

PENTAIR INC
Form 10-K405
March 19, 2002
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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, 2001

OR

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

Commission file number 1-11625

Pentair, Inc.

(Exact name of Registrant as specified in its charter)

Minnesota

41-0907434

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification number)

**1500 County Road B2 West, Suite 400,
St. Paul, Minnesota**

55113

(Address of principal executive offices)

(Zip code)

Registrant's telephone number, including area code: (651) 636-7920

Securities registered pursuant to Section 12(b) of the Act:

Title of each class

Name of each exchange on which registered

Common Shares, \$0.16 2/3 par value

New York Stock Exchange

Common Share Purchase Rights

New York Stock Exchange

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark 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.

The aggregate market value of voting stock held by nonaffiliates of the Registrant on March 4, 2002 was \$1,872,150,626 based upon a closing price of \$41.9063 per share. The number of shares outstanding of Registrant's only class of common stock on March 4, 2002, was 49,178,709.

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Annual Report on Form 10-K
For the Year Ended December 31, 2001**

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Unless otherwise indicated, all references to Pentair, we, our, and us refer to Pentair, Inc., a Minnesota corporation (incorporated in 1966), and its subsidiaries.

We are a diversified manufacturer operating in three segments on a global basis. Our diversification has enabled us to provide shareholders with relatively consistent and improved operating results despite difficult markets that may occur in one or another segment at times. Ongoing demand for power tools, the increasing need for clean water throughout the world, and the critical importance of protecting sensitive electronics give Pentair excellent prospects for long-term performance. Our basic operating strategies include:

long-term growth in sales and income;

ongoing cost containment and productivity improvement driven by lean manufacturing initiatives;

new product development and consistent product enhancement;

multi-channel distribution; and

portfolio management of our businesses.

Our address on the Internet is www.pentair.com. You may learn more about us by visiting this site. The information on our web site is not incorporated into this annual report on Form 10-K.

RECENT DEVELOPMENTS***Growth of our business***

We continually look at each of our businesses to determine whether they fit with our evolving strategic vision. Our primary focus is on businesses with strong fundamentals and growth opportunities. We seek growth both through product and service innovation and acquisitions. Acquisitions have played an important part in the 87 percent sales growth of our business over the past five years.

Discontinued operations

In December 2000, we adopted a plan to sell our Equipment segment businesses, Service Equipment (Century Mfg Co./Lincoln Automotive Company) and Lincoln Industrial, Inc (Lincoln Industrial). In October 2001, we completed the sale of the Service Equipment businesses to Clore Automotive, LLC and in December 2001, we completed the sale of Lincoln Industrial to affiliates of The Jordan Company LLC, other investors, and members of management of Lincoln Industrial.

The following table summarizes the components of the proceeds from the sales:

| <i>In thousands</i> | Century/Lincoln Automotive ⁽¹⁾ | Lincoln Industrial | Equipment Segment |
|-----------------------------|--|-------------------------------|------------------------------|
| Cash | \$ | \$ 58,047 | \$ 58,047 |
| Short-term notes receivable | 18,160 | 1,000 | 19,160 |
| Long-term notes receivable | | 1,000 | 1,000 |
| Preferred stock | | 18,400 | 18,400 |
| Total proceeds | \$ 18,160 | \$ 78,447 | \$ 96,607 |

⁽¹⁾ Amount received as of the end of 2001 was \$12,053.

As part of the sale of Lincoln Industrial, we received 37,500 shares of 5% Series C Junior Convertible Redeemable Preferred Stock convertible into a 15 percent equity interest in the new organization LN Holdings Corporation. The preferred stock has a \$37.5 million face value, but has been recorded at \$18.4 million, which represents the estimated fair value of the preferred stock based on an independent valuation. The selling price of Lincoln Industrial is subject to a final purchase price adjustment based on determination of audited net assets, which we expect to occur

in the first half of 2002.

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Also refer to ITEM 7, Management's Discussion and Analysis, and ITEM 8, Note 3 of the Notes to Consolidated Financial Statements, included in this Form 10-K.

BUSINESS SEGMENTS

We classify our continuing operations into the following business segments:

Tools which manufactures and markets tool products positioned at the mid- to upper-end of the market and targets professionals and upscale hobbyists. Tools segment products include woodworking machinery, portable power tools, metal and stoneworking tools, compressors, generators, and pressure washers.

Water which manufactures and markets essential products for the transport and treatment of water, wastewater and fluids. Water segment products include water and wastewater pumps, control valves, pumps and pumping stations for thick fluid transfer applications, storage tanks, filtration systems, and pool and spa accessories.

Enclosures which designs, manufactures, and markets customized and standard metal and composite enclosures that house and protect sensitive controls and components for markets that include data communications, networking, telecommunications, testing equipment, automotive, and general electronics. Products include metallic and composite enclosures, cabinets, cases, subracks, thermal management backplanes and power supplies.

Other is primarily composed of corporate expenses, our insurance subsidiary, intermediate finance companies, divested operations, discontinued operations, and intercompany eliminations.

Business segment and geographical financial information is contained in ITEM 8, Note 14 of the Notes to Consolidated Financial Statements, included in this Form 10-K.

TOOLS SEGMENT

Seasonality

In line with the Christmas gift-giving season, we typically experience stronger fourth quarter and weaker first quarter sales in our Tools segment. Because of this, we also experience higher inventories in the third quarter and growth in accounts receivable in the fourth and first quarters of each year.

Competition

The Tools segment faces numerous competitors and strong distributors, some of which are larger and have more resources. Competition in the Tools segment has been intense and continues to increase, especially as these industries consolidate. In most markets, only a few large players remain, each having extensive product lines. Growth is anticipated to come from product development, continued penetration of expanding market channels, and acquisitions, especially in the accessories arena.

Competition at the end-user level focuses primarily on brand names, product performance and features, quality, service and, most importantly, price. The competition for shelf space at home centers and national retailers is particularly intense, demanding continuing product innovation, special inventory and delivery programs, after-sale service capability, and competitive pricing. Our strategy is to be the price/quality leader in our selected markets. Our success in maintaining our position in the marketplace is primarily due to developing product feature innovations, new products, outsourcing, productivity, and promotions.

Customer concentration

Information regarding significant customers in our Tools segment is contained in ITEM 8, Note 14 of the Notes to Consolidated Financial Statements, included in this Form 10-K.

Table of Contents**WATER SEGMENT****Seasonality**

We experience strong seasonal demand in our Water segment for pool and spa equipment products in the March through July time period, with some advance sales occurring in earlier months, which generally receive longer payment terms. As the installed base grows throughout North America and Europe, the selling season tends to lengthen.

Competition

Our Water segment faces numerous competitors, some of which are larger, have more resources, and are more vertically integrated. Competition in the commercial and residential pump markets focuses on brand names, product performance, quality, and price. While home center and national retailers are important for residential lines of water and wastewater pumps, they are much less important in commercial pump markets. In municipal pump markets, competition focuses on performance to required specification, service and price. Competition in the water treatment component market focuses on product performance and design, quality, delivery and price. In the pool and spa equipment market, there are a number of competitors, one of which we consider our major competitor. We compete by offering a wide variety of innovative and high quality products, which are competitively priced. Our existing distribution channels and reputation for quality also contribute to our continuing market penetration.

Customer concentration

Information regarding significant customers in our Water segment is contained in ITEM 8, Note 14 of the Notes to Consolidated Financial Statements, included in this Form 10-K.

ENCLOSURES SEGMENT**Competition**

Competition in the enclosures markets can be very intense, especially in telecom and datacom markets, where product design, prototyping, global supply, and customer service are very significant factors. As we further penetrate the telecom and datacom markets, the Enclosures segment encounters increasing competition on a global basis from contract electronics manufacturers. The year 2001 was a difficult period in the Enclosures segment, however, we remained profitable while many competitors faced financing issues stemming from significant volume declines. Future growth in the Enclosures segment will likely come from continued channel penetration, growth in defined modification product offerings, product development, geographic expansion, and acquisitions. Consolidation, globalization, and outsourcing are the most important trends in the electronic enclosures business and we participated by making several acquisitions in the past few years. We believe our Enclosures business has the broadest array of products and also a significant footprint globally.

INFORMATION REGARDING ALL BUSINESS SEGMENTS**Backlog**

Our backlog of orders from continuing operations as of December 31 by segment was:

| <i>In thousands</i> | 2001 | 2000 | \$ change | % change |
|---------------------|-------------------|-------------------|--------------------|----------------|
| Tools | \$ 20,700 | \$ 32,906 | \$ (12,206) | (37.1%) |
| Water | 93,146 | 105,789 | (12,643) | (12.0%) |
| Enclosures | 69,579 | 118,409 | (48,830) | (41.2%) |
| Total | \$ 183,425 | \$ 257,104 | \$ (73,679) | (28.7%) |

The \$12.2 million decline in Tools segment backlog was primarily due to the timing of orders for pressure washers and air compressors. Large orders for these products were not received until early 2002. The \$12.6 million decline in Water segment backlog was primarily due to the timing of orders for our pool equipment products. Early-buy orders are normally received near the end of the year and shipped the following year. In

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2001, a larger portion of these orders were received and shipped in the same year. The \$48.8 million decline in Enclosures segment backlog reflects reduced capital spending in the industrial market and the downturn in the datacom and telecom markets.

Environmental

Matters pertaining to the environment are discussed in ITEM 3, ITEM 7, and in ITEM 8, Note 15 of the Notes to Consolidated Financial Statements, included in this Form 10-K.

Raw materials

The principal raw materials we purchase are plastic and steel. As a result of our significant diversification, we are not exposed to large swings in any one raw material price. The materials used in the various manufacturing processes are purchased on the open market, and the majority are available through multiple sources and are in adequate supply.

Intellectual Property

Patents, trademarks, and proprietary technology are important to our business. However, we do not regard our business as being materially dependent upon any single patent, trademark, or technology.

Employees

At the end of 2001, we employed approximately 11,700 people and consider our employee relations to be very good.

ITEM 2. PROPERTIES

Our corporate offices are located in St. Paul, Minnesota. Manufacturing operations are carried out at approximately 19 plants located throughout the United States and at 17 plants located in 11 other countries. Of these manufacturing facilities, two plants located in the United States and two plants located in Europe will be closed or abandoned in 2002. In addition, we have approximately 30 warehouse facilities and numerous sales and service offices throughout the world. Through a 40 percent-owned joint venture with a long-time Asian tool supplier, we have an interest in four additional factories in Asia.

We believe that our production facilities are suitable for their purpose and are adequate to support our businesses.

ITEM 3. LEGAL PROCEEDINGS

We have been made parties to a number of actions filed or have been given notice of potential claims relating to the conduct of our business, including those pertaining to product liability, environmental, safety and health, patent infringement, and employment matters. Major matters that may have an impact on Pentair are discussed below. We believe that the outcome of such legal proceedings and claims will not have a material adverse effect on our financial position, liquidity, or future results of operations.

Environmental

We have been named as defendants, targets or potentially responsible parties (PRPs) in a small number of environmental cleanups, in which our current or former business units have generally been given *deminimis* status. To date, none of these claims have resulted in cleanup costs, fines, penalties, or damages in an amount material to our financial condition or results of operations. We have disposed of a number of businesses over the past ten years and in certain cases, such as the disposition of the Lake Superior Paper Industries supercalendared paper business and the Cross Pointe Paper Corporation uncoated paper business in 1995 and the disposition of the Federal Cartridge Company ammunition business in 1997, we have retained responsibility and potential liability for certain environmental obligations. We have received claims for indemnification from purchasers of both the paper business and the ammunition business. We have established what we believe to be adequate accruals for potential liabilities arising out of retained responsibilities.

In addition, there are pending environmental issues concerning a limited number of sites including sites in Jackson, Tennessee, and Los Angeles, California. We acquired the site in Jackson from Rockwell International

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Corporation, with whom we have agreed on division of responsibility for remediation and other future costs relating to the site. The site in Los Angeles was acquired in the purchase of the pressure vessel and pool and spa equipment businesses of Essef Corporation and relates to operations no longer carried out at that site. We have established what we believe to be adequate accruals for remediation costs. We do not believe that projected response costs will result in a material liability.

Product liability claims

As of February 28, 2002, we are defendants in approximately 148 product liability lawsuits and have been notified of approximately 164 additional claims. We continue to have in place insurance coverage deemed adequate for our needs. A substantial number of these lawsuits and claims are insured and accrued for by Penwald Insurance Company (Penwald), a regulated insurance company wholly owned by Pentair. See discussion in ITEM 8, Note 1 of Notes to the Consolidated Financial Statements – Insurance subsidiary. Accounting accruals covering the deductible portion of liability claims not covered by Penwald have been established and are reviewed on a regular basis. We have not experienced unfavorable trends in either the severity or frequency of product liability claims.

Horizon litigation

Twenty-eight separate lawsuits involving 29 primary plaintiffs, a class action, and claims for indemnity by Celebrity Cruise Lines, Inc. (Celebrity), were brought against Essef Corporation (Essef) and certain of its subsidiaries prior to our acquisition in August 1999. These lawsuits alleged exposure to Legionnaires bacteria by passengers aboard the cruise ship M/V Horizon, a ship operated by Celebrity. The lawsuits included a class action brought on behalf of all passengers aboard the ship during the relevant time period, individual opt-out passenger suits, and a suit by Celebrity. Celebrity alleges in its suit that it has sustained economic damages due to loss of usage of the M/V Horizon while it was dry-docked.

The claims against Essef and its involved subsidiaries, are based upon the allegation that Essef designed, manufactured, and marketed two sand swimming pool filters that were installed as a part of the spa system on the Horizon, and allegations that the spa, and filters, contained bacteria that infected certain passengers on cruises from December 1993 through July 1994.

Prior to our acquisition of Essef, a settlement was reached in the class action. With regard to the individual opt-out passenger suits, the claims of one plaintiff were tried under a stipulation among all remaining parties providing that the liability findings would be applicable to all plaintiffs and defendants. The claims of this plaintiff were unusual because he alleged that he developed complications that profoundly impaired his mental functioning. No other plaintiff asserted similar claims.

The trial resulted in a jury verdict on June 13, 2000 finding liability on the part of the Essef defendants (70%) and Celebrity and its sister company, Fantasia (together 30%). Compensatory damages in the total amount of \$2.7 million were awarded, each defendant being accountable for its proportionate share of liability. The Essef defendants' proportionate share is covered by insurance. Punitive damages were separately awarded against the Essef defendants in the total amount of \$7 million, with 60% awarded to all remaining plaintiffs and 40% to Celebrity. Essef and its subsidiaries filed post-trial motions challenging the verdict, which were denied in February 2002. Essef intends to file an appeal to the United States Court of Appeal for the Second Circuit.

All of the remaining individual cases have been resolved through either settlement or trial. The only remaining unresolved case is that brought by Celebrity for interruption of its business. That case has been placed on hold pending a resolution of post-trial motions.

At the current time, we are optimistic that remaining suits will be resolved within available insurance coverage. With regard to Celebrity's claim against Essef, Westchester, one of Essef's insurance carriers, has issued a notice of rights letter. This is a pre-acquisition liability and we believe we have reserves sufficient to cover the amount of any uninsured awards or settlements.

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None.

EXECUTIVE OFFICERS OF THE REGISTRANT

Current executive officers of Pentair, their ages, current position, and their business experience during at least the past five years are as follows:

| <u>Name</u> | <u>Age</u> | <u>Current Position and Business Experience</u> |
|---------------------|------------|--|
| Randall J. Hogan | 46 | President and Chief Executive Officer since January 2001; President and Chief Operating Officer, December 1999 – December 2000; Executive Vice President and President of Pentair's Electrical and Electronic Enclosures Group, March 1998 – December 1999; President of United Technologies Carrier Transicold Division, February 1995 – August 1997. |
| David D. Harrison | 54 | Executive Vice President and Chief Financial Officer since February 2000; Executive Vice President and Chief Financial Officer of Scotts Company, August 1999 – February 2000; Executive Vice President and Chief Financial Officer of Coltec Industries, August 1996 – August 1999; Executive Vice President and Chief Financial Officer of Pentair, Inc., March 1994 – July 1996; Senior Executive with General Electric Technical Services organization, January 1990 – March 1994. |
| Richard J. Cathcart | 57 | President and Chief Operating Officer of Water Technologies segment since January 2001; Executive Vice President and President of Pentair's Water Technologies Group, February 1996 – December 2000; Executive Vice President, Corporate Development, March 1995 – January 1996. |
| Frank J. Feraco | 55 | President and Chief Operating Officer of Tools segment since December 2000; President, Textron Industrial Products Segment, 1998 – December 2000; President, Kohler Company International Plumbing Business, 1996 – 1998; President, Danaher Corp. Tools Group, 1994 – 1996. |
| Michael V. Schrock | 49 | President and Chief Operating Officer of Enclosures segment since October 2001; President, Pentair Water Technologies – Americas, January 2001 – October 2001; President, Pentair Pump and Pool Group, August 2000 – January 2001; President, Pentair Pump Group, January 1999 – August 2000; Vice President and General Manager, Aurora, Fairbanks Morse and Pentair Pump Group International, March 1998 – December 1998; Divisional Vice President and General Manager, Honeywell Inc, 1994 – 1998. |
| Louis L. Ainsworth | 54 | Senior Vice President and General Counsel since July 1997 and Secretary since January 2002; Shareholder and Officer of the law firm of Henson & Efron, P.A., November 1985 – June 1997. |
| Karen A. Durant | 42 | Vice President, Controller since September 1997; Controller, January 1996 – August 1997; Assistant Controller, September 1994 – December 1995; Director of Financial Planning and Control of Hoffman Enclosures Inc. (subsidiary of Registrant), October 1989 – August 1994. |
| Debbly S. Knutson | 47 | Vice President, Human Resources since September 1994; Assistant Vice President, Human Resources, August 1993 – September 1994; Vice President, Human Resources of Hoffman Enclosures, Inc. (subsidiary of Registrant), July 1990 – August 1993; Director of Human Resources of Hoffman Enclosures, Inc., January 1989 – July 1990. |

Table of Contents**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON STOCK AND RELATED SECURITY HOLDER MATTERS**

Our common stock is listed for trading on the New York Stock Exchange and trades under the symbol PNR. As of December 31, 2001, there were 4,229 shareholders of record.

The high, low, and closing sales price for our common stock and the dividends declared for each of the quarterly periods for 2001 and 2000 were as follows:

| | 2001 | | | | 2000 | | | |
|---------------------------|------------|------------|------------|------------|------------|------------|------------|------------|
| | First | Second | Third | Fourth | First | Second | Third | Fourth |
| High | \$ 30.5625 | \$ 36.4063 | \$ 38.0469 | \$ 39.2813 | \$ 39.4375 | \$ 44.0000 | \$ 36.3750 | \$ 30.5000 |
| Low | \$ 22.5000 | \$ 24.5000 | \$ 28.8906 | \$ 29.7344 | \$ 31.8125 | \$ 35.3125 | \$ 23.9375 | \$ 21.0000 |
| Close | \$ 25.4844 | \$ 33.7969 | \$ 30.7656 | \$ 36.5156 | \$ 37.0625 | \$ 35.5000 | \$ 26.7500 | \$ 24.1875 |
| Dividends declared | \$ 0.17 | \$ 0.17 | \$ 0.18 | \$ 0.18 | \$ 0.16 | \$ 0.16 | \$ 0.17 | \$ 0.17 |

Pentair has paid 104 consecutive quarterly dividends. See ITEM 8, Note 8 of Notes to Consolidated Financial Statements for certain dividend restrictions.

The Annual Meeting of Shareholders of Pentair will be held at the Lutheran Brotherhood Auditorium, 625 Fourth Avenue South, Minneapolis, Minnesota, on Wednesday, May 1, 2002, at 10:00 A.M.

