



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

*As of January 1, 2011 and March 31, 2010  
and for the three and nine months ended  
January 1, 2011 and December 26, 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 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 March 31, 2010 and January 1, 2011 and for the three and nine month periods ended December 26, 2009 and January 1, 2011. 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, 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 2011” or “fiscal 2011” means the period from April 1, 2010 to March 31, 2011).

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” in our Annual Report for the fiscal year ended March 31, 2010, 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

*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 the third quarter and nine months ended January 1, 2011 as compared to the performance for the same periods of the prior year.

*Non-GAAP Financial Measures.* This section provides an analysis of the Non-GAAP financial measures that we believe are important under our senior secured credit facilities and PIK toggle senior indebtedness.

*Liquidity and Capital Resources.* This section provides an analysis of our cash flows for the nine months ended January 1, 2011, 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 believe we are a leading, global multi-platform industrial company strategically positioned within the markets and industries we serve. Currently, our business is comprised of two strategic platforms, Process & Motion Control and Water Management. Our Process & Motion Control platform designs, manufactures, markets and services specified, highly-engineered mechanical components used within complex systems where our customers' reliability requirements and cost of failure or downtime is extremely high. The Process & Motion Control product portfolio includes gears, couplings, industrial bearings, aerospace bearings and seals, FlatTop modular belting, engineered chain and conveying equipment. Our Water Management platform designs, procures, manufactures and markets products that provide and enhance water quality, safety, flow control and conservation. The Water Management product portfolio includes professional grade specification drainage products, flush valves and faucet products, Pex piping and engineered valves and gates for the water and wastewater treatment market.

Our strategy is to build the Company around multiple, 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 a track record of acquiring and integrating companies 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 Process & Motion Control products in the industrial and aerospace end markets. Our Process & Motion Control products are used in the operations 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. Through recent acquisitions, we have gained entry into the municipal water and wastewater treatment markets. Typically, our Process & Motion Control products are initially incorporated into products sold by OEMs or sold to end users as critical components in large, complex systems where the cost of failure or downtime is high and thereafter replaced through industrial distributors as they are consumed or require replacement. The demand for our Water Management products is primarily driven by new infrastructure, the retro-fit of existing structures to make them more energy and water efficient, 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. Due to the similarity of our products across our portfolio of products, historically we have not experienced significant changes in gross margins due to changes in sales product mix or sales channel mix.

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, 2010.

### **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 Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") section of the Company's Annual Report for the fiscal year ended March 31, 2010 for information with respect to the Company's critical accounting policies, 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 January 1, 2011 and during the period from April 1, 2010 through January 1, 2011, there has been no material change to this information.

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

During the third quarter ended January 1, 2011, we completed the testing of our indefinite lived intangible assets (tradenames) and goodwill for impairment in accordance with ASC 350, *Intangibles - Goodwill and Other* ("ASC 350"). Pursuant to the guidance, an impairment loss is recognized if the estimated fair value of the intangible asset or reporting unit is less than its carrying amount. The fair value of our indefinite lived intangible assets and reporting units were primarily estimated using an income valuation model (discounted cash flow) and market approach (guideline public company comparables), which indicated that the fair value of our indefinite lived intangible assets and reporting units exceeded their carrying value, therefore, no impairment was present. The estimated fair value of our reporting units was dependent on several significant assumptions, including our weighted average cost of capital (discount rate) and future earnings and cash flow projections.

### ***Mecánica Falk Acquisition***

On August 31, 2010, we acquired full control of Mecánica Falk S.A. de C.V. ("Mecánica Falk"), a joint venture in which we previously maintained a 49% non-controlling interest. Located in Mexico City, Mexico, Mecánica Falk primarily serves as a distributor of our existing Process & Motion Control product lines in Latin America. The acquisition of the remaining 51% interest in Mecánica Falk provides us with the opportunity to expand our international presence through a more direct ownership structure. Mecánica Falk's results of operations have been wholly consolidated in all periods subsequent to August 31, 2010.

Due to the pre-existing 49% ownership interest in Mecánica Falk, this acquisition was accounted for as a step acquisition in accordance with ASC 805, *Business Combinations* ("ASC 805"). Accordingly, we recognized a gain of \$3.4 million in connection with this transaction to record our 49% ownership interest in Mecánica Falk at fair value on the acquisition date (The fair value was determined using a combination of the income approach and market approach. In completing this valuation management considered future earnings and cash flow potential of the business, earnings multiples, and recent market transactions of similar businesses). The transaction was consummated through a redemption of the exiting shareholders' shares in exchange for a \$6.1 million seller-financed note, which will be repaid in ratable installments over the next several quarters. Excluding the seller-financed note, we acquired net assets of \$12.1 million, including \$8.0 million of intangible assets (comprised of \$4.4 million of customer relationships and \$3.6 million of goodwill) and \$1.2 million of cash. Certain information about Mecánica Falk is not presented (e.g. pro forma financial information and allocation of purchase price) as the disclosure of such information is not material to our results of operations or financial position.

### ***Recent Accounting Pronouncements***

There have been no new accounting pronouncements issued during the first nine months of fiscal 2011 that will have a material impact on our financial statements. Additionally, we have not adopted any new accounting pronouncements during the first nine months of fiscal 2011.

### ***Evaluation of Subsequent Events***

The Company evaluated subsequent events from the balance sheet date of January 1, 2011 through February 17, 2011 (the date of this report) and has concluded that no subsequent events have occurred during this period.

### ***Fiscal Year***

Our fiscal year ends on March 31. Throughout this MD&A, we refer to the period from October 3, 2010 through January 1, 2011 as the “third quarter of fiscal 2011” or the “third quarter ended January 1, 2011.” Similarly, we refer to the period from September 27, 2009 through December 26, 2009 as the “third quarter of fiscal 2010” or the “third quarter ended December 26, 2009.” We refer to the period from April 1, 2010 through January 1, 2011 as the “first nine months of fiscal 2011” or the “nine months ended January 1, 2011.” Similarly, we refer to the period from April 1, 2009 through December 26, 2009 as the “first nine months of fiscal 2010” or the “nine months ended December 26, 2009.”

### ***Results of Operations***

Net sales for the third quarter of fiscal 2011 were \$419.8 million, an increase of 14.8% compared to the third quarter of fiscal 2010, while net sales for the first nine months of fiscal 2011 were \$1,239.4 million, an increase of 12.3% compared to the first nine months of fiscal 2010. The year-over-year net sales increase is a result of the increased demand we are experiencing across the majority of our Process & Motion Control end-markets and low single-digit growth in our Water Management end-markets.

Our backlog as of January 1, 2011 was \$394 million compared to \$359 million as of March 31, 2010, an increase of approximately 9.8% in the first nine months. The backlog improvement during the first nine months of fiscal 2011 is primarily the result of strong order rates within our Process & Motion Control businesses.

Income from operations for the third quarter of fiscal 2011 increased 35.8% to \$50.4 million compared to the third quarter of fiscal 2010, while income from operations for the first nine months of fiscal 2011 increased 53.9% to \$152.8 million compared to the first nine months of fiscal 2010. Comparability of results is impacted by \$1.1 million and \$4.3 million of restructuring expenses that were included in income from operations during the third quarter and first nine months of fiscal 2010, respectively. Excluding restructuring, income from operations would have increased by 31.9% in the third quarter of fiscal 2011 and by 47.5% in the first nine months of fiscal 2011 versus the comparable prior year periods. Excluding restructuring, income from operations as a percent of net sales would have increased by 160 basis points to 12.0% in the third quarter and by 290 basis points to 12.3% in the first nine months of fiscal 2011 versus the comparable prior year periods. The improvement in income from operations as a percent of net sales in both periods was primarily driven by the impact of operating leverage on higher year-over-year net sales and productivity gains, partially offset by higher material costs and targeted investments in new product development and global growth capabilities.

**Third Quarter Ended January 1, 2011 Compared with the Third Quarter Ended December 26, 2009:**

**Net sales**

(Dollars in Millions)

	Quarter Ended		Change	% Change
	December 26, 2009	January 1, 2011		
Process & Motion Control	\$ 246.4	\$ 299.6	\$ 53.2	21.6%
Water Management	119.3	120.2	0.9	0.8%
Consolidated	<u>\$ 365.7</u>	<u>\$ 419.8</u>	<u>\$ 54.1</u>	14.8%

Process & Motion Control

Process & Motion Control net sales in the third quarter of fiscal 2011 were \$299.6 million, an increase of 21.6% from \$246.4 million in the third quarter of fiscal 2010. Foreign currency fluctuations unfavorably impacted net sales by 0.9% during the third quarter primarily driven by the unfavorable impact of our Euro denominated sales translated to U.S. Dollars. Excluding foreign currency fluctuations, year-over-year core net sales increased by 22.5%. The year-over-year increase in net sales is driven by solid international growth, improving end-market demand in our North American businesses and market share gains across many of our businesses.

Water Management

Water Management net sales in the third quarter of fiscal 2011 were \$120.2 million, an increase of 0.8% from \$119.3 million in the third quarter of fiscal 2010. Foreign currency fluctuations favorably impacted net sales by approximately 0.4% during the quarter due primarily to the favorable impact of our Canadian Dollar denominated sales translated to U.S. Dollars. Excluding foreign currency fluctuations, year-over-year core net sales increased by 0.4%. Market share gains and growth in alternative markets offset the overall decline in the core infrastructure and non-residential construction markets.

**Income from operations**

(Dollars in Millions)

	Quarter Ended		Change	% Change
	December 26, 2009	January 1, 2011		
Process & Motion Control	\$ 27.7	\$ 45.1	\$ 17.4	62.8 %
% of net sales	11.2%	15.1%	3.9 %	
Water Management	16.6	13.3	(3.3)	(19.9)%
% of net sales	13.9%	11.1%	(2.8)%	
Corporate	(7.2)	(8.0)	(0.8)	(11.1)%
Consolidated	<u>\$ 37.1</u>	<u>\$ 50.4</u>	<u>\$ 13.3</u>	35.8 %
% of net sales	10.1%	12.0%	1.9 %	

Process & Motion Control

Process & Motion Control income from operations for the third quarter of fiscal 2011 improved 62.8% to \$45.1 million compared to the third quarter of fiscal 2010. Income from operations as a percent of net sales increased 390 basis points from the prior third quarter to 15.1%. Comparability of results is impacted by \$1.1 million of restructuring expenses that were included in income from operations during the third quarter of fiscal 2010. Excluding the effect of restructuring expenses, income from operations increased 56.6% and income from operations as a percent of net sales improved by 340 basis points from the comparable prior year period. The improvement in fiscal 2011 operating margin is primarily the result of operating leverage on higher year-over-year net sales volume, productivity gains and cost reductions, partially offset by higher material costs and targeted investments in new product development and global growth capabilities.

Water Management

Water Management income from operations for the third quarter of fiscal 2011 declined 19.9% to \$13.3 million compared to the third quarter of fiscal 2010. Income from operations as a percent of net sales decreased 280 basis points from the prior third quarter to 11.1%. The decline in fiscal 2011 operating margin is primarily due to higher year-over-year material costs and the impact of variability in the profitability of certain water and wastewater project shipments.

## Corporate

Corporate expenses increased by \$0.8 million, or 11.1%, from \$7.2 million in the third quarter of fiscal 2010 to \$8.0 million in the third quarter of fiscal 2011.

### ***Interest expense, net***

Interest expense, net was \$44.5 million in the third quarter of fiscal 2011 compared to \$47.0 million in the third quarter of fiscal 2010. The year-over-year reduction in interest expense is primarily the result of the lower weighted average fixed borrowing rates, partially offset by a slight increase in average debt outstanding as a result of the higher amount of notes issued in connection with the April 2010 refinancing.

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

During the third quarter of fiscal 2010, the Company purchased and extinguished \$43.8 million of outstanding face value PIK Toggle Senior Indebtedness due 2013 for \$28.0 million in cash. As a result, the Company recognized a \$15.4 million gain during the third quarter ended December 26, 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 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.

### ***Other expense, net***

Other expense, net for the quarter ended January 1, 2011, consists of management fee expense of \$0.8 million, foreign currency transaction losses of \$4.4 million, a CDSOA recovery of \$0.7 million and other miscellaneous losses of \$0.2 million. Other expense, net for the quarter ended December 26, 2009, consists of management fee expense of \$0.8 million, loss on the sale of fixed assets of \$0.4 million, foreign currency transaction losses of \$6.9 million, a CDSOA recovery of \$0.8 million and other miscellaneous losses of \$1.1 million.

