



**REXNORD HOLDINGS, INC. AND SUBSIDIARIES**  
**Interim Financial Report**  
(UNAUDITED)

*As of September 26, 2009 and March 31, 2009  
and for the three and six months ended  
September 26, 2009 and September 27, 2008*

*Report Posting Date: November24, 2009*



# Rexnord Holdings, Inc.

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## NOTICE

We are furnishing this Rexnord Holdings, Inc. and Subsidiaries Interim Financial Report in connection with the Rexnord Holdings, Inc. Credit Agreement dated as of March 2, 2007 and subsequent PIK Toggle Senior Notes Indenture dated as of August 8, 2008, each of which was exempt from registration under, or not subject to, the Securities Act of 1933, as amended, solely to meet our obligation to holders under the terms of the Credit Agreement and the PIK Toggle Senior Notes Indenture.

This is not an offering of indebtedness subject to the Credit Agreement, an offering of PIK Toggle Senior Notes subject to the Indenture or an offering of any other obligations or securities. The indebtedness governed by the Credit Agreement and PIK Toggle Senior Notes Indenture was issued in transactions that were not registered with, recommended by or approved by the Securities and Exchange Commission ("SEC"), or any other federal or state securities commission or regulatory authority, nor has the SEC or any such federal or state securities commission or authority passed upon the accuracy or adequacy of this information. Any representation to the contrary is a criminal offense.

The information in this report is given as of September 26, 2009 and March 31, 2009 and for the periods ending September 26, 2009 and September 27, 2008. We have made no promise to include information for subsequent periods or as of other dates. You should not assume that the information herein has not changed after the dates indicated.

## ABOUT REXNORD HOLDINGS, INC.

On July 21, 2006 (the “Merger Date”), affiliates of Apollo Management, L.P. (“Apollo”), George M. Sherman and certain members of management acquired RBS Global, Inc. (“RBS Global”) through the merger of Chase Merger Sub, Inc., an indirect, wholly-owned subsidiary of Rexnord Holdings, Inc. (“Rexnord Holdings”), an Apollo affiliate, with and into RBS Global (the “Merger”), and RBS Global became an indirect, wholly-owned subsidiary of Rexnord Holdings. RBS Global is the parent company of Rexnord LLC, a limited liability company that owns several domestic and foreign subsidiaries.

Unless otherwise noted, “Rexnord,” “we,” “us,” “our” and “the Company” mean Rexnord Holdings, Inc. and its predecessors and consolidated subsidiaries, including RBS Global and Rexnord LLC, and “Rexnord Holdings” means Rexnord Holdings, Inc. and its predecessors but not its subsidiaries.

As used in this report, “fiscal year” refers to our fiscal year ending March 31 of the corresponding calendar year (for example, “fiscal year 2010” or “fiscal 2010” means the period from April 1, 2009 to March 31, 2010). Throughout this report, we refer to the period from June 28, 2009 through September 26, 2009 as the “second quarter of fiscal 2010” or the “second quarter ended September 26, 2009.” Similarly, we refer to the period from June 29, 2008 through September 27, 2008 as the “second quarter of fiscal 2009” or the “second quarter ended September 27, 2008.” We refer to the period from April 1, 2009 through September 26, 2009 as the “first six months of fiscal 2010” or the “six months ended September 26, 2009.” Similarly, we refer to the period from April 1, 2008 through September 27, 2008 as the “first six months of fiscal 2009” or the “six months ended September 27, 2008.”

The address of our principal executive office is 4701 W. Greenfield Avenue, Milwaukee, Wisconsin 53214. Our phone number is (414) 643-3000. Our Internet website address is [www.rexnord.com](http://www.rexnord.com).

## **CAUTIONARY NOTICE REGARDING FORWARD-LOOKING STATEMENTS**

Our disclosure and analysis in this report, concerning our operations, cash flows and financial position, including, in particular, the likelihood of our success in developing and expanding our business and the realization of sales from our backlog, include forward-looking statements. Statements that are predictive in nature, that depend upon or refer to future events or conditions, or that include words such as “expects,” “anticipates,” “intends,” “plans,” “believes,” “estimates” and similar expressions are forward-looking statements. Although we believe these statements are based upon reasonable assumptions, including projections of orders, sales, operating margins, earnings, cash flow, research and development costs, working capital and capital expenditures, they are subject to risks and uncertainties, including those that are described more fully in the section titled “Risk Factors” within our Annual Report. Accordingly, we can give no assurance that we will achieve the results anticipated or implied by the forward-looking statements in this report. The forward-looking statements included in this report are made as of the date of the report, and we undertake no obligation to publicly update or revise any forward-looking statements or risk factors, whether as a result of new information, future events, or otherwise, except as required by law.

## **RISK FACTORS**

Information with respect to our risk factors is contained in the section titled “Risk Factors” of our Annual Report for the fiscal year ended March 31, 2009, which is available on our website. Management believes that as of the date of this posting, there have been no material changes to this information.

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

*You should read the following discussion of our results of operations and financial condition with our audited consolidated financial statements and related notes thereto, which are available on our website. This discussion contains forward-looking statements and involves numerous risks and uncertainties, including, but not limited to, those described in the "Risk Factors" section of our Annual Report. Actual results may differ materially from those contained in any forward-looking statements. See "Cautionary Notice Regarding Forward-Looking Statements" found elsewhere in this presentation.*

The information contained in this section is provided as a supplement to the unaudited condensed consolidated financial statements and the related notes to help provide an understanding of our financial condition, changes in our financial condition and results of our operations. This section is organized as follows:

*Company Overview.* This section provides a general description of our business as well as recent developments that we believe are necessary to understand our financial condition and results of operations and to anticipate future trends in our business.

*Critical Accounting Policies and Estimates.* This section discusses the accounting policies and estimates that we consider to be important to our financial condition and results of operations and that require significant judgment and estimates on the part of management in their application.

*Results of Operations.* This section provides an analysis of our results of operations for our second quarter and six months ended September 26, 2009 as compared to the performance for the same periods of the prior year.

*Liquidity and Capital Resources.* This section provides an analysis of our cash flows for the six months ended September 26, 2009, as well as a discussion of our indebtedness and its potential effects on our liquidity.

*Quantitative and Qualitative Disclosures about Market Risk.* This section discusses our exposure to potential losses arising from adverse changes in interest rates and foreign currency exchange rates.

### **Company Overview**

#### ***General***

We are a leading, global, multi-platform industrial company strategically positioned within the markets and industries we serve. Our business is comprised of two strategic platforms: (i) Power Transmission, which produces gears, couplings, industrial bearings, flattop chain and modular conveyer belts, aerospace bearings and seals, special components and industrial chain and conveying equipment, and (ii) Water Management, which produces professional grade specification plumbing, PEX piping, commercial brass and water and wastewater treatment and control products. Our strategy is to build the Company around multi-billion dollar, global strategic platforms that participate in end markets with above average growth characteristics where we are, or have the opportunity to become, the industry leader. We have successfully completed and integrated several acquisitions and expect to continue to pursue strategic acquisitions within our existing platforms that will expand our geographic presence, broaden our product lines and allow us to move into adjacent markets. Over time, we anticipate adding additional strategic platforms to our Company. We believe that we have one of the broadest portfolios of highly engineered, mission and project critical Power Transmission products in the industrial and aerospace end markets. Our Power Transmission products are used in the plants and equipment of companies in diverse end market industries, including aerospace, aggregates and cement, air handling, construction, chemicals, energy, beverage and container, forest and wood products, mining, material and package handling, marine, natural resource extraction and petrochemical. Our Water Management platform is a leader in the multi-billion dollar, specification driven, non-residential construction market for water management products, and with recent acquisitions, we have gained entry into the municipal water and wastewater treatment markets. Our Power Transmission products are either incorporated into products sold by OEMs or sold to end users through industrial distributors as aftermarket products. We have a significant installed base of Power Transmission products comprised primarily of components that are consumed or worn out in use and that have a predictable replacement cycle. The demand for our Water Management products is primarily driven by new infrastructure, commercial and, to a lesser extent, residential construction. Categories of the infrastructure end market include: municipal water and wastewater, transportation, government, health care and education. Categories of the commercial construction end market include: lodging, retail, dining, sports arenas, and warehouse/office. We believe we have become a market leader in the industry by meeting the stringent third party regulatory, building and plumbing code requirements and subsequently achieving specification of our products into projects and applications. The majority of these stringent testing and regulatory approval processes are completed through the University of Southern California, the International Association of Plumbing and Mechanical Codes, the National Sanitation Foundation or the American Water Works Association, prior to the commercialization of our products.

Although our results of operations are dependent on general economic conditions, we believe our significant installed base generates aftermarket sales that may partially mitigate the impact of economic downturns on our results of operations.

The following information should be read in conjunction with the consolidated financial statements and notes thereto, along with the Management's Discussion and Analysis or "MD&A" section in the Company's Annual Report for the fiscal year ended March 31, 2009.

### **Critical Accounting Policies and Estimates**

The Condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States which require the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities on the date of the financial statements and revenues and expenses during the periods reported. Actual results could differ from those estimates. Refer to the Audited Consolidated Financial Statements of Rexnord Holdings, Inc. for information with respect to the Company's critical accounting policies for the fiscal year ended March 31, 2009, which the Company believes could have the most significant effect on the Company's reported results and require subjective or complex judgments by management. Except for the items reported below, management believes that as of September 26, 2009 and during the period from April 1, 2009 through September 26, 2009, there has been no material change to this information.

#### ***Update on Goodwill and Other Intangible Assets***

Commensurate with our previously disclosed policy, goodwill and other intangible assets are reviewed for impairment at least annually or more frequently if events or changes in circumstances indicate that the carrying amount may not be recoverable. As of the date of this report, we are not aware of any events that have occurred since our last impairment testing date that requires us to review these assets for impairment prior to the annual testing date.

#### ***Recently Adopted and Issued Accounting Guidance***

##### *Adopted*

In June 2009, the Financial Accounting Standards Board ("FASB") issued the *FASB Accounting Standards Codification* (the "Codification" or "ASC"), the authoritative guidance for U.S. generally accepted accounting principles ("GAAP"). The Codification, which changes the referencing of financial standards, became effective for interim and annual periods ending on or after September 15, 2009. The Codification is now the single official source of authoritative U.S. GAAP (other than guidance issued by the SEC), superseding existing FASB, American Institute of Certified Public Accountants, and related literature. Only one level of authoritative U.S. GAAP now exists. All other literature is considered non-authoritative. The Codification does not change U.S. GAAP. The Company adopted the Codification during the quarter ended September 26, 2009. The adoption of the Codification did not have any substantive impact on our condensed consolidated financial statements or related footnotes.

On April 1, 2009, the Company adopted the guidance included in ASC 820, *Fair Value Measurements and Disclosures* ("ASC 820") related to the measurement of fair value used when evaluating nonfinancial assets and liabilities. See additional disclosures related to the adoption of the standard within Note 10 to the condensed consolidated financial statements.

On April 1, 2009, the Company adopted the guidance included in ASC 805, *Business Combinations* ("ASC 805"), which significantly changed the accounting for and reporting of business combination transactions. The objective of this guidance is to improve the information provided in financial reports about a business combination and its effects. ASC 805 states that all business combinations (whether full, partial or step acquisitions) must apply the "acquisition method." In applying the acquisition method, the acquirer must determine the fair value of the acquired business as of the acquisition date and recognize the fair value of the acquired assets and liabilities assumed. As a result, it will require that certain forms of contingent consideration and certain acquired contingencies be recorded at fair value at the acquisition date. ASC 805 also states acquisition costs will generally be expensed as incurred and restructuring costs will be expensed in periods after the acquisition date. The impact of the adoption of ASC 805 on the Company's financial statements will largely be dependent on the size and nature of the business combinations completed subsequent to adoption. Currently, the Company has not made any business acquisitions subsequent to the adoption of this standard. The Company estimates that approximately \$64.0 million and \$34.7 million of recorded valuation allowance and unrecognized tax benefits, respectively, which are associated with prior acquisitions, if recognized in future periods would impact income tax expense instead of goodwill.

On April 1, 2009 the Company adopted the guidance included in ASC 855, *Subsequent Events* ("ASC 855"), which requires companies, if applicable, to disclose any subsequent events either as recognized subsequent events or non-recognized subsequent events. ASC 855 also modified the definition of subsequent events to refer to events or transactions that occur after the balance sheet date, but before the financial statements are issued and requires entities to disclose the date through which an entity has evaluated subsequent events and the basis for that date.

##### *Issued*

In December 2008, the FASB issued guidance included in ASC 715, *Compensation – Retirement Benefits* ("ASC 715") which requires additional disclosures regarding assets held in an employer's defined benefit pension or other postretirement plan. This standard requires disclosure of the fair value of each major plan asset category, disclosure of the level within the fair value hierarchy in which each major category of plan assets falls using the guidance in ASC 820 and a reconciliation of beginning and ending balances

of plan asset fair values that are derived using significant unobservable inputs. The guidance is effective for fiscal years ending after December 15, 2009. The Company is currently reviewing the requirements of ASC 715 to determine the impact on its financial statement disclosures.

## Results of Operations

### Consolidated Overview

The comparability of our operating results for the second quarter and first six months of fiscal 2010 has been impacted by fluctuations in foreign currency exchange rates as approximately one fourth of our net sales are denominated in currencies other than the U.S. dollar. The relative strength of the U.S. dollar in the second quarter and six months ended September 26, 2009 has negatively impacted comparisons to the same periods in the prior fiscal year due to the translation of subsidiary results that are denominated in a foreign currency.

Net sales for the second quarter of fiscal 2010 were \$369.7 million, a decrease of \$140.9 million or 27.6% compared to the second quarter of fiscal 2009, while net sales for the first six months of fiscal 2010 were \$737.6 million, a decrease of \$269.1 million or 26.7% compared to the first six months of fiscal 2009. The majority of our year-over-year net sales decline in both periods is attributable to slower order rates within our Power Transmission platform (as our customers align their inventory levels with current demand) as well as a continued softening within certain segments of our Water Management end-markets of infrastructure, commercial and residential construction. While demand for our products has contracted over the last few quarters, we believe we are beginning to experience stabilization across many of our end-markets. Sequentially, daily sales rates in the second quarter of fiscal 2010 were relatively flat and daily order rates increased approximately 7.8% over the same period.

Our backlog as of September 26, 2009 was approximately \$373.0 million compared to \$456.0 million as of March 31, 2009, a reduction of approximately 18.0%. The reduction in backlog and orders was primarily the result of the weak macro-economic environment currently affecting a broad section of the end-markets in both our Power Transmission and Water Management platforms.

Income from operations for the second quarter of fiscal 2010 was \$38.1 million, a decrease of \$31.2 million or 45.0% compared to the second quarter of fiscal 2009, while income from operations for the first six months of fiscal 2010 was \$62.2 million, a decrease of \$70.4 million or 53.1% compared to the first six months of fiscal 2009. The comparability of our year-over-year results has been significantly impacted by a change in our pension expense resulting primarily from the losses incurred on plan assets associated with our U.S. defined benefit pension plans during fiscal 2009. During the second quarter and first six months of fiscal 2010, we incurred \$5.9 million and \$11.9 million of pension expense, respectively (compared to pension income of \$2.4 million and \$4.8 million in the second quarter and first six months of fiscal 2009, respectively). In addition, income from operations in the second quarter and first six months of fiscal 2010 includes \$0.8 and \$3.2 million of restructuring expenses, respectively. Excluding pensions and restructuring, income from operations would have decreased by \$22.1 million or 33.0% in the second quarter of fiscal 2010 and by \$50.5 million or 39.5% in the first six months of fiscal 2010 versus the comparable prior year period. On an adjusted basis (also excluding pensions and restructuring), income from operations as a percent of net sales would have declined by 100 basis points to 12.1% in the second quarter and by 220 basis points to 10.5% in the first six months of fiscal 2010 versus the comparable prior year period. This remaining decline in income from operations as a percent of net sales in both periods was primarily driven by the impact of lower year-over-year net sales, partially offset by productivity gains, cost reduction initiatives and lower material prices.

