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NATCO GROUP INC  
Form 10-Q  
November 13, 2002

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SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(MARK ONE)

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2002,

OR

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

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER 1-15603

NATCO GROUP INC.

(Exact name of registrant as specified in its charter)

DELAWARE  
(State or other jurisdiction of incorporation  
or organization)

22-2906892  
(I.R.S. Employer  
Identification No.)

2950 NORTH LOOP WEST,  
7TH FLOOR,  
HOUSTON, TEXAS  
(Address of principal executive offices)

77092  
(Zip Code)

713-683-9292  
(Registrant's telephone number, including area code)

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

As of November 1, 2002, \$0.01 par value per share, 15,803,797 shares

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NATCO GROUP INC.

FORM 10-Q  
FOR THE QUARTER ENDED SEPTEMBER 30, 2002

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PART I

ITEM 1. FINANCIAL STATEMENTS

NATCO GROUP INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS  
(IN THOUSANDS, EXCEPT SHARE DATA)

	SEPTEMBER 30, 2002	DECEMBER 31, 2001
	-----	-----
	(UNAUDITED)	
ASSETS		
Current assets:		
Cash and cash equivalents.....	\$ 2,366	\$ 3,093
Trade accounts receivable, net.....	74,931	67,922
Inventories.....	35,084	37,517
Prepaid expenses and other current assets.....	6,716	6,725
	-----	-----
Total current assets.....	119,097	115,257
Property, plant and equipment, net.....	31,484	31,003
Goodwill, net.....	80,155	79,907
Deferred income tax assets, net.....	3,529	4,378
Other assets, net.....	2,033	2,206
	-----	-----
Total assets.....	\$ 236,298	\$ 232,751
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current installments of long-term debt.....	\$ 7,097	\$ 7,000
Accounts payable.....	32,045	30,440
Accrued expenses and other.....	33,011	34,781
Customer advances.....	4,286	5,925
	-----	-----
Total current liabilities.....	76,439	78,146
Long-term debt, excluding current installments.....	54,277	51,568
Postretirement benefit and other long-term liabilities.....	14,275	14,107
	-----	-----
Total liabilities.....	144,991	143,821
	-----	-----
Stockholders' equity:		
Preferred stock \$.01 par value. Authorized 5,000,000 shares; no shares issued and outstanding.....	--	--
Class A Common stock, \$.01 par value. Authorized 45,000,000 shares; issued and outstanding 15,803,797 and 15,469,078 shares as of September 30, 2002 and December 31, 2001, respectively.....	158	155
Class B Common stock, \$.01 par value. Authorized 5,000,000 shares; issued and outstanding 334,719 shares as of December 31, 2001.....	--	3
Additional paid-in capital.....	97,223	97,223

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Accumulated earnings.....	7,428	4,857
Treasury stock, 795,692 shares at cost as of September 30, 2002 and December 31, 2001.....	(7,182)	(7,182)
Accumulated other comprehensive loss.....	(2,677)	(2,858)
Notes receivable from officers and stockholders.....	(3,643)	(3,268)
	-----	-----
Total stockholders' equity.....	91,307	88,930
	-----	-----
Commitments and contingencies		
Total liabilities and stockholders' equity.....	\$ 236,298	\$ 232,751
	=====	=====

See accompanying notes to unaudited condensed consolidated financial statements.

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NATCO GROUP INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(IN THOUSANDS, EXCEPT PER SHARE DATA)

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTH SEPTEMBER
	2002	2001	2002
	-----	-----	-----
Revenues.....	\$66,563	\$74,522	\$214,537
Cost of goods sold.....	51,655	53,905	163,704
	-----	-----	-----
Gross profit.....	14,908	20,617	50,833
Selling, general and administrative expense.....	13,299	13,828	39,863
Depreciation and amortization expense.....	1,288	2,176	3,640
Unusual charges.....	--	--	--
Interest expense.....	1,280	1,456	3,423
Interest cost on postretirement benefit liability.....	122	122	367
Interest income.....	(47)	(129)	(174)
Other, net.....	(271)	(61)	(236)
	-----	-----	-----
Income (loss) before income taxes.....	(763)	3,225	3,950
Income tax provision (benefit).....	(427)	1,458	1,379
	-----	-----	-----
Net income (loss).....	\$ (336)	\$ 1,767	\$ 2,571
	=====	=====	=====
EARNINGS (LOSS) PER SHARE:			
Basic.....	\$ (0.02)	\$ 0.11	\$ 0.16
Diluted.....	\$ (0.02)	\$ 0.11	\$ 0.16
WEIGHTED AVERAGE SHARES OF COMMON STOCK OUTSTANDING:			
Basic.....	15,804	15,747	15,804
Diluted.....	15,804	15,941	15,937

See accompanying notes to unaudited condensed consolidated financial statements.