### ***(Benefit) provision for income taxes***

The income tax provision was \$1.5 million in the third quarter of fiscal 2011 compared to an income tax benefit of \$11.1 million in the third quarter of fiscal 2010. The effective income tax rate for the third quarter of fiscal 2011 was 125.0% versus 382.8% in the third quarter of fiscal 2010. The effective income tax rate for the third quarter of fiscal 2011 includes the effect of the current recognition of certain foreign branch net income for U.S. income tax purposes 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, partially offset by the reduction of unrecognized income tax benefits which realization is now deemed more-likely-than-not. The extremely high effective income tax rate for the third quarter of fiscal 2010 is mainly due to the income tax benefit recognized as a result of a decrease in the liability for unrecognized tax benefits recorded during this period associated with the conclusion of the Internal Revenue Service ("IRS") examination and certain benefits provided under a new Brazilian tax settlement program.

### ***Net income (loss)***

Our net loss for the third quarter of fiscal 2011 was \$0.3 million compared to net income of \$8.2 million in the third quarter of fiscal 2010 as a result of the factors described above.

### ***Nine months ended January 1, 2011 Compared with the Nine months ended December 26, 2009:***

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

*(Dollars in Millions)*

	Nine Months Ended		Change	% Change
	December 26, 2009	January 1, 2011		
Process & Motion Control	\$ 719.2	\$ 847.2	\$ 128.0	17.8%
Water Management	384.1	392.2	8.1	2.1%
Consolidated	<u>\$ 1,103.3</u>	<u>\$ 1,239.4</u>	<u>\$ 136.1</u>	12.3%

#### Process & Motion Control

Process & Motion Control net sales in the first nine months of fiscal 2011 were \$847.2 million, an increase of 17.8% from \$719.2 million in the first nine months of fiscal 2010. Foreign currency fluctuations unfavorably impacted net sales by approximately 0.8% during the nine months primarily driven by the unfavorable impact of our Euro denominated sales

translated to U.S. Dollars. Excluding foreign currency fluctuations, year-over-year core net sales increased by 18.6%. The year-over-year increase in net sales is driven by solid growth in international sales, improving North America end-market demand and market share gains across many of our businesses.

### Water Management

Water Management net sales in the first nine months of fiscal 2011 were \$392.2 million, an increase of 2.1% from \$384.1 million in the first nine months of fiscal 2010. Foreign currency fluctuations favorably impacted net sales by approximately 0.5% during the nine months due primarily to the favorable impact of our Canadian Dollar denominated sales translated to U.S. Dollars. Excluding foreign currency fluctuations, year-over-year core net sales increased by 1.6%. Market share gains and growth in alternative markets offset the overall decline in the core infrastructure and non-residential construction markets.

### ***Income from Operations***

*(Dollars in Millions)*

	<b>Nine Months Ended</b>		<b>Change</b>	<b>% Change</b>
	<b>December 26, 2009</b>	<b>January 1, 2011</b>		
Process & Motion Control	\$ 66.3	\$ 121.9	\$ 55.6	83.9 %
<i>% of net sales</i>	<i>9.2%</i>	<i>14.4%</i>	<i>5.2 %</i>	
Water Management	58.2	54.9	(3.3)	(5.7)%
<i>% of net sales</i>	<i>15.2%</i>	<i>14.0%</i>	<i>(1.2)%</i>	
Corporate	(25.2)	(24.0)	1.2	4.8 %
Consolidated	<u>\$ 99.3</u>	<u>\$ 152.8</u>	<u>\$ 53.5</u>	<u>53.9 %</u>
<i>% of net sales</i>	<i>9.0%</i>	<i>12.3%</i>	<i>3.3 %</i>	

### Process & Motion Control

Process & Motion Control income from operations for the first nine months of fiscal 2011 nearly doubled, to \$121.9 million compared to the first nine months of fiscal 2010. Income from operations as a percent of net sales increased 520 basis points from the first nine months of the prior year to 14.4%. Comparability of results is impacted by \$3.8 million of restructuring expenses that were included in income from operations during the first nine months of fiscal 2010. Excluding the effect of restructuring expenses, income from operations would have increased 73.9%, and income from operations as a percent of net sales would have improved by 460 basis points from the comparable prior year period. The improvement in fiscal 2011 operating margin is primarily the result of increased leverage on higher year-over-year net sales volume, productivity gains and cost reductions, partially offset by higher material costs and targeted investments in new product development and global growth capabilities.

### Water Management

Water Management income from operations for the first nine months of fiscal 2011 declined 5.7% to \$54.9 million compared to the first nine months of fiscal 2010. Income from operations as a percent of net sales decreased 120 basis points from the first nine months of the prior year to 14.0%. Comparability of results is impacted by \$0.5 million of restructuring expenses that were included in income from operations during the first nine months of fiscal 2010. The decline in fiscal 2011 operating margin is primarily the result of higher year-over-year material costs and the impact of variability in the profitability of certain water and wastewater project shipments.

### Corporate

Corporate expenses decreased by \$1.2 million from \$25.2 million in the first nine months of fiscal 2010 to \$24.0 million in the first nine months of fiscal 2011.

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

Interest expense, net was \$136.7 million in the first nine months of fiscal 2011 compared to \$145.1 million in the first nine months of fiscal 2010. The year-over-year reduction in interest expense is primarily the result of the lower weighted average fixed borrowing rates, partially offset by a slight increase in average debt outstanding as a result of the incremental notes issued in connection with April 2010 refinancing.

### ***Gain (loss) on the extinguishment of debt***

During the first nine months of fiscal 2011 we recorded a \$100.8 million loss on debt extinguishment as a result of the cash tender offer for certain of RBS Global's outstanding debt, which we completed on May 5, 2010. See Liquidity and Capital Resources below for more details regarding this transaction. During the first nine months of fiscal 2010, we recorded a \$167.8 million gain on extinguishment as a result of the purchase and extinguishment of our PIK toggle senior indebtedness and our April 2009 debt exchange offer.

### ***Other expense, net***

Other expense, net for the nine months ended January 1, 2011, consists of management fee expense of \$2.3 million, loss on the sale of fixed assets of \$1.4 million, income in unconsolidated affiliates of \$4.0 million (including a \$3.4 million gain recorded as a result of our step acquisition of 100% of the voting shares in Mecánica Falk on August 31, 2010), foreign currency transaction losses of \$3.4 million, a CDSOA recovery of \$0.7 million and other miscellaneous losses of \$0.4 million. Other expense, net for the nine months ended December 26, 2009, consists of management fee expense of \$2.3 million, transaction costs associated with the debt exchange offer of \$6.0 million, foreign currency transaction gains of \$7.9 million, loss on the sale of fixed assets of \$0.6 million, income in unconsolidated affiliates of \$0.3 million, a CDSOA recovery of \$0.8 million and other miscellaneous losses of \$1.4 million.

### ***(Benefit) provision for income taxes***

The income tax benefit recorded in the first nine months of fiscal 2011 was \$29.8 million compared to an income tax provision of \$32.7 million in the first nine months of fiscal 2010. Our effective income tax rate for the first nine months of fiscal 2011 was 34.1% versus 27.1% in the first nine months of fiscal 2010. The effective income tax rate for the first nine months of fiscal 2011 includes the accrual of foreign income taxes at statutory rates which are generally below the U.S. federal statutory rate of 35.0% offset by an increase in the valuation allowance for U.S. foreign tax credits generated during this period for which realization of such benefits is not deemed more-likely-than-not. The effective income tax rate for the first nine months of fiscal 2010 is lower than the U.S. federal statutory rate of 35.0% mainly due to the income tax benefit recognized as a result of a decrease in the liability for unrecognized tax benefits recorded during this period associated with the conclusion of the IRS examination and certain benefits provided under a new Brazilian tax settlement program.

### ***Net income (loss)***

Our net loss for the first nine months of fiscal 2011 was \$57.7 million compared to our net income of \$88.0 million in the first nine months of fiscal 2010 due to the factors described above.

## **Non-GAAP Financial Measure**

In addition to net (loss) income, we believe Adjusted EBITDA (as described below in “Covenant Compliance”) is an important measure under our senior secured credit facilities and PIK toggle senior indebtedness, as our ability to incur certain types of acquisition debt and certain types of subordinated debt, make certain types of acquisitions or asset exchanges, operate our business and make dividends or other distributions, all of which will impact our financial performance, is impacted by our Adjusted EBITDA, as our lenders measure our performance by comparing the ratio of our senior secured bank debt to Adjusted EBITDA (see “Covenant Compliance” for additional discussion of this ratio). We reported Adjusted EBITDA of \$239.5 million in the first nine months of fiscal 2011, and net loss for the same period of \$57.7 million.

### ***Covenant Compliance***

The credit agreement and indentures that govern RBS Global's notes and Rexnord Holdings' PIK toggle senior indebtedness contain, among other provisions, restrictive covenants regarding indebtedness, payments and distributions, mergers and acquisitions, asset sales, affiliate transactions, capital expenditures and the maintenance of certain financial ratios. Payment of borrowings under the senior secured credit facilities and indentures that govern our notes may be accelerated if there is an event of default. Events of default include the failure to pay principal and interest when due, a material breach of a representation or warranty, covenant defaults, events of bankruptcy and a change of control. Certain covenants contained in the credit agreements that govern RBS Global's senior secured credit facilities and Rexnord Holdings' PIK toggle senior indebtedness restrict our ability to take certain actions, such as incurring additional debt or making acquisitions, if we are unable to meet certain maximum senior secured bank debt to Adjusted EBITDA ratios and, with respect to our revolving facility, also require us to remain at or below a certain maximum senior secured bank debt to Adjusted EBITDA ratio as of the end of each fiscal quarter. Certain covenants contained in the indentures that govern our notes restrict the ability to take certain actions, such as incurring additional debt or making acquisitions, if we are unable to achieve a minimum Adjusted EBITDA to Fixed Charges ratio. Under such indentures, the Company's ability to incur additional indebtedness and our ability to make future acquisitions under certain circumstances requires us to have an Adjusted EBITDA to Fixed Charges ratio (measured on a last twelve months, or LTM, basis) of at least 2.0:1.0 under RBS Global's indentures or 1.75:1.0 under Rexnord Holdings' credit agreement and indenture. Failure to comply with these covenants could limit our long-term growth prospects by hindering our ability to obtain future debt or make acquisitions.

“Fixed Charges” is defined in our indentures as net interest expense, excluding the amortization or write-off of deferred financing costs.

“Adjusted EBITDA” is defined in our credit facilities as net income, adjusted for the items summarized in the table below. Adjusted EBITDA is intended to show our unleveraged, pre-tax operating results and therefore reflects our financial performance based on operational factors, excluding non-operational, non-cash or non-recurring losses or gains. Adjusted EBITDA is not a presentation made in accordance with GAAP, and our use of the term Adjusted EBITDA varies from others in our industry. This measure should not be considered as an alternative to net income, income from operations or any other performance measures derived in accordance with GAAP. Adjusted EBITDA has important limitations as an analytical tool, and you should not consider it in isolation, or as a substitute for analysis of our results as reported under GAAP. For example, Adjusted EBITDA does not reflect: (a) our capital expenditures, future requirements for capital expenditures or contractual commitments; (b) changes in, or cash requirements for, our working capital needs; (c) the significant interest expenses, or the cash requirements necessary to service interest or principal payments, on our debt; (d) tax payments that represent a reduction in cash available to us; (e) any cash requirements for the assets being depreciated and amortized that may have to be replaced in the future; (f) management fees that may be paid to Apollo; or (g) the impact of earnings or charges resulting from matters that we and the lenders under our secured senior credit facilities may not consider indicative of our ongoing operations. In particular, our definition of Adjusted EBITDA allows us to add back certain non-cash, non-operating or non-recurring charges that are deducted in calculating net income, even though these are expenses that may recur, vary greatly and are difficult to predict and can represent the effect of long-term strategies as opposed to short-term results. In addition, certain of these expenses can represent the reduction of cash that could be used for other corporate purposes. Further, although not included in the calculation of Adjusted EBITDA below, the measure may at times allow us to add estimated cost savings and operating synergies related to operational changes ranging from acquisitions to dispositions to restructurings and/or exclude one-time transition expenditures that we anticipate we will need to incur to realize cost savings before such savings have occurred. As of the date of this posting, the calculation of Adjusted EBITDA under the credit agreement and indentures that govern RBS Global's notes and Rexnord Holdings' PIK toggle senior indebtedness result in a substantially identical calculation. However, the results of such calculations could differ in the future based on the different types of adjustments that may be included in such respective calculations at the time.

Set forth below is a reconciliation of net (loss) income to Adjusted EBITDA for the periods indicated below.

