FLOWSERVE CORP
Form 10-Q
July 23, 2014

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

FORM 10-Q
(Mark One)

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2014

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM to .

Commission File No. 1-13179

FLOWSERVE CORPORATION
(Exact name of registrant as specified in its charter)

New York	31-0267900
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
5215 N. O’Connor Blvd., Suite 2300, Irving, Texas	75039
(Address of principal executive offices)	(Zip Code)

(972) 443-6500
(Registrant’s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). þ Yes ¨ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of “accelerated filer,” “large accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ	Accelerated filer ¨	Non-accelerated filer ¨ (do not check if a smaller reporting company)

Smaller reporting company ¨

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

As of July 18, 2014, there were 136,804,037 shares of the issuer’s common stock outstanding.

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements.
FLOWSERVE CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

(Amounts in thousands, except per share data)	Three Months Ended June 30,	
	2014	2013
Sales	$1,224,378	$1,239,526
Cost of sales	(794,072)	(817,950)
Gross profit	430,306	421,576
Selling, general and administrative expense	(238,178)	(240,200)
Net earnings from affiliates	2,187	2,145
Operating income	194,315	183,521
Interest expense	(15,027)	(13,125)
Interest income	507	277
Other (expense) income, net	(3,836)	616
Earnings before income taxes	175,959	171,289
Provision for income taxes	(50,794)	(50,395)
Net earnings, including noncontrolling interests	125,165	120,894
Less: Net earnings attributable to noncontrolling interests	(1,652)	(508)
Net earnings attributable to Flowserve Corporation	$123,513	$120,386
Net earnings per share attributable to Flowserve Corporation common shareholders:		
Basic	$0.90	$0.85
Diluted	0.90	0.84
Cash dividends declared per share	$0.16	$0.14

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

(Amounts in thousands)	Three Months Ended June 30,	
	2014	2013
Net earnings, including noncontrolling interests	$125,165	$120,894
Other comprehensive income (loss):		
Foreign currency translation adjustments, net of taxes of $(4,677) and $17,811, respectively	7,782	(29,425)
Pension and other postretirement effects, net of taxes of $(819) and $(1,456), respectively	1,463	2,895
Cash flow hedging activity, net of taxes of $12 and $(151), respectively	(65)	234
Other comprehensive income (loss)	9,180	(26,296)
Comprehensive income, including noncontrolling interests	134,345	94,598
Comprehensive income attributable to noncontrolling interests	(1,651)	(349)
Comprehensive income attributable to Flowserve Corporation	$132,694	$94,249

See accompanying notes to condensed consolidated financial statements.

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FLOWSERVE CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

(Amounts in thousands, except per share data)	Six Months Ended June 30, 2014	2013
Sales	$2,292,514	$2,336,122
Cost of sales	(1,485,086)	(1,541,238)
Gross profit	807,428	794,884
Selling, general and administrative expense	(454,405)	(474,708)
Net earnings from affiliates (Note 2)	5,617	33,824
Operating income	358,640	354,000
Interest expense	(30,176)	(25,216)
Interest income	838	551
Other expense, net	(6,741)	(10,412)
Earnings before income taxes	322,561	318,923
Provision for income taxes	(88,809)	(99,128)
Net earnings, including noncontrolling interests	233,752	219,795
Less: Net earnings attributable to noncontrolling interests	(2,505)	(1,619)
Net earnings attributable to Flowserve Corporation	$231,247	$218,176
Net earnings per share attributable to Flowserve Corporation common shareholders:		
Basic	$1.68	$1.52
Diluted	1.67	1.51
Cash dividends declared per share	$0.32	$0.28

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

(Amounts in thousands)	Six Months Ended June 30, 2014	2013
Net earnings, including noncontrolling interests	$233,752	$219,795
Other comprehensive income (loss):		
Foreign currency translation adjustments, net of taxes of $(6,451) and $40,607, respectively	10,733	(67,086)
Pension and other postretirement effects, net of taxes of $(1,757) and $(3,053), respectively	4,242	9,627
Cash flow hedging activity, net of taxes of $(58) and $(325), respectively	103	475
Other comprehensive income (loss)	15,078	(56,984)
Comprehensive income, including noncontrolling interests	248,830	162,811
Comprehensive income attributable to noncontrolling interests	(2,682)	(1,693)
Comprehensive income attributable to Flowserve Corporation	$246,148	$161,118

See accompanying notes to condensed consolidated financial statements.

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FLOWSERVE CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

(Amounts in thousands, except par value)	June 30, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$143,569	$363,804
Accounts receivable, net of allowance for doubtful accounts of $25,422 and $24,073, respectively	1,157,758	1,155,327
Inventories, net	1,160,181	1,060,670
Deferred taxes	158,276	157,448
Prepaid expenses and other	109,206	110,133
Total current assets	2,728,990	2,847,382
Property, plant and equipment, net of accumulated depreciation of $866,938 and $849,863, respectively	696,751	716,289
Goodwill	1,101,869	1,107,551
Deferred taxes	20,711	19,533
Other intangible assets, net	151,959	160,548
Other assets, net	185,830	185,430
Total assets	$4,886,110	$5,036,733
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$516,020	$612,092
Accrued liabilities	756,604	861,010
Debt due within one year	65,698	72,678
Deferred taxes	12,394	12,319
Total current liabilities	1,350,716	1,558,099
Long-term debt due after one year	1,123,861	1,127,619
Retirement obligations and other liabilities	472,790	473,894
Shareholders' equity:		
Common shares, $1.25 par value	220,991	220,991
Shares authorized – 305,000		
Shares issued – 176,793		
Capital in excess of par value	472,329	476,218
Retained earnings	3,172,209	2,985,391
Treasury shares, at cost – 41,036 and 39,630 shares, respectively	(1,737,419)	(1,600,266)
Deferred compensation obligation	10,282	9,522
Accumulated other comprehensive loss	(206,574)	(221,477)
Total Flowserve Corporation shareholders' equity	1,931,818	1,870,379
Noncontrolling interests	6,925	6,742
Total equity	1,938,743	1,877,121
Total liabilities and equity	$4,886,110	$5,036,733

See accompanying notes to condensed consolidated financial statements.

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FLOWSERVE CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(Amounts in thousands)	Six Months Ended June 30, 2014	2013
Cash flows – Operating activities:		
Net earnings, including noncontrolling interests	$233,752	$219,795
Adjustments to reconcile net earnings to net cash used by operating activities:		
Depreciation	46,316	43,769
Amortization of intangible and other assets	9,327	7,854
Net (gain) loss on disposition of assets	(167)	347
Gain on sale of business	(13,403)	—
Gain on sale of equity investment in affiliate	—	(12,995)
Gain on remeasurement of acquired assets	—	(15,315)
Excess tax benefits from stock-based compensation arrangements	(8,490)	(8,399)
Stock-based compensation	18,272	16,285
Net earnings from affiliates, net of dividends received	(1,294)	(2,748)
Change in assets and liabilities:		
Accounts receivable, net	(14,695)	5,892
Inventories, net	(115,109)	(120,671)
Prepaid expenses and other	(8,038)	(9,991)
Other assets, net	(1,692)	(2,032)
Accounts payable	(72,649)	(94,326)
Accrued liabilities and income taxes payable	(86,059)	(69,784)
Retirement obligations and other liabilities	(5)	7,848
Net deferred taxes	2,667	1,645
Net cash flows used by operating activities	(11,267)	(32,826)
Cash flows – Investing activities:		
Capital expenditures	(53,666)	(61,159)
Proceeds from disposal of assets	789	336
Payments for acquisition, net of cash acquired	—	(10,143)
Proceeds from sale of business, net of cash divested	46,805	—
Proceeds from equity investments in affiliates	—	46,240
Net cash flows used by investing activities	(6,072)	(24,726)
Cash flows – Financing activities:		
Excess tax benefits from stock-based compensation arrangements	8,490	8,399
Payments on long-term debt	(20,000)	(10,000)
Short-term financing, net	—	209,000
Proceeds under other financing arrangements	13,233	9,701
Payments under other financing arrangements	(4,789)	(9,072)
Repurchases of common shares	(153,068)	(306,317)
Payments of dividends	(41,382)	(37,621)
Other	(2,499)	(73)
Net cash flows used by financing activities	(200,015)	(135,983)
Effect of exchange rate changes on cash	(2,881)	(6,005)

Net change in cash and cash equivalents	(220,235)	(199,540)
Cash and cash equivalents at beginning of period	363,804	304,252
Cash and cash equivalents at end of period	$143,569	$104,712

See accompanying notes to condensed consolidated financial statements.

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FLOWSERVE CORPORATION
(Unaudited)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
1. Basis of Presentation and Accounting Policies
Basis of Presentation
The accompanying condensed consolidated balance sheet as of June 30, 2014, the related condensed consolidated statements of income and comprehensive income for the three and six months ended June 30, 2014 and 2013, and the condensed consolidated statements of cash flows for the six months ended June 30, 2014 and 2013, of Flowserve Corporation are unaudited. In management’s opinion, all adjustments comprising normal recurring adjustments necessary for fair statement of such condensed consolidated financial statements have been made.
The accompanying condensed consolidated financial statements and notes in this Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2014 ("Quarterly Report") are presented as permitted by Regulation S-X and do not contain certain information included in our annual financial statements and notes thereto. Accordingly, the accompanying condensed consolidated financial information should be read in conjunction with the consolidated financial statements presented in our audited Annual Report on Form 10-K for the year ended December 31, 2013 ("2013 Annual Report").
As discussed in Note 15 to our consolidated financial statements included in our 2013 Annual Report, on May 23, 2013, our certificate of incorporation was amended to increase the number of authorized shares of common stock from 120.0 million to 305.0 million and enable a three-for-one stock split approved by the Board of Directors on February 7, 2013 in the form of a 200% common stock dividend. The record date for the stock split was June 7, 2013, and additional shares were distributed on June 21, 2013. Shareholders' equity and all share data, including treasury shares and stock-based compensation award shares, and per share data presented herein have been retrospectively adjusted to reflect the impact of the increase in authorized shares and the stock split, as appropriate.
Venezuela – Our operations in Venezuela generally consist of a service center that performs service and repair activities. In addition, certain of our operations in other countries sell equipment and parts that are typically denominated in United States ("U.S.") dollars directly to Venezuelan customers. Our Venezuelan subsidiary's sales for the three and six months ended June 30, 2014 and total assets at June 30, 2014 represented less than 1% of consolidated sales and total assets for the same periods. Effective February 13, 2013, the Venezuelan government devalued its currency (bolivar) from 4.3 to 6.3 bolivars to the U.S. dollar. As a result of the devaluation, we recognized a loss of $4.0 million in the first quarter of 2013. The loss was reported in other expense, net in our condensed consolidated statements of income and resulted in no tax benefit.
In the first quarter of 2014, the Venezuelan government expanded the use of periodic auctions for U.S. dollars conducted under the Complementary System of Foreign Currency Administration ("SICAD I"). At June 30, 2014 the SICAD I exchange rate was 10.8 bolivars to the U.S. dollar, compared with the official exchange rate of 6.3 bolivars to the U.S. dollar ("Official"). In addition, the Venezuelan government created a third currency exchange mechanism ("SICAD II") that is currently being interpreted to be available to all entities for all transactions at an exchange rate that is significantly less favorable than the Official exchange rate or the SICAD I exchange rate.
As of June 30, 2014, we believe the Official exchange rate continues to be the most appropriate rate to remeasure the U.S. dollar value of the assets, liabilities and results of operations of our Venezuelan subsidiary. We are continuing to assess and monitor the ongoing impact of the recent changes in the Venezuelan foreign exchange market on our Venezuelan operations and imports into the market, including our Venezuelan subsidiary's ability to remit cash for dividends and other payments at the Official exchange rate, as well as further actions of the Venezuelan government and economic conditions that may adversely impact our future consolidated financial condition or results of operations. For reference, if we were to remeasure our bolivar-denominated net monetary assets as of June 30, 2014 utilizing the SICAD I or SICAD II exchange rate, it is estimated that the resulting loss would have been

approximately $4 million or $8 million, respectively.

Accounting Policies

Significant accounting policies, for which no significant changes have occurred in the six months ended June 30, 2014, are detailed in Note 1 to our consolidated financial statements included in our 2013 Annual Report.

Accounting Developments

Pronouncements Implemented

In February 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2013-04, "Liabilities (Topic 405) - Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date," which requires a reporting entity that is jointly and severally liable to

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measure the obligation as the sum of the amount the entity has agreed with co-obligors to pay and any additional amount it expects to pay on behalf of one or more co-obligors. The scope of this ASU excludes obligations addressed by existing guidance. The ASU shall be applied retrospectively for arrangements existing at the beginning of the year of adoption. Our adoption of ASU No. 2013-04 effective January 1, 2014 did not have an impact on our consolidated financial condition and results of operations.

In April 2013, the FASB issued ASU No. 2013-07, "Presentation of Financial Statements (Topic 205) - Liquidation Basis of Accounting," which requires an entity to prepare its financial statements using the liquidation basis of accounting when liquidation is imminent. Liquidation is imminent when the likelihood is remote that the entity will return from liquidation and either (a) a plan for liquidation is approved by the person or persons with the authority to make such a plan effective and the likelihood is remote that the execution of the plan will be blocked by other parties or (b) a plan for liquidation is being imposed by other forces (for example, involuntary bankruptcy). The ASU shall be applied prospectively from the day that liquidation becomes imminent. Our adoption of ASU No. 2013-07 effective January 1, 2014 did not have an impact on our consolidated financial condition and results of operations.

In July 2013, the FASB issued ASU No. 2013-11, "Income Taxes (Topic 740) - Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists," which provides guidance on the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The ASU shall be applied prospectively to all unrecognized tax benefits that exist at the effective date. The adoption of ASU No. 2013-11 effective January 1, 2014 did not have an impact on our consolidated financial condition and results of operations.

In April 2014, the FASB issued ASU No. 2014-08, "Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360) - Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity," which provides guidance on the requirements for reporting discontinued operations. A discontinued operation may include a component of an entity or a group of components of an entity, or a business or nonprofit activity. A disposal of a component of an entity or a group of components of an entity is required to be reported in discontinued operations if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results when the component of an entity or group of components of an entity meets the criteria to be classified as held for sale, is disposed of by sale, or is disposed of other than by sale (e.g., by abandonment or in a distribution to owners in a spinoff). This ASU also introduces new disclosure requirements for discontinued operations. The ASU shall be applied prospectively to (a) all disposals (or classifications as held for sale) of components of an entity and (b) businesses or nonprofit activities that, on acquisition, are classified as held for sale that occur after the effective date. We early adopted this ASU effective January 1, 2014 and it did not have an impact on our consolidated financial condition and results of operations.