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NATCO GROUP INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(IN THOUSANDS)

	NINE MONTHS ENDED SEPTEMBER 30,	
	2002	2001
	-----	-----
Cash flows from operating activities:		
Net income.....	\$ 2,571	\$ 3,663
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Deferred income tax expense.....	1,894	507
Depreciation and amortization expense.....	3,640	5,962
Non-cash interest income.....	(115)	(140)
Interest cost on postretirement benefit liability	367	766
Gain on the sale of property, plant and equipment	(14)	(156)
Change in assets and liabilities, net of acquisitions:		
(Increase) decrease in trade accounts receivable	(4,747)	4,044
(Increase) decrease in inventories.....	2,572	(9,615)
Increase in prepaid expense and other current assets.....	(450)	(1,372)
Increase in long-term assets.....	(422)	(1,526)
Increase in accounts payable.....	1,114	6,180
Decrease in accrued expenses and other.....	(3,522)	(5,177)
Increase (decrease) in customer advances.....	(1,800)	11,816
	-----	-----
Net cash provided by operating activities	1,088	14,952
	-----	-----
Cash flows from investing activities:		
Capital expenditures for property, plant and equipment.....	(3,882)	(6,388)
Acquisitions, net of cash acquired.....	(240)	(48,224)
Issuance of related party note receivable.....	(260)	(1,178)
Proceeds from settlement.....	--	1,500
Other, net.....	44	257
	-----	-----
Net cash used in investing activities.....	(4,338)	(54,033)
	-----	-----
Cash flows from financing activities:		
Change in bank overdrafts.....	155	2,929
Net borrowings (repayments) under long-term revolving credit facilities.....	6,594	(6,577)
Repayments of short-term borrowings.....	--	(1,001)
Repayments of long-term debt.....	(5,299)	(3,500)
Borrowings of long-term debt.....	1,460	50,000
Payments on postretirement benefit liability.....	(1,434)	(1,449)
Treasury shares repurchased.....	--	(292)
Other, net.....	541	236
	-----	-----
Net cash provided by financing activities....	2,017	40,346

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	-----	-----
Effect of exchange rate changes on cash and cash equivalents.....	506	(397)
	-----	-----
Change in cash and cash equivalents.....	(727)	868
Cash and cash equivalents at beginning of period.....	3,093	1,031
	-----	-----
Cash and cash equivalents at end of period.....	\$ 2,366	\$ 1,899
	=====	=====
Cash payments for:		
Interest.....	\$ 2,277	\$ 2,689
Income taxes.....	\$ 2,350	\$ 1,691
Significant non-cash financing activity:		
Issuance of common stock for acquisition.....	\$ --	\$ 85

See accompanying notes to unaudited condensed consolidated financial statements.

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### NATCO GROUP INC. AND SUBSIDIARIES

#### NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

##### (1) BASIS OF PRESENTATION

The accompanying condensed consolidated interim financial statements and related disclosures are unaudited and have been prepared by NATCO Group Inc., ("the Company") pursuant to generally accepted accounting principles for interim financial statements and the rules and regulations of the Securities and Exchange Commission. As permitted by these regulations, certain information and footnote disclosures that would typically be required in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. However, the Company's management believes that these statements reflect all the normal recurring adjustments necessary for a fair presentation, in all material respects, of the results of operations for the periods presented, so that these interim financial statements are not misleading. These condensed consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's Form 10-K filing for the year ended December 31, 2001.

To prepare financial statements in accordance with generally accepted accounting principles, the Company's management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements, and reported amounts of revenues and expenses incurred during the reporting period. Actual results could differ from those estimates. Furthermore, certain reclassifications have been made to fiscal year 2001 amounts in order to present these results on a comparable basis with amounts for fiscal year 2002. These reclassifications had no impact on net income.

References to "NATCO" and "the Company" are used throughout this document and relate collectively to NATCO Group Inc. and its consolidated subsidiaries.

##### (2) CAPITAL STOCK

On January 1, 2002, all outstanding shares of the Company's Class B Common Stock, 334,719 shares, were converted to Class A Common Stock, on a share for share basis, in accordance with the terms under which the Class B shares were

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originally issued. As of September 30, 2002, Class A Common Stock was the Company's only class of equity securities outstanding.