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The table below sets forth summary consolidated historical data relating to Pentair and was derived from the audited historical Consolidated Financial Statements of Pentair.

| | Years ended December 31 | | | | | |
|---|-------------------------|------------------|------------------|------------------|------------------|------------------|
| | 2001 | 2000 | 1999 | 1998 | 1997 | 1996 |
| <i>Dollars in thousands, except per-share data</i> | | | | | | |
| Statement of operations | | | | | | |
| Net sales: Tools | \$ 1,038,606 | \$ 1,066,616 | \$ 875,643 | \$ 661,782 | \$ 573,787 | \$ 478,107 |
| Water | 887,518 | 903,672 | 582,927 | 441,030 | 306,047 | 218,344 |
| Enclosures | 689,820 | 777,725 | 657,500 | 586,829 | 600,491 | 566,919 |
| Other | | | | | 128,136 | 133,360 |
| Total | 2,615,944 | 2,748,013 | 2,116,070 | 1,689,641 | 1,608,461 | 1,396,730 |
| Cost of goods sold | 1,967,945 | 2,051,515 | 1,529,419 | 1,227,427 | 1,189,777 | 1,032,343 |
| Other costs and expenses | 450,133 | 469,679 | 361,877 | 297,972 | 272,578 | 240,982 |
| Restructuring charge | 40,105 | 24,789 | 23,048 | | | |
| Operating income: Tools | 63,232 | 23,751 | 100,680 | 80,383 | 62,669 | 45,800 |
| Water | 109,792 | 120,732 | 73,362 | 56,264 | 32,366 | 30,562 |
| Enclosures | 1,857 | 96,268 | 46,346 | 46,026 | 47,282 | 53,856 |
| Other | (17,120) | (38,721) | (18,662) | (18,431) | 3,789 | (6,813) |
| Total | 157,761 | 202,030 | 201,726 | 164,242 | 146,106 | 123,405 |
| Gain on sale of business | | | | | 10,313 | |
| Net interest expense | 61,488 | 74,899 | 43,582 | 19,855 | 19,729 | 16,849 |
| Other expense, write-off of investment | 2,985 | | | | | |
| Provision for income taxes | 35,772 | 45,263 | 60,056 | 53,667 | 58,089 | 42,860 |
| Income from continuing operations | 57,516 | 81,868 | 98,088 | 90,720 | 78,601 | 63,696 |
| Income (loss) from discontinued operations, net of tax | | (24,759) | 5,221 | 16,120 | 12,999 | 10,813 |
| Loss on disposal of discontinued operations, net of tax | (24,647) | | | | | |
| Cumulative effect of accounting change, net of tax | | (1,222) | | | | |
| Net income | 32,869 | 55,887 | 103,309 | 106,840 | 91,600 | 74,509 |
| Preferred dividends | | | | (4,267) | (4,867) | (4,928) |
| Income available to common shareholders | 32,869 | 55,887 | 103,309 | 102,573 | 86,733 | 69,581 |
| Common share data | | | | | | |
| Basic EPS continuing operations | \$ 1.17 | \$ 1.68 | \$ 2.24 | \$ 2.25 | \$ 1.94 | \$ 1.57 |
| Basic EPS discontinued operations | (0.50) | (0.51) | 0.12 | 0.42 | 0.34 | 0.29 |
| Basic EPS cumulative effect of accounting change | | (0.02) | | | | |
| Basic EPS net income | 0.67 | 1.15 | 2.36 | 2.67 | 2.28 | 1.86 |
| Diluted EPS continuing operations | 1.17 | 1.68 | 2.21 | 2.09 | 1.81 | 1.47 |
| Diluted EPS discontinued operations | (0.50) | (0.51) | 0.12 | 0.37 | 0.30 | 0.26 |
| Diluted EPS cumulative effect of accounting change | | (0.02) | | | | |
| Diluted EPS net income | 0.67 | 1.15 | 2.33 | 2.46 | 2.11 | 1.73 |
| Cash dividends declared per common share | 0.70 | 0.66 | 0.64 | 0.60 | 0.54 | 0.50 |
| Stock dividends declared per common share | | | | | | 100.0% |

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|---|------------|------------|------------|------------|------------|------------|
| Book value per common share | 20.67 | 20.75 | 20.51 | 16.99 | 15.04 | 13.60 |
| Balance sheet data | | | | | | |
| Property and equipment, net | \$ 329,500 | \$ 352,984 | \$ 367,783 | \$ 271,389 | \$ 261,486 | \$ 270,071 |
| Total assets | 2,372,198 | 2,644,025 | 2,706,516 | 1,484,207 | 1,413,494 | 1,236,694 |
| Total debt | 723,706 | 913,974 | 1,035,084 | 340,721 | 328,538 | 312,817 |
| Shareholders' equity | 1,015,002 | 1,010,591 | 990,771 | 707,628 | 627,653 | 560,751 |
| Debt/total capital | 41.6% | 47.5% | 51.1% | 32.5% | 34.4% | 35.8% |
| Return on average common shareholders' equity | 3.2% | 5.6% | 12.6% | 16.7% | 16.0% | 14.4% |
| Other data | | | | | | |
| Depreciation | \$ 62,674 | \$ 59,897 | \$ 56,081 | \$ 46,571 | \$ 47,577 | \$ 42,620 |
| Amortization of intangibles and unearned compensation | 41,675 | 39,131 | 25,987 | 15,483 | 15,240 | 12,795 |
| Capital expenditures | 53,668 | 68,041 | 53,671 | 43,335 | 69,364 | 67,216 |
| Employees of continuing operations | 11,700 | 13,100 | 12,400 | 8,800 | 8,800 | 8,000 |

All financial information reflects our Equipment segment (Century Mfg Co./Lincoln Automotive and Lincoln Industrial businesses) as discontinued operations.

The 2001 results reflect a pre-tax loss on the sale of these businesses of \$36.3 million (\$24.6 million after tax, or \$0.50 per share).

The 2000 results reflect a non-cash pre-tax cumulative effect of accounting change related to revenue recognition that reduced income by \$1.9 million (\$1.2 million after tax, or \$0.02 per share).

The 1997 results include a pre-tax gain on the sale of Federal Cartridge of \$10.3 million (\$1.2 million after tax, or \$0.03 per share).

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Our disclosure and analysis in this report may contain some forward-looking statements. Forward-looking statements give our current expectations or forecasts of future events. Forward-looking statements generally can be identified by the use of forward-looking terminology such as may, will, expected, intend, estimate, anticipate, believe, project, or continue, or the negative thereof or similar words. From time to time, we also may provide oral or written forward-looking statements in other materials we release to the public. Any or all of our forward-looking statements in this report and in any public statements we make could be materially different from actual results. They can be affected by assumptions we might make or by known or unknown risks or uncertainties. Consequently, no forward-looking statements can be guaranteed. Actual results may vary materially. Investors are cautioned not to place undue reliance on any forward-looking statements. Investors should also understand that it is not possible to predict or identify all such factors and should not consider the following list to be a complete statement of all-potential risks and uncertainties.

Any change in the following factors may impact the achievement of results:

changes in industry conditions, such as:

the strength of product demand;

the intensity of competition;

pricing pressures;

market acceptance of new product introductions;

the introduction of new products by competitors;

our ability to source components from third parties without interruption and at reasonable prices; and

the financial condition of our customers.

changes in our business strategies, including acquisition, divestiture, and restructuring activities;

governmental and regulatory policies;

general economic conditions, such as the rate of economic growth in our principal geographic or product markets or fluctuations in exchange rates;

changes in operating factors, such as continued improvement in manufacturing activities and the achievement of related efficiencies and inventory risks due to shifts in market demand; and

our ability to accurately evaluate the effects of contingent liabilities such as taxes, product liability, environmental, and other claims.

The foregoing factors are not exhaustive, and new factors may emerge or changes to the foregoing factors may occur that would impact our business.

CRITICAL ACCOUNTING POLICIES

In preparing the financial statements, we follow accounting principles generally accepted in the United States of America, which in many cases require us to make assumptions, estimates and judgments that affect the amounts reported. Many of these policies are relatively straightforward. There are, however, a few policies that are critical because they are important in determining the financial condition and results of operations and they can be difficult to apply. We believe that the most critical accounting policies applied in the preparation of our financial statements relate to:

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accounting for contingencies, under which we accrue an expense when it is probable that a liability has been incurred and the amount can be reasonably estimated;

measuring assets for impairment; and

accounting for pensions and other post-retirement benefits, because of the importance of management judgment in making the estimates necessary to apply these policies.

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The difficulty in applying these policies arises from the assumptions, estimates, and judgments that have to be made currently about matters that are inherently uncertain, such as future economic conditions, operating results, and valuations, as well as management intentions. As the difficulty increases, the level of precision decreases, meaning that actual results can and often will be different from those currently estimated. We base our assumptions, estimates, and judgments on a combination of historical experiences, as well as other factors we believe reasonable under the circumstances.

Contingencies, by their nature, relate to uncertainties that require management to exercise judgment both in assessing the likelihood that a liability has been incurred as well as in estimating the amount of the potential expense. The most important contingencies impacting our financial statements relate to:

the collectibility of accounts receivable;

the valuation of inventories and reserves to adjust inventory to the lower of cost or market;

estimating sales returns and warranty costs;

self-insurance reserves for product liability, workers' compensation, and employee medical liabilities;

assumptions used in the valuation of environmental remediation costs and pending litigation; and

the resolution of matters related to open tax years.

Measuring assets for impairment requires estimating intentions as to holding periods, future operating cash flows, and residual values of the assets under review. Changes in management intentions, market conditions, or operating performance could indicate that impairment charges might be necessary.

Accounting for pensions and other post-retirement benefits involves estimating the cost of benefits to be provided well into the future and attributing that cost over the time period each employee works. To accomplish this, extensive use is made of assumptions about inflation, investment returns, mortality, turnover, medical costs, and discount rates.

See ITEM 8, Note 1 of the Notes to Consolidated Financial Statements, included in this Form 10-K for a further discussion of certain specific accounting policies.

Table of Contents**RESULTS OF OPERATIONS**

The following table sets forth information from our consolidated statements of income.

| In thousands | 2001 | 2000 | 1999 | Percentage point change | |
|---|--------------|--------------|--------------|-------------------------|---------------|
| | | | | 2001 vs. 2000 | 2000 vs. 1999 |
| Net sales | \$ 2,615,944 | \$ 2,748,013 | \$ 2,116,070 | | |
| Cost of goods sold | 1,967,945 | 2,051,515 | 1,529,419 | | |
| Gross profit | 647,999 | 696,498 | 586,651 | | |
| % of net sales | 24.8% | 25.3% | 27.7% | (0.5) pts | (2.4) pts |
| SG&A and R&D | 450,133 | 469,679 | 361,877 | | |
| % of net sales | 17.2% | 17.1% | 17.1% | 0.1 pts | 0.0 pts |
| Restructuring charge | 40,105 | 24,789 | 23,048 | | |
| % of net sales | 1.5% | 0.9% | 1.1% | 0.6 pts | (0.2) pts |
| Operating income | 157,761 | 202,030 | 201,726 | | |
| % of net sales | 6.0% | 7.4% | 9.5% | (1.4) pts | (2.1) pts |
| Net interest expense | 61,488 | 74,899 | 43,582 | | |
| % of net sales | 2.4% | 2.7% | 2.1% | (0.3) pts | 0.6 pts |
| Other expense, write-off of investment | 2,985 | | | | |
| % of net sales | 0.1% | n/a | n/a | | |
| Income from continuing operations | | | | | |
| before income taxes | 93,288 | 127,131 | 158,144 | | |
| % of net sales | 3.6% | 4.6% | 7.5% | (1.0) pts | (2.9) pts |
| Provision for income taxes | 35,772 | 45,263 | 60,056 | | |
| Effective tax rate | 38.3% | 35.6% | 38.0% | 2.7 pts | (2.4) pts |
| Income from continuing operations | 57,516 | 81,868 | 98,088 | | |
| % of net sales | 2.2% | 3.0% | 4.6% | (0.8) pts | (1.6) pts |
| Income (loss) from discontinued operations, net of tax | | (24,759) | 5,221 | | |
| Loss on disposal of discontinued operations, net of tax | (24,647) | | | | |
| Cumulative effect of accounting change, net of tax | | (1,222) | | | |
| Net income | \$ 32,869 | \$ 55,887 | \$ 103,309 | | |

Percentages may reflect rounding adjustments.

SG&A and R&D Selling, general and administrative; and Research and development.

n/a not applicable

Net sales

The components of the net sales change were:

| Percentages | 2001 vs. 2000 | 2000 vs. 1999 |
|-------------|---------------|---------------|
| Volume | (4.4) | 32.5 |
| Price | 0.1 | (1.0) |
| Currency | (0.5) | (1.6) |

| | | |
|-------|-------|------|
| Total | (4.8) | 29.9 |
|-------|-------|------|

Net sales in 2001 totaled \$2,616 million, compared with \$2,748 million in 2000, and \$2,116 million in 1999. The 4.8 percent decline in 2001 was primarily due to volume declines in each of our business segments resulting from a weak global economy and the stronger U.S. dollar reducing the dollar value of foreign sales by about

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0.5 percent. In 2000, volume grew about 32.5 percent (up about 8 percent adjusted for acquisitions), with the stronger U.S. dollar reducing the dollar value of foreign sales by about 1.6 percent.

Sales by segment and the year-over-year changes were as follows:

| <i>In thousands</i> | 2001 | 2000 | 1999 | 2001 vs. 2000 | | 2000 vs. 1999 | |
|---------------------|---------------------|---------------------|---------------------|--------------------|---------------|-------------------|--------------|
| | | | | \$ change | % change | \$ change | % change |
| Tools | \$ 1,038,606 | \$ 1,066,616 | \$ 875,643 | \$ (28,010) | (2.6%) | \$ 190,973 | 21.8% |
| Water | 887,518 | 903,672 | 582,927 | (16,154) | (1.8%) | 320,745 | 55.0% |
| Enclosures | 689,820 | 777,725 | 657,500 | (87,905) | (11.3%) | 120,225 | 18.3% |
| Total | \$ 2,615,944 | \$ 2,748,013 | \$ 2,116,070 | \$(132,069) | (4.8%) | \$ 631,943 | 29.9% |

Tools

The 2.6 percent decline in Tools segment sales in 2001 was primarily due to:

lower sales volume due to the weak economy; and

lower average selling prices in the first nine months of the year, stemming from the mid-2000 price discounting activities, somewhat offset by an increase in realized selling prices in the fourth quarter of 2001.

The 21.8 percent increase in Tools segment sales in 2000 was primarily due to:

the September 1999 acquisition of DeVilbiss Air Power Company (DAPC); and

higher sales volume in our Porter-Cable/Delta business.

These increases in 2000 were partially offset by:

lower sales volume in 2000 for generators due to high inventories at distributors and retailers at the end of 1999 and lower storm sales in 2000; and

lower average selling prices, primarily in our Porter-Cable/Delta business, due to price discounting in some markets on some products in 2000 to recover market share.

Water

The 1.8 percent decline in Water segment sales in 2001 was primarily due to:

lower sales volume for our industrial pumps and components for large water filtration systems as a weaker economy slowed demand; and

unfavorable impacts of foreign currency translation.

These decreases in 2001 were partially offset by:

higher sales volume in our pool and spa equipment business as we increased our market share.

The 55.0 percent increase in Water segment sales in 2000 was primarily due to:

the August 1999 acquisition of the pressure vessel and pool and spa equipment businesses of Essef Corporation; and

higher sales volume in our pump and valve businesses due to increased demand.

These increases in 2000 were somewhat offset by:

unfavorable impacts of foreign currency translation.

Enclosures

The 11.3 percent decline in Enclosures segment sales in 2001 was primarily due to:

lower sales volume attributable to sharp declines in all enclosures markets, somewhat offset by increased sales due to the expansion in the number of Hoffman distributors; and

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unfavorable impacts of foreign currency translation.

The 18.3 percent increase in Enclosures segment sales in 2000 was primarily due to:

higher sales volume due to strong demand for our products in the telecom and datacom markets and with industrial original equipment manufacturers.

The increase in 2000 was somewhat offset by:

unfavorable impacts of foreign currency translation. Excluding the impacts of foreign currency translation, 2000 Enclosures segment sales increased by 22 percent over 1999.

The following table provides a comparison of our reported gross profit, SG&A & R&D, and operating income, and those results excluding special items (restructuring charges and one-time items to establish special reserves):

| | 2001 | | |
|--|--------------|--------------|------------------|
| | Gross profit | SG&A and R&D | Operating income |
| <i>In thousands</i> | | | |
| Reported results | \$ 647,999 | \$ 450,133 | \$ 157,761 |
| Restructuring charge | 955 | | 41,060 |
| Results excluding special items | \$ 648,954 | \$ 450,133 | \$ 198,821 |
| % of net sales | 24.8% | 17.2% | 7.6% |
| | 2000 | | |
| | Gross profit | SG&A and R&D | Operating income |
| <i>In thousands</i> | | | |
| Reported results | \$ 696,498 | \$ 469,679 | \$ 202,030 |
| Restructuring charge | | | 24,789 |
| Establish additional accounts receivable reserve | | 22,000 | 22,000 |
| Establish additional inventory reserve | 8,000 | | 8,000 |
| Results excluding special items | \$ 704,498 | \$ 447,679 | \$ 256,819 |
| % of net sales | 25.6% | 16.3% | 9.3% |
| | 1999 | | |
| | Gross profit | SG&A and R&D | Operating income |
| <i>In thousands</i> | | | |
| Reported results | \$ 586,651 | \$ 361,877 | \$ 201,726 |
| Restructuring charge | | | 23,048 |
| Results excluding special items | \$ 586,651 | \$ 361,877 | \$ 224,774 |
| % of net sales | 27.7% | 17.1% | 10.6% |

Gross profit

Gross profit margin excluding special items was 24.8 percent in 2001, compared with 25.6 percent in 2000, and 27.7 percent in 1999.

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The 0.8 percentage point decline in 2001 from 2000 was primarily the result of:

sharply lower sales volume and unfavorable product mix in our Enclosures segment, partially offset by improved gross margins in our Tools segment due to material price savings and other cost reduction programs.

The 2.1 percentage point decline in 2000 from 1999 was primarily the result of:

lower sales volume for generators in our DAPC business;

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lower average selling prices due to price discounting to recover market share in our Porter-Cable/Delta business;

unfavorable product mix in our Tools and Enclosures segments;

unfavorable inventory variances, primarily in our Porter-Cable/Delta business; and

higher costs due to challenges encountered in the setup of our new inventory distribution center for our Porter-Cable/Delta business in January 2000.

SG&A and R&D

SG&A and R&D expenses excluding special items was 17.2 percent of net sales in 2001, compared with 16.3 percent and 17.1 percent of net sales in 2000 and 1999, respectively.

The 0.9 percentage point increase in 2001 from 2000 primarily stems from:

an 11.3 percent decline in 2001 Enclosures segment sales, compared with only a 2.0 percent decrease in their SG&A and R&D expenses due to more restrictive short-term opportunities for cost reductions, especially in Europe; and

investments to redefine and streamline company-wide business processes in the areas of supply chain management and lean enterprise, which we expect will improve our future overall cost structure.

The 0.8 percentage point decline in 2000 from 1999 primarily stems from:

the Water and Enclosures sales growth in 2000 outpacing the growth in SG&A and increased R&D spending.

This decline in 2000 was partially offset by:

higher advertising and selling expenses in our Tools segment.

Restructuring charge

1999 restructuring charge

To reduce costs and improve productivity, we initiated a restructuring program in the first quarter of 1999 to consolidate manufacturing facilities, reduce overhead, and outsource certain product lines in our Tools and Enclosures segments. Related to this program, we recorded a restructuring charge of \$23.0 million. In the first quarter of 2000 we re-evaluated the status and progress of projects implemented in 1999 and recorded a change in estimate that reduced the restructuring charge by \$8.5 million. In addition, new projects were identified and we recorded an additional restructuring charge of \$6.0 million related to our Enclosures segment for the closure of a North American facility and the non-cash write-off of impaired goodwill. In the fourth quarter of 2000, we recorded a final change in estimate that increased the restructuring charge by \$0.5 million. As of the end of 2000, this restructuring program was complete.

