurance asset" while the receivable for previously paid liability

and defense costs is recorded in “Asbestos insurance receivable” in the accompanying condensed consolidated balance sheets.

The income related to these liabilities and legal defense was $4.3 million and $1.2 million, net of estimated insurance recoveries, for the three and nine months ended October 2, 2009, respectively, compared to income of $6.3 million and $6.7 million for the three and nine months ended September 26, 2008, respectively. Legal costs related to the subsidiaries' action against their asbestos insurers was $1.8 million and $8.8 million for the three and nine months ended October 2, 2009, respectively, compared to $5.1 million and $12.3 million for the three and nine months ended September 26, 2008, respectively.

Management's analyses are based on currently known facts and a number of assumptions. However, projecting future events, such as new claims to be filed each year, the average cost of resolving each claim, coverage issues among layers of insurers, the method in which losses will be allocated to the various insurance policies, interpretation of the effect on coverage of various policy terms and limits and their interrelationships, the continuing solvency of various insurance companies, the amount of remaining insurance available, as well as the numerous uncertainties inherent in asbestos litigation could cause the actual liabilities and insurance recoveries to be higher or lower than those projected or recorded which could materially affect our financial condition, results of operations or cash flow.

Guarantees

At October 2, 2009, there were $14.2 million of letters of credit outstanding. Additionally, at October 2, 2009, we had issued $12.2 million of bank guarantees securing primarily customer prepayments, performance, and product warranties in our European and Asian operations.

General Litigation

On June 3, 1997, one of our subsidiaries was served with a complaint in a case brought by Litton Industries, Inc. ("Litton") in the Superior Court of New Jersey which alleges damages in excess of $10.0 million incurred as a result of losses under a government contract bid transferred in connection with the sale of its former Electro-Optical Systems business. In the third quarter of 2004, this case was tried and the jury rendered a verdict of $2.1 million for the plaintiffs. After appeals by both parties, the Supreme Court of New Jersey upheld the plaintiffs' right to a refund of their attorney's fees and costs of trial, but remanded the issue to the trial court to reconsider the amount of fees using a proportionality analysis of the relationship between the fee requested and the damages recovered. The date for the new trial on additional claims allowed by the Appellate Division of the New Jersey Superior Court and the recalculation of attorney's fees has not been set. The subsidiary intends to continue to defend this matter vigorously. At October 2, 2009, the Company's consolidated balance sheet includes a liability, reflected in "Other liabilities", related to this matter of $9.5 million, which is unchanged from the prior period.

In April 1999, the Company's Imo Industries subsidiary resolved through a settlement the matter of Young v. Imo Industries Inc. that was pending in the United States District Court for the District of Massachusetts. This matter had been brought on behalf of a class of retirees of one of the subsidiary's divisions relating to retiree health care obligations. On June 15, 2005, a motion was filed seeking an order that certain of the features of the plan as implemented by the Company were in violation of the settlement agreement. On December 16, 2008, the parties executed a Memorandum of Understanding, memorializing the principal terms of a new settlement agreement that will resolve the litigation in its entirety. As a result of the parties' efforts in this regard, the case has been removed from the trial calendar, pending the filing of a final settlement agreement with the court. A final settlement agreement was signed on July 17, 2009 which will supersede and replace the Stipulation and Agreement of Settlement and Dismissal of Claims entered into by the parties on November 30, 1998. The Court preliminarily approved the settlement agreement; final approval will be discussed at a fairness hearing currently scheduled for November 24, 2009. At October 2, 2009, the Company's consolidated balance sheet includes an accumulated post retirement benefit obligation of $2.4 million for this matter.

The Company is also involved in various other pending legal proceedings arising out of the ordinary course of the Company's business. None of these legal proceedings are expected to have a material adverse effect on the financial condition, results of operations or cash flow of the Company. With respect to these proceedings and the litigation and claims described in the preceding paragraphs, management of the Company believes that it will either prevail, has adequate insurance coverage or has established appropriate reserves to cover potential liabilities. Any costs that management estimates may be paid related to these proceedings or claims are accrued when the liability is considered probable and the amount can be reasonably estimated. There can be no assurance, however, as to the ultimate outcome of any of these matters, and if all or substantially all of these legal proceedings were to be determined adversely to the Company, there could be a material adverse effect on the financial condition, results of operations or cash flow of the Company.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of our financial condition and results of operations should be read in conjunction with the financial statements and notes included in Part I, Item I "Financial Statements" of this quarterly report and the audited financial statements and related footnotes included in our Annual Report on Form 10-K for the year ended December 31, 2008 filed with the SEC on March 6, 2009.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Some of the statements contained in this Form 10-Q that are not historical facts are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934 (the "Exchange Act"). We intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in Section 21E of the Exchange Act. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date this Form 10-Q is filed with the SEC. All statements other than statements of historical fact are statements that could be deemed forward-looking statements, including statements regarding: projections of revenue, profit margins, expenses, tax provisions and tax rates, earnings or losses from operations, impact of foreign exchange rates, cash flows, pension and benefit obligations and funding requirements, synergies or other financial items; plans, strategies and objectives of management for future operations including statements relating to potential acquisitions, compensation plans, purchase commitments; developments, performance or industry or market rankings relating to products or services; future economic conditions or performance; the outcome of outstanding claims or legal proceedings including asbestos-related liabilities and insurance coverage litigation; potential gains and recoveries of costs; assumptions underlying any of the foregoing; and any other statements that address activities, events or developments that we intend, expect, project, believe or anticipate will or may occur in the future. Forward-looking statements may be characterized by terminology such as "believe," "anticipate," "should," "would," "intend," "plan," "will," "expect," "estimate," "project," "positioned," "strategy," and similar expressions. These stat based on assumptions and assessments made by our management in light of their experience and perception of historical trends, current conditions, expected future developments and other factors we believe to be appropriate. These forward-looking statements are subject to a number of risks and uncertainties, including but not limited to the following:

- risks associated with our international operations;
- significant movements in foreign currency exchange rates;
- changes in the general economy, including the current global economic downturn as well as the cyclical nature of our markets;
- our ability to accurately estimate the cost of or realize savings from restructuring programs;
- availability and cost of raw materials, parts and components used in our products;
- the competitive environment in our industry;
- our ability to identify, acquire and successfully integrate attractive acquisition targets;
- the amount of and our ability to estimate our asbestos-related liabilities;

- material disruption at any of our significant manufacturing facilities;
- the solvency of our insurers and the likelihood of payment for asbestos-related claims;

- our ability to manage and grow our business and execution of our business and growth strategies;
- loss of key management;
- our ability and the ability of customers to access required capital at a reasonable cost;
- our ability to expand our business in our targeted markets;
- our ability to cross-sell our product portfolio to existing customers;
- the level of capital investment and expenditures by our customers in our strategic markets;
- our financial performance; and
- others risks and factors, listed under the "Risk Factors" section of this Form 10-Q as well as our Annual Report on Form 10-K for the year ended December 31, 2008 filed with the SEC on March 6, 2009.

Any such forward-looking statements are not guarantees of future performance and actual results, developments and business decisions may differ materially from those envisaged by such forward-looking statements. These forward-looking statements speak only as of the date this Form 10-Q is filed with the SEC. We do not assume any obligation and do not intend to update any forward-looking statement except as required by law.

Overview

We are a global supplier of a broad range of fluid handling products, including pumps, fluid handling systems and controls, and specialty valves. We believe that we are a leading manufacturer of rotary positive displacement pumps, which include screw pumps, gear pumps and progressive cavity pumps. We have a global manufacturing footprint, with production facilities in Europe, North America and Asia, as well as worldwide sales and distribution channels. Our products serve a variety of applications in five strategic markets: commercial marine, oil and gas, power generation, global navy and general industrial. We design and engineer our products to high quality and reliability standards for use in critical fluid handling applications where performance is paramount. We also offer customized fluid handling solutions to meet individual customer needs based on our in-depth technical knowledge of the applications in which our products are used. Our products are marketed principally under the Allweiler, Fairmount, Houttuin, Imo, LSC, Portland Valve, Tushaco, Warren and Zenith brand names. We believe that our brands are widely known and have a premium position in our industry. Allweiler, Houttuin, Imo and Warren are among the oldest and most recognized brands in the markets in which we participate, with Allweiler dating back to 1860.

We believe that one of our most significant competitive advantages comes through a comprehensive set of tools and processes we employ that we refer to as the Colfax Business System ("CBS"). CBS is a disciplined strategic planning and execution methodology designed to achieve excellence and world-class financial performance in all aspects of our business by focusing on the Voice of the Customer and continuously improving quality, delivery and cost.

Outlook

The economic downturn had a significant impact our sales and operating profit through the third quarter of 2009. Our order rates are down significantly and if current economic conditions continue, our business results will continue to be negatively affected. In addition, we have had project delivery push-outs as well as cancellations which are likely to continue until conditions improve. We will continue to monitor global economic conditions and presently expect the following market conditions:

- In the commercial marine industry, we expect international trade and demand for crude oil and other commodities as well as the age of the global merchant fleet to continue to create demand for new ship construction over the long term. We expect sales to grow in 2009 primarily from our beginning of the year backlog. We also believe the increase in the size of the global fleet will create an opportunity to supply aftermarket parts and service. We expect new orders to continue to be significantly lower than in the past two years and we are also likely to have additional order cancellations as well as delivery date extensions.

- We expect activity within the crude oil market to remain favorable long term as capacity constraints and global demand drive further development of heavy oil fields, but we have been experiencing project delays. In pipeline applications, we expect demand for our highly efficient products to remain strong as our customers continue to focus on total cost of ownership. In refinery applications, a reduction in capital investment by our customers continues to impact the demand for our products.