Pronouncements Not Yet Implemented

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)" which supersedes the revenue recognition requirements in "Revenue Recognition (Topic 605)." The standard is principle-based and provides a five-step model to determine when and how revenue is recognized. The core principle is that a company should recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. There are also expanded disclosure requirements in this ASU. For public entities ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period and allows for either full retrospective adoption or modified retrospective adoption. We are currently evaluating the impact of ASU No. 2014-09 on our consolidated financial condition and results of operations.

In June 2014, the FASB issued ASU No. 2014-11 "Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures." This ASU changes the accounting for repurchase-to-maturity transactions and linked repurchase financings so that such transactions will now be accounted for as secured borrowings. This accounting change is effective for the first interim or annual period beginning after December 15, 2014 and early adoption is not permitted. There are also new disclosure requirements in this ASU. The adoption of ASU No. 2014-11 will not have a material impact on our consolidated financial condition and results of operations.

In June 2014, the FASB issued ASU No. 2014-12 "Compensation-Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period." This ASU was issued to address share-based payment awards with a performance target affecting vesting that could be achieved after the employee's requisite service period. This ASU is effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. This ASU may be applied either (a) prospectively to all awards granted or modified after the effective date or (b) retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter. The adoption of ASU No. 2014-12 will not have a material impact on our consolidated financial condition and results of operations.

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2. Disposition, Acquisition and Exit of Joint Venture

Effective March 31, 2014, we sold our Flow Control Division's ("FCD") Naval OY ("Naval") business to a Finnish valve manufacturer. The sale included Naval's manufacturing facility located in Laitila, Finland and a service and support center located in St. Petersburg, Russia. The cash proceeds for the sale totaled $46.8 million, net of cash divested, and resulted in a $13.4 million pre-tax gain recorded in selling, general and administrative expense in the condensed consolidated statements of income. Net sales related to the Naval business totaled $8.2 million in the first quarter of 2014.

As discussed in Note 2 to our consolidated financial statements included in our 2013 Annual Report, effective December 10, 2013, we acquired for inclusion in Industrial Product Division ("IPD"), 100% of Innovative Mag-Drive, LLC ("Innomag"), a privately-owned, U.S.-based company specializing in advanced sealless magnetic drive centrifugal pumps for the chemical and general industries, in an asset purchase up to $78.7 million in cash. Of the total purchase price, $66.7 million was paid at closing and $0.8 million represented a subsequent working capital adjustment. The remaining $11.2 million of the total purchase price is contingent upon Innomag achieving certain performance metrics during the two- and five-year periods following the acquisition, and to the extent achieved, is expected to be paid in cash within four months of the performance measurement dates. We initially recorded a liability of $7.5 million as an estimate of the acquisition date fair value of the contingent consideration, which is based on the weighted probability of achievement of the performance metrics as of the date of the acquisition. No pro forma financial information has been presented due to immateriality.

As discussed in Note 2 to our consolidated financial statements included in our 2013 Annual Report, effective March 28, 2013, we and our joint venture partner agreed to exit our joint venture, Audco India, Limited (“AIL”), which manufactures integrated industrial valves in India. To effect the exit, in two separate transactions, FCD acquired 100% ownership of AIL's plug valve manufacturing business in an asset purchase for cash of $10.1 million and sold its 50% equity interest in AIL to the joint venture partner for $46.2 million in cash. We remeasured to fair value our previously held equity interest in the purchased net assets of the plug valve manufacturing business resulting in net assets acquired of approximately $25 million and a pre-tax gain of $15.3 million. The sale of our equity interest in AIL resulted in a pre-tax gain of $13.0 million. In the first quarter of 2013, both of the above gains were recorded in net earnings from affiliates in the condensed consolidated statements of income. No pro forma information has been provided due to immateriality. Prior to these transactions, our 50% interest in AIL was recorded using the equity method of accounting.

3. Stock-Based Compensation Plans

We maintain the Flowserve Corporation Equity and Incentive Compensation Plan (the "2010 Plan"), which is a shareholder-approved plan authorizing the issuance of up to 8,700,000 shares of our common stock in the form of restricted shares, restricted share units and performance-based units (collectively referred to as "Restricted Shares"), incentive stock options, non-statutory stock options, stock appreciation rights and bonus stock. Of the 8,700,000 shares of common stock authorized under the 2010 Plan, 5,059,754 were available for issuance as of June 30, 2014. The Flowserve Corporation 2004 Stock Compensation Plan expired on June 22, 2014, with 827,835 shares unissued. No stock options have been granted since 2006.

Restricted Shares – Awards of Restricted Shares are valued at the closing market price of our common stock on the date of grant. The unearned compensation is amortized to compensation expense over the vesting period of the restricted shares. We had unearned compensation of $45.2 million and $31.5 million at June 30, 2014 and December 31, 2013, respectively, which is expected to be recognized over a weighted-average period of approximately one year. These amounts will be recognized into net earnings in prospective periods as the awards vest. The total fair value of Restricted Shares vested during the three months ended June 30, 2014 and 2013 was $1.5 million and $1.6 million, respectively. The total fair value of Restricted Shares vested during the six months ended June 30, 2014 and 2013 was $34.4 million and $34.8 million, respectively.

We recorded stock-based compensation expense of $5.5 million ($8.4 million pre-tax) and $5.4 million ($8.2 million pre-tax) for the three months ended June 30, 2014 and 2013, respectively. We recorded stock-based compensation expense of $12.0 million ($18.3 million pre-tax) and $10.7 million ($16.3 million pre-tax) for the six months ended June 30, 2014 and 2013, respectively.

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The following table summarizes information regarding Restricted Shares:

	Six Months Ended June 30, 2014	
	Shares	Weighted Average Grant-Date Fair Value
Number of unvested shares:		
Outstanding - January 1, 2014	2,020,678	$44.68
Granted	486,484	72.30
Vested	(778,643)	44.24
Canceled	(71,977)	50.93
Outstanding - June 30, 2014	1,656,542	$52.72

Unvested Restricted Shares outstanding as of June 30, 2014, includes approximately 829,000 units with performance-based vesting provisions. Performance-based units are issuable in common stock and vest upon the achievement of pre-defined performance targets, primarily based on our average annual return on net assets over a three-year period as compared with the same measure for a defined peer group for the same period. Most units were granted in three annual grants since January 1, 2012 and have a vesting percentage between 0% and 200% depending on the achievement of the specific performance targets. Compensation expense is recognized ratably over a cliff-vesting period of 36 months, based on the fair market value of our common stock on the date of grant, as adjusted for anticipated forfeitures. During the performance period, earned and unearned compensation expense is adjusted based on changes in the expected achievement of the performance targets. Vesting provisions range from 0 to approximately 1,610,000 shares based on performance targets. As of June 30, 2014, we estimate vesting of approximately 1,018,000 shares based on expected achievement of performance targets.

4. Derivative Instruments and Hedges

Our risk management and foreign currency derivatives and hedging policy specifies the conditions under which we may enter into derivative contracts. See Notes 1 and 6 to our consolidated financial statements included in our 2013 Annual Report and Note 7 of this Quarterly Report for additional information on our derivatives. We enter into foreign exchange forward and swap contracts to hedge our cash flow risks associated with transactions denominated in currencies other than the local currency of the operation engaging in the transaction. All designated foreign exchange hedging instruments are highly effective.

Foreign exchange contracts designated as hedging instruments had a notional value of $56.3 million and $6.2 million, at June 30, 2014 and December 31, 2013, respectively. The fair values of assets and liabilities and any changes in those fair values related to designated foreign exchange contracts are immaterial for the periods presented below.

Foreign exchange contracts with third parties not designated as hedging instruments had a notional value of $576.7 million and $610.7 million, at June 30, 2014 and December 31, 2013, respectively. At June 30, 2014, the length of foreign exchange contracts currently in place ranged from one day to 21 months.

Also as part of our risk management program, we enter into interest rate swap agreements to hedge exposure to floating interest rates on certain portions of our debt. At June 30, 2014 and December 31, 2013, we had $40.0 million and $140.0 million, respectively, of notional amount in outstanding interest rate swaps with third parties. All interest rate swaps are highly effective. At June 30, 2014, the maximum remaining length of any interest rate swap contract in place was approximately 12 months.

We are exposed to risk from credit-related losses resulting from nonperformance by counterparties to our financial instruments. We perform credit evaluations of our counterparties under foreign exchange contracts and interest rate swap agreements and expect all counterparties to meet their obligations. We have not experienced credit losses from our counterparties.

The fair value of foreign exchange contracts not designated as hedging instruments are summarized below:

(Amounts in thousands)	June 30, 2014	December 31, 2013
Current derivative assets	$3,136	$5,215
Noncurrent derivative assets	37	729
Current derivative liabilities	2,266	2,207
Noncurrent derivative liabilities	—	113

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The fair value of interest rate swaps and foreign exchange contracts designated as hedging instruments are summarized below:

(Amounts in thousands)	June 30, 2014	December 31, 2013
Current derivative assets	$149	$146
Noncurrent derivative assets	3	—
Current derivative liabilities	424	409
Noncurrent derivative liabilities	10	37

Current and noncurrent derivative assets are reported in our condensed consolidated balance sheets in prepaid expenses and other and other assets, net, respectively. Current and noncurrent derivative liabilities are reported in our condensed consolidated balance sheets in accrued liabilities and retirement obligations and other liabilities, respectively.

The impact of net changes in the fair values of foreign exchange contracts are summarized below:

	Three Months Ended June 30,		Six Months Ended June 30,	
(Amounts in thousands)	2014	2013	2014	2013
Gain (loss) recognized in income	$1,421	$(4,534)	$(123)	$(7,531)

Gains and losses recognized in our condensed consolidated statements of income for foreign exchange contracts are classified as other (expense) income, net.

The impact of net changes in the fair values of interest rate swaps in cash flow hedging relationships are summarized in Note 15.

5. Debt

Debt, including capital lease obligations, consisted of:

(Amounts in thousands, except percentages)	June 30, 2014	December 31, 2013
4.00% Senior Notes due November 15, 2023, net of unamortized discount	$298,673	$298,615
3.50% Senior Notes due September 15, 2022 net of unamortized discount	498,373	498,289
Term Loan Facility, interest rate of 1.48% at June 30, 2014 and 1.50% at December 31, 2013	350,000	370,000
Capital lease obligations and other borrowings	42,513	33,393
Debt and capital lease obligations	1,189,559	1,200,297
Less amounts due within one year	65,698	72,678
Total debt due after one year	$1,123,861	$1,127,619

Senior Notes

As discussed in Note 10 to our consolidated financial statements included in our 2013 Annual Report, on November 1, 2013 we completed the public offering of $300.0 million in aggregate principal amount of senior notes due November 15, 2023 ("2023 Senior Notes"). On September 11, 2012, we completed the public offering of $500.0 million in aggregate principal amount of senior notes due September 15, 2022 ("2022 Senior Notes").

Senior Credit Facility

As discussed in Note 10 to our consolidated financial statements included in our 2013 Annual Report, on October 4, 2013 we amended our existing credit agreement that provided for a $400.0 million term loan (“Term Loan Facility”) and a revolving credit facility (“Revolving Credit Facility” and, together with the Term Loan Facility, the “Senior Credit Facility”) with a maturity date of October 4, 2018. As of June 30, 2014 and December 31, 2013, we had no amounts outstanding under the Revolving Credit Facility. We had outstanding letters of credit of $80.0 million and $106.1

million at June 30, 2014 and December 31, 2013, respectively, which reduced our borrowing capacity to $920.0 million and $893.9 million, respectively. Our obligations under the Senior Credit Facility are guaranteed by certain of our 100% owned domestic subsidiaries. Such guarantees are released if we achieve certain credit ratings. We had not achieved these ratings as of June 30, 2014. Our compliance with applicable financial covenants under the Senior Credit Facility is tested quarterly, and we complied with all covenants at June 30, 2014.

We may prepay loans under our Senior Credit Facility in whole or in part, without premium or penalty, at any time. A commitment fee, which is payable quarterly on the daily unused portions of the Senior Credit Facility, was 0.175% (per annum) during the period ended June 30, 2014. During the six months ended June 30, 2014, we made scheduled repayments of $20.0 million under our Term Loan Facility. We have scheduled repayments of $10.0 million due in each of the next four quarters on our Senior Credit Facility. Our Senior Credit Facility bears a floating rate of interest, and we have $40.0 million of notional amount of interest rate swaps at June 30, 2014 to hedge exposure to floating interest rates.

European Letter of Credit Facility

Due to the increased capacity and the removal of the performance letters of credit sublimit of the amended Revolving Credit Facility, we elected not to renew our 364-day unsecured, committed €125.0 million European Letter of Credit Facility ("European LOC Facility"), which expired in October 2013; however, the existing letters of credit remain outstanding and are still bound by the facility's covenants. We were in compliance with all covenants under our European LOC Facility as of June 30, 2014.

We had outstanding letters of credit drawn on the European LOC Facility of €12.3 million ($16.8 million) and €69.6 million ($95.4 million) as of June 30, 2014 and December 31, 2013, respectively.

6. Supplemental Guarantor Financial Information

Our Senior Notes are fully and unconditionally and jointly and severally guaranteed by certain of our 100% owned domestic subsidiaries. The following condensed consolidating financial statements present the financial position, results of operations and cash flows of Flowserve Corporation (referred to as “Parent” for the purpose of this note only) on a Parent–only (Issuer) basis, the combined guarantor subsidiaries on a guarantor–only basis, the combined non-guarantor subsidiaries on a non-guarantor-only basis and elimination adjustments necessary to arrive at the information for the Parent, guarantor subsidiaries and non-guarantor subsidiaries on a condensed consolidated basis. Investments in subsidiaries have been accounted for using the equity method for this presentation.