### Second Quarter Ended September 26, 2009 Compared with the Second Quarter Ended September 27, 2008:

#### Net Sales

(Dollars in Millions)

	Quarter Ended		Change	% Change
	September 27, 2008	September 26, 2009		
Power Transmission	\$ 353.6	\$ 238.4	\$ (115.2)	-32.6%
Water Management	157.0	131.3	(25.7)	-16.4%
Consolidated	\$ 510.6	\$ 369.7	\$ (140.9)	-27.6%

#### Power Transmission

Power Transmission net sales in the second quarter of fiscal 2010 were \$238.4 million, a decrease of \$115.2 million, or 32.6%, from \$353.6 million in the second quarter of fiscal 2009. Foreign currency fluctuations unfavorably impacted net sales by approximately \$12.4 million, or 3.5%, during the quarter as the Euro, and other currencies, weakened against the U.S. dollar compared

to the prior year period. Excluding foreign currency fluctuations, year-over-year core net sales decreased by \$102.8 million or 29.1% as our customers continued to reduce their inventory levels.

### Water Management

Water Management net sales in the second quarter of fiscal 2010 were \$131.3 million, a decrease of \$25.7 million, or 16.4%, from \$157.0 million in the second quarter of fiscal 2009. Foreign currency fluctuations unfavorably impacted sales by approximately \$3.1 million, or 2.0%, during the quarter as the Canadian Dollar, and other currencies, weakened against the U.S. dollar compared to the prior year period. Excluding foreign currency fluctuations, year-over-year core net sales decreased by \$22.6 million, or 14.4%, versus the prior year second quarter which is attributable to continued softness within our commercial and residential construction end-markets as well as certain segments of our infrastructure end-markets, a trend which we expect to continue for the next few quarters. These declines were partially offset by an increase in year-over-year net sales in our water and wastewater end-markets.

### **Income from Operations (Dollars in Millions)**

	Quarter Ended		Change	% Change
	September 27, 2008	September 26, 2009		
Power Transmission	\$ 48.3	\$ 24.0	\$ (24.3)	-50.3%
<i>% of net sales</i>	<i>13.7%</i>	<i>10.1%</i>	<i>-3.6%</i>	
Water Management	22.2	22.4	0.2	0.9%
<i>% of net sales</i>	<i>14.1%</i>	<i>17.1%</i>	<i>2.9%</i>	
Corporate	(1.2)	(8.3)	(7.1)	591.7%
Consolidated	\$ 69.3	\$ 38.1	\$ (31.2)	-45.0%
<i>% of net sales</i>	<i>13.6%</i>	<i>10.3%</i>	<i>-3.3%</i>	

### Power Transmission

Power Transmission income from operations in the second quarter of fiscal 2010 was \$24.0 million compared to income from operations of \$48.3 million in the second quarter of fiscal 2009. The comparability of our year-over-year results has been significantly impacted by a change in our pension expense resulting primarily from the losses incurred on plan assets associated with our U.S. defined benefit pension plans during fiscal 2009. During the second quarter of fiscal 2010, we incurred \$3.0 million of pension expense (compared to pension expense of \$0.9 million in the second quarter of fiscal 2009). In addition, income from operations in the second quarter of fiscal 2010 includes \$0.8 million of restructuring expenses. Excluding the effect of restructuring expenses and pension expense, income from operations would have decreased \$21.4 million or 43.5% and income from operations as a percent of net sales would have declined by 220 basis points to 11.7% of sales in the second quarter of fiscal 2010 versus the comparable prior year period. The remaining decline in income from operations as a percent of net sales was primarily driven by the unfavorable impact of lower year-over-year net sales, partially offset by productivity gains, cost reduction initiatives and lower material prices.

### Water Management

Water Management income from operations in the second quarter of fiscal 2010 was \$22.4 million compared to income from operations of \$22.2 million in the second quarter of fiscal 2009. Despite a 16.4% decline in sales, operating income margins expanded 300 basis points as cost reduction actions, lower material prices and productivity gains more than offset the unfavorable impact of lower sales.

### Corporate

Corporate expenses increased by \$7.1 million from \$1.2 million in the second quarter of fiscal 2009 to \$8.3 million in the second quarter of fiscal 2010. This increase is primarily attributable to a \$6.2 million dollar increase in pension expense.

### **Interest Expense, net**

Interest expense, net was \$49.4 million in the second quarter of fiscal 2010 compared to \$58.5 million in the second quarter of fiscal 2009. The decrease in interest expense is primarily due to a reduction in debt of \$159.9 million in the first quarter of fiscal 2010 as a result of our debt exchange offer and the purchase and extinguishment of our PIK Toggle Senior Indebtedness as well as reduced borrowing costs on our variable rate debt.

### ***Other Income (Expense), net***

Other income (expense), net for the quarter ended September 26, 2009, consists of management fee expense of \$0.7 million, loss on the sale of fixed assets of \$0.2 million, foreign currency translation gains of \$9.1 million, income in unconsolidated affiliates of \$0.3 million and other miscellaneous losses of \$0.3 million. Other income (expense), net for the quarter ended September 27, 2008, consists of management fee expense of \$0.7 million, gains on the sale of fixed assets of \$0.1 million, foreign currency transaction gains of \$1.7 million, income in unconsolidated affiliates of \$0.1 million and other miscellaneous losses of \$0.2 million.

### ***Provision (benefit) for income taxes***

The income tax benefit was \$0.8 million in the second quarter of fiscal 2010 compared to an income tax provision of \$6.5 million in the second quarter of fiscal 2009. Our effective income tax rate for the second quarter of fiscal 2010 was 25.8% versus 55.1% in the second quarter of fiscal 2009. The effective tax rate for the second quarter of fiscal 2010 is lower than the U.S. federal statutory rate of 35.0% mainly due to the accrual of state income taxes, the accrual of interest expense (through income tax expense) relating to unrecognized tax benefits and an increase in the valuation allowance for foreign tax credits generated during this period for which realization of such benefits is not deemed more likely than not, relative to the pre-tax loss during this period. The high effective tax rate for the second quarter of fiscal 2009 is a result of the accrual of state income taxes, the accrual of interest expense (through income tax expense) relating to unrecognized tax benefits and an increase to the valuation allowance relating to foreign tax credits generated for which realization of such benefits is not deemed more likely than not, relative to the pre-tax income recognized during this period.

### ***Net Income (Loss)***

Our net loss for the second quarter of fiscal 2010 was \$2.3 million compared to net income of \$5.3 million in the second quarter of fiscal 2009 due to the factors described above.

### ***Six Months Ended September 26, 2009 Compared with the Six Months Ended September 27, 2008:***

#### ***Net Sales***

**(Dollars in Millions)**

	<u>Six Months Ended</u>			
	<u>September 27, 2008</u>	<u>September 26, 2009</u>	<u>Change</u>	<u>% Change</u>
Power Transmission	\$ 694.2	\$ 472.8	\$ (221.4)	-31.9%
Water Management	312.5	264.8	(47.7)	-15.3%
Consolidated	\$ 1,006.7	\$ 737.6	\$ (269.1)	-26.7%

#### Power Transmission

Power Transmission net sales in the first six months of fiscal 2010 were \$472.8 million, a decrease of \$221.4 million, or 31.9%, from \$694.2 million in the first six months of fiscal 2009. Foreign currency fluctuations unfavorably impacted sales by approximately \$22.7 million, or 3.3%, during the six months as the Euro, and other currencies, weakened against the U.S. dollar compared to the prior year period. Excluding foreign currency fluctuations, year-over-year core net sales decreased by \$198.7 million, or 28.6%, as our customers reduced their inventory levels during the first six months of fiscal 2010 compared to the same period a year ago.

#### Water Management

Water Management net sales in the first six months of fiscal 2010 were \$264.8 million, a decrease of \$47.7 million, or 15.3%, from \$312.5 million in the first six months of fiscal 2009. Foreign currency fluctuations unfavorably impacted sales by approximately \$4.3 million, or 1.4%, during the six months as the Canadian Dollar, and other currencies, weakened against the U.S. dollar compared to the prior year period. Excluding foreign currency fluctuations, year-over-year core net sales decreased by \$43.4 million or 13.9% versus the prior year six months which is attributable to continued softness within our commercial and residential construction end-markets as well as certain segments of our infrastructure end-markets, a trend which we expect to continue for the next few quarters. These declines were partially offset by an increase in year-over-year net sales in our water and wastewater end-markets.

## ***Income from Operations***

**(Dollars in Millions)**

	Six Months Ended			
	September 27, 2008	September 26, 2009	Change	% Change
Power Transmission	\$ 94.3	\$ 38.6	\$ (55.7)	-59.1%
<i>% of net sales</i>	<i>13.6%</i>	<i>8.2%</i>	<i>-5.4%</i>	
Water Management	45.3	41.6	(3.7)	-8.2%
<i>% of net sales</i>	<i>14.5%</i>	<i>15.7%</i>	<i>1.2%</i>	
Corporate	(7.0)	(18.0)	(11.0)	157.1%
Consolidated	\$ 132.6	\$ 62.2	\$ (70.4)	-53.1%
<i>% of net sales</i>	<i>13.2%</i>	<i>8.4%</i>	<i>-4.8%</i>	

### Power Transmission

Power Transmission income from operations in the first six months of fiscal 2010 was \$38.6 million compared to income from operations of \$94.3 million in the first six months of fiscal 2009. The comparability of our year-over-year results has been significantly impacted by a change in our pension expense resulting primarily from the losses incurred on plan assets associated with our U.S. defined benefit pension plans during fiscal 2009. During the first six months of fiscal 2010, we incurred \$6.2 million of pension expense (compared to pension expense of \$1.9 million in the first six months of fiscal 2009). In addition, income from operations in the first six months of fiscal 2010 includes \$2.7 million of restructuring expenses. Excluding the effect of restructuring expenses and pension expense, income from operations would have decreased \$48.7 million or 50.6% and income from operations as a percent of net sales would have declined by 390 basis points to 10.0% of sales in the first six months of fiscal 2010 versus the comparable prior year period. The remaining decline in income from operations as a percent of net sales was primarily driven by unfavorable impact of lower year-over-year net sales, partially offset by productivity gains, cost reduction initiatives and lower material prices.

### Water Management

Water Management income from operations in the first six months of fiscal 2010 was \$41.6 million compared to income from operations of \$45.3 million in the first six months of fiscal 2009. Despite a 15.3% decline in sales, operating income margins expanded 120 basis points as cost reduction actions, lower material prices and productivity gains more than offset the unfavorable impact of lower sales.

### Corporate

Corporate expenses increased by \$11.0 million from \$7.0 million in the first six months of fiscal 2009 to \$18.0 million in the first six months of fiscal 2010. This increase is directly attributable to a \$12.4 million dollar increase in pension expense.

### ***Interest Expense, net***

Interest expense, net was \$98.0 million in the first six months of fiscal 2010 compared to \$116.7 million in the first six months of fiscal 2009. The decrease in interest expense is primarily due to a reduction in debt of \$159.9 million in the first quarter of fiscal 2010 as a result of our debt exchange offer and the purchase and extinguishment of our PIK Toggle Senior Indebtedness as well as reduced borrowing costs on our variable rate debt.

### ***Gain on debt extinguishment***

During the first quarter of fiscal 2010, the Company recorded a \$152.4 million gain on debt extinguishment as a result of the purchase and extinguishment of our PIK Toggle Senior Indebtedness and our debt exchange offer. See below for a summary of these two transactions:

#### Purchase and Extinguishment of PIK Toggle Senior Indebtedness

On April 22, 2009, the Company purchased and extinguished \$23.6 million of outstanding face value of our PIK Toggle Loans for \$8.5 million in cash. As a result of the extinguishment, the Company recognized a \$14.9 million gain during the first quarter ended June 27, 2009, which was measured based on the difference between the cash paid and the net carrying amount of the debt (the net carrying amount of the debt included unamortized original issue discounts of \$0.3 million, unamortized debt issuance costs of \$0.2 million and \$0.3 million of accrued interest).

## Debt Exchange

On April 29, 2009, we finalized the results of a debt exchange offer to exchange (a) new RBS Global 9.50% Senior Notes due 2014 (the “New Senior Notes”) for any and all of RBS Global’s 8.875% Senior Notes due 2016 (the “Old 2016 Notes”), (b) the New Senior Notes for any and all of Rexnord Holdings’ PIK Toggle Exchange Notes (the “Old Holdco Notes” and, together with the Old 2016 Notes, the “Old Notes”), and (c) the New Senior Notes for any and all of the PIK Toggle Loans (the “Holdco Loans”) outstanding under the credit agreement, dated as of March 2, 2007, among Rexnord Holdings, Credit Suisse, as Administrative Agent, Banc of America Bridge LLC, as syndication agent, and the lenders from time to time party thereto.

Upon settlement of the exchange offer, (i) approximately \$71.0 million principal amount of Old 2016 Notes had been validly tendered and not withdrawn for exchange for New Senior Notes, (ii) approximately \$235.7 million principal amount of Old Holdco Notes had been validly tendered and not withdrawn for exchange for New Senior Notes, and (iii) approximately \$7.9 million principal amount of Holdco Loans had been validly surrendered and not withdrawn for exchange for New Senior Notes. Based on the principal amount of Old Notes and Holdco Loans validly tendered and accepted, approximately \$196.3 million of aggregate principal of New Senior Notes was issued in exchange for such Old Notes and Holdco Loans (excluding a net original issue discount of \$20.6 million).

The Company accounted for the debt exchange transaction pursuant ASC 470-50 *Debt Modifications and Extinguishments* (“ASC 470-50”). As a result of the debt exchange, the Company recognized a gain of \$137.5 million on the extinguishment of Old Holdco Notes and Holdco Loans. The gain on extinguishment of \$137.5 million relates to the extinguishment of \$235.7 million of outstanding face value Old Holdco Notes and \$7.9 million of outstanding face value of Holdco Loans and is measured based on the difference between the fair market value of the New Senior Notes issued of \$104.5 million and the net carrying amount of the debt (the net carrying amount of the debt includes unamortized original issue discount of \$2.5 million, unamortized debt issuance costs of \$2.2 million and \$3.1 million of accrued interest).

For more information about the debt exchange, see the Liquidity and Capital Resources section of this Management’s Discussion and Analysis of Financial Conditions and Results of Operations.

### ***Other Income (Expense), net***

Other income (expense), net for the six months ended September 26, 2009, consists of management fee expense of \$1.5 million, transaction costs associated with the debt exchange offer of \$6.0 million, foreign currency translation gains of \$14.8 million, loss on the sale of fixed assets of \$0.2 million, income in unconsolidated affiliates of \$0.3 million and other miscellaneous losses of \$0.2 million. Other income (expense), net for the six months ended September 27, 2008, consists of management fee expense of \$1.5 million, loss on disposition of fixed assets of \$0.2 million, foreign currency transaction gains of \$0.6 million and loss in unconsolidated affiliates of \$0.1 million.

### ***Provision for Income Taxes***

The income tax provision was \$43.8 million in the first six months of fiscal 2010 compared to \$9.2 million in the first six months of fiscal 2009. Our effective income tax rate for the first six months of fiscal 2010 was 35.4% versus 62.6% in the first six months of fiscal 2009. The effective tax rate for the first six months of fiscal 2010 includes the accrual of state income taxes, the accrual of interest expense (through income tax expense) relating to unrecognized tax benefits and an increase in the valuation allowance for foreign tax credits generated during this period for which realization of such benefits is not deemed more likely than not. The high effective tax rate for the first six months of fiscal 2009 is a result of the accrual of state income taxes, the accrual of interest expense (through income tax expense) relating to unrecognized tax benefits and an increase to the valuation allowance relating to foreign tax credits generated for which realization of such benefits is not deemed more likely than not, relative to the smaller amount of pre-tax income recognized during this period.

### ***Net Income (Loss)***

Our net income for the first six months of fiscal 2010 was \$80.0 million compared to net income of \$5.5 million in the first six months of fiscal 2009 due to the factors described above.

## **Liquidity and Capital Resources**

Our primary source of liquidity is available cash and cash equivalents, cash flow from operations and borrowing availability under our \$150.0 million revolving credit facility and our \$100.0 million accounts receivable securitization program. On September 15, 2008 and periodically thereafter, Lehman Brothers Holdings Inc. and certain of its subsidiaries (“Lehman”), who have a 5% or \$7.5 million credit commitment under our \$150.0 million credit facility, filed for bankruptcy and, therefore the availability under our \$150.0 million revolving credit facility had been effectively reduced by \$7.5 million until such time as a replacement lender could be found to cover this credit commitment. On November 3, 2009 Barclays Bank, PLC assumed the \$7.5 million commitment under the revolving credit line that was previously unfulfilled due to the Lehman bankruptcy.

