

PENTAIR INC
Form 10-K
February 24, 2009

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

FORM 10-K

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year Ended December 31, 2008
OR
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

Commission file number 000-04689

Pentair, Inc.

(Exact name of Registrant as specified in its charter)

Minnesota

*(State or other jurisdiction of
incorporation or organization)*

41-0907434

*(I.R.S. Employer
Identification number)*

**5500 Wayzata Boulevard,
Suite 800, Golden Valley, Minnesota**

(Address of principal executive offices)

55416-1259

(Zip code)

Registrant's telephone number, including area code: (763) 545-1730

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

Title of each class

Name of each exchange on which registered

Common Shares, \$0.162/3 par value

New York Stock Exchange

Preferred Share Purchase Rights

New York Stock Exchange

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

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

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

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

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required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

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

Aggregate market value of voting and non-voting common equity held by non-affiliates of the Registrant, based on the closing price of \$33.87 per share as reported on the New York Stock Exchange on June 27, 2008 (the last business day of Registrant's most recently completed second quarter): \$3,177,008,897

The number of shares outstanding of Registrant's only class of common stock on December 31, 2008 was 98,276,919

DOCUMENTS INCORPORATED BY REFERENCE

Parts of the Registrant's definitive proxy statement for its annual meeting to be held on April 30, 2009, are incorporated by reference in this Form 10-K in response to Part III, ITEM 10, 11, 12, 13 and 14.

Pentair, Inc.

**Annual Report on Form 10-K
For the Year Ended December 31, 2008**

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PART I

ITEM 1. BUSINESS

GENERAL

Pentair, Inc. is a focused diversified industrial manufacturing company comprised of two operating segments: Water and Technical Products. Our Water Group is a global leader in providing innovative products and systems used worldwide in the movement, storage, treatment, and enjoyment of water. Our Technical Products Group is a leader in the global enclosures and thermal management markets, designing and manufacturing standard, modified and custom enclosures that house and protect sensitive electronics and electrical components; thermal management products; and accessories.

Pentair Strategy

Our strategy is to achieve benchmark Return on Invested Capital (ROIC) performance for diversified industrial manufacturing companies by:

building operational excellence through the Pentair Integrated Management System (PIMS) consisting of strategy deployment, lean enterprise, and IGNITE, which is our process to drive organic growth;

driving long-term growth in sales, income and cash flows, through internal growth initiatives and acquisitions;

developing new products and enhancing existing products;

penetrating attractive growth markets, particularly international;

expanding multi-channel distribution; and

proactively managing our business portfolio, including consideration of new business platforms.

Pentair Financial Objectives

Our long-term financial objectives are to:

Achieve 5%+ annual organic sales growth, plus acquisitions

Achieve benchmark financial performance:

Earnings Before Interest and Taxes (EBIT) Margin	14%
ROIC (after-tax)	15%
Free Cash Flow (FCF)	100% conversion of net income
Earnings Per Share (EPS) Growth	10%+ (sales growth plus margin expansion)

Achieve 5% annual productivity improvement on core business cost

Unless the context otherwise indicates, references herein to Pentair , the Company, and such words as we, us, and include Pentair, Inc. and its subsidiaries. Pentair is a Minnesota corporation that was incorporated in 1966.

BUSINESS AND PRODUCTS

Business segment and geographical financial information is contained in ITEM 8, Note 15 of the Notes to Consolidated Financial Statements, included in this Form 10-K.

WATER GROUP

Our Water Group is a global leader in providing innovative products and systems used worldwide in the movement, storage, treatment, and enjoyment of water. Our Water Group offers a broad array of products and systems to multiple markets and customers. The core competencies of our Water Group center around flow and filtration. We have identified a target market totaling \$60 billion, with our current primary focus on three

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markets: Flow Technologies (approximately 40% of group sales), Filtration (approximately 30% of group sales), and Pool (approximately 30% of group sales).

Flow Technologies Market

Our Flow Technologies business is a global leader in residential, commercial and municipal water pump markets. Our primary markets are those serving residential well water installers and residential and commercial end-users; waste water dealers and distributors; commercial and industrial operations; and municipal water treatment facilities. We address these markets with products ranging from light duty diaphragm pumps to high-flow turbine pumps and solid handling pumps designed for water and wastewater applications, and agricultural spraying, as well as pressure tanks for residential applications. Applications for our broad range of products include pumps for residential and municipal wells, water treatment, wastewater solids handling, pressure boosting, engine cooling, fluid delivery, circulation, and transfer.

Brand names for the Flow Technologies market include STA-RITE[®], Myers[®], Aurora[®], Hydromatic[®], Fairbanks Morse[™], Flotec[®], Hypro[®], Water Ace[®], Berkeley[®], Aermotor[™], Simer[®], Verti-line[®], Diamond[®], FoamPro[®], Onga[™], Nocchi[™], SHURflo[®], Edwards[®], JUNG PUMPEN[®], oxynaut[®], and JUNG[®].

Filtration Market

Our Filtration business competes in residential and commercial water softening and filtration markets globally; in selected industrial markets for both water and other fluid filtration, largely in the United States; and for desalination and reverse osmosis projects globally. We address these markets with control valves, tanks, filter systems, filter cartridges, pressure vessels, and specialty dispensing pumps providing flow solutions for specific end-user market applications including residential, commercial, foodservice, industrial, recreation vehicles, marine, and aviation.

Filtration products are used in the manufacture of water softeners; filtration, deionization, and desalination systems; industrial, commercial and residential water filtration applications; and filtration and separation technologies for hydrocarbon, medical and hydraulic applications.

Brand names for the Filtration market include Everpure[®], SHURflo[®], Fleck[®], CodeLine[®], Structural[™], Pentek[®], SIATA[™], WellMate[™], American Plumber[®], Armor[®], OMNIFILTER[®], Fibredyne[™], and Porous Media[™].

Pool Market

We address the Pool equipment market with a complete line of commercial and residential pool equipment and accessories including pumps, filters, heaters, lights, automatic controls, automatic pool cleaners, commercial deck equipment, maintenance equipment, and Pool accessories. Applications for our pool products include commercial and residential pool construction, maintenance, repair, and service.

Brand names for the Pool market include Pentair Pool Products[®], Pentair Water Pool and Spa[™], STA-RITE[®], Paragon Aquatics[®], Kreepy Krauly[®], Compool[®], WhisperFlo[®], PoolShark[®], Legend[™], Rainbow[™], FIBERworks[®], IntelliTouch[™], IntelliFlow[®], IntelliChlor[®], and Acu-Trol[®].

Customers

Our Water Group distributes its products through wholesale distributors, retail distributors, original equipment manufacturers, home centers and home and pool builders. Information regarding significant customers in our Water Group is contained in ITEM 8, Note 15 of the Notes to Consolidated Financial Statements, included in this Form 10-K.

Seasonality

We experience seasonal demand in a number of markets within our Water Group. End-user demand for pool equipment follows warm weather trends and is at seasonal highs from April to August. The magnitude of the sales spike is partially mitigated by employing some advance sale early buy programs (generally including

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extended payment terms and/or additional discounts). Demand for residential and agricultural water systems is also impacted by weather patterns, particularly by heavy flooding and droughts.

Competition

Our Water Group faces numerous domestic and international competitors, some of which have substantially greater resources directed to the markets in which we compete. Consolidation, globalization, and outsourcing are continuing trends in the water industry. Competition in commercial and residential flow technologies markets focuses on brand names, product performance, quality, and price. While home center and national retailers are important for residential lines of water and wastewater pumps, they are not important for commercial pumps. For municipal pumps, competition focuses on performance to meet required specifications, service, and price. Competition in water treatment and filtration components focuses on product performance and design, quality, delivery, and price. For pool equipment, competition focuses on brand names, product performance, quality, and price. We compete by offering a wide variety of innovative and high-quality products, which are competitively priced. We believe our distribution channels and reputation for quality also contribute to our continuing market penetration.

TECHNICAL PRODUCTS GROUP

Our Technical Products Group is a leader in the global enclosures and thermal management markets, designing and manufacturing standard, modified, and custom enclosures that house and protect sensitive electronics and electrical components; thermal management products; and accessories. We have identified a target market of \$30 billion. Our Technical Products Group focuses its business portfolio on four primary industries: Commercial and Industrial (55% of group sales), Telecom and Datacom (20% of group sales), Electronics (20% of group sales), and Networking (5% of group sales). The primary brand names for the Technical Products Group are: Hoffman[®], Schroff[®], Pentair Electronic Packaging[™], Taunus[™], McLean[®], Electronic Solutions[™], Birtcher[®], Calmark[®] and Aspen Motion[™]. Products and related accessories of the Technical Products Group include metallic and composite enclosures, cabinets, cases, subracks, backplanes, heat exchangers, and blowers. Applications served include industrial machinery, data communications, networking, telecommunications, test and measurement, automotive, medical, security, defense, and general electronics.

Customers

Our Technical Products Group distributes its products through electrical and data contractors, electrical and electronic components distributors, and original equipment manufacturers. Information regarding significant customers in our Technical Products Group is contained in ITEM 8, Note 15 of the Notes to Consolidated Financial Statements, included in this Form 10-K.

Seasonality

Our Technical Products Group is not significantly impacted by seasonal demand fluctuations.

Competition

Competition in the technical products markets can be intense, particularly in telecom and datacom markets, where product design, prototyping, global supply, price competition, and customer service are significant factors. Our Technical Products Group has continued to focus on cost control and improving profitability. Recent growth in the Technical Products Group is a result of new products development, overall market growth, continued channel penetration, growth in targeted market segments, geographic expansion, price increases and acquisitions. Consolidation, globalization, and outsourcing are visible trends in the technical products marketplace and typically play to the strengths of a large and globally positioned supplier. We believe our Technical Products Group has the broadest array of enclosures products available for commercial and industrial uses.

RECENT DEVELOPMENTS

Growth of our business

We continually look at each of our businesses to determine whether they fit with our strategic vision. Our primary focus is on businesses with strong fundamentals and growth opportunities, including international

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markets. We seek growth through product and service innovation, market expansion, and acquisitions. Acquisitions have played an important part in the growth of our business, and while we expect acquisitions to be an important part of our future growth, until economic and credit market conditions improve, we are not currently planning any significant acquisitions.

Acquisitions

On June 28, 2008, we entered into a transaction with GE Water & Process Technologies (a unit of General Electric Company) (GE) that was accounted for as an acquisition of an 80.1 percent ownership interest in GE s global water softener and residential water filtration business in exchange for a 19.9 percent interest in our global water softener and residential water filtration business. The acquisition was effected through the formation of two new entities, (collectively, Pentair Residential Filtration or PRF) a U.S. entity and an international entity, into which we and GE contributed certain assets, properties, liabilities and operations representing our respective global water softener and residential water filtration businesses. We are an 80.1 percent owner of the new entities and GE is a 19.9 percent owner.

With the formation of this business, we believe PRF will be better positioned to serve residential customers with industry-leading technical applications in the areas of water conditioning, whole-house filtration, point of use water management and water sustainability and expect to accelerate revenue growth by selling GE s existing residential conditioning products through our sales channels.

On May 7, 2007, we acquired as part of our Technical Products Group the assets of Calmark Corporation (Calmark), a privately held business. Calmark s product portfolio includes enclosures, guides, card locks, retainers, extractors, card pullers and other products for the aerospace, medical, telecommunications and military market segments, among others.

On April 30, 2007, we acquired as part of our Water Group all of the capital interests in Porous Media Corporation and Porous Media, Ltd. (together, Porous Media), two privately held filtration and separation technologies businesses. Porous Media brings strong technical ability to our Water Group, including engineering, material science, media development and application capabilities. Porous Media s product portfolio includes high-performance filter media, membranes and related filtration products and purification systems for liquids, gases and solids for the general industrial, petrochemical, refining and healthcare market segments, among others.

On February 2, 2007, we acquired as part of our Water Group all the outstanding shares of capital stock of Jung Pumpen GmbH (Jung Pump). Jung Pump is a leading German manufacturer of wastewater products for municipal and residential markets. Jung Pump brings us its strong application engineering expertise and a complementary product offering, including a new line of water re-use products, submersible wastewater and drainage pumps, wastewater disposal units and tanks. Jung Pump also brings to Pentair its well-established European presence, a state-of-the-art training facility in Germany and sales offices in Germany, Austria, France, Hungary, Poland and Slovakia.

Also refer to ITEM 7, Management s Discussion and Analysis, and ITEM 8, Note 2 of the Notes to Consolidated Financial Statements, included in this Form 10-K.

Discontinued operations/divestitures

On December 15, 2008, we sold our Spa and Bath (Spa/Bath) business to Balboa Water Group in a cash transaction.

On February 28, 2008, we sold our National Pool Tile (NPT) business unit to Pool Corporation in a cash transaction. National Pool Tile is the leading wholesale distributor of pool tile and composite pool finishes serving professional contractors in the swimming pool refurbish and construction markets.

The results of Spa/Bath and NPT have been reported as discontinued operations for all periods presented. The assets and liabilities of Spa/Bath and NPT have been reclassified as discontinued operations for all periods presented.

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

INFORMATION REGARDING ALL BUSINESS SEGMENTS***Backlog***

Our backlog of orders as of December 31 by segment was:

<i>In thousands</i>	2008	2007	\$ change	% change
Water	\$ 324,748	\$ 303,625	\$ 21,123	7.0%
Technical Products	111,678	124,919	(13,241)	(10.6%)
Total	\$ 436,426	\$ 428,544	\$ 7,882	1.8%

The \$21.1 million increase in Water Group backlog was primarily due to increased backlog for pumps used in industrial and municipal market applications and growth in Asian markets, partially offset by declining market conditions in residential pool and pump markets. The \$13.2 million decrease in Technical Products Group backlog reflected declining market conditions in both our electrical and electronic markets. Due to the relatively short manufacturing cycle and general industry practice for the majority of our businesses, backlog, which typically represents less than 60 days of shipments, is not deemed to be a significant item. A substantial portion of our revenues result from orders received and product sold in the same month. We expect that most of our backlog at December 31, 2008 will be filled in 2009.

Research and development

We conduct research and development activities in our own facilities, which consist primarily of the development of new products, product applications, and manufacturing processes. Research and development expenditures during 2008, 2007, and 2006 were \$62.5 million, \$56.8 million, and \$56.5 million, respectively.

Environmental

Environmental matters are discussed in ITEM 3, ITEM 7, and in ITEM 8, Note 16 of the Notes to Consolidated Financial Statements, included in this Form 10-K.

Raw materials

The principal materials used in the manufacturing of our products are electric motors, mild steel, stainless steel, electronic components, plastics (resins, fiberglass, epoxies), and paint (powder and liquid). In addition to the purchase of raw materials, we purchase some finished goods for distribution through our sales channels.

The materials used in the various manufacturing processes are purchased on the open market, and the majority are available through multiple sources and are in adequate supply. We have not experienced any significant work stoppages to-date due to shortages of materials. We have certain long-term commitments, principally price

commitments, for the purchase of various component parts and raw materials and believe that it is unlikely that any of these agreements would be terminated prematurely. Alternate sources of supply at competitive prices are available for most materials for which long-term commitments exist, and we believe that the termination of any of these commitments would not have a material adverse effect on operations.

Certain commodities, such as metals and resin, are subject to market and duty-driven price fluctuations. We manage these fluctuations through several mechanisms, including long-term agreements with escalator / de-escalator clauses. Prices for raw materials, such as metals and resins, may trend higher in the future.

Intellectual property

Patents, non-compete agreements, proprietary technologies, customer relationships, trade marks, trade names, and brand names are important to our business. However, we do not regard our business as being materially dependent upon any single patent, non-compete agreement, proprietary technology, customer relationship, trade mark, trade name, or brand name.

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Patents, patent applications, and license agreements will expire or terminate over time by operation of law, in accordance with their terms or otherwise. We do not expect the termination of patents, patent applications, and license agreements to have a material adverse effect on our financial position, results of operations or cash flows.

Employees

As of December 31, 2008, we employed approximately 14,700 people worldwide. Total employees in the United States were approximately 8,000, of whom approximately 850 are represented by five different trade unions having collective bargaining agreements. Generally, labor relations have been satisfactory.

Captive Insurance Subsidiary

We insure certain general and product liability, property, workers' compensation, and automobile liability risks through our regulated wholly-owned captive insurance subsidiary, Penwald Insurance Company (Penwald). Reserves for policy claims are established based on actuarial projections of ultimate losses. Accruals with respect to liabilities insured by third parties, such as liabilities arising from acquired businesses, pre-Penwald liabilities and those of certain foreign operations are established without regard to the availability of insurance.

Matters pertaining to Penwald are discussed in ITEM 3 and ITEM 8, Note 1 of the Notes to Consolidated Financial Statements, included in this Form 10-K.

Available information

We make available free of charge (other than an investor's own Internet access charges) through our Internet website (<http://www.pentair.com>) our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and if applicable, amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission. Reports of beneficial ownership filed by our directors and executive officers pursuant to Section 16(a) of the Securities Exchange Act of 1934 are also available on our website. We are not including the information contained on our website as part of, or incorporating it by reference into, this Annual Report on Form 10-K.

ITEM 1A. RISK FACTORS

You should carefully consider the following risk factors and warnings before making an investment decision. You are cautioned not to place undue reliance on any forward-looking statements. You should also understand that it is not possible to predict or identify all such factors and should not consider the following list to be a complete statement of all potential risks and uncertainties. If any of the risks described below actually occur, our business, financial condition, results of operations or prospects could be materially adversely affected. In that case, the price of our securities could decline and you could lose all or part of your investment. You should also refer to other information set forth in this document.

General economic conditions, including difficult credit and residential construction markets, affect demand for our products.

We compete around the world in various geographic regions and product markets. Among these, the most significant are global industrial and commercial markets (for both the Water and Technical Products Groups) and residential markets (for the Water Group). The global credit crisis and recession have adversely affected the robustness of our markets as exemplified in the fourth quarter of 2008. Important factors for our businesses include the overall strength of the economy and our customers' confidence in the economy; industrial and governmental capital spending; the strength of the residential and commercial real estate markets; unemployment rates; availability of consumer and

commercial financing for our customers and end-users; and interest rates. New construction for residential housing and home improvement activity fell dramatically in both 2007 and 2008, which reduced revenue growth in each of the businesses within our Water Group. We believe that weakness in this market and the recent dramatic slowdown in our industrial and commercial markets will

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likely continue to affect our revenues and margins throughout 2009. Any continuing weakness in these markets beyond 2009 will negatively affect our sales and financial performance in future periods.

Our inability to sustain consistent organic growth or limit revenue decreases could adversely affect our financial performance.

Over the past three years, our organic growth was generated in part from expanding international sales, entering new distribution channels, price increases and introducing new products. To grow more rapidly than our end markets, we would have to continue to expand our geographic reach, further diversify our distribution channels, continue to introduce new products, and increase sales of existing products to our customer base. Difficult economic and competitive factors adversely affected our ability to sustain consistent organic growth in 2008, as revenues contracted in the fourth quarter. As a result of these economic conditions, that adversely impacted our anticipated financial performance, we did not meet our stated revenue growth targets in the fourth quarter and for the year 2008. We believe that our revenues will continue to decline as our markets weaken. Rather than focus our efforts primarily on broad-based revenue growth, we have chosen to limit our growth initiatives to specific end markets and geographies. We cannot assure you that these growth initiatives will be sufficient to offset revenue declines in other markets.

Our businesses operate in highly competitive markets, so we may be forced to cut prices or to incur additional costs.

Our businesses generally face substantial competition in each of their respective markets. Competition may force us to cut prices or to incur additional costs to remain competitive. We compete on the basis of product design, quality, availability, performance, customer service and price. Present or future competitors may have greater financial, technical or other resources which could put us at a disadvantage in the affected business or businesses. We cannot assure you that these and other factors will not have a material adverse effect on our future results of operations.

Material cost and other inflation have adversely affected and could continue to affect our results of operations.