During September 2001, the Company reacquired 39,700 shares of its Class A common stock pursuant to a stock repurchase plan for \$292,000, an average cost of \$7.35 per share. The cost to reacquire these shares was recorded as treasury stock at September 30, 2001.

On February 1, 2001, NATCO issued 8,520 shares of Class B Common Stock to the former shareholders of The Cynara Company ("Cynara"), in connection with the achievement of certain performance criteria defined in the November 1998 purchase agreement. Goodwill was increased \$85,000 as a result of this transaction.

### (3) EARNINGS PER SHARE

Basic earnings per share was computed by dividing net income by the weighted average number of shares outstanding for the period. Diluted earnings per common and potential common share was computed by dividing net income by the weighted average number of common and potential common shares outstanding for the period. For purposes of this calculation, outstanding employee stock options were considered potential common shares. For the quarter ended September 30, 2002, no potential common shares related to employee stock options were included in diluted weighted average shares since the impact would have been a dilution of the loss per share recorded. Diluted shares for the quarter ended September 30, 2001 included potential common shares related to employee stock options of 193,523 shares. For the nine months ended September 30, 2002 and 2001, diluted shares included potential common shares related to employee stock options of 133,677 shares and 277,180 shares, respectively. Anti-dilutive stock options were excluded from the calculation of potential common shares. For the quarter ended September 30, 2002, all potential common shares related to employee stock options, 115,179 shares, were anti-dilutive. If anti-dilutive shares were included for the quarter ended September 30, 2001, the impact would have been a reduction of 211,514 shares. Similarly, the impact of anti-dilutive shares for the nine months ended September 30, 2002 and 2001, would have been a reduction of 250,119 shares and 79,011 shares, respectively.

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### (4) ACQUISITIONS

On March 19, 2001, the Company acquired all the outstanding share capital of Axsia Group Limited ("Axsia"), a privately held company based in the United Kingdom, for approximately \$42.8 million, net of cash acquired. Axsia specializes in the design and supply of water re-injection systems for oil and gas fields, oily water treatment, oil separation, hydrogen production and other process equipment systems. This acquisition was financed with borrowings under NATCO's term loan facility and was accounted for using the purchase method of accounting. Results of operations for Axsia have been included in NATCO's condensed consolidated financial statements since the date of acquisition. The excess of the purchase price over the fair values of the net assets acquired was being amortized over a twenty-year period, prior to the adoption of Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets" on January 1, 2002. See "Recent Accounting Pronouncements." Goodwill and accumulated amortization related to the Axsia acquisition were \$48.4 million and \$1.9 million, respectively, at September 30, 2002.

Assuming the Axsia acquisition occurred on January 1, 2001, the unaudited pro forma results of the Company for the nine-month period ended September 30,

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2001, would have been as follows:

	PRO FORMA RESULTS NINE MONTHS ENDED SEPTEMBER 30, 2001 ----- (UNAUDITED, IN THOUSANDS, EXCEPT PER SHARE DATA)
Revenues.....	\$ 234,938
Income before income taxes.....	3,685
Net income.....	1,592
Net income per share:	
Basic.....	\$ 0.10
Diluted.....	\$ 0.10

These pro forma results assume debt service costs associated with the Axsia acquisition, net of tax effect, calculated at the Company's effective tax rate for the applicable period, and nondeductible goodwill amortization. Although prepared on a basis consistent with NATCO's condensed consolidated financial statements, these pro forma results do not purport to be indicative of the actual results which would have been achieved had the acquisition been consummated on January 1, 2001, and are not intended to be a projection of future results.

Effective January 8, 2001, the Company entered into a Compromise Settlement Agreement with the former owner of Total Engineering Services Team, Inc., ("TEST"), which resulted in a cash payment of \$1.5 million to NATCO on May 31, 2001, to settle certain contingencies related to NATCO's acquisition of TEST in 1997. The proceeds of this payment, net of related costs, were used to reduce goodwill associated with the TEST acquisition.

### (5) UNUSUAL CHARGES

In June 2001, the Company recorded an unusual charge of \$1.6 million. The charge consisted of \$920,000 pursuant to an approved plan to close and merge an existing NATCO office into the operations of Axsia, as well as other streamlining actions associated with the acquisition. This charge included costs for severance, office consolidation and other expenses. Also, the Company withdrew a proposed private placement of debt and recorded an unusual charge of \$680,000 for costs incurred related to the proposed offering.