2000 restructuring charge

To reduce costs and improve productivity and accountability, we initiated a restructuring program in the fourth quarter of 2000 to decentralize corporate service functions and reorganize our Tools segment infrastructure. As a result, we recorded a restructuring charge of \$26.8 million. In the fourth quarter of 2001, we recorded a final change in estimate that reduced the restructuring charge by \$1.7 million primarily due to favorable negotiation of contract termination costs. As of the end of 2001, this restructuring program was complete.

2001 restructuring charge

In the fourth quarter of 2001, we initiated a restructuring program designed to consolidate manufacturing operations and eliminate non-critical support facilities in our Enclosures segment. We also wrote off internal-use software development costs at corporate for the abandonment of a company-wide human resource system. Consequently, we recorded a restructuring charge of \$42.8 million, of which \$1.0 million is included in *cost of goods sold* on the consolidated statement of income for the write-down of inventory on certain custom enclosures product that was discontinued as a result of plant closures.

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The major components of the 1999, 2000 and 2001 restructuring charges and remaining restructuring liability follows:

| <i>In thousands</i> | Employee termination benefits | Non-cash asset disposals | Impaired goodwill | Exit costs | Total |
|--|--|---|------------------------------|-----------------------|--------------|
| 1999 restructuring charge (first quarter) | \$ 21,288 | \$ 1,100 | \$ | \$ 660 | \$ 23,048 |
| Utilization of 1999 restructuring charge | (8,678) | | | (167) | (8,845) |
| December 31, 1999 liability | 12,610 | 1,100 | | 493 | 14,203 |
| Change in estimate (first quarter) | (9,110) | | | 602 | (8,508) |
| 2000 restructuring charge (first quarter) | 800 | 915 | 2,985 | 1,340 | 6,040 |
| Change in estimate (fourth quarter) | 747 | 42 | | (332) | 457 |
| 2000 restructuring charge (fourth quarter) | 7,888 | 10,518 | | 8,394 | 26,800 |
| Utilization of 1999 and 2000 restructuring charges | (5,047) | (12,575) | (2,985) | (2,190) | (22,797) |
| December 31, 2000 liability | 7,888 | | | 8,307 | 16,195 |
| Change in estimate (fourth quarter) | 991 | | | (2,688) | (1,697) |
| 2001 restructuring charge (fourth quarter) | 16,696 | 11,050 | 7,362 | 7,649 | 42,757 |
| Utilization of 2000 and 2001 restructuring charges | (11,343) | (11,050) | (7,362) | (6,388) | (36,143) |
| December 31, 2001 liability | \$ 14,232 | \$ | \$ | \$ 6,880 | \$ 21,112 |

Included in *other current liabilities* on the consolidated balance sheets is the unused portion of the restructuring charge liability of \$21.1 million. We expect to complete the remaining restructuring activities in 2002.

As a result of our 1999 and 2000 restructuring charge programs, we reduced our workforce by approximately 800 and 225 employees, respectively. Workforce reductions related to the 2001 restructuring charge are for approximately 720 employees, of whom 227 were terminated in the fourth quarter of 2001. Employee termination benefits consist primarily of severance and outplacement counseling fees. Employee termination benefits for the 2001 restructuring charge includes a \$0.4 million non-cash charge for the intrinsic value of stock options modified as part of a severance agreement.

Non-cash asset disposals for the 1999, 2000, and 2001 restructuring charges were for the write-down of equipment, leasehold improvements, and inventory (2001 only) as a direct result of our decisions to exit certain facilities and the abandonment of internal use software under development. Exit costs are primarily related to contract and lease termination costs.

The following table summarizes the components of the 1999, 2000 and 2001 restructuring charges by segment, net of changes in estimates:

| <i>In thousands</i> | Tools | Enclosures | Other | Total |
|-------------------------------|--------------|-------------------|--------------|--------------|
| Employee termination benefits | \$ 5,105 | \$ 16,183 | \$ | \$ 21,288 |
| Non-cash asset disposals | 1,100 | | | 1,100 |
| Facility exit costs | 100 | 560 | | 660 |
| 1999 restructuring charge | \$ 6,305 | \$ 16,743 | \$ | \$ 23,048 |
| Employee termination benefits | \$ (96) | \$ (6,064) | \$ 6,485 | \$ 325 |
| Non-cash asset disposals | (55) | 1,012 | 10,518 | 11,475 |
| Impaired goodwill | | 2,985 | | 2,985 |
| Exit costs | 5,547 | 442 | 4,015 | 10,004 |
| 2000 restructuring charge | \$ 5,396 | \$ (1,625) | \$ 21,018 | \$ 24,789 |

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| | | | | |
|-------------------------------|----|-----------|----------|-----------|
| Employee termination benefits | \$ | \$ 16,696 | \$ 991 | \$ 17,687 |
| Non-cash asset disposals | | 7,675 | 3,375 | 11,050 |
| Impaired goodwill | | 7,362 | | 7,362 |
| Exit costs | | 7,649 | (2,688) | 4,961 |
| <hr/> | | | | |
| 2001 restructuring charge | \$ | \$ 39,382 | \$ 1,678 | \$ 41,060 |
| <hr/> | | | | |

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The following table provides a comparison of operating income by segment and the change from the prior year:

| In thousands | 2001 | 2000 | 1999 | Percentage point change | |
|--------------------------------|-------------------|-------------------|-------------------|-------------------------|---------------|
| | | | | 2001 vs. 2000 | 2000 vs. 1999 |
| Tools ⁽¹⁾ | \$ 63,232 | \$ 23,751 | \$ 100,680 | | |
| % of net sales | 6.1% | 2.2% | 11.5% | 3.9 pts | (9.3) pts |
| Water | 109,792 | 120,732 | 73,362 | | |
| % of net sales | 12.4% | 13.4% | 12.6% | (1.0) pts | 0.8 pts |
| Enclosures ⁽²⁾ | 1,857 | 96,268 | 46,346 | | |
| % of net sales | 0.3% | 12.4% | 7.0% | (12.1) pts | 5.4 pts |
| Corporate/other ⁽³⁾ | (17,120) | (38,721) | (18,662) | | |
| Total | \$ 157,761 | \$ 202,030 | \$ 201,726 | | |
| % of net sales | 6.0% | 7.4% | 9.5% | (1.4) pts | (2.1) pts |

(1) Tools segment operating income includes restructuring charge expense of \$5.4 million in 2000 and \$6.3 million in 1999. Operating income also reflects one-time pre-tax costs to establish an additional \$30.0 million in accounts receivable (\$5.0 million in the second quarter of 2000 and \$17.0 million in the fourth quarter of 2000) and inventory (\$8.0 million in the fourth quarter of 2000) reserves.

(2) Enclosures segment operating income includes restructuring charge expense (income) of \$39.4 million in 2001, \$(1.6) million in 2000 (due to a change in estimate of the 1999 restructuring liability), and \$16.7 million in 1999.

(3) Includes restructuring charge expense of \$1.7 million in 2001 and \$21.0 million in 2000.

Tools

The following table provides a comparison of Tools segment operating income as reported, and those results excluding special items (restructuring charges and one-time items to establish special reserves):

| In thousands | 2001 | 2000 | 1999 |
|--|------------------|------------------|-------------------|
| Tools | | | |
| Operating income as reported | \$ 63,232 | \$ 23,751 | \$ 100,680 |
| Restructuring charge | | 5,396 | 6,305 |
| Establish additional accounts receivable reserve | | 22,000 | |
| Establish additional inventory reserve | | 8,000 | |
| Operating income excluding special items | \$ 63,232 | \$ 59,147 | \$ 106,985 |
| % of net sales | 6.1% | 5.5% | 12.2% |
| Percentage point change | 0.6 pts | (6.7) pts | |

The 0.6 percentage point increase in Tools segment 2001 operating income margin excluding special items was primarily due to:

cost savings from our supply chain management and lean enterprise initiatives.

This increase in 2001 was partially offset by:

lower sales volume due to the weak economy;

lower average selling prices in the first nine months of the year, stemming from the mid-2000 price discounting activities, offset by an increase in realized selling prices in the fourth quarter of 2001;

higher warranty costs; and

unfavorable pension costs due to lower returns on pension assets.

The 6.7 percentage point decline in Tools segment 2000 operating income margin excluding special items was primarily due to:

lower sales volume for generators and a change in product mix in our Porter-Cable/Delta business; and

lower average selling prices due to price discounting to recover market share.

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The following table provides a comparison of Water segment operating income as reported:

| <i>In thousands</i> | 2001 | 2000 | 1999 |
|------------------------------|------------|------------|-----------|
| Water | | | |
| Operating income as reported | \$ 109,792 | \$ 120,732 | \$ 73,362 |
| % of net sales | 12.4% | 13.4% | 12.6% |
| Percentage point change | (1.0) pts | 0.8pts | |

The 1.0 percentage point decline in Water segment operating income margin in 2001 was primarily due to:

lower sales volume in our higher margin pump and water treatment businesses, which have been more directly affected by the economic slowdown.

The decline in 2001 was partially offset by:

higher sales volume in our pool and spa equipment business as we increased our market share.

The 0.8 percentage point increase in Water segment operating income margin in 2000 was primarily due to:

improved margins in the pool and spa equipment businesses acquired in August 1999;

increased volume for pumps and valves; and

material cost savings as a result of supply management initiatives coupled with increased labor productivity.

These increases in 2000 were partially offset by:

unfavorable impacts of foreign currency translation.

Enclosures

The following table provides a comparison of Enclosures segment operating income as reported, and those results excluding special items (restructuring charges):

| <i>In thousands</i> | 2001 | 2000 | 1999 |
|--|-----------|-----------|-----------|
| Enclosures | | | |
| Operating income as reported | \$ 1,857 | \$ 96,268 | \$ 46,346 |
| Restructuring charge (income) | 39,382 | (1,625) | 16,743 |
| Operating income excluding special items | \$ 41,239 | \$ 94,643 | \$ 63,089 |
| % of net sales | 6.0% | 12.2% | 9.6% |
| Percentage point change | (6.2) pts | 2.6pts | |

The 6.2 percentage point decline in Enclosures segment 2001 operating income margin excluding special items was primarily due to:

lower sales volume, attributable to sharp declines in all enclosures markets;

unfavorable product mix; and

unfavorable pension costs due to lower returns on pension assets.

These decreases in 2001 were partially offset by:

lower costs, primarily due to headcount reductions.

The 2.6 percentage point increase in Enclosures segment 2000 operating income margin excluding special items was primarily due to:

higher sales volume due to strong demand for our products in the telecom and datacom markets and with industrial original equipment manufacturers.

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This increase in 2000 was somewhat offset by:

unfavorable product mix; and

unfavorable impacts of foreign currency translation in 2000.

Other expense

In 2001, we incurred a non-cash charge of \$3.0 million primarily for the write-off of our business-to-business e-commerce equity investment that we made in early 2000.

Net interest expense

Net interest expense was \$61.5 million in 2001, compared with \$74.9 million in 2000 and \$43.6 million in 1999. The decline in 2001 net interest expense of \$13.4 million reflects lower average borrowings driven by our strong cash flow performance in 2001, and lower interest rates on our variable rate debt. The increase in net interest expense of \$31.3 million in 2000 reflects higher borrowings as a result of our 1999 and 1998 acquisitions and higher average interest rates in 2000 compared with 1999.

Provision for income taxes

Our effective tax rate on continuing operations was 38.3 percent in 2001, compared with 35.6 percent in 2000 and 38.0 percent in 1999. The 2.7 percentage point increase in the 2001 effective tax rate from 2000 was primarily the result of non-deductible amounts related to the 2001 restructuring charge and non-deductible amortization of goodwill, somewhat offset by favorable foreign tax effects. The effective tax rate on continuing operations excluding the 2001 restructuring charge was 35.0 percent. The 2.4 percentage point decline in the 2000 effective tax rate from 1999 was primarily due to the implementation of additional tax-planning strategies, somewhat offset by an increase in non-deductible amortization of goodwill resulting from our 1999 acquisitions.

We expect our effective tax rate on continuing operations to be 32.0 percent in 2002, primarily the result of adopting Statement of Financial Accounting Standards No. 142 (SFAS 142), *Goodwill and Other Intangible Assets*, on January 1, 2002. The adoption of this new accounting standard will result in the cessation of goodwill amortization, much of which was non-deductible.

Discontinued operations

In December 2000, we adopted a plan to sell our Equipment segment businesses, Service Equipment (Century Mfg Co./Lincoln Automotive Company) and Lincoln Industrial, Inc (Lincoln Industrial). In October 2001, we completed the sale of the Service Equipment businesses to Clore Automotive, LLC and in December 2001, we completed the sale of Lincoln Industrial to affiliates of The Jordan Company LLC, other investors, and members of management of Lincoln Industrial.

The following table summarizes the components of the proceeds from the sales:

| <i>In thousands</i> | Century/Lincoln Automotive ⁽¹⁾ | Lincoln Industrial | Equipment Segment |
|-----------------------------|--|-------------------------------|------------------------------|
| Cash | \$ | \$ 58,047 | \$ 58,047 |
| Short-term notes receivable | 18,160 | 1,000 | 19,160 |
| Long-term notes receivable | | 1,000 | 1,000 |
| Preferred stock | | 18,400 | 18,400 |
| Total proceeds | \$ 18,160 | \$ 78,447 | \$ 96,607 |

⁽¹⁾ Amount received as of the end of 2001 was \$12,053.

As part of the sale of Lincoln Industrial, we received 37,500 shares of 5% Series C Junior Convertible Redeemable Preferred Stock convertible into a 15 percent equity interest in the new organization LN Holdings Corporation. The preferred stock has a \$37.5 million face value, but has been recorded at \$18.4 million, which represents the estimated fair value of the preferred stock based on an independent valuation. The selling price of Lincoln Industrial is subject to a final purchase price adjustment based on determination of audited net assets, which we expect to occur in the first half of 2002.

Table of Contents**LIQUIDITY AND CAPITAL RESOURCES**

To fund capital expenditures, acquisitions, repurchase shares, and pay dividends, committed revolving credit facilities are used to complement operating cash flows. We have also accessed the public debt and equity markets in the past three years to fund acquisitions. Because of the seasonality of some of our businesses, particularly the pool and spa equipment business and the tools business, we have generally experienced negative cash flows from operations in the first half of any given year. However, we expect a more positive cash flow trend as a result of our emphasis on working capital management.

The following table presents selected annual measures of our liquidity calculated from our monthly operating results:

| <i>Days</i> | December 31 2001 | December 31 2000 |
|--------------------------------------|-----------------------------|-----------------------------|
| Days of sales in accounts receivable | 64 | 70 |
| Days inventory on hand | 75 | 80 |
| Days in accounts payable | 59 | 59 |
| Cash conversion cycle | 80 | 91 |

Operating activities

Operating activities provided \$232.3 million in 2001, compared with \$184.9 million in 2000, and \$144.3 million in 1999. The \$47.4 million increase in 2001 was primarily due to an emphasis on better management of accounts receivable and inventories, somewhat offset by the decrease in accounts payable and the decline in net income. The \$40.6 million increase in 2000 was also attributable to our increased emphasis on working capital management, somewhat offset by the decline in earnings. We expect to increase cash provided by operating activities in 2002 through higher earnings and our continued emphasis on working capital management.

Investing activities

Capital expenditures in 2001, 2000, and 1999 were \$53.7 million, \$68.0 million, and \$53.7 million, respectively. The \$14.3 million decrease in 2001 over 2000 reflects lower capital expenditures due to reduced needs for capacity and our lean enterprise initiatives and the \$14.3 million increase in 2000 over 1999 reflects increased investments, largely as a result of acquisitions. Capital expenditures as a percent of sales were 2.1 percent, 2.5 percent, and 2.5 percent for 2001, 2000, and 1999, respectively. We anticipate capital expenditures in 2002 to be around \$50.0 million as we expect to more aggressively expand our lean enterprise initiatives.

In the first quarter of 2001, we acquired Taunus, a Brazilian enclosures manufacturer, for \$6.9 million. The acquisition was financed through borrowings under our credit facilities. In the second quarter of 2001, we received \$5.0 million for the settlement of a purchase price dispute related to a 1999 acquisition. The amount received was accounted for as a reduction of goodwill.

In 2001, we invested \$5.0 million (\$3.0 million in the second quarter and \$2.0 million in the fourth quarter) to take a minority equity interest in a privately held developer and manufacturer of laser leveling and measuring devices. We are also investing approximately \$24.9 million to take a 40 percent interest in certain joint venture operations of an Asian supplier for bench and portable tools, of which \$20.4 million has been paid. We hold an option to increase our ownership interest in these joint ventures to as much as 100 percent.

In 1999, we acquired DeVilbiss Air Power Company, the pressure vessel and pool and spa equipment businesses of Essef Corporation, and WEB Tool & Manufacturing, Inc. for \$953.1 million. These acquisitions were primarily financed through an equity offering and the issuance of additional debt.

We periodically review our array of businesses in comparison to our overall strategic and performance objectives. As part of this review, we routinely acquire or divest of certain businesses. During 2002, we anticipate that any acquisitions completed will be funded through a combination of cash generated from operations and external funding sources or the issuance of stock.

Table of Contents**Financing activities**

As of the end of 2001, our capital structure consisted of \$723.7 million in long-term debt and \$1,015.0 million in shareholders' equity. The ratio of debt-to-total capital was 41.6 percent, compared with 47.5 percent as of the end of 2000. Our targeted debt-to-total capital ratio range is 30 to 40 percent. We will exceed this target from time to time as needed for operational purposes and/or acquisitions.

As a result of the 2001 restructuring charge, we expect future remaining cash outlays of approximately \$21.1 million in 2002. We expect to fund these outlays from existing cash balances and internally generated cash flows from operations.

The following summarizes our significant contractual obligations that impact our liquidity:

| Contractual obligations | Payments due by period | | | | |
|--|------------------------|-------------------|------------------|-------------------|-------------------|
| | Within 1 year | 2-3 years | 4-5 years | After 5 years | Total |
| <i>In thousands</i> | | | | | |
| Long-term debt, including current maturities | \$ 8,729 | \$ 426,706 | \$ 1,784 | \$ 286,487 | \$ 723,706 |
| Operating leases, net of sublease rentals | 25,288 | 30,950 | 13,199 | 5,962 | 75,399 |
| Other long-term obligations | 3,061 | 6,446 | 7,109 | 5,130 | 21,746 |
| Total contractual cash obligations, net | \$ 37,078 | \$ 464,102 | \$ 22,092 | \$ 297,579 | \$ 820,851 |

Long-term debt and lines of credit are explained in detail in ITEM 8, Note 8 of the Notes to Consolidated Financial Statements. Operating leases are explained in detail in ITEM 8, Note 15 of the Notes to Consolidated Financial Statements.

We have committed revolving credit facilities totaling \$705 million (the Facilities), consisting of a \$315 million 364-day facility that expires on August 29, 2002, and \$390 million of multi-currency facilities that expire on September 2, 2004. There were no amounts outstanding under the 364-day facility at December 31, 2001.

As of the end of 2001, we had \$329.0 million outstanding under the Facilities. Interest rates and fees on the Facilities vary based on our debt ratings by credit rating agencies. Aggregate borrowings on the Facilities had a weighted-average interest rate of 5.52 percent in 2001 and 6.71 percent in 2000. In addition to the Facilities, we have \$40.0 million of uncommitted credit facilities, under which we had no borrowings as of the end of 2001.

Our debt agreements contain certain financial covenants that restrict the amount paid for dividends and certain other payments, and require us to maintain certain financial ratios and a minimum net worth. Under the most restrictive covenant, \$101.4 million of retained earnings were restricted as of the end of 2001. We are in compliance with all covenants.