Over the past few years, we have experienced material cost and other inflation in a number of our businesses. We are striving for greater productivity improvements and implementing selective increases in selling prices to help mitigate cost increases in raw materials (especially metals and resins), energy and other costs such as pension, health care and insurance. While these inflationary pressures have begun to abate in late 2008 and early 2009 as a result of general economic conditions, we may not be able to recognize the full benefit from this moderating or reversal of material cost and other inflation. In addition, the recent reversal of material cost inflation may not be sustainable once the economy begins to strengthen. We also are continuing to implement our excellence in operations initiatives in order to continuously reduce our costs. We cannot assure you, however, that these actions will be successful in managing our costs or increasing our productivity. Continued cost inflation or failure of our initiatives to generate cost savings or improve productivity would likely negatively impact our results of operations.

Seasonality of sales and weather conditions may adversely affect our financial results.

We experience seasonal demand in a number of markets within our Water Group. End-user demand for pool equipment in our primary markets follows warm weather trends and is at seasonal highs from April to August. The magnitude of the sales spike is partially mitigated by employing some advance sale or early buy programs (generally including extended payment terms and/or additional discounts). Demand for residential and agricultural water systems is also impacted by weather patterns, particularly by heavy flooding and droughts. We cannot assure you that seasonality and weather conditions will not have a material adverse effect on our results of operations.

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Intellectual property challenges may hinder product development and marketing.

Patents, non-compete agreements, proprietary technologies, customer relationships, trade marks, trade names, and brand names are important to our business. Intellectual property protection, however, may not preclude competitors from developing products similar to ours or from challenging our names or products. Over the past few years, we have noticed an increasing tendency for participants in our markets to use conflicts over and challenges to intellectual property as a means to compete. Patent and trademark challenges increase our costs to develop, engineer and market our products.

Our results of operations may be negatively impacted by litigation.

Our business exposes us to potential litigation, such as product liability claims relating to the design, manufacture, and sale of our products. While we currently maintain what we believe to be suitable product liability insurance, we cannot assure you that we will be able to maintain this insurance on acceptable terms or that this insurance will provide adequate protection against potential liabilities. In addition, we self-insure a portion of product liability claims. A series of successful claims against us for significant amounts could materially and adversely affect our product reputation, financial condition, results of operations, and cash flows.

Reductions in our acquisition activity will likely slow our revenue growth or otherwise adversely affect our financial performance.

Over the past four years, much of our growth has resulted from acquisitions of businesses within our current business segments. While we intend to continue to evaluate acquisitions in these segments, given the current financial and economic environment, we currently do not expect to make significant acquisitions until credit markets and business conditions stabilize. We cannot assure you that we would be able to continue to grow or to limit revenue declines without making acquisitions. Acquisitions we may undertake could have a material adverse effect on our operating results, particularly in the fiscal quarters immediately following the acquisitions, while we attempt to integrate operations of the acquired businesses into our operations. Once integrated, acquired operations may not achieve the levels of profitability originally anticipated.

The availability and cost of capital could have a negative impact on our financial performance.

Our plans to vigorously compete in our chosen markets will require additional capital for future acquisitions, capital expenditures, growth of working capital, and continued international and regional expansion. In the past, we have financed growth of our businesses primarily through cash from operations and debt financing. While we refinanced our primary credit agreements in the second quarter of 2007 on what we believe to be favorable terms, future acquisitions or other uses of funds may require us to expand our debt financing resources or to issue equity securities. Our financial results may be adversely affected if new financing is not available on favorable terms or if interest costs under our debt financings are higher than the income generated by acquisitions or other internal growth. In addition, future acquisitions could be dilutive to your equity investment if we issue additional stock as consideration. We cannot assure you that we will be able to issue equity securities or obtain future debt financing at favorable terms. Without sufficient financing, we will not be able to pursue our targeted growth strategy, and our acquisition program, which will limit our revenue growth and future financial performance.

We are exposed to political, economic and other risks that arise from operating a multinational business.

Sales outside of the United States, including export sales from our domestic businesses, accounted for approximately 35% of our gross sales in 2008, up from 32% in 2007. Further, most of our businesses obtain some products,

components and raw materials from foreign suppliers. Accordingly, our business is subject to the political, economic and other risks that are inherent in operating in numerous countries. These risks include:

changes in general economic and political conditions in countries where we operate, particularly in emerging markets;

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relatively more severe economic conditions in some international markets than in the United States;

the difficulty of enforcing agreements and collecting receivables through foreign legal systems;

trade protection measures and import or export licensing requirements;

tax rates in certain foreign countries that exceed those in the U.S. and the imposition of withholding requirements on foreign earnings;

the possibility of terrorist action against us or our operations;

the imposition of tariffs, exchange controls or other trade restrictions;

difficulty in staffing and managing widespread operations in non-U.S. labor markets;

the difficulty of protecting intellectual property in foreign countries; and

required compliance with a variety of foreign laws and regulations.

Our business success depends in part on our ability to anticipate and effectively manage these and other risks. We cannot assure you that these and other factors will not have a material adverse effect on our international operations or on our business as a whole.

Our international operations are subject to foreign market and currency fluctuation risks.

We expect the percentage of our sales outside of North America to increase in the future. Over the past few years, the economies of some of the foreign countries in which we do business have had slower growth than the U.S. economy. The European Union currently accounts for the majority of our foreign sales and income, in which our most significant European market is Germany; each market area is currently experiencing similar economic difficulties to those in the United States, and sales in those markets slowed significantly by the end of 2008. In addition, we have a significant and growing business in the Asia-Pacific area, but the economic conditions in countries in this region are subject to different growth expectations, market weaknesses and business practices. We cannot predict how changing market conditions in these regions will impact our financial results.

We are also exposed to the risk of fluctuation of foreign currency exchange rates which may affect our financial results. In 2008, the weakness of the US dollar slightly benefited our financial results in foreign jurisdictions. We do not anticipate continuing US dollar weakness in foreign exchange markets in 2009 of a similar magnitude, which may hurt our financial results on a comparative basis. In addition, we source certain products, components and raw materials throughout the world, the import of which into the United States has raised the cost of these goods in US dollars and has impacted the results of our domestic businesses as well.

We have significant goodwill and intangible assets, and future impairment of our goodwill and intangible assets could have a material negative impact on our financial results.

We test goodwill and indefinite-lived intangible assets for impairment on an annual basis as required by Statement of Accounting Standards No. 142, *Goodwill and Other Intangible Assets* (SFAS No. 142), by comparing the estimated fair value of each of our reporting units to their respective carrying values on our balance sheet. At December 31, 2008 our goodwill and intangible assets were approximately \$2,617.4 million, and represented approximately 64.6%

of our total assets. While our annual assessment in 2008 did not indicate an impairment of goodwill at that time, long-term declines in projected future cash flows could result in future goodwill and intangible asset impairments. Because of the significance of our goodwill and intangible assets, any future impairment of these assets could have a material adverse effect on our financial results.

We are exposed to potential environmental and other laws, liabilities and litigation.

We are subject to federal, state, local and foreign laws and regulations governing our environmental practices, public and worker health and safety and the indoor and outdoor environment. Compliance with these environmental, health and safety regulations could require us to satisfy environmental liabilities, increase the

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cost of manufacturing our products or otherwise adversely affect our business, financial condition and results of operations. Any violations of these laws by us could cause us to incur unanticipated liabilities that could harm our operating results and cause our business to suffer. We are also required to comply with various environmental laws and maintain permits, some of which are subject to discretionary renewal from time to time, for many of our businesses, and we could suffer if we are unable to renew existing permits or to obtain any additional permits that we may require.

We have been named as defendants, targets, or potentially responsible parties (PRP) in a number of environmental clean-ups relating to our current or former business units. We have disposed of a number of businesses in recent years and, in certain cases, we have retained responsibility and potential liability for certain environmental obligations. We have received claims for indemnification from certain purchasers. We may be named as a PRP at other sites in the future for existing business units, as well as both divested and acquired businesses. We have also made claims against third parties for indemnification against potential liabilities for environmental remediations or other obligations. We cannot assure you that we will be successful in obtaining indemnity or reimbursement for such costs.

We cannot ensure you that environmental requirements will not change or become more stringent over time or that our eventual environmental clean-up costs and liabilities will not exceed the amount of our current reserves.

Provisions of our Restated Articles of Incorporation, Bylaws and Minnesota law could deter takeover attempts.

Anti-takeover provisions in our charter documents, under Minnesota law, and in our shareholder rights plan could prevent or delay transactions that our shareholders may favor.

Our Restated Articles of Incorporation and Bylaws include provisions relating to the election, appointment and removal of directors, as well as shareholder notice and shareholder voting requirements which could delay, prevent or make more difficult a merger, tender offer, proxy contest or other change of control. In addition, our common share purchase rights could cause substantial dilution to a person or group that attempts to acquire us, which could deter some acquirers from making takeover proposals or tender offers. Also, the Minnesota Business Corporations Act contains control share acquisition and business combination provisions which could delay, prevent or make more difficult a merger, tender offer, proxy contest or other change of control. Our shareholders might view any such transaction as being in their best interests since the transaction could result in a higher stock price than the current market price for our common stock.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our principal executive office is in leased premises located in Golden Valley, Minnesota. We carry out our Water Group manufacturing operations at 23 plants located throughout the United States and at 18 plants located in 10 other countries. In addition, our Water Group has 33 distribution facilities and 36 sales offices located in numerous countries throughout the world. We carry out our Technical Products Group manufacturing operations at 8 plants located throughout the United States and 10 plants located in 8 other countries. In addition, our Technical Products Group has 7 distribution facilities and 30 sales offices located in numerous countries throughout the world.

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

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ITEM 3. LEGAL PROCEEDINGS

We have been made parties to a number of actions filed or have been given notice of potential claims relating to the conduct of our business, including those pertaining to commercial disputes, product liability, environmental, safety and health, patent infringement, and employment matters.

We comply with the requirements of Statement of Financial Accounting Standards (SFAS) No. 5, *Accounting for Contingencies*, and related guidance, and record liabilities for an estimated loss from a loss contingency where the outcome of the matter is probable and can be reasonably estimated. Factors that are considered when determining whether the conditions for accrual have been met include the (a) nature of the litigation, claim, or assessment, (b) progress of the case, including progress after the date of the financial statements but before the issuance date of the financial statements, (c) opinions of legal counsel, and (d) management s intended response to the litigation, claim, or assessment. Where the reasonable estimate of the probable loss is a range, we record the most likely estimate of the loss. When no amount within the range is a better estimate than any other amount, however, the minimum amount in the range is accrued. Gain contingencies are not recorded until realized.

While we believe that a material adverse impact on our consolidated financial position, results of operations, or cash flows from any such future charges is unlikely, given the inherent uncertainty of litigation, a remote possibility exists that a future adverse ruling or unfavorable development could result in future charges that could have a material adverse impact. We do and will continue to periodically reexamine our estimates of probable liabilities and any associated expenses and receivables and make appropriate adjustments to such estimates based on experience and developments in litigation. As a result, the current estimates of the potential impact on our consolidated financial position, results of operations, and cash flows for the proceedings and claims described in *Legal Proceedings* could change in the future.

Environmental

We have been named as defendants, targets, or PRP in a small number of environmental clean-ups, in which our current or former business units have generally been given *de minimis* status. To date, none of these claims have resulted in clean-up costs, fines, penalties, or damages in an amount material to our financial position or results of operations. We have disposed of a number of businesses in recent years and in certain cases, such as the disposition of the Cross Pointe Paper Corporation uncoated paper business in 1995, the disposition of the Federal Cartridge Company ammunition business in 1997, the disposition of Lincoln Industrial in 2001, and the disposition of the Tools Group in 2004, we have retained responsibility and potential liability for certain environmental obligations. We have received claims for indemnification from purchasers of these businesses and have established what we believe to be adequate accruals for potential liabilities arising out of retained responsibilities. We settled some of the claims in prior years; to date our recorded accruals have been adequate.

In addition, there are ongoing environmental issues at a limited number of sites, including one site acquired in the acquisition of Essef Corporation in 1999, which relate to operations no longer carried out at the sites. We have established what we believe to be adequate accruals for remediation costs at these sites. We do not believe that projected response costs will result in a material liability.

We may be named as a PRP at other sites in the future, for both divested and acquired businesses. When the outcome of the matter is probable and it is possible to provide reasonable estimates of our liability with respect to environmental sites, provisions have been made in accordance with generally accepted accounting principles in the United States. As of December 31, 2008 and 2007, our undiscounted reserves for such environmental liabilities were approximately \$3.1 million and \$3.5 million, respectively. We cannot ensure that environmental requirements will not change or become more stringent over time or that our eventual environmental clean-up costs and liabilities will not

exceed the amount of our current reserves.

Product liability claims

We are subject to various product liability lawsuits and personal injury claims. A substantial number of these lawsuits and claims are insured and accrued for by Penwald, our captive insurance subsidiary. See discussion

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in ITEM 1 and ITEM 8, Note 1 of the Notes to Consolidated Financial Statements Insurance subsidiary. Penwald records a liability for these claims based on actuarial projections of ultimate losses. For all other claims, accruals covering the claims are recorded, on an undiscounted basis, when it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated based on existing information. The accruals are adjusted periodically as additional information becomes available. We have not experienced significant unfavorable trends in either the severity or frequency of product liability lawsuits or personal injury claims.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

Table of Contents**EXECUTIVE OFFICERS OF THE REGISTRANT**

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

Name	Age	Current Position and Business Experience
Randall J. Hogan	53	Chief Executive Officer since January 2001 and Chairman of the Board effective May 1, 2002; President and Chief Operating Officer, December 1999 December 2000; Executive Vice President and President of Pentair's Electrical and Electronic Enclosures Group, March 1998 December 1999; United Technologies Carrier Transicold President 1995 1997; Pratt & Whitney Industrial Turbines Vice President and General Manager 1994 1995; General Electric various executive positions 1988 1994; McKinsey & Company consultant 1981 1987.
Michael V. Schrock	56	President and Chief Operating Officer since September 2006; President and Chief Operating Officer of Filtration and Technical Products, October 2005 September 2006; President and Chief Operating Officer of Enclosures October 2001 September 2005; President, Pentair Water Technologies Americas, January 2001 October 2001; President, Pentair Pump and Pool Group, August 2000 January 2001; President, Pentair Pump Group, January 1999 August 2000; Vice President and General Manager, Aurora, Fairbanks Morse and Pentair Pump Group International, March 1998 December 1998; Divisional Vice President and General Manager, Honeywell Inc., 1994 1998.
John L. Stauch	44	Executive Vice President and Chief Financial Officer since February 2007; Chief Financial Officer of the Automation and Control Systems unit of Honeywell International Inc., July 2005 February 2007; Vice President, Finance and Chief Financial Officer of the Sensing and Controls unit of Honeywell International Inc., January 2004 July 2005; Vice President, Finance and Chief Financial Officer of the Automation & Control Products unit of Honeywell International Inc., July 2002 January 2004; Chief Financial Officer and IT Director of PerkinElmer Optoelectronics, a unit of PerkinElmer, Inc., April 2000 April 2002; Various executive, investor relations and managerial finance positions with Honeywell International Inc. and its predecessor AlliedSignal Inc., 1994 2000.
Louis L. Ainsworth	61	Senior Vice President and General Counsel since July 1997 and Secretary since January 2002; Shareholder and Officer of the law firm of Henson & Efron, P.A., November 1985 June 1997.
Frederick S. Koury	48	Senior Vice President, Human Resources, since August 2003; Vice President of Human Resources of the Victoria's Secret unit of Limited Brands, September 2000 August 2003; PepsiCo, Inc., various executive positions, June 1985 September 2000.
Michael G. Meyer	50	Vice President of Treasury and Tax since April 2004; Treasurer, January 2002 March 2004; Assistant Treasurer, September 1994 December 2001; Various executive positions with Federal-Hoffman, Inc. (former subsidiary of Pentair), August 1985 August 1994.
Mark C. Borin	41	Corporate Controller and Chief Accounting Officer since March 2008; Partner in the audit practice of the public accounting firm KPMG LLP, June 2000

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March 2008; Various positions in the audit practice of KPMG LLP, September 1989 - June 2000.

Table of Contents**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON STOCK, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Our common stock is listed for trading on the New York Stock Exchange and trades under the symbol PNR. As of December 31, 2008, there were 3,835 shareholders of record.

The high, low, and closing sales price for our common stock and the dividends declared for each of the quarterly periods for 2008 and 2007 were as follows:

	2008				2007			
	First	Second	Third	Fourth	First	Second	Third	Fourth
High	\$ 34.98	\$ 38.76	\$ 41.00	\$ 38.50	\$ 33.22	\$ 39.37	\$ 39.67	\$ 36.59
Low	\$ 26.02	\$ 31.14	\$ 31.72	\$ 18.42	\$ 29.35	\$ 30.09	\$ 31.47	\$ 32.03
Close	\$ 31.48	\$ 33.87	\$ 38.52	\$ 23.67	\$ 31.16	\$ 38.57	\$ 33.18	\$ 34.81
Dividends declared	\$ 0.17	\$ 0.17	\$ 0.17	\$ 0.17	\$ 0.15	\$ 0.15	\$ 0.15	\$ 0.15

Pentair has paid 132 consecutive quarterly dividends and has increased dividends each year for 32 consecutive years.

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The following information under the caption "Stock Performance Graph" in this ITEM 5 of this Annual Report on Form 10-K is not deemed to be soliciting material or to be filed with the SEC or subject to Regulation 14A or 14C under the Securities Exchange Act of 1934 or to the liabilities of Section 18 of the Securities Exchange Act of 1934, and will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent we specifically incorporate it by reference into such a filing.

The following graph sets forth the cumulative total shareholder return on our common stock for the last five years, assuming the investment of \$100 on December 31, 2003 and the reinvestment of all dividends since that date to December 31, 2008. The graph also contains for comparison purposes the S&P 500 Index and the S&P MidCap 400 Index, assuming the same investment level and reinvestment of dividends.

By virtue of our market capitalization, we are a component of the S&P MidCap 400 Index. On the basis of our size and diversity of businesses, we have not found a readily identifiable peer group. We believe the S&P MidCap 400 Index is an appropriate comparison. We have evaluated other published indices, but have determined that the results are skewed by significantly larger companies included in the indices. We believe such a comparison would not be meaningful.

Company / Index	Base Period December 2003	INDEXED RETURNS Years Ending December 31:				
		2004	2005	2006	2007	2008
PENTAIR INC	100	193.43	155.37	143.66	162.12	112.58
S&P 500 INDEX	100	110.88	116.33	134.70	142.10	89.53
S&P MIDCAP 400 INDEX	100	116.48	131.11	144.64	156.18	99.59

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The following table provides information with respect to purchases made by Pentair of common stock during the fourth quarter of 2008:

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
September 28 – October 25, 2008	168,549	\$ 29.77	168,058	\$ 6,908,012
October 26 – November 22, 2008	204,996	\$ 24.53	203,787	\$ 1,908,261
November 23 – December 31, 2008	97,807	\$ 23.03	83,989	\$ 0
Total	471,352		455,834	

- (a) The purchases in this column include shares repurchased as part of our publicly announced programs and, in addition, 491 shares for the period September 28 – October 25, 2008, 1,209 shares for the period October 26 – November 22, 2008, and 13,818 shares for the period November 23 – December 31, 2008 deemed surrendered to us by participants in our Omnibus Stock Incentive Plan and the Outside Directors Nonqualified Stock Option Plan (the Plans) to satisfy the exercise price or withholding of tax obligations related to the exercise of stock options and non-vested shares.
- (b) The average price paid in this column includes shares repurchased as part of our publicly announced programs and shares deemed surrendered to us by participants in the Plans to satisfy the exercise price or withholding of tax obligations related to the exercise price of stock options and non-vested shares.
- (c) The number of shares in this column represents the number of shares repurchased as part of a publicly announced program to repurchase up to \$50 million of our common stock during 2008.
- (d) In December 2007, the Board of Directors authorized the repurchase of shares of our common stock during 2008 up to a maximum dollar limit of \$50 million. As of December 31, 2008, we had purchased 1,549,893 shares for \$50.0 million pursuant to this authorization. This authorization expired on December 31, 2008. There is currently no repurchase authorization for 2009.

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The following table sets forth our selected historical financial data from continuing operations for the five years ended December 31.