### (6) INVENTORIES

Inventories consisted of the following amounts:

	SEPTEMBER 30, 2002 ----- (UNAUDITED)	DECEMBER 31, 2001 ----- (IN THOUSANDS)
Finished goods.....	\$ 11,822	\$ 9,902
Work-in-process.....	9,378	13,441



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Raw materials and supplies.....	15,072	15,242
	-----	-----
Inventories at FIFO.....	36,272	38,585
Excess of FIFO over LIFO cost.....	(1,188)	(1,068)
	-----	-----
	\$ 35,084	\$37,517
	=====	=====

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(7) COSTS AND ESTIMATED EARNINGS ON UNCOMPLETED CONTRACTS

Cost and estimated earnings on uncompleted contracts were as follows:

	SEPTEMBER 30, 2002	DECEMBER 31, 2001
	-----	-----
	(UNAUDITED)	
	(IN THOUSANDS)	
Cost incurred on uncompleted contracts.....	\$ 88,761	\$131,702
Estimated earnings.....	27,108	51,343
	-----	-----
	115,869	183,045
Less billings to date.....	88,293	169,925
	-----	-----
	\$ 27,576	\$ 13,120
	=====	=====
Included in the accompanying balance sheet under the captions:		
Trade accounts receivable.....	\$ 30,976	\$ 17,497
Advance payments.....	(3,400)	(4,377)
	-----	-----
	\$ 27,576	\$ 13,120
	=====	=====

(8) LONG-TERM DEBT

The consolidated borrowings of the Company were as follows:

	SEPTEMBER 30, 2002	DECEMBER 31, 2001
	-----	-----
	(UNAUDITED)	
	(IN THOUSANDS)	

BANK DEBT

Term loan with variable interest rate (4.26% at September 30, 2002 and 4.25% at December 31, 2001) and quarterly payments of principal

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(\$1,750) and interest, due March 16, 2006.....	\$39,500	\$44,750
Revolving credit bank loans with variable interest rate (4.75% at September 30, 2002 and 4.52% at December 31, 2001) and quarterly interest payments, due March 15, 2004.....	14,788	12,768
Promissory note with variable interest rate (5.00% at September 30, 2002) and quarterly payments of principal (\$24) and interest, due February 8, 2007.....	1,411	--
Revolving credit bank loans (Export Sales Facility) with variable interest rate (4.75% at September 30, 2002 and December 31, 2001) and monthly interest payments, due July 23, 2004.....	5,675	1,050
	-----	-----
Total.....	\$61,374	\$58,568
Less current installments.....	(7,097)	(7,000)
	-----	-----
Long-term debt.....	\$54,277	\$51,568
	=====	=====

On March 16, 2001, the Company entered into a credit facility that consisted of a \$50.0 million term loan, a \$35.0 million U.S. revolving facility, a \$10.0 million Canadian revolving facility and a \$5.0 million U.K. revolving facility. The term loan matures on March 15, 2006, and each of the revolving facilities matures on March 15, 2004. In October 2001, the Company amended this revolving credit agreement to reduce the borrowing capacity in the U.S. from \$35.0 million to \$30.0 million, and to increase the borrowing capacity in the U.K. from \$5.0 million to \$10.0 million. No other material modifications were made to the agreement.

In July 2002, the Company's lenders approved the amendment of various provisions of the term loan and revolving credit facility agreement, effective April 1, 2002. This amendment revised certain restrictive debt covenants, modified certain defined terms, allowed for future capital investment in the Company's CO2 processing facility in West Texas, facilitates the issuance of up to \$7.5 million of subordinated indebtedness, increased the aggregate amount of operating lease expense allowed during a fiscal year and permitted an increase in borrowings under the export sales credit facility, without further consent, up to a maximum of \$20.0 million. These modifications will result in higher commitment fee percentages and interest rates if the Funded Debt to EBITDA ratio, as defined, exceeds 3 to 1.

Amounts borrowed under the term loan bear interest at a rate of 4.26% per annum as of September 30, 2002. Amounts borrowed under the revolving portion of the facility bear interest at a rate based upon the ratio of funded debt to EBITDA (as defined in the credit facility) and ranging from, at the Company's election, (1) a high of the London Inter-bank Borrowing Rate ("LIBOR") plus 3.00% to a low of LIBOR plus 1.75% or, (2) a high of a base rate plus 1.50% to a low of a base rate plus 0.25%.

NATCO will pay commitment fees of 0.30% to 0.625% per year depending upon the ratio of funded debt to EBITDA, on the undrawn portion of the facility.