FLOWSERVE CORPORATION

CONDENSED CONSOLIDATING STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

	Three Months Ended June 30, 2014				
	Parent (Issuer)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated Total
(Amounts in thousands)					
Sales	$—	$474,960	$ 831,814	$(82,396)	$1,224,378
Cost of sales	—	(305,643)	(570,825)	82,396	(794,072)
Gross profit	—	169,317	260,989	—	430,306
Selling, general and administrative expense	(447)	(119,378)	(118,353)	—	(238,178)
Net earnings from affiliates	—	(25)	2,212	—	2,187
Net earnings from consolidated subsidiaries, net of tax	130,035	106,025	—	(236,060)	—
Operating income	129,588	155,939	144,848	(236,060)	194,315
Interest expense, net	(8,924)	(2,768)	(2,828)	—	(14,520)
Other expense, net	—	(3,112)	(724)	—	(3,836)
Earnings before income taxes	120,664	150,059	141,296	(236,060)	175,959
Provision for income taxes	2,849	(20,024)	(33,619)	—	(50,794)
Net earnings, including noncontrolling interests	123,513	130,035	107,677	(236,060)	125,165

Less: Net earnings attributable to noncontrolling interests	—	—	(1,652)	—	(1,652)
Net earnings attributable to Flowserve Corporation	$123,513	$130,035	$ 106,025	$(236,060)	$123,513
Comprehensive income attributable to Flowserve Corporation	$132,694	$139,131	$ 112,495	$(251,626)	$132,694

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	Three Months Ended June 30, 2013				
	Parent (Issuer)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated Total
(Amounts in thousands)					
Sales	$—	$492,643	$ 842,124	$(95,241)	$1,239,526
Cost of sales	—	(321,255)	(591,936)	95,241	(817,950)
Gross profit	—	171,388	250,188	—	421,576
Selling, general and administrative expense	(1,724)	(69,928)	(168,548)	—	(240,200)
Net earnings from affiliates	—	176	1,969	—	2,145
Net earnings from consolidated subsidiaries, net of tax	126,771	65,156	—	(191,927)	—
Operating income	125,047	166,792	83,609	(191,927)	183,521
Interest expense, net	(7,233)	(2,981)	(2,634)	—	(12,848)
Other (expense) income, net	—	(1,708)	2,324	—	616
Earnings before income taxes	117,814	162,103	83,299	(191,927)	171,289
Provision for income taxes	2,572	(35,332)	(17,635)	—	(50,395)
Net earnings, including noncontrolling interests	120,386	126,771	65,664	(191,927)	120,894
Less: Net earnings attributable to noncontrolling interests	—	—	(508)	—	(508)
Net earnings attributable to Flowserve Corporation	$120,386	$126,771	$ 65,156	$(191,927)	$120,386
Comprehensive income attributable to Flowserve Corporation	$94,249	$95,295	$ 31,795	$(127,090)	$94,249

	Six Months Ended June 30, 2014				
	Parent (Issuer)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated Total
(Amounts in thousands)					
Sales	$—	$917,467	$ 1,533,886	$(158,839)	$2,292,514
Cost of sales	—	(587,856)	(1,056,069)	158,839	(1,485,086)
Gross profit	—	329,611	477,817	—	807,428
Selling, general and administrative expense	(896)	(170,550)	(282,959)	—	(454,405)
Net earnings from affiliates	—	362	5,255	—	5,617
Net earnings from consolidated subsidiaries, net of tax	244,494	145,207	—	(389,701)	—
Operating income	243,598	304,630	200,113	(389,701)	358,640
Interest expense, net	(18,057)	(5,447)	(5,834)	—	(29,338)
Other income (expense), net	2	(4,977)	(1,766)	—	(6,741)
Earnings before income taxes	225,543	294,206	192,513	(389,701)	322,561
Provision for income taxes	5,704	(49,712)	(44,801)	—	(88,809)
Net earnings, including noncontrolling interests	231,247	244,494	147,712	(389,701)	233,752
Less: Net earnings attributable to noncontrolling interests	—	—	(2,505)	—	(2,505)

Net earnings attributable to Flowserve Corporation	$231,247	$244,494	$ 145,207	$(389,701)	$231,247
Comprehensive income attributable to Flowserve Corporation	$246,148	$259,185	$ 158,823	$(418,008)	$246,148

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	Six Months Ended June 30, 2013				
	Parent (Issuer)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated Total
(Amounts in thousands)					
Sales	$—	$940,221	$ 1,573,510	$(177,609)	$2,336,122
Cost of sales	—	(610,220)	(1,108,627)	177,609	(1,541,238)
Gross profit	—	330,001	464,883	—	794,884
Selling, general and administrative expense	(2,063)	(162,716)	(309,929)	—	(474,708)
Net earnings from affiliates	—	400	33,424	—	33,824
Net earnings from consolidated subsidiaries, net of tax	229,328	125,433	—	(354,761)	—
Operating income	227,265	293,118	188,378	(354,761)	354,000
Interest expense, net	(13,733)	(5,760)	(5,172)	—	(24,665)
Other expense, net	—	(3,382)	(7,030)	—	(10,412)
Earnings before income taxes	213,532	283,976	176,176	(354,761)	318,923
Provision for income taxes	4,644	(54,648)	(49,124)	—	(99,128)
Net earnings, including noncontrolling interests	218,176	229,328	127,052	(354,761)	219,795
Less: Net earnings attributable to noncontrolling interests	—	—	(1,619)	—	(1,619)
Net earnings attributable to Flowserve Corporation	$218,176	$229,328	$ 125,433	$(354,761)	$218,176
Comprehensive income attributable to Flowserve Corporation	$161,118	$264,467	$ 159,285	$(423,752)	$161,118

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FLOWSERVE CORPORATION
CONDENSED CONSOLIDATING BALANCE SHEETS

	June 30, 2014				
	Parent (Issuer)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated Total
(Amounts in thousands)					
ASSETS					
Current assets:					
Cash and cash equivalents	$909	$—	$ 142,660	$—	$143,569
Accounts receivable, net	—	255,706	902,052	—	1,157,758
Intercompany receivables	4,180	130,587	322,601	(457,368)	—
Inventories, net	—	398,760	761,421	—	1,160,181
Other current assets, net	626	141,468	125,388	—	267,482
Total current assets	5,715	926,521	2,254,122	(457,368)	2,728,990
Property, plant and equipment, net	—	221,421	475,330	—	696,751
Goodwill	—	709,239	392,630	—	1,101,869
Intercompany receivables	432,500	11,376	56,542	(500,418)	—
Investment in consolidated subsidiaries	2,646,529	1,997,900	—	(4,644,429)	—
Other assets, net	13,831	199,680	144,989	—	358,500
Total assets	$3,098,575	$4,066,137	$ 3,323,613	$(5,602,215)	$4,886,110
LIABILITIES AND EQUITY					
Current liabilities:					
Accounts payable	$—	$139,773	$ 376,247	$—	$516,020
Intercompany payables	103	326,678	130,587	(457,368)	—
Accrued liabilities	11,772	248,091	496,741	—	756,604
Debt due within one year	40,000	—	25,698	—	65,698
Deferred taxes	—	—	12,394	—	12,394
Total current liabilities	51,875	714,542	1,041,667	(457,368)	1,350,716
Long-term debt due after one year	1,107,046	—	16,815	—	1,123,861
Intercompany payables	1,144	487,898	11,376	(500,418)	—
Retirement obligations and other liabilities	6,692	217,168	248,930	—	472,790
Total liabilities	1,166,757	1,419,608	1,318,788	(957,786)	2,947,367
Total Flowserve Corporation shareholders' equity	1,931,818	2,646,529	1,997,900	(4,644,429)	1,931,818
Noncontrolling interests	—	—	6,925	—	6,925
Total equity	1,931,818	2,646,529	2,004,825	(4,644,429)	1,938,743
Total liabilities and equity	$3,098,575	$4,066,137	$ 3,323,613	$(5,602,215)	$4,886,110

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	December 31, 2013				
	Parent (Issuer)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated Total
(Amounts in thousands)					
ASSETS					
Current assets:					
Cash and cash equivalents	$29,086	$—	$ 334,718	$—	$363,804
Accounts receivable, net	—	263,594	891,733	—	1,155,327
Intercompany receivables	—	155,422	74,089	(229,511)	—
Inventories, net	—	371,172	689,498	—	1,060,670
Other current assets, net	1,879	144,551	121,151	—	267,581
Total current assets	30,965	934,739	2,111,189	(229,511)	2,847,382
Property, plant and equipment, net	—	220,072	496,217	—	716,289
Goodwill	—	715,722	391,829	—	1,107,551
Intercompany receivables	432,500	9,520	186,789	(628,809)	—
Investment in consolidated subsidiaries	2,579,701	1,850,998	—	(4,430,699)	—
Other assets, net	15,486	211,755	138,270	—	365,511
Total assets	$3,058,652	$3,942,806	$ 3,324,294	$(5,289,019)	$5,036,733
LIABILITIES AND EQUITY					
Current liabilities:					
Accounts payable	$—	$163,254	$ 448,838	$—	$612,092
Intercompany payables	81	74,008	155,422	(229,511)	—
Accrued liabilities	12,874	293,012	555,124	—	861,010
Debt due within one year	40,000	5	32,673	—	72,678
Deferred taxes	—	—	12,319	—	12,319
Total current liabilities	52,955	530,279	1,204,376	(229,511)	1,558,099
Long-term debt due after one year	1,126,904	—	715	—	1,127,619
Intercompany payables	1,144	618,145	9,520	(628,809)	—
Retirement obligations and other liabilities	7,270	214,681	251,943	—	473,894
Total liabilities	1,188,273	1,363,105	1,466,554	(858,320)	3,159,612
Total Flowserve Corporation shareholders' equity	1,870,379	2,579,701	1,850,998	(4,430,699)	1,870,379
Noncontrolling interests	—	—	6,742	—	6,742
Total equity	1,870,379	2,579,701	1,857,740	(4,430,699)	1,877,121
Total liabilities and equity	$3,058,652	$3,942,806	$ 3,324,294	$(5,289,019)	$5,036,733

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FLOWSERVE CORPORATION
CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS

	Six Months Ended June 30, 2014				
	Parent (Issuer)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated Total
(Amounts in thousands)					
Net cash flows provided (used) by operating activities	$186,273	$72,926	$ (64,561)	$(205,905)	$(11,267)
Cash flows — Investing activities:					
Capital expenditures	—	(20,953)	(32,713)	—	(53,666)
Proceeds from sale of business, net of cash divested	—	—	46,805	—	46,805
Intercompany short-term financing, net	—	—	(268,067)	268,067	—
Intercompany loan proceeds	—	8	130,247	(130,255)	—
Intercompany loan payments	—	(1,864)	—	1,864	—
Proceeds from disposition of assets	—	78	711	—	789
Net cash flows (used) provided by investing activities	—	(22,731)	(123,017)	139,676	(6,072)
Cash flows — Financing activities:					
Excess tax benefits from stock-based payment arrangements	—	6,487	2,003	—	8,490
Payments on long-term debt	(20,000)	—	—	—	(20,000)
Proceeds under other financing arrangements	—	—	13,233	—	13,233
Payments under other financing arrangements	—	(5)	(4,784)	—	(4,789)
Repurchases of common shares	(153,068)	—	—	—	(153,068)
Payments of dividends	(41,382)	—	—	—	(41,382)
Intercompany short-term financing, net	—	268,067	—	(268,067)	—
Intercompany loan proceeds	—	—	1,864	(1,864)	—
Intercompany loan payments	—	(130,247)	(8)	130,255	—
Intercompany dividends	—	(194,497)	(11,408)	205,905	—
All other financing, net	—	—	(2,499)	—	(2,499)
Net cash flows (used) provided by financing activities	(214,450)	(50,195)	(1,599)	66,229	(200,015)
Effect of exchange rate changes on cash	—	—	(2,881)	—	(2,881)
Net change in cash and cash equivalents	(28,177)	—	(192,058)	—	(220,235)
Cash and cash equivalents at beginning of period	29,086	—	334,718	—	363,804
Cash and cash equivalents at end of period	$909	$—	$ 142,660	$—	$143,569

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	Six Months Ended June 30, 2013				
	Parent (Issuer)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated Total
(Amounts in thousands)					
Net cash flows provided (used) by operating activities	$143,558	$132,215	$ (155,904)	$ (152,695)	$(32,826)
Cash flows — Investing activities:					
Capital expenditures	—	(17,817)	(43,342)	—	(61,159)
Payments for acquisition, net of cash acquired	—	—	(10,143)	—	(10,143)
Intercompany loan proceeds	—	911	56,332	(57,243)	—
Intercompany loan payments	—	(15)	(76,757)	76,772	—
Proceeds from disposition of assets	—	73	263	—	336
Affiliate investment activity, net	—	—	46,240	—	46,240
Net cash flows (used) provided by investing activities	—	(16,848)	(27,407)	19,529	(24,726)
Cash flows — Financing activities:					
Excess tax benefits from stock-based payment arrangements	—	6,578	1,821	—	8,399
Payments on long-term debt	(10,000)	—	—	—	(10,000)
Short-term financing, net	209,000	—	—	—	209,000
Proceeds under other financing arrangements	—	—	9,701	—	9,701
Payments under other financing arrangements	—	(10)	(9,062)	—	(9,072)
Repurchases of common shares	(306,317)	—	—	—	(306,317)
Payments of dividends	(37,621)	—	—	—	(37,621)
Intercompany loan proceeds	—	76,757	15	(76,772)	—
Intercompany loan payments	—	(56,332)	(911)	57,243	—
Intercompany dividends	—	(142,360)	(10,335)	152,695	—
All other financing, net	59	—	(132)	—	(73)
Net cash flows (used) provided by financing activities	(144,879)	(115,367)	(8,903)	133,166	(135,983)
Effect of exchange rate changes on cash	—	—	(6,005)	—	(6,005)
Net change in cash and cash equivalents	(1,321)	—	(198,219)	—	(199,540)
Cash and cash equivalents at beginning of period	2,609	—	301,643	—	304,252
Cash and cash equivalents at end of period	$1,288	$—	$ 103,424	$ —	$104,712

7. Fair Value

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Where available, fair value is based on observable market prices or parameters or derived from such prices or parameters. Where observable prices or inputs are not available, valuation models may be applied. Assets and liabilities recorded at fair value in our condensed consolidated balance sheets are categorized by hierarchical levels based upon the level of judgment associated with the inputs used to measure their fair values. Recurring fair value measurements are limited to investments in derivative instruments. The fair value measurements of our derivative instruments are determined using models that maximize the use of the observable market inputs including interest rate curves and both forward and spot prices for currencies, and are classified as Level II under the fair value hierarchy. The fair values of our derivatives are included in Note 4.