	Years ended December 31,				
	2008 ⁽¹⁾	2007 ⁽¹⁾	2006 ⁽¹⁾	2005 ⁽¹⁾	2004
Statement of Operations Data:					
Net sales	\$ 3,351,976	\$ 3,280,903	\$ 3,022,602	\$ 2,801,715	\$ 2,221,909
Operating income	324,685	379,049	312,943	313,320	239,834
Income from continuing operations	256,363	212,118	186,251	179,183	133,233
Per Share Data:⁽²⁾					
Basic:					
EPS from continuing operations	\$ 2.62	\$ 2.15	\$ 1.87	\$ 1.78	\$ 1.34
Weighted average shares	97,887	98,762	99,784	100,665	99,316
Diluted					
EPS from continuing operations	\$ 2.59	\$ 2.12	\$ 1.84	\$ 1.75	\$ 1.31
Weighted average shares	99,068	100,205	101,371	102,618	101,706
Cash dividends declared per common share	\$ 0.68	\$ 0.60	\$ 0.56	\$ 0.52	\$ 0.43
Balance Sheet Data:					
Total assets	\$ 4,053,213	\$ 4,000,614	\$ 3,364,979	\$ 3,253,755	\$ 3,120,575
Total debt	954,092	1,060,586	743,552	752,614	736,105
Total shareholders equity	1,898,681	1,910,871	1,669,999	1,555,610	1,447,794

(1) In 2005 we early adopted SFAS 123R retroactively to January 1, 2005. The incremental impact of the adoption of SFAS 123R to the results of operations for 2008, 2007, 2006 and 2005 include after tax expense of \$7.5 million, \$9.2 million, \$9.9 million and \$12.0 million, respectively, or (\$0.08), (\$0.09), (\$0.10) and (\$0.12) diluted EPS, respectively.

(2) All share and per share information presented in this Annual Report on Form 10-K has been retroactively restated to reflect the effect of a 100% stock dividend in 2004.

In July 2004, we acquired as part of our Water Group all of the capital stock of WICOR, Inc. In December 2005, we acquired as part of our Technical Products Group the McLean Thermal Management, Aspen Motion Technologies and Electronic Solutions businesses. In February and April 2007, we acquired the outstanding shares of capital stock of Jung Pump and all of the capital interests of Porous Media, respectively, as part of our Water Group. In May 2007, we acquired as part of our Technical Products Group the assets of Calmark. In June 2008, we entered into a transaction with GE that was accounted for as an acquisition of an 80.1 percent ownership interest in GE's global water softener and residential water filtration business in exchange for a 19.9 percent interest in our global water softener and residential water filtration business.

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

This report contains statements that we believe to be forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements give our current expectations or forecasts of future events. Forward-looking statements generally can be identified by the use of forward-looking terminology such as may, will, expect, intend, estimate, anticipate, believe, project, or continue, or similar words or their derivatives. From time to time, we also may provide oral or written forward-looking statements in other materials we release to the public. Any or all of our forward-looking statements in this report and in any public statements we make could be materially different from actual results. They can be affected by assumptions we might make or by known or unknown risks or uncertainties. Consequently, we cannot guarantee any forward-looking statements. Investors are cautioned not to place undue reliance on any forward-looking statements. Investors should also understand that it is not possible to predict or identify all such factors and should not consider the following list to be a complete statement of all potential risks and uncertainties.

The following factors and those discussed in ITEM 1A, Risk Factors, of this Form 10-K may impact the achievement of forward-looking statements:

general economic and political conditions, such as political instability, credit market uncertainty, the rate of economic growth or decline in our principal geographic or product markets or fluctuations in exchange rates;

changes in general economic and industry conditions in markets in which we participate, such as:

continued deterioration in the global economy;

continued deterioration in or stabilization of the North America housing market;

the strength of product demand and the markets we serve;

the intensity of competition, including that from foreign competitors;

pricing pressures;

the financial condition of our customers;

market acceptance of new product introductions and enhancements;

the introduction of new products and enhancements by competitors;

our ability to maintain and expand relationships with large customers;

our ability to source raw material commodities from our suppliers without interruption and at reasonable prices;
and

our ability to source components from third parties, in particular from foreign manufacturers, without interruption and at reasonable prices;

our ability to access capital markets and obtain anticipated financing under favorable terms;

our ability to identify, complete and integrate acquisitions successfully and to realize expected synergies on our anticipated timetable;

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

any impairment of goodwill and indefinite-lived intangible assets as a result of deterioration in our markets;

domestic and foreign governmental and regulatory policies;

changes in operating factors, such as continued improvement in manufacturing activities and the achievement of related efficiencies, cost reductions and inventory risks due to shifts in market demand and costs associated with moving production overseas;

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our ability to generate savings from our excellence in operations initiatives consisting of lean enterprise, supply management and cash flow practices;

our ability to generate savings from our restructuring actions;

unanticipated developments that could occur with respect to contingencies such as litigation, intellectual property matters, product liability exposures and environmental matters; and

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

The foregoing factors are not exhaustive, and new factors may emerge or changes to the foregoing factors may occur that would impact our business. We assume no obligation, and disclaim any duty, to update the forward-looking statements in this report.

Overview

We are a focused diversified industrial manufacturing company comprised of two operating segments: Water and Technical Products. Our Water Group is a global leader in providing innovative products and systems used worldwide in the movement, storage, treatment and enjoyment of water. Our Technical Products Group is a leader in the global enclosures and thermal management markets, designing and manufacturing standard, modified and custom enclosures that house and protect sensitive electronics and electrical components; thermal management products; and accessories. In 2009, we expect our Water Group and Technical Products Group to generate approximately 2/3 and 1/3 of total revenues, respectively.

Our Water Group has progressively become a more important part of our business portfolio with sales increasing from approximately \$125 million in 1995 to approximately \$2.2 billion in 2008. We believe the water industry is structurally attractive as a result of a growing demand for clean water and the large global market size (of which we have identified a target market totaling \$60 billion). Our vision is to be a leading global provider of innovative products and systems used in the movement, storage, treatment and enjoyment of water.

On February 28, 2008, we sold our National Pool Tile (NPT) business to Pool Corporation in a cash transaction. The results of NPT have been reported as discontinued operations for all periods presented. The assets and liabilities of NPT have been reclassified as discontinued operations for all periods presented.

On June 28, 2008, we entered into a transaction with GE Water & Process Technologies (a unit of General Electric Company) (GE) that was accounted for as an acquisition of an 80.1 percent ownership interest in GE 's global water softener and residential water filtration business in exchange for a 19.9 percent interest in our global water softener and residential water filtration business. The acquisition was effected through the formation of two new entities, (collectively, Pentair Residential Filtration or PRF) a U.S. entity and an international entity, into which we and GE contributed certain assets, properties, liabilities and operations representing our respective global water softener and residential water filtration businesses. We are an 80.1 percent owner of the new entities and GE is a 19.9 percent owner.

With the formation of Pentair Residential Filtration, we believe we will be better positioned to serve residential customers with industry-leading technical applications in the areas of water conditioning, whole house filtration, point of use water management and water sustainability and expect to accelerate revenue growth by selling GE 's existing residential conditioning products through our sales channels.

On December 15, 2008, we sold our Spa and Bath (Spa/Bath) business to Balboa Water Group in a cash transaction. The results of Spa/Bath have been reported as discontinued operations for all periods presented. The assets and liabilities of Spa/Bath have been reclassified as discontinued operations for all periods presented.

Our Technical Products Group operates in a large global market with significant potential for growth in industry segments such as defense, security, medical and networking. We believe we have the largest industrial and commercial distribution network in North America for enclosures and the highest brand recognition in the industry in North America. From mid-2001 through 2003, the Technical Products Group experienced

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significantly lower sales volumes as a result of severely reduced capital spending in the industrial and commercial markets and over-capacity and weak demand in the data communication and telecommunication markets. From 2004 through 2008, sales volumes increased due to the addition of new distributors, new products, price increases and higher demand in targeted markets.

Key Trends and Uncertainties

The following trends and uncertainties affected our financial performance in 2008 and will likely impact our results in 2009 and beyond:

Many markets we serve have slowed dramatically as a result of the tumultuous credit markets and the resulting recession. We have identified specific product and geographic markets we serve that we believe will stagnate, contract or continue contracting in 2009, as noted below. We have begun and expect to continue to restructure our operations serving those markets to close facilities in order to reduce or relocate capacity, to reduce labor and material costs, to optimize our manufacturing footprint and to simplify our business structure. We have also identified specific markets in which we participate that we believe will continue to grow over this period and are selectively reinforcing our businesses in these markets. Because our businesses are significantly affected by general economic trends, further deterioration in our most important markets addressed below would likely have an adverse impact on our results of operation for 2009 and beyond.

New home building and new pool starts have contracted for each of the past three years in the United States and have started to slow significantly in Europe as well. We believe that construction of new homes and new pool starts in North America affect approximately 10% - 15% of sales of our water businesses, while repair, replacement and refurbishment accounts for approximately 15% - 20% of sales in these businesses. We expect the current recession to continue to adversely impact our sales for all or a significant portion of 2009. As sales of products into domestic residential end-markets in our Water Group business continued to slow appreciably, we have reduced our investments in businesses in those markets, and further restructured our operations by closing or downsizing facilities, reducing headcount and taking other market-related actions.

Industrial, communications and commercial markets for all of our businesses, including commercial and industrial construction, have also slowed significantly during the fourth quarter of 2008, especially in December, and this weakness has continued throughout the early part of the first quarter of 2009. We have a high level of uncertainty over the course of the economy and hence the strength of many of our significant markets both in the United States and around the world for the balance of the year and beyond. We have reduced our investments in businesses in these markets, and further restructured our operations by closing or downsizing facilities, reducing headcount and taking other market-related actions.

We experienced material cost and other inflation in a number of our businesses during 2008. To offset this inflation, we implemented productivity improvements and selective increases in selling prices to help mitigate inflationary cost increases we experienced in base materials such as carbon steel, copper and resins and other costs such as health care and other employee benefit costs. We expect the current economic environment will result in price volatility for many of our raw materials; material costs have declined in the fourth quarter of 2008 and the first quarter of 2009, and we believe they will continue to decline so long as general economic conditions remain weak. We believe that these cost decreases we are experiencing will not begin to be fully realized in our results of operations until the second quarter of 2009.

As a result of the dramatic fall in securities and other investment markets over 2008, our unfunded pension liability increased from fiscal year end 2007 to fiscal year end 2008 from \$147 million to \$257 million, or an increase of \$110 million primarily reflecting our reduced investment return and significantly lower asset values in our US

defined benefit plans during 2008. We believe that this will increase our pension expense in 2009 over year-earlier levels, and more significantly, require an increase in our 2009 contributions to the plans to approximately \$40-\$45 million, an increase of over \$30 million in the year.

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We have a long-term goal to consistently generate free cash flow that equals or exceeds 100% conversion of our net income. We define free cash flow as cash flow from continuing operating activities less capital expenditures plus proceeds from sale of property and equipment. Free cash flow for the full year 2008 was approximately \$164 million, or 72% of our net income. Our target for free cash flow in 2009 remains at 100% of net income, and we have instituted several measures internally to maintain our strong collection experience and to decrease our working capital. See our discussion of *Other financial measures* under the caption Liquidity and Capital Resources in this report.

We experience seasonal demand in a number of markets within our Water Group. End-user demand for pool equipment follows warm weather trends and is normally at seasonal highs from April to August. The magnitude of the sales spike is partially mitigated by employing some advance sale early buy programs (generally including extended payment terms and/or additional discounts). Demand for residential and agricultural water systems is also impacted by economic conditions and weather patterns, particularly by heavy flooding and droughts. While we believe that this seasonality will continue in the second and third quarters of 2009, due to the unknown impact of the current economic situation, we are uncertain of the size and impact of the seasonal spike for the year, and contemplate that any seasonal impact will likely be less than in prior years.

We experienced year over year favorable foreign currency effects on net sales and operating results in 2007 and the first nine months of 2008, due to the weakening of the U.S. dollar in relation to other foreign currencies. Our currency effect is primarily for the U.S. dollar against the euro, which may or may not trend favorably in the future.

On June 28, 2008, we formed Pentair Residential Filtration in order to expand our product lines, accelerate opportunities to provide our customers complete water filtration systems, increase revenue growth and exploit cost synergy opportunities. The one-time gain on the transaction increased diluted earnings per share, on an after tax basis, by 86 cents in the second quarter of 2008. Integration and inventory step-up costs arising out of the formation of the PRF business amounted to approximately \$7 million in 2008. We believe we will continue to incur integration costs as we combine facilities in this business throughout most of 2009.

The effective income tax rate for 2008 was 29.5%. We estimate our effective tax rate for the full year 2009 to be between 32% and 33%. We continue to actively pursue initiatives to reduce our effective tax rate. The tax rate in any quarter can be affected positively or negatively by adjustments that are required to be reported in the specific quarter of resolution.

Outlook

In 2009, our operating objectives include the following:

Restructuring our operations in challenging markets while investing in more favorable markets and geographies;

Increasing our vertical market focus within each of our Global Business Units to grow in those markets in which we have competitive advantages;

Driving operating excellence through lean enterprise initiatives, with special focus on sourcing and supply management, cash flow management, and lean operations;

Stressing proactive talent development, particularly in international management and other key functional areas; and

Completing integration of the newly formed PRF business and prior acquisitions, and realizing identified synergistic opportunities.

On February 3, 2009, we announced our results of operations for fiscal year 2008 and modified our earnings guidance for the first quarter of 2009 to a range of \$0.20 to \$0.30 per share on a diluted basis. Our prior guidance for the first quarter of 2009, given in December 2008, was a range of \$0.30 to \$0.35 per share. Our

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revised outlook for the quarter is based on what we believe will be a continuation of the order rates and level of economic activity realized in December and January lasting throughout the first quarter.

In December 2008, we also initiated earnings guidance for the year 2009 that anticipated our earnings to be approximately \$1.70 to \$2.00 per share on a diluted basis. This guidance has not been withdrawn or modified because we do not have sufficient certainty at this time to support any revision. We do caution, however, that we are uncertain of the economic performance trajectory, both in the United States and globally, for the calendar year. As noted above, significant deterioration in general economic conditions in our primary markets and geographies beyond what we have seen to date in the first quarter would adversely impact our revenues and financial performance.

This outlook is based on several variables. First, our guidance anticipates revenue declines in our businesses throughout 2009 of approximately 10% as a result of overall market conditions, bringing our total revenue to approximately \$3.0 billion for the full year. Second, we expect to get the benefit in the second, third and fourth quarters of 2009 of restructuring and other market-related expense reduction efforts taken during 2008 and early in 2009. Third, we anticipate that our manufacturing productivity initiatives, in particular our materials sourcing programs, will improve through our lean enterprise initiatives and commodity deflation.

We have heightened our focus on increasing the conversion of our net income into free cash flow from that achieved in 2008. In addition, in response to continuing turbulence in the credit markets, we are taking actions we believe will help maintain our liquidity and increase our capital resources by allowing us to repay indebtedness at a faster rate than would otherwise be the case. We do not intend to implement our stock buyback program for 2009, as we have in the past, nor do we currently intend to make any significant cash acquisitions until credit markets and business conditions stabilize.

If economic conditions worsen in North America and Europe, then we expect that our sales, manufacturing productivity and cash flow may deteriorate from the current forecast. In that event, we would further reduce discretionary capital spending and selling, marketing and R&D costs as well as accelerate our restructuring actions in order to minimize the impact of these declines on our earnings per share. Conversely, if economic conditions hold up and improve over the year we would then have the flexibility to increase expenditures in our selling, marketing and R&D efforts to maximize organic sales growth in favorable markets in 2009 and to anticipate growth in 2010.

Our guidance assumes an absence of significant acquisitions or divestitures in 2009. In 2009, we may seek to expand our geographic reach internationally, expand our presence in our various channels to market and acquire technologies and products to broaden our businesses' capabilities to serve additional markets. We may also consider the divestiture or closure of discrete business units to further focus our businesses on their most attractive markets.

The ability to achieve our operating objectives and 2009 guidance will depend, to a certain extent, on factors outside our control. See **Risk Factors** under Part I of this report.

RESULTS OF OPERATIONS***Net sales***

The components of the net sales change were:

<i>Percentages</i>	2008 vs. 2007	2007 vs. 2006
Volume	(1.6)	4.3
Price	2.3	2.6

Currency	1.5	1.6
Total	2.2	8.5

The 2.2 percent increase in consolidated net sales in 2008 from 2007 was primarily the result of:
selective increases in selling prices to mitigate inflationary cost increases;

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an increase in sales volume due to the formation of PRF and our 2007 acquisitions of Jung Pumpen GmbH (Jung Pump) Porous Media Corporation and Porous Media, Ltd. (together Porous Media);

favorable foreign currency effects; and

higher Technical Products Group sales.

These increases were partially offset by:

lower sales of certain pump, pool and filtration products primarily related to the downturn in the North American residential housing market throughout 2008 and other global markets in the fourth quarter.

The 8.5 percent increase in consolidated net sales in 2007 from 2006 was primarily the result of:

an increase in sales volume due to our February 2, 2007 acquisition of Jung Pump and our April 30, 2007 acquisition of Porous Media;

organic sales growth of approximately 2 percent for the full year 2007 (excluding acquisitions and foreign currency exchange), which included selective increases in selling prices to mitigate inflationary cost increases due to:

growth in the Europe and Asia-Pacific markets;

higher Technical Product sales into electrical markets;

higher second quarter sales of municipal pumps related to a large flood control project; and

growth in commercial and industrial water markets.

These increases were partially offset by:

lower Technical Products sales into North American electronics markets driven by contraction and consolidation in the telecommunication equipment industry which have delayed buying activity and by datacommunication projects reaching end-of-life;

lower sales of certain pump, pool and filtration products related to the downturn in the North American residential housing market and softness in residential pool construction markets; and

favorable foreign currency effects.

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

<i>In thousands</i>	2008	2007	2006	2008 vs. 2007		2007 vs. 2006	
				\$ change	% change	\$ change	% change
Water	\$ 2,206,142	\$ 2,230,770	\$ 2,023,358	\$ (24,628)	(1.1%)	\$ 207,412	10.3%
Technical Products	1,145,834	1,050,133	999,244	95,701	9.1%	50,889	5.1%

Total	\$ 3,351,976	\$ 3,280,903	\$ 3,022,602	\$ 71,073	2.2%	\$ 258,301	8.5%
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Water

The 1.1 percent decrease in Water segment sales in 2008 from 2007 was primarily the result of:

organic sales decline (excluding acquisitions and foreign currency exchange) of 5.1 percent for the full year 2008, which included:

lower sales of certain pump, pool and filtration products into North American and Western European residential housing markets; and

second quarter 2007 sales of municipal pumps related to a large flood control project that did not recur in 2008.

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These decreases were partially offset by:

selective increases in selling prices to mitigate inflationary cost increases; and

continued growth in China and in other markets in Asia-Pacific as well as continued success in penetrating markets in Europe and the Middle East.

These decreases were further offset by:

an increase in sales volume driven by the formation of PRF and our 2007 acquisitions of Jung Pump and Porous Media; and

favorable foreign currency effects.

The 10.3 percent increase in Water segment sales in 2007 from 2006 was primarily the result of:

an increase in sales volume driven by our February 2, 2007 acquisition of Jung Pump and our April 30, 2007 acquisition of Porous Media;

organic sales growth of 2 percent for the full year 2007 (excluding acquisitions and foreign currency exchange), which included selective increases in selling prices to mitigate inflationary cost increases:

continued growth in China and in other markets in Asia-Pacific as well as continued success in penetrating markets in Europe and the Middle East;

higher second quarter sales of municipal pumps related to a large flood control project; and

growth in commercial and industrial water markets.

These increases were partially offset by:

a decline in sales of certain pump, pool and filtration products into North American residential markets and softness in residential pool construction markets; and

favorable foreign currency effects.

Technical Products

The 9.1 percent increase in Technical Products segment sales in 2008 from 2007 was primarily the result of:

an increase in sales into electrical markets, which includes new products and selective increases in selling prices to mitigate inflationary cost increases;

an increase in sales into electronics markets as sales to our datacommunication and telecommunications customers rebounded and we expanded into other vertical markets;

strong sales performance in Asia and Europe; and

favorable foreign currency effects.

These increases were partially offset by:

an organic sales decline in our North American electronics markets.