- In the power generation industry, we expect activity in Asia and the Middle East to remain strong as economic growth and fundamental undersupply of power generation capacity continues to drive investment in energy infrastructure projects. In the world's developed economies, we expect efficiency improvements will continue to drive demand. Activity in this market is currently stable but we are experiencing delivery date push outs.

- In the U.S., we expect Congress to continue to appropriate funds for new ship construction as older naval vessels are decommissioned. We also expect increased demand for integrated fluid handling systems for both new ship platforms and existing ship classes that reduce operating costs and improve efficiency as the U.S. Navy seeks to man vessels with fewer personnel. Outside of the U.S., we expect other sovereign nations will continue to expand their fleets as they address national security concerns. We expect both increased sales and orders in the near term.

- In the general industrial market, we expect that global infrastructure development will drive capital investment over the long term and will benefit local suppliers as well as international exporters of fluid handling equipment. However, demand has softened across the board and has declined significantly in several portions of this market, including machinery support, building products, chemical, distribution, and waste water, primarily in Europe and North America.

Based on declining orders and our culture of continuous improvement, we initiated a series of restructuring actions during 2009 to better position the Company's cost structure for future periods. As a result, the Company recorded pre-tax restructuring and other related costs of $9.6 million and $10.8 million for the three and nine month periods ended October 2, 2009, respectively. As of October 2, 2009, we have reduced our company-wide workforce by 230 associates from December 31, 2008. Additionally, 628 associates participate in a German government-sponsored furlough program in which the government pays the wage-related costs of workers that work less than a full work week. We are currently implementing a voluntary termination program to convert a portion of the furloughed workforce to permanent headcount reductions. We closed a repair facility in Aberdeen, NC and have announced our plan to close an additional facility in Sanford, NC and move the production operations to two of our other facilities, which we expect to complete by the end of 2009. We expect to realize savings of approximately $16 million in 2009 from our restructuring activities to date. We continue to monitor our order rates and will adjust our manufacturing capacity and cost structure as demand warrants.

Key Performance Measures

The discussion of our results of operations that follows focuses on some of the key financial measures that we use to evaluate our business. We evaluate growth using several measures described below, including net sales, orders and order backlog. Our sales growth is affected by many factors, particularly the impact of acquisitions, the impact of fluctuating foreign exchange rates and growth in our existing businesses. To facilitate the comparison between

reporting periods, we describe the impact of each of these three factors, to the extent they impact the periods presented, on our sales growth below in tabular format under the heading “Sales and Orders.”

Orders and order backlog are highly indicative of our future revenue and thus a key measure of anticipated performance. Orders consist of orders for products or services from our customers. Order backlog consists of unfilled orders.

Seasonality

We experience seasonality in our fluid handling business. As our customers seek to fully utilize capital spending budgets before the end of the year, historically our shipments have peaked during the fourth quarter. Also, our European operations typically experience a slowdown during the July and August holiday season. General economic conditions as well as backlog levels may, however, impact future seasonal variations.

Results of Operations

Items Affecting Comparability of Reported Results

Our results for the nine months ended October 2, 2009 include the impact of three additional business days as compared to the nine months ended September 26, 2008. The third quarter of 2009 had one additional business day as compared to 2008. The fourth quarter of 2009 will have four fewer business days than the fourth quarter of 2008. The comparability of our operating results for the three and nine months ended October 2, 2009 and September 26, 2008 is affected by the following significant items:

Acquisitions

Acquisitions affect our reported results and can make period to period comparisons of results difficult. As a result, we disclose our sales growth between periods both from existing and acquired businesses.

On August 31, 2009, we completed the acquisition of PD-Technik Ingenieurbüro GmbH (“PD-Technik”), a provider of marine aftermarket related products and services located in Hamburg, Germany, for $1.3 million, net of cash acquired in the transaction.

Selling, general and administrative expenses for the three and nine months ended September 26, 2008 include $0.6 million of due diligence costs related to a potential acquisition that did not result in a purchase agreement.

Foreign Currency Fluctuations

A significant portion of our sales, approximately 66% and 67%, respectively, for the three and nine months ended October 2, 2009, is denominated in currencies other than the U.S. dollar, most notably the Euro and the Swedish Krona. Because much of our manufacturing and employee costs are outside the U.S., a significant portion of our costs are also denominated in currencies other than the U.S. dollar. Changes in foreign exchange rates can impact our results and are quantified, when significant, in our discussion of the results of our operations.

Restructuring and Other Related Charges

Our results for the three and nine months ended October 2, 2009 include $9.6 million and $10.8 million, respectively, of restructuring and other related charges incurred to better position the Company’s cost structure for future periods.

IPO-related Costs

Results for the nine months ended September 26, 2008 include $57.0 million of nonrecurring costs associated with our initial public offering in May 2008.

Legacy Legal Adjustment

Selling, general and administrative expenses for the nine months ended September 26, 2008 include a $4.1 million charge to legacy legal reserves related to a non-asbestos legal matter that was settled in the third quarter of 2008.