As of the end of 2001, we had \$7.2 million of letters of credit outstanding. These letters of credit secure our performance to third parties under self-insurance programs and other commitments in the ordinary course of business.

Dividends paid in 2001 were \$34.3 million, compared with \$32.0 million in 2000, and \$28.2 million in 1999. The year-over-year increases reflect an increase in our annual per-share dividend rate of \$0.70 in 2001, compared with \$0.66 in 2000, and \$0.64 in 1999. We have paid dividends for the past twenty-six years and anticipate paying future dividends.

In addition to measuring our cash flow generation or usage based upon operating, investing, and financing classifications included in the consolidated statements of cash flows, we also measure our free cash flow. We define free cash flow as cash flow from operating activities less capital expenditures, including both continuing and discontinued operations. We generated free cash flow of \$178.7 million in 2001, compared with

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\$116.9 million in 2000, and \$90.6 million in 1999. We intend to increase our free cash flow in 2002 through higher earnings and continuing to reduce working capital. Our management incentive plans include a component that emphasizes free cash flow.

We believe cash generated from operating activities, together with credit available under committed and uncommitted facilities and our current cash position will provide adequate short-term and long-term liquidity.

Off-balance sheet financing

We are a party to a synthetic leasing arrangement for a distribution center and office building in our Tools segment. The lease is designed and qualifies as an operating lease for accounting purposes, where only the monthly lease amount is recorded in the statement of income and the value of the underlying asset and related debt is off-balance sheet. The value of this off-balance sheet financing arrangement is approximately \$23.0 million and the agreement terminates in December 2004.

COMMITMENTS AND CONTINGENCIES

Environmental

We have been named as defendants, targets or potentially responsible parties (PRPs) in a small number of environmental cleanups, in which our current or former business units have generally been given *deminimis* status. To date, none of these claims have resulted in cleanup costs, fines, penalties, or damages in an amount material to our financial condition or results of operations. We have disposed of a number of businesses over the past ten years and in certain cases, such as the disposition of the Lake Superior Paper Industries supercalendared paper business and the Cross Pointe Paper Corporation uncoated paper business in 1995 and the disposition of the Federal Cartridge Company ammunition business in 1997, we have retained responsibility and potential liability for certain environmental obligations. We have received claims for indemnification from purchasers of both the paper business and the ammunition business. We have established what we believe to be adequate accruals for potential liabilities arising out of retained responsibilities.

In addition, there are pending environmental issues concerning a limited number of sites including sites in Jackson, Tennessee, and Los Angeles, California. We acquired the site in Jackson from Rockwell International Corporation, with whom we have agreed on division of responsibility for remediation and other future costs relating to the site. The site in Los Angeles was acquired in the purchase of the pressure vessel and pool and spa equipment businesses of Essef Corporation and relates to operations no longer carried out at that site. We have established what we believe to be adequate accruals for remediation costs. We do not believe that projected response costs will result in a material liability.

NEW ACCOUNTING STANDARDS

In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 141 (SFAS 141), *Business Combinations*, and SFAS No. 142 (SFAS 142), *Goodwill and Other Intangible Assets*. SFAS 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. All of our acquisitions in recent years were accounted for under the purchase method. The new standard had no impact on Pentair in 2001. SFAS 142 changes the accounting for goodwill and certain other intangible assets from an amortization method to an impairment only approach. We will adopt the provisions of SFAS 142 effective January 1, 2002. Had SFAS 142 been in effect for 2001, net income would have been \$32.0 million (\$36.1 million pre-tax) or \$0.65 per share higher. The standard also requires a reassessment of the useful lives of identifiable intangible assets other than goodwill and a test for impairment of goodwill and intangibles with indefinite lives annually, or more frequently if events and circumstances indicate that the carrying amounts may not be recoverable. We expect to complete this assessment in the first half of 2002.

In August 2001, the FASB issued SFAS No. 143 (SFAS 143), *Accounting for Asset Retirement Obligations*, which is effective January 1, 2003. SFAS 143 requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. We are currently in the process of evaluating the effect

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the adoption of this standard will have on our consolidated results of operations, financial position and cash flows.

In September 2001, the FASB issued SFAS No. 144 (SFAS 144), *Accounting for the Impairment or Disposal of Long-Lived Assets*, which addresses financial accounting and reporting for the impairment or disposal of long-lived assets. While SFAS 144 supersedes SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of*, it retains many of the fundamental provisions of that statement. We will adopt SFAS 144 on January 1, 2002. We do not expect the adoption of this new standard to have a material effect on our historical consolidated results of operations, financial position and cash flows.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**Market risk**

We are exposed to various market risks, including changes in interest rates, foreign currency rates and prices of raw materials and sourced components. Market risk is the potential loss arising from adverse changes in market rates and prices, such as interest rates and foreign currency exchange rates. We use derivative financial instruments to manage and reduce the impact of some of these risks. We do not hold or issue derivative financial instruments for trading purposes.

Interest rate risk

We are exposed to changes in interest rates primarily as a result of our borrowing activities used to fund operations. We utilize committed floating rate credit facilities to fund a portion of our operations. Interest rates on \$74.5 million of floating rate debt are swapped to fixed rates through agreements with financial institutions. The table below summarizes our floating and fixed rate debt obligations and interest rate swap agreements as of December 31, 2001 along with interest rates for the swapped portion and fair value of the swap agreement. The average variable rates depicted below for the interest rate swaps are based on implied forward rates in the yield curve at December 31, 2001.

| <i>Dollars in thousands</i> | <i>Expected year of maturity</i> | | | | | | Total | Fair value |
|--|----------------------------------|-------------|-------------|-------------|-------------|-------------------|--------------|-------------------|
| | 2002 | 2003 | 2004 | 2005 | 2006 | Thereafter | | |
| Long-term debt, including current portion | | | | | | | | |
| Variable rate | \$ | \$ | \$ 254,500 | \$ | \$ | \$ | \$ 254,500 | \$ 254,500 |
| Average interest rate | | | 3.21% | | | | 3.21% | |
| Fixed rate | \$ 8,729 | \$ 53,943 | \$ 118,263 | \$ 1,749 | \$ 35 | \$ 286,487 | \$ 469,206 | \$ 470,940 |
| Average interest rate | 6.96% | 6.70% | 7.25% | 7.00% | 7.00% | 7.74% | 7.48% | |
| Portion subject to interest rate swaps | | | | | | | | |
| Variable to fixed | \$ 19,500 | \$ 15,000 | \$ 20,000 | \$ 20,000 | \$ | \$ | \$ 74,500 | \$ (3,453) |
| Average rate to be received | 2.00% | 4.40% | 5.80% | 6.20% | | | 4.42% | |
| Average rate to be paid | 6.31% | 6.31% | 6.31% | 6.31% | | | 6.31% | |

Foreign currency risk

We have entered into foreign currency swap agreements with a major financial institution to hedge firm foreign currency commitments. As of December 31, 2001, the following table presents principal cash flows of our open currency swap agreements:

| <i>In thousands</i> | <i>Expected year of maturity</i> | | | | | | Total | Fair value |
|------------------------------------|----------------------------------|-------------|-------------|-------------|-------------|-------------------|--------------|-------------------|
| | 2002 | 2003 | 2004 | 2005 | 2006 | Thereafter | | |
| Forward exchange agreements | | | | | | | | |
| (1) | | | | | | | | |
| Receive U.S. dollars | \$ | \$ 50,000 | \$ | \$ | \$ | \$ | \$ 50,000 | \$ 7,209 |
| Pay Canadian dollars | | 69,385 | | | | | 69,385 | |
| Receive Canadian dollars | \$ | \$ 69,385 | \$ | \$ | \$ | \$ | \$ 69,385 | \$ 4,171 |
| Pay Euros | | 45,313 | | | | | 45,313 | |
| Total exchange gain | | | | | | | | \$ 11,380 |

(1) Foreign exchange information is presented in local currency by maturity, however, the fair value is presented in U.S. dollars

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF MANAGEMENT

We are responsible for the integrity and objectivity of the financial information presented in this report. The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and include certain amounts based on our best estimates and judgment.

We are also responsible for establishing and maintaining our accounting systems and related internal controls, which are designed to provide reasonable assurance that assets are safeguarded and transactions are properly recorded. These systems and controls are reviewed by the internal auditors. In addition, our code of conduct states that our affairs are to be conducted under the highest ethical standards.

The independent auditors provide an independent review of the financial statements and the fairness of the information presented therein. The Audit and Finance Committee of the Board of Directors, composed solely of outside directors, meets regularly with us, our internal auditors and our independent auditors to review audit activities, internal controls, and other accounting, reporting, and financial matters. Both the independent auditors and internal auditors have unrestricted access to the Audit and Finance Committee.

Randall J. Hogan
President and Chief Executive Officer
St. Paul, Minnesota
February 8, 2002

David D. Harrison
Executive Vice President and Chief Financial Officer

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INDEPENDENT AUDITORS REPORT

To the Board of Directors and Shareholders of Pentair, Inc.:

We have audited the accompanying consolidated balance sheets of Pentair, Inc. and subsidiaries (the Company) as of December 31, 2001 and 2000, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2001. Our audits also included the financial statement schedule listed in the Index at Item 14. These financial statements and the financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and the financial statement schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001 in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

Minneapolis, Minnesota
February 8, 2002

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Pentair, Inc. and Subsidiaries
Consolidated Statements of Income

| <i>In thousands, except per-share data</i> | Years ended December 31 | | |
|--|-------------------------|------------------|-------------------|
| | 2001 | 2000 | 1999 |
| Net sales | \$ 2,615,944 | \$ 2,748,013 | \$ 2,116,070 |
| Cost of goods sold | 1,967,945 | 2,051,515 | 1,529,419 |
| Gross profit | 647,999 | 696,498 | 586,651 |
| Selling, general and administrative | 418,962 | 438,488 | 339,707 |
| Research and development | 31,171 | 31,191 | 22,170 |
| Restructuring charge | 40,105 | 24,789 | 23,048 |
| Operating income | 157,761 | 202,030 | 201,726 |
| Interest income | 960 | 1,488 | 1,472 |
| Interest expense | 62,448 | 76,387 | 45,054 |
| Other expense, write-off of investment | 2,985 | | |
| Income from continuing operations before income taxes | 93,288 | 127,131 | 158,144 |
| Provision for income taxes | 35,772 | 45,263 | 60,056 |
| Income from continuing operations | 57,516 | 81,868 | 98,088 |
| Income (loss) from discontinued operations, net of tax | | (24,759) | 5,221 |
| Loss on disposal of discontinued operations, net of tax | (24,647) | | |
| Cumulative effect of accounting change, net of tax | | (1,222) | |
| Net income | \$ 32,869 | \$ 55,887 | \$ 103,309 |
| Earnings per common share | | | |
| <i>Basic</i> | | | |
| Continuing operations | \$ 1.17 | \$ 1.68 | \$ 2.24 |
| Discontinued operations | (0.50) | (0.51) | 0.12 |
| Cumulative effect of accounting change | | (0.02) | |
| Basic earnings per common share | \$ 0.67 | \$ 1.15 | \$ 2.36 |
| <i>Diluted</i> | | | |
| Continuing operations | \$ 1.17 | \$ 1.68 | \$ 2.21 |
| Discontinued operations | (0.50) | (0.51) | 0.12 |
| Cumulative effect of accounting change | | (0.02) | |
| Diluted earnings per common share | \$ 0.67 | \$ 1.15 | \$ 2.33 |
| Pro forma amounts assuming the accounting change is applied retroactively | | | |
| Continuing operations | \$ 57,516 | \$ 81,868 | \$ 97,514 |
| Discontinued operations | (24,647) | (24,759) | 5,221 |
| Net income | \$ 32,869 | \$ 57,109 | \$ 102,735 |
| Pro forma earnings per common share | | | |

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| | | | |
|---|---------|---------|---------|
| Basic | | | |
| Continuing operations | \$ 1.17 | \$ 1.68 | \$ 2.23 |
| Discontinued operations | (0.50) | (0.51) | 0.12 |
| <hr/> | | | |
| Basic earnings per common share | \$ 0.67 | \$ 1.17 | \$ 2.35 |
| <hr/> | | | |
| Diluted | | | |
| Continuing operations | \$ 1.17 | \$ 1.68 | \$ 2.20 |
| Discontinued operations | (0.50) | (0.51) | 0.12 |
| <hr/> | | | |
| Diluted earnings per common share | \$ 0.67 | \$ 1.17 | \$ 2.32 |
| <hr/> | | | |
| Weighted average common shares outstanding | | | |
| Basic | 49,047 | 48,544 | 43,803 |
| Diluted | 49,297 | 48,645 | 44,287 |

See accompanying notes to consolidated financial statements.

Table of Contents**Pentair, Inc. and Subsidiaries****Consolidated Balance Sheets****December 31***In thousands, except share and per-share data*

| | 2001 | 2000 |
|--|---------------------|---------------------|
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | \$ 39,844 | \$ 34,944 |
| Accounts and notes receivable, net of allowance of \$14,142 and \$18,636, respectively | 398,579 | 468,081 |
| Inventories | 300,923 | 392,495 |
| Deferred income taxes | 69,953 | 72,577 |
| Prepaid expenses and other current assets | 20,979 | 22,442 |
| Net assets of discontinued operations | 5,325 | 101,263 |
| Total current assets | 835,603 | 1,091,802 |
| Property, plant and equipment, net | 329,500 | 352,984 |
| Other assets | | |
| Goodwill, net | 1,088,206 | 1,141,102 |
| Other | 118,889 | 58,137 |
| Total other assets | 1,207,095 | 1,199,239 |
| Total assets | \$ 2,372,198 | \$ 2,644,025 |
| Liabilities and Shareholders' Equity | | |
| Current liabilities | | |
| Short-term borrowings | \$ | \$ 108,141 |
| Current maturities of long-term debt | 8,729 | 23,999 |
| Accounts and notes payable | 179,149 | 250,088 |
| Employee compensation and benefits | 74,888 | 84,197 |
| Accrued product claims and warranties | 37,590 | 42,189 |
| Income taxes | 6,252 | 5,487 |
| Other current liabilities | 121,825 | 134,691 |
| Total current liabilities | 428,433 | 648,792 |
| Long-term debt | 714,977 | 781,834 |
| Pension and other retirement compensation | 74,263 | 59,313 |
| Postretirement medical and other benefits | 43,583 | 34,213 |
| Deferred income taxes | 34,128 | 37,133 |
| Other noncurrent liabilities | 61,812 | 72,149 |
| Total liabilities | 1,357,196 | 1,633,434 |
| Commitments and contingencies | | |
| Shareholders' equity | | |
| Common shares par value \$0.16 ² /3; 49,110,859 and 48,711,955 shares issued and outstanding, respectively | 8,193 | 8,119 |
| Additional paid-in capital | 478,541 | 468,425 |
| Retained earnings | 566,626 | 568,084 |
| Unearned restricted stock compensation | (9,440) | (7,285) |
| Accumulated other comprehensive loss | (28,918) | (26,752) |

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| | | |
|--|--------------|--------------|
| Total shareholders' equity | 1,015,002 | 1,010,591 |
| Total liabilities and shareholders' equity | \$ 2,372,198 | \$ 2,644,025 |

See accompanying notes to consolidated financial statements.

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Pentair, Inc. and Subsidiaries
Consolidated Statements of Cash Flows

| <i>In thousands</i> | Years ended December 31 | | |
|--|-------------------------|-----------|-------------|
| | 2001 | 2000 | 1999 |
| Operating activities | | | |
| Net income | \$ 32,869 | \$ 55,887 | \$ 103,309 |
| Depreciation | 62,674 | 59,897 | 56,081 |
| Amortization of intangibles and unearned compensation | 41,675 | 39,131 | 25,987 |
| Deferred income taxes | (5,315) | 9,735 | (1,954) |
| Restructuring charge | 41,060 | 24,789 | 23,048 |
| Other expense, write-off of investment | 2,985 | | |
| Loss on disposal of discontinued operations | 24,647 | | |
| Cumulative effect of accounting change | | 1,222 | |
| Changes in assets and liabilities, net of effects of business acquisitions and dispositions | | | |
| Accounts and notes receivable | 70,890 | 17,908 | (28,282) |
| Inventories | 87,840 | (45,893) | (26,449) |
| Prepaid expenses and other current assets | 653 | (9,588) | 7,779 |
| Accounts payable | (69,321) | 32,973 | 26,423 |
| Employee compensation and benefits | (13,185) | (10,810) | 32,660 |
| Accrued product claims and warranties | (4,468) | (6,318) | 8,344 |
| Income taxes | 9,942 | (8,467) | (4,462) |
| Other current liabilities | (50,758) | (17,715) | (48,076) |
| Pension and post-retirement benefits | 17,199 | 5,353 | 953 |
| Other assets and liabilities | (7,205) | (7,296) | (18,791) |
| Net cash provided by continuing operations | 242,182 | 140,808 | 156,570 |
| Net cash provided by (used for) discontinued operations | (9,848) | 44,139 | (12,274) |
| Net cash provided by operating activities | 232,334 | 184,947 | 144,296 |
| Investing activities | | | |
| Capital expenditures | (53,668) | (68,041) | (53,671) |
| Proceeds from sale of businesses | 70,100 | | |
| Acquisitions, net of cash acquired | (1,937) | | (953,124) |
| Equity investments | (25,438) | | |
| Other | (186) | (32) | 1,664 |
| Net cash used for investing activities | (11,129) | (68,073) | (1,005,131) |
| Financing activities | | | |
| Net short-term borrowings (repayments) | (108,336) | (42,471) | 150,612 |
| Proceeds from long-term debt | 2,811 | 8,108 | 351,297 |
| Repayment of long-term debt | (84,525) | (82,271) | (59,814) |
| Proceeds from long-term bonds | | | 250,000 |
| Debt issuance costs | | | (2,430) |
| Proceeds from bridge loans | | | 450,000 |
| Repayment of bridge loans | | | (450,000) |
| Proceeds from exercise of stock options | 2,913 | 3,100 | 4,454 |
| Proceeds from issuance of common stock, net | | 774 | 214,480 |
| Repurchases of common stock | (1,458) | (410) | (4,030) |
| Dividends paid | (34,327) | (32,038) | (28,201) |
| Net cash provided by (used for) financing activities | (222,922) | (145,208) | 876,368 |

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| | | | |
|---|------------------|------------------|------------------|
| Effect of exchange rate changes on cash | 6,617 | 263 | 18,344 |
| Change in cash and cash equivalents | 4,900 | (28,071) | 33,877 |
| Cash and cash equivalents, beginning of period | 34,944 | 63,015 | 29,138 |
| Cash and cash equivalents, end of period | \$ 39,844 | \$ 34,944 | \$ 63,015 |

See accompanying notes to consolidated financial statements.