The 5.1 percent increase in Technical Products segment sales in 2007 from 2006 was primarily the result of:

organic sales (excluding acquisitions and foreign currency exchange) which were up approximately 2 percent for the full year 2007 ,which included selective increases in selling prices to mitigate inflationary cost increases;

strong sales performance in Asia; and

increased sales into electrical markets.

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These increases were partially offset by:

lower sales into North American electronics markets driven by contraction and consolidation in the telecommunication equipment industry which have delayed buying activity and by datacommunication projects reaching end-of-life; and

favorable foreign currency effects.

Gross profit

<i>In thousands</i>	2008	% of sales	2007	% of sales	2006	% of sales
Gross profit	\$ 1,014,550	30.3%	\$ 1,012,698	30.9%	\$ 896,056	29.6%
Percentage point change		(0.6) pts		1.3 pts		

The 0.6 percentage point decrease in gross profit as a percent of sales in 2008 from 2007 was primarily the result of:

inflationary increases related to raw materials and labor costs;

lower sales of certain pump, pool and filtration products primarily related to the downturn in the North American residential housing market and the slowing of residential markets in Western Europe;

higher cost of goods sold in 2008 as a result of a fair market value inventory step-up related to the formation of PRF; and

operating inefficiencies related to product moves and plant consolidations.

These decreases were partially offset by:

selective increases in selling prices in our Water and Technical Products Groups to mitigate inflationary cost increases;

the gross margin impact from increased sales volume in our Technical Products Group and the resulting improved fixed cost leverage;

savings generated from our PIMS initiatives including lean and supply management practices; and

lower comparative cost in 2008 for our Jung Pump and Porous Media businesses due to the absence of a fair market value inventory step-up that was recorded in connection with those acquisitions.

The 1.3 percentage point increase in gross profit as a percent of sales in 2007 from 2006 was primarily the result of:

savings generated from our PIMS initiatives including lean and supply management practices;

selective increases in selling prices in our Water and Technical Products Groups to mitigate inflationary cost increases; and

a decrease in costs related to capacity rationalization and market-related actions in 2007 compared to 2006.

These increases were partially offset by:

inflationary increases related to raw materials and labor; and

higher cost as a result of a fair market value inventory step-up related to the Jung Pump and Porous Media acquisitions.

Table of Contents***Selling, general and administrative (SG&A)***

<i>In thousands</i>	2008	% of sales	2007	% of sales	2006	% of sales
*SG&A	\$ 627,415	18.7%	\$ 576,828	17.6%	\$ 526,568	17.4%
Percentage point change		1.1 pts		0.2 pts		

* Includes Legal settlement, which is presented on a separate line in the Consolidated Statements of Income

The 1.1 percentage point increase in SG&A expense as a percent of sales in 2008 from 2007 was primarily the result of:

restructuring actions in both our Water and Technical Products Groups during the second half of 2008;

higher selling and general expense to fund investments in future growth with emphasis on growth in the international markets, including personnel and business infrastructure investments; and

expenses related to the settlement of the Horizon litigation.

These increases were partially offset by:

reduced costs related to productivity actions taken in the second half of 2007 and throughout 2008; and

reduced costs related to the completion of the European SAP implementation in 2007.

The 0.2 percentage point increase in SG&A expense as a percent of sales in 2007 from 2006 was primarily the result of:

higher selling and general expense to fund investments in future growth with emphasis on growth in the international markets, including personnel and business infrastructure investments;

proportionately higher SG&A expenses in the acquired Jung Pump and Porous Media businesses caused in part by amortization expense related to the intangible assets from those acquisitions; and

exit costs incurred in 2007 related to a previously announced 2001 French facility closure.

These increases were partially offset by:

a decrease in costs related to capacity rationalization and market-related actions in 2007 compared to 2006.

Research and development (R&D)

<i>In thousands</i>	2008	% of sales	2007	% of sales	2006	% of sales
R&D	\$ 62,450	1.9%	\$ 56,821	1.7%	\$ 56,545	1.9%
Percentage point change		0.2 pts		(0.2) pts		

The 0.2 percentage point increase in R&D expense as a percent of sales in 2008 from 2007 was primarily the result of:

increased R&D spending with emphasis on new product development and value engineering.

The 0.2 percentage point decrease in R&D expense as a percent of sales in 2007 from 2006 was primarily the result of:

relatively flat R&D expense spending on higher volume.

Table of Contents***Operating income******Water***

<i>In thousands</i>	2008	% of sales	2007	% of sales	2006	% of sales
Operating income	\$ 206,357	9.4%	\$ 273,677	12.3%	\$ 219,611	10.9%
Percentage point change		(2.9) pts		1.4 pts		

The 2.9 percentage point decrease in Water segment operating income as a percent of net sales in 2008 from 2007 was primarily the result of:

inflationary increases related to raw materials and labor;

a decline in sales of certain pump, pool and filtration products resulting from the downturn in North American and Western European markets;

restructuring actions taken throughout 2008;

expenses related to the settlement of the Horizon litigation;

second quarter 2007 sales of municipal pumps related to a large flood control project, which did not recur in 2008; and

higher cost in 2008 as a result of a fair market value inventory step-up and intangible amortization related to the June 2008 formation of PRF.

These increases were partially offset by:

selective increases in selling prices to mitigate inflationary cost increases;

savings generated from our PIMS initiatives including lean and supply management practices;

an increase in sales volume driven by our February 2, 2007 acquisition of Jung Pump, our April 30, 2007 acquisition of Porous Media, and the June 2008 formation of PRF;

curtailment of long-term defined benefit pension and retiree medical plans in 2007; and

lower comparative cost in 2008 for our Jung Pump and Porous Media businesses due to the absence of a fair market value inventory step-up that was recorded in connection with those acquisitions.

The 1.4 percentage point increase in Water segment operating income as a percent of net sales in 2007 from 2006 was primarily the result of:

selective increases in selling prices to mitigate inflationary cost increases;

savings generated from our PIMS initiatives including lean and supply management practices;

income generated by our February 2, 2007 acquisition of Jung Pump and our April 30, 2007 acquisition of Porous Media;

curtailment of long-term defined benefit pension and retiree medical plans; and

a decrease in costs related to capacity rationalization and market-related actions in 2007 compared to 2006.

These increases were partially offset by:

inflationary increases related to raw materials and labor;

a decline in sales of certain pump, pool and filtration products into North American residential markets;

amortization expense related to the intangible assets from the Jung Pump and Porous Media acquisitions; and

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higher cost as a result of fair market value market step-up related to the Jung Pump and Porous Media acquisitions.

Technical Products

<i>In thousands</i>	2008	% of sales	2007	% of sales	2006	% of sales
Operating income	\$ 169,315	14.8%	\$ 153,586	14.6%	\$ 148,905	14.9%
Percentage point change		0.2 pts		(0.3) pts		

The 0.2 percentage point increase in Technical Products segment operating income as a percent of net sales in 2008 from 2007 was primarily the result of:

an increase in sales to electrical and electronics markets, which includes selective increases in selling prices to mitigate inflationary cost increases;

savings realized from the continued success of PIMS, including lean and supply management activities.

These increases were partially offset by:

inflationary increases related to raw materials such as carbon steel and labor costs; and

expenses associated with restructuring actions taken during the second half of 2008.

The 0.3 percentage point decrease in Technical Products segment operating income as a percent of net sales in 2007 from 2006 was primarily the result of:

inflationary increases related to raw materials such as stainless steel and labor costs;

lower sales into North American electronics markets driven by contraction and consolidation in the telecommunication equipment industry which have delayed buying activity and by datacommunication projects reaching end-of-life; and

exit costs incurred in 2007 related to a previously announced 2001 French facility closure.

These decreases were partially offset by:

selective increases in selling prices to mitigate inflationary cost increases;

savings realized from the continued success of PIMS, including lean and supply management activities; and

increased sales in our electrical markets.

Net interest expense

<i>In thousands</i>	2008	2007	Difference	% change	2007	2006	Difference	% change
Net interest expense	\$ 59,435	\$ 68,393	\$ (8,958)	(13.1%)	\$ 68,393	\$ 50,300	\$ 18,093	36.0%

The 13.1 percent decrease in interest expense from continuing operations in 2008 from 2007 was primarily the result of:

a decrease in outstanding debt; and

favorable impact of lower interest rates.

The 36.0 percent increase in interest expense from continuing operations in 2007 from 2006 was primarily the result of:

an increase in outstanding debt primarily related to the Jung Pump and Porous Media acquisitions.

Table of Contents***Loss on early extinguishment of debt***

On July 8, 2008, we commenced a cash tender offer for all of our outstanding \$250 million aggregate principal 7.85% Senior Notes due 2009 (the Notes). Upon expiration of the tender offer on August 4, 2008, we purchased \$116.1 million aggregate principal amount of the Notes. As a result of this transaction, we recognized a loss of \$4.6 million on early extinguishment of debt. The loss included the write off of \$0.1 million in unamortized deferred financing fees in addition to recognition of \$0.6 million in previously unrecognized swap gains and cash paid of \$5.1 million related to the tender premium and other costs associated with the purchase.

Provision for income taxes from continuing operations

<i>In thousands</i>	2008	2007	2006
Income from continuing operations before income taxes and minority interest	\$ 367,140	\$ 306,561	\$ 259,675
Provision for income taxes	108,344	94,443	73,424
Effective tax rate	29.5%	30.8%	28.3%

The 1.3 percentage point decrease in the tax rate in 2008 from 2007 was primarily the result of:

- higher earnings in lower-tax rate jurisdictions during 2008; and
- a portion of the gain on the formation of PRF taxed at a rate of 0%.

These decreases were partially offset by:

- the impact in 2007 of a favorable adjustment related to the measurement of deferred tax assets and liabilities to account for changes in German tax law enacted on August 17, 2007.

The 2.5 percentage point increase in the tax rate in 2007 from 2006 was primarily the result of:

- higher utilization of foreign tax credits in 2006; and
- the favorable settlement in 2006 of prior years federal tax returns.

These increases were partially offset by:

- a favorable adjustment in 2007 related to the measurement of deferred tax assets and liabilities to account for changes in German tax law enacted on August 17, 2007.

We expect our full year effective tax rate in 2009 to be between 32% and 33%. We will continue to pursue tax rate reduction opportunities.

LIQUIDITY AND CAPITAL RESOURCES

We generally fund cash requirements for working capital, capital expenditures, equity investments, acquisitions, debt repayments, dividend payments and share repurchases from cash generated from operations, availability under

existing committed revolving credit facilities, and in certain instances, public and private debt and equity offerings. We have grown our businesses in significant part over the past few years through acquisitions, such as Jung Pump and Porous Media in 2007, financed by credit provided under our revolving credit facilities and, from time to time, by private or public debt issuance. Our primary revolving credit facilities have generally been adequate for these purposes, although we have negotiated additional credit facilities as needed to allow us to complete acquisitions; these are temporary loans that have in the past been repaid within less than a year.

In light of the current global economic situation and the state of credit markets generally, we have instituted a more conservative financial policy. We do not currently plan to make any significant acquisitions in 2009, and we do not plan to continue in 2009 the annual share repurchase programs that we have undertaken over the

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past few years. We are focusing on increasing our cash flow and maximizing debt repayment for the foreseeable future. Our intent is to maintain investment grade ratings and a solid liquidity position.

We previously had a targeted debt-to-total-capital ratio of 40%, which could and had been exceeded from time to time as needed for operational purposes and, especially, acquisitions. Our capital structure as of December 31, 2008 consisted of \$954.1 million in total indebtedness and \$1,898.7 million in shareholders' equity. The ratio of debt-to-total capital was 33.4 percent, compared with 35.7 percent at year-end 2007 and 30.8 percent in 2006. In line with our new financial policy, we no longer target a particular debt-to-total-capital ratio, but we will strive to maintain our investment grade ratings.

Our current \$800 million multi-currency revolving credit facility (the "Credit Facility") was entered into in the second quarter of 2007 and does not expire until June 4, 2012. The agent banks under the Credit Facility are J. P. Morgan, Bank of America, Wells Fargo, U. S. Bank and Bank of Tokyo-Mitsubishi. We have borrowing capacity of over \$580 million at December 31, 2008, and the only significant required debt repayment before 2012 is for the retirement in October 2009 of the remaining 7.85% Senior Notes originally issued in 1999, of which approximately \$134 million are currently outstanding.

We experience seasonal cash flows primarily due to seasonal demand in a number of markets within our Water Group. We generally borrow in the first quarter of our fiscal year for operational purposes, which usage reverses in the second quarter as the seasonality of our businesses peaks. End-user demand for pool equipment follows warm weather trends and is at seasonal highs from April to August. The magnitude of the sales spike is partially mitigated by employing some advance sale "early buy" programs (generally including extended payment terms and/or additional discounts). Demand for residential and agricultural water systems is also impacted by weather patterns, particularly by heavy flooding and droughts.

Operating activities

Cash provided by operating activities was \$204.2 million in 2008, or \$137.1 million lower compared with the same period in 2007. The decrease in cash provided by operating activities was due primarily to an increase in working capital, higher prepaid expenses (particularly prepaid taxes) and lower income from continuing operations, excluding the gain from the formation of PRF.

Cash provided by operating activities was \$341.3 million in 2007, or \$109.8 million higher compared with the same period in 2006. The increase in cash provided by operating activities was due primarily to working capital reductions during 2007 versus 2006 and higher net income.

In December 2008 and 2007, we sold approximately \$44 million and \$50 million, respectively, of a customer's account receivable to a third-party financial institution to mitigate accounts receivable concentration risk. In compliance with Statement of Financial Accounting Standards ("SFAS") No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, sales of accounts receivable are reflected as a reduction of accounts receivable in our Consolidated Balance Sheets and the proceeds are included in the cash flows from operating activities in our Consolidated Statements of Cash Flows. In 2008 and 2007, a loss in the amount of \$0.5 million and \$1.2 million related to the sale of accounts receivable is included in the line item *Other* in our Consolidated Statements of Income.

Investing activities

Capital expenditures in 2008, 2007, and 2006 were \$53.1 million, \$61.5 million and \$50.9 million, respectively. We anticipate capital expenditures for fiscal 2009 to be approximately \$45 to \$50 million, primarily for capacity expansions in our low cost country manufacturing facilities, new product development, and general maintenance capital.

On May 7, 2007, we acquired as part of our Technical Products Group the assets of Calmark Corporation (Calmark), a privately held business, for \$28.4 million, including a cash payment of \$29.2 million and transaction costs of \$0.2 million, less cash acquired of \$1.0 million.

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On April 30, 2007, we acquired as part of our Water Group all of the capital interests in Porous Media, two privately held filtration and separation technologies businesses, for \$224.9 million, including a cash payment of \$225.0 million and transaction costs of \$0.4 million, less cash acquired of \$0.5 million.

On February 2, 2007, we acquired as part of our Water Group all the outstanding shares of capital stock of Jung Pump for \$229.5 million, including a cash payment of \$239.6 million and transaction costs of \$1.3 million, less cash acquired of \$11.4 million.

On December 15, 2008, we sold our Spa/Bath business to Balboa Water Group in a cash transaction for approximately \$8.3 million subject to certain price adjustments based on working capital at closing. The results of Spa/Bath have been reported as discontinued operations for all periods presented. The assets and liabilities of Spa/Bath have been reclassified as discontinued operations for all periods presented.

On February 28, 2008, we sold our NPT business to Pool Corporation in a cash transaction for approximately \$30.0 million subject to certain price adjustments. The results of NPT have been reported as discontinued operations for all periods presented. The assets and liabilities of NPT have been reclassified as discontinued operations for all periods presented.

Cash proceeds from the sale of property and equipment of \$4.7 million in 2008 was primarily related to the sale of a facility in our Water Group. Cash proceeds from the sale of property and equipment of \$5.2 million in 2007 was primarily related to the sale of a facility used by our Technical Products Group.

Financing activities

Net cash used for financing activities was \$217.2 million in 2008 versus net cash provided by financing activities of \$222.7 in 2007. The difference in cash usage between the two years is primarily attributable to the three acquisitions in 2007. Other financing activities included draw downs and repayments on our revolving credit facilities to fund our operations in the normal course of business, payments of dividends, cash used to repurchase Company stock, cash received from stock option exercises, and tax benefits related to stock-based compensation.

The Credit Facility creates an unsecured, committed revolving credit facility of up to \$800 million, with multi-currency sub facilities to support investments outside the U.S. The Credit Facility expires on June 4, 2012. Borrowings under the Credit Facility bear interest at the rate of LIBOR plus 0.50%. Interest rates and fees on the Credit Facility vary based on our credit ratings. We believe that internally generated funds and funds available under our Credit Facility will be sufficient to support our normal operations, dividend payments, stock repurchases (if authorized) and debt maturities over the life of the Credit Facility.

We are authorized to sell short-term commercial paper notes to the extent availability exists under the Credit Facility. We use the Credit Facility as back-up liquidity to support 100% of commercial paper outstanding. Our use of commercial paper as a funding vehicle depends upon the relative interest rates for our commercial paper compared to the cost of borrowing under our Credit Facility. As of December 31, 2008, we had \$0.2 million of commercial paper outstanding that matures within 41 days. All of the commercial paper was classified as long-term as we have the intent and the ability to refinance such obligations on a long-term basis under the Credit Facility.

In May 2007, we entered into a Note Purchase Agreement with various institutional investors (the Agreement) for the sale of \$300 million aggregate principal amount of our 5.87% Senior Notes (Fixed Notes) and \$105 million aggregate principal amount of our Floating Rate Senior Notes (Floating Notes and with the Fixed Notes, the Notes). The Fixed Notes are due in May 2017. The Floating Notes are due in May 2012 and bear interest equal to the 3 month LIBOR plus 0.50%. The Agreement contains customary events of default.

We used \$250 million of the proceeds from the sale of the Notes to retire a \$250 million 364-day Term Loan Agreement that we entered into in April 2007, which we used in part to pay the cash purchase price of our Porous Media acquisition which closed in April 2007.

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Our debt agreements contain certain financial covenants, the most restrictive of which is a leverage ratio (total consolidated indebtedness, as defined, over consolidated EBITDA, as defined) that may not exceed 3.5 to 1.0. We were in compliance with all covenants under our debt agreements as of December 31, 2008.

In addition to the Credit Facility, we have \$25.0 million of uncommitted credit facilities, under which we had no borrowings as of December 31, 2008.

Our current credit ratings are as follows:

Rating Agency	Long-Term Debt Rating	Current Rating Outlook
Standard & Poor's	BBB	Negative
Moody's	Baa3	Stable

Our long-term debt rating is an investment grade rating. Investment grade is a credit rating of BBB- or higher by Standard & Poor's or Baa3 or higher by Moody's.

On March 7, 2007, Standard & Poor's Ratings Services revised its current rating outlook on us from stable to negative. At the same time, Standard & Poor's affirmed its long-term debt rating of BBB-. Standard & Poor's stated that the outlook revision reflects the additional leverage and stress on credit metrics that would result from the acquisition of Porous Media. The negative outlook indicates the rating could be lowered if financial policies become more aggressive or if operating results are weaker than expected.

We believe the potential impact of a downgrade in our financial outlook is currently not material to our liquidity exposure or cost of debt. A credit rating is a current opinion of the creditworthiness of an obligor with respect to a specific financial obligation, a specific class of financial obligations, or a specific financial program. The credit rating takes into consideration the creditworthiness of guarantors, insurers, or other forms of credit enhancement on the obligation and takes into account the currency in which the obligation is denominated. The ratings outlook also highlights the potential direction of a short or long-term rating. It focuses on identifiable events and short-term trends that cause ratings to be placed under observation by the respective rating agencies. A change in rating outlook does not mean a rating change is inevitable. Prior changes in our ratings outlook have had no immediate impact on our liquidity exposure or on our cost of debt.

We issue short-term commercial paper notes that are currently not rated by Standard & Poor's or Moody's. Even though our short-term commercial paper is unrated, we believe a downgrade in our long-term debt rating could have a negative impact on our ability to continue to issue unrated commercial paper.

We do not expect that a one rating downgrade of our long-term debt by either Standard & Poor's or Moody's would substantially affect our ability to access the long-term debt capital markets. However, depending upon market conditions, the amount, timing and pricing of new borrowings could be adversely affected. If both of our long-term debt ratings were downgraded to below BBB-/Baa3, our flexibility to access the term debt capital markets would be reduced.