Our financial instruments are presented at fair value in our condensed consolidated balance sheets, with the exception of our long-term debt. The estimated fair value of our long-term debt, excluding the Senior Notes, approximates the carrying value and is classified as Level II under the fair value hierarchy. The carrying value of our debt is included in Note 5. The estimated fair value of our Senior Notes at June 30, 2014 was $799.7 million compared to the carrying value of $797.0 million. The estimated fair value of the Senior Notes is based on Level I quoted market rates. The carrying amounts of our other financial instruments (e.g., cash and cash equivalents, accounts receivable, net, accounts payable and short-term debt) approximated fair value due to their short-term nature at June 30, 2014 and December 31, 2013.

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8. Inventories

Inventories, net consisted of the following:

(Amounts in thousands)	June 30, 2014	December 31, 2013
Raw materials	$383,726	$356,899
Work in process	890,779	786,664
Finished goods	308,950	306,765
Less: Progress billings	(339,455)	(304,395)
Less: Excess and obsolete reserve	(83,819)	(85,263)
Inventories, net	$1,160,181	$1,060,670

9. Earnings Per Share

The following is a reconciliation of net earnings of Flowserve Corporation and weighted average shares for calculating net earnings per common share. Earnings per weighted average common share outstanding was calculated as follows:

	Three Months Ended June 30,	
(Amounts in thousands, except per share data)	2014	2013
Net earnings of Flowserve Corporation	$123,513	$120,386
Dividends on restricted shares not expected to vest	3	3
Earnings attributable to common and participating shareholders	$123,516	$120,389
Weighted average shares:		
Common stock	136,613	141,524
Participating securities	573	688
Denominator for basic earnings per common share	137,186	142,212
Effect of potentially dilutive securities	809	670
Denominator for diluted earnings per common share	137,995	142,882
Earnings per common share:		
Basic	$0.90	$0.85
Diluted	0.90	0.84

	Six Months Ended June 30,	
(Amounts in thousands, except per share data)	2014	2013
Net earnings of Flowserve Corporation	$231,247	$218,176
Dividends on restricted shares not expected to vest	6	6
Earnings attributable to common and participating shareholders	$231,253	$218,182
Weighted average shares:		
Common stock	136,868	142,617
Participating securities	592	724
Denominator for basic earnings per common share	137,460	143,341
Effect of potentially dilutive securities	972	915
Denominator for diluted earnings per common share	138,432	144,256
Earnings per common share:		
Basic	$1.68	$1.52
Diluted	1.67	1.51

Diluted earnings per share above is based upon the weighted average number of shares as determined for basic earnings per share plus shares potentially issuable in conjunction with stock options and Restricted Shares.

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For the three and six months ended both June 30, 2014 and 2013, no options to purchase common stock were excluded from the computation of potentially dilutive securities.

10. Legal Matters and Contingencies

Asbestos-Related Claims

We are a defendant in a substantial number of lawsuits that seek to recover damages for personal injury allegedly caused by exposure to asbestos-containing products manufactured and/or distributed by our heritage companies in the past. While the overall number of asbestos-related claims has generally declined in recent years, there can be no assurance that this trend will continue, or that the average cost per claim will not further increase. Asbestos-containing materials incorporated into any such products were primarily encapsulated and used as internal components of process equipment, and we do not believe that any significant emission of asbestos fibers occurred during the use of this equipment.

Our practice is to vigorously contest and resolve these claims, and we have been successful in resolving a majority of claims with little or no payment. Historically, a high percentage of resolved claims have been covered by applicable insurance or indemnities from other companies, and we believe that a substantial majority of existing claims should continue to be covered by insurance or indemnities. Accordingly, we have recorded a liability for our estimate of the most likely settlement of asserted claims and a related receivable from insurers or other companies for our estimated recovery, to the extent we believe that the amounts of recovery are probable and not otherwise in dispute. While unfavorable rulings, judgments or settlement terms regarding these claims could have a material adverse impact on our business, financial condition, results of operations and cash flows, we currently believe the likelihood is remote. Additionally, we have claims pending against certain insurers that, if resolved more favorably than reflected in the recorded receivables, would result in discrete gains in the applicable quarter. We are currently unable to estimate the impact, if any, of unasserted asbestos-related claims, although future claims would also be subject to then existing indemnities and insurance coverage.

United Nations Oil-for-Food Program

In mid-2006, French authorities began an investigation of over 170 French companies, of which one of our French subsidiaries was included, concerning suspected inappropriate activities conducted in connection with the United Nations Oil for Food Program. As previously disclosed, the French investigation of our French subsidiary was formally opened in the first quarter of 2010, and our French subsidiary filed a formal response with the French Court. In July 2012, the French Court ruled against our procedural motions to challenge the constitutionality of the charges and quash the indictment. While the French Court ruling is currently proceeding through a formal review process, we currently do not expect to incur additional case resolution costs of a material amount in this matter. However, if the French authorities take enforcement action against our French subsidiary regarding its investigation, we may be subject to monetary and non-monetary penalties, which we currently do not believe will have a material adverse financial impact on our company.

In addition to the governmental investigation referenced above, on June 27, 2008, the Republic of Iraq filed a civil suit in federal court in New York against 93 participants in the United Nations Oil-for-Food Program, including us and our two foreign subsidiaries that participated in the program. On February 6, 2013 the U.S. District Court for the Southern District of New York issued a ruling that dismissed the suit with prejudice. The plaintiff appealed the dismissal, and that appeal remains pending. We will continue to vigorously contest the suit, and we believe that we have valid defenses to the claims asserted. We do not currently believe the resolution of this suit will have a material adverse financial impact on our company.

Other

We are currently involved as a potentially responsible party at five former public waste disposal sites in various stages of evaluation or remediation. The projected cost of remediation at these sites, as well as our alleged "fair share" allocation, will remain uncertain until all studies have been completed and the parties have either negotiated an amicable resolution or the matter has been judicially resolved. At each site, there are many other parties who have similarly been identified. Many of the other parties identified are financially strong and solvent companies that appear able to pay their share of the remediation costs. Based on our information about the waste disposal practices at these sites and the environmental regulatory process in general, we believe that it is likely that ultimate remediation liability costs for each site will be apportioned among all liable parties, including site owners and waste transporters, according to the volumes and/or toxicity of the wastes shown to have been disposed of at the sites. We believe that our financial exposure for existing disposal sites will not be materially in excess of accrued reserves.

We are also a defendant in a number of other lawsuits, including product liability claims, that are insured, subject to the applicable deductibles, arising in the ordinary course of business, and we are also involved in other uninsured routine litigation, including contract disputes, incidental to our business. We currently believe none of such litigation, either individually or in the aggregate, is material to our business, operations or overall financial condition. However, litigation is inherently unpredictable,

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and resolutions or dispositions of claims or lawsuits by settlement or otherwise could have an adverse impact on our financial position, results of operations or cash flows for the reporting period in which any such resolution or disposition occurs.

Although none of the aforementioned potential liabilities can be quantified with absolute certainty except as otherwise indicated above, we have established reserves covering exposures relating to contingencies, to the extent believed to be reasonably estimable and probable based on past experience and available facts. While additional exposures beyond these reserves could exist, they currently cannot be estimated. We will continue to evaluate and update the reserves as necessary and appropriate.

11. Retirement and Postretirement Benefits

Components of the net periodic cost for retirement and postretirement benefits for the three months ended June 30, 2014 and 2013 were as follows:

	U.S. Defined Benefit Plans		Non-U.S. Defined Benefit Plans		Postretirement Medical Benefits	
(Amounts in millions)	2014	2013	2014	2013	2014	2013
Service cost	$5.8	$6.1	$1.8	$1.7	$—	$—
Interest cost	4.3	3.8	3.7	3.4	0.3	0.2
Expected return on plan assets	(5.5)	(5.1)	(2.6)	(2.3)	—	—
Amortization of prior service benefit	0.1	—	—	—	—	—
Amortization of unrecognized net loss (gain)	2.2	3.4	1.7	1.6	(0.2)	(0.3)
Net periodic cost (benefit) recognized	$6.9	$8.2	$4.6	$4.4	$0.1	$(0.1)

Components of the net periodic cost for retirement and postretirement benefits for the six months ended June 30, 2014 and 2013 were as follows:

	U.S. Defined Benefit Plans		Non-U.S. Defined Benefit Plans		Postretirement Medical Benefits	
(Amounts in millions)	2014	2013	2014	2013	2014	2013
Service cost	$11.5	$12.2	$3.5	$3.4	$—	$—
Interest cost	8.7	7.6	7.4	6.8	0.6	0.5
Expected return on plan assets	(11.0)	(10.2)	(5.3)	(4.7)	—	—
Amortization of prior service benefit	0.2	—	0.1	—	—	—
Amortization of unrecognized net loss (gain)	4.2	6.9	3.4	3.3	(0.6)	(0.6)
Net periodic cost (benefit) recognized	$13.6	$16.5	$9.1	$8.8	$—	$(0.1)

12. Shareholders' Equity

Dividends – On February 17, 2014, our Board of Directors authorized an increase in the payment of quarterly dividends on our common stock from $0.14 per share to $0.16 per share payable quarterly beginning on April 11, 2014. On February 19, 2013, our Board of Directors authorized an increase in the payment of quarterly dividends on our common stock from $0.12 per share to $0.14 per share, payable quarterly beginning on April 12, 2013. Generally, our dividend date-of-record is in the last month of the quarter, and the dividend is paid the following month. Any subsequent dividends will be reviewed by our Board of Directors and declared in its discretion dependent on its assessment of our financial situation and business outlook at the applicable time.

Share Repurchase Program – On February 19, 2013, our Board of Directors approved a $750.0 million share repurchase authorization, which included approximately $193 million of remaining capacity under the prior $1.0 billion share repurchase authorization. Our share repurchase program does not have an expiration date, and we reserve the right to limit or terminate the repurchase program at any time without notice.

We repurchased 573,881 shares of our outstanding common stock for $43.5 million, and 2,784,000 shares for $150.8 million, during the three months ended June 30, 2014 and 2013, respectively. We repurchased 2,010,304 shares of our outstanding common stock for $153.1 million, and 5,761,104 shares for $306.3 million, during the six months ended June 30, 2014 and 2013, respectively. As of June 30, 2014, we have $231.3 million of remaining capacity under our current share repurchase program.

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13. Income Taxes

For the three months ended June 30, 2014, we earned $176.0 million before taxes and provided for income taxes of $50.8 million, resulting in an effective tax rate of 28.9%. For the six months ended June 30, 2014, we earned $322.6 million before taxes and provided for income taxes of $88.8 million resulting in an effective tax rate of 27.5%. The effective tax rate varied from the U.S. federal statutory rate for the three and six months ended June 30, 2014 primarily due to the net impact of foreign operations.

For the three months ended June 30, 2013, we earned $171.3 million before taxes and provided for income taxes of $50.4 million, resulting in an effective tax rate of 29.4%. For the six months ended June 30, 2013, we earned $318.9 million before taxes and provided for income taxes of $99.1 million, resulting in an effective tax rate of 31.1%. The effective tax rate varied from the U.S. federal statutory rate for the three months ended June 30, 2013 primarily due to the net impact of foreign operations. The effective tax rate varied from the U.S. federal statutory rate for the six months ended June 30, 2013 primarily due to the net impact of foreign operations, partially offset by taxes incurred on the exit of our equity investment in the AIL joint venture discussed in Note 2.

As of June 30, 2014, the amount of unrecognized tax benefits increased by $3.5 million from December 31, 2013. With limited exception, we are no longer subject to U.S. federal income tax audits for years through 2012, state and local income tax audits for years through 2009 or non-U.S. income tax audits for years through 2007. We are currently under examination for various years in Austria, France, Germany, India, Italy, Singapore, the U.S., Venezuela and Vietnam.

It is reasonably possible that within the next 12 months the effective tax rate will be impacted by the resolution of some or all of the matters audited by various taxing authorities. It is also reasonably possible that we will have the statute of limitations close in various taxing jurisdictions within the next 12 months. As such, we estimate we could record a reduction in our tax expense of approximately $10.9 million within the next 12 months.

14. Segment Information

The following is a summary of the financial information of the reportable segments reconciled to the amounts reported in the condensed consolidated financial statements:

Three Months Ended June 30, 2014

(Amounts in thousands)	Engineered Product Division	Industrial Product Division	Flow Control Division	Subtotal–Reportable Segments	Eliminations and All Other	Consolidated Total
Sales to external customers	$592,921	$226,841	$404,616	$ 1,224,378	$—	$1,224,378
Intersegment sales	16,270	11,217	1,769	29,256	(29,256)	—
Segment operating income	103,769	31,556	79,129	214,454	(20,139)	194,315

Three Months Ended June 30, 2013

(Amounts in thousands)	Engineered Product Division	Industrial Product Division	Flow Control Division	Subtotal–Reportable Segments	Eliminations and All Other	Consolidated Total
Sales to external customers	$607,607	$222,234	$409,685	$ 1,239,526	$—	$1,239,526
Intersegment sales	17,344	16,649	1,486	35,479	(35,479)	—
Segment operating income	98,187	30,482	72,867	201,536	(18,015)	183,521

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Six Months Ended June 30, 2014

(Amounts in thousands)	Engineered Product Division	Industrial Product Division	Flow Control Division	Subtotal–Reportable Segments	Eliminations and All Other	Consolidated Total
Sales to external customers	$1,082,219	$423,848	$786,447	$ 2,292,514	$—	$2,292,514
Intersegment sales	32,198	26,032	2,877	61,107	(61,107)	—
Segment operating income	183,093	54,874	162,262	400,229	(41,589)	358,640

Six Months Ended June 30, 2013

(Amounts in thousands)	Engineered Product Division	Industrial Product Division	Flow Control Division	Subtotal–Reportable Segments	Eliminations and All Other	Consolidated Total
Sales to external customers	$1,131,381	$413,180	$791,561	$ 2,336,122	$—	$2,336,122
Intersegment sales	33,260	37,003	3,640	73,903	(73,903)	—
Segment operating income	182,790	51,835	160,036	394,661	(40,661)	354,000

15. Accumulated Other Comprehensive Loss

The following table presents the changes in accumulated other comprehensive loss ("AOCL"), net of tax for the three months ended June 30, 2014 and 2013:

(Amounts in thousands)	2014 Foreign currency translation items(1)	Pension and other post-retirement effects	Cash flow hedging activity	Total(1)	2013 Foreign currency translation items(1)	Pension and other post-retirement effects	Cash flow hedging activity	Total(1)
Balance - April 1	$(87,002)	$ (126,749)	$(646)	$(214,397)	(98,744)	(155,025)	(13)	$(253,782)
Other comprehensive income (loss) before reclassifications	7,782	(1,193)	(167)	6,422	(29,425)	(357)	231	(29,551)
Amounts reclassified from AOCL	—	2,656	102	2,758	—	3,252	3	3,255
Net current-period other comprehensive income (loss)	7,782	1,463	(65)	9,180	(29,425)	2,895	234	(26,296)
Balance - June 30	$(79,220)	$ (125,286)	$(711)	$(205,217)	$(128,169)	$ (152,130)	$221	$(280,078)

(1) Includes foreign currency translation adjustments attributable to noncontrolling interests of $1.4 million at April 1, 2014 and 2013, $1.4 million and $1.3 million at June 30, 2014 and 2013, respectively.