As of September 26, 2009, we had \$235.4 million of cash and cash equivalents and approximately \$196.5 million of additional borrowings available to us (\$110.5 million of available borrowings under our revolving credit facility and \$86.0 million available under our accounts receivable securitization program). Both our revolving credit facility and accounts receivable securitization program are available to fund our working capital requirements, capital expenditures and for other general corporate purposes. As of September 26, 2009, the available borrowings under our credit facility have been reduced by the aforementioned \$7.5 million reduction due to Lehman's inability to fund its commitment. In addition, \$32.0 million of the credit facility was utilized in connection with outstanding letters of credit. As of September 26, 2009 the available borrowings under our accounts receivable securitization program have been reduced by \$14.0 million due to borrowing base limitations.

### **Cash Flows**

Net cash provided by operating activities in the first six months of fiscal 2010 was \$79.7 million compared to \$45.4 million in the first six months of fiscal 2009. Fiscal 2010 cash provided by operating activities includes an incremental \$6.0 million of transaction costs associated with our debt exchange offer and \$11.6 million of restructuring payments. Excluding the incremental transaction and restructuring payments, cash flow from operations improved by \$51.9 million. Decreases in trade working capital (accounts receivable, inventories and accounts payable) contributed a \$75.3 million source of cash year-over-year, primarily due to a \$55.0 million reduction in inventory. The remaining \$23.4 million decline in operating cash flow is due to the volume impact on \$269.1 million of lower net sales, partially offset by the cash savings generated from our restructuring initiatives year-over-year.

Cash used for investing activities was \$9.3 million in the first six months of fiscal 2010 compared to \$21.7 million in the first six months of fiscal 2009. The year-over-year decrease in cash used for investing activities is primarily due to lower capital expenditures as we aligned our capital expenditures with current sales volume.

Cash used for financing activities was \$128.2 million in the first six months of fiscal 2010 compared to a use of \$0.8 million in the first six months of fiscal 2009. The cash used for financing activities in the first six months of fiscal 2010 consisted of an \$8.5 million payment made to retire a portion of our outstanding PIK Toggle Senior Indebtedness Due 2013, financing fee payments of \$4.9 million associated with our debt exchange offer and \$114.6 million of repayments on our revolver (\$82.7 million), AR Securitization facility (\$30 million) and other borrowings (\$1.9 million). The current year also includes a \$0.4 million use of cash for the purchase of common stock, which is partially offset by \$0.2 million of net cash proceeds from issuance of common stock and stock option exercises. Cash used of \$0.8 million in the first six months of fiscal 2009 consisted of a debt repayment of \$0.5 million on our term loans along with \$0.3 million of repayments on borrowings at various foreign subsidiaries.

### **Indebtedness**

As of September 26, 2009 we had \$2,258.5 million of total indebtedness outstanding as follows (in millions):

	<b>Total Debt at September 26, 2009</b>	<b>Short-term Debt and Current Maturities of Long-Term Debt</b>	<b>Long-term Portion</b>
Term loans	\$ 765.0	\$ 2.0	\$ 763.0
PIK toggle senior indebtedness due 2013 (1)	126.5	-	126.5
9.50% Senior notes due 2014 (2)	978.4	-	978.4
8.875% Senior notes due 2016	79.0	-	79.0
11.75% Senior subordinated notes due 2016	300.0	-	300.0
10.125% Senior subordinated notes due 2012	0.3	-	0.3
Other	9.3	5.4	3.9
<b>Total Debt</b>	<b>\$ 2,258.5</b>	<b>\$ 7.4</b>	<b>\$ 2,251.1</b>

(1) Includes an unamortized bond issue discount of \$1.1 million at September 26, 2009.

(2) Includes a net unamortized bond issue discount of \$12.9 million at September 26, 2009.

Our outstanding debt was issued or guaranteed by Rexnord Holdings, RBS Global and various subsidiaries of RBS Global. Rexnord Holdings is the issuer of the PIK toggle senior indebtedness and RBS Global, as well as its wholly-owned subsidiary Rexnord LLC, are the co-issuers of the term loans, senior notes and senior subordinated notes.

### **Rexnord Holdings, Inc. PIK Toggle Senior Indebtedness Due 2013**

On March 2, 2007, Rexnord Holdings entered into a Credit Agreement with various lenders which provided \$449.8 million (\$459.0 million of debt financing, net of a \$9.2 million original issue discount) that was primarily used to pay a distribution to its

shareholders as well as to holders of fully vested rollover options. The PIK Toggle Loans (or "Loans") issued pursuant to the Credit Agreement are due March 1, 2013 and bear interest at a floating rate. The floating rate is equal to adjusted LIBOR (the interest rate per annum equal to the product of (a) the LIBOR in effect and (b) Statutory Reserves) plus 7.0%.

On July 10, 2008, Rexnord Holdings commenced an exchange offer with respect to the PIK Toggle Loans. Approximately \$460.8 million of the then outstanding PIK Toggle Loans were tendered for exchange. The PIK Toggle Loans that were not tendered for exchange continue to be governed by the terms and conditions in the Credit Agreement while the PIK Toggle Loans tendered and exchanged for PIK Toggle Senior Notes due 2013 (the "PIK Toggle Exchange Notes" or "Exchange Notes") are governed by the terms and conditions of an indenture. The Exchange Notes were issued under an indenture between Rexnord Holdings and Wells Fargo Bank, N.A. as trustee (the "indenture"), which is capable of being qualified under the Trust Indenture Act of 1939. The terms of the Exchange Notes are substantially the same as the terms of the Loans in all material respects (including their maturity, variable interest rates and our ability to make certain interest payments in kind, which we refer to as "PIK Interest," rather than in cash), except that (1) interest on the Exchange Notes is payable semi-annually (generally at the three month LIBOR in effect for the interest period plus 7.0% per annum) while interest on the Loans is payable quarterly (also generally at the three month LIBOR in effect for the interest period plus 7.0% per annum), (2) the Exchange Notes were issued pursuant to the indenture, (3) a change of control is not an event of default under the Exchange Notes but instead requires us to make an offer to purchase the Exchange Notes at a price of 101% of their principal amount plus accrued and unpaid interest, and (4) certain other provisions have been adjusted as required or permitted by Section 6.13 of the Credit Agreement. None of our subsidiaries currently guarantee any of our indebtedness, so there are no guarantors of the Exchange Notes or of the Loans. The Exchange Notes and the Loans are required to be guaranteed by any of our domestic subsidiaries which in the future may guarantee our indebtedness. We refer to the Loans and the Exchange Notes collectively as the PIK toggle senior indebtedness.

As of September 26, 2009, the interest rate was 7.35% and 7.36% for the Exchange Notes and the Loans, respectively. As of March 31, 2009, the interest rate was 8.26% for both the Exchange Notes and the Loans. Pursuant to the terms of the Credit Agreement and the indenture, Rexnord Holdings has elected to pay interest in-kind and has accordingly paid interest with additional PIK Toggle Loans and Exchange Notes, as the case may be, on pre-determined interest rate reset dates. During the six months ended September 26, 2009, \$5.1 million of interest was paid in the form of additional PIK toggle senior indebtedness.

The PIK toggle senior indebtedness is an unsecured obligation. The governing instruments of the PIK toggle senior indebtedness contain customary affirmative and negative covenants including: (i) limitations on the incurrence of indebtedness and the issuance of disqualified and preferred stock, (ii) limitations on restricted payments, dividends and certain other payments, (iii) limitations on asset sales, (iv) limitations on transactions with affiliates, (v) requirements as to the addition of future guarantors in certain circumstances and (vi) limitations on liens. Notwithstanding these covenants, the PIK toggle senior indebtedness significantly restricts the payment of dividends and also limits the incurrence of additional indebtedness and the issuance of certain forms of equity. However, Rexnord Holdings may incur additional indebtedness and issue certain forms of equity if immediately prior to the consummation of such events, the fixed charge coverage ratio for the most recently ended four full fiscal quarters for which internal financial statements are available, as defined in the Credit Agreement, would have been at least 1.75 to 1.00, or, 2.00 to 1.00 in the case of the Rexnord Holdings' subsidiaries, including the pro forma application of the additional indebtedness or equity issuance.

### ***RBS Global, Inc. and Subsidiaries Indebtedness***

RBS Global borrows under certain secured credit facilities with a syndicate of banks and other financial institutions consisting of: (i) a \$810.0 million term loan facility with a maturity date of July 19, 2013 and (ii) a \$150.0 million revolving credit facility with a maturity date of July 20, 2012 and borrowing capacity available for letters of credit and for borrowing on same-day notice, referred to as swingline loans.

As of September 26, 2009, RBS Global's outstanding borrowings under the term loan facility were apportioned between two primary tranches: a \$570.0 million term loan B1 facility and a \$195.0 million term loan B2 facility. Borrowings under the term loan B1 facility accrue interest, at our option, at the following rates per annum: (i) 2.50% plus LIBOR, or (ii) 1.50% plus the Base Rate (which is defined as the higher of the Federal funds rate plus 0.5% or the Prime rate). Borrowings under the B2 facility accrue interest, at our option, at the following rates per annum: (i) 2.25% plus LIBOR or (ii) 1.00% plus the Base Rate (which is defined as the higher of the Federal funds rate plus 0.5% or the Prime rate). The weighted average interest rate on the outstanding term loans at September 26, 2009 was 4.41%.

Borrowings under RBS Global's \$150.0 million revolving credit facility accrue interest, at our option, at the following rates per annum: (i) 1.75% plus LIBOR, or (ii) 0.75% plus the Base Rate (which is defined as the higher of the Federal funds rate plus 0.5% or the Prime rate). All amounts outstanding under the revolving credit facility will be due and payable in full, and the commitments thereunder will terminate, on July 20, 2012. On September 15, 2008 Lehman who had a 5% or \$7.5 million credit commitment under our \$150.0 million credit facility, filed for bankruptcy. Therefore, the availability under our \$150.0 million revolving credit facility had been effectively temporarily reduced by \$7.5 million until such time as a replacement lender could be found to cover this credit commitment. On November 3, 2009 Barclays Bank, PLC assumed the \$7.5 million commitment under the revolving credit line that

was previously unfulfilled due to the Lehman bankruptcy. In addition, \$30.3 million and \$32.0 million of the revolving credit facility was considered utilized in connection with outstanding letters of credit at March 31, 2009 and September 26, 2009, respectively. Outstanding borrowings under the revolving credit facility were \$82.7 million as of March 31, 2009. Due to the volatile credit markets, management did not intend to repay the outstanding balance of the revolving credit facility within one year and accordingly classified the borrowings as long-term debt. Continuing improvements in the credit markets during the second quarter of fiscal 2010 caused management to reconsider its previous intent and lead to the decision to repay the balance due under the revolving credit facility during the second quarter ended September 26, 2009.

In addition to paying interest on outstanding principal under the senior secured credit facilities, we are required to pay a commitment fee to the lenders under the revolving credit facility in respect to the unutilized commitments thereunder at a rate equal to 0.50% per annum (subject to reduction upon attainment and maintenance of a certain senior secured leverage ratio). We also must pay customary letter of credit and agency fees.

As of September 26, 2009, the remaining mandatory principal payments prior to maturity on both the term loan B1 and B2 facilities are \$1.2 million and \$8.0 million, respectively. We have fulfilled all mandatory principal payments prior to maturity on the B1 facility through March 31, 2013. Principal payments of \$0.5 million are scheduled to be made at the end of each calendar quarter until June 30, 2013 on the B2 facility. We may voluntarily repay outstanding loans under the senior secured credit facilities at any time without premium or penalty, other than customary "breakage" costs with respect to Eurocurrency loans.

The senior secured credit facilities contain a number of covenants that, among other things, restrict, subject to certain exceptions, our ability, and the ability of our subsidiaries, to: sell assets; incur additional indebtedness; repay other indebtedness; pay dividends and distributions, repurchase its capital stock, or make payments, redemptions or repurchases in respect of subordinated debt (including our 11.75% senior subordinated notes due 2016); create liens on assets; make investments, loans, guarantees or advances; make certain acquisitions; engage in certain mergers or consolidations; enter into sale-and-leaseback transactions; engage in certain transactions with affiliates; amend certain material agreements governing its indebtedness; make capital expenditures; enter into hedging agreements; amend its organizational documents; change the business conducted by it and its subsidiaries; and enter into agreements that restrict dividends from subsidiaries. Our senior secured credit facilities limit our maximum senior secured bank leverage ratio to 4.25 to 1.00. As of September 26, 2009, the senior secured bank leverage ratio was 1.85 to 1.00.

On April 22, 2009, the Company purchased and extinguished \$23.6 million of its outstanding face value PIK Toggle Loans for \$8.5 million in cash. As a result of the extinguishment, the Company recognized a \$14.9 million gain during the first quarter ended June 27, 2009, which was measured based on the difference between the cash paid and the net carrying amount of the debt (the net carrying amount of the debt included unamortized original issue discounts of \$0.3 million, unamortized debt issuance costs of \$0.2 million and \$0.3 million of accrued interest).

On April 29, 2009, the Company finalized the results of a debt exchange offer to exchange (a) new 9.50% Senior Notes due 2014 (the "New Senior Notes") for any and all of the Company's 8.875% Senior Notes due 2016 (the "Old 2016 Notes"), (b) the New Senior Notes for any and all of Rexnord Holdings' PIK Toggle Senior Notes due 2013 (the "Old Holdco Notes" and, together with the Old 2016 Notes, the "Old Notes"), and (c) the New Senior Notes for any and all of the senior unsecured term loans (the "Holdco Loans") outstanding under the credit agreement, dated as of March 2, 2007, among Rexnord Holdings, Credit Suisse, as Administrative Agent, Banc of America Bridge LLC, as syndication agent, and the lenders from time to time party thereto.

Upon settlement of the exchange offer, (i) approximately \$71.0 million principal amount of Old 2016 Notes had been validly tendered and not withdrawn for exchange for New Senior Notes, (ii) approximately \$235.7 million principal amount of Old Holdco Notes had been validly tendered and not withdrawn for exchange for New Senior Notes, and (iii) approximately \$7.9 million principal amount of Holdco Loans had been validly surrendered and not withdrawn for exchange for New Senior Notes. Based on the principal amount of Old Notes and Holdco Loans validly tendered and accepted, approximately \$196.3 million of aggregate principal of New Senior Notes was issued in exchange for such Old Notes and Holdco Loans (excluding a net original issue discount of \$20.6 million). In addition, the Company also incurred \$11.1 million of transaction costs (\$0.2 million of these transaction costs were issued in the form of New Senior Notes) to complete the exchange offer, of which \$5.1 million was capitalized as deferred financing costs.

The Company accounted for the debt exchange transaction pursuant ASC 470-50. Pursuant to this guidance, the Company recognized a gain of \$137.5 million on the extinguishment of Old Holdco Notes and Holdco Loans. The gain on extinguishment of \$137.5 million relates to the extinguishment of \$235.7 million of outstanding face value Old Holdco Notes and \$7.9 million of outstanding face value of Holdco Loans and is measured based on the difference between the fair market value of the New Senior Notes issued of \$104.5 million and the net carrying amount of the debt (the net carrying amount of the debt includes unamortized original issue discount of \$2.5 million, unamortized debt issuance costs of \$2.2 million and \$3.1 million of accrued interest). In connection with the \$235.7 million of Old Holdco Notes and \$7.9 million of Holdco Loans tendered in the exchange, the Company issued approximately \$130.6 million of face value of New Senior Notes, net of a \$26.1 million original issue discount.

Pursuant to ASC 470-50, the exchange of the Old 2016 Notes did not constitute a significant modification of debt, therefore, the carrying value of the \$71.0 million in Old 2016 Notes tendered was carried-forward as the net carrying value of the New Senior Notes, inclusive of a \$5.5 million original issue premium. The premium is a result of the difference between the \$71.0 million carrying value

of the Old 2016 Notes and the \$65.5 million of corresponding face value of New Senior Notes issued with respect to this component of the exchange. This premium will be amortized as a reduction to interest expense (via the effective interest method) over the life of the New Senior Notes in conformity with the standard.

Post exchange offer, we have issued a total of \$991.3 million in aggregate principal amount of 9.50% senior notes which bear interest at a rate of 9.50% per annum which will mature on August 1, 2014. This amount includes \$196.3 million of aggregate principal related to the aforementioned debt exchange. The terms of the New Senior Notes and our previously existing 9.50% Senior Notes are substantially similar with the exception of interest payment dates. Interest on the \$795.0 million of previously existing 9.50% Senior Notes is payable on February 1 and August 1, while interest on the \$196.3 million of New Senior Notes is payable on May 1 and November 1.

As of September 26, 2009, a total of \$79.0 million in aggregate principal amount of 8.875% senior notes due 2016 remained outstanding. These notes bear interest at a rate of 8.875% per annum, payable on each March 1 and September 1, and will mature on September 1, 2016.