Table of Contents**Pentair, Inc. and Subsidiaries****Consolidated Statements of Changes in Shareholders' Equity**

| <i>In thousands, except share and per-share data</i> | <u>Preferred shares</u> | | <u>Common shares</u> | | | <u>Additional paid-in capital</u> | <u>Retained earnings</u> | <u>Unearned restricted stock compensation</u> | <u>Accumulated other comprehensive loss</u> | <u>Total</u> | <u>Comprehensive income</u> |
|--|-------------------------|---------------|----------------------|---------------|------------|---|------------------------------|---|---|--------------|---------------------------------|
| | <u>Number</u> | <u>Amount</u> | <u>Number</u> | <u>Amount</u> | | | | | | | |
| Balance December 31, 1998 | 1,534,919 | \$ 53,638 | 38,503,587 | \$ 6,417 | \$ 184,145 | \$ 469,127 | \$ (1,737) | \$ (3,962) | \$ 707,628 | | |
| Net income | | | | | | 103,309 | | | 103,309 | \$ 103,309 | |
| Change in cumulative translation adjustment | | | | | | | | (13,027) | (13,027) | (13,027) | |
| Adjustment in minimum pension liability, net of \$889 tax expense | | | | | | | | 1,390 | 1,390 | 1,390 | |
| Comprehensive income | | | | | | | | | | \$ 91,672 | |
| Tax benefit of stock options | | | | | | 3,190 | | | 3,190 | | |
| Cash dividends \$0.64 per common share | | | | | | (28,201) | | | (28,201) | | |
| Issuance of common shares from secondary offering | | | 5,500,000 | 917 | 213,563 | | | | 214,480 | | |
| Share repurchases | | | (117,000) | (19) | (4,011) | | | | (4,030) | | |
| Exercise of stock options | | | 321,278 | 53 | 4,401 | | | | 4,454 | | |
| Issuance of restricted shares, net of cancellations | | | 30,616 | 5 | 2,270 | | (2,275) | | | | |
| Amortization of restricted shares | | | | | | | 1,578 | | 1,578 | | |
| Conversion into common stock | (1,534,919) | (53,638) | 4,078,587 | 680 | 52,958 | | | | | | |
| Balance December 31, 1999 | | | 48,317,068 | 8,053 | 456,516 | 544,235 | (2,434) | (15,599) | 990,771 | | |
| Net income | | | | | | 55,887 | | | 55,887 | \$ 55,887 | |
| Change in cumulative translation adjustment | | | | | | | | (9,705) | (9,705) | (9,705) | |
| Adjustment in minimum pension liability, net of \$926 tax benefit | | | | | | | | (1,448) | (1,448) | (1,448) | |
| Comprehensive income | | | | | | | | | | \$ 44,734 | |
| Tax benefit of stock options | | | | | | 985 | | | 985 | | |
| Cash dividends \$0.66 per common share | | | | | | (32,038) | | | (32,038) | | |
| Adjustment for 1999 secondary offering | | | | | 774 | | | | 774 | | |
| Share repurchases | | | (13,700) | (2) | (408) | | | | (410) | | |
| Exercise of stock options | | | 151,529 | 25 | 3,075 | | | | 3,100 | | |

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| | | | | | | | | |
|---|---------------|----------|------------|------------|------------|-------------|--------------|------------------|
| Issuance of restricted shares, net of cancellations | 257,058 | 43 | 7,483 | (7,526) | | | | |
| Amortization of restricted shares | | | | 2,675 | | 2,675 | | |
| Balance December 31, 2000 | 48,711,955 | 8,119 | 468,425 | 568,084 | (7,285) | (26,752) | 1,010,591 | |
| Net income | | | | 32,869 | | | 32,869 | \$ 32,869 |
| Cumulative effect of accounting change | | | | | | 6,739 | 6,739 | 6,739 |
| Change in cumulative translation adjustment | | | | | | (9,468) | (9,468) | (9,468) |
| Adjustment in minimum pension liability, net of \$399 tax benefit | | | | | | (625) | (625) | (625) |
| Changes in market value of derivative financial instruments | | | | | | 1,188 | 1,188 | 1,188 |
| Comprehensive income | | | | | | | | \$ 30,703 |
| Tax benefit of stock options | | | 601 | | | | 601 | |
| Cash dividends \$0.70 per common share | | | | (34,327) | | | (34,327) | |
| Share repurchases | (50,000) | (8) | (1,450) | | | | (1,458) | |
| Exercise of stock options | 128,254 | 21 | 2,892 | | | | 2,913 | |
| Issuance of restricted shares, net of cancellations | 320,650 | 61 | 7,662 | (7,723) | | | | |
| Amortization of restricted shares | | | | | 5,568 | | 5,568 | |
| Stock compensation | | | 411 | | | | 411 | |
| Balance December 31, 2001 | \$ 49,110,859 | \$ 8,193 | \$ 478,541 | \$ 566,626 | \$ (9,440) | \$ (28,918) | \$ 1,015,002 | |

See accompanying notes to consolidated financial statements.

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Pentair, Inc. and subsidiaries

Notes to consolidated financial statements

1. Summary of Significant Accounting Policies

Fiscal year

Our fiscal year ends on December 31. Additionally, we report our interim quarterly periods on a 13-week basis ending on a Saturday.

Principles of consolidation

The accompanying consolidated financial statements include the accounts of Pentair, and all significant subsidiaries, both U.S. and non-U.S., that we control. In substantially all cases, we own 100 percent of the voting stock of the subsidiaries that we control. Investments in companies of which we own 20 percent to 50 percent of the voting stock and have the ability to exercise significant influence over operating and financial policies of the investee are accounted for using the equity method of accounting and, as a result, our share of the earnings or losses of such equity affiliates is included in the statement of income. All intercompany accounts and transactions have been eliminated in consolidation. Certain balances have been reclassified to conform to the 2001 presentation.

Use of estimates

The preparation of our consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the amounts of assets and liabilities and the disclosures of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates.

Cash equivalents

We consider highly liquid investments with original maturities of three months or less to be cash equivalents.

Revenue recognition, sales returns and warranty costs

We recognize revenue when the earnings process is complete, and the risks and rewards of ownership have transferred to the customer. Provisions for sales returns and warranty costs are recorded at the time of sale based on historical information and current trends.

In December 1999, the Securities and Exchange Commission (SEC) staff issued Staff Accounting Bulletin No. 101, *Revenue Recognition in Financial Statements* (SAB 101), which among other guidance, clarified the Staff's views on various revenue recognition and reporting matters. In the fourth quarter of 2000, we changed our method of accounting for certain sales transactions to comply with SAB 101. As a result of this change, we reported a change in accounting principle in accordance with Accounting Principles Board Opinion No. 20 (APB 20), *Accounting Changes*, by a cumulative effect adjustment. Because we are a calendar year entity that adopted SAB 101 in the fourth quarter of 2000, the cumulative effect of the change was included in the first quarter of 2000 pursuant to APB 20, which requires that the change be made as of the beginning of the year (January 1, 2000) and that the financial information for pre-change interim periods be restated by applying SAB 101 to those periods. Accordingly, the quarterly results for 2000 were restated pursuant to the adoption of SAB 101.

Inventories

Inventories are stated at the lower of cost or market. Inventories of domestic subsidiaries are generally determined by the last-in, first-out (LIFO) method. Inventories of foreign subsidiaries are determined by the first-in, first-out (FIFO) and moving average methods. Reserves to adjust slow moving and obsolete inventories to lower of cost or market are provided based on historical experience and current product demand. We regularly evaluate the adequacy of these reserves.

Table of Contents***Pentair, Inc. and subsidiaries******Notes to consolidated financial statements (continued)******Property, plant, and equipment***

Property, plant and equipment is recorded at cost. We compute depreciation principally by the straight-line method based on the following estimated useful lives:

| | <u>Years</u> |
|--------------------------------------|--------------|
| Land improvements | 5 to 20 |
| Buildings and leasehold improvements | 5 to 50 |
| Machinery and equipment | 3 to 15 |

Significant improvements that add to productive capacity or extend the lives of properties are capitalized. Costs for repairs and maintenance are charged to expense as incurred. When property is retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts and any related gains or losses are included in income.

Goodwill

Goodwill represents the excess of the cost over the net tangible and identified intangible assets of acquired businesses, is stated at cost, and amortized on a straight-line basis over the estimated future periods to be benefited, ranging from 25 to 40 years. Upon the adoption of Statement of Financial Accounting Standards No. 142 (SFAS 142), *Goodwill and Other Intangible Assets*, effective January 1, 2002, goodwill will no longer be amortized, but will be evaluated annually for impairment. Accumulated amortization as of the end of 2001 and 2000 was \$147.4 million and \$114.4 million, respectively.

Impairment of long-lived assets

We review long-lived assets for impairment when events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If impairment indicators are present and the estimated future undiscounted cash flows are less than the carrying value of the assets and any related goodwill, the carrying value is reduced to the estimated fair value as measured by the discounted cash flow method. Losses on long-lived assets to be disposed of are based upon estimated selling prices adjusted for the cost to sell.

Income taxes

Deferred taxes are recognized for the estimated taxes ultimately payable or recoverable based on enacted tax law. Changes in enacted tax rates are reflected in the tax provision as they occur.

Foreign currency translation

Assets and liabilities denominated in foreign currency are translated at the current exchange rate as of the balance sheet date, and income statement amounts are translated at the average monthly exchange rate. Translation adjustments resulting from fluctuations in exchange rates are recorded in comprehensive income.

Stock-based compensation

In accordance with SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS 123), we elected to account for our stock-based compensation using the intrinsic value method prescribed by APB Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25).

The exercise price of stock options equals the market price on the date of grant. In general, there is no recorded compensation expense related to stock options.

Insurance subsidiary

We insure general and product liability, product recall, workers compensation, and automobile liability risks through our wholly owned insurance subsidiary. Reserves for policy claims are established based on actuarial projections of ultimate losses. As of the end of 2001 and 2000, reserves for policy claims were \$23.4 million

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Pentair, Inc. and subsidiaries

Notes to consolidated financial statements (continued)

(\$10.0 million included in *accrued product claims and warranties* and \$13.4 million included in *other noncurrent liabilities*) and \$26.2 million (\$10.0 million included in *accrued product claims and warranties* and \$16.2 million included in *other noncurrent liabilities*).

Derivative financial instruments

Effective January 1, 2001, we adopted the provisions of SFAS No. 133 (SFAS 133), *Accounting for Derivative Instruments and Hedging Activities*, as amended. These standards require us to recognize all derivatives, including those embedded in other contracts, as either assets or liabilities at fair value in our balance sheet. If the derivative is designated as a fair-value hedge, the changes in the fair value of the derivative and the hedged item is recognized in earnings. If the derivative is designated and is effective as a cash-flow hedge, changes in the fair value of the derivative is recorded in other comprehensive income (OCI) and is recognized in the consolidated statements of income when the hedged item affects earnings. SFAS 133 defines new requirements for designation and documentation of hedging relationships as well as ongoing effectiveness assessments in order to use hedge accounting. For a derivative that is not designated as or does not qualify as a hedge, changes in fair value are reported in earnings immediately.

The adoption of SFAS 133 on January 1, 2001, resulted in an increase to other assets and other noncurrent liabilities of \$7.5 million and \$0.8 million, respectively, and a cumulative transition adjustment of \$6.7 million in OCI. The transition adjustment relates to our hedging activities through December 31, 2000. Prior to the adoption of SFAS 133, financial instruments designated as hedges were not recorded in the financial statements, but cash flows from such contracts were recorded as adjustments to earnings as the hedged items affected earnings.

We use derivative financial instruments for the purpose of hedging interest rate and currency exposures, which exist as part of ongoing business operations. All hedging instruments are designated and effective as hedges, in accordance with the provisions of SFAS 133. We do not hold or issue derivative financial instruments for trading or speculative purposes. All other contracts that contain provisions meeting the definition of a derivative also meet the requirements of, and have been designated as, normal purchases or sales. Our policy is to not enter into contracts with terms that cannot be designated as normal purchases or sales.

Earnings per common share

Basic earnings per share are computed by dividing net income by the weighted-average number of common shares outstanding. Diluted earnings per share are computed by dividing net income by the weighted average number of common shares outstanding, including the dilutive effects of stock options, restricted stock, and assumed conversion of preferred stock. Unless otherwise noted, references are to diluted earnings per share.

Table of Contents***Pentair, Inc. and subsidiaries******Notes to consolidated financial statements (continued)***

Basic and diluted earnings per share were calculated using the following:

In thousands, except per-share data

| | 2001 | 2000 | 1999 |
|---|------------------|------------------|-------------------|
| Earnings per common share basic | | | |
| Continuing operations | \$ 57,516 | \$ 81,868 | \$ 98,088 |
| Discontinued operations | (24,647) | (24,759) | 5,221 |
| Cumulative effect of accounting change | | (1,222) | |
| Net income | \$ 32,869 | \$ 55,887 | \$ 103,309 |
| Earnings per common share diluted | | | |
| Continuing operations | \$ 1.17 | \$ 1.68 | \$ 2.24 |
| Discontinued operations | (0.50) | (0.51) | 0.12 |
| Cumulative effect of accounting change | | (0.02) | |
| Basic earnings per common share | \$ 0.67 | \$ 1.15 | \$ 2.36 |
| Earnings per common share basic | | | |
| Continuing operations | \$ 57,516 | \$ 81,868 | \$ 98,088 |
| Discontinued operations | (24,647) | (24,759) | 5,221 |
| Cumulative effect of accounting change | | (1,222) | |
| Net income | \$ 32,869 | \$ 55,887 | \$ 103,309 |
| Earnings per common share diluted | | | |
| Continuing operations | \$ 1.17 | \$ 1.68 | \$ 2.21 |
| Discontinued operations | (0.50) | (0.51) | 0.12 |
| Cumulative effect of accounting change | | (0.02) | |
| Diluted earnings per common share | \$ 0.67 | \$ 1.15 | \$ 2.33 |
| Weighted average common shares outstanding basic | | | |
| | 49,047 | 48,544 | 43,803 |
| Dilutive impact of stock options, restricted stock, and assumed conversion of preferred stock | 250 | 101 | 484 |
| Weighted average common shares outstanding diluted | 49,297 | 48,645 | 44,287 |

There were 1.3 million, 1.1 million, and 0.2 million stock options excluded in 2001, 2000 and 1999, respectively, from the computation of diluted earnings per common share due to their anti-dilutive effect.

New accounting standards

In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 141 (SFAS 141), *Business Combinations*, and SFAS No. 142 (SFAS 142), *Goodwill and Other Intangible Assets*. SFAS 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. All of the our acquisitions in recent years were accounted for under the purchase method. The new standard had no impact on Pentair in 2001. SFAS 142 changes the accounting for goodwill and certain other intangible assets from an amortization method to an impairment only approach. We will adopt the provisions of SFAS 142 effective January 1, 2002. Had SFAS 142 been in effect for 2001, net income would have been \$32.0 million (\$36.1 million pre-tax) or \$0.65 per share higher. The standard also requires a reassessment of the useful lives of identifiable intangible assets other than goodwill and a test for impairment of goodwill and intangibles with indefinite lives annually, or more frequently if events and circumstances indicate that the carrying amounts may not be recoverable. We expect

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to complete this assessment in the first half of 2002.

In August 2001, the FASB issued SFAS No. 143 (SFAS 143), *Accounting for Asset Retirement Obligations*, which is effective January 1, 2003. SFAS 143 requires entities to record the fair value of a liability for an asset

Table of Contents***Pentair, Inc. and subsidiaries******Notes to consolidated financial statements (continued)***

retirement obligation in the period in which it is incurred. We are currently in the process of evaluating the effect the adoption of this standard will have on our consolidated results of operations, financial position and cash flows.

In September 2001, the FASB issued SFAS No. 144 (SFAS 144), *Accounting for the Impairment or Disposal of Long-Lived Assets*, which addresses financial accounting and reporting for the impairment or disposal of long-lived assets. While SFAS 144 supersedes SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of*, it retains many of the fundamental provisions of that statement. We will adopt SFAS 144 on January 1, 2002. We do not expect the adoption of this new standard to have a material effect on our historical consolidated results of operations, financial position and cash flows.

2. Restructuring Charge**1999 restructuring charge**

To reduce costs and improve productivity, we initiated a restructuring program in the first quarter of 1999 to consolidate manufacturing facilities, reduce overhead, and outsource certain product lines in our Tools and Enclosures segments. Related to this program, we recorded a restructuring charge of \$23.0 million. In the first quarter of 2000 we re-evaluated the status and progress of projects implemented in 1999 and recorded a change in estimate that reduced the restructuring charge by \$8.5 million. In addition, new projects were identified and we recorded an additional restructuring charge of \$6.0 million related to our Enclosures segment for the closure of a North American facility and the non-cash write-off of impaired goodwill. In the fourth quarter of 2000, we recorded a final change in estimate that increased the restructuring charge by \$0.5 million. As of the end of 2000, this restructuring program was complete.

2000 restructuring charge

To reduce costs and improve productivity and accountability, we initiated a restructuring program in the fourth quarter of 2000 to decentralize corporate service functions and reorganize our Tools segment infrastructure. As a result, we recorded a restructuring charge of \$26.8 million. In the fourth quarter of 2001, we recorded a final change in estimate that reduced the restructuring charge by \$1.7 million primarily due to favorable negotiation of contract termination costs. As of the end of 2001, this restructuring program was complete.

2001 restructuring charge

In the fourth quarter of 2001, we initiated a restructuring program designed to consolidate manufacturing operations and eliminate non-critical support facilities in our Enclosures segment. We also wrote off internal-use software development costs at corporate for the abandonment of a company-wide human resource system. Consequently, we recorded a restructuring charge of \$42.8 million, of which \$1.0 million is included in *cost of goods sold* on the consolidated statement of income for the write-down of inventory on certain custom enclosures product that was discontinued as a result of plant closures.

Table of Contents***Pentair, Inc. and subsidiaries******Notes to consolidated financial statements (continued)***

The major components of the 1999, 2000 and 2001 restructuring charges and remaining restructuring liability follows:

| <i>In thousands</i> | Employee termination benefits | Non-cash asset disposals | Impaired goodwill | Exit costs | Total |
|--|--|---|------------------------------|-----------------------|------------------|
| 1999 restructuring charge (first quarter) | \$ 21,288 | \$ 1,100 | \$ | \$ 660 | \$ 23,048 |
| Utilization of 1999 restructuring charge | (8,678) | | | (167) | (8,845) |
| December 31, 1999 liability | 12,610 | 1,100 | | 493 | 14,203 |
| Change in estimate (first quarter) | (9,110) | | | 602 | (8,508) |
| 2000 restructuring charge (first quarter) | 800 | 915 | 2,985 | 1,340 | 6,040 |
| Change in estimate (fourth quarter) | 747 | 42 | | (332) | 457 |
| 2000 restructuring charge (fourth quarter) | 7,888 | 10,518 | | 8,394 | 26,800 |
| Utilization of 1999 and 2000 restructuring charges | (5,047) | (12,575) | (2,985) | (2,190) | (22,797) |
| December 31, 2000 liability | 7,888 | | | 8,307 | 16,195 |
| Change in estimate (fourth quarter) | 991 | | | (2,688) | (1,697) |
| 2001 restructuring charge (fourth quarter) | 16,696 | 11,050 | 7,362 | 7,649 | 42,757 |
| Utilization of 2000 and 2001 restructuring charges | (11,343) | (11,050) | (7,362) | (6,388) | (36,143) |
| December 31, 2001 liability | \$ 14,232 | \$ | \$ | \$ 6,880 | \$ 21,112 |

Included in *other current liabilities* on the consolidated balance sheets is the unused portion of the restructuring charge liability of \$21.1 million. We expect to complete the remaining restructuring activities in 2002.

As a result of our 1999 and 2000 restructuring charge programs, we reduced our workforce by approximately 800 and 225 employees, respectively. Workforce reductions related to the 2001 restructuring charge are for approximately 720 employees, of whom 227 were terminated in the fourth quarter of 2001. Employee termination benefits consist primarily of severance and outplacement counseling fees. Employee termination benefits for the 2001 restructuring charge includes a \$0.4 million non-cash charge for the intrinsic value of stock options modified as part of a severance agreement.

Non-cash asset disposals for the 1999, 2000, and 2001 restructuring charges were for the write-down of equipment, leasehold improvements, and inventory (2001 only) as a direct result of our decisions to exit certain facilities and the abandonment of internal use software under development. Exit costs are primarily related to contract and lease termination costs.