We expect to continue to have cash requirements to support working capital needs and capital expenditures, to pay interest and service debt, and to pay dividends to shareholders. In order to meet these cash requirements, we intend to

use available cash and internally generated funds, and to borrow under our committed and uncommitted credit facilities.

We paid dividends in 2008 of \$67.3 million, compared with \$59.9 million in 2007 and \$56.6 million in 2006. We recently announced an increase in our dividend rate for 2009 from \$0.68 per share in 2008 to \$0.72 per share in 2009, which is the 33rd consecutive year in which we have increased our dividend.

In December 2007, the Board of Directors authorized the repurchase of shares of our common stock during 2008 up to a maximum dollar limit of \$50 million. As of December 31, 2008, we had purchased 1,549,893 shares for \$50 million pursuant to this authorization. This authorization expired on December 31, 2008. No authorization for the repurchase of shares of our common stock has been granted for 2009.

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

<i>In thousands</i>	Payments Due by Period					More than 5 Years	Total
	2009	2010	2011	2012	2013		
Long-term debt obligations	\$ 134,773	\$ 78	\$ 6	\$ 319,206	\$ 200,007	\$ 300,022	\$ 954,092
Interest obligations on fixed-rate debt	41,811	33,524	33,524	29,990	24,095	59,264	222,208
Operating lease obligations, net of sublease rentals	25,952	19,790	17,773	13,310	9,121	11,952	97,898
Pension and post-retirement plan contributions	50,200	35,200	30,200	30,100	30,100	78,000	253,800
Other long-term liabilities	948	546	229	229	114		2,066
Total contractual cash obligations, net	\$ 253,684	\$ 89,138	\$ 81,732	\$ 392,835	\$ 263,437	\$ 449,238	\$ 1,530,064

Our long-term debt obligations that are due in 2009 include \$134.1 million that has been classified as long-term in our Consolidated Balance Sheets as we have the intent and the ability to refinance such obligations on a long-term basis under the Credit Facility.

In addition to the summary of significant contractual obligations, we will incur annual interest expense on outstanding variable rate debt. As of December 31, 2008, variable interest rate debt, including the effects of derivative financial instruments, was \$214.4 million at a weighted average interest rate of 1.21%.

Pension and post-retirement plan contributions are based on an assumed discount rate of 6.5% for all periods and an expected rate of return on plan assets ranging from 6.5% to 8.5%.

As of December 31, 2008, the gross liability for uncertain tax positions under FIN 48 is \$28.1 million. We do not expect a significant payment related to these obligations to be made within the next twelve months. We are not able to provide a reasonably reliable estimate of the timing of future payments relating to the non-current FIN 48 obligations.

Other financial measures

In addition to measuring our cash flow generation or usage based upon operating, investing, and financing classifications included in the Consolidated Statements of Cash Flows, we also measure our free cash flow and our conversion of net income. We have a long-term goal to consistently generate free cash flow that equals or exceeds 100% conversion of net income. Free cash flow and conversion of net income are non-GAAP financial measures that

we use to assess our cash flow performance. We believe free cash flow and conversion of net income are important measures of operating performance because they provide us and our investors a measurement of cash generated from operations that is available to pay dividends and repay debt. In addition, free cash flow and conversion of net income are used as a criterion to measure and pay compensation-based incentives. Our measure of free cash flow and conversion of net income may not be comparable to similarly titled measures reported by other companies. The following table is a reconciliation of free cash flow and a calculation of the conversion of net income with cash flows from continuing operations:

<i>In thousands</i>	Twelve Months Ended December 31		
	2008	2007	2006
Cash flow provided by (used for) continuing operations	\$ 212,612	\$ 336,990	\$ 229,399
Capital expenditures	(53,089)	(61,516)	(50,894)
Proceeds from sale of property and equipment	4,741	5,198	654
Free cash flow	164,264	280,672	179,159
Net income	228,734	210,927	183,731
Conversion of net income	72%	133%	98%

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In 2009, our objective is to generate free cash flow that equals or exceeds 100% of net income.

Off-balance sheet arrangements

At December 31, 2008, we had no off-balance sheet financing arrangements.

COMMITMENTS AND CONTINGENCIES

Environmental

We have been named as defendants, targets, or PRP in a small number of environmental clean-ups, in which our current or former business units have generally been given *de minimis* status. To date, none of these claims have resulted in clean-up costs, fines, penalties, or damages in an amount material to our financial position or results of operations. We have disposed of a number of businesses in recent years and in certain cases, such as the disposition of the Cross Pointe Paper Corporation uncoated paper business in 1995, the disposition of the Federal Cartridge Company ammunition business in 1997, the disposition of Lincoln Industrial in 2001, and the disposition of the Tools Group in 2004, we have retained responsibility and potential liability for certain environmental obligations. We have received claims for indemnification from purchasers of these businesses and have established what we believe to be adequate accruals for potential liabilities arising out of retained responsibilities. We settled some of the claims in prior years; to date our recorded accruals have been adequate.

In addition, there are ongoing environmental issues at a limited number of sites, including one site acquired in the acquisition of Essef Corporation in 1999, which relate to operations no longer carried out at the sites. We have established what we believe to be adequate accruals for remediation costs at these sites. We do not believe that projected response costs will result in a material liability.

We may be named as a PRP at other sites in the future, for both divested and acquired businesses. When the outcome of the matter is probable and it is possible to provide reasonable estimates of our liability with respect to environmental sites, provisions have been made in accordance with GAAP in the United States. As of December 31, 2008 and 2007, our undiscounted reserves for such environmental liabilities were approximately \$3.1 million and \$3.5 million, respectively. We cannot ensure that environmental requirements will not change or become more stringent over time or that our eventual environmental clean-up costs and liabilities will not exceed the amount of our current reserves.

Stand-by letters of credit

In the ordinary course of business, we are required to commit to bonds that require payments to our customers for any non-performance. The outstanding face value of the bonds fluctuates with the value of our projects in process and in our backlog. In addition, we issue financial stand-by letters of credit primarily to secure our performance to third parties under self-insurance programs and certain legal matters. As of December 31, 2008 and 2007, the outstanding value of these instruments totaled \$64.5 million and \$58.5 million, respectively.

NEW ACCOUNTING STANDARDS

See ITEM 8, Note 1 of the Notes to Consolidated Financial Statements for information pertaining to recently adopted accounting standards or accounting standards to be adopted in the future.

CRITICAL ACCOUNTING POLICIES

We have adopted various accounting policies to prepare the consolidated financial statements in accordance with accounting principles generally accepted in the United States. Our significant accounting policies are more fully described in ITEM 8, Note 1 of the Notes to Consolidated Financial Statements. Certain of our accounting policies require the application of significant judgment by management in selecting the appropriate assumptions for calculating financial estimates. By their nature, these judgments are subject to an inherent degree of uncertainty. These judgments are based on our historical experience, terms of existing contracts, our

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observance of trends in the industry, and information available from other outside sources, as appropriate. We consider an accounting estimate to be critical if:

it requires us to make assumptions about matters that were uncertain at the time we were making the estimate; and

changes in the estimate or different estimates that we could have selected would have had a material impact on our financial condition or results of operations.

Our critical accounting estimates include the following:

Impairment of Goodwill

Goodwill represents the excess of the cost of acquired businesses over the fair value of identifiable tangible net assets and identifiable intangible assets purchased.

Goodwill is tested at least annually for impairment, and is tested for impairment more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test is performed using a two-step process. In the first step, the fair value of each reporting unit is compared with the carrying amount of the reporting unit, including goodwill. If the estimated fair value is less than the carrying amount of the reporting unit, an indication that goodwill impairment exists and a second step must be completed in order to determine the amount of the goodwill impairment, if any, that should be recorded. In the second step, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation. The fair value of each reporting unit is determined using a discounted cash flow analysis. Projecting discounted future cash flows requires us to make significant estimates regarding future revenues and expenses, projected capital expenditures, changes in working capital and the appropriate discount rate. The projections also take into account several factors including current and estimated economic trends and outlook, costs of raw materials, consideration of our market capitalization in comparison to the estimated fair values of our reporting units determined using discounted cash flow analyses and other factors which are beyond our control.

At December 31, 2008 our goodwill and intangible assets were approximately \$2,617.4 million, and represented approximately 64.6% of our total assets. Declines in projected future cash flows could result in future goodwill and intangible impairments. Because of the significance of our goodwill and intangible assets, any future impairment of these assets could have a material adverse effect on our financial statements.

We completed step one of our annual goodwill impairment evaluation during the fourth quarter with each reporting unit's fair value exceeding its carrying value. Accordingly, step two of the impairment analysis was not required.

Our primary identifiable intangible assets include trade marks and trade names, brand names, patents, non-compete agreements, proprietary technology, and customer relationships. Under the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets*, identifiable intangibles with finite lives are amortized and those identifiable intangibles with indefinite lives are not amortized. Identifiable intangible assets that are subject to amortization are evaluated for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Identifiable intangible assets not subject to amortization are tested for impairment annually or more frequently if events warrant. The impairment test consists of a comparison of the fair value of the intangible asset with its carrying amount. During the fourth quarter of 2008, we completed our annual impairment test for those identifiable assets not subject to amortization and recorded an impairment charge of \$1.0 million. The charge was recorded in *Selling, general and administrative* in our Consolidated Statements of Income.

Impairment of Long-lived Assets

We review the recoverability of long-lived assets to be held and used, such as property, plant and equipment, when events or changes in circumstances occur that indicate the carrying value of the asset or asset group may not be recoverable. The assessment of possible impairment is based on our ability to recover the carrying

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value of the asset or asset group from the expected future pre-tax cash flows (undiscounted and without interest charges) of the related operations. If these cash flows are less than the carrying value of such asset, an impairment loss is recognized for the difference between estimated fair value and carrying value. Impairment losses on long-lived assets held for sale are determined in a similar manner, except that fair values are reduced for the cost to dispose of the assets. The measurement of impairment requires us to estimate future cash flows and the fair value of long-lived assets.

Pension

We sponsor domestic and foreign defined-benefit pension and other post-retirement plans. The amounts recognized in our consolidated financial statements related to our defined-benefit pension and other post-retirement plans are determined from actuarial valuations. Inherent in these valuations are assumptions including expected return on plan assets, discount rates, rate of increase in future compensation levels, and health care cost trend rates. These assumptions are updated annually and are disclosed in ITEM 8, Note 12 to the Notes to Consolidated Financial Statements. Changes to these assumptions will affect pension expense, pension contributions and the funded status of our pension plans.

In December 2006, we adopted SFAS No. 158, *Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106, and 132(R)* (SFAS 158). SFAS 158 requires that we recognize the overfunded or underfunded status of our defined benefit and retiree medical plans as an asset or liability in our 2006 year-end balance sheet, with changes in the funded status recognized through comprehensive income in the year in which they occur.

Discount rate

The discount rate reflects the current rate at which the pension liabilities could be effectively settled at the end of the year based on our December 31 measurement date. The discount rate was determined by matching our expected benefit payments to payments from a stream of AA or higher bonds available in the marketplace, adjusted to eliminate the effects of call provisions. This produced a discount rate for our U.S. plans of 6.50% in 2008 and 2007 and 6.00% in 2006. The discount rates on our foreign plans ranged from 2.00% to 6.25% in 2008, 2.00% to 5.25% in 2007 and 2.00% to 5.15% in 2006. There are no other known or anticipated changes in our discount rate assumption that will impact our pension expense in 2009.

Expected rate of return

Our expected rate of return on plan assets in 2008 equaled 8.5%, which remained unchanged from 2007 and 2006. The expected rate of return is designed to be a long-term assumption that may be subject to considerable year-to-year variance from actual returns. In developing the expected long-term rate of return, we considered our historical returns, with consideration given to forecasted economic conditions, our asset allocations, input from external consultants and broader longer-term market indices.

We base our determination of pension expense or income on a market-related valuation of assets which reduces year-to-year volatility. This market-related valuation recognizes investment gains or losses over a five-year period from the year in which they occur. Investment gains or losses for this purpose are the difference between the expected return calculated using the market-related value of assets and the actual return based on the market-related value of assets. Since the market-related value of assets recognizes gains or losses over a five-year-period, the future value of assets will be impacted as previously deferred gains or losses are recorded.

See ITEM 8, Note 12 of the Notes to Consolidated Financial Statements for further information regarding pension plans.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk

Market risk is the potential economic loss that may result from adverse changes in the fair value of financial instruments. We are exposed to various market risks, including changes in interest rates and foreign currency rates. We use derivative financial instruments to manage or reduce the impact of some of these risks.

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Counterparties to all derivative contracts are major financial institutions. All instruments are entered into for other than trading purposes. The major accounting policies and utilization of these instruments is described more fully in ITEM 8, Note 1 of the Notes to Consolidated Financial Statements.

Our derivatives and other financial instruments consist of long-term debt (including current portion), short-term borrowing and interest rate swaps. The net market value of these financial instruments combined is referred to below as the net financial instrument position. As of December 31, 2008 and December 31, 2007, the net financial instrument position was a liability of \$923.9 million and \$1,076.5 million, respectively.

Failure of one or more of our swap counterparties would result in the loss of any benefit to us of the swap agreement. In this case, we would continue to be obligated to pay the variable interest payments per the underlying debt agreements which are at variable interest rates of 3 month LIBOR plus .50% for \$105 million of debt and 3 month LIBOR plus .60% for \$100 million of debt. Additionally, failure of one or all of our swap counterparties would not eliminate our obligation to continue to make payments under our existing swap agreements if we continue to be in a net pay position.

Interest rate risk

Our debt portfolio, including swap agreements, as of December 31, 2008 was comprised of debt predominantly denominated in U.S. dollars. This debt portfolio is comprised of 56% fixed-rate debt and 44% variable-rate debt, not considering the effects of our interest rate swaps. Taking into account the variable to fixed rate swap agreement we entered with an effective date of April 2006 and August 2007, our debt portfolio is comprised of 78% fixed-rate debt and 22% variable-rate debt. Changes in interest rates have different impacts on the fixed and variable-rate portions of our debt portfolio. A change in interest rates on the fixed portion of the debt portfolio impacts the net financial instrument position but has no impact on interest incurred or cash flows. A change in interest rates on the variable portion of the debt portfolio impacts the interest incurred and cash flows but does not impact the net financial instrument position.

Based on the variable-rate debt included in our debt portfolio, including the interest rate swap agreements, as of December 31, 2008, a 100 basis point increase or decrease in interest rates would result in a \$2.1 million increase or decrease in interest incurred.

Foreign currency risk

We conduct business in various locations throughout the world and are subject to market risk due to changes in the value of foreign currencies in relation to our reporting currency, the U.S. dollar. We generally do not use derivative financial instruments to manage these risks. The functional currencies of our foreign operating locations are the local currency in the country of domicile. We manage these operating activities at the local level and revenues, costs, assets, and liabilities are generally denominated in local currencies, thereby mitigating the risk associated with changes in foreign exchange. However, our results of operations and assets and liabilities are reported in U.S. dollars and thus will fluctuate with changes in exchange rates between such local currencies and the U.S. dollar.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management of Pentair, Inc. and its subsidiaries (the Company) is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) of the Securities Exchange Act of 1934. The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The Company's internal control over financial reporting includes those policies and procedures that (1) pertain to maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of the financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of the effectiveness of internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2008. In making this assessment, management used the criteria for effective internal control over financial reporting described in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management believes that, as of December 31, 2008, the Company's internal control over financial reporting was effective based on those criteria.

Our independent registered public accounting firm, Deloitte & Touche LLP, has issued an attestation report on the Company's internal control over financial reporting as of year ended December 31, 2008. That attestation report is set forth immediately following this management report.

Randall J. Hogan
Chairman and Chief Executive Officer

John L. Stauch
Executive Vice President and Chief Financial Officer

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the internal control over financial reporting of Pentair, Inc. and subsidiaries (the Company) as of December 31, 2008, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on the criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedule listed in the Index at ITEM 15 as of and for the year ended December 31, 2008, of the Company, and our report dated February 23, 2009, expressed an unqualified opinion on those consolidated financial statements and financial statement schedule.

Minneapolis, Minnesota
February 23, 2009

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated balance sheets of Pentair, Inc. and subsidiaries (the Company) as of December 31, 2008 and 2007, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2008. Our audits also included the financial statement schedule listed in the Index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Notes 1 and 11 to the consolidated financial statements, the Company changed its method of accounting for uncertain tax benefits in 2007 and as discussed in Notes 1 and 12 to the consolidated financial statements, the Company changed its method of accounting for defined benefit pension and postretirement benefit plans in 2006.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2008, based on the criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 23, 2009, expressed an unqualified opinion on the Company's internal control over financial reporting.

Minneapolis, Minnesota
February 23, 2009

Table of Contents**Pentair, Inc. and Subsidiaries****Consolidated Statements of Income**

<i>In thousands, except per-share data</i>	Years ended December 31		
	2008	2007	2006
Net sales	\$ 3,351,976	\$ 3,280,903	\$ 3,022,602
Cost of goods sold	2,337,426	2,268,205	2,126,546
Gross profit	1,014,550	1,012,698	896,056
Selling, general and administrative	606,980	576,828	526,568
Research and development	62,450	56,821	56,545
Legal settlement	20,435		
Operating income	324,685	379,049	312,943
Other (income) expense:			
Gain on sale of interest in subsidiaries	(109,648)		
Equity losses of unconsolidated subsidiary	3,041	2,865	3,332
Loss on early extinguishment of debt	4,611		
Interest income	(2,029)	(1,510)	(744)
Interest expense	61,464	69,903	51,044
Other	106	1,230	(364)
Income from continuing operations before income taxes and minority interest	367,140	306,561	259,675
Provision for income taxes	108,344	94,443	73,424
Minority interest	2,433		
Income from continuing operations	256,363	212,118	186,251
Loss from discontinued operations, net of tax	(5,783)	(1,629)	(2,484)
Gain (loss) on disposal of discontinued operations, net of tax	(21,846)	438	(36)
Net income	\$ 228,734	\$ 210,927	\$ 183,731
Earnings per common share			
<i>Basic</i>			
Continuing operations	\$ 2.62	\$ 2.15	\$ 1.87
Discontinued operations	(0.28)	(0.01)	(0.03)

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Basic earnings per common share	\$ 2.34	\$ 2.14	\$ 1.84
<i>Diluted</i>			
Continuing operations	\$ 2.59	\$ 2.12	\$ 1.84
Discontinued operations	(0.28)	(0.01)	(0.03)
Diluted earnings per common share	\$ 2.31	\$ 2.11	\$ 1.81
Weighted average common shares outstanding			
Basic	97,887	98,762	99,784
Diluted	99,068	100,205	101,371

See accompanying notes to consolidated financial statements.

Table of Contents**Pentair, Inc. and Subsidiaries****Consolidated Balance Sheets**

	December 31	
	2008	2007
<i>In thousands, except share and per-share data</i>		
ASSETS		
Current assets		
Cash and cash equivalents	\$ 39,344	\$ 70,795
Accounts and notes receivable, net of allowances of \$25,156 and \$27,471, respectively	461,081	461,408
Inventories	417,287	379,018
Deferred tax assets	51,354	50,511
Prepaid expenses and other current assets	63,113	35,799
Current assets of discontinued operations		40,490
Total current assets	1,032,179	1,038,021
Property, plant and equipment, net	343,881	361,690
Other assets		
Goodwill	2,101,851	1,999,119
Intangibles, net	515,508	487,028
Other	59,794	82,238
Non-current assets of discontinued operations		32,518
Total other assets	2,677,153	2,600,903
Total assets	\$ 4,053,213	\$ 4,000,614
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities		
Short-term borrowings	\$	\$ 13,586
Current maturities of long-term debt	624	5,075
Accounts payable	217,898	227,786
Employee compensation and benefits	90,210	111,082
Current pension and post-retirement benefits	8,890	8,557
Accrued product claims and warranties	41,559	49,077
Income taxes	5,451	14,999
Accrued rebates and sales incentives	28,897	36,430
Other current liabilities	104,975	90,021
Current liabilities of discontinued operations		3,704

Total current liabilities	498,504	560,317
Other liabilities		
Long-term debt	953,468	1,041,925
Pension and other retirement compensation	270,139	161,042
Post-retirement medical and other benefits	34,723	37,147
Long-term income taxes payable	28,139	21,306
Deferred tax liabilities	146,559	166,917
Other non-current liabilities	101,612	97,085
Non-current liabilities of discontinued operations		4,004
Total liabilities	2,033,144	2,089,743
Commitments and contingencies		
Minority interest	121,388	
Shareholders' equity		
Common shares par value \$0.162/3; 98,276,919 and 99,221,831 shares issued and outstanding, respectively	16,379	16,537
Additional paid-in capital	451,241	476,242
Retained earnings	1,457,676	1,296,226
Accumulated other comprehensive income (loss)	(26,615)	121,866
Total shareholders' equity	1,898,681	1,910,871
Total liabilities and shareholders' equity	\$ 4,053,213	\$ 4,000,614

See accompanying notes to consolidated financial statements.