Asbestos-related (Income) Expense

Asbestos-related (income) expense includes all asbestos-related costs and is comprised of projected indemnity cost, changes in the projected asbestos liability, changes in the probable insurance recovery of the projected asbestos-related liability, changes in the probable recovery of asbestos liability and defense costs paid in prior periods, and actual defense costs expensed in the period (“Asbestos liability and defense income”). It also includes legal costs related to the actions against two of our subsidiaries’ respective insurers and a former parent company of one of the subsidiaries (“Asbestos coverage litigation expenses”).

The table below presents asbestos-related expense (income) for the periods indicated:

(Amounts in millions)	Three Months Ended October 2, 2009	Three Months Ended September 26, 2008	Nine Months Ended October 2, 2009	Nine Months Ended September 26, 2008
Asbestos liability and defense income	$ (4.3)	$ (6.3)	$ (1.2)	$ (6.7)
Asbestos coverage litigation expenses	1.8	5.1	8.8	12.3
Asbestos-related (income) expense	$ (2.5)	$ (1.2)	$ 7.7	$ 5.6

Asbestos liability and defense income was $4.3 million and $1.2 million for the three and nine months ended October 2, 2009, respectively, compared to income of $6.3 million and $6.7 million for the three and nine months ended September 26, 2008, respectively. The decrease in asbestos liability and defense income for the three and nine months ended October 2, 2009 relates primarily to a $17.3 million increase in the insurance asset as a result of a favorable court ruling and a determination that defense costs do not erode insurance limits, offset by an $11.6 million increase to the asbestos liability arising from a revision to our 15 year estimate of asbestos-related liabilities. These two items recorded in the three months ended October 2, 2009, resulted in a net pretax gain of $5.7 million. During 2008, the Company recorded pretax gains totaling $7.9 million resulting from a carrier acknowledging an additional $7.0 million of solvent coverage and the receipt of $0.9 million from an insurer previously considered insolvent.

Legal costs related to the subsidiaries’ action against their asbestos insurers were $1.8 million and $8.8 million for the three and nine months ended October 2, 2009, respectively, compared to $5.1 million and $12.3 million for the three and nine months ended September 26, 2008, respectively. Legal costs were higher in the prior year due to trial preparation efforts by one of our subsidiaries against a number of its insurers and former parent. The trial had been expected to begin in the fourth quarter of 2008 but has been delayed until the fourth quarter of 2009. See Note 12 to our Condensed Consolidated Financial Statements for a further discussion of recent developments in asbestos litigation.

Sales and Orders

Our sales are affected by many factors including but not limited to acquisitions, fluctuating foreign exchange rates and growth (decline) in our existing businesses. To facilitate the comparison between reporting periods, we disclose the impact of each of these factors to the extent they impact the periods presented. The impact of foreign currency translation is the difference between sales from existing businesses valued at current-year foreign exchange rates and

the same sales valued at prior-year foreign exchange rates. Sales growth (decline) from existing businesses excludes the impact of foreign exchange rate fluctuations, thus providing a measure of growth due to factors such as price, mix and volume.

Orders and order backlog are highly indicative of our future revenue and thus are key measures of anticipated performance. Orders consist of orders for products or services from our customers, net of cancellations, during a period. Order backlog consists of unfilled orders at the end of a period. The components of order growth are presented on the same basis as sales growth.

The following tables present components of the decline in our sales and orders, as well as sales by fluid handling product for the periods indicated:

	Sales		Orders	
(Amounts in millions)	$	%	$	%
Three Months Ended September 26, 2008	$ 153.5		$ 173.8	
Components of Change:				
Existing Businesses	(18.4)	(12.0)%	(44.3)	(25.5)%
Acquisitions	0.5	0.3%	0.4	0.2%
Foreign Currency Translation	(7.1)	(4.6)%	(5.6)	(3.2)%
Total	(25.0)	(16.2)%	(49.5)	(28.5)%
Three Months Ended October 2, 2009	$ 128.5		$ 124.3	

	Sales		Orders		Backlog at	
(Amounts in millions)	$	%	$	%	Period End	
Nine Months Ended September 26, 2008	$ 445.5		$ 542.9		$ 383.1	
Components of Change:						
Existing Businesses	(11.4)	(2.5)%	(162.6)	(29.9)%	(83.9)	(21.9)%
Acquisitions	0.5	0.1%	0.4	0.1%	0.5	0.1%
Foreign Currency Translation	(40.5)	(9.1)%	(31.5)	(5.8)%	(1.7)	(0.4)%
Total	(51.4)	(11.6)%	(193.7)	(35.7)%	(85.1)	(22.2)%
Nine Months Ended October 2, 2009	$ 394.1		$ 349.2		$ 298.0	

	Three Months Ended		Nine Months Ended	
(Amounts in millions)	October 2, 2009	September 26, 2008	October 2, 2009	September 26, 2008
Net Sales by Product:				
Pumps, including aftermarket parts and service	$ 107.1	$ 136.3	$ 336.7	$ 392.2
Systems, including installation service	17.8	12.5	49.1	41.4