(in millions)	Nine months ended December 26, 2009	Year ended March 31, 2010	Nine months ended January 1, 2011	Twelve months ended January 1, 2011
Net income (loss)	\$ 88.0	\$ 85.1	\$ (57.7)	\$ (60.6)
Interest expense, net	145.1	194.2	136.7	185.8
Income tax provision (benefit)	32.7	28.6	(29.8)	(33.9)
Depreciation and amortization	81.6	109.3	79.6	107.3
<b>EBITDA</b>	<b>\$ 347.4</b>	<b>\$ 417.2</b>	<b>\$ 128.8</b>	<b>\$ 198.6</b>
<b>Adjustments to EBITDA:</b>				
Restructuring and other similar costs (1)	4.3	6.8	—	2.5
(Gain) loss on extinguishment of debt (2)	(167.8)	(167.8)	100.8	100.8
Stock option expense	4.1	5.5	4.1	5.5
Impact of inventory fair value adjustment (3)	0.3	0.3	—	—
LIFO expense (4)	3.4	1.7	3.0	1.3
CDSOA Recovery (5)	(0.8)	(0.8)	(0.7)	(0.7)
Other expense, net (6)	2.1	17.2	3.5	18.6
Subtotal of adjustments to EBITDA	\$ (154.4)	\$ (137.1)	\$ 110.7	\$ 128.0
<b>Adjusted EBITDA</b>	<b>\$ 193.0</b>	<b>\$ 280.1</b>	<b>\$ 239.5</b>	<b>\$ 326.6</b>
Fixed Charges of Rexnord Holdings, Inc. and subsidiaries (7)				\$ 176.9
Ratio of Adjusted EBITDA to Fixed Charges - Rexnord Holdings, Inc. and subsidiaries				<b>1.85x</b>
Fixed Charges of RBS Global, Inc. and subsidiaries (7)				\$ 170.0
Ratio of Adjusted EBITDA to Fixed Charges - RBS Global, Inc. and subsidiaries				<b>1.92x</b>
Net senior secured bank indebtedness (8)				\$ 460.1
Net senior secured bank leverage ratio (9)				<b>1.41x</b>

- (1) Represents costs incurred by the Company to reduce operating costs and improve profitability. These charges are primarily comprised of work force reductions, asset impairments and contract termination costs.
- (2) The gain on extinguishment of debt is a result of the purchase and extinguishment of our PIK toggle senior indebtedness and our debt exchange offer that we completed in fiscal 2010. The loss on extinguishment of debt is the result of the cash tender offer that RBS Global completed during the first quarter of fiscal 2011. See the "Liquidity and Capital Resources - Indebtedness" section below for further details.
- (3) Represents the incremental unfavorable expenses of selling inventories that had been adjusted to fair value in purchase accounting as a result of the acquisition of Fontaine-Alliance Inc. and affiliates.
- (4) Last-in first-out (LIFO) inventory adjustments are excluded in calculating Adjusted EBITDA as defined in our senior secured credit facilities.
- (5) Recovery under Continued Dumping and Subsidy Offset Act ("CDSOA") (see Note 4 of the Notes to the condensed consolidated financial statements for further information on CDSOA).
- (6) Other expense, net for the periods indicated below, consists of:

(in millions)	Nine months ended December 26, 2009	Year Ended March 31, 2010	Nine months ended January 1, 2011	Twelve months ended January 1, 2011
Management fee expense	\$ 2.3	\$ 3.0	\$ 2.3	\$ 3.0
(Gain) loss on foreign currency transactions	(7.9)	4.3	3.4	15.6
Loss on the sale of fixed assets	0.6	2.5	1.4	3.3
Equity in earnings of unconsolidated affiliates	(0.3)	(0.5)	(4.0)	(4.2)
Other expense	7.4	7.9	0.4	0.9
Total	<b>\$ 2.1</b>	<b>\$ 17.2</b>	<b>\$ 3.5</b>	<b>\$ 18.6</b>

- (7) The indentures governing Rexnord Holdings' PIK toggle senior indebtedness and RBS Global's senior notes define fixed charges as interest expense excluding the amortization or write-off of deferred financing costs for the trailing four quarters.
- (8) The RBS Global senior secured credit facilities define net senior secured bank indebtedness as consolidated secured indebtedness for borrowed money, less unrestricted cash, which was \$301.9 million (as defined by RBS Global's senior secured credit facilities) at January 1, 2011. Net senior secured bank indebtedness reflected in the table consists of borrowings under RBS Global's senior secured credit facilities.
- (9) The senior secured credit facilities define the net senior secured bank leverage ratio as the ratio of net senior secured bank debt to Adjusted EBITDA for the trailing four fiscal quarters.

## **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.

As of January 1, 2011, we had \$318.8 million of cash and cash equivalents and approximately \$202.6 million of additional borrowings available to us (\$122.2 million of available borrowings under our revolving credit facility and \$80.4 million available under our accounts receivable securitization program). As of March 31, 2010, we had \$263.9 million of cash and approximately \$207.4 million of additional borrowings available to us (\$118.6 million of available borrowings under our revolving credit facility and \$88.8 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.

### ***Cash Flows***

Net cash provided by operating activities in the first nine months of fiscal 2011 was \$76.5 million compared to \$139.2 million in the first nine months of fiscal 2010. The decrease in cash provided by operating activities was primarily driven by a \$91.8 million increase in trade working capital (accounts receivable, inventories and accounts payable), as a result of the year-over-year change in sales volume as well as a \$21.6 million increase in cash interest as compared to the prior year. That increase was partially offset by \$12.4 million of lower cash restructuring and approximately \$38.3 million of incremental cash flows generated on \$136.1 million of higher net sales year-over-year.

Cash used for investing activities was \$17.6 million in the first nine months of fiscal 2011 compared to a use of \$13.6 million in the first nine months of fiscal 2010. The year-over-year increase in cash used for investing activities relates to a \$6.1 million increase in capital expenditures partially offset by the net cash acquired in connection with the acquisition of Mecánica Falk (excluding a \$6.1 million seller-financed note payable assumed in connection with the acquisition) and \$0.9 million of cash proceeds received in connection with the sale of our 9.5% interest in a non-core joint venture within our Water Management platform during the first nine months of fiscal 2011.

Cash used for financing activities was \$5.4 million in the first nine months of fiscal 2011 compared to a use of \$159.3 million in the first nine months of fiscal 2010. The cash used for financing activities in the first nine months of fiscal 2011 consisted of a source of cash from the issuance of \$1,145.0 million of 8.50% Senior Notes due 2018 (the "8.50% Notes"), the proceeds of which were utilized to retire \$1,067.4 million of previously outstanding senior notes, pay the \$63.5 million tender premium to holders of the retired senior notes, as well as \$14.6 million of related debt issue costs. Additionally, we made repayments of \$3.0 million of other long-term debt (including a \$1.5 million payment on RBS Global's term loan and a \$0.9 million payment to redeem 100% of RBS Global's then outstanding 9.50% senior notes) and \$0.2 million of net short-term borrowings at various foreign subsidiaries. The current year also includes a \$1.0 million use of cash for the purchase of common stock and \$1.2 million of net cash used resulting from stock option exercises and subsequent repurchases of shares. Cash used for financing activities was \$159.3 million in the first nine months of fiscal 2010 and consisted of a \$36.5 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 \$116.2 million of repayments on our revolving credit facility (\$82.7 million), AR Securitization facility (\$30 million) and other borrowings (\$3.5 million). The current year also includes a \$0.4 million use of cash for the purchase of common stock and a net use of \$1.3 million related to stock option exercises and stock repurchases.

## Indebtedness

As of January 1, 2011 we had \$2,312.8 million of total indebtedness outstanding as follows (in millions):

	Total Debt at January 1, 2011	Short-term Debt and Current Maturities of Long- Term Debt	Long-term Portion
Term loans	\$ 762.0	\$ 2.0	\$ 760.0
PIK toggle senior indebtedness due 2013 (1)	90.7	—	90.7
8.50% Senior notes due 2018	1,145.0	—	1,145.0
8.875% Senior notes due 2016	2.0	—	2.0
11.75% Senior subordinated notes due 2016	300.0	—	300.0
10.125% Senior subordinated notes due 2012	0.3	—	0.3
Other (2)	12.8	9.6	3.2
Total Debt	<u>\$ 2,312.8</u>	<u>\$ 11.6</u>	<u>\$ 2,301.2</u>

- (1) Includes an unamortized bond issue discount of \$0.6 million and \$0.5 million at March 31, 2010 and January 1, 2011, respectively.
- (2) Includes, at January 1, 2011, \$4.7 million outstanding principal related to a seller-financed note payable incurred in connection with the acquisition of Mecánica Falk on August 31, 2010 (see Note 2).

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 (the “Holdco 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 (see Note 15 of the Notes to the condensed consolidated financial statements for further information on stock options). The PIK Toggle Loans (the “Holdco Loans”) issued pursuant to the Holdco 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%.

In fiscal 2009, we completed an exchange offer with respect to the Holdco Loans. Approximately \$460.8 million of the then outstanding Holdco Loans were tendered and exchanged for PIK Toggle Senior Notes due 2013 (the “Old Holdco Notes”). The Holdco Loans that were not tendered for exchange continue to be governed by the terms and conditions of the Holdco Credit Agreement while the Holdco Loans tendered and exchanged for Old Holdco Notes are governed by the terms and conditions of an indenture. The Old Holdco 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 Old Holdco Notes are substantially the same as the terms of the Holdco 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 Old Holdco 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 Holdco Loans is payable quarterly (also generally at the three month LIBOR in effect for the interest period plus 7.0% per annum), (2) the Old Holdco Notes were issued pursuant to the indenture, (3) a change of control is not an event of default under the Old Holdco Notes but instead requires us to make an offer to purchase the Old Holdco 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 Holdco Credit Agreement. None of our subsidiaries currently guarantee any of our indebtedness, so there are no guarantors of the Old Holdco Notes or of the Holdco Loans. The Old Holdco Notes and the Holdco Loans are required to be guaranteed by any of our domestic subsidiaries which in the future may guarantee our indebtedness. We refer to the Holdco Loans and the Old Holdco Notes collectively as the PIK toggle senior indebtedness.

As of January 1, 2011, the interest rate was 7.29% for both the Old Holdco Notes and Holdco Loans. As of March 31, 2010, the interest rate was 7.25% for both the Old Holdco Notes and Holdco Loans. Pursuant to the terms of the Holdco Credit Agreement and the indenture, Rexnord Holdings has elected to pay interest in-kind and has accordingly paid interest with additional Old Holdco Notes and Holdco Loans, as the case may be, on pre-determined interest rate reset dates.

During the nine months ended January 1, 2011, \$4.3 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 Holdco Credit Agreement, would have been at least 1.75 to 1.00, or, 2.00 to 1.00 in the case of RBS Global, Inc. and subsidiaries, including the pro forma application of the additional indebtedness or equity issuance.

### ***RBS Global, Inc. and Subsidiaries Long-Term Debt***

#### ***Senior Secured Credit Facility***

On October 5, 2009, RBS Global entered into an Amended and Restated Credit Agreement (the "Credit Agreement") amending and restating the credit agreement dated as of July 21, 2006. The senior secured credit facilities provided under the Credit Agreement are funded by 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 January 1, 2011, 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 \$192.0 million term loan B2 facility. Borrowings under the term loan B1 facility accrue interest, at RBS Global'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 RBS Global'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 January 1, 2011 was 3.67%.

Borrowings under RBS Global's \$150.0 million revolving credit facility accrue interest, at RBS Global'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. In addition, \$31.4 million and \$27.8 million of the revolving credit facility was considered utilized in connection with outstanding letters of credit at March 31, 2010 and January 1, 2011, respectively.

The Credit Agreement, among other things: (i) allows 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 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 Credit Agreement at par; (ii) subject to the requirement to make such offers on a pro rata basis to all lenders, allows RBS Global to agree with individual lenders to extend the maturity of their term loans or revolving commitments, and for RBS Global to pay increased interest rates or otherwise modify the terms of their loans or revolving commitments in connection with such an extension; and (iii) allows 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 Credit Agreement, in an amount not to exceed the amount of incremental facility availability under the Credit Agreement.

In addition to paying interest on outstanding principal under the senior secured credit facilities, RBS Global 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). RBS Global also must pay customary letter of credit and agency fees.

As of January 1, 2011, the remaining mandatory principal payments prior to maturity on both the term loan B1 and B2 facilities are \$1.2 million and \$5.0 million, respectively. RBS Global 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. RBS Global 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 typical covenants that, among other things, constrain, subject to certain fully-negotiated exceptions, RBS Global's ability, and the ability of RBS Global'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 certain indebtedness (including the senior notes and senior subordinated notes); 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. RBS Global's senior secured credit facilities limit RBS Global's maximum senior secured bank leverage ratio to 4.25 to 1.00. As of January 1, 2011, the senior secured bank leverage ratio was 1.41 to 1.00.