Table of Contents**Pentair, Inc. and subsidiaries****Notes to consolidated financial statements (continued)**

The following table summarizes the components of the 1999, 2000 and 2001 restructuring charges by segment, net of changes in estimates:

| <i>In thousands</i> | Tools | Enclosures | Other | Total |
|----------------------------------|-----------------|-------------------|------------------|------------------|
| Employee termination benefits | \$ 5,105 | \$ 16,183 | \$ | \$ 21,288 |
| Non-cash asset disposals | 1,100 | | | 1,100 |
| Facility exit costs | 100 | 560 | | 660 |
| 1999 restructuring charge | \$ 6,305 | \$ 16,743 | \$ | \$ 23,048 |
| Employee termination benefits | \$ (96) | \$ (6,064) | \$ 6,485 | \$ 325 |
| Non-cash asset disposals | (55) | 1,012 | 10,518 | 11,475 |
| Impaired goodwill | | 2,985 | | 2,985 |
| Exit costs | 5,547 | 442 | 4,015 | 10,004 |
| 2000 restructuring charge | \$ 5,396 | \$ (1,625) | \$ 21,018 | \$ 24,789 |
| Employee termination benefits | \$ | \$ 16,696 | \$ 991 | \$ 17,687 |
| Non-cash asset disposals | | 7,675 | 3,375 | 11,050 |
| Impaired goodwill | | 7,362 | | 7,362 |
| Exit costs | | 7,649 | (2,688) | 4,961 |
| 2001 restructuring charge | \$ | \$ 39,382 | \$ 1,678 | \$ 41,060 |

3. Discontinued Operations/Divestitures

In December 2000, we adopted a plan to sell our Equipment segment businesses, Service Equipment (Century Mfg Co./Lincoln Automotive Company) and Lincoln Industrial, Inc (Lincoln Industrial). In October 2001, we completed the sale of the Service Equipment businesses to Clore Automotive, LLC and in December 2001, we completed the sale of Lincoln Industrial to affiliates of The Jordan Company LLC, other investors, and members of management of Lincoln Industrial.

The following table summarizes the components of the proceeds from the sales:

| <i>In thousands</i> | Century/ Lincoln Automotive ⁽¹⁾ | Lincoln Industrial | Equipment Segment |
|-----------------------------|---|---------------------------|--------------------------|
| Cash | \$ | \$ 58,047 | \$ 58,047 |
| Short-term notes receivable | 18,160 | 1,000 | 19,160 |
| Long-term notes receivable | | 1,000 | 1,000 |
| Preferred stock | | 18,400 | 18,400 |
| Total proceeds | \$ 18,160 | \$ 78,447 | \$ 96,607 |

⁽¹⁾ Amount received as of the end of 2001 was \$12,053.

As part of the sale of Lincoln Industrial, we received 37,500 shares of 5% Series C Junior Convertible Redeemable Preferred Stock convertible into a 15 percent equity interest in the new organization LN Holdings Corporation. The preferred stock has a \$37.5 million face value, but has

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been recorded at \$18.4 million, which represents the estimated fair value of the preferred stock based on an independent valuation. The selling price of Lincoln Industrial is subject to a final purchase price adjustment based on determination of audited net assets, which we expect to occur in the first half of 2002.

Our financial statements have been restated to reflect the Equipment segment as a discontinued operation for all periods presented. Operating results of the discontinued Equipment segment are summarized below. The amounts

Table of Contents***Pentair, Inc. and subsidiaries******Notes to consolidated financial statements (continued)***

exclude general corporate overhead previously allocated to the Equipment segment. The amounts include an allocation of interest based on a ratio of the net assets of the discontinued operations to the total net assets of Pentair.

| <i>In thousands</i> | 2001 | 2000 | 1999 |
|--|--------------------|--------------------|-----------------|
| Net sales | \$ 189,782 | \$ 255,256 | \$ 318,334 |
| Pre-tax income (loss) from operations of discontinued businesses | \$ | \$ (37,809) | \$ 8,385 |
| Pre-tax loss on disposal of discontinued businesses | (36,298) | | |
| Provision for income taxes | (11,651) | (13,050) | 3,164 |
| Income (loss) from discontinued operations, net of tax | \$ (24,647) | \$ (24,759) | \$ 5,221 |

Net assets of the discontinued Equipment segment consisted of the following:

| <i>In thousands</i> | 2001 | 2000 |
|--|-----------------|-------------------|
| Net current assets | \$ 1,988 | \$ 59,708 |
| Property, plant and equipment, net | 3,337 | 28,339 |
| Net other noncurrent assets and liabilities | | 13,216 |
| Net assets of discontinued operations | \$ 5,325 | \$ 101,263 |

Net assets of the discontinued Equipment segment as of the end of 2001 consisted of consigned inventory and certain property and equipment of Service Equipment that were not included in the sale of the business. These assets have been stated at estimated net realizable value and we expect to dispose of them in 2002.

4. Acquisitions

All of the following acquisitions were accounted for as purchases and, accordingly, the respective purchase prices were allocated to the respective assets and liabilities based upon their estimated fair values as of the acquisition date. Operating results of businesses acquired have been included in the consolidated statements of income from the respective acquisition dates forward.

A summary of our purchase transactions for the past three years is included in the following table (In thousands):

| Entity name and description of business acquired | Business segment | Date acquired | Consideration | Intangibles |
|---|------------------|---------------|---------------|-------------|
| 2001 acquisitions | | | | |
| Metalurgica Taunus LTDA. (Taunus) Manufacturer of electrical and electronic enclosures | Enclosures | 1/01 | \$ 6,937 | \$ 5,854 |
| 1999 acquisitions | | | | |
| DeVilbiss Air Power Company Manufacturer of air compressors, generators, and pressure washers | Tools | 9/99 | 466,579 | 360,445 |
| Essef Corporation (Structural Fibers and Pac-Fab) Manufacturer of pressure vessels and pool and spa equipment | Water | 8/99 | 424,633 | 349,608 |
| WEB Tool & Manufacturing, Inc. Designer, manufacturer and marketer of custom server subracks for the datacom and telecom markets | Enclosures | 4/99 | 61,912 | 45,342 |

Table of Contents***Pentair, Inc. and subsidiaries******Notes to consolidated financial statements (continued)***

In the second quarter of 2001, we received \$5.0 million for the settlement of a purchase price dispute related to a 1999 acquisition. The amount received was accounted for as a reduction of goodwill.

5. Supplemental Balance Sheet Information

| <i>In thousands</i> | 2001 | 2000 |
|--|-------------------|-------------------|
| Inventories | | |
| Raw materials and supplies | \$ 94,404 | \$ 110,935 |
| Work-in-process | 38,760 | 48,392 |
| Finished goods | 167,759 | 233,168 |
| Total inventories | \$ 300,923 | \$ 392,495 |
| Property, plant and equipment | | |
| Land and land improvements | \$ 16,688 | \$ 17,238 |
| Buildings and leasehold improvements | 152,873 | 149,620 |
| Machinery and equipment | 518,141 | 496,175 |
| Construction in progress | 21,304 | 25,682 |
| Total property, plant and equipment | 709,006 | 688,715 |
| Less accumulated depreciation and amortization | 379,506 | 335,731 |
| Property, plant and equipment, net | \$ 329,500 | \$ 352,984 |
| Other assets | | |
| Equity method investments | \$ 25,247 | \$ |
| Cost method investments | 23,400 | |
| Fair market value of currency swaps | 11,380 | |
| Other | 58,862 | 58,137 |
| Total other assets | \$ 118,889 | \$ 58,137 |

Certain inventories are valued at LIFO. If all inventories were valued at FIFO as of the end of 2001 and 2000, inventories would have been \$305.6 million and \$396.9 million, respectively.

Equity method investments

We have invested approximately \$24.9 million to take a 40 percent interest in certain joint venture operations of an Asian supplier for bench and portable tools, of which \$20.4 million has been paid and \$4.5 million is included in *other current liabilities*. We hold an option to increase our ownership interest in these joint ventures to as much as 100 percent. Our portion of the earnings of these joint ventures is included in *cost of goods sold*, however, was not material.

Cost method investments

As part of the sale of Lincoln Industrial, we received 37,500 shares of 5% Series C Junior Convertible Redeemable Preferred Stock convertible into a 15 percent equity interest in the new organization LN Holdings Corporation. The preferred stock has a \$37.5 million face value, but has been recorded at \$18.4 million, which represents the estimated fair value of the preferred stock based on an independent valuation.

In 2001, we invested \$5.0 million (\$3.0 million in the second quarter and \$2.0 million in the fourth quarter) to take a minority equity interest in a privately held developer and manufacturer of laser leveling and measuring devices.

Table of Contents***Pentair, Inc. and subsidiaries******Notes to consolidated financial statements (continued)*****6. Supplemental Cash Flow Information**

The following table summarizes supplemental cash flow information:

| <i>In thousands</i> | 2001 | 2000 | 1999 |
|---------------------|-----------|-----------|-----------|
| Interest payments | \$ 69,411 | \$ 81,401 | \$ 46,359 |
| Income tax payments | 3,224 | 42,449 | 68,108 |

Supplemental disclosure of non-cash investing and financing activities

As part of the sale of Lincoln Industrial, we received 37,500 shares of 5% Series C Junior Convertible Redeemable Preferred Stock convertible into a 15 percent equity interest in the new organization LN Holdings Corporation. The preferred stock has a \$37.5 million face value, but has been recorded at \$18.4 million, which represents the estimated fair value of the preferred stock based on an independent valuation.

7. Accumulated Other Comprehensive Loss

Components of accumulated other comprehensive loss consist of the following:

| <i>In thousands</i> | 2001 | 2000 | 1999 |
|---|-------------|-------------|-------------|
| Minimum pension liability adjustments, net of tax | \$ (3,058) | \$ (2,433) | \$ (985) |
| Foreign currency translation adjustments | (33,787) | (24,319) | (14,614) |
| Market value of derivative financial instruments | 7,927 | | |
| Accumulated other comprehensive loss | \$ (28,918) | \$ (26,752) | \$ (15,599) |

8. Debt***Credit facilities***

We have committed revolving credit facilities totaling \$705 million (the Facilities), consisting of a \$315 million 364-day facility that expires on August 29, 2002, and \$390 million of multi-currency facilities that expire on September 2, 2004. There were no amounts outstanding under the 364-day facility at December 31, 2001.

As of the end of 2001, we had \$329.0 million outstanding under the Facilities. Interest rates and fees on the Facilities vary based on our debt ratings by credit rating agencies. Aggregate borrowings on the Facilities had a weighted-average interest rate of 5.52 percent in 2001 and 6.71 percent in 2000. In addition to the Facilities, we have \$40.0 million of uncommitted credit facilities, under which we had no borrowings as of the end of 2001.

Our debt agreements contain certain financial covenants that restrict the amount paid for dividends and certain other payments, and require us to maintain certain financial ratios and a minimum net worth. Under the most restrictive covenant, \$101.4 million of retained earnings were restricted as of the end of 2001. We are in compliance with all covenants.

We have not accessed the commercial paper markets since the credit rating agencies lowered our commercial paper ratings during 2001.

Table of Contents***Pentair, Inc. and subsidiaries******Notes to consolidated financial statements (continued)***

Long-term debt and the average interest rate on debt outstanding as of December 31, is summarized as follows:

| <i>In thousands</i> | Average interest rate December 31, 2001 | Maturity (Year) | 2001 | 2000 |
|---|---|--------------------|------------|------------|
| Commercial paper, maturing within 60 days | | | \$ | \$ 315,172 |
| Revolving credit facilities | 3.21% | 2004 | 329,000 | 74,828 |
| Private placement | 6.78% | 2002 - 2007 | 131,787 | 149,814 |
| Senior notes | 7.85% | 2009 | 250,000 | 250,000 |
| Other | Various | 2002 - 2007 | 12,919 | 16,019 |
| Long-term debt, including current portion | | | 723,706 | 805,833 |
| Less current maturities of long-term debt | | | (8,729) | (23,999) |
| Long-term debt | | | \$ 714,977 | \$ 781,834 |

Long-term debt outstanding at December 31, 2001 matures as follows:

| <i>In thousands</i> | 2002 | 2003 | 2004 | 2005 | 2006 | Thereafter | Total |
|---------------------|----------|-----------|------------|----------|-------|------------|------------|
| Maturities | \$ 8,729 | \$ 53,943 | \$ 372,763 | \$ 1,749 | \$ 35 | \$ 286,487 | \$ 723,706 |

9. Derivative and Financial Instruments***Cash-flow hedges***

We have entered into interest rate swap agreements with a major financial institution to exchange variable rate interest payment obligations for fixed rate obligations without the exchange of the underlying principal amounts in order to manage interest rate exposures. As of the end of 2001, we had swap agreements outstanding with an aggregate notional amount of \$74.5 million that expire in various amounts through June 2005. The swap agreements have a fixed interest rate of 6.31 percent.

We have entered into foreign currency swap agreements with a major financial institution to hedge firm foreign currency commitments. The currency swap agreements mature on October 1, 2003. The notional amounts were \$100.0 million in both 2001 and 2000. The currency swaps have terms that match the hedged exposure, thus no ineffectiveness is recorded.

The interest rate and currency swaps are designated as and are effective cash-flow hedges. The fair values of the swaps are recorded on the balance sheet, with changes in fair values included in other comprehensive income (OCI). The ineffective portion of the hedge is not material to the financial statements. Derivative gains and losses included in OCI are reclassified into earnings at the time the related interest expense is recognized or the settlement of the related commitment occurs. We estimate \$0.5 million of net derivative losses will be reclassified into earnings in 2002. No hedging relationships were de-designated during 2001.

Table of Contents*Pentair, Inc. and subsidiaries**Notes to consolidated financial statements (continued)**Fair value of financial instruments*

The recorded amounts and estimated fair values of financial instruments, including derivative financial instruments were as follows:

| <i>In thousands</i> | 2001 | | 2000 | |
|---|-------------------|-------------------|-------------------|-------------------|
| | Recorded amount | Fair value | Recorded amount | Fair value |
| Long-term debt, including current portion | | | | |
| Variable rate | \$ 254,500 | \$ 254,500 | \$ 390,000 | \$ 390,000 |
| Fixed rate | 469,206 | 470,940 | 415,833 | 399,087 |
| Total | \$ 723,706 | \$ 725,440 | \$ 805,833 | \$ 789,087 |
| Derivative financial instruments | | | | |
| Interest rate swap liability | \$ (3,453) | \$ (3,453) | \$ | \$ (826) |
| Interest rate cap asset | | | | 59 |
| Currency swap asset | 11,380 | 11,380 | | 7,506 |
| Market value of derivative financial instruments | \$ 7,927 | \$ 7,927 | \$ | \$ 6,739 |

The following methods were used to estimate the fair values of each class of financial instrument:

short-term financial instruments (cash and cash equivalents, accounts and notes receivable, accounts and notes payable, and short-term borrowings) recorded amount approximates fair value because of the short maturity period;

long-term debt, including current maturities fair value is based on market quotes available for issuance of debt with similar terms;

interest rate swap agreements fair value is based on market or dealer quotes; and

currency swap fair value is based on market or dealer quotes.

10. Income Taxes

Income from continuing operations before income taxes consisted of the following:

| <i>In thousands</i> | 2001 | 2000 | 1999 |
|---|------------------|-------------------|-------------------|
| United States | \$ 103,446 | \$ 89,111 | \$ 146,420 |
| International | (10,158) | 38,020 | 11,724 |
| Income from continuing operations before taxes | \$ 93,288 | \$ 127,131 | \$ 158,144 |

The provision for income taxes from continuing operations consisted of the following:

| <i>In thousands</i> | 2001 | 2000 | 1999 |
|--------------------------|-----------|-----------|-----------|
| Currently payable | | | |
| Federal | \$ 19,790 | \$ 18,869 | \$ 48,122 |

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| | | | |
|----------------------------------|-----------|-----------|-----------|
| State | 3,131 | 2,132 | 8,220 |
| International | 6,849 | 16,708 | 8,869 |
| <hr/> | | | |
| Total current taxes | 29,770 | 37,709 | 65,211 |
| Deferred | | | |
| Federal | 13,573 | 11,317 | 11 |
| International | (7,571) | (3,763) | (5,166) |
| <hr/> | | | |
| Total deferred taxes | 6,002 | 7,554 | (5,155) |
| <hr/> | | | |
| Total provision for income taxes | \$ 35,772 | \$ 45,263 | \$ 60,056 |
| <hr/> | | | |

Table of Contents***Pentair, Inc. and subsidiaries******Notes to consolidated financial statements (continued)***

Reconciliation of the U.S. statutory income tax rate to our effective tax rate for continuing operations follows:

| <i>Percentages</i> | 2001 | 2000 | 1999 |
|--|-------------|-------------|-------------|
| U.S. statutory income tax rate | 35.0 | 35.0 | 35.0 |
| State income taxes, net of federal tax benefit | 3.7 | 2.1 | 3.6 |
| Tax effect of international operations | (7.6) | (5.6) | (2.8) |
| Non-deductible goodwill | 9.4 | 7.0 | 3.3 |
| ESOP dividend benefit | (0.9) | (0.6) | (0.6) |
| Non-deductible restructuring charge items | 3.3 | | |
| Tax credits | (3.4) | (2.4) | (0.7) |
| All other, net | (1.2) | 0.1 | 0.2 |
| Effective tax rate on continuing operations | 38.3 | 35.6 | 38.0 |

Deferred taxes arise because of different treatment between financial statement accounting and tax accounting, known as temporary differences. We record the tax effect of these temporary differences as deferred tax assets (generally items that can be used as a tax deduction or credit in future periods) and deferred tax liabilities (generally items that we received a tax deduction for, but not yet been recorded in the consolidated statements of income).

The tax effects of the major items recorded as deferred tax assets and liabilities are:

| <i>In thousands</i> | 2001 Deferred tax | | 2000 Deferred tax | |
|---------------------------------------|--------------------------|--------------------|--------------------------|--------------------|
| | Assets | Liabilities | Assets | Liabilities |
| Accounts receivable allowances | \$ 6,220 | \$ | \$ 8,185 | \$ |
| Inventory reserves | 10,220 | | 10,194 | |
| Accelerated depreciation/amortization | | 23,200 | | 23,166 |
| Accrued product claims and warranties | 29,668 | | 31,791 | |
| Employee benefit accruals | 46,153 | | 39,113 | |
| Other, net | | 33,236 | | 30,673 |
| Total deferred taxes | \$ 92,261 | \$ 56,436 | \$ 89,283 | \$ 53,839 |
| Net deferred tax asset | \$ 35,825 | | \$ 35,444 | |

The determination of annual income tax expense takes into consideration amounts, which may be needed to cover exposures for open tax years. The Internal Revenue Service (IRS) has examined our U.S. federal income tax returns through 1997, and we have paid all tax claims. In addition, Escef Corporation tax years 1995 through 1997 are currently under examination. We do not expect any material impact on earnings to result from the resolution of matters related to open tax years, however, actual settlements may differ from amounts accrued.

11. Benefit Plans***Pension and post-retirement benefits***

We have various non-contributory defined-benefit pension plans that cover nearly all U.S. employees and many employees outside the United States. Pension benefits are based principally on an employee's years of service and/or compensation levels near retirement. Our pension funding policy is to deposit with independent trustees amounts as required by applicable law. In addition, we also provide certain post-retirement health care and life insurance benefits for nearly all retirees. Generally, the post-retirement health care and life insurance plans require contributions from retirees.