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The following table presents the reclassifications out of AOCL:

(Amounts in thousands)	Affected line item in the statement of income	Three Months Ended June 30, 2014(1)	2013(1)
Cash flow hedging activity			
Interest rate swaps	Interest expense	$ (161)	$ (5)
	Tax benefit	59	2
	Net of tax	$ (102)	$ (3)
Pension and other postretirement effects			
Amortization of actuarial losses(2)		$ (3,605)	$ (4,801)
Prior service costs(2)		(221)	—
	Tax benefit	1,170	1,549
	Net of tax	$ (2,656)	$ (3,252)

(1) Amounts in parentheses indicate decreases to income. None of the reclass amounts have a noncontrolling interest component.
(2) These accumulated other comprehensive loss components are included in the computation of net periodic pension cost. See Note 11 for additional details.

The following table presents the changes in AOCL, net of tax for the six months ended June 30, 2014 and 2013:

(Amounts in thousands)	2014 Foreign currency translation items(1)	Pension and other post-retirement effects	Cash flow hedging activity	Total(1)	2013 Foreign currency translation items(1)	Pension and other post-retirement effects	Cash flow hedging activity	Total(1)
Balance - January 1	$ (89,953)	$ (129,528)	$ (814)	$ (220,295)	$ (61,083)	$ (161,757)	$ (254)	$ (223,094)
Other comprehensive income (loss) before reclassifications	5,273	(894)	(143)	4,236	(68,303)	3,124	202	(64,977)
Amounts reclassified from AOCL	5,460	5,136	246	10,842	1,217	6,503	273	7,993
Net current-period other comprehensive income (loss)	10,733	4,242	103	15,078	(67,086)	9,627	475	(56,984)
Balance - June 30	$ (79,220)	$ (125,286)	$ (711)	$ (205,217)	$ (128,169)	$ (152,130)	$ 221	$ (280,078)

(1) Includes foreign currency translation adjustments attributable to noncontrolling interests of $1.2 million at January 1, 2014 and 2013, $1.4 million and $1.3 million at June 30, 2014 and 2013, respectively.

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The following table presents the reclassifications out of AOCL:

(Amounts in thousands)	Affected line item in the statement of income	Six Months Ended June 30, 2014(1)	Six Months Ended June 30, 2013(1)
Foreign currency translation items			
Release of cumulative translation adjustments upon sale of equity method investment	Net earnings from affiliates	$—	$(1,217)
Release of cumulative translation adjustments due to sale of business	Selling, general and administrative expense	(5,460)	—
	Tax benefit	—	—
	Net of tax	$(5,460)	$(1,217)
Cash flow hedging activity			
Interest rate swaps	Interest expense	$(391)	$(438)
	Tax benefit	145	165
	Net of tax	$(246)	$(273)
Pension and other postretirement effects			
Amortization of actuarial losses(2)		$(7,031)	$(9,602)
Prior service costs(2)		(339)	—
	Tax benefit	2,234	3,099
	Net of tax	$(5,136)	$(6,503)

(1) Amounts in parentheses indicate decreases to income. None of the reclass amounts have a noncontrolling interest component.

(2) These accumulated other comprehensive loss components are included in the computation of net periodic pension cost. See Note 11 for additional details.

16. Realignment Program

In the fourth quarter of 2013, we initiated a realignment program to reduce and optimize certain non-strategic QRC and manufacturing facilities and our overall cost structure ("2013 Realignment Program"). See Note 20 to our consolidated financial statements included in our 2013 Annual Report for additional information on our 2013 Realignment Program. We expect total 2013 Realignment Program charges will be $15.8 million for approved plans, of which $12.6 million has been incurred through June 30, 2014. The restructuring reserve was $3.8 million and $6.3 million at June 30, 2014 and December 31, 2013, respectively. Generally, the aforementioned charges were or will be paid in cash, except for asset write-downs, which are non-cash charges. The majority of remaining cash payments related to our 2013 Realignment Program will be incurred by the end of 2014.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements, and notes thereto, and the other financial data included elsewhere in this Quarterly Report. The following discussion should also be read in conjunction with our audited consolidated financial statements, and notes thereto, and "Management’s Discussion and Analysis of Financial Condition and Results of Operations" ("MD&A") included in our 2013 Annual Report.

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EXECUTIVE OVERVIEW

Our Company

We are a world-leading manufacturer and aftermarket service provider of comprehensive flow control systems. We develop and manufacture precision-engineered flow control equipment integral to the movement, control and protection of the flow of materials in our customers' critical processes. Our product portfolio of pumps, valves, seals, automation and aftermarket services supports global infrastructure industries, including oil and gas, chemical, power generation and water management, as well as general industrial markets where our products and services add value. Through our manufacturing platform and global network of Quick Response Centers ("QRCs"), we offer a broad array of aftermarket equipment services, such as installation, advanced diagnostics, repair and retrofitting. We currently employ approximately 18,000 employees in more than 50 countries.

Our business model is significantly influenced by the capital spending of global infrastructure industries for the placement of new products into service and aftermarket services for existing operations. The worldwide installed base of our products is an important source of aftermarket revenue, where products are expected to ensure the maximum operating time of many key industrial processes. Over the past several years, we have significantly invested in our aftermarket strategy to provide local support to drive customer investments in our offerings and use of our services to replace or repair installed products. The aftermarket portion of our business also helps provide business stability during various economic periods. The aftermarket business, which is served by our network of 172 QRCs located around the globe, provides a variety of service offerings for our customers including spare parts, service solutions, product life cycle solutions and other value-added services. It is generally a higher margin business compared to our original equipment business and a key component of our profitable growth strategy.

Our operations are conducted through three business segments that are referenced throughout this MD&A:

- Engineered Product Division ("EPD") for long lead-time, custom and other highly-engineered pumps and pump systems, mechanical seals, auxiliary systems and replacement parts and related services;
- IPD for engineered and pre-configured industrial pumps and pump systems and related products and services; and
- FCD for engineered and industrial valves, control valves, actuators and controls and related services.

Our business segments share a focus on industrial flow control technology and have a high number of common customers. These segments also have complementary product offerings and technologies that are often combined in applications that provide us a net competitive advantage. Our segments also benefit from our global footprint and our economies of scale in reducing administrative and overhead costs to serve customers more cost effectively. For example, the segments share leadership for operational support functions such as research and development, marketing and supply chain.

The reputation of our product portfolio is built on more than 50 well-respected brand names such as Worthington, IDP, Valtek, Limitorque, Durco, Edward, Anchor/Darling and Durametallic, which we believe to be one of the most comprehensive in the industry. Our products and services are sold either directly or through designated channels to more than 10,000 companies, including some of the world's leading engineering, procurement and construction ("EPC") firms, original equipment manufacturers, distributors and end users.

We continue to build on our geographic breadth through our QRC network with the goal to be positioned as near to customers as possible for service and support in order to capture valuable aftermarket business. Along with ensuring that we have the local capability to sell, install and service our equipment in remote regions, it is equally imperative to continuously improve our global operations. We continue to expand our global supply chain capability to meet global customer demands and ensure the quality and timely delivery of our products. We continue to devote resources to improving the supply chain processes across our business segments to find areas of synergy and cost reduction and to improve our supply chain management capability to ensure it can meet global customer demands. We also remain focused on improving on-time delivery and quality, while managing warranty costs as a percentage of sales across our global operations, through the assistance of a focused Continuous Improvement Process ("CIP") initiative. The goal of the CIP initiative, which includes lean manufacturing, six sigma business management strategy and value engineering, is to maximize service fulfillment to customers through on-time delivery, reduced cycle time and quality at the highest internal productivity.

During the first half of 2014, we experienced strengthening in our bookings across all industries. Larger original equipment project opportunities showed areas of strength, especially in the chemical and oil and gas industries. From a geographical standpoint, we saw continued strengthening in Europe, North America, the Middle East and Africa.

We continue to experience favorable conditions in our aftermarket business, which has been driven by our customers' need to maintain continuing operations across several industries and the expansion of our aftermarket capabilities through our integrated solutions offerings. Our pursuit of major capital projects globally and our investments in localized customer service remain key components of our long-term growth strategy, and also provide stability during various economic periods. We believe that our

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commitment to localize service support capabilities close to our customers' operations through our QRC network has enabled us to grow our market share in the aftermarket portion of our business.
We believe that with our customer relationships, global presence and highly-regarded technical capabilities, we will continue to have opportunities in our core industries; however, we face ongoing challenges affecting many companies in our industry with a significant multinational presence, such as economic, political, currency and other risks.
RESULTS OF OPERATIONS — Three and six months ended June 30, 2014 and 2013
Throughout this discussion of our results of operations, we discuss the impact of fluctuations in foreign currency exchange rates. We have calculated currency effects on operations by translating current year results on a monthly basis at prior year exchange rates for the same periods.
As discussed in Note 2 to our condensed consolidated financial statements included in this Quarterly Report, effective March 31, 2014 we sold our FCD Naval business to a Finnish valve manufacturer.
As discussed in Note 2 to our condensed consolidated financial statements included in this Quarterly Report, effective December 10, 2013, we acquired for inclusion in IPD, Innomag, a privately-owned, U.S. based company specializing in advanced sealless magnetic drive centrifugal pumps in the chemical and general industries.
As discussed in Note 2 to our condensed consolidated financial statements included in this Quarterly Report, FCD sold its equity interest in the AIL joint venture and acquired AIL's plug valve manufacturing business in an asset purchase for cash, effective March 28, 2013.
Consolidated Results
Bookings, Sales and Backlog

	Three Months Ended June 30,	
(Amounts in millions)	2014	2013
Bookings	$1,384.2	$1,229.0
Sales	1,224.4	1,239.5

	Six Months Ended June 30,	
(Amounts in millions)	2014	2013
Bookings	$2,577.7	$2,409.3
Sales	2,292.5	2,336.1

We define a booking as the receipt of a customer order that contractually engages us to perform activities on behalf of our customer with regard to manufacturing, service or support. Bookings recorded and subsequently canceled within the year-to-date period are excluded from year-to-date bookings. Bookings for the three months ended June 30, 2014 increased by $155.2 million, or 12.6%, as compared with the same period in 2013. The increase included negative currency effects of approximately $2 million. All industries increased during the three months ended June 30, 2014 with the oil and gas industry showing the most growth. The increase was more heavily weighted toward customer original equipment bookings.

Bookings for the six months ended June 30, 2014 increased by $168.4 million, or 7.0%, as compared with the same period in 2013. The increase included negative currency effects of approximately $26 million. The increase during the six months ended June 30, 2014 was primarily driven by the oil and gas, chemical and water management industries. The increase was more heavily weighted toward customer original equipment bookings.

Sales for the three months ended June 30, 2014 decreased by $15.1 million, or 1.2%, as compared with the same period in 2013. The decrease included currency benefits of approximately $4 million. The decrease was driven by customer original equipment sales and decreased sales into Europe, partially offset by increased sales into North

America. Net sales to international customers, including export sales from the U.S., were approximately 68% and 70% of total sales for the three months ended June 30, 2014 and 2013, respectively.

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Sales for the six months ended June 30, 2014 decreased by $43.6 million, or 1.9%, as compared with the same period in 2013. The decrease included negative currency effects of approximately $10 million. The decrease was driven by customer original equipment sales and decreased sales into Europe and the Middle East, partially offset by increased sales into North America. Net sales to international customers, including export sales from the U.S., were approximately 68% and 69% of total sales for the six months ended June 30, 2014 and 2013, respectively.
Backlog represents the aggregate value of booked but uncompleted customer orders and is influenced primarily by bookings, sales, cancellations and currency effects. Backlog of $2,849.8 million at June 30, 2014 increased by $292.9 million, or 11.5%, as compared with December 31, 2013. Currency effects provided an increase of approximately $13 million. Approximately 25% of the backlog at June 30, 2014 was related to aftermarket orders.

Gross Profit and Gross Profit Margin

	Three Months Ended June 30,			
(Amounts in millions, except percentages)	2014		2013	
Gross profit	$430.3		$421.6	
Gross profit margin	35.1	%	34.0	%
	Six Months Ended June 30,			
(Amounts in millions, except percentages)	2014		2013	
Gross profit	$807.4		$794.9	
Gross profit margin	35.2	%	34.0	%

Gross profit for the three months ended June 30, 2014 increased by $8.7 million, or 2.1%, as compared with the same period in 2013. Gross profit margin for the three months ended June 30, 2014 of 35.1% increased from 34.0% for the same period in 2013. The increase was primarily attributed to a mix shift to higher margin aftermarket sales, the effects of lower costs as a result of operational improvements and disciplined selectivity of customer bookings, as compared with the same period in 2013. As a result of the sales mix shift, aftermarket sales increased to approximately 41% of total sales, as compared with approximately 40% of total sales for the same period in 2013.