### ***Senior Notes and Senior Subordinated Notes***

#### **April 2010 Cash Tender Offers and \$1,145.0 Million Note Offering**

On May 5, 2010, RBS Global finalized the results of the cash tender offers and consent solicitations launched on April 7, 2010 with respect to any and all of its outstanding (i) 9.50% Senior Notes due 2014 issued in 2006 (the "2006 9.50% Notes"), (ii) 9.50% Senior Notes due 2014 issued in April 2009 (the "2009 9.50% Notes" and, together with the 2006 9.50% Notes, the "9.50% Notes") and (iii) 8.875% Senior Notes due 2016 (the "8.875% Notes"). Upon completion of the tender offers, 99.7% of the holders had tendered their notes and consented to the proposed amendments. At closing, (i) \$0.9 million aggregate principal amount of the 2006 9.50% Notes, (ii) \$13,000 aggregate principal amount of the 2009 9.50% Notes and (iii) \$2.0 million aggregate principal amount of the 8.875% Notes had not been tendered, and remained outstanding.

In connection with the April 2010 tender offers and consent solicitations, on April 20, 2010, RBS Global entered into supplemental indentures by and among RBS Global, each of the guarantors party thereto, and Wells Fargo Bank, National Association, as Trustee, pursuant to which the 2006 9.50% Notes, 2009 9.50% Notes and 8.875% Notes were issued (as amended and supplemented, the "Supplemental Indentures"). The Supplemental Indentures amended the terms governing the respective notes to, among other things, eliminate substantially all of the material restrictive covenants, eliminate or modify certain events of default and eliminate or modify related provisions in the respective indentures governing the notes.

On April 28, 2010, RBS Global issued \$1,145.0 million aggregate principal amount of 8.50% Senior Notes due 2018 (the "8.50% Notes") in a private offering. The proceeds from the offering were used to fund (including transaction costs) the cash tender offers discussed above. The 8.50% Notes will mature on May 1, 2018, pursuant to an indenture, dated as of April 28, 2010, by and among RBS Global, the guarantors named therein, and Wells Fargo Bank, National Association, as Trustee. RBS Global pays interest on the 8.50% Notes at 8.50% per annum, semiannually on May 1 and November 1 of each year, commencing on November 1, 2010.

RBS Global accounted for the cash tender offers and the issuance of the 8.50% Notes in accordance with ASC 470-50, *Debt Modifications and Extinguishments* (“ASC 470-50”). Pursuant to this guidance, the cash tender offers were accounted for as an extinguishment of debt. In connection with the offering, RBS Global incurred an increase in long-term debt of approximately \$89.5 million. RBS Global recognized a \$100.8 million loss on the debt extinguishment in the fiscal quarter ended July 3, 2010, which was comprised of a bond tender premium paid to lenders, as well as the non-cash write-off of deferred financing fees and net original issue discount associated with the extinguished debt. Additionally, RBS Global capitalized approximately \$14.6 million of third party transaction costs, which are being amortized over the life of the 8.50% Notes as interest expense using the effective interest method. Below is a summary of the transaction costs and other offering expenses recorded along with their corresponding pre-tax financial statement impact (in millions):

	Financial Statement Impact			
	Balance Sheet -Debit (Credit)		Statement of Operations	
	Deferred Financing Costs (1)	Original Issue Discount (2)	Expense (3)	Total
<b>Cash transaction costs:</b>				
Third party transaction costs	\$ 14.6	\$ —	\$ —	\$ 14.6
Bond tender premiums (paid to lenders)	—	—	63.5	63.5
Total cash transaction costs	14.6	—	63.5	<u>78.1</u>
<b>Non-cash write-off of unamortized amounts:</b>				
Deferred financing costs	(25.4)	—	25.4	
Net original issue discount	—	(11.9)	11.9	
Net financial statement impact	<u>\$ (10.8)</u>	<u>\$ (11.9)</u>	<u>\$ 100.8</u>	

- (1) Recorded as a component of other assets within the condensed consolidated balance sheet.
- (2) Recorded as a reduction in the face value of long-term debt within the condensed consolidated balance sheet.
- (3) Recorded as a component of other non-operating expense within the condensed consolidated statement of operations.

#### Redemption of Notes

Subsequent to the April 2010 tender offers and consent solicitations, on September 24, 2010, RBS Global completed a redemption of the then outstanding \$0.9 million aggregate principal amount of the 2006 9.50% Notes and all of the then outstanding \$13,000 aggregate principal amount of the 2009 9.50% Notes, at a redemption price of 104.75% of principal amount outstanding plus accrued and additional interest applicable to the redemption date. Following the redemption, no 2006 9.50% Notes and no 2009 9.50% Notes remained outstanding.

#### Outstanding Tranches of Notes

At January 1, 2011, RBS Global had outstanding \$1,145.0 million in aggregate principal 8.50% Notes and \$300.0 million in aggregate principal 11.75% Senior Subordinated Notes due 2016 (the “11.75% Notes”). RBS Global also had outstanding \$2.3 million in aggregate principal under other notes, consisting of the 8.875% Notes and 10.125% senior subordinated notes due 2012.

The 8.50% Notes bear interest at a rate of 8.50% per annum, payable on each May 1 and November 1 (commencing on November 1, 2010), and will mature on May 1, 2018. The 11.75% 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 indenture governing the 8.50% Notes permits optional redemption of the notes, generally on or after May 1, 2014, on specified terms and at specified prices. In addition, the indenture provides that, prior to May 1, 2014, the outstanding 8.50% Notes may be redeemed at RBS Global's option in whole at any time or in part from time to time at a redemption price equal to the sum of (i) 100% of the principal amount of the notes redeemed plus (ii) a “make whole” premium specified in the indenture, and (iii) accrued and unpaid interest and additional interest, if any, to the redemption date. In the case of the 11.75% Notes, the indenture permits optional redemption on or after August 1, 2011 at the redemption prices set forth in the indenture plus accrued and unpaid interest. RBS Global must provide specified prior notice for redemption of the notes in accordance with the indentures.

In addition, at any time (which may be more than once) on or prior to May 1, 2013, RBS Global has the right to redeem up to 35% of the principal amount of the 8.50% Notes at a redemption price equal to 108.50% of the face amount thereof, plus accrued and unpaid interest and additional interest, if any, with the net proceeds of one or more equity offerings so long as at least 65% of the aggregate principal amount of the 8.50% Notes issued remains outstanding after each redemption and such redemption occurs within a specified period after the equity offering.

Notwithstanding the above, RBS Global'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 constrained 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.

The senior notes and senior subordinated notes are unsecured obligations. 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 RBS Global 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 RBS Global to incur additional debt as long as it can satisfy the fixed charge coverage ratio of the indenture after giving effect thereto on a pro forma basis.

The indentures governing the 8.50% Notes and 11.75% Notes contain customary covenants, among others, limiting dividends, investments, purchases or redemptions of stock, restricted payments, transactions with affiliates and mergers and sales of assets, and requiring RBS Global to make an offer to purchase notes upon the occurrence of a change in control, as defined in those indentures. These covenants are subject to a number of important qualifications. For example, the indentures do not impose any limitation on the incurrence by RBS Global 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 RBS Global's subsidiaries, if any, that might be designated as "unrestricted subsidiaries" (as defined in the applicable indenture). The indentures governing the other notes do not contain material restrictive covenants.

In addition, Rexnord Holdings relies heavily on RBS Global for the purpose of servicing its indebtedness. In the event Rexnord Holdings is unable to meet its debt service obligations, it could attempt to restructure or refinance its indebtedness or seek additional equity capital. The governing instruments for the Rexnord Holdings' indebtedness contain customary affirmative and negative covenants that may result in restrictions to Rexnord Holdings. Though the restrictions on these obligations are not directly imposed on RBS Global, a default under the Rexnord Holdings debt obligations could result in a change of control and/or event of default under RBS Global's other debt instruments and lead to an acceleration of all outstanding loans under RBS Global's senior secured credit facilities and other debt.

At March 31, 2010 and January 1, 2011, various wholly-owned subsidiaries had additional debt of \$7.2 million and \$12.8 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 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 will be recorded within "Interest expense, net" in the consolidated statement of operations if revolving loans or letters of credit are 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 January 1, 2011, the Company's available borrowing capacity under the AR Securitization Program was \$80.4 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 January 1, 2011, 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 swaps to cover known foreign exchange transactions and interest rate fluctuations.

### ***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 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, 2010.

Approximately 30% of our sales originate outside of the United States. 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. As of January 1, 2011, stockholders' equity increased by \$7.0 million from March 31, 2010 as a result of foreign currency translation adjustments. If the U.S. Dollar had strengthened by 10% as of January 1, 2011, the result would have decreased stockholders' equity by approximately \$15.4 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 January 1, 2011, we had outstanding forward foreign currency contracts that exchange United States dollars (“USD”) for Canadian dollars (“CAD”) as well as CAD for USD. The forward contracts currently in place expire between January and March of fiscal 2011 and have notional amounts of \$1.5 million USD (\$1.6 million CAD) and \$6.1 million CAD (\$6.0 million USD) and contract rates ranging from \$1USD:\$1.07CAD to \$1CAD:\$1.01USD. 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. We believe that a hypothetical 10% adverse change in the foreign currency exchange rates would not have a material impact on our financial statements as of January 1, 2011.

### ***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 indebtedness under the senior secured credit facilities bears interest at rates that fluctuate with changes in certain short-term prevailing interest rates. As of January 1, 2011, our outstanding borrowings under the senior secured term loan credit facility were \$762.0 million. The term loan credit facility is apportioned between two primary tranches: a \$570.0 million term loan B1 facility and a \$192.0 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) 2.25% 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 January 1, 2011 was 3.67%. We have entered into three interest rate swaps, which became effective beginning October 20, 2009 and mature on July 20, 2012, to hedge the variability in future cash flows associated with our variable-rate term loans. 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 loss before income taxes would likely be affected by changes in market interest rates on the un-hedged portion of these variable-rate obligations. After considering the interest rate swaps, a 100 basis point increase in the January 1, 2011 interest rates would increase interest expense under the senior secured credit facilities by approximately \$3.9 million on an annual basis.

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 January 1, 2011, the interest rate was 7.29% for both the Old Holdco Notes and Holdco Loans.

Our loss before income taxes would likely be affected by changes in market interest rates on the un-hedged portion of these variable-rate obligations. After considering the interest rate swaps and PIK toggle senior indebtedness, a 100 basis point increase in the January 1, 2011 interest rates would increase interest expense under our variable-rate obligations by approximately \$4.8 million on an annual basis.

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

	<b>March 31, 2010</b>	<b>January 1, 2011</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 263.9	\$ 318.8
Receivables, net	234.1	240.2
Inventories, net	273.8	294.9
Other current assets	29.4	34.4
Total current assets	801.2	888.3
Property, plant and equipment, net	376.2	352.4
Intangible assets, net	688.5	656.7
Goodwill	1,012.2	1,015.9
Insurance for asbestos claims	86.0	86.0
Other assets	52.4	31.4
Total assets	\$ 3,016.5	\$ 3,030.7
<b>Liabilities and stockholders' deficit</b>		
Current liabilities:		
Current portion of long-term debt	\$ 5.3	\$ 11.6
Trade payables	135.3	139.4
Compensation and benefits	58.7	56.1
Current portion of pension and postretirement obligations	6.1	6.1
Interest payable	30.7	38.2
Other current liabilities	83.2	87.9
Total current liabilities	319.3	339.3
Long-term debt	2,210.2	2,301.2
Pension and postretirement obligations	137.5	125.5
Deferred income taxes	273.2	235.2
Reserve for asbestos claims	86.0	86.0
Other liabilities	47.8	48.3
Total liabilities	3,074.0	3,135.5
Stockholders' deficit:		
Common stock, \$0.01 par value; 25,000,000 shares authorized; shares issued: 16,142,886 at March 31, 2010 and 16,240,773 at January 1, 2011	0.2	0.2
Additional paid-in capital	285.6	291.8
Retained deficit	(241.5)	(299.2)
Accumulated other comprehensive loss	(99.7)	(91.5)
Treasury stock at cost, 102,770 shares at March 31, 2010 and 212,367 shares at January 1, 2011	(2.1)	(6.1)
Total stockholders' deficit	(57.5)	(104.8)
Total liabilities and stockholders' deficit	\$ 3,016.5	\$ 3,030.7

See notes to the condensed consolidated financial statements.