Table of Contents**Pentair, Inc. and Subsidiaries****Consolidated Statements of Cash Flows**

<i>In thousands</i>	Years Ended December 31		
	2008	2007	2006
Operating activities			
Net income	\$ 228,734	\$ 210,927	\$ 183,731
Adjustments to reconcile net income to net cash provided by (used for) operating activities			
Loss from discontinued operations	5,783	1,629	2,484
(Gain) loss on disposal of discontinued operations	21,846	(438)	36
Equity losses of unconsolidated subsidiary	3,041	2,865	3,332
Minority interest	2,433		
Depreciation	59,673	57,603	55,682
Amortization	27,608	25,561	18,177
Deferred income taxes	40,754	(16,652)	(10,611)
Stock compensation	20,572	22,913	25,377
Excess tax benefits from stock-based compensation	(1,617)	(4,204)	(3,043)
Gain (loss) on sale of assets	510	(1,929)	(364)
Gain on sale of interest in subsidiaries	(109,648)		
Changes in assets and liabilities, net of effects of business acquisitions and dispositions			
Accounts and notes receivable	(18,247)	(19,068)	15,470
Inventories	(33,311)	14,714	(45,769)
Prepaid expenses and other current assets	(27,394)	2,175	(5,008)
Accounts payable	(1,973)	19,482	(18,409)
Employee compensation and benefits	(21,919)	3,995	(12,688)
Accrued product claims and warranties	(7,286)	4,763	1,196
Income taxes	(4,409)	2,849	10,353
Other current liabilities	8,987	(3,218)	(13,291)
Pension and post-retirement benefits	301	6	19,397
Other assets and liabilities	18,174	13,017	3,347
Net cash provided by (used for) continuing operations	212,612	336,990	229,399
Net cash provided by (used for) operating activities of discontinued operations	(8,397)	4,288	2,058
Net cash provided by (used for) operating activities	204,215	341,278	231,457
Investing activities			
Capital expenditures	(53,089)	(61,516)	(50,894)
Proceeds from sale of property and equipment	4,741	5,198	654
Acquisitions, net of cash acquired	(2,027)	(487,561)	(29,286)
Divestitures	37,907		(24,007)

Other	(12)	(5,544)	(6,370)
Net cash provided by (used for) investing activities	(12,480)	(549,423)	(109,903)
Financing activities			
Net short-term borrowings	(16,994)	(1,830)	13,831
Proceeds from long-term debt	715,000	1,269,428	608,975
Repayment of long-term debt	(805,016)	(954,077)	(631,755)
Debt issuance costs	(114)	(1,876)	
Excess tax benefits from stock-based compensation	1,617	4,204	3,043
Proceeds from exercise of stock options	5,590	7,388	4,066
Repurchases of common stock	(50,000)	(40,641)	(59,359)
Dividends paid	(67,284)	(59,910)	(56,583)
Net cash provided by (used for) financing activities	(217,201)	222,686	(117,782)
Effect of exchange rate changes on cash and cash equivalents	(5,985)	1,434	2,548
Change in cash and cash equivalents	(31,451)	15,975	6,320
Cash and cash equivalents, beginning of period	70,795	54,820	48,500
Cash and cash equivalents, end of period	\$ 39,344	\$ 70,795	\$ 54,820

See accompanying notes to consolidated financial statements.

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

	Common shares		Additional	Retained	Accumulated	Total	Comprehensive
	Number	Amount	paid-in capital	earnings	other comprehensive income (loss)		
<i>Amounts, except share and per-share data</i>							
December 31, 2005	101,202,237	\$ 16,867	\$ 518,751	\$ 1,020,978	\$ (986)	\$ 1,555,610	
Net income				183,731		183,731	\$
Change in cumulative translation adjustment					28,471	28,471	
Change in minimum pension liability, net of tax benefit					1,513	1,513	
Change in market value of derivative financial instruments					657	657	
Comprehensive income							\$
Change in net income to initially apply SFAS 158, net of tax benefit					(12,951)	(12,951)	
Change in net income from stock compensation			3,338			3,338	
Change in net income from dividends \$0.56 per common share				(56,583)		(56,583)	
Change in net income from purchases of stock options, net of 183,866 shares for payment	(1,986,026)	(332)	(59,027)			(59,359)	
Change in net income from restricted shares, net of forfeitures	310,963	52	2,846			2,898	
Change in net income from cancellation of restricted shares	324,219	54	304			358	
Change in net income from shares surrendered by employees to pay taxes	(74,228)	(12)	(2,589)			(2,601)	
Change in net income from stock compensation			14,240			14,240	
December 31, 2006	99,777,165	\$ 16,629	\$ 488,540	\$ 1,148,126	\$ 16,704	\$ 1,669,999	
Net income				210,927		210,927	\$
Change in cumulative translation adjustment					72,901	72,901	
Change in minimum pension liability, net of tax					37,201	37,201	
Change in market value of derivative financial instruments					(4,940)	(4,940)	
Comprehensive income							\$

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nt to initially apply FIN 48				(2,917)		(2,917)
fit of stock compensation			5,654			5,654
dends \$0.60 per common share				(59,910)		(59,910)
urchases	(1,209,257)	(202)	(40,439)			(40,641)
of stock options, net of 342,870 shares						
for payment	491,618	83	4,348			4,431
of restricted shares, net of						
ons	313,160	52	530			582
tion of restricted shares			9,256			9,256
rrendered by employees to pay taxes	(150,855)	(25)	(4,820)			(4,845)
mpensation			13,173			13,173

December 31, 2007 99,221,831 \$ 16,537 \$ 476,242 \$ 1,296,226 \$ 121,866 \$ 1,910,871

ne				228,734		228,734	\$
n cumulative translation adjustment					(72,117)	(72,117)	
nt in minimum pension liability, net of							
ax					(66,933)	(66,933)	
n market value of derivative financial							
ts, net of \$6,284 tax					(9,431)	(9,431)	

ensive income \$

fit of stock compensation			2,247			2,247
dends \$0.68 per common share				(67,284)		(67,284)
urchases	(1,549,893)	(258)	(49,742)			(50,000)
of stock options, net of 121,638 shares						
for payment	322,574	53	4,948			5,001
of restricted shares, net of						
ons	366,005	61	388			449
tion of restricted shares			9,378			9,378
rrendered by employees to pay taxes	(83,598)	(14)	(2,730)			(2,744)
mpensation			10,510			10,510

December 31, 2008 98,276,919 \$ 16,379 \$ 451,241 \$ 1,457,676 \$ (26,615) \$ 1,898,681

See accompanying notes to consolidated financial statements.

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Pentair, Inc. and Subsidiaries

Notes to consolidated financial statements

1. Summary of Significant Accounting Policies

Fiscal year

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

Principles of consolidation

The accompanying consolidated financial statements include the accounts of Pentair and all subsidiaries, both U.S. and non-U.S., that we control. Intercompany accounts and transactions have been eliminated. Investments in companies of which we own 20% to 50% of the voting stock or have the ability to exercise significant influence over operating and financial policies of the investee are accounted for using the equity method of accounting and, as a result, our share of the earnings or losses of such equity affiliates is included in the statement of income. The cost method of accounting is used for investments in which Pentair has less than a 20% ownership interest and we do not have the ability to exercise significant influence. These investments are carried at cost and are adjusted only for other-than-temporary declines in fair value.

Use of estimates

The preparation of our consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires us to make estimates and assumptions that affect the amounts reported in these consolidated financial statements and accompanying notes. Due to the inherent uncertainty involved in making estimates, actual results reported in future periods may be based upon amounts that could differ from those estimates. The critical accounting policies that require our most significant estimates and judgments include:

the assessment of recoverability of long-lived assets, including goodwill; and

accounting for pension benefits, because of the importance in making the estimates necessary to apply these policies.

Revenue recognition

We recognize revenue when it is realized or realizable and has been earned. Revenue is recognized when persuasive evidence of an arrangement exists; shipment or delivery has occurred (depending on the terms of the sale); the seller's price to the buyer is fixed or determinable; and collectibility is reasonably assured.

Generally, there is no post-shipment obligation on product sold other than warranty obligations in the normal, ordinary course of business. In the event significant post-shipment obligations were to exist, revenue recognition would be deferred until substantially all obligations were satisfied.

Sales returns

The right of return may exist explicitly or implicitly with our customers. Our return policy allows for customer returns only upon our authorization. Goods returned must be product we continue to market and must be in salable condition. Returns of custom or modified goods are normally not allowed. At the time of sale, we reduce revenue for the estimated effect of returns. Estimated sales returns include consideration of historical sales levels, the timing and magnitude of historical sales return levels as a percent of sales, type of product, type of customer, and a projection of this experience into the future.

Pricing and sales incentives

We record estimated reductions to revenue for customer programs and incentive offerings including pricing arrangements, promotions, and other volume-based incentives at the later of the date revenue is recognized or the incentive is offered. Sales incentives given to our customers are recorded as a reduction of revenue unless we (1) receive an identifiable benefit for the goods or services in exchange for the consideration and (2) we

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

can reasonably estimate the fair value of the benefit received. The following represents a description of our pricing arrangements, promotions, and other volume-based incentives:

Pricing arrangements

Pricing is established up front with our customers, and we record sales at the agreed upon net selling price. However, one of our businesses allows customers to apply for a refund of a percentage of the original purchase price if they can demonstrate sales to a qualifying OEM customer. At the time of sale, we estimate the anticipated refund to be paid based on historical experience and reduce sales for the probable cost of the discount. The cost of these refunds is recorded as a reduction in gross sales.

Promotions

Our primary promotional activity is what we refer to as cooperative advertising. Under our cooperative advertising programs, we agree to pay the customer a fixed percentage of sales as an allowance that may be used to advertise and promote our products. The customer is generally not required to provide evidence of the advertisement or promotion. We recognize the cost of this cooperative advertising at the time of sale. The cost of this program is recorded as a reduction in gross sales.

Volume-based incentives

These incentives involve rebates that are negotiated up front with the customer and are redeemable only if the customer achieves a specified cumulative level of sales or sales increase. Under these incentive programs, at the time of sale, we reforecast the anticipated rebate to be paid based on forecasted sales levels. These forecasts are updated at least quarterly, for each customer and sales are reduced for the anticipated cost of the rebate. If the forecasted sales for a customer changes, the accrual for rebates is adjusted to reflect the new amount of rebates expected to be earned by the customer.

Shipping and handling costs

Amounts billed to customers for shipping and handling are recorded in *Net sales* in the accompanying Consolidated Statements of Income. Shipping and handling costs incurred by Pentair for the delivery of goods to customers are included in *Cost of goods sold* in the accompanying Consolidated Statements of Income.

Cash equivalents

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

Trade receivables and concentration of credit risk

We record an allowance for doubtful accounts; reducing our receivables balance to an amount we estimate is collectible from our customers. Estimates used in determining the allowance for doubtful accounts are based on historical collection experience, current trends, aging of accounts receivable, and periodic credit evaluations of our customers' financial condition. We generally do not require collateral. No customer receivable balances exceeded 10% of total net receivable balances as of December 31, 2008 and 2007, respectively.

In December 2008 and 2007, we sold approximately \$44 million and \$50 million, respectively, of one customer's accounts receivable to a third-party financial institution to mitigate accounts receivable concentration risk. In compliance with Statement of Financial Accounting Standards (SFAS) No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, sales of accounts receivable are reflected as a

reduction of accounts receivable in our Consolidated Balance Sheets and the proceeds are included in the cash flows from operating activities in our Consolidated Statements of Cash Flows. In 2008 and 2007, a loss in the amount of \$0.5 million and \$1.2 million related to the sale of accounts receivable is included in the line item *Other* in our Consolidated Statements of Income.

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

Inventories are stated at the lower of cost or market with substantially all costed using the first-in, first-out (FIFO) method and with an insignificant amount of inventories located outside the United States costed using a moving average method which approximates FIFO.

Property, plant, and equipment

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

	Years
Land improvements	5 to 20
Buildings and leasehold improvements	5 to 50
Machinery and equipment	3 to 15

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

We review the recoverability of long-lived assets to be held and used, such as property, plant and equipment, when events or changes in circumstances occur that indicate the carrying value of the asset or asset group may not be recoverable. The assessment of possible impairment is based on our ability to recover the carrying value of the asset or asset group from the expected future pre-tax cash flows (undiscounted and without interest charges) of the related operations. If these cash flows are less than the carrying value of such asset or asset group, an impairment loss is recognized for the difference between estimated fair value and carrying value. Impairment losses on long-lived assets held for sale are determined in a similar manner, except that fair values are reduced for the cost to dispose of the assets. The measurement of impairment requires us to estimate future cash flows and the fair value of long-lived assets.

Goodwill and identifiable intangible assets

Goodwill represents the excess of the cost of acquired businesses over the fair value of identifiable tangible net assets and identifiable intangible assets purchased.

Goodwill is tested at least annually for impairment, and is tested for impairment more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test is performed using a two-step process. In the first step, the fair value of each reporting unit is compared with the carrying amount of the reporting unit, including goodwill. If the estimated fair value is less than the carrying amount of the reporting unit, an indication that goodwill impairment exists and a second step must be completed in order to determine the amount of the goodwill impairment, if any, that should be recorded. In the second step, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price

allocation. The fair value of each reporting unit is determined using a discounted cash flow analysis. Projecting discounted future cash flows requires is to make significant estimates regarding future revenues and expenses, projected capital expenditures, changes in working capital and the appropriate discount rate. The projections also take into account several factors including current and estimated economic trends and outlook, costs of raw materials, consideration of our market capitalization in comparison to the estimated fair values of our reporting units determined using discounted cash flow analyses and other factors which are beyond our control.

At December 31, 2008 our goodwill and intangible assets were approximately \$2,617.4 million, and represented approximately 64.6% of our total assets. Declines in projected future cash flows could result in

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Pentair, Inc. and Subsidiaries

Notes to consolidated financial statements (continued)

future goodwill and intangible impairments. Because of the significance of our goodwill and intangible assets, any future impairment of these assets could have a material adverse effect on our financial statements.

We completed step one of our annual goodwill impairment evaluation during the fourth quarter with each reporting unit's fair value exceeding its carrying value. Accordingly, step two of the impairment analysis was not required.

Our primary identifiable intangible assets include trade marks and trade names, brand names, patents, non-compete agreements, proprietary technology, and customer relationships. Under the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets*, identifiable intangibles with finite lives are amortized and those identifiable intangibles with indefinite lives are not amortized. Identifiable intangible assets that are subject to amortization are evaluated for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Identifiable intangible assets not subject to amortization are tested for impairment annually or more frequently if events warrant. The impairment test consists of a comparison of the fair value of the intangible asset with its carrying amount. During the fourth quarter of 2008, we completed our annual impairment test for those identifiable assets not subject to amortization and recorded an impairment charge of \$1.0 million. The charge was recorded in *Selling, general and administrative* in our Consolidated Statements of Income.

Cost and equity method investments

We have investments that are accounted for at historical cost or, if we have significant influence over the investee, using the equity method. Our proportionate share of income or losses from investments accounted for under the equity method is recorded in the Consolidated Statements of Income. We write down or write off an investment and recognize a loss when events or circumstances indicate there is impairment in the investment that is other-than-temporary. This requires significant judgment, including assessment of the investee's financial condition and in certain cases the possibility of subsequent rounds of financing, as well as the investee's historical and projected results of operations and cash flows. If the actual outcomes for the investee are significantly different from projections, we may incur future charges for the impairment of these investments.

Income taxes

In accordance with FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, the Company recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs.

We use the asset and liability approach to account for income taxes. Under this method, deferred tax assets and liabilities are recognized for the expected future tax consequences of differences between the carrying amounts of assets and liabilities and their respective tax basis using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period when the change is enacted. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Changes in valuation allowances from period to period are included in our tax provision in the period of change.

Environmental

In accordance with SOP 96-1, *Environmental Remediation Liabilities*, we recognize environmental clean-up liabilities on an undiscounted basis when a loss is probable and can be reasonably estimated. Such liabilities generally are not subject to insurance coverage. The cost of each environmental clean-up is estimated by engineering, financial, and legal specialists based on current law. Such estimates are based primarily upon the

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

estimated cost of investigation and remediation required and the likelihood that, where applicable, other potentially responsible parties (PRPs) will be able to fulfill their commitments at the sites where Pentair may be jointly and severally liable. The process of estimating environmental clean-up liabilities is complex and dependent primarily on the nature and extent of historical information and physical data relating to a contaminated site, the complexity of the site, the uncertainty as to what remedy and technology will be required, and the outcome of discussions with regulatory agencies and other PRPs at multi-party sites. In future periods, new laws or regulations, advances in clean-up technologies, and additional information about the ultimate clean-up remedy that is used could significantly change our estimates. Accruals for environmental liabilities are included in *Other current liabilities* and *Other non-current liabilities* in the Consolidated Balance Sheets.

Insurance subsidiary

We insure certain general and product liability, property, workers compensation, and automobile liability risks through our regulated wholly-owned captive insurance subsidiary, Penwald Insurance Company (Penwald). Reserves for policy claims are established based on actuarial projections of ultimate losses. As of December 31, 2008 and 2007, reserves for policy claims were \$59.2 million (\$10.0 million included in *Accrued product claims and warranties* and \$49.2 million included in *Other non-current liabilities*) and \$61.4 million (\$10.0 million included in *Accrued product claims and warranties* and \$51.4 million included in *Other non-current liabilities*), respectively.

Stock-based compensation

We account for the fair value recognition provisions of SFAS No. 123R (revised 2004), *Share Based Payment*, (SFAS 123R) which revised SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS 123) and supersedes Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25) requiring us to recognize expense related to the fair value of our stock-based compensation awards.

In accordance with SFAS 123R, the estimated grant date fair value of each stock-based award is recognized in income on an accelerated basis over the requisite service period (generally the vesting period). The estimated fair value of each option is calculated using the Black-Scholes option-pricing model. From time to time, we have elected to modify the terms of the original grant. These modified grants are accounted for as a new award and measured using the fair value method under SFAS 123R, resulting in the inclusion of additional compensation expense in our Consolidated Statements of Income. Non-vested share awards are recorded as compensation cost over the requisite service periods based on the market value on the date of grant.

Earnings per common share

Basic earnings per share are computed by dividing net income by the weighted-average number of common shares outstanding. Diluted earnings per share are computed by dividing net income by the weighted average number of common shares outstanding including the dilutive effects of common stock equivalents. The dilutive effects of stock options and non-vested shares increased weighted average common shares outstanding by 1,181 thousand, 1,443 thousand and 1,587 thousand in 2008, 2007 and 2006, respectively.

Stock options excluded from the calculation of diluted earnings per share because the exercise price was greater than the average market price of the common shares were 5,268 thousand, 2,841 thousand, and 3,089 thousand in 2008, 2007 and 2006, respectively.

Derivative financial instruments

We recognize all derivatives, including those embedded in other contracts, as either assets or liabilities at fair value in our Consolidated Balance Sheets. If the derivative is designated as a fair-value hedge, the changes in the fair value of the derivative and the hedged item are recognized in earnings. If the derivative is designated and is effective as a cash-flow hedge, changes in the fair value of the derivative are recorded in other

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

comprehensive income (OCI) and are recognized in the Consolidated Statements of Income when the hedged item affects earnings. If the underlying hedged transaction ceases to exist or if the hedge becomes ineffective, all changes in fair value of the related derivatives that have not been settled are recognized in current earnings. For a derivative that is not designated as or does not qualify as a hedge, changes in fair value are reported in earnings immediately.