The revolving credit facility is guaranteed by all of the Company's domestic subsidiaries and is secured by a first priority lien on substantially

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all inventory, accounts receivable and other material tangible and intangible assets. NATCO has also pledged 65% of the voting stock of its active foreign subsidiaries.

On February 6, 2002, the Company borrowed \$1.5 million under a long-term promissory note. This note accrues interest at the 90-day LIBOR plus 3.25% per annum, and requires quarterly payments of principal of approximately \$24,000 and interest for five years beginning May 2002. This promissory note is collateralized by a manufacturing facility in Magnolia, Texas that the Company purchased in the fourth quarter of 2001.

The Company maintains a working capital facility for export sales that provides for aggregate borrowings of \$10.0 million, subject to borrowing base limitations, under which borrowings of \$5.7 million were outstanding at September 30, 2002. Letters of credit outstanding under the export sales credit facility as of September 30, 2002 totaled \$548,000. The export sales credit facility is secured by specific project inventory and receivables, and is partially guaranteed by the EXIM Bank. The export sales credit facility loans mature in July 2004.

As of September 30, 2002, the Company was in compliance with all restrictive debt covenants. NATCO had letters of credit outstanding under the revolving credit facilities totaling \$16.6 million at September 30, 2002. These letters of credit constitute contract performance and warranty collateral and expire at various dates through September 2005.

The Company had unsecured letters of credit, guarantees and bonds totaling \$180,000 at September 30, 2002.

### (9) INCOME TAXES

NATCO's effective income tax rate for the nine months ended September 30, 2002 was 34.9%, which exceeded the amount that would have resulted from applying the U.S. federal statutory tax rate due to the impact of state income taxes, foreign income tax rate differentials and certain permanent book-to-tax differences.

### (10) INDUSTRY SEGMENTS

The Company's operations are organized into three separate business segments: North American operations, a segment which primarily provides traditional, standard and small custom production equipment and components, replacement parts, used equipment and components, equipment servicing and field operating support including operations of the Company's domestic membrane facility; engineered systems, a segment which primarily provides customized and more complex technological equipment, large scale integrated oil and gas production systems, and equipment and services provided by certain international operations, including Axsia; and automation and control systems, a segment which provides control panels and systems that monitor and control oil and gas production, as well as installation and start-up and other field services related to instrumentation and electrical systems.

The accounting policies of the reportable segments were consistent with the policies used to prepare the Company's condensed consolidated financial statements for the respective periods presented. Summarized financial information concerning the Company's reportable segments is shown in the following table.

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	NORTH AMERICAN OPERATIONS	ENGINEERED SYSTEMS	AUTOMATION & CONTROL SYSTEMS
(UNAUDITED, IN THOUSANDS)			
THREE MONTHS ENDED			
SEPTEMBER 30, 2002			
Revenues from unaffiliated customers.....	\$ 31,230	\$ 23,484	\$11,849
Inter-company revenues.....	837	210	1,016
Segment profit (loss).....	2,247	(771)	1,049
Total assets.....	102,079	103,905	19,871
Capital expenditures.....	521	349	103
Depreciation and amortization.....	660	477	138
THREE MONTHS ENDED			
SEPTEMBER 30, 2001			
Revenues from unaffiliated customers.....	\$ 37,326	\$ 26,980	\$10,216
Inter-company revenues.....	1,302	580	858
Segment profit (loss).....	3,103	4,314	897
Total assets.....	97,356	115,904	19,351
Capital expenditures.....	2,063	910	84
Depreciation and amortization.....	1,243	823	100
NINE MONTHS ENDED			
SEPTEMBER 30, 2002			
Revenues from unaffiliated customers.....	\$102,032	\$ 78,190	\$34,315
Inter-company revenues.....	2,354	923	3,545
Segment profit (loss).....	8,847	1,456	3,465
Total assets.....	102,079	103,905	19,871
Capital expenditures.....	1,536	1,803	381
Depreciation and amortization.....	1,774	1,381	332
NINE MONTHS ENDED			
SEPTEMBER 30, 2001			
Revenues from unaffiliated customers.....	\$107,221	\$ 79,350	\$33,420
Inter-company revenues.....	3,569	618	2,752
Segment profit (loss).....	9,138	9,038	3,566
Total assets.....	97,356	115,904	19,351
Capital expenditures.....	3,068	2,322	340
Depreciation and amortization.....	2,748	2,651	361

(11) COMMITMENTS AND CONTINGENCIES

The Porta-Test International, Inc. ("Porta-Test") purchase agreement, executed in January 2000, contains a provision to calculate a payment to certain former stockholders of Porta-Test Systems, Inc. for a three-year period ended January 23, 2003, based upon sales of a limited number of specified products designed by or utilizing technology that existed at the time of the acquisition. Liability under this arrangement is contingent upon attaining certain performance criteria, including gross margins and sales volumes for the specified products. If applicable, payment is required annually. In January 2002, the Company accrued \$219,000 under this arrangement for the year ended January 23, 2002, resulting in an increase in goodwill, of which \$197,000 was paid in August 2002. In April 2001, the Company paid \$226,000 in accordance with the purchase agreement. Any future liabilities incurred under this arrangement will be recorded to goodwill.