Valves	3.1	2.0	6.5	5.9
Other	0.5	2.7	1.8	6.0
Total net sales	$ 128.5	$ 153.5	$ 394.1	$ 445.5

As detailed above, for the three months ended October 2, 2009, sales from existing businesses were down 12.0%, primarily due to a significant decline in sales volume in the general industrial end market as well as declines in the commercial marine and oil and gas end markets, resulting from the global economic downturn, partially offset by sales volume increases in the global navy and power generation end markets. For the nine month period, sales from existing businesses decreased 2.5%, as increased sales volumes in the commercial marine, global navy and oil and gas end markets were more than offset by the decline in the general industrial end market resulting from the global economic downturn. Foreign currency translation negatively impacted sales and orders for both the three and nine month periods ending October 2, 2009, primarily due to the strengthening of the U.S. dollar against the Euro.

Orders, net of cancellations, from existing businesses for the three and nine months ended October 2, 2009 declined 25.5% and 29.9%, respectively, over the comparable period in the prior year. In both periods, the declines in orders from existing businesses were primarily attributable to a significant decline in demand in the commercial marine, general industrial, oil and gas and power generation end markets. We experienced commercial marine project cancellations of approximately $0.5 million and $15.5 million for the three and nine months ended October 2, 2009, respectively, as a result of the economic downturn. Backlog as of October 2, 2009 of $298.0 million decreased $85.1 million, or 22.2%, as compared to $383.1 million at September 27, 2008. Since July 3, 2009, backlog decreased $4.6 million, or 1.6%, excluding the impacts of foreign currency translation and acquisitions, which had positive impacts of $9.8 million and $0.5 million, respectively.

Gross Profit

The following table presents our gross profit figures for the periods indicated:

	Three Months Ended		Nine Months Ended	
(Amounts in millions)	October 2, 2009	September 26, 2008	October 2, 2009	September 26, 2008
Gross Profit	$ 46.2	$ 54.5	$ 138.8	$ 159.4
Gross Profit Margin	35.9%	35.5%	35.2%	35.8%

Gross profit decreased $8.3 million to $46.2 million for the three months ended October 2, 2009. Gross profit from existing businesses decreased $6.0 million, with an additional $2.3 million negative impact of foreign exchange rates. For the quarter, gross profit margin improved over the prior year period as our restructuring programs offset the impact of lower revenues in the quarter.

Gross profit for the nine months ended October 2, 2009 decreased $20.7 million to $138.8 million, primarily due to a $14.5 million negative impact of foreign exchange rates. The margin decline was primarily driven by decreased production resulting in lower absorption of fixed manufacturing costs which more than offset restructuring program cost savings and favorable pricing and product mix in the commercial marine and general industrial markets.

Selling, General and Administrative Expenses (“SG&A”)

The following table presents our selling, general and administrative expenses for the periods indicated:

	Three Months Ended		Nine Months Ended	
(Amounts in millions)	October 2, 2009	September 26, 2008	October 2, 2009	September 26, 2008
SG&A Expenses	$ 28.1	$ 33.2	$ 86.2	$ 97.5
SG&A Expenses as a percentage of sales	21.9%	21.7%	21.9%	21.9%

Selling, general and administrative expenses decreased $5.1 million to $28.1 million for the three months ended October 2, 2009 compared to $33.2 million for the three months ended September 26, 2008. The impact of foreign exchange rates reduced SG&A expenses by $1.5 million. Excluding this impact, selling, general and administrative expenses for the three months ended October 2, 2009 were $3.6 million lower than the prior year period, primarily attributable to $1.9 million of lower selling expenses and $1.3 million of higher income on raw material futures and

foreign currency contracts for which we did not elect hedge accounting.

Selling, general and administrative expenses decreased $11.3 million to $86.2 million for the nine months ended October 2, 2009 compared to $97.5 million for the nine months ended September 26, 2008, due primarily to the $7.8 million negative impact of foreign exchange rates. The remaining decrease was primarily due to lower charges for legacy legal matters.

Operating Income

The table below presents operating income data for the periods indicated:

(Amounts in millions)	Three Months Ended October 2, 2009	Three Months Ended September 26, 2008	Nine Months Ended October 2, 2009	Nine Months Ended September 26, 2008
Operating income (loss)	$ 9.4	$ 20.9	$ 29.5	$ (5.0)
Operating margin	7.3%	13.6%	7.5%	(1.1)%

Operating income for the three months ended October 2, 2009 decreased $11.5 million to $9.4 million from $20.9 million for the three months ended September 26, 2008. This decrease was largely due to $9.6 million of restructuring and other related charges incurred in the current-year period as well as a $0.4 million negative impact of foreign exchange rates. Excluding these impacts, operating income was $1.5 million lower than the prior year quarter, primarily attributable to lower sales from existing businesses, offset substantially by lower SG&A expenses.