We use derivative instruments for the purpose of hedging interest rate and currency exposures, which exist as part of ongoing business operations. All hedging instruments are designated and effective as hedges, in accordance with the provisions of SFAS No. 133, *Accounting for Derivative Instruments and Hedge Activities*, as amended. We do not hold or issue derivative financial instruments for trading or speculative purposes. All other contracts that contain provisions meeting the definition of a derivative also meet the requirements of, and have been designated as, normal purchases or sales. Our policy is not to enter into contracts with terms that cannot be designated as normal purchases or sales.

Foreign currency translation

The financial statements of subsidiaries located outside of the United States are measured using the local currency as the functional currency. Assets and liabilities of these subsidiaries are translated at the rates of exchange at the balance sheet date. Income and expense items are translated at average monthly rates of exchange. The resultant translation adjustments are included in accumulated other comprehensive income, a separate component of shareholders' equity.

New accounting standards

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS 157 is effective for fiscal years beginning after November 15, 2007 (adopted by Pentair as of January 1, 2008), with the exception of the application of the statement to the determination of fair value of nonfinancial assets and liabilities that are recognized or disclosed on a nonrecurring basis, which is effective for fiscal years beginning after November 15, 2008.

SFAS 157 establishes a valuation hierarchy for disclosure of the inputs to valuation used to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument. Level 3 inputs are unobservable inputs based upon our own assumptions used to measure assets and liabilities at fair value. A financial asset or liability's classification within the hierarchy is determined based on the lowest level of input that is significant to the fair value measurement.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value (the Fair Value Option). SFAS 159 is effective for fiscal years beginning after November 15, 2007. We have not chosen the Fair Value Option; therefore, the adoption of SFAS 159 did not have any impact on our consolidated results of operations and financial condition.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), *Business Combinations* (SFAS 141R). SFAS 141R replaces SFAS No. 141. SFAS 141R retains the purchase method of accounting for acquisitions, but requires a number of changes, including changes in the way assets and liabilities are recognized in the purchase accounting. SFAS 141R also changes the recognition of assets acquired and liabilities assumed

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

arising from contingencies, requires the capitalization of in-process research and development at fair value, and requires the expensing of acquisition-related costs as incurred. SFAS 141R is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. We will apply SFAS 141R prospectively to business combinations completed on or after that date. We do not expect adoption to have a significant impact to our current consolidated results of operations and financial condition.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB 51* (SFAS 160). SFAS 160 changes the accounting and reporting for minority interests. Minority interests will be recharacterized as noncontrolling interests and will be reported as a component of equity separate from the parent's equity, and purchases or sales of equity interests that do not result in a change in control will be accounted for as equity transactions. In addition, net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the income statement and upon a loss of control, the interest sold, as well as any interest retained, will be recorded at fair value with any gain or loss recognized in earnings. SFAS 160 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years, except for the presentation and disclosure requirements, which will apply retrospectively. Upon adoption, we will classify minority interest as a component of equity for all periods presented.

In March 2008, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB statement No. 133* (SFAS 161). SFAS 161 expands the disclosure requirements in Statement 133 about an entity's derivative instruments and hedging activities. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The adoption of SFAS 161 will not have a material impact on our consolidated results of operations and financial condition.

2. Acquisitions

On June 28, 2008, we entered into a transaction with GE Water & Process Technologies (a unit of General Electric Company) (GE) that was accounted for as an acquisition of an 80.1 percent ownership interest in GE's global water softener and residential water filtration business in exchange for a 19.9 percent interest in our global water softener and residential water filtration business. The acquisition was effected through the formation of two new entities (collectively, Pentair Residential Filtration or PRF), a U.S. entity and an international entity, into which we and GE contributed certain assets, properties, liabilities and operations representing our respective global water softener and residential water filtration businesses. We are an 80.1 percent owner of PRF and GE is a 19.9 percent owner. The fair value of the acquisition was \$229.2 million, which includes approximately \$3.3 million of acquisition related costs. The acquisition and related sale of our 19.9 percent interest resulted in a gain of \$109.6 million (\$85.8 million after tax), representing the difference between the carrying amount and the fair value of the 19.9 percent interest sold.

With the formation of Pentair Residential Filtration, we believe we will be better positioned to serve residential customers with industry-leading technical applications in the areas of water conditioning, whole-house filtration, point of use water management and water sustainability and expect to accelerate revenue growth by selling GE's existing residential conditioning products through our sales channels.

The fair value of the 80.1% interest in the global water softener and residential water filtration business of GE Water and Process Technologies acquired was determined using both an income approach and a market approach. The

income approach utilizes a discounted cash flow analysis based on certain key assumptions including a discount rate based on a computed weighted average cost of capital and expected long-term revenue and expense growth rates. The market approach indicates the fair value of a business based on a comparison of the business to guideline publicly traded companies and transactions in its industry.

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

The fair value of the business acquired was allocated to the assets acquired and liabilities assumed based on their estimated fair values. The excess of the fair value acquired over the identifiable assets acquired and liabilities assumed is reflected as goodwill. Goodwill recorded as part of the purchase price allocation was approximately \$137.9 million, none of which is tax deductible. Identifiable intangible assets acquired as part of the acquisition were \$66.5 million, including definite-lived intangibles, such as customer relationships, proprietary technology and trade names with a weighted average amortization period of approximately 15 years. We continue to evaluate the purchase price allocation, including tangible and intangible assets, which primarily consist of trademarks, proprietary technology and customer relationships, contingent liabilities and liabilities associated with exit or disposal activities, and expect to revise the purchase price allocation in future periods as these estimates are finalized. The following table represents the preliminary purchase price allocation:

<i>In thousands</i>	December 31, 2008	
Inventory	\$	12,188
Property, plant & equipment		12,934
Goodwill		137,868
Identifiable intangible assets		66,483
Current liabilities		(234)
	\$	229,239

On May 7, 2007, we acquired as part of our Technical Products Group the assets of Calmark Corporation (Calmark), a privately held business, for \$28.4 million, including a cash payment of \$29.2 million and transaction costs of \$0.2 million, less cash acquired of \$1.0 million. Calmark's results of operations have been included in our consolidated financial statements since the date of acquisition. Calmark's product portfolio includes enclosures, guides, card locks, retainers, extractors, card pullers and other products for the aerospace, medical, telecommunications and military market segments, among others. Goodwill recorded as part of the purchase price allocation was \$11.7 million, all of which is tax deductible. Identifiable intangible assets acquired as part of the acquisition were \$14.0 million, including definite-lived intangibles, such as non-compete agreements, customer relationships and proprietary technology of \$10.5 million with a weighted average amortization period of approximately 8 years.

On April 30, 2007, we acquired as part of our Water Group all of the capital interests in Porous Media Corporation and Porous Media, Ltd. (together, Porous Media), two privately held filtration and separation technologies businesses, for \$224.9 million, including a cash payment of \$225.0 million and transaction costs of \$0.4 million, less cash acquired of \$0.5 million. Porous Media's results of operations have been included in our consolidated financial statements since the date of acquisition. Porous Media brings strong technical ability to our Water Group, including engineering, material science, media development and application capabilities. Porous Media's product portfolio includes high-performance filter media, membranes and related filtration products and purification systems for liquids,

gases and solids for the general industrial, petrochemical, refining and healthcare market segments, among others. Goodwill recorded as part of the purchase price allocation was \$128.1 million, all of which is tax deductible. Identifiable intangible assets acquired as part of the acquisition were \$73.8 million, including definite-lived intangibles, such as proprietary technology and customer relationships of \$60.6 million with a weighted average amortization period of approximately 11 years.

On February 2, 2007, we acquired as part of our Water Group all the outstanding shares of capital stock of Jung Pumpen GmbH (Jung Pump) for \$229.5 million, including a cash payment of \$239.6 million and transaction costs of \$1.3 million, less cash acquired of \$11.4 million. Jung Pump s results of operations have been included in our consolidated financial statements since the date of acquisition. Jung Pump is a leading German manufacturer of wastewater products for municipal and residential markets. Jung Pump brings us its

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

strong application engineering expertise and a complementary product offering, including a new line of water re-use products, submersible wastewater and drainage pumps, wastewater disposal units and tanks. Jung Pump also brings to Pentair its well-established European presence, a state-of-the-art training facility in Germany and sales offices in Germany, Austria, France, Hungary, Poland and Slovakia. Goodwill recorded as part of the purchase price allocation was \$123.4 million, of which approximately \$53 million is tax deductible. Identifiable intangible assets acquired as part of the acquisition were \$135.7 million, including definite-lived intangibles, primarily customer relationships of \$71.6 million with a weighted average amortization period of approximately 15 years.

The following pro forma consolidated condensed financial results of operations for the years ended December 31, 2008, and 2007 are presented as if the acquisitions had been completed at the beginning of each period presented:

<i>In thousands, except per-share data</i>	Years Ended December 31	
	2008	2007
Pro forma net sales from continuing operations	\$ 3,406,449	\$ 3,390,975
Pro forma net income from continuing operations	256,363	211,932
Pro forma net income	228,734	210,741
Pro forma earnings per common share continuing operations		
Basic	\$ 2.62	\$ 2.15
Diluted	\$ 2.59	\$ 2.11
Weighted average common shares outstanding		
Basic	97,887	98,762
Diluted	99,068	100,205

These pro forma consolidated condensed financial results have been prepared for comparative purposes only and include certain adjustments, such as increased interest expense on acquisition debt. The adjustments do not reflect the effect of synergies that would have been expected to result from the integration of these acquisitions. The pro forma information does not purport to be indicative of the results of operations that actually would have resulted had the combination occurred on January 1 of each year presented, or of future results of the consolidated entities.

3. Discontinued Operations/Divestitures

On December 15, 2008, we sold our Spa and Bath (Spa/Bath) business to Balboa Water Group in a cash transaction for \$8.3 million including certain price adjustments based on working capital at closing. The results of Spa/Bath have been reported as discontinued operations for all periods presented. The assets and liabilities of Spa/Bath have been reclassified as discontinued operations for all periods presented. Goodwill of \$5.6 million was included in the assets of Spa/Bath.

On February 28, 2008, we sold our National Pool Tile (NPT) business to Pool Corporation in a cash transaction for approximately \$30.0 million subject to certain price adjustments. The results of NPT have been reported as discontinued operations for all periods presented. The assets and liabilities of NPT have been reclassified as discontinued operations for all periods presented. Goodwill of \$16.8 million was included in the assets of NPT.

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

Operating results of the discontinued operations are summarized below.

<i>In thousands</i>	2008	2007	2006
Net sales	\$ 43,346	\$ 117,795	\$ 131,867
Loss from discontinued operations before income taxes	(9,392)	(2,917)	(4,206)
Income tax benefit	3,609	1,288	1,722
Loss from discontinued operations, net of income taxes	(5,783)	(1,629)	(2,484)
Gain (loss) on disposal of discontinued operations, before taxes	(28,692)	762	(3,621)
Income tax (expense) benefit	6,846	(324)	3,585
Gain (loss) on disposal of discontinued operations, net of tax	\$ (21,846)	\$ 438	\$ (36)

Net assets and liabilities of discontinued operations consist of the following:

<i>In thousands</i>	December 31 2007
Accounts and notes receivable, net	\$ 10,814
Inventories	28,109
Other current assets	1,567
Current assets of discontinued operations	40,490
Property, plant and equipment, net	5,736
Goodwill	22,407
Other non-current assets	4,375
Non-current assets of discontinued operations	32,518
Total assets	\$ 73,008

Accounts payable	\$	3,857
Other current liabilities		(153)
Current liabilities of discontinued operations		3,704
Deferred income tax		3,116
Other non-current liabilities		888
Non-current liabilities of discontinued operations		4,004
Total liabilities		7,708
Net assets (liabilities) of discontinued operations	\$	65,300

4. Restructuring

During 2008, we announced and initiated certain business restructuring initiatives aimed at reducing our fixed cost structure and rationalizing our manufacturing footprint. These initiatives included the announcement of the closure of certain manufacturing facilities as well as the reduction in hourly and salaried headcount of approximately 1,700 employees, 1,300 in the Water Group and 400 in the Technical Products Group. We expect these actions to generally be completed by the end of 2009.

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

Restructuring related costs included in *Selling, general and administrative* expenses on the Consolidated Statements of Income include costs for severance and related benefits, asset impairment charges and other restructuring costs as follows:

<i>In thousands</i>	Year ended December 31 2008
Severance and related costs	\$ 34,615
Asset impairment	5,282
Contract termination costs	5,309
 Total restructuring costs	 \$ 45,206

Restructuring accrual activity recorded on the Consolidated Balance Sheets is summarized as follows:

Balance at January 1, 2008	\$
 Costs incurred	 39,924
Cash payments & other	(5,750)
 Balance at December 31, 2008	 \$ 34,174

5. Goodwill and Other Identifiable Intangible Assets

The changes in the carrying amount of goodwill for the years ended December 31, 2008 and 2007 by segment are as follows:

<i>In thousands</i>	December 31, 2007	Acquisitions	Foreign Currency Translation	December 31, 2008
---------------------	------------------------------	---------------------	---------------------------------------------	------------------------------

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Water	\$	1,706,626	\$	132,720	\$	(20,876)	\$	1,818,470
Technical Products		292,493		106		(9,218)		283,381
Consolidated Total	\$	1,999,119	\$	132,826	\$	(30,094)	\$	2,101,851

<i>In thousands</i>		December 31, 2006	Acquisitions	Foreign Currency Translation		December 31, 2007		
Water	\$	1,427,053	\$	253,380	\$	26,193	\$	1,706,626
Technical Products		269,311		11,634		11,548		292,493
Consolidated Total	\$	1,696,364	\$	265,014	\$	37,741	\$	1,999,119

In 2008, the acquired goodwill in the Water Group is related primarily to the formation of PRF and Jung Pump and in 2007, it related primarily to Jung Pump and Porous Media. The acquired goodwill in the Technical Products Group is related primarily to our acquisition of Calmark during 2007. In 2008, goodwill allocated to divested businesses was \$22.4 million.

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

The detail of acquired intangible assets consisted of the following:

<i>In thousands</i>	2008			2007		
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Finite-life intangible assets						
Patents	\$ 15,427	\$ (9,774)	\$ 5,653	\$ 15,457	\$ (7,904)	\$ 7,553
Non-compete agreements	4,722	(4,566)	156	4,722	(4,050)	672
Proprietary technology	72,375	(17,652)	54,723	59,944	(12,564)	47,380
Customer relationships	283,015	(46,841)	236,174	238,712	(30,378)	208,334
Brand names	961	(77)	884			
Total finite-life intangible assets	\$ 376,500	\$ (78,910)	\$ 297,590	\$ 318,835	\$ (54,896)	\$ 263,939
Indefinite-life intangible assets						
Brand names	\$ 217,918	\$	\$ 217,918	\$ 223,089	\$	\$ 223,089
Total intangibles, net	\$ 594,418	\$ (78,910)	\$ 515,508	\$ 541,924	\$ (54,896)	\$ 487,028

Intangible asset amortization expense in 2008, 2007, and 2006 was \$24.0 million, \$21.8 million, and \$13.2 million, respectively.

Additionally, in 2008 we recorded an impairment charge to write-off a brand name intangible assets of \$1.0 million in the Technical Products Group. The charge was recorded in *Selling, general and administrative* in our Consolidated Statement of Income.

The estimated future amortization expense for identifiable intangible assets during the next five years is as follows:

<i>In thousands</i>	2009	2010	2011	2012	2013
Estimated amortization expense	\$ 26,015	\$ 25,331	\$ 25,327	\$ 24,214	\$ 24,053

6. Supplemental Balance Sheet Information

<i>In thousands</i>	2008	2007
Inventories		
Raw materials and supplies	\$ 212,792	\$ 194,090
Work-in-process	53,241	50,785
Finished goods	151,254	134,143
Total inventories	\$ 417,287	\$ 379,018
Property, plant and equipment		
Land and land improvements	\$ 32,949	\$ 35,038
Buildings and leasehold improvements	204,757	210,412
Machinery and equipment	580,632	548,042
Construction in progress	24,376	30,166
Total property, plant and equipment	842,714	823,658
Less accumulated depreciation and amortization	498,833	461,968
Property, plant and equipment, net	\$ 343,881	\$ 361,690

Table of Contents**Pentair, Inc. and Subsidiaries****Notes to consolidated financial statements (continued)*****Cost method investments***

As part of the sale of Lincoln Industrial in 2001, we received 37,500 shares of 5% Series C Junior Convertible Redeemable Preferred Stock convertible into a 15% equity interest in the new organization LN Holdings Corporation. During the second quarter of 2005 we sold our interest in the stock of LN Holdings Corporation for cash consideration of \$23.6 million, resulting in a pre-tax gain of \$5.2 million or an after-tax gain of \$3.5 million. The terms of the sale agreement established two escrow accounts totaling \$14 million. We received payments from an escrow of \$0.2 million during the fourth quarter of 2005, increasing our gain. During 2006 we received \$1.2 million from the escrow accounts which also increased our gain from the sale. Remaining escrow balances are to be distributed to former shareholders in accordance with their ownership percentages. Any funds received from settlement of escrows in future periods will be accounted for as additional gain on sale of this interest.

Equity method investments

We have a 50% investment in FARADYNE Motors LLC (FARADYNE), a joint venture with ITT Water Technologies, Inc. that began design, development, and manufacturing of submersible pump motors in 2005. We do not consolidate the investment in our financial statements as we do not have a controlling interest over the investment. There were no investments in or loans to FARADYNE in 2008. There were investments in and loans to FARADYNE of \$5.0 million and \$8.7 million at December 31, 2008 and December 31, 2007, respectively, which is net of our proportionate share of the results of their operations.

7. Supplemental Cash Flow Information

The following table summarizes supplemental cash flow information:

<i>In thousands</i>	2008	2007	2006
Interest payments	\$ 63,851	\$ 66,044	\$ 51,375
Income tax payments	80,765	98,798	77,225

On June 28, 2008, we entered into a transaction with GE that was accounted for as an acquisition of an 80.1 percent ownership interest in GE's global water softener and residential water filtration business in exchange for a 19.9 percent interest in our global water softener and residential water filtration business. The transaction is more fully described in Note 2. *Acquisitions*.

8. Accumulated Other Comprehensive Income (Loss)

Components of accumulated other comprehensive income (loss) consist of the following:

<i>In thousands</i>	2008	2007
Retirement liability adjustments, net of tax	\$ (58,704)	\$ 8,229

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Foreign currency translation adjustments	45,300	117,417
Market value of derivative financial instruments, net of tax	(13,211)	(3,780)
Accumulated other comprehensive income (loss)	\$ (26,615)	\$ 121,866

Table of Contents**Pentair, Inc. and Subsidiaries****Notes to consolidated financial statements (continued)****9. Debt**

Debt and the average interest rates on debt outstanding as of December 31 are summarized as follows:

<i>In thousands</i>	Average interest rate December 31, 2008	Maturity (Year)	December 31 2008	December 31 2007
Commercial paper	2.61%		\$ 249	\$ 105,990
Revolving credit facilities	1.21%	2012	214,200	76,722
Private placement fixed rate	5.65%	2013-17	400,000	400,000
Private placement floating rate	3.37%	2012-13	205,000	205,000
Senior notes	7.85%	2009	133,900	250,000
Other	4.44%	2008-16	275	20,387
Total contractual debt obligations			953,624	1,058,099
Deferred income related to swaps			468	2,487
Total debt, including current portion per balance sheet			954,092	1,060,586
Less: Current maturities			(624)	(5,075)
Short-term borrowings				(13,586)
Long-term debt			\$ 953,468	\$ 1,041,925

We have a multi-currency revolving Credit Facility (Credit Facility). The Credit Facility creates an unsecured, committed revolving credit facility of up to \$800 million, with multi-currency sub facilities to support investments outside the U.S. The Credit Facility expires on June 4, 2012. Borrowings under the Credit Facility will bear interest at the rate of LIBOR plus 0.50%. Interest rates and fees on the Credit Facility vary based on our credit ratings.

Total availability under our existing Credit Facility was \$585.6 million at December 31, 2008.