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

	Third Quarter Ended		Nine Months Ended	
	December 26, 2009	January 1, 2011	December 26, 2009	January 1, 2011
Net sales	\$ 365.7	\$ 419.8	\$ 1,103.3	\$ 1,239.4
Cost of sales	241.6	275.8	739.9	809.2
Gross profit	124.1	144.0	363.4	430.2
Selling, general and administrative expenses	72.6	81.2	222.4	241.0
Restructuring and other similar costs	1.1	—	4.3	—
Amortization of intangible assets	13.3	12.4	37.4	36.4
Income from operations	37.1	50.4	99.3	152.8
Non-operating (expense) income:				
Interest expense, net	(47.0)	(44.5)	(145.1)	(136.7)
Gain (loss) on debt extinguishment	15.4	—	167.8	(100.8)
Other expense, net	(8.4)	(4.7)	(1.3)	(2.8)
(Loss) income before income taxes	(2.9)	1.2	120.7	(87.5)
(Benefit) provision for income taxes	(11.1)	1.5	32.7	(29.8)
Net income (loss)	\$ 8.2	\$ (0.3)	\$ 88.0	\$ (57.7)

See notes to the condensed consolidated financial statements.

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

	<b>Nine Months Ended</b>	
	<b>December 26, 2009</b>	<b>January 1, 2011</b>
<b>Operating activities</b>		
Net income (loss)	\$ 88.0	\$ (57.7)
Adjustments to reconcile net income (loss) to cash provided by operating activities:		
Depreciation	44.2	43.2
Amortization of intangible assets	37.4	36.4
Amortization of deferred financing costs	8.5	6.0
Loss on dispositions of property, plant and equipment	0.6	1.4
Equity in earnings of unconsolidated affiliates	(0.3)	(4.1)
Other non-cash credits	(10.7)	1.1
(Gain) loss on debt extinguishment	(167.8)	100.8
Interest expense converted to long-term debt	6.0	4.3
Stock-based compensation expense	4.1	4.1
Changes in operating assets and liabilities:		
Receivables	41.8	(3.9)
Inventories	57.6	(16.4)
Other assets	7.0	(2.8)
Accounts payable	(24.6)	3.3
Accruals and other	47.4	(39.2)
Cash provided by operating activities	<u>139.2</u>	<u>76.5</u>
<b>Investing activities</b>		
Expenditures for property, plant and equipment	(13.6)	(19.7)
Proceeds from sale of unconsolidated affiliate	—	0.9
Acquisitions, net of cash	—	1.2
Cash used for investing activities	<u>(13.6)</u>	<u>(17.6)</u>
<b>Financing activities</b>		
Proceeds from borrowings of long-term debt	—	1,145.0
Repayments of long-term debt	(115.1)	(1,070.4)
Proceeds from borrowings of short-term debt	—	1.6
Repayments of short-term debt	(1.1)	(1.8)
Purchase of PIK toggle senior indebtedness	(36.5)	—
Payment of deferred financing fees	(4.9)	(14.6)
Payment of tender premium	—	(63.5)
Tax benefit on stock options	—	0.5
Purchase of common stock	(0.4)	(1.0)
Net payments from issuance of common stock and stock option exercises	(1.3)	(1.2)
Cash used for financing activities	<u>(159.3)</u>	<u>(5.4)</u>
Effect of exchange rate changes on cash and cash equivalents	<u>4.8</u>	<u>1.4</u>
(Decrease) increase in cash and cash equivalents	(28.9)	54.9
Cash and cash equivalents at beginning of period	287.9	263.9
Cash and cash equivalents at end of period	<u>\$ 259.0</u>	<u>\$ 318.8</u>

See notes to the condensed consolidated financial statements.

**Rexnord Holdings, Inc. and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements**  
**January 1, 2011**  
**(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, 2011. 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 multi-platform industrial company strategically positioned within the markets and industries it serves. Currently, the business is comprised of two strategic platforms, Process & Motion Control and Water Management. The Process & Motion Control platform designs, manufactures, markets and services specified, highly-engineered mechanical components used within complex systems where our customers' reliability requirements and cost of failure or downtime is extremely high. The Process & Motion Control product portfolio includes gears, couplings, industrial bearings, aerospace bearings and seals, FlatTop modular belting, engineered chain and conveying equipment. The Water Management platform designs, procures, manufactures and markets products that provide and enhance water quality, safety, flow control and conservation. The Water Management product portfolio includes professional grade specification drainage products, flush valves and faucet products, Pex piping and engineered valves and gates for the water and wastewater treatment market.

***Reclassification***

Certain prior year amounts have been reclassified to conform to the fiscal 2011 presentation.

***Recent Accounting Pronouncements***

There have been no new accounting pronouncements issued during the first nine months of fiscal 2011 that will have a material impact on the Company's financial statements. Additionally, the Company has not adopted any new accounting pronouncements during the first nine months of fiscal 2011.

***Evaluation of Subsequent Events***

The Company evaluated subsequent events from the balance sheet date of January 1, 2011 through February 16, 2011 (the date of this report) and has concluded that no subsequent events have occurred during this period.

**2. Acquisitions**

On August 31, 2010, the Company acquired full control of Mecánica Falk S.A. de C.V. ("Mecánica Falk"), a joint venture in which the Company previously maintained a 49% non-controlling interest. Located in Mexico City, Mexico, Mecánica Falk primarily serves as a distributor of the Company's existing Process & Motion Control product lines in Latin America. The acquisition of the remaining 51% interest in Mecánica Falk provides the Company with the opportunity to expand its international presence through a more direct ownership structure. Mecánica Falk's results of operations have been wholly consolidated in all periods subsequent to August 31, 2010.

Due to the pre-existing 49% ownership interest in Mecánica Falk, this acquisition was accounted for as a step acquisition in accordance with ASC 805, *Business Combinations* ("ASC 805"). Accordingly, the Company recognized a gain of \$3.4 million in connection with this transaction to record its 49% ownership interest in Mecánica Falk at fair value on the

acquisition date (The fair value was determined using a combination of the income approach and market approach. In completing this valuation, management considered future earnings and cash flow potential of the business, earnings multiples, and recent market transactions of similar businesses). The transaction was consummated through a redemption of the exiting shareholders' shares in exchange for a \$6.1 million seller-financed note, which will be repaid in ratable installments over the next several quarters. Excluding the seller-financed note, the Company acquired net assets of \$12.1 million, including \$8.0 million of intangible assets (comprised of \$4.4 million of customer relationships and \$3.6 million of goodwill) and \$1.2 million of cash. Certain information about Mecánica Falk is not presented (e.g. pro forma financial information and allocation of purchase price) as the disclosure of such information is not material to the Company's results of operations and financial position.

### 3. Restructuring and Other Similar Costs

During the third quarter of fiscal 2009 (quarter ended December 27, 2008), the Company commenced certain restructuring actions to reduce operating costs and improve profitability. The Company recorded restructuring charges of \$1.1 million and \$4.3 million during the three and nine months ended December 26, 2009, respectively, primarily consisting of severance costs related to workforce reductions. As the restructuring actions were substantially completed during fiscal 2010, the Company did not record any restructuring charges during the three or nine months ended January 1, 2011. At March 31, 2010 the Company's remaining restructuring liability was \$3.3 million compared to the January 1, 2011 restructuring liability of \$1.2 million.

The following table summarizes the cumulative costs incurred in connection with the restructuring actions executed by the Company from September 28, 2008 to March 31, 2010 by reportable segment (in millions):

	<b>Restructuring Costs</b> <b>(Period from September 28, 2008 to March 31, 2010)</b>			
	Process & Motion Control	Water Management	Corporate	Consolidated
Severance costs	\$ 19.7	\$ 2.5	\$ 0.2	\$ 22.4
Fixed asset impairments	—	3.2	—	3.2
Inventory impairments	0.4	2.5	—	2.9
Lease termination and other costs	2.7	0.1	—	2.8
Total restructuring and other similar costs	<u>\$ 22.8</u>	<u>\$ 8.3</u>	<u>\$ 0.2</u>	<u>\$ 31.3</u>

The following table summarizes the activity in the Company's restructuring reserve for the nine months ended January 1, 2011 (in millions):

	<b>Severance Costs</b>	<b>Lease Termination and Other Costs</b>	<b>Total</b>
Restructuring reserve, March 31, 2010	\$ 1.3	\$ 2.0	\$ 3.3
Cash payments	(1.2)	(0.8)	(2.0)
Currency translation adjustment	(0.1)	—	(0.1)
Restructuring reserve, January 1, 2011 (1)	<u>\$ —</u>	<u>\$ 1.2</u>	<u>\$ 1.2</u>

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

### 4. Recovery Under Continued Dumping and Subsidy Offset Act ("CDSOA")

The Company, as a producer of ball bearing products in the United States, participated in the distribution of monies collected by Customs and Border Protection ("CBP") from anti-dumping cases under the CDSOA. As a result of providing relevant information to CBP regarding historical manufacturing, personnel and development costs for previous calendar years, the Company received, in the third quarter and nine months ended December 26, 2009, \$0.8 million representing its pro rata share of the total CDSOA distribution. Similarly, a recovery of \$0.7 million was recorded during the third quarter and nine months ended January 1, 2011 related to the submission of previous calendar year data to CBP. These recoveries are included in other expense, net on the condensed consolidated statement of operations.

In February 2006, U.S. legislation was enacted that ends CDSOA distributions to U.S. manufacturers for imports covered

by anti-dumping duty orders entering the U.S. after September 30, 2007. Because monies were collected by CBP until September 30, 2007 and for prior year entries, the Company has continued to receive some additional distributions; however, because of the pending cases, the 2006 legislation and the administrative operation of the law, the Company cannot reasonably estimate the amount of CDSOA payments, if any, that it may receive in future years.

## 5. Income Taxes

The provision (benefit) 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 ("NOL") carryforwards.

The effective income tax rate for the third quarter of fiscal 2010 was 382.8% versus 125.0% in the third quarter of fiscal 2011. The extremely high effective income tax rate for the third quarter of fiscal 2010 is mainly due to the income tax benefit recognized as a result of a decrease in the liability for unrecognized tax benefits recorded during this period associated with the conclusion of the IRS examination and certain benefits provided under a new Brazilian tax settlement program. The effective income tax rate for the third quarter of fiscal 2011 includes the effect of the current recognition of certain foreign branch net income for U.S. income tax purposes 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, partially offset by the reduction of unrecognized income tax benefits which realization is now deemed more-likely-than-not.

The effective income tax rate for the first nine months of fiscal 2010 was 27.1% versus 34.1% in the first nine months of fiscal 2011. The effective income tax rate for the first nine months of fiscal 2010 is lower than the U.S. federal statutory rate of 35.0% mainly due to the income tax benefit recognized as a result of a decrease in the liability for unrecognized tax benefits recorded during this period associated with the conclusion of the IRS examination and certain benefits provided under a new Brazilian tax settlement program. The effective income tax rate for the first nine months of fiscal 2011 includes the accrual of foreign income taxes at statutory rates which are generally below the U.S. federal statutory rate of 35.0% offset by an increase in the valuation allowance for U.S. foreign tax credits generated during this period for which realization of such benefits is not deemed more-likely-than-not.

At March 31, 2010, the Company's total liability for unrecognized net income tax benefits was \$27.3 million. At January 1, 2011, the Company had a \$26.1 million liability for unrecognized net income tax benefits. Due to the adoption of ASC 805 effective April 1, 2009, any future recognition of unrecognized income tax benefits will impact income tax expense instead of goodwill.

The Company recognizes accrued interest and penalties related to unrecognized income tax benefits in income tax expense. As of March 31, 2010 and January 1, 2011, the total amount of gross, unrecognized income tax benefits includes \$7.7 million and \$8.4 million of accrued interest and penalties, respectively. The Company recognized \$4.3 million of net interest and penalties as income tax benefit during the nine months ended December 26, 2009. This benefit was largely a result of the significant discount for interest and penalties provided under the new Brazilian tax settlement program executed by the Company during this period. The Company recognized \$0.5 million of net interest and penalties as income tax benefit during the nine months ended January 1, 2011.

The Company 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. 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 tax years ending prior to fiscal 2008, state and local income tax examinations for years ending prior to fiscal 2007 or significant foreign income tax examinations for years ending prior to fiscal 2006. However, due to U.S. federal NOL carryforwards which were generated in two short periods ended prior to March 31, 2008, the statutes of limitations generally remain open such that the IRS may not adjust the income tax liability reported for these periods but may reduce the NOL carryforward to future, open tax years.