We issued \$300.0 million in aggregate principal amount of 11.75% senior subordinated notes due 2016. Those notes bear interest at a rate of 11.75% per annum, payable on each February 1 and August 1, and will mature on August 1, 2016.

The senior notes and senior subordinated notes are unsecured obligations of the Company. The senior subordinated notes are subordinated in right of payment to all existing and future senior indebtedness. The indentures governing the senior notes and senior subordinated notes permit us to incur all permitted indebtedness (as defined in the applicable indenture) without restriction, which includes amounts borrowed under the senior secured credit facilities. The indentures also allow us to incur additional debt as long as it can satisfy the coverage ratio of the indenture after giving effect thereto on a pro forma basis.

The indentures governing the senior notes and senior subordinated notes contain customary covenants, among others, limiting dividends, investments, purchases or redemptions of stock, transactions with affiliates and mergers and sales of assets, and requiring us to make an offer to purchase notes upon the occurrence of a change in control, as defined in the indentures. These covenants are subject to a number of important qualifications. For example, the indentures do not impose any limitation on the incurrence by the Company of liabilities that are not considered "indebtedness" under the indentures, such as certain sale/leaseback transactions; nor do the indentures impose any limitation on the amount of liabilities incurred by our subsidiaries, if any, that might be designated as "unrestricted subsidiaries" (as defined in the applicable indenture).

The indentures governing the senior notes and the senior subordinated notes permit optional redemption of the notes on certain terms and at certain prices, as described below.

The indentures provide that, prior to August 1, 2011 (or in the case of the 9.50% senior notes due 2014, prior to August 1, 2010), the notes may be redeemed at our option in whole at any time or in part from time to time, upon not less than 30 and not more than 60 days' prior notice, at a redemption price equal to (i) 100% of the principal amount of the notes redeemed plus (ii) a "make whole" premium as set forth in the applicable indenture, and (iii) accrued and unpaid interest and additional interest, if any, to the applicable redemption date.

Further, on or after August 1, 2011 (or in the case of the 9.50% senior notes due 2014, on or after August 1, 2010), the indentures permit optional redemption of the notes, in whole or in part upon not less than 30 and not more than 60 days' prior notice, at the redemption prices stated in the indentures.

Notwithstanding the above, our ability to make payments on, redeem, repurchase or otherwise retire for value, prior to the scheduled repayment or maturity, the senior notes or senior subordinated notes may be restricted or prohibited under the above-referenced senior secured credit facilities and, in the case of the senior subordinated notes, by the provisions in the indentures governing the senior notes.

At March 31, 2009 and September 26, 2009, various wholly-owned subsidiaries had additional debt of \$9.8 million and \$9.3 million, respectively, comprised primarily of borrowings at various foreign subsidiaries and capital lease obligations.

#### ***Account Receivable Securitization Program***

On September 26, 2007, three of our wholly-owned domestic subsidiaries entered into an accounts receivable securitization program (the "AR Securitization Program" or the "Program") whereby they continuously sell substantially all of their domestic trade accounts receivable to Rexnord Funding LLC (a wholly-owned bankruptcy remote special purpose subsidiary) for cash and subordinated notes. Rexnord Funding LLC in turn may obtain revolving loans and letters of credit from General Electric Capital Corporation ("GECC") pursuant to a five year revolving loan agreement. The maximum borrowing amount under the Receivables Financing and Administration Agreement is \$100.0 million, subject to certain borrowing base limitations related to the amount and type of receivables owned by Rexnord Funding LLC. All of the receivables purchased by Rexnord Funding LLC are pledged as collateral for revolving loans and letters of credit obtained from GECC under the loan agreement.

The AR Securitization Program does not qualify for sale accounting under ASC 860, and as such, any borrowings are accounted for as secured borrowings on the consolidated balance sheet. Financing costs associated with the Program are recorded within “Interest expense, net” in the consolidated statement of operations with respect to revolving loans or letters of credit obtained under the loan agreement.

Borrowings under the loan agreement bear interest at a rate equal to LIBOR plus 1.35%. Outstanding borrowings mature on September 26, 2012. In addition, a non-use fee of 0.30% is applied to the unutilized portion of the \$100.0 million commitment. These rates are per annum and the fees are paid to GECC on a daily basis.

At March 31, 2009, \$30.0 million was outstanding under the Program and was classified as long-term debt in the consolidated balance sheets. Due to the volatile credit markets, management did not intend to repay the outstanding balance under the Program within one year and accordingly classified the borrowings as long-term debt. Continuing improvements in the credit markets during the second quarter of fiscal 2010 caused management to reconsider its previous intent and lead to the decision to repay the balance due under the Program during the second quarter ended September 26, 2009. At September 26, 2009 the Company’s available borrowing capacity under the AR Securitization Program was \$86.0 million. All of the receivables purchased by Rexnord Funding LLC are pledged as collateral for revolving loans and letters of credit obtained from GECC under the loan agreement. Additionally, the Program requires compliance with certain covenants and performance ratios contained in the Receivables Financing and Administration Agreement. As of September 26, 2009, Rexnord Funding LLC was in compliance with all applicable covenants and performance ratios.

### ***Off-Balance Sheet Arrangements***

We do not have any off-balance sheet or unconsolidated special-purpose entities.

### **Quantitative and Qualitative Disclosures about Market Risk**

We are exposed to market risk during the normal course of business from changes in foreign currency exchange rates and interest rates. The exposure to these risks is managed through a combination of normal operating and financing activities and derivative financial instruments in the form of foreign exchange forward contracts and interest rate collars and swaps to cover known foreign exchange transactions and interest rate volatility.

#### ***Foreign Currency Exchange Rate Risk***

Our exposure to foreign currency exchange rates relates primarily to our foreign operations. For our foreign operations, exchange rates impact the United States Dollar (“USD” or “U.S. Dollar”) value of our reported earnings, our investments in the subsidiaries and the intercompany transactions with the subsidiaries. See “Risk Factors—Our international operations are subject to uncertainties, which could adversely affect our operating results”, in our Annual Report for the fiscal year ended March 31, 2009, which is available on our website.

Approximately 25% of our sales originate outside of the United States, with approximately 15% generated from our European operations that use the Euro as their functional currency. As a result, fluctuations in the value of foreign currencies against the U.S. Dollar, particularly the Euro, may have a material impact on our reported results. Revenues and expenses denominated in foreign currencies are translated into U.S. Dollars at the end of the fiscal period using the average exchange rates in effect during the period. Consequently, as the value of the U.S. Dollar changes relative to the currencies of our major markets, our reported results vary.

Fluctuations in currency exchange rates also impact the U.S. Dollar amount of our stockholders’ equity. The assets and liabilities of our non-U.S. subsidiaries are translated into U.S. Dollars at the exchange rates in effect at the end of the fiscal periods. The U.S. Dollar has weakened during fiscal 2010 relative to many foreign currencies. As of September 26, 2009, stockholders’ equity decreased by \$2.6 million from March 31, 2009 as a result of foreign currency translation adjustments. If the U.S. Dollar had strengthened by 10% as of September 26, 2009, the result would have decreased stockholders’ equity by approximately \$11.3 million.

As we continue to expand our business globally, our success will depend, in large part, on our ability to anticipate and effectively manage these and other risks associated with our international operations. However, any of these factors could adversely affect our international operations and, consequently, our operating results.

At September 26, 2009, we had outstanding forward foreign currency contracts that exchange Canadian dollars (“CAD”) for USD as well as USD for CAD which were entered into to hedge firm and anticipated monthly cash flows through fiscal 2010. The forward contracts currently in place expire between October and March of fiscal 2010 and have notional amounts of \$12.5 million CAD (\$11.4 million USD) and \$4.8 million USD (\$5.4 million CAD) and contract rates ranging from \$1CAD:\$0.8120 USD to \$1CAD:\$0.9154 USD. These contracts are not designated as effective cash flow hedges for ASC 815 accounting purposes and as such, the outstanding contracts are marked to market through earnings. We believe that a hypothetical 10% adverse change in the foreign currency exchange rates would have resulted in a \$1.1 million decrease in the fair value of foreign exchange forward contracts as of September 26, 2009.

### ***Interest Rate Risk***

We utilize a combination of short-term and long-term debt to finance our operations and are exposed to interest rate risk on these debt obligations.

A substantial portion of our indebtedness, including the senior secured credit facilities bears interest at rates that fluctuate with changes in certain short-term prevailing interest rates. As of September 26, 2009, our outstanding borrowings under the senior secured credit facility were \$765.0 million. The term loan credit facility is apportioned between two primary tranches: a \$570.0 million term loan B1 facility and a \$195.0 million term loan B2 facility. Borrowings under the term loan B1 facility accrue interest, at our option, at the following rates per annum: (i) 2.50% plus the LIBOR, or (ii) 1.50% plus the Base Rate (which is defined as the higher of the Federal funds rate plus 0.5% or the Prime rate). Borrowings under the B2 facility accrue interest, at our option, at the following rates: (i) 2.00% plus the LIBOR per annum or (ii) 1.00% plus the Base Rate (which is defined as the higher of the Federal funds rate plus 0.5% or the Prime rate). The weighted average interest rate on the outstanding term loans at September 26, 2009 was 4.41%. In order to hedge the variability in future cash flows associated with a portion of our variable-rate term loans, we previously entered into an interest rate collar and an interest rate swap to hedge the variability in future cash flows associated with a portion of our variable-rate term loans. The interest rate collar provides an interest rate floor of 4.0% plus the applicable margin and an interest rate cap of 6.065% plus the applicable margin on \$262.0 million of our variable-rate term loans, while the interest rate swap converts \$68.0 million of our variable-rate term loans to a fixed interest rate of 5.14% plus the applicable margin. Both the interest rate collar and the interest rate swap became effective on October 20, 2006 and have a maturity of three years. Through the second quarter ended September 26, 2009, we entered into three forward starting interest rate swaps to hedge the variability in future cash flows associated with our variable-rate term loans. All three interest rate swaps become effective beginning October 20, 2009 and mature on July 20, 2012. The three swaps convert an aggregate of \$370.0 million of our variable-rate term loans to a fixed interest rates ranging from 2.08% to 2.39%, plus the applicable margin.

Our PIK toggle senior indebtedness bears interest at a floating rate. The floating rate is equal to adjusted LIBOR (the interest rate per annum equal to the product of (a) the LIBOR rate then in effect and (b) Statutory Reserves) plus 7.0%. As of September 26, 2009, the interest rate was 7.35% and 7.36% for the Exchange Notes and the Loans, respectively.

Our results of operations would likely be affected by changes in market interest rates on the un-hedged portion of these variable-rate obligations. Based upon the our un-hedged variable rate debt as of September 26, 2009, a 100 basis point increase in the September 26, 2009 interest rates would increase interest expense by approximately \$5.2 million on an annual basis.

**Rexnord Holdings, Inc. and Subsidiaries**  
**Index to Financial Statements**

**UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS OF REXNORD HOLDINGS, INC.**

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**Rexnord Holdings, Inc. and Subsidiaries**  
**Condensed Consolidated Balance Sheets**  
(in Millions, except share amounts)  
(Unaudited)

	<b>March 31, 2009</b>	<b>September 26, 2009</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 287.9	\$ 235.4
Receivables, net	258.8	231.1
Inventories, net	327.1	281.3
Other current assets	29.0	27.6
Total current assets	902.8	775.4
Property, plant and equipment, net	413.5	399.7
Intangible assets, net	736.4	713.0
Goodwill	1,010.9	1,011.8
Insurance for asbestos claims	90.0	90.0
Other assets	65.2	62.8
Total assets	\$ 3,218.8	\$ 3,052.7
<b>Liabilities and stockholders' equity</b>		
Current liabilities:		
Current portion of long-term debt	\$ 8.1	\$ 7.4
Trade payables	134.6	102.2
Income taxes payable	3.7	6.0
Deferred income taxes	10.8	4.1
Compensation and benefits	62.1	59.4
Current portion of pension obligations	2.6	2.6
Current portion of postretirement benefit obligations	2.2	2.2
Interest payable	26.9	30.9
Other current liabilities	96.6	91.4
Total current liabilities	347.6	306.2
Long-term debt	2,518.0	2,251.1
Pension obligations	134.5	138.4
Postretirement benefit obligations	24.8	23.5
Deferred income taxes	223.2	271.1
Reserve for asbestos claims	90.0	90.0
Other liabilities	58.5	65.5
Total liabilities	3,396.6	3,145.8
Stockholders' equity:		
Common stock, \$0.01 par value; 25,000,000 shares authorized; shares issued: 16,067,564 at March 31, 2009 and 16,142,886 at September 26, 2009	0.2	0.2
Additional paid in capital	280.5	284.6
Retained deficit	(326.6)	(246.6)
Accumulated other comprehensive loss	(131.1)	(129.2)
Treasury stock at cost, 37,802 shares at March 31, 2009 and 102,770 at September 26, 2009	(0.8)	(2.1)
Total stockholders' equity	(177.8)	(93.1)
Total liabilities and stockholders' equity	\$ 3,218.8	\$ 3,052.7

*See notes to the condensed consolidated financial statements.*

**Rexnord Holdings, Inc. and Subsidiaries**  
**Condensed Consolidated Statements of Operations**  
(in Millions)  
(Unaudited)

	<b>Second Quarter Ended</b>		<b>Six Months Ended</b>	
	<b>September 27, 2008</b>	<b>September 26, 2009</b>	<b>September 27, 2008</b>	<b>September 26, 2009</b>
Net sales	\$ 510.6	\$ 369.7	\$ 1,006.7	\$ 737.6
Cost of sales	347.4	245.0	681.6	498.3
Gross profit	163.2	124.7	325.1	239.3
Selling, general and administrative expenses	81.5	73.8	167.6	149.8
Restructuring and other similar charges	-	0.8	-	3.2
Amortization of intangible assets	12.4	12.0	24.9	24.1
Income from operations	69.3	38.1	132.6	62.2
Non-operating expense:				
Interest expense, net	(58.5)	(49.4)	(116.7)	(98.0)
Gain on debt extinguishment	-	-	-	152.4
Other income (expense), net	1.0	8.2	(1.2)	7.2
Income (loss) before income taxes	11.8	(3.1)	14.7	123.8
Provision (benefit) for income taxes	6.5	(0.8)	9.2	43.8
Net income (loss)	<u>\$ 5.3</u>	<u>\$ (2.3)</u>	<u>\$ 5.5</u>	<u>\$ 80.0</u>

*See notes to the condensed consolidated financial statements.*

**Rexnord Holdings, Inc. and Subsidiaries**  
**Condensed Consolidated Statements of Cash Flows**  
(in Millions)  
(Unaudited)

**Six Months Ended**

	<b>September 27, 2008</b>	<b>September 26, 2009</b>
<b>Operating activities</b>		
Net income	\$ 5.5	\$ 80.0
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation	30.7	29.2
Amortization of intangible assets	24.9	24.1
Gain on debt extinguishment	-	(152.4)
Amortization of original net bond discount	0.8	1.2
Accretion of original bond premium	(0.5)	(0.6)
Amortization of deferred financing costs	5.8	5.7
Interest expense on PIK toggle senior indebtedness	26.3	5.1
Loss on dispositions of property, plant and equipment	0.2	0.2
Equity in loss (earnings) of unconsolidated affiliates	0.1	(0.3)
Other non-cash charges (credits)	0.5	(18.1)
Stock-based compensation expense	3.2	3.0
Changes in operating assets and liabilities:		
Receivables	(14.9)	35.0
Inventories	(3.1)	51.9
Other assets	(8.9)	2.8
Accounts payable	(5.6)	(35.2)
Accruals and other	(19.6)	48.1
Cash provided by operating activities	45.4	79.7
<b>Investing activities</b>		
Expenditures for property, plant and equipment	(22.6)	(9.3)
Proceeds from surrender of life insurance policies	0.9	-
Cash used for investing activities	(21.7)	(9.3)
<b>Financing activities</b>		
Repayments of long-term debt	(0.8)	(114.6)
Payment of financing fees	-	(4.9)
Purchase of PIK toggle senior indebtedness	-	(8.5)
Purchase of common stock	-	(0.4)
Net Proceeds from issuance of common stock and stock option exercises	-	0.2
Cash used for financing activities	(0.8)	(128.2)
Effect of exchange rate changes on cash and cash equivalents	(0.5)	5.3
Increase (decrease) in cash and cash equivalents	22.4	(52.5)
Cash and cash equivalents at beginning of period	156.3	287.9
Cash and cash equivalents at end of period	\$ 178.7	\$ 235.4

*See notes to the condensed consolidated financial statements.*

**Rexnord Holdings, Inc. and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements**  
**September 26, 2009**  
**(Unaudited)**

**1. Basis of Presentation and Significant Accounting Policies**

The accompanying unaudited condensed consolidated financial statements include the accounts of Rexnord Holdings, Inc. and subsidiaries (collectively, the “Company”).