Table of Contents**Pentair, Inc. and subsidiaries****Notes to consolidated financial statements (continued)**

The weighted-average assumptions used for these plans consisted of:

| Percentages | Pension benefits | | | Post-retirement | | |
|--------------------------------|------------------|------|------|-----------------|------|------|
| | 2001 | 2000 | 1999 | 2001 | 2000 | 1999 |
| Discount rate | 7.25 | 7.75 | 7.75 | 7.25 | 7.75 | 7.75 |
| Expected return on plan assets | 8.50 | 8.50 | 8.50 | | | |
| Rate of compensation increase | 5.00 | 5.00 | 5.00 | | | |

Components of the net periodic benefit cost are as follows:

| In thousands | Pension benefits | | | Post-retirement | | |
|---|------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| | 2001 | 2000 | 1999 | 2001 | 2000 | 1999 |
| Service cost | \$ 13,467 | \$ 12,405 | \$ 13,410 | \$ 494 | \$ 433 | \$ 552 |
| Interest cost | 23,802 | 22,406 | 20,237 | 2,596 | 2,695 | 2,256 |
| Expected return on plan assets | (26,897) | (29,672) | (27,635) | | | |
| Amortization of transition (asset) obligation | 25 | (110) | (151) | | | |
| Amortization of prior year service cost (benefit) | 867 | 893 | 1,085 | (906) | (990) | (990) |
| Recognized net actuarial gain | (1,196) | (5,183) | (3,309) | (374) | (73) | (67) |
| Special termination benefits | 482 | 2,191 | | | | |
| Net periodic benefit cost | \$ 10,550 | \$ 2,930 | \$ 3,637 | \$ 1,810 | \$ 2,065 | \$ 1,751 |
| Continuing operations | \$ 10,162 | \$ 3,042 | \$ 3,370 | \$ 1,606 | \$ 1,871 | \$ 1,568 |
| Discontinued operations | 388 | (112) | 267 | 204 | 194 | 183 |
| Net periodic benefit cost | \$ 10,550 | \$ 2,930 | \$ 3,637 | \$ 1,810 | \$ 2,065 | \$ 1,751 |

The following tables present reconciliations of the benefit obligation of the plans, the plan assets of the pension plans, and the funded status of the plans:

| In thousands | Pension benefits | | Post-retirement | |
|---------------------------------------|-------------------|-------------------|------------------|------------------|
| | 2001 | 2000 | 2001 | 2000 |
| Change in benefit obligation | | | | |
| Benefit obligation beginning of year | \$ 325,209 | \$ 301,788 | \$ 34,899 | \$ 36,235 |
| Service cost | 13,467 | 12,405 | 494 | 433 |
| Interest cost | 23,802 | 22,406 | 2,596 | 2,695 |
| Plan amendments | 529 | 618 | 278 | (245) |
| Actuarial (gain) loss | 12,867 | 7,731 | 3,932 | (2,527) |
| Special termination benefits | 482 | 2,191 | | |
| Disposition of Equipment segment | (26,638) | | (4,083) | |
| Translation gain | (1,112) | (1,545) | | |
| Benefits paid | (19,747) | (20,385) | (3,287) | (1,692) |
| Benefit obligation end of year | \$ 328,859 | \$ 325,209 | \$ 34,829 | \$ 34,899 |

Change in plan assets

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| | | | | |
|---|-------------|-------------|-------------|-------------|
| Fair value of plan assets beginning of year | \$ 325,866 | \$ 360,184 | \$ | \$ |
| Actual return on plan assets | (14,119) | (15,119) | | |
| Disposition of Equipment segment | (26,042) | | | |
| Company contributions | 2,721 | 1,542 | 3,287 | 1,692 |
| Translation gain | (241) | (356) | | |
| Benefits paid | (19,747) | (20,385) | (3,287) | (1,692) |
| <hr/> | | | | |
| Fair value of plan assets end of year | \$ 268,438 | \$ 325,866 | \$ | \$ |
| <hr/> | | | | |
| Funded status | | | | |
| Plan assets in excess of/(less than) benefit obligation | \$ (60,421) | \$ 657 | \$ (34,829) | \$ (34,899) |
| Unrecognized cost: | | | | |
| Net transition obligation | 148 | 77 | | |
| Net actuarial (gains) loss | 10,912 | (43,403) | (5,411) | (9,180) |
| Prior service cost (benefit) | 2,913 | 3,609 | (3,343) | (4,835) |
| <hr/> | | | | |
| Net amount recognized | \$ (46,448) | \$ (39,060) | \$ (43,583) | \$ (48,914) |
| <hr/> | | | | |

Table of Contents***Pentair, Inc. and subsidiaries******Notes to consolidated financial statements (continued)***

Plan assets consist primarily of listed stocks and bonds as well as cash and short-term investments. Our common stock accounted for approximately 11 percent and 7 percent of plan assets as of the end of 2001 and 2000, respectively. The majority of the underfunding relates to foreign pension plans and our supplemental executive retirement plan which are not commonly funded.

Amounts recognized in the consolidated balance sheets consist of:

| <i>In thousands</i> | Pension benefits | | Post-retirement | |
|--|-------------------------|--------------------|------------------------|--------------------|
| | 2001 | 2000 | 2001 | 2000 |
| Prepaid benefit cost | \$ 7,402 | \$ 9,109 | \$ | \$ |
| Accrued benefit liability | (60,379) | (53,690) | (43,583) | (48,914) |
| Intangible asset | 1,516 | 1,532 | | |
| Accumulated other comprehensive income pre-tax | 5,013 | 3,989 | | |
| Net amount recognized | \$ (46,448) | \$ (39,060) | \$ (43,583) | \$ (48,914) |

Pension plans with obligations in excess of plan assets were as follows:

| <i>In thousands</i> | 2001 | 2000 |
|---|-------------|-------------|
| Pension plans with an accumulated benefit obligation in excess of plan assets: | | |
| Fair value of plan assets | \$ 10,791 | \$ 827 |
| Accumulated benefit obligation | 63,614 | 51,330 |
| Pension plans with a benefit obligation in excess of plan assets: | | |
| Fair value of plan assets | \$ 239,813 | \$ 827 |
| Benefit obligation | 303,797 | 55,362 |

A one-percentage-point change in the assumed health care cost trend rate would have the following effects:

| <i>In thousands</i> | Increase | Decrease |
|--|-----------------|-----------------|
| Effect on total of service and interest cost | \$ 63 | \$ 55 |
| Effect on post-retirement benefit obligation | 751 | 647 |

Health care cost trend rate was 9.62 percent in 2001 and assumed to gradually decline to 5.5 percent in 2022.

Savings plan

We have a 401(k) plan (the plan) with an employee stock ownership (ESOP) bonus component, which covers certain union and nearly all-nonunion U.S. employees who meet certain age requirements. Under the plan, eligible U.S. employees may voluntarily contribute a percentage of their eligible compensation. Matching contributions are made in cash to employees who meet certain eligibility and service requirements. Our matching contribution is based on our financial performance and ranges from 30 percent to 90 percent of eligible employee contributions, limited to 4 percent of compensation contributed by employees.

In addition to the matching contribution, all employees who meet certain service requirements receive a discretionary ESOP contribution equal to 1.5 percent of annual eligible compensation.

Our combined contributions to the 401(k) and ESOP were \$9.8 million, \$11.9 million, and \$9.2 million in 2001, 2000, and 1999, respectively.

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Pentair, Inc. and subsidiaries

Notes to consolidated financial statements (continued)

12. Shareholders Equity

Authorized shares

We may issue up to 250 million shares of common stock. Our Board of Directors may designate up to 15 million of those shares as preferred stock.

Common share purchase rights

We have a ten-year Share Rights Agreement dated July 31, 1995. Under this agreement, each outstanding share of our common stock has one common share purchase right attached to it and entitles the holder to purchase one share of our common stock, currently at a price of \$80 per share, subject to adjustment. However, these rights are not exercisable unless certain change-in-control events transpire, such as a person acquiring or obtaining the right to acquire beneficial ownership of 15 percent or more of our outstanding common stock.

The rights are redeemable by us for \$0.01 per right until ten business days after certain defined change-in-control events transpire, or at any time prior to the expiration of the rights.

Share repurchases

In December 2001, the Board of Directors authorized the repurchase of up to 400,000 shares of our common stock in open market or negotiated transactions to partially offset dilution due to normal grants of restricted shares and options to employees. No shares have been purchased pursuant to this authority. In 2001 and 2000, respectively, we repurchased 50,000 and 13,700 shares of our common stock under similar plans.

13. Stock Plans

Omnibus stock incentive plan

In April 2001, the Omnibus Stock Incentive Plan as Amended and Restated (the Plan) was approved. The Plan authorizes the issuance of additional shares of our common stock and extends through February 2006. The Plan allows for the granting of:

- | | |
|-----------------------------|--------------------------------------|
| nonqualified stock options; | incentive compensation units (ICUs); |
| incentive stock options; | stock appreciation rights; |
| restricted stock; | performance shares; and |
| rights to restricted stock; | performance units. |

The Plan is administered by our Compensation and Human Resources Committee (the Committee), which is made up of members of our Board of Directors. Employees eligible to receive awards under the Plan are managerial, administrative, or other key employees who are in a position to make a material contribution to the continued profitable growth and long-term success of Pentair. The Committee has the authority to select the recipients of awards, determine the type and size of awards, establish certain terms and conditions of award grants, and take certain other actions as permitted under the Plan. The Plan provides that no more than 20 percent of the total shares available for issuance under the Plan may be used to make awards other than stock options and limits the Committee's authority to reprice awards or to cancel and reissue awards at lower prices.

Incentive stock options

Under the Plan we may grant stock options to any eligible employee with an exercise price equal to the market value of the shares on the dates the options were granted. Options generally vest over a three-year period commencing on the first anniversary of the grant date and expire ten years after the grant date.

Restricted stock, rights to restricted stock and ICUs

Under the Plan, eligible employees are awarded restricted shares or rights to restricted shares (awards) of our common stock and ICUs. Restrictions on awards and ICUs generally expire from three to five years

Table of Contents***Pentair, Inc. and subsidiaries******Notes to consolidated financial statements (continued)***

after issuance, subject to continuous employment and certain other conditions. Restricted stock awards are recorded at market value on the date of the grant as unearned compensation. Unearned compensation is shown as a reduction of shareholders' equity in our consolidated financial statements and is being amortized to expense over the restriction period. The value of ICUs is based on a matrix, which takes into account growth in operating income and return on invested capital. Annual expense for the value of restricted stock and ICUs was \$5.8 million in 2001, \$0.1 million in 2000 and \$7.3 million in 1999.

Outside directors nonqualified stock option plan

Nonqualified stock options are granted to outside directors under the Outside Directors Nonqualified Stock Option Plan (the Directors Plan) with an exercise price equal to 100 percent of the market value of the shares on the dates the options were granted. Options generally vest over a three-year period commencing on the first anniversary of the grant date and expire ten years after the grant date. The Directors Plan extends to January 2008.

Stock options

The following table summarizes stock option activity under all plans:

| Options Outstanding | 2001 | | 2000 | | 1999 | |
|---|-----------|-------------------------------|-----------|-------------------------------|-----------|-------------------------------|
| | Shares | Exercise price ⁽¹⁾ | Shares | Exercise price ⁽¹⁾ | Shares | Exercise price ⁽¹⁾ |
| Balance January 1 | 1,826,356 | \$ 35.07 | 1,522,518 | \$ 33.21 | 1,483,472 | \$ 28.41 |
| Granted | 840,025 | 23.36 | 693,321 | 34.88 | 431,972 | 39.55 |
| Exercised | (302,661) | 30.38 | (301,664) | 24.82 | (384,486) | 21.44 |
| Canceled | (101,232) | 28.35 | (87,819) | 36.44 | (8,440) | 34.33 |
| Balance December 31 | 2,262,488 | \$ 31.65 | 1,826,356 | \$ 35.07 | 1,522,518 | \$ 33.21 |
| Options exercisable December 31 | 1,231,183 | \$ 34.60 | 788,999 | \$ 33.65 | 710,468 | \$ 28.67 |
| Shares available for grant December 31 | | | | | | |
| Omnibus Plan | 2,446,236 | | 1,108,787 | | 1,970,055 | |
| Directors Plan | 373,198 | | 372,798 | | 384,498 | |
| Total | 2,819,434 | | 1,481,585 | | 2,354,553 | |

⁽¹⁾ Weighted average

The following table summarizes information concerning stock options outstanding as of the end of 2001 under all plans:

| Range of exercise prices | Options outstanding | | | Options exercisable | | |
|--------------------------|---------------------|---|-------------------------------|---------------------|-------------------------------|--|
| | Shares | Remaining life ⁽¹⁾ (in years) | Exercise price ⁽¹⁾ | Shares | Exercise price ⁽¹⁾ | |
| \$ 21.00 - 25.00 | 823,250 | 8.3 | \$ 22.62 | 195,000 | \$ 22.56 | |
| 25.01 - 30.00 | 9,535 | 8.7 | 28.93 | 3,186 | 28.94 | |
| 30.01 - 35.00 | 432,461 | 4.5 | 34.37 | 397,670 | 34.51 | |
| 35.01 - 40.00 | 950,372 | 6.4 | 37.69 | 590,741 | 37.99 | |
| 40.01 - 45.00 | 21,599 | 5.7 | 41.48 | 19,365 | 41.63 | |
| 45.01 - 50.00 | 25,271 | 6.3 | 45.14 | 25,221 | 45.14 | |
| | 2,262,488 | 6.7 | \$ 31.65 | 1,231,183 | \$ 34.60 | |

(1) Weighted average

Table of Contents***Pentair, Inc. and subsidiaries******Notes to consolidated financial statements (continued)***

We apply APB No. 25 and related interpretations in accounting for employee stock options. Generally, no compensation expense is recognized related to stock options. The following table summarizes results as if we had recorded compensation expense for our stock option plans under SFAS No. 123.

| <i>In thousands, except per-share data</i> | 2001 | 2000 | 1999 |
|--|-------------|-------------|-------------|
| Net income | | | |
| As reported | \$ 32,869 | \$ 55,887 | \$ 103,309 |
| Pro forma | \$ 28,969 | \$ 52,256 | \$ 100,519 |
| Earnings per common share basic | | | |
| As reported | \$ 0.67 | \$ 1.15 | \$ 2.36 |
| Pro forma | \$ 0.59 | \$ 1.08 | \$ 2.29 |
| Earnings per common share diluted | | | |
| As reported | \$ 0.67 | \$ 1.15 | \$ 2.33 |
| Pro forma | \$ 0.59 | \$ 1.07 | \$ 2.27 |

The weighted-average fair value of options granted in 2001, 2000 and 1999 was \$7.17, \$10.93, and \$12.20 per option, respectively. We estimated the fair values using the Black-Scholes option-pricing model, modified for dividends and using the following assumptions:

| <i>Percentages</i> | 2001 | 2000 | 1999 |
|---|-------------|-------------|-------------|
| Risk-free rate | 4.0 | 4.5 | 6.5 |
| Dividend yield | 1.9 | 2.0 | 1.7 |
| Expected stock price volatility | 42.0 | 40.0 | 34.0 |
| Expected life after vesting period (years): | | | |
| Omnibus Plan | 2.05 | 2.07 | 1.91 |
| Directors Plan | 2.42 | 2.24 | 2.13 |

The expected life was determined separately for each plan due to varying exercise patterns. The fair value of options is amortized to expense over a three-year option-vesting period in determining the pro forma impact.

14. Business Segments

We classify our continuing operations into the following business segments:

Tools which manufactures and markets tool products positioned at the mid- to upper-end of the market and targets professionals and upscale hobbyists. Tools segment products include woodworking machinery, portable power tools, metal and stoneworking tools, compressors, generators, and pressure washers.

Water which manufactures and markets essential products for the transport and treatment of water, wastewater and fluids. Water segment products include water and wastewater pumps, control valves, pumps and pumping stations for thick fluid transfer applications, storage tanks, filtration systems, and pool and spa accessories.

Enclosures which designs, manufactures, and markets customized and standard metal and composite enclosures that house and protect sensitive controls and components for markets that include data communications, networking, telecommunications, testing equipment, automotive, and general electronics. Products include metallic and composite enclosures, cabinets, cases, subracks, thermal management backplanes and power supplies.

Other is primarily composed of corporate expenses, our insurance subsidiary, intermediate finance companies, divested operations, discontinued operations, and intercompany eliminations.

Table of Contents***Pentair, Inc. and subsidiaries******Notes to consolidated financial statements (continued)***

The accounting policies of our operating segments are the same as those described in the summary of significant accounting policies. We evaluate performance based on the operating income of the segment and use a variety of ratios to measure performance.

Financial information by reportable business segment is included in the following summary:

| <i>In thousands</i> | 2001 | 2000 | 1999 | 2001 | 2000 | 1999 |
|----------------------|---|---------------------|---------------------|--------------------------------|-------------------|-------------------|
| | Net sales to external customers | | | Operating income (loss) | | |
| Tools | \$ 1,038,606 | \$ 1,066,616 | \$ 875,643 | \$ 63,232 | \$ 23,751 | \$ 100,680 |
| Water | 887,518 | 903,672 | 582,927 | 109,792 | 120,732 | 73,362 |
| Enclosures | 689,820 | 777,725 | 657,500 | 1,857 | 96,268 | 46,346 |
| Other | | | | (17,120) | (38,721) | (18,662) |
| Consolidated | \$ 2,615,944 | \$ 2,748,013 | \$ 2,116,070 | \$ 157,761 | \$ 202,030 | \$ 201,726 |
| | Identifiable assets ⁽¹⁾ | | | Depreciation | | |
| Tools | \$ 794,908 | \$ 864,051 | \$ 936,096 | \$ 20,033 | \$ 17,406 | \$ 13,615 |
| Water | 930,759 | 990,730 | 953,736 | 19,472 | 19,157 | 15,453 |
| Enclosures | 481,311 | 552,853 | 546,426 | 23,008 | 20,701 | 26,846 |
| Other ⁽¹⁾ | 165,220 | 236,391 | 270,258 | 161 | 2,633 | 167 |
| Consolidated | \$ 2,372,198 | \$ 2,644,025 | \$ 2,706,516 | \$ 62,674 | \$ 59,897 | \$ 56,081 |
| | Amortization | | | Capital expenditures | | |
| Tools | \$ 9,274 | \$ 9,285 | \$ 3,282 | \$ 14,290 | \$ 23,154 | \$ 23,019 |
| Water | 18,560 | 18,074 | 12,714 | 16,705 | 11,966 | 12,413 |
| Enclosures | 8,273 | 9,097 | 8,413 | 22,311 | 20,254 | 14,395 |
| Other | 5,568 | 2,675 | 1,578 | 362 | 12,667 | 3,844 |
| Consolidated | \$ 41,675 | \$ 39,131 | \$ 25,987 | \$ 53,668 | \$ 68,041 | \$ 53,671 |

⁽¹⁾ Segment assets include all assets except cash and cash equivalents. These assets are included in Other, which also includes the net assets of discontinued operations.

Operating income

Tools segment operating income includes:

restructuring charge expense of \$5.4 million in 2000 and \$6.3 million in 1999; and

one-time working capital charges of \$30 million in 2000 to establish additional accounts receivable (\$22 million) and inventory valuation (\$8 million) reserves.

Enclosures segment operating income includes:

restructuring charge expense (income) of \$39.4 million in 2001, \$(1.6) million in 2000 (due to a change in estimate of the 1999 restructuring liability), and \$16.7 million in 1999.

Other segment operating income includes:

restructuring charge expense of \$1.7 million in 2001 and \$21.0 million in 2000.

Table of Contents**Pentair, Inc. and subsidiaries****Notes to consolidated financial statements (continued)**

The following table presents certain geographic information:

| <i>In thousands</i> | 2001 | 2000 | 1999 | 2001 | 2000 | 1999 |
|---------------------|---------------------------------|--------------|--------------|-------------------|--------------|--------------|
| | Net sales to external customers | | | Long-lived assets | | |
| United States | \$ 2,240,276 | \$ 2,339,478 | \$ 1,754,961 | \$ 1,229,400 | \$ 1,308,169 | \$ 1,324,577 |
| Germany | 121,455 | 129,884 | 136,131 | 77,004 | 84,594 | 92,389 |
| Canada | 64,754 | 59,976 | 58,077 | 719 | 752 | 557 |
| All other | 189,459 | 218,675 | 166,901 | 110,583 | 100,571 | 114,316 |
| Consolidated | \$ 2,615,944 | \$ 2,748,013 | \$ 2,116,070 | \$ 1,417,706 | \$ 1,494,086 | \$ 1,531,839 |

Net sales are based on the location in which the sale originated. Long-lived assets include property, plant and equipment, and goodwill, net of related depreciation and amortization.