Operating income for the nine months ended October 2, 2009 increased $34.5 million to $29.5 million from a loss of $5.0 million for the nine months ended September 26, 2008. This increase was primarily due to the absence of $57.0 million of initial public offering-related costs incurred in the second quarter of 2008. The impact of foreign exchange rates reduced operating income by $6.0 million. Excluding these impacts, operating income was $16.5 million lower than the nine months ended September 26, 2008, primarily due to lower sales volume from existing businesses and restructuring charges incurred in the current-year period.

Interest Expense

For a description of our outstanding indebtedness, please refer to "—Liquidity and Capital Resources" below.

Interest expense for the three months ended October 2, 2009 decreased $0.1 million to $1.8 million from $2.0 million for the three months ended September 26, 2008. The decrease was primarily due to lower debt levels during the third quarter of 2009 compared to the same period in 2008. A decrease in the weighted-average interest rate on our variable rate borrowings from 5.7% for the three months ended September 26, 2008 to 5.6% for the three months ended October 2, 2009 contributed less than $0.1 million to the decrease in interest expense.

Interest expense for the nine months ended October 2, 2009 decreased $4.2 million to $5.5 million from $9.7 million for the nine months ended September 26, 2008. The decrease was primarily due to lower debt levels during 2009 compared to 2008 as a result of debt repayments of $105.4 million from a portion of the IPO proceeds in the second quarter of 2008. A decrease in the weighted-average interest rate on our variable rate borrowings from 5.9% for the nine months ended September 26, 2008 to 5.6% for the nine months ended October 2, 2009 contributed approximately $0.2 million to the decrease in interest expense.

Provision for Income Taxes

The effective income tax rates for the three and nine months ended October 2, 2009 were 28.9% and 30.9%, respectively. Our effective tax rate for the three months ended October 2, 2009 was lower than the U.S. federal statutory rate primarily due to international tax rates which are lower than the U.S. tax rate and the net effect of the realization of previously unrecognized tax benefits as well as other discrete items. The effective tax rate for the nine months ended October 2, 2009 differs from the U.S. federal statutory rate primarily due to international tax rates which are lower than the U.S. tax rate, including the impact of the reduction in 2009 of the Swedish tax rate from 28% to 26.3% that is applied to our Swedish operations, offset in part by a net increase to our valuation allowance and unrecognized tax benefit liability.

For the three and nine months ended September 26, 2008, the Company had effective tax expense (benefit) rates of 28.1% and (25.6)%. The effective tax expense rate for the three months ended September 26, 2008 was lower than the U.S. federal statutory rate primarily due to expected lower effective tax rates on normal operations in Germany and other international jurisdictions compared to the U.S. tax rate plus the net effect of the realization of previously unrecognized tax benefits. The lower effective tax (benefit) rate for the nine months ended September 26, 2008 compared to the U.S. federal statutory rate is primarily due to an $11.8 payment to reimburse certain selling shareholders for underwriters discounts that are not deductible for tax purposes offset in part by an expected lower overall rate on normal operations due to reductions in the German corporate tax rates in 2008, other international tax rates that are lower than the U.S. tax rate, changes in overall profitability and the net effect of the realization of previously unrecognized tax benefits.

Liquidity and Capital Resources

Overview

Historically, we have financed our capital and working capital requirements through a combination of cash flows from operating activities and borrowings under our credit facility. We expect that our primary ongoing requirements for cash will be for working capital, funding for potential acquisitions, capital expenditures, asbestos-related outflows and pension plan funding. If additional funds are needed for strategic acquisitions or other corporate purposes, we believe we could raise additional funds in the form of debt or equity.

Borrowings

During the nine months ended October 2, 2009, we made principal payments of $3.8 million on our Term A Note, leaving $92.5 million outstanding at the end of the period. At October 2, 2009, the interest rate on the Term A Note was 2.50% inclusive of 2.25% margin and the annual commitment fee on our $150.0 million revolver was 0.4%. At October 2, 2009, there was $14.2 million outstanding on the letter of credit sub-facility, leaving approximately $135.8 million available under the revolver loan. Of the total $135.8 million available, it is unlikely that we would be able to draw on Lehman Brothers' $6.0 million commitment due to their bankruptcy and resulting default under the terms of the revolver.

Substantially all assets and stock of the Company's domestic subsidiaries and 65% of the shares of certain European subsidiaries are pledged as collateral against borrowings under our credit agreement. Certain European assets are pledged against borrowings directly made to our European subsidiary. Our credit agreement contains customary covenants limiting the Company's ability to, among other things, pay cash dividends, incur debt or liens, redeem or repurchase Company stock, enter into transactions with affiliates, make investments, merge or consolidate with others or dispose of assets. In addition, our credit agreement contains financial covenants requiring the Company to maintain a total leverage ratio of not more than 3.25 to 1.0 and a fixed charge coverage ratio of not less than 1.5 to 1.0,

measured at the end of each quarter. If the Company does not comply with the various covenants under our credit agreement and related agreements, the lenders may, subject to various customary cure rights, require the immediate payment of all amounts outstanding under the Term A Note and revolver and foreclose on the collateral. The Company believes it is in compliance with all such covenants as of October 2, 2009 and expects to be in compliance for the next 12 months.