(12) NEW ACCOUNTING PRONOUNCEMENTS

The Financial Accounting Standards Board ("FASB") approved SFAS No. 142,

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"Goodwill and Other Intangible Assets" in June 2001. This pronouncement requires that intangible assets with indefinite lives, including goodwill, cease being amortized and be evaluated on an impairment basis. Intangible assets with a defined term, such as patents, would continue to be amortized over the useful life of the asset.

The Company adopted SFAS No. 142 on January 1, 2002. Intangible assets subject to amortization under the pronouncement as of September 30, 2002 and 2001 are summarized in the following table:

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TYPE OF INTANGIBLE ASSET	AS OF SEPTEMBER 30, 2002		AS OF SEPTEMBER 30, 2001	
	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION
	(UNAUDITED, IN THOUSANDS)			
Deferred Financing Fees.....	\$ 3,300	\$ 1,752	\$ 2,889	\$ 1,120
Patents.....	141	15	101	9
Employment Contracts.....	--	--	818	752
Other.....	257	165	262	93
	-----	-----	-----	-----
Total.....	\$ 3,698	\$ 1,932	\$ 4,070	\$ 1,974
	=====	=====	=====	=====

Amortization and interest expense of \$230,000 and \$180,000 were recognized related to these assets for the quarters ended September 30, 2002 and 2001, respectively, and \$639,000 and \$463,000 for the nine-month periods ended September 30, 2002 and 2001, respectively. The estimated aggregate amortization and interest expense for these assets for each of the following five fiscal years is: 2002 -- \$790,000; 2003 -- \$555,000; 2004 -- \$270,000; 2005 -- \$228,000; and 2006 -- \$70,000. For segment reporting purposes, these intangible assets and the related amortization expense were recorded under "Corporate and Eliminations," excluding the employment contracts which were allocated between the engineered systems and North American operations business segments.

Goodwill was the Company's only intangible asset that required no periodic amortization as of the date of the adoption of SFAS No. 142. Net goodwill at September 30, 2002 was \$80.4 million. The pro forma impact of applying SFAS No. 142 to operating results for the quarter and nine-month period ended September 30, 2001, would have been a reduction of amortization expense of \$1.1 million and \$2.6 million, respectively, resulting in net income of \$2.8 million and \$6.3 million, respectively, and an increase in basic and diluted earnings per share of \$.07 and \$.17, respectively.

In accordance with SFAS No. 142, the Company tested impairment of goodwill. Based upon the testing performed, management determined that goodwill was not impaired as of September 30, 2002. Therefore, no impairment charge was recorded under SFAS No. 142 as of September 30, 2002. Goodwill will be tested for impairment annually on December 31.

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In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." This standard provides guidance on reporting and accounting for obligations associated with the retirement of long-lived tangible assets and the associated retirement costs. This standard is effective for financial statements issued for fiscal years beginning after June 15, 2002. The Company has not yet determined the impact that this pronouncement will have on its financial condition or results of operations.

On January 1, 2002, the Company adopted SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." This statement replaces SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," and standardizes the accounting model to be used for asset dispositions and related implementation issues. This pronouncement did not have a material impact on the Company's financial condition or results of operations.

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13 and Technical Corrections." This statement provides guidance for income statement classification of gains and losses on extinguishment of debt and accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. SFAS No. 145 is effective for the Company in January 2003. The Company will apply this pronouncement to future transactions, if applicable.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Exit or Disposal Activities," which addresses significant issues regarding the recognition, measurement and reporting of costs that are associated with exit and disposal activities, including restructuring activities that are currently accounted for pursuant to the guidance set forth in EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity." SFAS No. 146 is effective for the Company in January 2003. The Company has not determined the impact that this pronouncement will have on its financial condition or results of operations.