Gross profit for the six months ended June 30, 2014 increased by $12.5 million, or 1.6%, as compared with the same period in 2013. Gross profit margin for the six months ended June 30, 2014 of 35.2% increased from 34.0% for the same period in 2013. The increase was primarily attributed to a mix shift to higher margin aftermarket sales, the effects of lower costs as a result of operational improvements and disciplined selectivity of customer bookings, as compared with the same period in 2013. As a result of the sales mix shift, aftermarket sales increased to approximately 42% of total sales, as compared with approximately 41% of total sales for the same period in 2013.

Selling, General and Administrative Expense ("SG&A")

	Three Months Ended June 30,			
(Amounts in millions, except percentages)	2014		2013	
SG&A	$238.2		$240.2	
SG&A as a percentage of sales	19.5	%	19.4	%
	Six Months Ended June 30,			
(Amounts in millions, except percentages)	2014		2013	
SG&A	$454.4		$474.7	
SG&A as a percentage of sales	19.8	%	20.3	%

SG&A for the three months ended June 30, 2014 decreased by $2.0 million, or 0.8%, as compared with the same period in 2013. Currency effects yielded an increase of approximately $1 million. SG&A as a percentage of sales for the three months ended June 30, 2014 increased 10 basis points as compared with the same period in 2013.

SG&A for the six months ended June 30, 2014 decreased by $20.3 million, or 4.3%, as compared with the same period in 2013. Currency effects yielded a decrease of approximately $2 million. SG&A as a percentage of sales for the six months ended

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June 30, 2014 decreased 50 basis points as compared with the same period in 2013 due primarily to a $13.4 million gain from the sale of the Naval business in the first quarter of 2014.

Net Earnings from Affiliates

	Three Months Ended June 30,	
(Amounts in millions)	2014	2013
Net earnings from affiliates	$2.2	$2.1
	Six Months Ended June 30,	
(Amounts in millions)	2014	2013
Net earnings from affiliates	$5.6	$33.8

Net earnings from affiliates represents our net income from investments in our joint ventures that are accounted for using the equity method of accounting. Net earnings from affiliates for the three months ended June 30, 2014 increased $0.1 million, or 4.8%, as compared with the same period in 2013.

Net earnings from affiliates for the six months ended June 30, 2014, decreased $28.2 million or 83.4% as compared with the same period in 2013. The decrease was primarily a result of the AIL transactions, which resulted in total pre-tax gains of $28.3 million recorded in net earnings from affiliates in the first quarter of 2013.

Operating Income and Operating Margin

	Three Months Ended June 30,			
(Amounts in millions, except percentages)	2014		2013	
Operating income	$194.3		$183.5	
Operating income as a percentage of sales	15.9	%	14.8	%
	Six Months Ended June 30,			
(Amounts in millions, except percentages)	2014		2013	
Operating income	$358.6		$354.0	
Operating income as a percentage of sales	15.6	%	15.2	%

Operating income for the three months ended June 30, 2014 increased by $10.8 million, or 5.9%, as compared with the same period in 2013. The increase included negative currency effects of less than $1 million. The increase was primarily a result of the $8.7 million increase in gross profit and the $2.0 million decrease in SG&A.

Operating income for the six months ended June 30, 2014 increased by $4.6 million, or 1.3%, as compared with the same period in 2013. The increase included negative currency effects of approximately $3 million. The increase was primarily a result of the $12.5 million increase in gross profit and the $20.3 million decrease in SG&A, which included a $13.4 million pre-tax gain from the sale of the Naval business in the first quarter of 2014. These increases were partially offset by the $28.3 million in pre-tax gains in 2013 from the AIL transactions that did not recur in 2014.

Interest Expense and Interest Income

	Three Months Ended June 30,	
(Amounts in millions)	2014	2013

Interest expense	$(15.0)	$(13.1)
Interest income	0.5	0.3

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	Six Months Ended June 30,	
(Amounts in millions)	2014	2013
Interest expense	$(30.2)	$(25.2)
Interest income	0.8	0.6

Interest expense for the three and six months ended June 30, 2014 increased by $1.9 million and $5.0 million, respectively, as compared with the same periods in 2013. The increases were primarily attributable to interest expense associated with our senior notes issued in the fourth quarter of 2013. Approximately 11% of our Term Loan Facility was at fixed interest rates at June 30, 2014, including the effects of $40.0 million of notional interest rate swaps.

Other (Expense) Income, Net

	Three Months Ended June 30,	
(Amounts in millions)	2014	2013
Other (expense) income, net	$(3.8)	$0.6
	Six Months Ended June 30,	
(Amounts in millions)	2014	2013
Other expense, net	$(6.7)	$(10.4)

Other expense, net for the three months ended June 30, 2014 increased $4.4 million as compared with the same period in 2013, primarily driven by a $7.3 million increase in losses arising from transactions in currencies other than our sites' functional currencies, partially offset by a $3.1 million decrease in losses on foreign exchange contracts. The changes are primarily due to the foreign currency exchange rate movements of the Brazilian real, Mexican peso and Singapore dollar in relation to the U.S. dollar during the three months ended June 30, 2014, as compared with the same period in 2013.

Other expense, net for the six months ended June 30, 2014 decreased $3.7 million, as compared with the same period in 2013, primarily driven by the $4.0 million loss due to the Venezuelan currency devaluation in 2013 that did not recur and a $7.7 million decrease in losses on foreign exchange contracts, partially offset by a $7.3 million increase in losses arising from transactions in currencies other than our sites' functional currencies. The changes are primarily due to the foreign currency exchange rate movements of the Brazilian real, British pound and Japanese yen in relation to the U.S. dollar during the six months ended June 30, 2014, as compared with the same period in 2013.

Tax Expense and Tax Rate

	Three Months Ended June 30,	
(Amounts in millions, except percentages)	2014	2013
Provision for income taxes	$50.8	$50.4
Effective tax rate	28.9%	29.4%
	Six Months Ended June 30,	
(Amounts in millions, except percentages)	2014	2013
Provision for income taxes	$88.8	$99.1
Effective tax rate	27.5%	31.1%

Our effective tax rate of 28.9% for the three months ended June 30, 2014 decreased from 29.4% for the same period in 2013. The effective tax rate varied from the U.S. federal statutory rate for the three months ended June 30, 2014 primarily due to the net impact of foreign operations.

Our effective tax rate of 27.5% for the six months ended June 30, 2014 decreased from 31.1% for the same period in 2013. The effective tax rate varied from the U.S. federal statutory rate for the six months ended June 30, 2014 primarily due to the net impact of foreign operations.

Other Comprehensive Income (Loss)

	Three Months Ended June 30,	
(Amounts in millions)	2014	2013
Other comprehensive income (loss)	$9.2	$(26.3)
	Six Months Ended June 30,	
(Amounts in millions)	2014	2013
Other comprehensive income (loss)	$15.1	$(57.0)

Other comprehensive income (loss) for the three months ended June 30, 2014 increased $35.5 million as compared with the same period in 2013. The increase was primarily due to the strengthening of the British pound, Brazilian real, Indian rupee and Euro versus the U.S. dollar during the three months ended June 30, 2014, as compared with the same period in 2013.

Other comprehensive income (loss) for the six months ended June 30, 2014 increased $72.1 million as compared with the same period in 2013. The increase was primarily due to the strengthening of the Brazilian real, Indian rupee, and Mexican peso versus the U.S. dollar during the six months ended June 30, 2014, as compared with the same period in 2013.

Business Segments

We conduct our operations through three business segments based on type of product and how we manage the business. We evaluate segment performance and allocate resources based on each segment’s operating income. The key operating results for our three business segments, EPD, IPD and FCD, are discussed below.

Engineered Product Division Segment Results

Our largest business segment is EPD, through which we design, manufacture, distribute and service custom and other highly-engineered pumps and pump systems, mechanical seals, auxiliary systems and spare parts (collectively referred to as "original equipment"). EPD includes longer lead-time, highly-engineered pump products and shorter cycle engineered pumps and mechanical seals that are generally manufactured more quickly. EPD also manufactures replacement parts and related equipment and provides a full array of replacement parts, repair and support services (collectively referred to as "aftermarket"). EPD primarily operates in the oil and gas, power generation, chemical, water management and general industries. EPD operates in 43 countries with 30 manufacturing facilities worldwide, nine of which are located in Europe, 11 in North America, five in Asia and five in Latin America, and it has 125 QRCs, including those co-located in manufacturing facilities.

	Three Months Ended June 30,	
(Amounts in millions, except percentages)	2014	2013
Bookings	$744.3	$606.5
Sales	609.2	625.0
Gross profit	209.9	210.0
Gross profit margin	34.5%	33.6%
Segment operating income	103.8	98.2
Segment operating income as a percentage of sales	17.0%	15.7%
	Six Months Ended June 30,	
(Amounts in millions, except percentages)	2014	2013
Bookings	$1,338.5	$1,182.3
Sales	1,114.4	1,164.6

Gross profit	388.4	398.2
Gross profit margin	34.9 %	34.2 %
Segment operating income	183.1	182.8
Segment operating income as a percentage of sales	16.4 %	15.7 %

Bookings for the three months ended June 30, 2014 increased by $137.8 million, or 22.7%, as compared with the same period in 2013. The increase included negative currency effects of approximately $14 million. The increase in customer bookings was primarily driven by the oil and gas and power generation industries, partially offset by general industries. Bookings increased $43.3 million into Europe, $35.3 million into the Middle East, $27.3 million into Latin America and $26.3 million into North America. The increase was primarily driven by customer original equipment bookings. Interdivision bookings (which are eliminated and are not included in consolidated bookings as disclosed above) decreased $1.3 million.

Bookings for the six months ended June 30, 2014 increased by $156.2 million, or 13.2%, as compared with the same period in 2013. The increase included negative currency effects of approximately $42 million. The increase in customer bookings was primarily driven by the oil and gas, chemical and power generation industries, partially offset by general industries. Increased bookings of $53.0 million into North America, $41.2 million into the Middle East, $39.5 million into Europe and $14.4 million into Latin America were partially offset by decreased bookings of $20.0 million into Asia Pacific. The increase was primarily driven by customer original equipment bookings. Interdivision bookings (which are eliminated and are not included in consolidated bookings as disclosed above) increased $10.5 million.

Sales for the three months ended June 30, 2014 decreased $15.8 million, or 2.5%, as compared with the same period in 2013. The decrease included negative currency effects of approximately $9 million. The decrease was driven by customer original equipment sales, resulting from decreased sales of $32.9 million into Europe, $7.6 million into Latin America and $4.1 million into Asia Pacific, partially offset by increased sales of $18.9 million into North America and $5.4 million into the Middle East. Interdivision sales (which are eliminated and are not included in consolidated sales as disclosed above) decreased $1.1 million.

Sales for the six months ended June 30, 2014 decreased $50.2 million, or 4.3%, as compared with the same period in 2013. The decrease included negative currency effects of approximately $28 million. The decrease was driven by customer original equipment sales, resulting from decreased sales of $44.4 million into Europe, $21.7 million into Latin America and $11.8 million into the Middle East, partially offset by increased sales of $22.3 million into North America. Interdivision sales (which are eliminated and are not included in consolidated sales as disclosed above) decreased $1.1 million.

Gross profit for the three months ended June 30, 2014 increased less than $1 million as compared with the same period in 2013. Gross profit margin for the three months ended June 30, 2014 of 34.5% increased from 33.6% for the same period in 2013. The increase in gross profit margin was primarily attributable to a sales mix shift to higher margin aftermarket sales and the effects of lower costs associated with operational execution improvements and disciplined selectivity of customer bookings.

Gross profit for the six months ended June 30, 2014 decreased by $9.8 million, or 2.5%, as compared with the same period in 2013. Gross profit margin for the six months ended June 30, 2014 of 34.9% increased from 34.2% for the same period in 2013. The increase in gross profit margin was primarily attributable to a mix shift to higher margin aftermarket sales, the effects of lower costs associated with operational execution improvements and disciplined selectivity of customer bookings.

Operating income for the three months ended June 30, 2014 increased by $5.6 million, or 5.7%, as compared with the same period in 2013. The increase included negative currency effects of approximately $2 million. The increase was due primarily to a $5.7 million decrease in SG&A due primarily to decreased bad debt expense and decreased research and development costs.

Operating income for the six months ended June 30, 2014 increased by $0.3 million, or 0.2%, as compared with the same period in 2013. The increase included negative currency effects of approximately $5 million. The increase was due to a $9.1 million decrease in SG&A and increased earnings from affiliates, substantially offset by a $9.8 million

decrease in gross profit. The decrease in SG&A was due to decreased bad debt expense and research and development costs and included a decrease due to currency effects of approximately $5 million.
Backlog of $1,546.0 million at June 30, 2014 increased by $234.6 million, or 17.9%, as compared with December 31, 2013. Currency effects provided an increase of approximately $12 million. Backlog at June 30, 2014 and December 31, 2013 included $30.5 million and $21.6 million, respectively, of interdivision backlog (which is eliminated and not included in consolidated backlog as disclosed above).
Industrial Product Division Segment Results
Through IPD, we design, manufacture, distribute and service engineered, pre-configured industrial pumps and pump systems, including submersible motors (collectively referred to as "original equipment"). Additionally, IPD manufactures replacement parts and related equipment, and provides a full array of support services (collectively referred to as "aftermarket"). IPD primarily operates in the oil and gas, chemical, water management, power generation and general industries. IPD operates 13 manufacturing facilities, four of which are located in the U.S and six in Europe, and it operates 19 QRCs worldwide, including nine sites in Europe and four in the U.S., including those co-located in manufacturing facilities.

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	Three Months Ended June 30,			
(Amounts in millions, except percentages)	2014		2013	
Bookings	$248.0		$209.1	
Sales	238.1		238.9	
Gross profit	66.7		62.2	
Gross profit margin	28.0	%	26.0	%
Segment operating income	31.6		30.5	
Segment operating income as a percentage of sales	13.3	%	12.8	%
	Six Months Ended June 30,			
(Amounts in millions, except percentages)	2014		2013	
Bookings	$476.7		$416.2	
Sales	449.9		450.2	
Gross profit	121.9		115.2	
Gross profit margin	27.1	%	25.6	%
Segment operating income	54.9		51.8	
Segment operating income as a percentage of sales	12.2	%	11.5	%

Bookings for the three months ended June 30, 2014 increased by $38.9 million, or 18.6%, as compared with the same period in 2013. The increase included currency benefits of approximately $4 million. The increase in customer bookings was primarily driven by the general and oil and gas industries. Increased bookings of $29.4 million into Asia Pacific, $12.3 million into Europe and $8.3 million into North America were partially offset by a decrease of $5.1 million into the Middle East. The increase was primarily driven by customer original equipment bookings. Interdivision bookings (which are eliminated and are not included in consolidated bookings as disclosed above) remained consistent with the same period in 2013.