Comparative Cash Flows

The table below presents selected cash flow data for the periods indicated:

(Amounts in millions)	Nine Months Ended October 2, 2009	Nine Months Ended September 26, 2008
Net cash provided by (used in) operating activities	$ 34.0	$ (30.7)
Purchases of fixed assets	(7.8)	(13.3)
Acquisitions, net of cash acquired	(1.3)	-
Other	0.3	-
Net cash used in investing activities	$ (8.8)	$ (13.3)
Proceeds and repayments of borrowings, net	(3.8)	(107.8)
Net proceeds from IPO	-	193.0
Dividends paid to preferred shareholders	-	(38.5)
Payments made for loan costs	-	(3.2)
Other uses, net	(0.4)	(0.2)
Net cash (used in) provided by financing activities	$ (4.2)	$ 43.3

Cash flows from operating activities can fluctuate significantly from period to period as working capital needs, the timing of payments for items such as pension funding decisions and other items impact reported cash flows. Changes in significant operating cash flow items are discussed below.

- Cash paid for asbestos-related costs net of insurance proceeds, including the disposition of claims, defense costs and legal expenses related to litigation against our insurers, was a significant cash outflow. For the nine months ended October 2, 2009 and September 26, 2008 net cash paid for asbestos-related costs, net of insurance proceeds, was $13.0 million and $10.9 million, respectively.

- Funding requirements of our defined benefit plans, including both pensions and other post-retirement benefits, can vary significantly among periods due to government funding requirements, investment strategy, changes in the fair value of plan assets and actuarial assumptions. For the nine months ended October 2, 2009 and September 26, 2008, cash contributions for defined benefit plans were $4.3 million and $3.6 million, respectively.

- Net cash used in operating activities for the nine months ended September 26, 2008 includes cash paid for nonrecurring IPO-related costs of $42.4 million ($30.6 million of special bonuses and related fringe costs paid under previously adopted executive compensation plans and $11.8 million to reimburse the selling stockholders for the underwriting discount on the shares sold by them in the IPO).

- Changes in working capital also affected the operating cash flows for the periods presented. We define working capital as trade receivables plus inventories less accounts payable.

- As the result of lower sales volumes, working capital, excluding the effect of foreign currency translation, decreased $6.0 million from December 31, 2008 to October 2, 2009, reflecting a $5.8 million decline in inventory. A $15.7 million reduction in accounts payable was more than offset by a $15.9 million decrease in accounts receivable.

- Net working capital as a percentage of sales is a key ratio that we use to measure working capital efficiency. For the nine months ended October 2, 2009 and September 26, 2008, net working capital as a percentage of annualized sales was 24.7% and 22.6%, respectively.

Investing activities consist primarily of purchases of fixed assets.

- In all periods presented, capital expenditures were invested in new and replacement machinery, equipment and information technology. We generally target capital expenditures at approximately 2.0% to 2.5% of revenues.

- In August 2009, we acquired PD-Technik for $1.3 million, net of cash acquired in the transaction.

Financing cash flows consist primarily of borrowings and repayments of indebtedness, payment of dividends to shareholders and redemptions of stock.

- During the nine months ended October 2, 2009, we repaid $3.8 million of long-term borrowings.

- Net IPO proceeds of $193.0 million were received in the first nine months of 2008. We used these proceeds to: (i) repay approximately $105.4 million of indebtedness outstanding under our credit facility existing at that time, (ii) pay dividends to existing preferred stockholders of record immediately prior to the consummation of the IPO in the amount of $38.5 million, (iii) pay $11.8 million to the selling stockholders in the IPO as reimbursement for the underwriting discount incurred on the shares sold by them, and (iv) pay special bonuses of approximately $27.8 million to certain of our executives under previously adopted executive compensation plans. The remainder of the proceeds was applied to working capital.

- We paid approximately $3.2 million in deferred loan costs related to our new credit facility entered into in May 2008.

Critical Accounting Estimates

The methods, estimates and judgments we use in applying our critical accounting policies have a significant impact on the results we report in our financial statements. We evaluate our estimates and judgments on an ongoing basis. Our estimates are based upon our historical experience, our evaluation of business and macroeconomic trends, and information from other outside sources as appropriate. Our experience and assumptions form the basis for our judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may vary from what our management anticipates and different assumptions or estimates about the future could change our reported results.

There have been no significant changes for the nine months ended October 2, 2009 to the items that we disclosed as our critical accounting policies and estimates in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2008 filed with the SEC on March 6, 2009.

Recent Accounting Pronouncements

See Note 3 to our Condensed Consolidated Financial Statements for a discussion of recently issued and adopted accounting pronouncements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to market risk from changes in interest rates, foreign currency exchange rates and commodity prices that could impact our results of operations and financial condition. We address our exposure to these risks through our normal operating and financing activities.

Information concerning market risk for the nine months ended October 2, 2009 is discussed below.