We sell our products through various distribution channels including home centers and retail chains. In 2001 and 2000, sales to The Home Depot, a major customer of our Tools segment, accounted for approximately 12.8 percent and 10.5 percent of total net sales, respectively. In addition, three customers accounted for about 58 percent of our Tools segment net sales in both 2001 and 2000, and two customers accounted for about 18 percent and 9 percent of our Water segment net sales in 2001 and 2000, respectively. If these customers were lost, it would have a material adverse effect on our business.

15. Commitments and Contingencies**Operating lease commitments**

Net rental expense under operating leases follows:

| <i>In thousands</i> | 2001 | 2000 | 1999 |
|------------------------|-----------|-----------|-----------|
| Gross rental expense | \$ 32,343 | \$ 35,381 | \$ 25,018 |
| Sublease rental income | (239) | | |
| Net rental expense | \$ 32,104 | \$ 35,381 | \$ 25,018 |

Future minimum lease commitments under non-cancelable operating leases, principally related to facilities, vehicles, and machinery and equipment is as follows:

| <i>In thousands</i> | 2002 | 2003 | 2004 | 2005 | 2006 | Thereafter | Total |
|--------------------------------------|-----------|-----------|-----------|----------|----------|------------|-----------|
| Minimum lease payments | \$ 25,920 | \$ 18,864 | \$ 13,492 | \$ 8,377 | \$ 6,366 | \$ 8,068 | \$ 81,087 |
| Minimum sublease rentals | (632) | (703) | (703) | (822) | (722) | (2,106) | (5,688) |
| Net future minimum lease commitments | \$ 25,288 | \$ 18,161 | \$ 12,789 | \$ 7,555 | \$ 5,644 | \$ 5,962 | \$ 75,399 |

Environmental

We have been named as defendants, targets or potentially responsible parties (PRPs) in a small number of environmental cleanups, in which our current or former business units have generally been given *deminimis* status. To date, none of these claims have resulted in cleanup costs, fines, penalties, or damages in an amount material to our financial condition or results of operations. We have disposed of a number of businesses over

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the past ten years and in certain cases, such as the disposition of the Lake Superior Paper Industries supercalendared paper business and the Cross Pointe Paper Corporation uncoated paper business in 1995 and the disposition of

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Pentair, Inc. and subsidiaries

Notes to consolidated financial statements (continued)

the Federal Cartridge Company ammunition business in 1997, we have retained responsibility and potential liability for certain environmental obligations. We have received claims for indemnification from purchasers of both the paper business and the ammunition business. We have established what we believe to be adequate accruals for potential liabilities arising out of retained responsibilities.

In addition, there are pending environmental issues concerning a limited number of sites including sites in Jackson, Tennessee, and Los Angeles, California. We acquired the site in Jackson from Rockwell International Corporation, with whom we have agreed on division of responsibility for remediation and other future costs relating to the site. The site in Los Angeles was acquired in the purchase of the pressure vessel and pool and spa equipment businesses of Esfef Corporation and relates to operations no longer carried out at that site. We have established what we believe to be adequate accruals for remediation costs. We do not believe that projected response costs will result in a material liability.

Litigation

We are occasionally a party to litigation arising in the normal course of business. We regularly analyze current information and, as necessary, provide accruals for probable liabilities based on the expected eventual disposition of these matters. We believe the effect on our consolidated results of operations and financial position, if any, for the disposition of all currently pending matters will not be material.

Table of Contents**Pentair, Inc. and subsidiaries****Notes to consolidated financial statements (continued)****16. Selected Quarterly Financial Data (Unaudited)**

| <i>In thousands, except per-share data</i> | 2001 | | | | |
|---|-----------------------------|------------------------------|--------------|----------------------------------|------------------------------------|
| | First | Second | Third | Fourth ⁽¹⁾ | Year ^{(1) (4)} |
| Net sales | \$ 671,383 | \$ 702,076 | \$ 646,559 | \$ 595,926 | \$ 2,615,944 |
| Gross profit | 163,987 | 170,782 | 159,526 | 153,704 | 647,999 |
| Operating income (loss) | 52,856 | 60,349 | 51,184 | (6,628) | 157,761 |
| Income (loss) from continuing operations | 20,563 | 28,556 | 24,671 | (16,274) | 57,516 |
| Loss on disposal of discontinued operations, net of tax | | | | (24,647) | (24,647) |
| Net income (loss) | 20,563 | 28,556 | 24,671 | (40,921) | 32,869 |
| Earnings per common share ⁽⁴⁾ | | | | | |
| Basic | | | | | |
| Continuing operations | \$ 0.42 | \$ 0.58 | \$ 0.50 | \$ (0.33) | \$ 1.17 |
| Discontinued operations | | | | (0.50) | (0.50) |
| Basic earnings per common share | \$ 0.42 | \$ 0.58 | \$ 0.50 | \$ (0.83) | \$ 0.67 |
| Diluted | | | | | |
| Continuing operations | \$ 0.42 | \$ 0.58 | \$ 0.50 | \$ (0.33) | \$ 1.17 |
| Discontinued operations | | | | (0.50) | (0.50) |
| Diluted earnings per common share | \$ 0.42 | \$ 0.58 | \$ 0.50 | \$ (0.83) | \$ 0.67 |
| 2000 | | | | | |
| <i>In thousands, except per-share data</i> | First ⁽²⁾ | Second ⁽³⁾ | Third | Fourth ^{(2) (3)} | Year ^{(2) (3) (4)} |
| Net sales | \$ 647,691 | \$ 733,761 | \$ 691,784 | \$ 674,777 | \$ 2,748,013 |
| Gross profit | 179,902 | 192,147 | 172,859 | 151,590 | 696,498 |
| Operating income (loss) | 72,752 | 79,437 | 61,350 | (11,509) | 202,030 |
| Income (loss) from continuing operations | 33,641 | 38,673 | 28,021 | (18,467) | 81,868 |
| Income (loss) from discontinued operations, net of tax | (975) | (1,440) | (14,382) | (7,962) | (24,759) |
| Cumulative effect of accounting change, net of tax | (1,222) | | | | (1,222) |
| Net income (loss) | 31,444 | 37,233 | 13,639 | (26,429) | 55,887 |
| Earnings per common share | | | | | |
| Basic | | | | | |
| Continuing operations | \$ 0.69 | \$ 0.80 | \$ 0.58 | \$ (0.38) | \$ 1.68 |
| Discontinued operations | (0.02) | (0.03) | (0.30) | (0.16) | (0.51) |
| Cumulative effect of accounting change | (0.02) | | | | (0.02) |
| Basic earnings per common share | \$ 0.65 | \$ 0.77 | \$ 0.28 | \$ (0.54) | \$ 1.15 |
| Diluted | | | | | |
| Continuing operations | \$ 0.69 | \$ 0.79 | \$ 0.58 | \$ (0.38) | \$ 1.68 |
| Discontinued operations | (0.02) | (0.03) | (0.30) | (0.16) | (0.51) |
| Cumulative effect of accounting change | (0.02) | | | | (0.02) |

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| | | | | | | | | | | |
|-----------------------------------|----|------|----|------|----|------|----|--------|----|------|
| Diluted earnings per common share | \$ | 0.65 | \$ | 0.76 | \$ | 0.28 | \$ | (0.54) | \$ | 1.15 |
|-----------------------------------|----|------|----|------|----|------|----|--------|----|------|

- (1) Fourth quarter 2001 net income reflects pre-tax restructuring charge of \$41.1 million, or \$0.60 per share.
- (2) First quarter 2000 net income reflects pre-tax restructuring charge (income) of \$(2.5) million, or \$(0.03) per share, and fourth quarter net income reflects pre-tax restructuring charge expense of \$27.3, or \$0.36 per share.
- (3) Second quarter 2000 net income reflects a one-time pre-tax cost to establish an additional \$5.0 million in accounts receivable reserves.
Fourth quarter 2000 net income reflects one-time pre-tax costs to establish an additional \$25.0 million for accounts receivable (\$17.0 million) and inventory valuation (\$8.0 million) reserves.
- (4) Amounts may not total to the annual earnings per share because each quarter and the year are calculated separately based on basic and diluted weighted average common shares outstanding during that period.

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ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEM 10. DIRECTORS AND OFFICERS OF THE REGISTRANT

Information required under this item with respect to Directors is contained in our Notice of Annual Meeting of Shareholders and Proxy Statement under the captions Election of Directors and Section 16(a) Beneficial Ownership Reporting Compliance and is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

Information required under this item is contained in our Notice of Annual Meeting of Shareholders and Proxy Statement under the captions Election of Directors and Executive Compensation and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Information required under this item is contained in our Notice of Annual Meeting of Shareholders and Proxy Statement under the caption Security Ownership of Management and Beneficial Ownership and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

None.

Table of Contents**PART IV****ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K**

| | |
|-------------|--|
| (a) | List of documents filed as part of this report: |
| (1) | Financial Statements |
| | Consolidated Statements of Income for the Years Ended December 31, 2001, 2000, and 1999 |
| | Consolidated Balance Sheets as of December 31, 2001 and December 31, 2000 |
| | Consolidated Statements of Cash Flows for the Years Ended December 31, 2001, 2000, and 1999 |
| | Consolidated Statements of Changes in Shareholders' Equity for the Years Ended December 31, 2001, 2000, and 1999 |
| | Notes to Consolidated Financial Statements |
| (2) | Financial Statement Schedules |
| | Schedule II Valuation and Qualifying Accounts |
| | All other schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission have been omitted because they are not applicable or the required information is shown in the financial statements or notes thereto. |
| (3) | Exhibits |
| 3.1 | Second Restated Articles of Incorporation as amended through June 14, 1999 (Incorporated by reference to Exhibit 3.1 contained in Pentair's Amendment 1 to Registration Statement on Form S-3 dated July 16, 1999). |
| 3.2 | Third Amended and Restated By-Laws as amended effective October 26, 2001 (Incorporated by reference to Exhibit 3.2 contained in Pentair's Quarterly Report on Form 10-Q for the quarterly period ended September 29, 2001). |
| 4.1 | Rights Agreement as of July 21, 1995 between Norwest Bank N.A. and Pentair, Inc. (Incorporated by reference to Exhibit 4.1 contained in Pentair's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 1995). |
| 4.2 | Form of Indenture, dated June 1, 1999, between Pentair, Inc. and U.S. Bank National Association, as Trustee Agent (Incorporated by reference to Exhibit 4.2 contained in Pentair's Annual Report on Form 10-K for the year ended December 31, 2000). |
| 10.1 | Pentair's Supplemental Employee Retirement Plan as Amended and Restated effective August 23, 2000 (Incorporated by reference to Exhibit 10.1 contained in Pentair's Current Report on Form 8-K filed September 21, 2000). |
| 10.2 | Pentair's 1999 Supplemental Executive Retirement Plan as Amended and Restated effective August 23, 2000 (Incorporated by reference to Exhibit 10.2 contained in Pentair's Current Report on Form 8-K filed September 21, 2000). |
| 10.3 | Pentair's Restoration Plan as Amended and Restated effective August 23, 2000 (Incorporated by reference to Exhibit 10.3 contained in Pentair's Current Report on Form 8-K filed September 21, 2000). |
| 10.4 | Form of Pentair, Inc. Omnibus Stock Incentive Plan as Amended and Restated, dated February 14, 2001 as approved by shareholders on April 25, 2001. (Incorporated by reference to Exhibit 10.30 contained in Pentair's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2001). |

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|--------------|---|
| 10.5 | Fourth Amended and Restated Compensation Plan for Non-Employee Directors (Incorporated by reference to Exhibit 10.12 contained in Pentair's Annual Report on Form 10-K for the year ended December 31, 1996). |
| 10.6 | Amendment effective August 23, 2000 to Pentair's Fourth Amended and Restated Compensation Plan for Non-Employee Directors (Incorporated by reference to Exhibit 10.5 contained in Pentair's Current Report on Form 8-K filed September 21, 2000). |
| 10.7 | Amended and Restated Pentair, Inc. Outside Directors Nonqualified Stock Option Plan as amended through February 27, 2002 (Filed herewith). |
| 10.8 | Pentair, Inc. Deferred Compensation Plan effective January 1, 1993 (Incorporated by reference to Exhibit 10.21 contained in Pentair's Annual Report on Form 10-K for the year ended December 31, 1992). |
| 10.9 | Amendment effective August 23, 2000 to Pentair's Deferred Compensation Plan effective January 1, 1993 (Incorporated by reference to Exhibit 10.7 contained in Pentair's Current Report on Form 8-K filed September 21, 2000). |
| 10.10 | Pentair, Inc. Non-Qualified Deferred Compensation Plan effective January 1, 1996 (Incorporated by reference to Exhibit 10.17 contained in Pentair's Annual Report on Form 10-K for the year ended December 31, 1995). |
| 10.11 | Trust Agreement for Pentair, Inc. Non-Qualified Deferred Compensation Plan between Pentair, Inc. and State Street Bank and Trust Company (Incorporated by reference to Exhibit 10.18 contained in Pentair's Annual Report on Form 10-K for the year ended December 31, 1995). |
| 10.12 | Amendment effective August 23, 2000 to Pentair's Non-Qualified Deferred Compensation Plan effective January 1, 1996 (Incorporated by reference to Exhibit 10.8 contained in Pentair's Current Report on Form 8-K filed September 21, 2000). |
| 10.13 | Executive Officer Performance Plan (Incorporated by reference to Exhibit 10.14 contained in Pentair's Annual Report on Form 10-K for the year ended December 31, 1997). |
| 10.14 | Amendment effective August 23, 2000 to Pentair's Executive Officer Performance Plan (Incorporated by reference to Exhibit 10.9 contained in Pentair's Current Report on Form 8-K filed September 21, 2000). |
| 10.15 | Proposed form of Pentair, Inc. Executive Officer Performance Plan as amended and restated, dated February 27, 2002 (Submitted for shareholder approval on May 1, 2002) (Filed herewith). |
| 10.16 | Pentair's Management Incentive Plan as amended and restated January 1, 2002 (Filed herewith). |
| 10.17 | Employee Stock Purchase and Bonus Plan as amended and restated effective January 1, 1992 (Incorporated by reference to Exhibit 10.16 contained in Pentair's Annual Report on Form 10-K for the year ended December 31, 1991). |
| 10.18 | Pentair's Flexible Perquisite Program as amended to January 1, 1989 (Incorporated by reference to Exhibit 10.20 contained in Pentair's Annual Report on Form 10-K for the year ended December 31, 1989). |
| 10.19 | Form of Key Executive Employment and Severance Agreement effective August 23, 2000 for Randall J. Hogan (Incorporated by reference to Exhibit 10.11 contained in Pentair's Current Report on Form 8-K filed September 21, 2000). |

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| | |
|--------------|---|
| 10.20 | Form of Key Executive Employment and Severance Agreement effective August 23, 2000 for Louis Ainsworth, Richard J. Cathcart, Michael V. Schrock, Karen A. Durant, David D. Harrison, Deb S. Knutson, Frank J. Feraco and others (Incorporated by reference to Exhibit 10.13 contained in Pentair's Current Report on Form 8-K filed September 21, 2000). |
| 10.21 | Long-Term Credit Agreement, dated as of September 2, 1999, between Pentair and subsidiaries and various financial institutions and Bank of America, N.A., as Administrative Agent (Incorporated by reference to Exhibit 4.1 contained in Pentair's Current Report on Form 8-K filed September 3, 1999). |
| 10.22 | First Amendment, dated as of February 16, 2001, to the Long-Term Credit Agreement, dated as of September 2, 1999, between Pentair and subsidiaries and various financial institutions and Bank of America, N.A., as Administrative Agent (Incorporated by reference to Exhibit 10.25 contained in Pentair's Annual Report on Form 10-K for the year ended December 31, 2000). |
| 10.23 | Second Amendment, dated as of April 30, 2001, to the Long-Term Credit Agreement dated as of September 2, 1999, between Pentair and various financial institutions and Bank of America, N.A., as Administrative Agent (Filed herewith). |
| 10.24 | InterCreditor Agreement, dated as of May 1, 2001, between Bank of America, N.A., as a bank and in its capacity as agent for the financial institutions which are parties to the Bank Credit Agreements (Filed herewith). |
| 10.25 | Amended and Restated 364-Day Credit Agreement dated as of August 30, 2001, between Pentair and Various Financial Institutions and Bank One, NA, as Syndication Agent (Incorporated by reference to Exhibit 10.26 contained in Pentair's Quarterly Report on Form 10-Q for the quarterly period ended September 29, 2001). |
| 10.26 | Employment Agreement dated October 17, 2001, between Pentair, Inc. and Richard J. Cathcart. (Incorporated by reference to Exhibit 10.31 contained in Pentair's Quarterly Report on Form 10-Q for the quarterly period ended September 29, 2001). |
| 10.27 | Retirement Agreement and Release dated March 8, 2002, between Pentair, Inc. and Roy T. Rueb (Filed herewith). |
| 10.28 | Separation Agreement and Release dated December 4, 2001, between Pentair, Inc. and George Danko (Filed herewith). |
| 21 | List of Pentair subsidiaries. |
| 23 | Consent of Independent Auditors Deloitte & Touche LLP |
| 24 | Power of Attorney (See signature page) |
| (b) | Reports on Form 8-K None. |

Table of Contents**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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, on March 19, 2002.

PENTAIR, INC.

By /s/ David D. Harrison

David D. Harrison
Executive Vice President and
Chief Financial Officer

Power of Attorney

KNOW ALL MEN BY THESE PRESENTS that the undersigned directors of Pentair, Inc., a Minnesota corporation, hereby constitute and appoint Louis L. Ainsworth his/her attorney-in-fact and agent, with full power of substitution, for the purpose of signing on his/her behalf as a director of Pentair, Inc. the Annual Report on Form 10-K, to be filed with the Securities and Exchange Commission within the next sixty days, and to file the same, with all exhibits thereto and other supporting documents, with the Commission, granting unto such attorney-in-fact, full power and authority to do and perform any and all acts necessary or incidental to the performance and execution of the powers herein expressly granted.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on March 19, 2002 in the capacities indicated.

| <u>Signature</u> | <u>Title</u> | <u>Signature</u> | <u>Title</u> |
|---|---|--|--------------|
| <u>/s/ Randall J. Hogan</u> Randall J. Hogan | President and Chief Executive Officer; Director | <u>/s/ WilliamH. Hernandez</u> William H. Hernandez | Director |
| <u>/s/ Winslow H. Buxton</u> Winslow H. Buxton | Chairman of the Board | <u>/s/ Stuart Maitland</u> Stuart Maitland | Director |
| <u>/s/ William J. Cadogan</u> William J. Cadogan | Director | <u>/s/ Augusto Meozzi</u> Augusto Meozzi | Director |
| <u>/s/ Barbara B. Grogan</u> Barbara B. Grogan | Director | <u>/s/ William T. Monahan</u> William T. Monahan | Director |
| <u>/s/ Charles A. Haggerty</u> Charles A. Haggerty | Director | <u>/s/ Karen E. Welke</u> Karen E. Welke | Director |

Table of Contents**Schedule II Valuation and Qualifying Accounts***Pentair, Inc. and subsidiaries*

| <i>In thousands</i> | Balance beginning of period | Additions charged to costs and expenses | Deductions describe | Other changes add (deduct) describe | Balance end of period |
|---|-----------------------------------|--|--------------------------|--|-----------------------------|
| Allowances for doubtful accounts | | | | | |
| Year ended December 31, 2001 | \$ 18,636 | \$ 1,884 | \$ 6,601 ⁽¹⁾ | \$ 223 ⁽²⁾ | \$ 14,142 |
| Year ended December 31, 2000 | \$ 14,242 | \$ 28,055 | \$ 23,661 ⁽¹⁾ | \$ ⁽²⁾ | \$ 18,636 |
| Year ended December 31, 1999 | \$ 9,373 | \$ 3,008 | \$ 2,397 ⁽¹⁾ | \$ 4,258 ⁽²⁾ | \$ 14,242 |

⁽¹⁾ Uncollectible accounts written off, net of recoveries.⁽²⁾ Result of acquisitions