## 6. Comprehensive Income (Loss)

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

	Third Quarter Ended		Nine Months Ended	
	December 26, 2009	January 1, 2011	December 26, 2009	January 1, 2011
Net income (loss)	\$ 8.2	\$ (0.3)	\$ 88.0	\$ (57.7)
Other comprehensive (loss) income:				
Unrealized (loss) gain on interest rate derivatives, net of tax	(0.5)	0.8	—	(1.7)
Amortization of pension and postretirement unrecognized prior service costs and actuarial gains, net of tax	1.7	1.3	5.7	2.9
Foreign currency translation adjustments	6.4	4.4	3.8	7.0
Comprehensive income (loss)	<u>\$ 15.8</u>	<u>\$ 6.2</u>	<u>\$ 97.5</u>	<u>\$ (49.5)</u>

## 7. Inventories

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

	March 31, 2010	January 1, 2011
Finished goods	\$ 171.7	\$ 187.0
Work in progress	51.1	57.2
Raw materials	30.9	33.6
Inventories at First-in, First-Out ("FIFO") cost	<u>253.7</u>	<u>277.8</u>
Adjustment to state inventories at Last-in, First-Out ("LIFO") cost	20.1	17.1
	<u>\$ 273.8</u>	<u>\$ 294.9</u>

## 8. Goodwill and Intangible Assets

During the third quarter ended January 1, 2011, the Company completed the testing of indefinite lived intangible assets (tradenames) and goodwill for impairment in accordance with ASC 350, *Intangibles - Goodwill and Other* ("ASC 350"). Pursuant to the guidance, an impairment loss is recognized if the estimated fair value of the intangible asset or reporting unit is less than its carrying amount. The fair value of the Company's indefinite lived intangible assets and reporting units were primarily estimated using an income valuation model (discounted cash flow) and market approach (guideline public company comparables), which indicated that the fair value of the Company's indefinite lived intangible assets and reporting units exceeded their carrying value, therefore, no impairment was present. The estimated fair value of the Company's reporting units was dependent on several significant assumptions, including our weighted average cost of capital (discount rate) and future earnings and cash flow projections.

The changes in the net carrying value of goodwill and identifiable intangible assets for the nine months ended January 1, 2011 by operating segment, are presented below (dollars in millions):

	<u>Amortizable Intangible Assets</u>						<b>Total Identifiable Intangible Assets Excluding Goodwill</b>
	<b>Goodwill</b>	<b>Indefinite Lived Intangible Assets (Trade Names)</b>	<b>Customer Relationships</b>	<b>Patents</b>	<b>Non- Compete</b>		
<b>Process &amp; Motion Control</b>							
Net carrying amount as of March 31, 2010	\$ 852.3	\$ 190.7	\$ 170.0	\$ 8.6	\$ —	\$ 369.3	
Amortization	—	—	(20.4)	(1.1)	—	(21.5)	
Acquisitions	3.6	—	4.4	—	—	4.4	
Net carrying amount as of January 1, 2011	<u>\$ 855.9</u>	<u>\$ 190.7</u>	<u>\$ 154.0</u>	<u>\$ 7.5</u>	<u>\$ —</u>	<u>\$ 352.2</u>	
<b>Water Management</b>							
Net carrying amount as of March 31, 2010	\$ 159.9	\$ 101.5	\$ 205.2	\$ 12.4	\$ 0.1	\$ 319.2	
Amortization	—	—	(13.4)	(1.5)	—	(14.9)	
Currency translation adjustment	0.1	—	0.2	—	—	0.2	
Net carrying amount as of January 1, 2011	<u>\$ 160.0</u>	<u>\$ 101.5</u>	<u>\$ 192.0</u>	<u>\$ 10.9</u>	<u>\$ 0.1</u>	<u>\$ 304.5</u>	
<b>Consolidated</b>							
Net carrying amount as of March 31, 2010	\$ 1,012.2	\$ 292.2	\$ 375.2	\$ 21.0	\$ 0.1	\$ 688.5	
Amortization	—	—	(33.8)	(2.6)	—	(36.4)	
Acquisitions	3.6	—	4.4	—	—	4.4	
Currency translation adjustment	0.1	—	0.2	—	—	0.2	
Net carrying amount as of January 1, 2011	<u>\$ 1,015.9</u>	<u>\$ 292.2</u>	<u>\$ 346.0</u>	<u>\$ 18.4</u>	<u>\$ 0.1</u>	<u>\$ 656.7</u>	

The gross carrying amount and accumulated amortization for each major class of identifiable intangible assets as of March 31, 2010 and January 1, 2011 are as follows (in millions):

	<b>Weighted Average Useful Life</b>	<u>March 31, 2010</u>		
		<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>	<b>Net Carrying Amount</b>
Intangible assets subject to amortization:				
Patents	10 Years	\$ 36.3	\$ (15.3)	\$ 21.0
Customer relationships (including distribution network)	12 Years	529.5	(154.3)	375.2
Non-competes	2 Years	0.1	—	0.1
Intangible assets not subject to amortization - trademarks and tradenames		292.2	—	292.2
		<u>\$ 858.1</u>	<u>\$ (169.6)</u>	<u>\$ 688.5</u>
<b>January 1, 2011</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	\$ 36.3	\$ (17.9)	\$ 18.4
Customer relationships (including distribution network)	12 Years	534.1	(188.1)	346.0
Non-competes	2 Years	0.1	—	0.1
Intangible assets not subject to amortization - trademarks and tradenames		292.2	—	292.2
		<u>\$ 862.7</u>	<u>\$ (206.0)</u>	<u>\$ 656.7</u>

Intangible asset amortization expense totaled \$13.3 million and \$37.4 million for the third quarter and nine months ended December 26, 2009, respectively. Intangible asset amortization expense totaled \$12.4 million and \$36.4 million for the third

quarter and nine months ended January 1, 2011, respectively.

The Company expects to recognize amortization expense on the intangible assets subject to amortization of \$48.6 million in fiscal year 2011 (inclusive of \$36.4 million of amortization expense recognized in the nine months ended January 1, 2011), \$47.9 million in fiscal year 2012, and \$47.5 million in each of fiscal years 2013, 2014, and 2015, respectively.

## 9. Other Current Liabilities

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

	<u>March 31, 2010</u>	<u>January 1, 2011</u>
Taxes, other than income taxes	\$ 4.6	\$ 5.9
Sales rebates	12.0	17.5
Restructuring obligations (1)	3.3	1.2
Customer advances	12.4	14.7
Product warranty (2)	10.7	8.4
Commissions	6.6	5.7
Risk management reserves (3)	8.6	9.0
Deferred income taxes	2.1	3.9
Other	22.9	21.6
	<u>\$ 83.2</u>	<u>\$ 87.9</u>

(1) See more information related to the restructuring obligations balance within Note 3.

(2) See more information related to the product warranty obligations balance within Note 13.

(3) Includes projected liabilities related to the Company's deductible portion of insured losses arising from automobile, general and product liability claims.

## 10. Long-Term Debt

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

	<u>March 31, 2010</u>	<u>January 1, 2011</u>
Term loans	\$ 763.5	\$ 762.0
PIK toggle senior indebtedness due 2013 (1)	86.3	90.7
8.50% Senior notes due 2018	—	1,145.0
9.50% Senior notes due 2014 (2)	979.2	—
8.875% Senior notes due 2016	79.0	2.0
11.75% Senior subordinated notes due 2016	300.0	300.0
10.125% Senior subordinated notes due 2012	0.3	0.3
Other (3)	7.2	12.8
Total	<u>2,215.5</u>	<u>2,312.8</u>
Less current portion	5.3	11.6
Long-term debt	<u>\$ 2,210.2</u>	<u>\$ 2,301.2</u>

(1) Includes an unamortized bond issue discount of \$0.6 million and \$0.5 million at March 31, 2010 and January 1, 2011, respectively.

(2) Includes a net unamortized bond issue discount of \$12.1 million at March 31, 2010.

(3) Includes, at January 1, 2011, \$4.7 million outstanding principal related to a seller-financed note payable incurred in connection with the acquisition of Mecánica Falk on August 31, 2010 (see Note 2).

The Company's outstanding debt was issued 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, the Company entered into a Credit Agreement (the "Holdco 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 (see Note 15 of the Notes to the condensed consolidated financial statements for further information on stock options). The PIK Toggle Loans (or "Holdco Loans") issued pursuant to the Holdco 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%.

In fiscal 2009, the Company completed an exchange offer with respect to the Holdco Loans. Approximately \$460.8 million of the then outstanding Holdco Loans were tendered and exchanged for PIK Toggle Senior Notes due 2013 (the "Old Holdco Notes"). The Holdco Loans that were not tendered for exchange continue to be governed by the terms and conditions in the Holdco Credit Agreement while the Holdco Loans tendered and exchanged for Old Holdco Notes are governed by the terms and conditions of an indenture. The Old Holdco 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 Old Holdco Notes are substantially the same as the terms of the Holdco Loans in all material respects (including their maturity, variable interest rates and our 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 Old Holdco 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 Holdco Loans is payable quarterly (also generally at the three month LIBOR in effect for the interest period plus 7.0% per annum), (2) the Old Holdco Notes were issued pursuant to the indenture, (3) a change of control is not an event of default under the Old Holdco Notes but instead requires us to make an offer to purchase the Old Holdco 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 Holdco Credit Agreement. None of our subsidiaries currently guarantee any of our indebtedness, so there are no guarantors of the Old Holdco Notes or of the Holdco Loans. The Old Holdco Notes and the Holdco Loans are required to be guaranteed by any of our domestic subsidiaries which in the future may guarantee our indebtedness. The Company refers to the Holdco Loans and the Old Holdco Notes collectively as the PIK toggle senior indebtedness.

### April 2009 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 Holdco 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).

### October 2009 Purchase and Extinguishment of PIK toggle senior indebtedness

On October 19, 2009, the Company purchased and extinguished \$43.8 million of outstanding face value 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 recognized a gain of \$15.4 million in its third quarter ended December 26, 2009. 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.

### April 2009 Exchange Offer

On April 29, 2009, the Company finalized the results of a debt exchange offer to exchange (a) new RBS Global 9.50% Senior Notes due 2014 (the "2009 9.50% Notes") for any and all of RBS Global's 8.875% Senior Notes due 2016 (the "8.875% Notes"), (b) 2009 9.50% Notes for any and all of the Old Holdco Notes (together with the 8.875% Notes, the "Old Notes"), and (c) 2009 9.50% Notes for any and all of the Holdco Loans outstanding under the Holdco Credit Agreement.

Upon settlement of the April 2009 exchange offer, (i) approximately \$71.0 million principal amount of 8.875% Notes were exchanged for 2009 9.50% Notes, (ii) approximately \$235.7 million principal amount of Old Holdco Notes were exchanged for 2009 9.50% Notes, and (iii) approximately \$7.9 million principal amount of Holdco Loans were exchanged for 2009 9.50% Notes. Based on the principal amount of Old Notes and Holdco Loans validly tendered and accepted, approximately \$196.3 million of aggregate principal of the 2009 9.50% Notes was issued in exchange for such Old Notes and Holdco Loans (excluding a net original issue discount of \$20.6 million). In addition, RBS Global incurred \$11.1 million of

transaction costs (\$0.2 million of these transaction costs were issued in the form of 2009 9.50% Notes) to complete the exchange offer, of which \$5.1 million was capitalized as deferred financing costs.

The Company accounted for the April 2009 exchange offer pursuant to ASC 470-50 Debt Modification and Extinguishments ("ASC 470-50"). As a result of the April 2009 exchange offer, 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 2009 9.50% 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, RBS Global issued approximately \$130.6 million of face value of 2009 9.50% Notes, net of a \$26.1 million original issue discount.

Pursuant to ASC 470-50, the exchange of RBS Global's 8.875% Notes did not constitute a significant modification of debt (that is, the change in the present value of expected cash flows under the terms of the modified debt as compared to the present value of expected cash flows under the original debt was less than 10%). Therefore, the carrying value of the \$71.0 million in 8.875% Notes tendered was carried-forward as the net carrying value of the 2009 9.50% 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 8.875% notes and the \$65.5 million of corresponding face value of the 2009 9.50% Notes issued with respect to this component of the exchange. This premium is being amortized as a reduction to interest expense (via the effective interest method) over the life of the 2009 9.50% Notes in conformity with the standard.

After and including the April 2009 exchange offer, RBS Global had 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 included \$196.3 million of aggregate principal related to the aforementioned debt exchange. The terms of the 2009 9.50% Notes and RBS Global's 2006 9.50% Notes are substantially similar with the exception of interest payment dates. See "RBS Global, Inc. and Subsidiaries Long-Term Debt - Senior Notes and Senior Subordinates Notes" section below for subsequent transactions related to the 2006 9.50% Notes and the 2009 9.50% Notes.