The financial statements included herein have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading. In the opinion of management, the condensed consolidated financial statements include all adjustments necessary for a fair presentation of the results of operations for the interim periods. Results for the interim periods are not necessarily indicative of results that may be expected for the fiscal year ending March 31, 2010. It is suggested that these condensed consolidated financial statements be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company’s most recent Annual Report.

**The Company**

The Company is a leading global, diversified, multi-platform industrial company comprised of two key segments, Power Transmission and Water Management. The Power Transmission platform manufactures gears, couplings, industrial bearings, flattop chain and modular conveyer belts, aerospace bearings and seals, special components, and industrial chain and conveying equipment serving the industrial and aerospace markets. The products are either incorporated into products sold by original equipment manufacturers (“OEMs”) or sold to end-users through industrial distributors as aftermarket products. The Water Management platform is a leading supplier of professional grade specification drainage, PEX piping, commercial brass and water and wastewater treatment and control products, serving the infrastructure, commercial and residential markets.

**Recently Adopted and Issued Accounting Guidance**

*Adopted*

In June 2009, the Financial Accounting Standards Board (“FASB”) issued the *FASB Accounting Standards Codification* (the “Codification” or “ASC”), the authoritative guidance for U.S. generally accepted accounting principles (“GAAP”). The Codification, which changes the referencing of financial standards, became effective for interim and annual periods ending on or after September 15, 2009. The Codification is now the single official source of authoritative U.S. GAAP (other than guidance issued by the SEC), superseding existing FASB, American Institute of Certified Public Accountants, and related literature. Only one level of authoritative U.S. GAAP now exists. All other literature is considered non-authoritative. The Codification does not change U.S. GAAP. The Company adopted the Codification during the quarter ended September 26, 2009. The adoption of the Codification did not have any substantive impact on our condensed consolidated financial statements or related footnotes.

On April 1, 2009, the Company adopted the guidance included in ASC 820, *Fair Value Measurements and Disclosures* (“ASC 820”) related to the measurement of fair value used when evaluating nonfinancial assets and liabilities. See additional disclosures related to the adoption of the standard within Note 10.

On April 1, 2009, the Company adopted the guidance included in ASC 805, *Business Combinations* (“ASC 805”), which significantly changed the accounting for and reporting of business combination transactions. The objective of this guidance is to improve the information provided in financial reports about a business combination and its effects. ASC 805 states that all business combinations (whether full, partial or step acquisitions) must apply the “acquisition method.” In applying the acquisition method, the acquirer must determine the fair value of the acquired business as of the acquisition date and recognize the fair value of the acquired assets and liabilities assumed. As a result, it will require that certain forms of contingent consideration and certain acquired contingencies be recorded at fair value at the acquisition date. ASC 805 also states acquisition costs will generally be expensed as incurred and restructuring costs will be expensed in periods after the acquisition date. The impact of the adoption of ASC 805 on the Company’s financial statements will largely be dependent on the size and nature of the business combinations completed subsequent to adoption. Currently, the Company has not made any business acquisitions subsequent to the adoption of this standard. The Company estimates that approximately \$64.0 million and \$34.7 million of recorded valuation allowance and unrecognized tax benefits, respectively, which are associated with prior acquisitions, if recognized in future periods would impact income tax expense instead of goodwill.

On April 1, 2009, the Company adopted the guidance included in ASC 855, *Subsequent Events* (“ASC 855”), which requires companies, if applicable, to disclose any subsequent events either as recognized subsequent events or non-recognized subsequent events. ASC 855 also modified the definition of subsequent events to refer to events or transactions that occur after the balance sheet date but before the financial statements are issued and requires entities to disclose the date through which an entity has evaluated subsequent events and the basis for that date. The Company’s evaluation of subsequent events is disclosed within this footnote in the section titled “Evaluation of Subsequent Events” below.

*Issued*

In December 2008, the FASB issued guidance included in ASC 715, *Compensation – Retirement Benefits* (“ASC 715”), which requires additional disclosures regarding assets held in an employer’s defined benefit pension or other postretirement plan. This standard requires disclosure of the fair value of the plan assets by each major asset category, disclosure of the level within the fair value hierarchy in which each major category of plan assets falls using the guidance in ASC 820 and a reconciliation of beginning and ending balances of plan asset fair values that are derived using significant unobservable inputs. The guidance is effective for fiscal years ending after December 15, 2009. The Company is currently reviewing the requirements of ASC 715 to determine the impact on its financial statement disclosures.

**Evaluation of Subsequent Events**

The Company evaluated subsequent events from the balance sheet date of September 26, 2009 through November 24, 2009 (the date of this report) and has concluded that certain non-recognizable subsequent events have occurred. See the disclosure of these subsequent events in Note 15.

**2. Restructuring and Other Similar Costs**

During the third quarter of our fiscal year 2009 (quarter ended December 27, 2008), the Company commenced certain restructuring actions to reduce operating costs and improve profitability. The Company continued to execute certain restructuring actions during the three and six months ended September 26, 2009. The restructuring charges taken during the three and six months ended September 26, 2009 consisted of \$0.8 and \$3.2 million, respectively, of severance costs related to workforce reductions of approximately 500 employees, or a 8.4% reduction from the Company’s March 31, 2009 employee base. The following table summarizes the restructuring costs incurred during the second quarter and six months ended September 26, 2009 and the total restructuring costs incurred since such actions began (i.e., the period from September 28, 2008 to September 26, 2009) by reportable segment (in millions):

<b>Quarter Ended September 26, 2009</b>				
	Power Transmission	Water Management	Corporate	Consolidated
Severance costs	\$ 0.8	\$ -	\$ -	\$ 0.8
<b>Six Months Ended September 26, 2009</b>				
	Power Transmission	Water Management	Corporate	Consolidated
Severance costs	\$ 2.7	\$ 0.5	\$ -	\$ 3.2
<b>Restructuring costs to date (Period from September 28, 2008 to September 26, 2009)</b>				
	Power Transmission	Water Management	Corporate	Consolidated
Severance costs	\$ 18.7	\$ 2.5	\$ 0.2	\$ 21.4
Fixed asset impairments	-	3.2	-	3.2
Inventory impairments	-	2.5	-	2.5
Lease termination and other costs	0.5	0.1	-	0.6
Total restructuring and other similar costs	\$ 19.2	\$ 8.3	\$ 0.2	\$ 27.7

The following table summarizes the activity in the Company's restructuring reserve for the six months ended September 26, 2009 (in millions):

	<u>Severance Costs</u>	<u>Lease Termination and Other Costs</u>	<u>Total</u>
Restructuring reserve, March 31, 2009	\$ 12.6	\$ 0.6	\$ 13.2
Charges	3.2	-	3.2
Cash payments	(11.5)	(0.1)	(11.6)
Currency translation adjustment	0.3	-	0.3
Restructuring reserve, September 26, 2009 (1)	<u>\$ 4.6</u>	<u>\$ 0.5</u>	<u>\$ 5.1</u>

(1) The restructuring reserve is included in other current liabilities on the condensed consolidated balance sheets.

The remaining accrued severance costs will be paid during the remainder of fiscal 2010.

### 3. Income Taxes

The provision for income taxes for all periods presented is based on an estimated effective income tax rate for the respective full fiscal years. The estimated annual effective income tax rate is determined excluding the effect of significant discrete items or items that are reported net of their related tax effects. The tax effect of significant, discrete items is reflected in the period in which they occur. The Company's income tax expense is impacted by a number of factors, including the amount of taxable earnings derived in foreign jurisdictions with tax rates that are higher or lower than the U.S. federal statutory rate, state tax rates in the jurisdictions where the Company does business and the Company's ability to utilize various tax credits and net operating loss carryforwards.

The effective income tax rate for the second quarter of fiscal 2009 was 55.1% versus 25.8% in the second quarter of fiscal 2010. The effective tax rate for the second quarter of fiscal 2009 is higher than the U.S. federal statutory rate of 35.0% due to the accrual of state income taxes, the accrual of interest expense (through income tax expense) relating to unrecognized tax benefits and an increase in the valuation allowance for foreign tax credits generated during this period for which realization of such benefits is not deemed more likely than not, relative to the pre-tax income recognized during this period. The effective tax rate for the second quarter of fiscal 2010 is lower than the U.S. federal statutory rate of 35.0% mainly due to the effect of the accrual of state income taxes, the accrual of interest expense (through income tax expense) relating to unrecognized tax benefits and an increase to the valuation allowance relating to foreign tax credits generated for which realization of such benefits is not deemed more likely than not, relative to the pre-tax loss recognized during this period.

At March 31, 2009, the Company's total liability for unrecognized net tax benefits was \$42.5 million. At September 26, 2009, the Company had a \$46.0 million liability for unrecognized net tax benefits. Due to the adoption of ASC 805, effective April 1, 2009, the entire amount of \$46.0 million of unrecognized tax benefits as of September 26, 2009 would impact income tax expense if recognized in a future period.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits in income tax expense. As of March 31, 2009 and September 26, 2009, the total amount of gross, unrecognized tax benefits includes \$14.0 million and \$15.5 million of accrued interest and penalties, respectively. The Company recognized \$0.4 million of net interest and penalties as income tax expense during the six months ended September 27, 2008. The Company recognized \$0.6 million of net interest and penalties as income tax expense during the six months ended September 26, 2009.

The Company or one or more of its subsidiaries conducts business in multiple locations within and outside the U.S. Consequently, the Company is subject to periodic income tax examinations by domestic and foreign income tax authorities. Currently, the Company is undergoing routine, periodic income tax examinations in both domestic and foreign jurisdictions. In addition, the Company is currently undergoing an examination of its U.S. federal income tax returns by the Internal Revenue Service ("IRS") for the tax periods ended March 31, 2006 and July 21, 2006. The IRS' examination for these tax periods began in January 2009. It appears reasonably possible that the amounts of unrecognized income tax benefits could change in the next twelve months as a result of such examinations; however, any potential payments of income tax, interest and penalties are not expected to be significant to the Company's consolidated financial statements. With certain exceptions, the Company is no longer subject to U.S. federal income tax examinations for years ending prior to fiscal 2006, state and local income tax examinations for years ending prior to fiscal 2005 or significant foreign income tax examinations for years ending prior to fiscal 2004. With respect to the Company's U.S. federal net operating loss ("NOL") carryforward, fiscal year 2003 is open under statutes of limitations; whereby, the IRS may not adjust the

income tax liability for this year, but may reduce the NOL carryforward and any other tax attribute carryforward to future, open tax years.

#### 4. Comprehensive Income (Loss)

Comprehensive income (loss) consists of the following (in millions):

	Second Quarter Ended		Six Months Ended	
	September 27, 2008	September 26, 2009	September 27, 2008	September 26, 2009
Net income (loss)	\$ 5.3	\$ (2.3)	\$ 5.5	\$ 50.0
Other comprehensive income (loss):				
Unrealized gain (loss) on interest rate derivatives, net of tax	0.4	(1.2)	3.3	0.5
Amortization of pension and postretirement unrecognized prior service costs and actuarial gains, net of tax	0.1	2.0	0.2	4.0
Foreign currency translation adjustments	(6.1)	(3.0)	(4.7)	(2.6)
Comprehensive income (loss)	\$ (0.3)	\$ (4.5)	\$ 4.3	\$ 51.9

#### 5. Inventories

The major classes of inventories are summarized as follows (in millions):

	March 31, 2009	September 26, 2009
Finished goods	\$ 208.6	\$ 178.4
Work in progress	54.8	47.9
Raw materials	41.8	35.6
Inventories at First-in, First-Out ("FIFO") cost	305.2	261.9
Adjustment to state inventories at Last-in, First-Out ("LIFO") cost	21.9	19.4
	\$ 327.1	\$ 281.3

#### 6. Goodwill and Intangible Assets

The changes in the net carrying value of goodwill and identifiable intangible assets for the six months ended September 26, 2009, by operating segment, are presented below (in millions):

	Goodwill	Indefinite Lived Intangible Assets (Trade Names)	Amortizable Intangible Assets			Total Identifiable Intangible Assets Excluding Goodwill
			Customer Relationships	Patents	Non-Compete	
<b>Power Transmission</b>						
Net carrying amount as of March 31, 2009	\$ 852.3	\$ 191.9	\$ 197.0	\$ 10.3	\$ -	\$ 399.2
Amortization	-	-	(13.5)	(0.8)	-	(14.3)
Net carrying amount as of September 26, 2009	\$ 852.3	\$ 191.9	\$ 183.5	\$ 9.5	\$ -	\$ 384.9
<b>Water Management</b>						
Net carrying amount as of March 31, 2009	\$ 158.6	\$ 100.7	\$ 222.3	\$ 14.1	\$ 0.1	\$ 337.2
Amortization	-	-	(8.8)	(1.0)	-	(9.8)
Currency translation adjustment	0.9	0.6	0.1	-	-	0.7
Net carrying amount as of September 26, 2009	\$ 159.5	\$ 101.3	\$ 213.6	\$ 13.1	\$ 0.1	\$ 328.1
<b>Consolidated</b>						
Net carrying amount as of March 31, 2009	\$ 1,010.9	\$ 292.6	\$ 419.3	\$ 24.4	\$ 0.1	\$ 736.4
Amortization	-	-	(22.3)	(1.8)	-	(24.1)
Currency translation adjustment	0.9	0.6	0.1	-	-	0.7
Net carrying amount as of September 26, 2009	\$ 1,011.8	\$ 293.2	\$ 397.1	\$ 22.6	\$ 0.1	\$ 713.0

The gross carrying amount and accumulated amortization for each major class of identifiable intangible assets as of March 31, 2009 and September 26, 2009 are as follows (in millions):

		<b>March 31, 2009</b>		
	<b>Weighted Average Useful Life</b>	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>	<b>Net Carrying Amount</b>
Intangible assets subject to amortization:				
Patents	10 Years	\$ 36.1	\$ (11.7)	\$ 24.4
Customer relationships (including distribution network)	12 Years	528.8	(109.5)	419.3
Non-compete	2 Years	0.1	-	0.1
Intangible assets not subject to amortization - trademarks and tradenames				
		292.6	-	292.6
		<u>\$ 857.6</u>	<u>\$ (121.2)</u>	<u>\$ 736.4</u>

		<b>September 26, 2009</b>		
	<b>Weighted Average Useful Life</b>	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>	<b>Net Carrying Amount</b>
Intangible assets subject to amortization:				
Patents	10 Years	\$ 36.1	\$ (13.5)	\$ 22.6
Customer relationships (including distribution network)	12 Years	528.9	(131.8)	397.1
Non-compete	2 Years	0.1	-	0.1
Intangible assets not subject to amortization - trademarks and tradenames				
		293.2	-	293.2
		<u>\$ 858.3</u>	<u>\$ (145.3)</u>	<u>\$ 713.0</u>

Intangible asset amortization expense totaled \$12.4 million and \$24.9 million for the second quarter and six months ended September 27, 2008, respectively. Intangible asset amortization expense totaled \$12.0 million and \$24.1 million for the second quarter and six months ended September 26, 2009, respectively.

The Company expects to recognize amortization expense on the intangible assets subject to amortization of \$48.2 million in fiscal year 2010 (inclusive of \$24.1 million of amortization expense recognized in the six months ended September 26, 2009), \$48.1 million in fiscal year 2011, \$47.6 million in fiscal year 2012, \$47.1 million in fiscal year 2013 and \$47.0 million in fiscal year 2014.

## 7. Other Current Liabilities

Other current liabilities are summarized as follows (in millions):

	<b>March 31, 2009</b>	<b>September 26, 2009</b>
Taxes, other than income taxes	\$ 4.8	\$ 6.1
Sales rebates	15.1	15.3
Restructuring obligations (1)	13.2	5.1
Customer advances	23.3	21.2
Product warranty	7.2	8.3
Commissions	6.5	6.7
Risk management reserves (2)	4.0	4.3
Derivative liability (3)	5.7	1.0
Other	16.8	23.4
	<u>\$ 96.6</u>	<u>\$ 91.4</u>

- (1) See more information related to the restructuring obligations balance within Note 2.
- (2) Includes projected liabilities related to the Company's deductible portion of insured losses arising from automobile, general and product liability claims.
- (3) Represents the fair value of the Company's interest rate collar, 5.14% interest rate swap, and foreign currency forward contracts. See Note 9 for more information regarding the interest rate collar, swap, and foreign currency forward contracts.