Bookings for the six months ended June 30, 2014 increased by $60.5 million, or 14.5%, as compared with the same period in 2013. The increase included currency benefits of approximately $6 million. Increased customer bookings in the general, oil and gas and water management industries were partially offset by a decrease in the power generation industry. Increased bookings of $34.4 million into Asia Pacific, $25.3 million into North America and $20.4 million into Europe were partially offset by a decrease of $9.2 million into the Middle East. The increase was primarily driven by customer original equipment bookings. Interdivision bookings (which are eliminated and are not included in consolidated bookings as disclosed above) decreased $4.0 million.

Sales for the three months ended June 30, 2014 decreased less than $1 million as compared with the same period in 2013. The decrease included currency benefits of approximately $5 million. Increased customer sales of $7.9 million into Europe were partially offset by decreased sales of $3.5 million into the Middle East and $1.2 million into North America. Interdivision sales (which are eliminated and are not included in consolidated sales as disclosed above) decreased $5.4 million.

Sales for the six months ended June 30, 2014 decreased less than $1 million as compared with the same period in 2013. The decrease included currency benefits of approximately $7 million. Increased customer sales of $9.6 million into Latin America, $7.7 million into Europe and $5.3 million into Asia Pacific were partially offset by decreased sales of $5.3 million into the Middle East, $4.5 million into North America and $2.9 million into Africa. Interdivision sales (which are eliminated and are not included in consolidated sales as disclosed above) decreased $11.0 million.

Gross profit for the three months ended June 30, 2014 increased by $4.5 million, or 7.2%, as compared with the same period in 2013. Gross profit margin for the three months ended June 30, 2014 of 28.0% increased from 26.0% for the same period in 2013. The increase was primarily attributable to a sales mix shift to higher margin aftermarket sales and lower manufacturing costs resulting from our execution of operational improvements and disciplined selectivity of customer bookings.

Gross profit for the six months ended June 30, 2014 increased by $6.7 million, or 5.8%, as compared with the same period in 2013. Gross profit margin for the six months ended June 30, 2014 of 27.1% increased from 25.6% for the same period in 2013. The increase was primarily attributable to lower manufacturing costs resulting from our execution of operational improvements, a sales mix shift to higher margin aftermarket sales and disciplined selectivity of customer bookings.

Operating income for the three months ended June 30, 2014 increased by $1.1 million, or 3.6%, as compared with the same period in 2013. The increase included currency benefits of approximately $1 million. The increase was primarily due to the $4.5 million increase in gross profit, partially offset by a $3.4 million increase in SG&A due in part to increased research and development costs.

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Operating income for the six months ended June 30, 2014 increased by $3.1 million, or 6.0%, as compared with the same period in 2013. The increase included currency benefits of approximately $1 million. The increase was primarily due to the $6.7 million increase in gross profit, partially offset by a $3.6 million increase in SG&A due in part to increased research and development costs.

Backlog of $556.1 million at June 30, 2014 increased by $26.0 million, or 4.9%, as compared with December 31, 2013. Currency effects provided an increase of approximately $2 million. Backlog at June 30, 2014 and December 31, 2013 included $30.5 million and $30.0 million, respectively, of interdivision backlog (which is eliminated and not included in consolidated backlog as disclosed above).

Flow Control Division Segment Results

Our second largest business segment is FCD, which designs, manufactures and distributes a broad portfolio of engineered-to-order and configured-to-order isolation valves, control valves, valve automation products, boiler controls and related services. FCD leverages its experience and application know-how by offering a complete menu of engineered services to complement its expansive product portfolio. FCD has a total of 58 manufacturing facilities and QRCs in 25 countries around the world, with five of its 26 manufacturing operations located in the U.S., 13 located in Europe and seven located in Asia Pacific. Based on independent industry sources, we believe that we are the fourth largest industrial valve supplier on a global basis.

	Three Months Ended June 30,	
(Amounts in millions, except percentages)	2014	2013
Bookings	$422.2	$447.0
Sales	406.4	411.2
Gross profit	152.7	147.1
Gross profit margin	37.6 %	35.8 %
Segment operating income	79.1	72.9
Segment operating income as a percentage of sales	19.5 %	17.7 %

	Six Months Ended June 30,	
(Amounts in millions, except percentages)	2014	2013
Bookings	$835.9	$877.6
Sales	789.3	795.2
Gross profit	297.1	281.0
Gross profit margin	37.6 %	35.3 %
Segment operating income	162.3	160.0
Segment operating income as a percentage of sales	20.6 %	20.1 %

Bookings for the three months ended June 30, 2014 decreased $24.8 million, or 5.5%, as compared with the same period in 2013. The decrease included currency benefits of approximately $8 million and negative effects on the comparison due to the sale of the Naval business in the first quarter of 2014. The decrease in customer bookings was primarily driven by the oil and gas and general industries, partially offset by an increase in the chemical industry. Decreased customer bookings of $19.7 million into Latin America, $9.9 million into North America and $4.8 million into Asia Pacific were partially offset by an increase of $7.9 million into the Middle East and $3.8 million into Europe. The decrease was primarily driven by decreased customer original equipment bookings.

Bookings for the six months ended June 30, 2014 decreased $41.7 million, or 4.8%, as compared with the same period in 2013. The decrease included currency benefits of approximately $10 million. The decrease in customer bookings was primarily driven by the oil and gas, general and water management industries, partially offset by an increase in the chemical industry. Decreased customer bookings of $36.3 million into Latin America, $21.7 million into Asia Pacific and $15.1 million into North America were partially offset by an increase of $21.8 million into Europe. The decrease was primarily driven by decreased customer original equipment bookings.

Sales for the three months ended June 30, 2014 decreased $4.8 million, or 1.2%, as compared with the same period in 2013. The decrease included currency benefits of approximately $7 million and negative effects on the comparison due to the sale of the Naval business in the first quarter of 2014. The decrease was primarily driven by decreased customer original equipment sales. A sales decrease of $14.5 million into Europe, primarily related to the Naval business, and $4.1 million into Asia Pacific were partially offset by an increase of $7.3 million into Latin America, $4.0 million into North America and $3.7 million into Africa.

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Sales for the six months ended June 30, 2014 decreased $5.9 million, or 0.7%, as compared with the same period in 2013. The decrease included currency benefits of approximately $10 million and was primarily driven by decreased customer original equipment sales. A sales decrease of $16.8 million into Europe and $7.3 million into Asia Pacific were partially offset by an increase of $10.4 million into Latin America and $7.0 million into North America.

Gross profit for the three months ended June 30, 2014 increased $5.6 million, or 3.8%, as compared with the same period in 2013. Gross profit margin for the three months ended June 30, 2014 of 37.6% increased from 35.8% for the same period in 2013. The increase was attributable to continued traction of low cost sourcing, cost control initiatives and product line mix.

Gross profit for the six months ended June 30, 2014 increased by $16.1 million, or 5.7%, as compared with the same period in 2013. Gross profit margin for the six months ended June 30, 2014 of 37.6% increased from 35.3% for the same period in 2013. The increase was attributable to continued traction of low cost sourcing and cost control initiatives.

Operating income for the three months ended June 30, 2014 increased by $6.2 million, or 8.5%, as compared with the same period in 2013. The increase included currency benefits of approximately $1 million. The increase was primarily attributable to the $5.6 million increase in gross profit.

Operating income for the six months ended June 30, 2014 increased by $2.3 million, or 1.4%, as compared with the same period in 2013. The increase included currency benefits of less than $1 million. The increase was primarily attributable to the $16.1 million increase in gross profit and the $13.4 million gain from the sale of the Naval business in the first quarter of 2014, partially offset by the $28.3 million in pre-tax gains realized from transactions concerning the AIL joint venture in 2013, that did not recur.

Backlog of $811.7 million at June 30, 2014 increased by $42.1 million, or 5.5%, as compared with December 31, 2013. Currency effects provided a decrease of approximately $1 million.

LIQUIDITY AND CAPITAL RESOURCES

Cash Flow and Liquidity Analysis

	Six Months Ended June 30,	
(Amounts in millions)	2014	2013
Net cash flows used by operating activities	$(11.3)	$(32.8)
Net cash flows used by investing activities	(6.1)	(24.7)
Net cash flows used by financing activities	(200.0)	(136.0)

Existing cash, cash generated by operations and borrowings available under our existing revolving credit facility are our primary sources of short-term liquidity. We monitor the depository institutions that hold our cash and cash equivalents on a regular basis, and we believe that we have placed our deposits with creditworthy financial institutions. Our sources of operating cash generally include the sale of our products and services and the conversion of our working capital, particularly accounts receivable and inventories. Our cash balance at June 30, 2014 was $143.6 million, as compared with $363.8 million at December 31, 2013.

Our cash balance decreased by $220.2 million to $143.6 million as of June 30, 2014 as compared with December 31, 2013. The cash used in the first six months of 2014 included $153.1 million of share repurchases, $53.7 million in capital expenditures, $41.4 million in dividend payments and $20.0 million of payments on long-term debt, partially offset by $46.8 million in net proceeds from the sale of our Naval business.

For the six months ended June 30, 2014, our cash used by operating activities was $11.3 million, as compared with $32.8 million for the same period in 2013, to support short-term and seasonal working capital needs. Working capital increased for the six months ended June 30, 2014, due primarily to higher inventory of $115.1 million, lower accrued liabilities of $86.1 million and lower accounts payable of $72.6 million. Working capital increased for the six months ended June 30, 2013, due primarily to higher inventory of $120.7 million and lower accounts payable of $94.3

million.

Increases in accounts receivable used $14.7 million of cash flow for the six months ended June 30, 2014 as compared with a source of $5.9 million for the same period in 2013. As of June 30, 2014, our days' sales outstanding ("DSO") was 85 days as compared with 78 days as of June 30, 2013. We have experienced increased aging and slower collections of accounts receivable with certain customers in Latin America due to unfavorable economic conditions in the region. However, these accounts receivable have extended terms compared to our usual terms and are not disputed, and we have not historically had write-offs relating to these customers. For reference purposes based on 2014 sales, an improvement of one day could provide approximately $12 million in cash flow.

Increases in inventory used $115.1 million of cash flow for the six months ended June 30, 2014 as compared with $120.7 million for the same period in 2013. Inventory turns were 2.7 and 2.8 times for June 30, 2014 and 2013, respectively. Our calculation

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of inventory turns does not reflect the impact of advanced cash received from our customers. For reference purposes based on 2014 data, an improvement of one-tenth of a turn could yield approximately $31 million in cash flow. Decreases in accounts payable used $72.6 million of cash flow for the six months ended June 30, 2014 as compared with $94.3 million for the same period in 2013.

Cash flows used by investing activities during the six months ended June 30, 2014 were $6.1 million as compared with $24.7 million for the same period in 2013. Capital expenditures during the six months ended June 30, 2014 were $53.7 million, a decrease of $7.5 million as compared with the same period in 2013. In 2014, our capital expenditures are focused on strategic initiatives to pursue new markets, geographic expansion, information technology infrastructure and cost reduction opportunities, and total capital expenditures are expected to be between $130 million and $140 million, before consideration of any acquisition activity. As discussed in Note 2 to our condensed consolidated financial statements included in this Quarterly Report, during the first quarter of 2014 we sold our Naval business for $46.8 million in net cash proceeds and in the first quarter of 2013 we sold our 50% equity interest in AIL to our joint venture partner for $46.2 million in cash.

Cash flows used by financing activities during the six months ended June 30, 2014 were $200.0 million as compared with $136.0 million for the same period in 2013. Cash outflows during the six months ended June 30, 2014 resulted primarily from the repurchase of $153.1 million of common shares, $41.4 million of dividend payments and $20.0 million in payments on long-term debt. Cash outflows for the same period in 2013 resulted primarily from the repurchase of $306.3 million of common shares and $37.6 million in dividend payments, partially offset by $209.0 million in net proceeds from short-term financing.

Approximately 6% of our Term Loan Facility is due to mature in the second half of 2014 and approximately 13% in 2015. Our Senior Credit Facility, as amended, matures in October 2018. After the effects of $40.0 million of notional interest rate swaps, approximately 11% of our Term Loan Facility was at fixed rates at June 30, 2014. As of June 30, 2014, we had available capacity of $920.0 million on our $1.0 billion Revolving Credit Facility. Our Revolving Credit Facility is committed and held by a diversified group of financial institutions.

During both the six months ended June 30, 2014 and 2013, we contributed $7.0 million to our U.S. pension plan. At December 31, 2013, as a result of increases in values of the plan’s assets and our contributions to the plan, our U.S. pension plan was fully funded as defined by applicable law. After consideration of our funded status, we currently anticipate making $13 million in additional contributions to our U.S. pension plan in 2014, excluding direct benefits paid. We continue to maintain an asset allocation consistent with our strategy to maximize total return, while reducing portfolio risks through asset class diversification.

At June 30, 2014, $141.9 million of our total cash balance of $143.6 million was held by foreign subsidiaries, $91.3 million of which we consider permanently reinvested outside the U.S. Based on the expected near-term liquidity needs of our various geographies and our currently available sources of domestic short-term liquidity, we currently do not anticipate the need to repatriate any permanently reinvested cash to fund domestic operations that would generate adverse tax results. However, in the event this cash is needed to fund domestic operations, we estimate the full $91.3 million could be repatriated resulting in a U.S. cash tax liability between $5 million and $15 million. Should we be required to repatriate this cash, it could limit our ability to assert permanent reinvestment of foreign earnings and invested capital in future periods.

Considering our current debt structure and cash needs, we currently believe cash flows generated from operating activities combined with availability under our Revolving Credit Facility and our existing cash balance will be sufficient to meet our cash needs for the next 12 months. Cash flows from operations could be adversely affected by economic, political and other risks associated with sales of our products, operational factors, competition, fluctuations in foreign exchange rates and fluctuations in interest rates, among other factors. See "Cautionary Note Regarding Forward-Looking Statements" below.