As of January 1, 2011, the interest rate was 7.29% for both the Old Holdco Notes and Holdco Loans. As of March 31, 2010, the interest rate was 7.25% for both the Old Holdco Notes and Holdco Loans. Pursuant to the terms of the Holdco Credit Agreement and the indenture, the Company has elected to pay interest in-kind and has accordingly paid interest with additional Old Holdco Notes and Holdco Loans, as the case may be, on pre-determined interest rate reset dates. During the nine months ended January 1, 2011, \$4.3 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, the Company 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 Holdco Credit Agreement, would have been at least 1.75 to 1.00, or, 2.00 to 1.00 in the case of RBS Global, Inc. and subsidiaries, including the pro forma application of the additional indebtedness or equity issuance.

### ***RBS Global, Inc. and Subsidiaries Long-Term Debt***

#### ***Senior Secured Credit Facility***

On October 5, 2009, RBS Global entered into an Amended and Restated Credit Agreement (the "Credit Agreement") amending and restating the credit agreement dated as of July 21, 2006. The senior secured credit facilities provided under the Credit Agreement are funded by 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 January 1, 2011, 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 \$192.0 million term loan B2 facility. Borrowings under the term

loan B1 facility accrue interest, at RBS Global'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 RBS Global'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 January 1, 2011 was 3.67%.

Borrowings under RBS Global's \$150.0 million revolving credit facility accrue interest, at RBS Global'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. In addition, \$31.4 million and \$27.8 million of the revolving credit facility was considered utilized in connection with outstanding letters of credit at March 31, 2010 and January 1, 2011, respectively.

The Credit Agreement, among other things: (i) allows 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 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 Credit Agreement at par; (ii) subject to the requirement to make such offers on a pro rata basis to all lenders, allows RBS Global to agree with individual lenders to extend the maturity of their term loans or revolving commitments, and for RBS Global to pay increased interest rates or otherwise modify the terms of their loans or revolving commitments in connection with such an extension; and (iii) allows 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 Credit Agreement, in an amount not to exceed the amount of incremental facility availability under the Credit Agreement.

In addition to paying interest on outstanding principal under the senior secured credit facilities, RBS Global 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). RBS Global also must pay customary letter of credit and agency fees.

As of January 1, 2011, the remaining mandatory principal payments prior to maturity on both the term loan B1 and B2 facilities are \$1.2 million and \$5.0 million, respectively. RBS Global 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. RBS Global 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 typical covenants that, among other things, constrain, subject to certain fully-negotiated exceptions, RBS Global's ability, and the ability of RBS Global'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 certain indebtedness (including the senior notes and senior subordinated notes); 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. RBS Global's senior secured credit facilities limit RBS Global's maximum senior secured bank leverage ratio to 4.25 to 1.00. As of January 1, 2011, the senior secured bank leverage ratio was 1.41 to 1.00.

### ***Senior Notes and Senior Subordinated Notes***

#### **April 2010 Cash Tender Offers and \$1,145.0 Million Note Offering**

On May 5, 2010, RBS Global finalized the results of the cash tender offers and consent solicitations launched on April 7, 2010 with respect to any and all of its outstanding 2006 9.50% Notes, 2009 9.50% Notes and 8.875% Notes. Upon completion of the tender offers, 99.7% of the holders had tendered their notes and consented to the proposed amendments. At closing, (i) \$0.9 million aggregate principal amount of the 2006 9.50% Notes, (ii) \$13,000 aggregate principal amount of the 2009 9.50% Notes and (iii) \$2.0 million aggregate principal amount of the 8.875% Notes had not been tendered, and remained outstanding.

In connection with the April 2010 tender offers and consent solicitations, on April 20, 2010, RBS Global entered into supplemental indentures by and among RBS Global, each of the guarantors party thereto, and Wells Fargo Bank, National Association, as Trustee, pursuant to which the 2006 9.50% Notes, 2009 9.50% Notes and 8.875% Notes were issued (as amended and supplemented, the "Supplemental Indentures"). The Supplemental Indentures amended the terms governing the

respective notes to, among other things, eliminate substantially all of the material restrictive covenants, eliminate or modify certain events of default and eliminate or modify related provisions in the respective indentures governing the notes.

On April 28, 2010, RBS Global issued \$1,145.0 million aggregate principal amount of 8.50% Senior Notes due 2018 (the “8.50% Notes”) in a private offering. The proceeds from the offering were used to fund (including transaction costs) the cash tender offers discussed above. The 8.50% Notes will mature on May 1, 2018, pursuant to an indenture, dated as of April 28, 2010, by and among RBS Global, the guarantors named therein, and Wells Fargo Bank, National Association, as Trustee. RBS Global pays interest on the 8.50% Notes at 8.50% per annum, semiannually on May 1 and November 1 of each year, commencing on November 1, 2010.

RBS Global accounted for the cash tender offers and the issuance of the 8.50% Notes in accordance with ASC 470-50. Pursuant to this guidance, the cash tender offers were accounted for as an extinguishment of debt. In connection with the offering, RBS Global incurred an increase in long-term debt of approximately \$89.5 million. RBS Global recognized a \$100.8 million loss on the debt extinguishment in the fiscal quarter ended July 3, 2010, which was comprised of a bond tender premium paid to lenders, as well as the non-cash write-off of deferred financing fees and net original issue discount associated with the extinguished debt. Additionally, RBS Global capitalized approximately \$14.6 million of third party transaction costs, which are being amortized over the life of the 8.50% Notes as interest expense using the effective interest method. Below is a summary of the transaction costs and other offering expenses recorded along with their corresponding pre-tax financial statement impact (in millions):

	Financial Statement Impact			
	Balance Sheet -Debit (Credit)		Statement of Operations	
	Deferred Financing Costs (1)	Original Issue Discount (2)	Expense (3)	Total
<b>Cash transaction costs:</b>				
Third party transaction costs	\$ 14.6	\$ —	\$ —	\$ 14.6
Bond tender premiums (paid to lenders)	—	—	63.5	63.5
Total expected cash transaction costs	14.6	—	63.5	<u>\$ 78.1</u>
<b>Non-cash write-off of unamortized amounts:</b>				
Deferred financing costs	(25.4)	—	25.4	
Net original issue discount	—	(11.9)	11.9	
Net financial statement impact	<u>\$ (10.8)</u>	<u>\$ (11.9)</u>	<u>\$ 100.8</u>	

- (1) Recorded as a component of other assets within the condensed consolidated balance sheet.
- (2) Recorded as a reduction in the face value of long-term debt within the condensed consolidated balance sheet.
- (3) Recorded as a component of other non-operating expense within the condensed consolidated statement of operations.

#### Redemption of Notes

Subsequent to the April 2010 tender offers and consent solicitations, on September 24, 2010, RBS Global completed a redemption of the then outstanding \$0.9 million aggregate principal amount of the 2006 9.50% Notes and all of the then outstanding \$13,000 aggregate principal amount of the 2009 9.50% Notes, at a redemption price of 104.75% of principal amount outstanding plus accrued and additional interest applicable to the redemption date. Following the redemptions, no 2006 9.50% Notes and no 2009 9.50% Notes remained outstanding.

#### Outstanding Tranches of Notes

At January 1, 2011, RBS Global had outstanding \$1,145.0 million in aggregate principal 8.50% Notes and \$300.0 million in aggregate principal 11.75% Senior Subordinated Notes due 2016 (the “11.75% Notes”). RBS Global also had outstanding \$2.3 million in aggregate principal under other notes, consisting of the 8.875% Notes and 10.125% senior subordinated notes due 2012.

The 8.50% Notes bear interest at a rate of 8.50% per annum, payable on each May 1 and November 1 (commencing on November 1, 2010), and will mature on May 1, 2018. The 11.75% 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 indenture governing the 8.50% Notes permits optional redemption of the notes, generally on or after May 1, 2014, on specified terms and at specified prices. In addition, the indenture provides that, prior to May 1, 2014, the outstanding 8.50%

Notes may be redeemed at RBS Global's option in whole at any time or in part from time to time at a redemption price equal to the sum of (i) 100% of the principal amount of the notes redeemed plus (ii) a "make whole" premium specified in the indenture, and (iii) accrued and unpaid interest and additional interest, if any, to the redemption date. In the case of the 11.75% Notes, the indenture permits optional redemption on or after August 1, 2011 at the redemption prices set forth in the indenture plus accrued and unpaid interest. RBS Global must provide specified prior notice for redemption of the notes in accordance with the indentures.

In addition, at any time (which may be more than once) on or prior to May 1, 2013, RBS Global has the right to redeem up to 35% of the principal amount of the 8.50% Notes at a redemption price equal to 108.50% of the face amount thereof, plus accrued and unpaid interest and additional interest, if any, with the net proceeds of one or more equity offerings so long as at least 65% of the aggregate principal amount of the 8.50% Notes issued remains outstanding after each redemption and such redemption occurs within a specified period after the equity offering.

Notwithstanding the above, RBS Global'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 constrained 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.

The senior notes and senior subordinated notes are unsecured obligations. 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 RBS Global 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 RBS Global to incur additional debt as long as it can satisfy the fixed charge coverage ratio of the indenture after giving effect thereto on a pro forma basis.

The indentures governing the 8.50% Notes and 11.75% Notes contain customary covenants, among others, limiting dividends, investments, purchases or redemptions of stock, restricted payments, transactions with affiliates and mergers and sales of assets, and requiring RBS Global to make an offer to purchase notes upon the occurrence of a change in control, as defined in those indentures. These covenants are subject to a number of important qualifications. For example, the indentures do not impose any limitation on the incurrence by RBS Global 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 RBS Global's subsidiaries, if any, that might be designated as "unrestricted subsidiaries" (as defined in the applicable indenture). The indentures governing the other notes do not contain material restrictive covenants.

In addition, Rexnord Holdings relies heavily on RBS Global for the purpose of servicing its indebtedness. In the event Rexnord Holdings is unable to meet its debt service obligations, it could attempt to restructure or refinance its indebtedness or seek additional equity capital. The governing instruments for the Rexnord Holdings' indebtedness contain customary affirmative and negative covenants that may result in restrictions to Rexnord Holdings. Though the restrictions on these obligations are not directly imposed on RBS Global, a default under the Rexnord Holdings debt obligations could result in a change of control and/or event of default under RBS Global's other debt instruments and lead to an acceleration of all outstanding loans under RBS Global's senior secured credit facilities and other debt.

At March 31, 2010 and January 1, 2011, various wholly-owned subsidiaries had additional debt of \$7.2 million and \$12.8 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 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 will be recorded within "Interest expense, net" in the consolidated statement of operations if revolving loans or letters of credit are 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 January 1, 2011, the Company's available borrowing capacity under the AR Securitization Program was \$80.4 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 January 1, 2011, Rexnord Funding LLC was in compliance with all applicable covenants and performance ratios.

## 11. 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 contracts to manage its foreign currency and interest rate risks. All hedging transactions are authorized and executed pursuant to defined policies and procedures that prohibit the use of financial instruments for speculative purposes.

### 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 flows expected to occur during the fiscal year. The Company currently has entered into forward foreign currency contracts that exchange United States dollars ("USD") for Canadian dollars ("CAD") as well as CAD for USD. The forward contracts currently in place expire between January and March of fiscal 2011 and have notional amounts of \$1.5 million USD (\$1.6 million CAD) and \$6.1 million CAD (\$6.0 million USD) and contract rates ranging from \$1USD:\$1.07CAD to \$1CAD:\$1.01USD. 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 amounts recorded on the condensed consolidated balance sheets and recognized within the condensed consolidated statements of operations related to the Company's foreign currency forward contracts within the tables below.

### Interest Rate Swaps

Effective October 20, 2009, the Company entered into three 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 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. 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 condensed 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 condensed consolidated balance sheets and recognized within the condensed consolidated statements of operations related to the Company's interest rate swaps within the tables below.