## 8. Long-Term Debt

Long-term debt is summarized as follows (in millions):

	<u>March 31, 2009</u>	<u>September 26, 2009</u>
Term loans	\$ 765.5	\$ 765.0
PIK toggle senior indebtedness due 2013 (1)	385.6	126.5
Borrowings under revolving credit facility	82.7	-
Borrowings under AR securitization facility	30.0	-
9.50% Senior notes due 2014 (2)	802.2	978.4
8.875% Senior notes due 2016	150.0	79.0
11.75% Senior subordinated notes due 2016	300.0	300.0
10.125% Senior subordinated notes due 2012	0.3	0.3
Other	9.8	9.3
	<hr/>	<hr/>
Total	2,526.1	2,258.5
Less current portion	8.1	7.4
	<hr/>	<hr/>
Long-term debt	<u>\$ 2,518.0</u>	<u>\$ 2,251.1</u>

- (1) Includes an unamortized bond issue discount of \$4.1 million and \$1.1 million at March 31, 2009 and September 26, 2009, respectively.
- (2) Includes an unamortized bond issue premium of \$7.2 million at March 31, 2009 and a net unamortized bond issue discount of \$12.9 million at September 26, 2009.

The Company's outstanding debt was issued or guaranteed by Rexnord Holdings, RBS Global, and various subsidiaries of RBS Global. Rexnord Holdings is the issuer of the PIK toggle senior indebtedness and RBS Global as well as its wholly-owned subsidiary Rexnord LLC are the co-issuers of the term loans, senior notes and senior subordinated notes.

On March 2, 2007, Rexnord Holdings entered into a Credit Agreement with various lenders which provided \$449.8 million (\$459.0 million of debt financing, net of a \$9.2 million original issue discount) that was primarily used to pay a distribution to its shareholders as well as to holders of fully vested rollover options. The PIK Toggle Loans (or "Loans") issued pursuant to the Credit Agreement are due March 1, 2013 and bear interest at a floating rate. The floating rate is equal to adjusted LIBOR (the interest rate per annum equal to the product of (a) the LIBOR in effect and (b) Statutory Reserves) plus 7.0%.

On July 10, 2008, Rexnord Holdings commenced an exchange offer with respect to the PIK Toggle Loans. Approximately \$460.8 million of the then outstanding PIK Toggle Loans were tendered for exchange. The PIK Toggle Loans that were not tendered for exchange continue to be governed by the terms and conditions in the Credit Agreement while the PIK Toggle Loans tendered and exchanged for PIK Toggle Senior Notes due 2013 (the "PIK Toggle Exchange Notes" or "Exchange Notes") are governed by the terms and conditions of an indenture. The Exchange Notes were issued under an indenture between Rexnord Holdings and Wells Fargo Bank, N.A, as trustee (the "indenture"), which is capable of being qualified under the Trust Indenture Act of 1939. The terms of the Exchange Notes are substantially the same as the terms of the Loans in all material respects (including their maturity, variable interest rates and the Company's ability to make certain interest payments in kind, which the Company refers to as "PIK Interest," rather than in cash), except that (1) interest on the Exchange Notes is payable semi-annually (generally at the three month LIBOR in effect for the interest period plus 7.0% per annum) while interest on the Loans is payable quarterly (also generally at the three month LIBOR in effect for the interest period plus 7.0% per annum), (2) the Exchange Notes were issued pursuant to the indenture, (3) a change of control is not an event of default under the Exchange Notes but instead requires us to make an offer to purchase the Exchange Notes at a price of 101% of their principal amount plus accrued and unpaid interest, and (4) certain other provisions have been adjusted as required or permitted by Section 6.13 of the Credit Agreement. None of the Company's subsidiaries currently guarantee any of the Company's indebtedness, so there are no guarantors of the Exchange Notes or of the Loans. The Exchange Notes and the Loans are required to be guaranteed by any of the Company's domestic subsidiaries which in the future may guarantee the Company's indebtedness. The Company refers to the Loans and the Exchange Notes collectively as the PIK toggle senior indebtedness.

As of September 26, 2009, the interest rate was 7.35% and 7.36% for the Exchange Notes and the Loans, respectively. Pursuant to the terms of the Credit Agreement and the indenture, Rexnord Holdings has elected to pay interest in-kind and has accordingly paid interest with additional PIK Toggle Loans and Exchange Notes, as the case may be, on pre-determined interest

rate reset dates. During the six months ended September 26, 2009, \$5.1 million of interest was paid in the form of additional PIK toggle senior indebtedness.

The PIK toggle senior indebtedness is an unsecured obligation. The governing instruments of the PIK toggle senior indebtedness contain customary affirmative and negative covenants including: (i) limitations on the incurrence of indebtedness and the issuance of disqualified and preferred stock, (ii) limitations on restricted payments, dividends and certain other payments, (iii) limitations on asset sales, (iv) limitations on transactions with affiliates, (v) requirements as to the addition of future guarantors in certain circumstances and (vi) limitations on liens. Notwithstanding these covenants, the PIK toggle senior indebtedness significantly restricts the payment of dividends and also limits the incurrence of additional indebtedness and the issuance of certain forms of equity. However, Rexnord Holdings may incur additional indebtedness and issue certain forms of equity if immediately prior to the consummation of such events, the fixed charge coverage ratio for the most recently ended four full fiscal quarters for which internal financial statements are available, as defined in the Credit Agreement, would have been at least 1.75 to 1.00, or, 2.00 to 1.00 in the case of the Rexnord Holdings' subsidiaries, including the pro forma application of the additional indebtedness or equity issuance.

RBS Global borrows under certain secured credit facilities with a syndicate of banks and other financial institutions consisting of: (i) a \$810.0 million term loan facility with a maturity date of July 19, 2013 and (ii) a \$150.0 million revolving credit facility with a maturity date of July 20, 2012 and borrowing capacity available for letters of credit and for borrowing on same-day notice, referred to as swingline loans.

As of September 26, 2009, RBS Global's outstanding borrowings under the term loan facility were apportioned between two primary tranches: a \$570.0 million term loan B1 facility and a \$195.0 million term loan B2 facility. Borrowings under the term loan B1 facility accrue interest, at the Company's option, at the following rates per annum: (i) 2.50% plus LIBOR, or (ii) 1.50% plus the Base Rate (which is defined as the higher of the Federal funds rate plus 0.5% or the Prime rate). Borrowings under the B2 facility accrue interest, at the Company's option, at the following rates per annum: (i) 2.25% plus LIBOR or (ii) 1.00% plus the Base Rate (which is defined as the higher of the Federal funds rate plus 0.5% or the Prime rate). The weighted average interest rate on the outstanding term loans at September 26, 2009 was 4.41%.

Borrowings under RBS Global's \$150.0 million revolving credit facility accrue interest, at the Company's option, at the following rates per annum: (i) 1.75% plus LIBOR, or (ii) 0.75% plus the Base Rate (which is defined as the higher of the Federal funds rate plus 0.5% or the Prime rate). All amounts outstanding under the revolving credit facility will be due and payable in full, and the commitments thereunder will terminate, on July 20, 2012. On September 15, 2008, Lehman Brothers Holdings Inc. and certain of its subsidiaries ("Lehman"), who have a 5% or \$7.5 million credit commitment under the Company's \$150.0 million credit facility, filed for bankruptcy. Therefore, the availability under the Company's \$150.0 million revolving credit facility has been temporarily reduced by \$7.5 million until such time as a replacement lender covers this credit commitment. In addition, \$30.3 million and \$32.0 million of the revolving credit facility was considered utilized in connection with outstanding letters of credit at March 31, 2009 and September 26, 2009, respectively (see Note 15 for subsequent update with respect to the \$7.5 million unfulfilled commitment). Outstanding borrowings under the revolving credit facility were \$82.7 million as of March 31, 2009. Due to the volatile credit markets, management did not intend to repay the outstanding balance of the revolving credit facility within one year and accordingly classified the borrowings as long-term debt. Continuing improvements in the credit markets during the second quarter of fiscal 2010 caused management to reconsider its previous intent and lead to the decision to repay the balance due under the revolving credit facility during the second quarter ended September 26, 2009.

In addition to paying interest on outstanding principal under the senior secured credit facilities, the Company is required to pay a commitment fee to the lenders under the revolving credit facility in respect to the unutilized commitments thereunder at a rate equal to 0.50% per annum (subject to reduction upon attainment and maintenance of a certain senior secured leverage ratio). The Company also must pay customary letter of credit and agency fees.

As of September 26, 2009, the remaining mandatory principal payments prior to maturity on both the term loan B1 and B2 facilities are \$1.2 million and \$8.0 million, respectively. The Company has fulfilled all mandatory principal payments prior to maturity on the B1 facility through March 31, 2013. Principal payments of \$0.5 million are scheduled to be made at the end of each calendar quarter until June 30, 2013 on the B2 facility. The Company may voluntarily repay outstanding loans under the senior secured credit facilities at any time without premium or penalty, other than customary "breakage" costs with respect to Eurocurrency loans.

The senior secured credit facilities contain a number of covenants that, among other things, restrict, subject to certain exceptions, the Company's ability, and the ability of the Company's subsidiaries, to: sell assets; incur additional indebtedness; repay other indebtedness; pay dividends and distributions, repurchase its capital stock, or make payments, redemptions or repurchases in respect of subordinated debt (including the Company's 11.75% senior subordinated notes due 2016); create liens on assets; make investments, loans, guarantees or advances; make certain acquisitions; engage in certain mergers or consolidations; enter into sale-and-leaseback transactions; engage in certain transactions with affiliates; amend certain material agreements governing its indebtedness; make capital expenditures; enter into hedging agreements; amend its organizational documents; change the business

conducted by it and its subsidiaries; and enter into agreements that restrict dividends from subsidiaries. The Company's senior secured credit facilities limit the Company's maximum senior secured bank leverage ratio to 4.25 to 1.00. As of September 26, 2009, the senior secured bank leverage ratio was 1.85 to 1.00.

On April 22, 2009, the Company purchased and extinguished \$23.6 million of its outstanding face value PIK Toggle Loans for \$8.5 million in cash. As a result of the extinguishment, the Company recognized a \$14.9 million gain during the first quarter ended June 27, 2009, which was measured based on the difference between the cash paid and the net carrying amount of the debt (the net carrying amount of the debt included unamortized original issue discounts of \$0.3 million, unamortized debt issuance costs of \$0.2 million and \$0.3 million of accrued interest).

On April 29, 2009, the Company finalized the results of a debt exchange offer to exchange (a) new 9.50% Senior Notes due 2014 (the "New Senior Notes") for any and all of the Company's 8.875% Senior Notes due 2016 (the "Old 2016 Notes"), (b) the New Senior Notes for any and all of Rexnord Holdings' PIK Toggle Senior Notes due 2013 (the "Old Holdco Notes" and, together with the Old 2016 Notes, the "Old Notes"), and (c) the New Senior Notes for any and all of the senior unsecured term loans (the "Holdco Loans") outstanding under the credit agreement, dated as of March 2, 2007, among Rexnord Holdings, Credit Suisse, as Administrative Agent, Banc of America Bridge LLC, as syndication agent, and the lenders from time to time party thereto.

Upon settlement of the exchange offer, (i) approximately \$71.0 million principal amount of Old 2016 Notes had been validly tendered and not withdrawn for exchange for New Senior Notes, (ii) approximately \$235.7 million principal amount of Old Holdco Notes had been validly tendered and not withdrawn for exchange for New Senior Notes, and (iii) approximately \$7.9 million principal amount of Holdco Loans had been validly surrendered and not withdrawn for exchange for New Senior Notes. Based on the principal amount of Old Notes and Holdco Loans validly tendered and accepted, approximately \$196.3 million of aggregate principal of New Senior Notes was issued in exchange for such Old Notes and Holdco Loans (excluding a net original issue discount of \$20.6 million). In addition, the Company also incurred \$11.1 million of transaction costs (\$0.2 million of these transaction costs were issued in the form of New Senior Notes) to complete the exchange offer, of which \$5.1 million was capitalized as deferred financing costs.

The Company accounted for the debt exchange transaction pursuant to ASC 470-50 *Debt Modification and Extinguishments* ("ASC 470-50"). Pursuant to this guidance, the Company recognized a gain of \$137.5 million on the extinguishment of Old Holdco Notes and Holdco Loans. The gain on extinguishment of \$137.5 million relates to the extinguishment of \$235.7 million of outstanding face value Old Holdco Notes and \$7.9 million of outstanding face value of Holdco Loans and is measured based on the difference between the fair market value of the New Senior Notes issued of \$104.5 million and the net carrying amount of the debt (the net carrying amount of the debt includes unamortized original issue discount of \$2.5 million, unamortized debt issuance costs of \$2.2 million and \$3.1 million of accrued interest). In connection with the \$235.7 million of Old Holdco Notes and \$7.9 million of Holdco Loans tendered in the exchange, the Company issued approximately \$130.6 million of face value of New Senior Notes, net of a \$26.1 million original issue discount.

Pursuant to ASC 470-50, the exchange of the Old 2016 Notes did not constitute a significant modification of debt, therefore, the carrying value of the \$71.0 million in Old 2016 Notes tendered was carried-forward as the net carrying value of the New Senior Notes, inclusive of a \$5.5 million original issue premium. The premium is a result of the difference between the \$71.0 million carrying value of the Old 2016 Notes and the \$65.5 million of corresponding face value of New Senior Notes issued with respect to this component of the exchange. This premium will be amortized as a reduction to interest expense (via the effective interest method) over the life of the New Senior Notes in conformity with the standard.

Post-exchange offer, the Company has issued a total of \$991.3 million in aggregate principal amount of 9.50% senior notes which bear interest at a rate of 9.50% per annum and which will mature on August 1, 2014. This amount includes \$196.3 million of aggregate principal related to the aforementioned debt exchange. The terms of the New Senior Notes and the Company's previously existing 9.50% senior notes are substantially similar with the exception of interest payment dates. Interest on the \$795.0 million of previously existing 9.50% senior notes is payable on February 1 and August 1, while interest on the \$196.3 million of New Senior Notes is payable on May 1 and November 1.

As of September 26, 2009, a total of \$79.0 million in aggregate principal amount of 8.875% senior notes due 2016 remained outstanding. These notes bear interest at a rate of 8.875% per annum, payable on each March 1 and September 1, and will mature on September 1, 2016.

The Company issued \$300.0 million in aggregate principal amount of 11.75% senior subordinated notes due 2016. Those notes bear interest at a rate of 11.75% per annum, payable on each February 1 and August 1, and will mature on August 1, 2016.

The senior notes and senior subordinated notes are unsecured obligations of the Company. The senior subordinated notes are subordinated in right of payment to all existing and future senior indebtedness. The indentures governing the senior notes and senior subordinated notes permit the Company to incur all permitted indebtedness (as defined in the applicable indenture) without restriction, which includes amounts borrowed under the senior secured credit facilities. The indentures also allow the Company to incur additional debt as long as it can satisfy the coverage ratio of the indenture after giving effect thereto on a pro forma basis.

The indentures governing the senior notes and senior subordinated notes contain customary covenants, among others, limiting dividends, investments, purchases or redemptions of stock, transactions with affiliates and mergers and sales of assets, and requiring the Company to make an offer to purchase notes upon the occurrence of a change in control, as defined in the indentures. These covenants are subject to a number of important qualifications. For example, the indentures do not impose any limitation on the incurrence by the Company of liabilities that are not considered “indebtedness” under the indentures, such as certain sale/leaseback transactions; nor do the indentures impose any limitation on the amount of liabilities incurred by the Company’s subsidiaries, if any, that might be designated as “unrestricted subsidiaries” (as defined in the applicable indenture).

The indentures governing the senior notes and the senior subordinated notes permit optional redemption of the notes on certain terms and at certain prices, as described below.

The indentures provide that, prior to August 1, 2011 (or in the case of the 9.50% senior notes due 2014, prior to August 1, 2010), the notes may be redeemed at the Company’s option in whole at any time or in part from time to time, upon not less than 30 and not more than 60 days’ prior notice, at a redemption price equal to (i) 100% of the principal amount of the notes redeemed plus (ii) a “make whole” premium as set forth in the in the applicable indenture, and (iii) accrued and unpaid interest and additional interest, if any, to the applicable redemption date.

Further, on or after August 1, 2011 (or in the case of the 9.50% senior notes due 2014, on or after August 1, 2010), the indentures permit optional redemption of the notes, in whole or in part upon not less than 30 and not more than 60 days’ prior notice, at the redemption prices stated in the indentures.