Interest Rate Risk

We are subject to exposure from changes in interest rates based on our financing activities. Under our credit facility, all of our borrowings at October 2, 2009 are variable rate facilities based on LIBOR or EURIBOR. In order to mitigate our interest rate risk, we periodically enter into interest rate swap or collar agreements. A hypothetical increase in the interest rate of 1.00% on the portion of our variable rate debt that is not hedged during the nine months ended October 2, 2009 would have increased our interest cost by approximately $0.2 million.

On June 24, 2008, we entered into an interest rate swap with an aggregate notional value of $75 million whereby we exchanged our LIBOR-based variable rate interest for a fixed rate of 4.1375%. The notional value decreases to $50 million and then $25 million on June 30, 2010 and June 30, 2011, respectively and expires on June 29, 2012. The fair value of the swap agreement, based on third-party quotes, was a liability of $3.7 million at October 2, 2009. The swap agreement has been designated as a cash flow hedge, and therefore changes in its fair value are recorded as an adjustment to other comprehensive income.

Exchange Rate Risk

We have manufacturing sites throughout the world and sell our products globally. As a result, we are exposed to movements in the exchange rates of various currencies against the U.S. dollar and against the currencies of other countries in which we manufacture and sell products and services. During the three and nine months ended October 2, 2009, approximately 65.8% and 66.9%, respectively, of our sales were derived from operations outside the U.S., with approximately 61.8% and 63.4%, respectively, generated from our European operations. In particular, we have more sales in European currencies than we have expenses in those currencies. Therefore, when European currencies strengthen or weaken against the U.S. dollar, operating profits increase or decrease, respectively. To assist with the matching of revenues and expenses and assets and liabilities in foreign currencies, we may periodically enter into derivative instruments such as cross currency swaps or forward contracts. To illustrate the potential impact of changes in foreign currency exchange rates, assuming a 10% increase in average foreign exchange rates compared to the U.S. dollar, income before income taxes for the three and nine months ended October 2, 2009, would have increased by $0.3 million and $2.9 million, respectively.

Commodity Price Risk

We are exposed to changes in the prices of raw materials used in our production processes. Commodity futures contracts are periodically used to manage such exposure. As of October 2, 2009, we had copper and nickel futures contracts with notional values of $0.6 million that were in an unrealized loss position of $0.1 million. We have not elected hedge accounting for these futures contracts, and therefore changes in their fair value are included in net income.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as of the end of the period covered by this report. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective in providing reasonable assurance that the information required to be disclosed in this report has been recorded, processed, summarized and reported as of the end of the period covered by this report.

Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commissions rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There was no change in our "internal control over financial reporting" (as defined in Rule 13a-15(f)) identified in connection with the evaluation required by Rule 13a-15(d) of the Exchange Act that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

Discussion of legal matters is incorporated by reference to Part I, Item 1, Note 12, "Commitments and Contingencies," in the Notes to the Condensed Consolidated Financial Statements.

Item 1A. Risk Factors

An investment in our common stock involves a high degree of risk. The following risk factor is provided to supplement and update the Risk Factors previously disclosed in the Risk Factors section of our Annual Report on Form 10-K for the year ended December 31, 2008, filed with the SEC on March 6, 2009.

Changes in the general economy, including the current global financial crisis and economic downturn, and the cyclical nature of our markets could harm our operations and financial performance.

Our financial performance depends, in large part, on conditions in the markets we serve and on the general condition of the global economy. Any sustained weakness in demand, downturn or uncertainty in the global economy could reduce our sales and profitability, and result in restructuring efforts. Restructuring efforts are inherently risky and we may not be able to predict the cost and timing of such actions accurately or properly estimate the impact on demand, if any. We also may not be able to realize the anticipated savings we expected from restructuring activities. The current global economic downturn may materially affect demand for our products and we may not be able to predict the effect on our results. In addition, our products are sold in many industries, some of which are cyclical and may experience periodic downturns. Cyclical weakness in the industries we serve could lead to reduced demand for our products and affect our profitability and financial performance.

We believe that many of our customers and suppliers are reliant on liquidity from global credit markets and in some cases, require external financing to purchase products or finance operations. If the current conditions impacting the credit markets and general economy are prolonged, demand for our products may be negatively affected and orders may be canceled or delayed, which could materially impact our financial position, results of operations and cash flow. Further, lack of liquidity by our customers could impact our ability to collect amounts owed to us and lack of liquidity by financial institutions could impact our ability to fully access our existing credit facility.

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

None.

Item 3. Defaults Upon Senior Securities

None.

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

None.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit No.	Exhibit Description
31.01	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.02	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.01	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.02	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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.

Registrant: Colfax Corporation

By:

/s/ JOHN A. YOUNG John A. Young	President and Chief Executive Officer (Principal Executive Officer)	November 16, 2009
/s/ G. SCOTT FAISON G. Scott Faison	Senior Vice President, Finance and Chief Financial Officer (Principal Financial and Accounting Officer)	November 16, 2009

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