The Company's derivatives are measured at fair value in accordance with ASC 820, *Fair Value Measurements and Disclosure* ("ASC 820"). See Note 12 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 condensed 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:

	<b>Liability Derivatives</b>		<b>Balance Sheet Classification</b>
	<b>March 31, 2010</b>	<b>January 1, 2011</b>	
Interest rate swaps	\$ 6.6	\$ 9.3	Other long-term liabilities

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

	<b>Asset Derivatives</b>		<b>Balance Sheet Classification</b>
	<b>March 31, 2010</b>	<b>January 1, 2011</b>	
Foreign currency forward contracts	\$ 0.1	\$ 0.2	Other current assets

The following table indicates the location and the amount of gains and losses associated with the Company's derivative instruments, net of tax, within the condensed consolidated balance sheet (for qualifying ASC 815-20 instruments) and recognized within the condensed 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 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	
				Third Quarter Ended		Nine Months Ended	
	March 31, 2010	January 1, 2011		December 26, 2009	January 1, 2011	December 26, 2009	January 1, 2011
Interest rate swaps	\$ (4.0)	\$ (5.7)	Interest expense, net	\$ (2.1)	\$ (1.8)	\$ (7.7)	\$ (5.7)

  

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		Amount recognized in other income (expense), net	
		Third Quarter Ended		Nine Months Ended	
		December 26, 2009	January 1, 2011	December 26, 2009	January 1, 2011
Foreign currency forward contracts	Other income (expense), net	\$ 0.2	\$ 0.2	\$ 0.5	\$ 0.3

The Company currently expects to reclassify \$6.5 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 twelve months.

## 12. Fair Value Measurements

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.

If applicable, the Company uses quoted market prices in active markets to determine fair value, and therefore classifies such measurements within Level 1. In some cases where market prices are not available, the Company makes use of observable market based inputs to calculate fair value, in which case the measurements are classified within Level 2. If quoted or observable market prices are not available, fair value is based upon internally developed models that use, where possible, current market-based parameters. These measurements are classified within Level 3 if they use significant unobservable inputs.

The Company's fair value measurements which were impacted by ASC 820 as of January 1, 2011 include:

### Interest Rate Swaps

The fair value of interest rate swap 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 January 1, 2011 (in millions):

	Fair Value as of January 1, 2011			
	Level 1	Level 2	Level 3	Total
Assets:				
Foreign currency forward contracts	\$ —	\$ 0.2	\$ —	\$ 0.2
<b>Total assets at fair value</b>	<b>\$ —</b>	<b>\$ 0.2</b>	<b>\$ —</b>	<b>\$ 0.2</b>
Liabilities:				
Interest rate swaps	\$ —	\$ 9.3	\$ —	\$ 9.3
<b>Total liabilities at fair value</b>	<b>\$ —</b>	<b>\$ 9.3</b>	<b>\$ —</b>	<b>\$ 9.3</b>

### Fair Value of Non-Derivative Financial Instruments

The carrying amounts of cash, receivables, payables and accrued liabilities approximated fair value at March 31, 2010 and January 1, 2011 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, 2010 and January 1, 2011 was approximately \$2,215.5 million and \$2,312.8 million, respectively, whereas the fair value of long-term debt as of March 31, 2010 and January 1, 2011 was approximately \$2,212.2 million and \$2,368.9 million, respectively. The fair value is based on quoted market prices for the same issues.

### 13. 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):

	Third Quarter Ended		Nine Months Ended	
	December 26, 2009	January 1, 2011	December 26, 2009	January 1, 2011
Balance at beginning of period	\$ 8.3	\$ 9.8	\$ 7.2	\$ 10.7
Charged to operations	1.2	—	4.8	1.3
Claims settled	(0.8)	(1.4)	(3.3)	(3.6)
Balance at end of period	<b>\$ 8.7</b>	<b>\$ 8.4</b>	<b>\$ 8.7</b>	<b>\$ 8.4</b>

#### Contingencies:

The Company's subsidiaries 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 Group (“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 \$900.0 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 and reimbursement of USEPA's past costs. Rexnord Industries' allocated share of past and 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.
- Multiple lawsuits (with approximately 1,435 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. Additionally, there are approximately 3,700 individuals who have filed asbestos related claims against Prager; however, these claims are currently on the Texas Multi-district Litigation inactive docket. The ultimate outcome of these asbestos matters cannot presently be determined. To date, the Company's insurance providers have paid 100% of the costs related to the Prager asbestos matters. The Company believes that the combination of its insurance coverage and the Invensys indemnity obligations will cover any future costs of these matters.

In connection with the Falk Corporation (“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 200 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 570 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 January 1, 2011, Zurn and an average of approximately 80 other unrelated companies were defendants in approximately 7,000 asbestos related lawsuits representing approximately 28,500 claims. 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 January 1, 2011, 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 \$86.0 million of which Zurn expects to pay approximately \$67.0 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 January 1, 2011, is approximately \$267.5 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 \$191.5 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 \$267.5 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 such recoveries, if any.

As of January 1, 2011, the Company recorded a receivable from its insurance carriers of \$86.0 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 \$267.5 million of insurance coverage will ultimately be available or that Zurn's asbestos liabilities will not ultimately exceed \$267.5 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 regarding 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 fourteen lawsuits, brought between July 2007 and December 2009, in various U.S. courts (MN, ND, CO, NC, MT, AL, VA, LA, NM, MI and HI). The plaintiffs in these suits represent (in the case of the proceedings in Minnesota), or 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). All but the Hawaii suit, which remains in Hawaii state court, have been transferred to a multi-district litigation docket in the District of Minnesota for coordinated pretrial proceedings. The court in the Minnesota proceedings recently certified certain classes of plaintiffs in Minnesota for negligence and negligent failure to warn claims and for breach of warranty claims. While the Company will seek reconsideration and appeal of the class certification decision in the Minnesota proceedings, and will otherwise vigorously defend itself in the various 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.

## 14. Retirement Benefits

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

	Third Quarter Ended		Nine Months Ended	
	December 26, 2009	January 1, 2011	December 26, 2009	January 1, 2011
<b>Pension Benefits:</b>				
Service cost	\$ 0.8	\$ 0.5	\$ 2.4	\$ 1.5
Interest cost	8.6	8.3	26.3	25.1
Expected return on plan assets	(8.0)	(9.0)	(22.9)	(27.4)
Amortization of:				
Prior service cost	—	—	0.2	0.2
Actuarial losses	2.6	1.9	9.9	5.1
Net periodic benefit cost	<u>\$ 4.0</u>	<u>\$ 1.7</u>	<u>\$ 15.9</u>	<u>\$ 4.5</u>
<b>Other Postretirement Benefits:</b>				
Service cost	\$ —	\$ —	\$ 0.1	\$ —
Interest cost	0.7	0.5	1.6	1.5
Amortization:				
Prior service cost	(0.5)	(0.5)	(1.5)	(1.5)
Actuarial losses	0.5	0.3	0.5	0.9
Net periodic benefit cost	<u>\$ 0.7</u>	<u>\$ 0.3</u>	<u>\$ 0.7</u>	<u>\$ 0.9</u>

The net periodic benefit cost for the three and nine months ended December 26, 2009 is higher compared to the three and nine months ended January 1, 2011 primarily due to the market recovery of plan assets within the Company's funded pension plans in fiscal 2010, as well as a current year benefit of certain plan amendments (plan freezes) made in the fourth quarter of fiscal 2010.

During the first nine months of fiscal 2010 and 2011, the Company made contributions of \$3.3 million and \$7.3 million, respectively, to its U.S. qualified pension plan trusts.

## 15. Stock Options

ASC 718, *Compensation-Stock Compensation* (“ASC 718”), requires compensation costs related to share-based payment transactions to be recognized in the financial statements. Generally, compensation cost is measured based on the grant-date fair value of the equity or liability instruments issued. In addition, liability awards are re-measured each reporting period. Compensation cost is recognized over the requisite service period, generally as the awards vest. As a nonpublic entity that previously used the minimum value method for pro forma disclosure purposes under the prior authoritative literature, the Company adopted 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 Apollo Management L.P. (“Apollo”) transaction, 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 January 1, 2011, 377,623 of these rollover stock options remained outstanding.

In connection with the Apollo transaction, the Board of Directors of Rexnord Holdings 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 2015.

The fair value of each option granted under the Option Plan during the nine months ended January 1, 2011 was estimated on the date of grant using the Black-Scholes valuation model that uses the following assumptions: expected volatility between 34% and 41% based on the expected volatility 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 2.28% 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 215,000 options granted under the Option Plan between April 1, 2010 and January 1, 2011 was \$16.80.

For the third quarter and nine months ended December 26, 2009, the Company recorded \$1.1 million and \$4.1 million, respectively, of stock-based compensation expense. For the third quarter and nine months ended January 1, 2011, the Company recorded \$1.4 million and \$4.1 million, respectively, of stock-based compensation expense. As of January 1, 2011, there was \$9.3 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 2.6 years.

The following table presents the Company's stock option activity during the first nine months of fiscal 2010 and 2011:

	Period from April 1, 2009 through December 26, 2009		Period from April 1, 2010 through January 1, 2011	
	Shares	Weighted Avg. Exercise Price	Shares	Weighted Avg. Exercise Price
Number of shares under option:				
Outstanding at beginning of period (1)	2,721,505	\$ 17.69	2,498,666	\$ 18.25
Granted	535,093	20.00	215,000	37.00
Exercised	(191,114)	10.17	(97,887)	17.87
Canceled/Forfeited	(602,169)	19.94	(28,318)	24.17
Outstanding at end of period (1) (2)	<u>2,463,315</u>	<u>\$ 18.23</u>	<u>2,587,461</u>	<u>\$ 19.76</u>
Exercisable at end of period (3)	<u>1,143,544</u>	<u>\$ 15.67</u>	<u>1,436,425</u>	<u>\$ 16.79</u>

(1) Includes 377,623 roll-over options as of January 1, 2011.

(2) The weighted average remaining contractual life of options outstanding at January 1, 2011 is 6.8 years.

(3) The weighted average remaining contractual life of options exercisable at January 1, 2011 is 6.0 years.

## **16. Business Segment Information**

The results of operations are reported in two business segments, consisting of the Process & Motion Control platform and the Water Management platform. The Process & Motion Control platform manufactures gears, couplings, industrial bearings, flattop chain and modular conveyor 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. The same accounting policies are used throughout the organization (see Note 1).

Business Segment Information:  
(In Millions)

	Quarter Ended		Nine Months Ended	
	December 26, 2009	January 1, 2011	December 26, 2009	January 1, 2011
<b>Net sales</b>				
Process & Motion Control	\$ 246.4	\$ 299.6	\$ 719.2	\$ 847.2
Water Management	119.3	120.2	384.1	392.2
Consolidated	<u>\$ 365.7</u>	<u>\$ 419.8</u>	<u>\$ 1,103.3</u>	<u>\$ 1,239.4</u>
<b>Income (loss) from operations</b>				
Process & Motion Control	\$ 27.7	\$ 45.1	\$ 66.3	\$ 121.9
Water Management	16.6	13.3	58.2	54.9
Corporate	(7.2)	(8.0)	(25.2)	(24.0)
Consolidated	<u>\$ 37.1</u>	<u>\$ 50.4</u>	<u>\$ 99.3</u>	<u>\$ 152.8</u>
<b>Non-operating (expense) income:</b>				
Interest expense, net	\$ (47.0)	\$ (44.5)	\$ (145.1)	\$ (136.7)
Gain (loss) on the extinguishment of debt	15.4	—	167.8	(100.8)
Other expense, net	(8.4)	(4.7)	(1.3)	(2.8)
(Loss) income before income taxes	(2.9)	1.2	120.7	(87.5)
(Benefit) provision for income taxes	(11.1)	1.5	32.7	(29.8)
Net income (loss)	<u>\$ 8.2</u>	<u>\$ (0.3)</u>	<u>\$ 88.0</u>	<u>\$ (57.7)</u>
<b>Restructuring and other similar costs (included in Income from operations)</b>				
Process & Motion Control	\$ 1.1	\$ —	\$ 3.8	\$ —
Water Management	—	—	0.5	—
Consolidated	<u>\$ 1.1</u>	<u>\$ —</u>	<u>\$ 4.3</u>	<u>\$ —</u>
<b>Depreciation and Amortization</b>				
Process & Motion Control	\$ 21.7	\$ 20.4	\$ 62.1	\$ 59.7
Water Management	6.6	6.9	19.5	19.9
Consolidated	<u>\$ 28.3</u>	<u>\$ 27.3</u>	<u>\$ 81.6</u>	<u>\$ 79.6</u>
<b>Capital Expenditures</b>				
Process & Motion Control	\$ 3.3	\$ 7.3	\$ 10.7	\$ 16.1
Water Management	1.0	1.0	2.9	3.6
Consolidated	<u>\$ 4.3</u>	<u>\$ 8.3</u>	<u>\$ 13.6</u>	<u>\$ 19.7</u>
			<b>March 31, 2010</b>	<b>January 1, 2011</b>
<b>Total Assets</b>				
Process & Motion Control			\$ 2,170.0	\$ 2,210.4
Water Management			799.1	789.2
Corporate			47.4	31.1
Consolidated			<u>\$ 3,016.5</u>	<u>\$ 3,030.7</u>