We are authorized to sell short-term commercial paper notes to the extent availability exists under the Credit Facility. We use the Credit Facility as back-up liquidity to support 100% of commercial paper outstanding. Our use of

commercial paper as a funding vehicle depends upon the relative interest rates for our paper compared to the cost of borrowing under our Credit Facility. As of December 31, 2008, we had \$0.2 million of commercial paper outstanding that matures within 41 days.

All of the commercial paper and Senior Notes were classified as long-term as we have the intent and the ability to refinance such obligations on a long-term basis under the Credit Facility.

In addition to the Credit Facility, we have \$25.0 million of uncommitted credit facilities, under which we had no borrowings as of December 31, 2008.

Our debt agreements contain certain financial covenants, the most restrictive of which is a leverage ratio (total consolidated indebtedness, as defined, over consolidated EBITDA, as defined) that may not exceed 3.5 to 1.0. We were in compliance with all covenants in our debt agreements as of December 31, 2008.

On July 8, 2008, we commenced a cash tender offer for all of our outstanding \$250 million aggregate principal 7.85% Senior Notes due 2009 (the Notes). Upon expiration of the tender offer on August 4, 2008, we purchased \$116.1 million aggregate principal amount of the Notes. As a result of this transaction, we recognized a loss of \$4.6 million on early extinguishment of debt. The loss included the write off of \$0.1 million in unamortized deferred financing fees in addition to recognition of \$0.6 million in previously unrecognized swap gains and cash paid of \$5.1 million related to the tender premium and other costs associated with the purchase.

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

Debt outstanding at December 31, 2008, matures on a calendar year basis as follows:

<i>In thousands</i>	2009	2010	2011	2012	2013	Thereafter	Total
Contractual debt obligation maturities	\$ 134,305	\$ 78	\$ 6	\$ 319,206	\$ 200,007	\$ 300,022	\$ 953,624
Other maturities	468						468
Total maturities	\$ 134,773	\$ 78	\$ 6	\$ 319,206	\$ 200,007	\$ 300,022	\$ 954,092

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

In August 2007, we entered into a \$105 million interest rate swap agreement with a major financial institution to exchange variable rate interest payment obligations for a fixed rate obligation without the exchange of the underlying principal amounts in order to manage interest rate exposures. The effective date of the swap was August 30, 2007. The swap agreement has a fixed interest rate of 4.89% and expires in May 2012. The fixed interest rate of 4.89% plus the .50% interest rate spread over LIBOR results in an effective fixed interest rate of 5.39%. The fair value of the swap was a liability of \$10.7 million and \$3.7 million at December 31, 2008 and December 31, 2007, respectively, and was recorded in *Other non-current liabilities*.

In September 2005, we entered into a \$100 million interest rate swap agreement with several major financial institutions to exchange variable rate interest payment obligations for fixed rate obligations without the exchange of the underlying principal amounts in order to manage interest rate exposures. The effective date of the fixed rate swap was April 25, 2006. The swap agreement has a fixed interest rate of 4.68% and expires in July 2013. The fixed interest rate of 4.68% plus the .60% interest rate spread over LIBOR results in an effective fixed interest rate of 5.28%. The fair value of the swap was a liability of \$11.6 million and \$2.5 million at December 31, 2008 and December 31, 2007, respectively, and was recorded in *Other non-current liabilities*.

The variable to fixed interest rate swaps are designated as and are effective as cash-flow hedges. The fair value of these swaps are recorded as assets or liabilities on the Consolidated Balance Sheets, with changes in their fair value included in *Accumulated other comprehensive income* (OCI). Derivative gains and losses included in OCI are reclassified into earnings at the time the related interest expense is recognized or the settlement of the related commitment occurs.

Failure of one or more of our swap counterparties would result in the loss of any benefit to us of the swap agreement. In this case, we would continue to be obligated to pay the variable interest payments per the underlying debt agreements which are at variable interest rates of 3 month LIBOR plus .50% for \$105 million of debt and 3 month

LIBOR plus .60% for \$100 million of debt. Additionally, failure of one or all of our swap counterparties would not eliminate our obligation to continue to make payments under our existing swap agreements if we continue to be in a net pay position.

At December 31, 2008, our interest rate swaps are carried at fair value measured on a recurring basis. Fair values are determined through the use of models that consider various assumptions, including time value, yield curves, as well as other relevant economic measures, which are inputs that are classified as Level 2 in the valuation hierarchy defined by SFAS 157.

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

The recorded amounts and estimated fair values of long-term debt, excluding the effects of derivative financial instruments, and the recorded amounts and estimated fair value of those derivative financial instruments were as follows:

<i>In thousands</i>	2008		2007	
	Recorded amount	Fair value	Recorded amount	Fair value
Total debt, including current portion				
Variable rate	\$ 419,449	\$ 419,449	\$ 407,398	\$ 407,398
Fixed rate	534,175	482,148	650,701	662,906
Total	\$ 953,624	\$ 901,597	\$ 1,058,099	\$ 1,070,304
Derivative financial instruments				
Market value of variable to fixed interest rate swap (liability) asset	\$ (22,309)	\$ (22,309)	\$ (6,198)	\$ (6,198)

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

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

long-term fixed rate debt, including current maturities fair value is based on market quotes available for issuance of debt with similar terms, which are inputs that are classified as Level 2 in the valuation hierarchy defined by SFAS 157; and

interest rate swap agreements fair values are determined through the use of models that consider various assumptions, including time value, yield curves, as well as other relevant economic measures, which are inputs that are classified as Level 2 in the valuation hierarchy defined by SFAS 157.

11. Income Taxes

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

<i>In thousands</i>	2008	2007	2006
United States	\$ 220,294	\$ 229,012	\$ 211,908
International	146,846	77,549	47,767
Income from continuing operations before taxes and minority interest	\$ 367,140	\$ 306,561	\$ 259,675

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

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

<i>In thousands</i>	2008	2007	2006
Currently payable			
Federal	\$ 41,985	\$ 70,610	\$ 54,319
State	5,140	9,851	10,168
International	25,735	19,250	13,390
Total current taxes	72,860	99,711	77,877
Deferred			
Federal and state	35,535	3,405	(8,113)
International	(51)	(8,673)	3,660
Total deferred taxes	35,484	(5,268)	(4,453)
Total provision for income taxes	\$ 108,344	\$ 94,443	\$ 73,424

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

<i>Percentages</i>	2008	2007	2006
U.S. statutory income tax rate	35.0	35.0	35.0
State income taxes, net of federal tax benefit	1.6	2.6	2.5
Tax effect of stock-based compensation	0.2	0.3	0.4
Tax effect of international operations	(6.1)	(5.1)	(8.1)
Tax credits	(1.0)	(0.8)	(1.1)
Domestic manufacturing deduction	(0.7)	(1.3)	(0.8)
ESOP dividend benefit	(0.2)	(0.2)	(0.3)
All other, net	0.7	0.3	0.7
Effective tax rate on continuing operations	29.5	30.8	28.3

Reconciliation of the beginning and ending gross unrecognized tax benefits follows:

<i>In thousands</i>	2008	2007
Gross unrecognized tax benefits beginning balance	\$ 23,879	\$ 16,923
Gross increases for tax positions in prior periods	3,526	4,476
Gross decreases for tax positions in prior periods	(411)	(305)
Gross increases based on tax positions related to the current year	2,666	3,617
Reductions due to statute expiration	(1,521)	(832)
Gross unrecognized tax benefits at December 31	\$ 28,139	\$ 23,879

Included in the \$28.1 million of total gross unrecognized tax benefits as of December 31, 2008 was \$25.2 million of tax benefits that, if recognized, would impact the effective tax rate. It is reasonably possible that the gross unrecognized tax benefits as of December 31, 2008 may decrease by a range of \$0 to \$14.5 million during the next twelve months primarily as a result of the resolution of federal, state and foreign examinations and the expiration of various statutes of limitations.

The determination of annual income tax expense takes into consideration amounts which may be needed to cover exposures for open tax years. The Internal Revenue Service (IRS) has examined our U.S. federal income tax returns through 2003 with no material adjustments. The IRS has also completed a survey of our 2004 U.S. federal income tax return with no material findings. In connection with the completion of the 2002 to 2003 federal income tax audit and the 2004 survey, we recognized benefits of \$8.0 million and \$1.8 million in our second and third quarter 2006 income statements, respectively. The IRS is currently examining our

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

2005 and 2006 federal tax returns. No adjustments have been proposed; however, actual settlements may differ from amounts accrued.

We record penalties and interest related to unrecognized tax benefits in *Provision for income taxes* and *Net interest expense*, respectively, which is consistent with our past practices. As of December 31, 2008, we had recorded approximately \$0.6 million for the possible payment of penalties and \$4.6 million related to the possible payment of interest.

United States income taxes have not been provided on undistributed earnings of international subsidiaries. It is our intention to reinvest these earnings permanently or to repatriate the earnings only when it is tax effective to do so. As of December 31, 2008, approximately \$145.1 million of unremitted earnings attributable to international subsidiaries were considered to be indefinitely invested. It is not practicable to estimate the amount of tax that might be payable if such earnings were to be remitted.

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

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

<i>In thousands</i>	2008 Deferred tax		2007 Deferred tax	
	Assets	Liabilities	Assets	Liabilities
Accounts receivable allowances	\$ 2,684	\$	\$ 3,508	\$
Inventory valuation	7,064		2,954	
Accelerated depreciation/amortization		13,190		16,205
Accrued product claims and warranties	30,779		38,736	
Employee benefit accruals	131,493		87,645	
Goodwill and other intangibles		191,313		177,611
Other, net		54,637		46,819
Total deferred taxes	\$ 172,020	\$ 259,140	\$ 132,843	\$ 240,635
Net deferred tax liability		\$ (87,120)		\$ (107,792)

Included in Other, net in the table above is a deferred tax asset of \$8.1 million and \$10.7 million as of December 31, 2008 and December 31, 2007, respectively, related to a foreign tax credit carryover from the tax period ended December 31, 2006. This foreign tax credit is eligible for carryforward until the tax period ending December 31, 2016. The deferred tax asset is included in the *Other* line in our Consolidated Balance Sheets.

Non-U.S. tax losses of \$19.8 million and \$27.0 million were available for carryforward at December 31, 2008 and 2007, respectively. A valuation allowance reflected above in other, of \$3.3 million and \$2.4 million exists for deferred income tax benefits related to the non-U.S. loss carryforwards available as of December 31, 2008 and 2007, respectively that may not be realized. We believe that sufficient taxable income will be generated in the respective countries to allow us to fully recover the remainder of the tax losses. The non-U.S. operating losses are subject to varying expiration periods and will begin to expire in 2009. State tax losses of \$73.0 million and \$69.0 million were available for carryforward at December 31, 2008 and 2007, respectively. A valuation allowance reflected above in other, of \$2.0 million and \$2.4 million exists for deferred income tax benefits related to the carryforwards available at December 31, 2008 and December 31, 2007, respectively. Certain state tax losses will expire in 2009, while others are subject to carryforward periods of up to twenty years.

Table of Contents**Pentair, Inc. and Subsidiaries****Notes to consolidated financial statements (continued)****12. Benefit Plans*****Pension and post-retirement benefits***

We sponsor domestic and foreign defined-benefit pension and other post-retirement plans. Pension benefits are based principally on an employee's years of service and/or compensation levels near retirement. In addition, we also provide certain post-retirement health care and life insurance benefits. Generally, the post-retirement health care and life insurance plans require contributions from retirees. We use a December 31 measurement date each year.

In 2007, under the requirements of SFAS No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, we recognized a pension curtailment gain of \$5.5 million related to the announcement that we will be freezing certain pension plans as of December 31, 2017. Also, we recognized a curtailment gain of \$4.1 million related to the termination of certain post-retirement health care benefits.

Obligations and Funded Status

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

<i>In thousands</i>	Pension benefits		Post-retirement	
	2008	2007	2008	2007
Change in benefit obligation				
Benefit obligation beginning of year	\$ 534,648	\$ 563,895	\$ 40,836	\$ 51,577
Service cost	14,104	17,457	263	585
Interest cost	32,383	31,584	2,534	2,983
Amendments	(207)	76		
Benefits curtailed		(16,323)		(4,126)
Actuarial gain	(26,978)	(44,069)	(1,624)	(6,639)
Translation (gain) loss	(5,446)	7,700		
Benefits paid	(26,806)	(25,672)	(3,592)	(3,544)
Benefit obligation end of year	\$ 521,698	\$ 534,648	\$ 38,417	\$ 40,836
Change in plan assets				
Fair value of plan assets beginning of year	\$ 388,037	\$ 373,229	\$	\$
Actual (loss) return on plan assets	(106,546)	27,286		
Company contributions	12,815	13,000	3,592	3,544
Translation (loss) gain	(2,388)	194		
Benefits paid	(26,806)	(25,672)	(3,592)	(3,544)

Fair value of plan assets end of year	\$ 265,112	\$ 388,037	\$	\$
Funded status				
Plan assets less than benefit obligation	\$ (256,586)	\$ (146,611)	\$ (38,417)	\$ (40,836)
Net amount recognized	\$ (256,586)	\$ (146,611)	\$ (38,417)	\$ (40,836)

Of the \$256.6 million underfunding at December 31, 2008, \$102.8 million relates to foreign pension plans and our supplemental executive retirement plans which are not commonly funded.

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

Amounts recognized in the Consolidated Balance Sheets are as follows:

<i>In thousands</i>	Pension benefits		Post-retirement	
	2008	2007	2008	2007
Noncurrent assets	\$	\$ 154	\$	\$
Current liabilities	(5,197)	(4,578)	(3,693)	(3,689)
Noncurrent liabilities	(251,389)	(142,187)	(34,724)	(37,147)
Net amount recognized	\$ (256,586)	\$ (146,611)	\$ (38,417)	\$ (40,836)

The accumulated benefit obligation for all defined benefit plans was \$489.3 million and \$482.7 million at December 31, 2008, and 2007, respectively.

Information for pension plans with an accumulated benefit obligation or projected benefit obligation in excess of plan assets are as follows:

<i>In thousands</i>	2008	2007
Pension plans with an accumulated benefit obligation in excess of plan assets:		
Fair value of plan assets	\$ 265,112	\$ 90,449
Accumulated benefit obligation	489,258	198,108
Pension plans with a projected benefit obligation in excess of plan assets:		
Fair value of plan assets	\$ 265,112	\$ 371,297
Accumulated benefit obligation	521,698	518,062

Components of net periodic benefit cost are as follows:

<i>In thousands</i>	Pension benefits			Post-retirement		
	2008	2007	2006	2008	2007	2006
Service cost	\$ 14,104	\$ 17,457	\$ 18,411	\$ 263	\$ 585	\$ 735

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Interest cost	32,383	31,584	29,676	2,534	2,983	3,195
Expected return on plan assets	(29,762)	(28,539)	(27,977)			
Amortization of transition obligation	25	20	20			
Amortization of prior year service cost (benefit)	179	160	289	(136)	(245)	(236)
Recognized net actuarial (gain) loss	121	3,195	4,119	(3,301)	(1,423)	(846)
Curtailment gain		(5,533)			(4,126)	
Net periodic benefit cost	\$ 17,050	\$ 18,344	\$ 24,538	\$ (640)	\$ (2,226)	\$ 2,848

Amounts not yet recognized in net periodic benefit cost and included in accumulated other comprehensive income (pre-tax):

<i>In thousands</i>	Pension benefits		Post-retirement	
	2008	2007	2008	2007
Net transition obligation	\$ 37	\$ 50	\$	\$
Prior service cost (benefit)	170	404	357	222
Net actuarial (gain) loss	120,910	12,753	(25,238)	(26,915)
Accumulated other comprehensive income (loss)	\$ 121,117	\$ 13,207	\$ (24,881)	\$ (26,693)

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

The estimated amount that will be amortized from accumulated other comprehensive income into net periodic benefit cost in 2009 is as follows:

<i>In thousands</i>	Pension benefits	Post- retirement
Net actuarial loss	\$ 67	\$
Prior service cost	61	(41)
Transition obligation	25	(3,060)
Total estimated 2009 amortization	\$ 153	\$ (3,101)

Additional Information

Change in accumulated other comprehensive income, net of tax:

<i>In thousands</i>	2008	2007
Beginning of the year	\$ 8,229	\$ (28,972)
Additional prior service cost incurred during the year	126	(46)
Actuarial (losses) gains incurred during the year	(65,755)	42,995
Translation gains (losses) incurred during the year	594	(900)
Amortization during the year:		
Transition obligation	15	12
Unrecognized prior service cost	27	(52)
Actuarial gains	(1,940)	(4,808)
End of the year	\$ (58,704)	\$ 8,229

Assumptions

Weighted-average assumptions used to determine domestic benefit obligations at December 31 are as follows:

<i>Percentages</i>	Pension benefits			Post-retirement		
	2008	2007	2006	2008	2007	2006

Discount rate	6.50	6.50	6.00	6.50	6.50	6.00
Rate of compensation increase	4.00	5.00	5.00			

Weighted-average assumptions used to determine the domestic net periodic benefit cost for years ending December 31 are as follows:

<i>Percentages</i>	Pension benefits			Post-retirement		
	2008	2007	2006	2008	2007	2006
Discount rate	6.50	6.00	5.75	6.50	6.00	5.75
Expected long-term return on plan assets	8.50	8.50	8.50			
Rate of compensation increase	4.00	5.00	5.00			

Discount rate

The discount rate reflects the current rate at which the pension liabilities could be effectively settled at the end of the year based on our December 31 measurement date. The discount rate was determined by matching our expected benefit payments to payments from a stream of AA or higher bonds available in the marketplace, adjusted to eliminate the effects of call provisions. This produced a discount rate for our U.S. plans of 6.50% in 2008, 6.50% in 2007 and 6.00% in 2006. The discount rates on our foreign plans ranged from 2.00% to 6.25% in 2008, 2.00% to 5.25% in 2007 and 2.00% to 5.15% in 2006. There are no other known or anticipated changes in our discount rate assumption that will impact our pension expense in 2009.

Table of Contents**Pentair, Inc. and Subsidiaries****Notes to consolidated financial statements (continued)***Expected rate of return*

Our expected rate of return on plan assets in 2008 equaled 8.5%, which remained unchanged from 2007 and 2006. The expected rate of return is designed to be a long-term assumption that may be subject to considerable year-to-year variance from actual returns. In developing the expected long-term rate of return, we considered our historical returns, with consideration given to forecasted economic conditions, our asset allocations, input from external consultants and broader longer-term market indices. In 2008, the pension plan assets yielded a loss of 28.8 %, compared to returns of 7.8% in 2007 and 12.3% in 2006.

We base our determination of pension expense or income on a market-related valuation of assets which reduces year-to-year volatility. This market-related valuation recognizes investment gains or losses over a five-year period from the year in which they occur. Investment gains or losses for this purpose are the difference between the expected return calculated using the market-related value of assets and the actual return based on the market-related value of assets. Since the market-related value of assets recognizes gains or losses over a five-year-period, the future value of assets will be impacted as previously deferred gains or losses are recorded.

Unrecognized pension and post-retirement losses

As of our December 31, 2008 measurement date, our plans have \$95.7 million of cumulative unrecognized losses. To the extent the unrecognized losses, when adjusted for the difference between market and market related values of assets, exceeds 10% of the projected benefit obligation, it will be amortized into expense each year on a straight-line basis over the remaining expected future-working lifetime of active participants (currently approximating 12 years).

The assumed health care cost trend rates at December 31 are as follows:

	2008	2007
Health care cost trend rate assumed for next year	9.50%	10.00%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	2018	2018

The assumed health care cost trend rates can have a significant effect on the amounts reported for health care plans. A one-percentage-point change in the assumed health care cost trend rates would have the following effects:

<i>In thousands</i>	1-Percentage-Point Increase	1-Percentage-Point Decrease
Effect on total annual service and interest cost	\$ 38	\$ (34)
Effect on post-retirement benefit obligation	476	(427)

Plan Assets

Objective

The primary objective of our investment strategy is to meet the pension obligation to our employees at a reasonable cost to the company. This is primarily accomplished through growth of capital and safety of the funds invested. The plans will therefore be actively invested to achieve real growth of capital over inflation through appreciation of securities held and through the accumulation and reinvestment of dividend and interest income.

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Pentair, Inc. and Subsidiaries

Notes to consolidated financial statements (continued)

Asset allocation

Our actual overall asset allocation for the plans as compared to our investment policy goals is as follows:

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