### (13) POSTRETIREMENT BENEFITS

On May 1, 2001, the Company amended a postretirement benefit plan that provided medical and dental coverage to retirees of a predecessor company. Under the amended plan, retirees bear additional costs of coverage. Significant plan changes include higher deductibles, prescription coverage under a drug card program and the elimination of dental benefits. As of July 1, 2001, the Company obtained a third-party valuation of its liability under this plan arrangement, as amended, resulting in a cumulative unrecognized gain of \$3.3 million.

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In accordance with SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," this unrecognized gain will be amortized to income over the remaining life expectancy of the plan participants.

### (14) RELATED PARTY TRANSACTIONS

As previously agreed during 2001, the Company loaned an employee who is an executive officer and director of the Company \$216,000 on April 15, 2002, under a full-recourse note arrangement which accrues interest at 6% per annum and matures on July 31, 2003. The funds were used to pay tax burdens associated with stock options exercised during 2001. Effective July 1, 2002, the note was amended to extend the maturity date to July 31, 2004, and to require interest to be calculated at an annual rate based on LIBOR plus 300 basis points, adjusted quarterly, applied to the note balance as of June 30, 2002, including previously accrued interest.

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As of June 30, 2002, the Company had several outstanding notes receivable from an employee who is an executive officer and director of the Company, with principal and accrued interest totaling \$3.4 million. The maturity of these loans, which are full-recourse note arrangements, was July 31, 2003, and interest accrued at rates ranging from 6% to 7.8% per annum. Effective July 1, 2002, the notes were amended to extend the maturity dates to July 31, 2004, and to require interest to be calculated at an annual rate based on LIBOR plus 300 basis points, adjusted quarterly, applied to the notes balances as of June 30, 2002, including previously accrued interest.

### (15) SUBSEQUENT EVENTS

As of November 4, 2002, the Company's management committed to a plan to close a manufacturing and engineering facility in Edmonton, Alberta, Canada. This plan includes the involuntary termination of plant workers and administrative staff, the relocation of equipment and certain personnel to other facilities and costs related to modifying certain operating lease arrangements. The Company will begin implementing this plan during November 2002, and expects to incur costs under this plan through the second quarter of 2003. The Company recorded no liabilities related to this restructuring plan as of September 30, 2002, and has not yet quantified the overall cost of this restructuring.

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## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### FORWARD-LOOKING STATEMENTS

Management's Discussion and Analysis includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (each a "Forward-Looking Statement"). The words "believe," "expect," "plan," "intend," "estimate," "project," "will," "could," "may" and similar expressions are intended to identify Forward-Looking Statements. Forward-Looking Statements in this document include, but are not limited to, discussions regarding indicated trends in the level of oil and gas exploration and production and the effect of such conditions on the Company's results of operations (see " -- Industry and Business Environment"), future uses of and requirements for financial resources (see " -- Liquidity and Capital Resources"), and anticipated backlog levels for 2002 (see " -- Liquidity and Capital Resources"). The Company's expectations about its business outlook, customer spending, oil and gas prices and the business environment for the Company and the industry in general are only its expectations regarding these matters. No assurance can be given that actual results may not differ materially from those in the Forward-Looking Statements herein for reasons including, but not limited to: market factors such as pricing and demand for petroleum related products, the level of petroleum industry exploration and production expenditures, the effects of competition, world economic conditions, the level of drilling activity, the legislative environment in the United States and other countries, policies of the Organization of Petroleum Exporting Countries ("OPEC"), conflict in major petroleum producing or consuming regions, the development of technology which could lower overall finding and development costs, weather patterns and the overall condition of capital and equity markets for countries in which the Company operates.

The following discussion should be read in conjunction with the financial statements, related notes and other financial information appearing elsewhere in this Form 10-Q. Readers are also urged to carefully review and consider the various disclosures advising interested parties of the factors that affect the

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Company, including without limitation, the disclosures made under the caption "Risk Factors" and the other factors and risks discussed in the Company's Annual Report on Form 10-K as of December 31, 2001, and in subsequent reports filed with the Securities and Exchange Commission. The Company expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any Forward-Looking Statement to reflect any change in the Company's expectations with regard thereto or any change in events, conditions or circumstances on which any Forward-Looking Statement is based.

### OVERVIEW

References to "NATCO" "the Company" "we" and "our" are used throughout this document and relate collectively to NATCO Group Inc. and its consolidated subsidiaries.

Our operations are organized into three separate business segments: North American operations, a segment which primarily provides traditional, standard and small custom production equipment and components, replacement parts, used equipment and components, equipment servicing and field operating support including operations of our domestic membrane facility; engineered systems, a segment which primarily provides customized and more complex technological equipment, large scale integrated oil and gas production systems, and equipment and services provided by certain international operations, including Axsia; and automation and control systems, a segment which provides control panels and systems that monitor and control oil and gas production, as well as installation and start-up and other field services related to instrumentation and electrical systems.