Notwithstanding the above, the Company’s ability to make payments on, redeem, repurchase or otherwise retire for value, prior to the scheduled repayment or maturity, the senior notes or senior subordinated notes may be restricted or prohibited under the above-referenced senior secured credit facilities and, in the case of the senior subordinated notes, by the provisions in the indentures governing the senior notes.

At March 31, 2009 and September 26, 2009, various wholly-owned subsidiaries had additional debt of \$9.8 million and \$9.3 million, respectively, comprised primarily of borrowings at various foreign subsidiaries and capital lease obligations.

#### ***Account Receivable Securitization Program***

On September 26, 2007, three wholly-owned domestic subsidiaries of the Company entered into an accounts receivable securitization program (the “AR Securitization Program” or the “Program”) whereby they continuously sell substantially all of their domestic trade accounts receivable to Rexnord Funding LLC (a wholly-owned bankruptcy remote special purpose subsidiary) for cash and subordinated notes. Rexnord Funding LLC in turn may obtain revolving loans and letters of credit from General Electric Capital Corporation (“GECC”) pursuant to a five year revolving loan agreement. The maximum borrowing amount under the Receivables Financing and Administration Agreement is \$100.0 million, subject to certain borrowing base limitations related to the amount and type of receivables owned by Rexnord Funding LLC. All of the receivables purchased by Rexnord Funding LLC are pledged as collateral for revolving loans and letters of credit obtained from GECC under the loan agreement.

The AR Securitization Program does not qualify for sale accounting under ASC 860 *Transfers and Servicing* (“ASC 860”), and as such, any borrowings are accounted for as secured borrowings on the consolidated balance sheet. Financing costs associated with the Program are recorded within “Interest expense, net” in the consolidated statement of operations with respect to revolving loans or letters of credit obtained under the loan agreement.

Borrowings under the loan agreement bear interest at a rate equal to LIBOR plus 1.35%. Outstanding borrowings mature on September 26, 2012. In addition, a non-use fee of 0.30% is applied to the unutilized portion of the \$100.0 million commitment. These rates are per annum and the fees are paid to GECC on a daily basis.

At March 31, 2009, \$30.0 million was outstanding under the Program and was classified as long-term debt in the consolidated balance sheets. Due to the volatile credit markets, management did not intend to repay the outstanding balance under the Program within one year and accordingly classified the borrowings as long-term debt. Continuing improvements in the credit markets during the second quarter of fiscal 2010 caused management to reconsider its previous intent and lead to the decision to repay the balance due under the Program during the second quarter ended September 26, 2009. At September 26, 2009 the Company’s available borrowing capacity under the AR Securitization Program was \$86.0 million. All of the receivables purchased by Rexnord Funding LLC are pledged as collateral for revolving loans and letters of credit obtained from GECC under the loan agreement. Additionally, the Program requires compliance with certain covenants and performance ratios contained in the Receivables Financing and Administration Agreement. As of September 26, 2009, Rexnord Funding LLC was in compliance with all applicable covenants and performance ratios.

## 9. Derivative Financial Instruments

The Company is exposed to certain financial risks relating to fluctuations in foreign currency exchange rates and interest rates. The Company selectively uses foreign currency forward exchange contracts and interest rate swap and collar contracts to manage its foreign currency and interest rate risks. All hedging transactions are authorized and executed pursuant to defined policies and procedures which prohibit the use of financial instruments for speculative purposes. See below for a description of the Company's derivative financial instruments.

### Foreign Currency Forward Contracts

The Company periodically enters into foreign exchange forward contracts to mitigate the foreign currency volatility relative to certain intercompany and external cash flow requirements expected to occur during the fiscal year. The Company currently has entered into forward foreign currency contracts that exchange Canadian dollars ("CAD") for United States dollars ("USD") as well as USD for CAD. The forward contracts currently in place expire between October and March of fiscal 2010 and have notional amounts of \$12.5 million CAD (\$11.4 million USD) and \$4.8 million USD (\$5.4 million CAD) and contract rates ranging from \$1CAD:\$0.8120 USD to \$1CAD:\$0.9154 USD. These foreign exchange forward contracts were not accounted for as effective cash flow hedges in accordance with ASC 815, *Derivatives and Hedging* ("ASC 815") and as such were marked to market through earnings. See the amount recorded on the balance sheets and recognized within the income statements related to the Company's foreign currency forward contracts within the tables below.

### Interest Rate Collar and Swaps

In August 2006, the Company entered into an interest rate collar and an interest rate swap to hedge the variability in future cash flows associated with a portion of the Company's variable-rate term loans. The interest rate collar provides an interest rate floor of 4.0% plus the applicable margin and an interest rate cap of 6.065% plus the applicable margin on \$262.0 million of the Company's variable-rate term loans, while the interest rate swap converts \$68.0 million of the Company's variable-rate term loans to a fixed interest rate of 5.14% plus the applicable margin. Both the interest rate collar and the interest rate swap became effective on October 20, 2006 and have a maturity of three years. Through the second quarter ended September 26, 2009, the Company entered into three forward starting interest rate swaps to hedge the variability in future cash flows associated with the Company's variable rate term loans. All three interest rate swaps become effective beginning October 20, 2009 and mature on July 20, 2012. The three swaps convert an aggregate of \$370.0 million of the Company's variable-rate term loans to fixed interest rates ranging from 2.08% to 2.39% plus the applicable margin. These interest rate derivatives have been accounted for as effective cash flow hedges in accordance with ASC 815. The fair values of these interest rate derivatives are recorded on the Company's consolidated balance sheet with the corresponding offset recorded as a component of accumulated other comprehensive loss, net of tax. See the amounts recorded on the balance sheets and recognized within the income statements related to the Company's interest rate collar and swaps within the tables below.

The Company's derivatives are measured at fair value in accordance with ASC 820. See Note 10 for more information as it relates to the fair value measurement of the Company's derivative financial instruments.

The following tables indicate the location and the fair value of the Company's derivative instruments within the consolidated balance sheet segregated between designated, qualifying ASC 815-20 hedging instruments and non-qualifying, non-designated hedging instruments (in millions).

Fair value of derivatives designated as hedging instruments under ASC 815-20:

	Liability Derivatives		Balance Sheet Classification
	March 31, 2009	September 26, 2009	
Interest rate collar and swap	\$ (5.7)	\$ (0.7)	Other current liabilities
Interest rate swaps		(4.3)	Other long-term liabilities

Fair value of derivatives not designated as hedging instruments under ASC 815-20:

<b>Asset Derivatives</b>			
	<u>March 31, 2009</u>	<u>September 26, 2009</u>	<u>Balance Sheet Classification</u>
Foreign currency forward contracts	\$ -	\$ 0.1	Other current assets

  

<b>Liability Derivatives</b>			
	<u>March 31, 2009</u>	<u>September 26, 2009</u>	<u>Balance Sheet Classification</u>
Foreign currency forward contracts	\$ -	\$ (0.3)	Other current liabilities

The following table indicates the location and the amount of gains and losses associated with the Company's derivative instruments within the consolidated balance sheet (for qualifying ASC 815-20 instruments) and recognized within the consolidated statement of operations. The information is segregated between designated, qualifying ASC 815-20 hedging instruments and non-qualifying, non-designated hedging instruments (in millions).

Derivative Instruments designated as cash flow hedging relationships under ASC 815-20	Amount of Gain or (Loss) Recognized in Accumulated OCI on Derivatives		Location of Gain or (Loss) Reclassified from Accumulated OCI into Income	Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income		Amount of Gain or (Loss) Reclassified from Accumulated OCI into Income	
				Second Quarter Ended		Six Months Ended	
	March 31, 2009	September 26, 2009		September 27, 2008	September 26, 2009	September 27, 2008	September 26, 2009
Interest rate contracts	\$ (3.5)	\$ (3.1)	Interest expense, net	\$ (1.1)	\$ (3.0)	\$ (2.1)	\$ (5.6)

  

Derivative Instruments not designated as hedging instruments under ASC 815-20	Location of Gain or (Loss) Recognized in Income on Derivatives	Amount Recognized in Other income (expense) net during quarter ended		Amount Recognized in Other income (expense) net during six months ended	
		Second Quarter Ended		Six Months Ended	
		September 27, 2008	September 26, 2009	September 27, 2008	September 26, 2009
Foreign exchange forward contracts	Other income (expense), net	\$ 0.5	\$ (0.6)	\$ (0.2)	\$ 0.3

The Company currently expects to reclassify \$5.5 million within accumulated other comprehensive loss into earnings (as interest expense) during the next year as the Company's current mark to market calculations assume that variable rates will remain below its fixed contract rates for the next 12 months.

## 10. Fair Value Measurements

The Company adopted the guidance in ASC 820, effective April 1, 2008 for all financial instruments and non-financial instruments accounted for at fair value on a recurring basis. Effective April 1, 2009, the Company adopted the guidance in ASC 820 for all non-financial assets and liabilities accounted for at fair value on a non-recurring basis.

ASC 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants. ASC 820 also specifies a fair value hierarchy based upon the observability of inputs used in valuation techniques. Observable inputs (highest level) reflect market data obtained from independent sources, while unobservable inputs (lowest level) reflect internally developed assumptions about the assumptions a market participant would use.

In accordance with ASC 820, fair value measurements are classified under the following hierarchy:

- Level 1- Quoted prices for identical instruments in active markets.
- Level 2- Quoted prices for similar instruments; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs or significant value-drivers are observable.
- Level 3- Model-derived valuations in which one or more inputs or value-drivers are both significant to the fair value measurement and unobservable.

The valuation methodologies and instruments the Company uses relating to financial instruments accounted for at fair value on a recurring basis include:

#### Interest Rate Collar and Swaps

The fair value of interest rate swap and collar derivatives is primarily based on pricing models. These models use discounted cash flows that utilize the appropriate market-based forward swap curves and interest rates.

#### Foreign currency forward contracts

The fair value of foreign exchange forward contracts is based on a pricing model that utilizes the differential between the contract price and the market-based forward rate as applied to fixed future deliveries of currency at pre-designated settlement dates.

The following describes the valuation methodologies the Company uses to measure non-financial assets accounted for at fair value on a non-recurring basis.

#### Long-lived Assets and Intangible Assets

Long-lived assets (which includes property, plant and equipment and real estate) may be measured at fair value if such assets are held for sale or when there is a determination that the asset is impaired. Intangible assets (which includes patents, tradenames, customer relationships, and non-compete agreements) also may be measured at fair value when there is a determination that the asset is impaired. The determination of fair value for these assets is based on the best information available, including internal cash flow estimates discounted at an appropriate interest rate, quoted market prices when available, market prices for similar assets and independent appraisals, as appropriate. For real estate, cash flow estimates are based on current market estimates that reflect current and projected lease profiles and available industry information about expected trends in rental, occupancy and capitalization rates.

The Company endeavors to utilize the best available information in measuring fair value. As required by the standard, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company has determined that its financial instruments reside within level 2 of the fair value hierarchy. The following table provides a summary of the Company's assets and liabilities that were recognized at fair value on a recurring basis as of September 26, 2009 (in millions):

	<b>Fair Value as of September 26, 2009</b>			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<b>Assets:</b>				
Foreign currency forward contracts	\$ -	\$ 0.1	\$ -	\$ 0.1
<b>Total assets at fair value</b>	<u>\$ -</u>	<u>\$ 0.1</u>	<u>\$ -</u>	<u>\$ 0.1</u>
<b>Liabilities:</b>				
Foreign currency forward contracts	\$ -	\$ (0.3)	\$ -	\$ (0.3)
Interest rate collar and swaps	-	(5.0)	-	\$ (5.0)
<b>Total liabilities at fair value</b>	<u>\$ -</u>	<u>\$ (5.3)</u>	<u>\$ -</u>	<u>\$ (5.3)</u>

During the quarter ended September 26, 2009, the Company did not incur any fair value adjustments on non-financial assets valued on a non-recurring basis.

#### **Fair Value of Non-Derivative Financial Instruments**

The carrying amounts of cash, receivables, payables and accrued liabilities approximated fair value at March 31, 2009 and September 26, 2009 due to the short-term nature of those instruments. The carrying value of long-term debt recognized within the Condensed Consolidated Balance Sheets as of March 31, 2009 and September 26, 2009 was approximately \$2,526.1 million and

\$2,258.5 million, respectively, whereas the fair value of long-term debt as of March 31, 2009 and September 26, 2009 was approximately \$1,854.9 million and \$2,091.2 million, respectively. The fair value is based on quoted market prices for the same issues.

## 11. Commitments and Contingencies

### Warranties:

The Company offers warranties on the sales of certain products and records an accrual for estimated future claims. Such accruals are based upon historical experience and management's estimate of the level of future claims. The following table presents changes in the Company's product warranty liability (in millions):

	Second Quarter Ended		Six Months Ended	
	September 27, 2008	September 26, 2009	September 27, 2008	September 26, 2009
Balance at beginning of period	\$ 6.2	\$ 8.5	\$ 6.8	\$ 7.2
Charged to operations	(0.3)	1.5	(0.2)	3.6
Claims settled	(1.3)	(1.7)	(2.0)	(2.5)
Balance at end of period	\$ 4.6	\$ 8.3	\$ 4.6	\$ 8.3

### Contingencies:

The Company's entities are involved in various unresolved legal actions, administrative proceedings and claims in the ordinary course of business involving, among other things, product liability, commercial, employment, workers' compensation, intellectual property claims and environmental matters. The Company establishes reserves in a manner that is consistent with accounting principles generally accepted in the United States for costs associated with such matters when liability is probable and those costs are capable of being reasonably estimated. Although it is not possible to predict with certainty the outcome of these unresolved legal actions or the range of possible loss or recovery, based upon current information, management believes the eventual outcome of these unresolved legal actions either individually, or in the aggregate, will not have a material adverse effect on the financial position, results of operations or cash flows of the Company.

In connection with the Carlyle acquisition in November 2002, Invensys plc has provided the Company with indemnification against certain contingent liabilities, including certain pre-closing environmental liabilities. The Company believes that, pursuant to such indemnity obligations, Invensys is obligated to defend and indemnify the Company with respect to the matters described below relating to the Ellsworth Industrial Park Site and to various asbestos claims. The indemnity obligations relating to the matters described below are not subject to any time limitations and are subject to an overall dollar cap equal to the purchase price, which is an amount in excess of \$900 million. The following paragraphs summarize the most significant actions and proceedings:

- In 2002, Rexnord Industries, LLC (formerly known as Rexnord Corporation) ("Rexnord Industries") was named as a potentially responsible party ("PRP"), together with at least ten other companies, at the Ellsworth Industrial Park Site, Downers Grove, DuPage County, Illinois (the "Site"), by the United States Environmental Protection Agency ("USEPA"), and the Illinois Environmental Protection Agency ("IEPA"). Rexnord Industries' Downers Grove property is situated within the Ellsworth Industrial Complex. The USEPA and IEPA allege there have been one or more releases or threatened releases of chlorinated solvents and other hazardous substances, pollutants or contaminants, allegedly including but not limited to a release or threatened release on or from the Company's property, at the Site. The relief sought by the USEPA and IEPA includes further investigation and potential remediation of the Site. Rexnord Industries' allocated share of future costs related to the Site, including for investigation and/or remediation, could be significant.
- All previously pending lawsuits related to the Site have been settled and dismissed. Pursuant to its indemnity obligation, Invensys continues to defend the Company in matters related to the Site and has paid 100% of the costs to date. To provide additional protection, the Company has brought several indemnification suits against previous property owners who retained certain environmental liabilities associated with its property, and is also involved in litigation with its insurance companies for a declaration of coverage. These suits are progressing in accordance with the respective court's scheduling order.
- Approximately 600 lawsuits (with approximately 3,500 claimants) are pending in state or federal court in numerous jurisdictions relating to alleged personal injuries due to the alleged presence of asbestos in certain brakes and clutches previously manufactured by the Company's Stearns division and/or its predecessor owners. Invensys and FMC, prior owners of the Stearns business, have paid 100% of the costs to date related to the Stearns lawsuits. Similarly, the Company's Prager subsidiary is a defendant in two pending multi-defendant lawsuits relating to alleged personal injuries due to the alleged presence of asbestos in a product allegedly manufactured by Prager. There are approximately 3,700 claimants in the Prager lawsuits. The ultimate outcome of these lawsuits cannot presently be determined. To date, the Company's insurance providers have paid 100% of the costs related to the Prager asbestos claims. The Company believes

that the combination of its insurance coverage and the Invensys indemnity obligations will cover any future costs of this suit.