On February 19, 2013, our Board of Directors approved a $750.0 million share repurchase authorization, which included approximately $193 million of remaining capacity under the previous $1.0 billion share repurchase authorization. As of June 30, 2014, we have $231.3 million of remaining capacity under our current share repurchase program. While we intend to continue to return cash through dividends and/or share repurchases for the foreseeable future, any future returns of cash through dividends and/or share repurchases will be reviewed individually, declared by our Board of Directors and implemented by management at its discretion, depending on our financial condition, business opportunities and market conditions at such time.

Acquisitions and Dispositions

We regularly evaluate acquisition opportunities of various sizes. The cost and terms of any financing to be raised in conjunction with any acquisition, including our ability to raise economical capital, is a critical consideration in any such evaluation.

Note 2 to our condensed consolidated financial statements included in this Quarterly Report contains a discussion of our disposition, acquisition and exit of our AIL joint venture.

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Financing

Credit Facilities

On October 4, 2013 we amended our existing credit agreement that provided for a $400.0 million Term Loan Facility and a Revolving Credit Facility. A discussion of our amended Senior Credit Facility and our European LOC facility is included in Note 5 to our condensed consolidated financial statements included in this Quarterly Report.

We have entered into interest rate swap agreements to hedge our exposure to variable interest payments related to our Senior Credit Facility. These agreements are more fully described in Note 4 to our condensed consolidated financial statements included in this Quarterly Report, and in "Item 3. Quantitative and Qualitative Disclosures about Market Risk" below.

See Note 10 to our consolidated financial statements included in our 2013 Annual Report and Note 5 to our condensed consolidated financial statements included in this Quarterly Report for a discussion of covenants related to our European LOC and Senior Credit Facilities. We complied with all covenants through June 30, 2014.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Management's discussion and analysis of financial condition and results of operations are based on our condensed consolidated financial statements and related footnotes contained within this Quarterly Report. Our critical accounting policies used in the preparation of our condensed consolidated financial statements were discussed in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" of our 2013 Annual Report. These critical policies, for which no significant changes have occurred in the six months ended June 30, 2014, include:

- Revenue Recognition;
- Deferred Taxes, Tax Valuation Allowances and Tax Reserves;
- Reserves for Contingent Loss;
- Retirement and Postretirement Benefits; and
- Valuation of Goodwill, Indefinite-Lived Intangible Assets and Other Long-Lived Assets.

The process of preparing condensed consolidated financial statements in conformity with U.S. GAAP requires the use of estimates and assumptions to determine certain of the assets, liabilities, revenues and expenses. These estimates and assumptions are based upon what we believe is the best information available at the time of the estimates or assumptions. The estimates and assumptions could change materially as conditions within and beyond our control change. Accordingly, actual results could differ materially from those estimates. The significant estimates are reviewed quarterly with the Audit Committee of our Board of Directors.

Based on an assessment of our accounting policies and the underlying judgments and uncertainties affecting the application of those policies, we believe that our condensed consolidated financial statements provide a meaningful and fair perspective of our consolidated financial condition and results of operations. This is not to suggest that other general risk factors, such as changes in worldwide demand, changes in material costs, performance of acquired businesses and others, could not adversely impact our consolidated financial condition, results of operations and cash flows in future periods. See "Cautionary Note Regarding Forward-Looking Statements" below.

ACCOUNTING DEVELOPMENTS

We have presented the information about pronouncements not yet implemented in Note 1 to our condensed consolidated financial statements included in this Quarterly Report.

Cautionary Note Regarding Forward-Looking Statements

This Quarterly Report includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, as amended. Words or phrases such as, "may," "should," "expects," "could," "intends," "plans," "anticipates," "estimates," "believes," "predicts" or other similar expressions are intended to identify forward-looking statements, which include, without limitation, statements concerning our future financial performance, future debt and financing levels, investment objectives, implications of litigation and regulatory investigations and other management plans for future operations and performance.
The forward-looking statements included in this Quarterly Report are based on our current expectations, projections, estimates and assumptions. These statements are only predictions, not guarantees. Such forward-looking statements are subject to numerous risks and uncertainties that are difficult to predict. These risks and uncertainties may cause actual results to differ materially from what is forecast in such forward-looking statements, and include, without limitation, the following:

- a portion of our bookings may not lead to completed sales, and our ability to convert bookings into revenues at acceptable profit margins;
- changes in the global financial markets and the availability of capital and the potential for unexpected cancellations or delays of customer orders in our reported backlog;
- our dependence on our customers' ability to make required capital investment and maintenance expenditures;
- risks associated with cost overruns on fixed fee projects and in accepting customer orders for large complex custom engineered products;
- the substantial dependence of our sales on the success of the oil and gas, chemical, power generation and water management industries;
- the adverse impact of volatile raw materials prices on our products and operating margins;
- economic, political and other risks associated with our international operations, including military actions or trade embargoes that could affect customer markets, particularly North African, Russian and Middle Eastern markets and global oil and gas producers, and non-compliance with U.S. export/reexport control, foreign corrupt practice laws, economic sanctions and import laws and regulations;
- increased aging and slower collection of receivables, particularly in Latin America and other emerging markets;
- our exposure to fluctuations in foreign currency exchange rates, particularly the Euro and British pound and in hyperinflationary countries such as Venezuela;
- our furnishing of products and services to nuclear power plant facilities and other critical applications;
- potential adverse consequences resulting from litigation to which we are a party, such as litigation involving asbestos-containing material claims;
- a foreign government investigation regarding our participation in the United Nations Oil-For-Food Program;
- expectations regarding acquisitions and the integration of acquired businesses;
- our relative geographical profitability and its impact on our utilization of deferred tax assets, including foreign tax credits;

- the potential adverse impact of an impairment in the carrying value of goodwill or other intangible assets;
- our dependence upon third-party suppliers whose failure to perform timely could adversely affect our business operations;
- the highly competitive nature of the markets in which we operate;
- environmental compliance costs and liabilities;
- potential work stoppages and other labor matters;
- access to public and private sources of debt financing;
- our inability to protect our intellectual property in the U.S., as well as in foreign countries; and
- obligations under our defined benefit pension plans.

These and other risks and uncertainties are more fully discussed in the risk factors identified in "Item 1A. Risk Factors" in Part I of our 2013 Annual Report, and may be identified in our Quarterly Reports on Form 10-Q and our other filings with the U.S. Securities and Exchange Commission ("SEC") and/or press releases from time to time. All forward-looking statements included in this document are based on information available to us on the date hereof, and we assume no obligation to update any forward-looking statement.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

We have market risk exposure arising from changes in interest rates and foreign currency exchange rate movements. We are exposed to credit-related losses in the event of non-performance by counterparties to financial instruments, including interest rate swaps and foreign exchange contracts, but we currently expect our counterparties will continue to meet their obligations given their current creditworthiness.

Interest Rate Risk

Our earnings are impacted by changes in short-term interest rates as a result of borrowings under our Senior Credit Facility, which bear interest based on floating rates. At June 30, 2014, after the effect of interest rate swaps, we had $310.0 million of variable rate debt obligations outstanding under our Senior Credit Facility with a weighted average interest rate of 1.48%. A hypothetical change of 100 basis points in the interest rate for these borrowings, assuming constant variable rate debt levels, would have changed interest expense by $1.6 million for the six months ended June 30, 2014. At June 30, 2014 and December 31, 2013, we had $40.0 million and $140.0 million, respectively, of notional amount in outstanding interest rate swaps with third parties with varying maturities through June 2015.

Foreign Currency Exchange Rate Risk

A substantial portion of our operations are conducted by our subsidiaries outside of the U.S. in currencies other than the U.S. dollar. Almost all of our non-U.S. subsidiaries conduct their business primarily in their local currencies, which are also their functional currencies. Foreign currency exposures arise from translation of foreign-denominated assets and liabilities into U.S. dollars and from transactions, including firm commitments and anticipated transactions, denominated in a currency other than a non-U.S. subsidiary’s functional currency. Generally, we view our investments in foreign subsidiaries from a long-term perspective and, therefore, do not hedge these investments. We use capital structuring techniques to manage our investment in foreign subsidiaries as deemed necessary. We realized net gains (losses) associated with foreign currency translation of $7.8 million and $(29.4) million for the three months ended June 30, 2014 and 2013, respectively, and $10.7 million and $(67.1) million for the six months ended June 30, 2014 and 2013, respectively, which are included in other comprehensive income (loss).

We employ a foreign currency risk management strategy to minimize potential changes in cash flows from unfavorable foreign currency exchange rate movements. Where available, the use of foreign exchange contracts allows us to mitigate transactional exposure to exchange rate fluctuations as the gains or losses incurred on the foreign exchange contracts will offset, in whole or in part, losses or gains on the underlying foreign currency exposure. Our policy allows foreign currency coverage only for identifiable foreign currency exposures and beginning in the fourth quarter of 2013 instruments that meet certain criteria are designated for hedge accounting. As of June 30, 2014, we had a U.S. dollar equivalent of $576.7 million in aggregate notional amount outstanding in foreign exchange contracts with third parties, as compared with $610.7 million at December 31, 2013. Transactional currency gains and losses arising from transactions outside of our sites' functional currencies and changes in fair value of non-designated foreign exchange contracts are included in our consolidated results of operations. We recognized foreign currency net (losses) gains of $(3.7) million and $0.5 million for the three months ended June 30, 2014 and 2013, respectively, and $(5.9) million and $(10.3) million for the six months ended June 30, 2014 and 2013, respectively, which are included in other (expense) income, net in the accompanying condensed consolidated statements of income.

Based on a sensitivity analysis at June 30, 2014, a 10% change in the foreign currency exchange rates for the six months ended June 30, 2014 would have impacted our net earnings by approximately $15 million, due primarily to the Euro and Swedish krona. This calculation assumes that all currencies change in the same direction and proportion relative to the U.S. dollar and that there are no indirect effects, such as changes in non-U.S. dollar sales volumes or prices. This calculation does not take into account the impact of the foreign currency exchange contracts discussed above.

Item 4. Controls and Procedures.

Disclosure Controls and Procedures

Disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) are controls and other procedures that are designed to ensure that the information that we are required to disclose in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

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In connection with the preparation of this Quarterly Report, our management, under the supervision and with the participation of our principal executive officer and principal financial officer, carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of June 30, 2014. Based on this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of June 30, 2014.

Changes in Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) during the quarter ended June 30, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings.

We are party to the legal proceedings that are described in Note 10 to our condensed consolidated financial statements included in "Item 1. Financial Statements" of this Quarterly Report, and such disclosure is incorporated by reference into this "Item 1. Legal Proceedings." In addition to the foregoing, we and our subsidiaries are named defendants in certain other ordinary routine lawsuits incidental to our business and are involved from time to time as parties to governmental proceedings, all arising in the ordinary course of business. Although the outcome of lawsuits or other proceedings involving us and our subsidiaries cannot be predicted with certainty, and the amount of any liability that could arise with respect to such lawsuits or other proceedings cannot be predicted accurately, management does not currently expect the amount of any liability that could arise with respect to these matters, either individually or in the aggregate, to have a material adverse effect on our financial position, results of operations or cash flows.

Item 1A. Risk Factors

There are numerous factors that affect our business and results of operations, many of which are beyond our control. In addition to other information set forth in this Quarterly Report, careful consideration should be given to "Item 1A. Risk Factors" in Part I and "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" in Part II of our 2013 Annual Report, which contain descriptions of significant factors that might cause the actual results of operations in future periods to differ materially from those currently expected or desired.

There have been no material changes in risk factors discussed in our 2013 Annual Report and subsequent SEC filings. The risks described in this Quarterly Report, our 2013 Annual Report and in our other SEC filings or press releases from time to time are not the only risks we face. Additional risks and uncertainties are currently deemed immaterial based on management's assessment of currently available information, which remains subject to change; however, new risks that are currently unknown to us may surface in the future that materially adversely affect our business, financial condition, results of operations or cash flows.

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

Note 12 to our condensed consolidated financial statements included in this Quarterly Report includes a discussion of our share repurchase program and payment of quarterly dividends on our common stock. The number of shares repurchased and price paid per share below have been adjusted to reflect the 2013 three-for-one stock split discussed in Note 1 to our condensed consolidated financial statements included in "Item 1. Financial Statements" of this Quarterly Report.

During the quarter ended June 30, 2014, we repurchased a total of 573,881 shares of our common stock for $43.5 million (representing an average cost of $75.74 per share). As of June 30, 2014, we have $231.3 million of remaining capacity under our current share repurchase program. The following table sets forth the repurchase data for each of the three months during the quarter ended June 30, 2014:

	Total Number of	Average Price Paid	Total Number of	Maximum Number of

Period	Shares Purchased		per Share	Shares Purchased as Part of Publicly Announced Program	Shares (or Approximate Dollar Value) That May Yet Be Purchased Under the Program (in millions)
April 1 - 30	207,488	(1)	$76.78	202,293	$259.2
May 1 - 31	198,596	(2)	74.26	197,906	244.5
June 1 - 30	174,134	(3)	76.10	173,682	231.3
Total	580,218		$75.71	573,881	

(1) Includes 2,817 shares that were tendered by employees to satisfy minimum tax withholding amounts for Restricted Shares at an average price per share of $73.50, and includes 2,378 shares purchased at a price of $72.52 per share by a rabbi trust that we established in connection with our director deferral plans, pursuant to which non-employee directors may elect to defer directors' quarterly cash compensation to be paid at a later date in the form of common stock.

(2) Includes 690 shares that were tendered by employees to satisfy minimum tax withholding amounts for Restricted Shares at an average price per share of $74.60.

(3) Includes 452 shares that were tendered by employees to satisfy minimum tax withholding amounts for Restricted Shares at an average price per share of $74.35.

Item 6. Exhibits.

A list of exhibits filed or furnished as part of this Quarterly Report on Form 10-Q is set forth on the Exhibits Index immediately following the signature page of this report and is incorporated herein by reference.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	FLOWSERVE CORPORATION
Date: July 23, 2014	/s/ Mark A. Blinn Mark A. Blinn President and Chief Executive Officer (Principal Executive Officer)
Date: July 23, 2014	/s/ Michael S. Taff Michael S. Taff Senior Vice President and Chief Financial Officer (Principal Financial Officer)

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Exhibits Index

Exhibit No.	Description
31.1+	Certification of Principal Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2+	Certification of Principal Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1++	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2++	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document

\+ Filed herewith.
++ Furnished herewith.