In connection with the Falk acquisition, Hamilton Sundstrand has provided the Company with indemnification against certain contingent liabilities, including coverage for certain pre-closing environmental liabilities. The Company believes that, pursuant to such indemnity obligations, Hamilton Sundstrand is obligated to defend and indemnify the Company with respect to the asbestos claims described below, and that, with respect to these claims, such indemnity obligations are not subject to any time or dollar limitations. The following paragraph summarizes the most significant actions and proceedings for which Hamilton Sundstrand has accepted responsibility:

- Falk, through its successor entity, is a defendant in approximately 190 lawsuits pending in state or federal court in numerous jurisdictions relating to alleged personal injuries due to the alleged presence of asbestos in certain clutches and drives previously manufactured by Falk. There are approximately 1,400 claimants in these suits. The ultimate outcome of these lawsuits cannot presently be determined. Hamilton Sundstrand is defending the Company in these lawsuits pursuant to its indemnity obligations and has paid 100% of the costs to date.

Certain Water Management subsidiaries are also subject to asbestos and class action related litigation.

As of September 26, 2009, Zurn and an average of approximately 100 other unrelated companies were defendants in approximately 5,800 asbestos related lawsuits representing approximately 30,400 claims. The suits allege damages in an aggregate amount of approximately \$15.5 billion against all defendants. Plaintiffs' claims allege personal injuries caused by exposure to asbestos used primarily in industrial boilers formerly manufactured by a segment of Zurn. Zurn did not manufacture asbestos or asbestos components. Instead, Zurn purchased them from suppliers. These claims are being handled pursuant to a defense strategy funded by insurers. As of September 26, 2009, the Company estimates the potential liability for asbestos-related claims pending against Zurn as well as the claims expected to be filed in the next ten years to be approximately \$90.0 million of which Zurn expects to pay approximately \$79.0 million in the next ten years on such claims, with the balance of the estimated liability being paid in subsequent years. However, there are inherent uncertainties involved in estimating the number of future asbestos claims, future settlement costs, and the effectiveness of defense strategies and settlement initiatives.

As a result, Zurn's actual liability could differ from the estimate described herein. Further, while this current asbestos liability is based on an estimate of claims through the next ten years, such liability may continue beyond that time frame, and such liability could be substantial.

Management estimates that its available insurance to cover its potential asbestos liability as of September 26, 2009, is approximately \$271.5 million, and believes that all current claims are covered by this insurance. However, principally as a result of the past insolvency of certain of the Company's insurance carriers, certain coverage gaps will exist if and after the Company's other carriers have paid the first \$195.5 million of aggregate liabilities. In order for the next \$51.0 million of insurance coverage from solvent carriers to apply, management estimates that it would need to satisfy \$14.0 million of asbestos claims. Layered within the final \$25.0 million of the total \$271.5 million of coverage, management estimates that it would need to satisfy an additional \$80.0 million of asbestos claims. If required to pay any such amounts, the Company could pursue recovery against the insolvent carriers, but it is not currently possible to determine the likelihood or amount of any such recoveries, if any.

As of September 26, 2009, the Company recorded a receivable from its insurance carriers of \$90.0 million, which corresponds to the amount of its potential asbestos liability that is covered by available insurance and is currently determined to be probable of recovery. However, there is no assurance that \$271.5 million of insurance coverage will ultimately be available or that Zurn's asbestos liabilities will not ultimately exceed \$271.5 million. Factors that could cause a decrease in the amount of available coverage include: changes in law governing the policies, potential disputes with the carriers on the scope of coverage, and insolvencies of one or more of the Company's carriers.

As of the date of this report, subsidiaries, Zurn Pex, Inc. and Zurn Industries, LLC (formerly known as Zurn Industries, Inc.), have been named as defendants in thirteen lawsuits, brought between July 2007 and September 2009, in various U.S. federal courts (MN, ND, CO, NC, MT, AL, VA, LA, NM and MI). The plaintiffs in these suits seek to represent a class of plaintiffs alleging damages due to the alleged failure or anticipated failure of the Zurn brass crimp fittings on the PEX plumbing systems in homes and other structures. The complaints assert various causes of action, including but not limited to negligence, breach of warranty, fraud, and violations of the Magnuson Moss Act and certain state consumer protection laws, and seek declaratory and injunctive relief, and damages (including punitive damages) in unspecified amounts. The suits were transferred to a multi-district litigation docket in the District of Minnesota for coordinated pretrial proceedings. While the Company intends to vigorously defend itself in these actions, the uncertainties of litigation and the uncertainties related to insurance coverage and collection as well as the actual number or value of claims make it difficult to accurately predict the financial effect these claims may ultimately have on the Company.

## 12. Retirement Benefits

The components of net periodic benefit cost (income) are as follows (in millions):

	Second Quarter Ended		Six Months Ended	
	September 27, 2008	September 26, 2009	September 27, 2008	September 26, 2009
<b>Pension Benefits:</b>				
Service cost	\$ 1.2	\$ 0.8	\$ 2.4	\$ 1.6
Interest cost	8.8	8.8	17.6	17.7
Expected return on plan assets	(12.5)	(7.5)	(25.0)	(14.9)
Amortization of:				
Prior service cost	0.1	0.1	0.2	0.2
Actuarial losses	-	3.7	-	7.3
Net periodic benefit cost (income)	\$ (2.4)	\$ 5.9	\$ (4.8)	\$ 11.9
<b>Other Postretirement Benefits:</b>				
Service cost	\$ 0.2	\$ -	\$ 0.3	\$ 0.1
Interest cost	0.7	0.5	1.5	0.9
Amortization:				
Prior service cost	(0.1)	(0.5)	(0.1)	(1.0)
Actuarial losses	0.1	-	0.1	-
Net periodic benefit cost	\$ 0.9	\$ -	\$ 1.8	\$ -

In the first six months of fiscal 2009 and 2010, the Company made contributions of \$1.2 million and \$2.5 million, respectively, to its U.S. qualified pension plan trusts.

## 13. Stock Options

As a nonpublic entity that used the minimum value method for pro forma disclosure purposes under prior authoritative literature, the Company adopted ASC 718, *Compensation-Stock Compensation* (“ASC 718”), using the prospective transition method of adoption on April 1, 2006. Accordingly, the provisions of this guidance are applied prospectively to new awards and to awards modified, repurchased or cancelled after the adoption date. In connection with the acquisition of the Company by Apollo Management, L.P. (“Apollo”) on July 21, 2006, all previously outstanding stock options became fully vested and were either cashed out or rolled into fully-vested stock options of Rexnord Holdings. On July 22, 2006, a total of 577,945 of stock options were rolled over, each with an exercise price of \$7.13. As of September 26, 2009, 509,204 of these rollover stock options remain outstanding.

In connection with the acquisition of the Company by Apollo on July 21, 2006, the Board of Directors of Rexnord Holdings also adopted, and stockholders approved, the 2006 Stock Option Plan of Rexnord Holdings, Inc. (the “Option Plan”). Persons eligible to receive options under the Option Plan include officers, employees or directors of Rexnord Holdings or any of its subsidiaries and certain consultants and advisors to Rexnord Holdings or any of its subsidiaries. The maximum number of shares of Rexnord Holdings common stock that may be issued or transferred pursuant to options under the Option Plan equals 2,700,000 shares (excluding rollover options mentioned above). Approximately 50% of the options granted under the Option Plan vest ratably over five years from the date of grant; the remaining 50% of the options are eligible to vest based on the Company’s achievement of earnings before interest, taxes, depreciation and amortization (“EBITDA”) targets and debt repayment targets for fiscal years 2007 through 2014.

The fair value of each option granted under the Option Plan during the second quarter and six months ended September 26, 2009 was estimated on the date of grant using the Black-Scholes valuation model that uses the following assumptions: expected volatility of 33% based on the expected volatilities of publicly-traded companies within the Company’s industry; an expected term of 7.5 years based on the midpoint between when the options vest and when they expire; a weighted average risk free interest rate of 3.26% based on the U.S. Treasury yield curve in effect at the date of grant; and expected dividends of zero. The weighted average grant date fair value of the 390,850 options granted under the Option Plan between April 1, 2009 and September 26, 2009 was \$8.58.

For the second quarter and six months ended September 27, 2008, the Company recorded \$1.4 million and \$3.2 million, respectively, of stock-based compensation expense. For the second quarter and six months ended September 26, 2009, the Company recorded \$1.7 million and \$3.0 million, respectively, of stock-based compensation expense. As of September 26, 2009, there was \$11.3 million of total unrecognized compensation cost related to non-vested stock options granted under the Option Plan. That cost is expected to be recognized over a weighted average period of 2.5 years.

The following table presents the Company's stock option activity during the six month period ended September 27, 2008 and September 26, 2009:

		<b>Period from April 1, 2008 through September 27, 2008</b>		<b>Period from April 1, 2009 through September 26, 2009</b>	
		<b>Shares</b>	<b>Weighted Avg. Exercise Price</b>	<b>Shares</b>	<b>Weighted Avg. Exercise Price</b>
Number of shares under option:					
Outstanding at beginning of period	(1)	2,795,887	\$ 17.47	2,721,505	\$ 17.69
Granted		44,900	40.00	390,850	20.00
Exercised		-	-	(75,323)	14.83
Canceled/Forfeited		(57,624)	19.94	(471,426)	19.94
Outstanding at end of period	(1) (2)	<u>2,783,163</u>	<u>\$ 17.78</u>	<u>2,565,606</u>	<u>\$ 17.72</u>
Exercisable at end of period	(3)	<u>1,709,574</u>	<u>\$ 13.54</u>	<u>1,304,683</u>	<u>\$ 15.06</u>

(1) Includes 509,204 roll-over options.

(2) The weighted average remaining contractual life of options outstanding at September 26, 2009 is 7.6 years.

(3) The weighted average remaining contractual life of options exercisable at September 26, 2009 is 7.0 years.

#### 14. Business Segment Information

The results of operations are reported in two business segments, consisting of the Power Transmission platform and the Water Management platform. The Power Transmission platform manufactures gears, couplings, industrial bearings, flattop chain and modular conveyer belts, aerospace bearings and seals, special components and industrial chain and conveying equipment serving the industrial and aerospace markets. This segment serves a diverse group of end market industries, including aerospace, aggregates and cement, air handling, construction, chemicals, energy, beverage and container, forest and wood products, mining, material and package handling, marine, natural resource extraction and petrochemical. The Water Management platform manufactures professional grade specification plumbing, PEX piping, commercial brass and water and wastewater treatment and control products serving the infrastructure, commercial and residential markets. Categories of the infrastructure end market include: municipal water and wastewater, transportation, government, health care and education. Categories of the commercial construction end market include: lodging, retail, dining, sports arenas, and warehouse/office. The financial information of the Company's segments is regularly evaluated by the chief operating decision makers in determining resource allocation and assessing performance and is periodically reviewed by the Company's Board of Directors. Management evaluates the performance of each business segment based on its operating results.

Business Segment Information:  
(In Millions)

	Second Quarter Ended		Six Months Ended	
	September 27, 2008	September 26, 2009	September 27, 2008	September 26, 2009
<b>Net sales</b>				
Power Transmission	\$ 353.6	\$ 238.4	\$ 694.2	\$ 472.8
Water Management	157.0	131.3	312.5	264.8
Consolidated	<u>\$ 510.6</u>	<u>\$ 369.7</u>	<u>\$ 1,006.7</u>	<u>\$ 737.6</u>
<b>Income from operations</b>				
Power Transmission	\$ 48.3	\$ 24.0	\$ 94.3	\$ 38.6
Water Management	22.2	22.4	45.3	41.6
Corporate	(1.2)	(8.3)	(7.0)	(18.0)
Consolidated	<u>\$ 69.3</u>	<u>\$ 38.1</u>	<u>\$ 132.6</u>	<u>\$ 62.2</u>
<b>Non-operating expense:</b>				
Interest expense, net	(58.5)	(49.4)	(116.7)	(98.0)
Gain on debt extinguishment	-	-	-	152.4
Other income (expense), net	1.0	8.2	(1.2)	7.2
Income (loss) before income taxes	11.8	(3.1)	14.7	123.8
Provision (benefit) for income taxes	6.5	(0.8)	9.2	43.8
Net income (loss)	<u>\$ 5.3</u>	<u>\$ (2.3)</u>	<u>\$ 5.5</u>	<u>\$ 80.0</u>
<b>Restructuring charges and other similar costs (included in Income from operations)</b>				
Power Transmission	\$ -	\$ 0.8	\$ -	\$ 2.7
Water Management	-	-	-	0.5
Consolidated	<u>\$ -</u>	<u>\$ 0.8</u>	<u>\$ -</u>	<u>\$ 3.2</u>
<b>Depreciation and Amortization</b>				
Power Transmission	\$ 20.6	\$ 20.3	\$ 40.7	\$ 40.4
Water Management	7.9	6.4	14.9	12.9
Consolidated	<u>\$ 28.5</u>	<u>\$ 26.7</u>	<u>\$ 55.6</u>	<u>\$ 53.3</u>
<b>Capital Expenditures</b>				
Power Transmission	\$ 10.7	\$ 4.1	\$ 20.7	\$ 7.4
Water Management	0.9	0.6	1.9	1.9
Consolidated	<u>\$ 11.6</u>	<u>\$ 4.7</u>	<u>\$ 22.6</u>	<u>\$ 9.3</u>
	<u>March 31, 2009</u>	<u>September 26, 2009</u>		
<b>Total Assets</b>				
Power Transmission	\$ 2,324.0	\$ 2,190.5		
Water Management	828.6	807.2		
Corporate	66.2	55.0		
Consolidated	<u>\$ 3,218.8</u>	<u>\$ 3,052.7</u>		

## **15. Subsequent Events**

### **Amended and Restated Credit Agreement**

On October 5, 2009, Chase Acquisition I, Inc. (the direct parent of RBS Global, Inc.), RBS Global, Inc., and Rexnord LLC (collectively, the “Issuers”), Credit Suisse, Cayman Islands Branch, as administrative agent (the “Administrative Agent”) and the lenders party thereto entered into an Amended and Restated Credit Agreement (the “Amended and Restated Credit Agreement”), amending and restating the credit agreement dated as of July 21, 2006, to, among other things: (i) allow for one or more future issuances of secured notes, which may include, in each case, indebtedness secured on a pari passu basis with the obligations under the Amended and Restated Credit Agreement, so long as, in each case, among other things, an agreed amount of the net cash proceeds from any such issuance are used to prepay term loans under the Amended and Restated Credit Agreement at par; (ii) subject to the requirement to make such offers on a pro rata basis to all lenders, allow the Issuers to agree with individual lenders to extend the maturity of their term loans or revolving commitments, and for the Issuers to pay increased interest rates or otherwise modify the terms of their loans or revolving commitments in connection with such an extension; and (iii) allow for one or more future issuances of additional secured notes, which may include, in each case, indebtedness secured on a pari passu basis with the obligations under the Amended and Restated Credit Agreement, in an amount not to exceed the amount of incremental facility availability under the Amended and Restated Credit Agreement.

### **Amended and Restated Guarantee and Collateral Agreement**

On October 5, 2009, the Issuers, the subsidiary guarantors party thereto, and the Administrative Agent entered into an Amended and Restated Guarantee and Collateral Agreement (the “Amended and Restated Guarantee and Collateral Agreement”). Pursuant to the Amended and Restated Guarantee and Collateral Agreement, future issuances of secured notes may be secured by substantially all of the assets of the Issuers and the assets of certain subsidiaries on a pari passu basis with obligations under the Amended and Restated Credit Agreement, and the Administrative Agent is authorized to act as the Authorized Representative for the secured parties.

At this time, an estimate of the financial effect of these amendments cannot be made as the events that will lead to a change in the future cash flows related to this debt cannot be determined.

### **Retirement of a portion of Holdings’ outstanding PIK Toggle Senior Indebtedness Due 2013**

On October 19, 2009, Rexnord Holdings, Inc. purchased from Apollo, its majority owner, and extinguished \$43.8 million of outstanding face value of its PIK Toggle Senior Indebtedness due 2013 for \$28.0 million in cash. The purchase price of the notes was based on indicative market values for similar issuers. As a result, the Company will recognize a gain of approximately \$15.4 million in its third quarter of fiscal 2010. The gain was measured based on the difference between the cash paid and the net carrying amount of the debt (the net carrying amount of the debt included unamortized original issue discount of \$0.3 million and unamortized debt issuance costs of \$0.4 million) along with the forgiveness of \$0.4 million of accrued interest.

### **Revolving Credit Line Fulfillment**

On November 3, 2009 Barclays Bank, PLC assumed the \$7.5 million commitment under the Company’s revolving credit line that was previously unfulfilled due to the Lehman bankruptcy.