### CRITICAL ACCOUNTING POLICIES

The preparation of our consolidated financial statements requires management to make certain estimates and assumptions that affect the results reported in our consolidated financial statements and accompanying notes. These estimates and assumptions are based on historical experience and on future expectations that we believe to be reasonable under the circumstances. Note 2 to the consolidated financial statements filed in our Annual Report on Form 10-K at December 31, 2001, contains a summary of our significant accounting policies. We believe the following accounting policy is the most critical in the preparation of our condensed consolidated financial statements:

**Revenue Recognition: Percentage-of-Completion Method.** We recognize revenues from significant contracts (greater than \$250,000 and longer than four months in duration) and all automation and control systems contracts and orders on the percentage-of-completion method of accounting. Earned revenue is based on the percentage that costs incurred to date relate to total estimated costs of the project, after giving effect to the most recent estimates of total cost. The timing of costs incurred, and therefore recognition of revenue, could be affected by various internal or external factors including, but not limited to: changes in project scope (change orders), changes in productivity, scheduling, the cost and availability of labor, the cost and availability of raw materials, the weather, client delays in providing approvals at benchmark stages of the

project and the timing of deliveries from third-party providers of key components. The cumulative impact of revisions in total cost estimate during the progress of work is reflected in the period in which these changes become known. Earned revenues reflect the original contract price adjusted for agreed claims and change order revenues, if applicable. Losses expected to be incurred on the jobs in progress, after consideration of estimated minimum recoveries from claims and change orders, are charged to income as soon as such losses are



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known. Claims for additional contract revenue are recognized if it is probable that the claim will result in additional revenue and the amount can be reliably estimated. We generally recognize revenue and earnings to which the percentage-of-completion method applies over a period of two to six quarters. In the event a project is terminated by our customer before completion, our customer is liable for costs incurred under the contract. We believe that our operating results should be evaluated over a term of several years to evaluate performance under long-term contracts, after all change orders, scope changes and cost recoveries have been negotiated and realized. We record revenues and profits on all other sales as shipments are made or services are performed.

### RECENT ACCOUNTING PRONOUNCEMENTS

The Financial Accounting Standards Board ("FASB") approved Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets" in June 2001. This pronouncement requires that intangible assets with indefinite lives, including goodwill, cease being amortized and be evaluated on an impairment basis. Intangible assets with a defined term, such as patents, would continue to be amortized over the useful life of the asset. We adopted SFAS No. 142 on January 1, 2002, and continued to amortize certain net assets totaling \$1.8 million at September 30, 2002, and recorded amortization and interest expense related to those assets for the quarter and nine-month period ended September 30, 2002 of \$230,000 and \$639,000, respectively. We ceased periodic amortization of goodwill on the date of adoption. Net goodwill at September 30, 2002 was \$80.2 million. The pro forma impact of applying SFAS No. 142 to operating results for the quarter and nine-month period ended September 30, 2001, would have been a reduction of amortization expense of \$1.1 million and \$2.6 million, respectively, resulting in net income of \$2.8 million and \$6.3 million, respectively, and an increase in basic and diluted earnings per share of \$.07 and \$.17, respectively.

In accordance with SFAS No. 142, we tested impairment of goodwill. Based upon the testing performed, we determined that goodwill was not impaired as of September 30, 2002. Therefore, no impairment charge was recorded under SFAS No. 142 as of September 30, 2002. Goodwill will be tested for impairment annually on December 31.

In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." This standard provides guidance on reporting and accounting for obligations associated with the retirement of long-lived tangible assets and the related retirement costs. This standard is effective for financial statements issued for fiscal years beginning after June 15, 2002. We have not yet determined the impact that this pronouncement will have on our financial condition or results of operations.

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13 and Technical Corrections." This statement provides guidance for income statement classification of gains and losses on extinguishment of debt and accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. SFAS No. 145 is effective for us in January 2003. We will apply this pronouncement to future transactions, if applicable.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Exit or Disposal Activities," which addresses significant issues regarding the recognition, measurement and reporting of costs that are associated with exit and disposal activities, including restructuring activities that are currently accounted for pursuant to the guidance set forth in EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity." SFAS No. 146 is effective for us in January 2003. We have not yet determined the impact that this pronouncement will have on our financial condition or results of operations.

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### ACQUISITIONS

On March 19, 2001, we acquired all the outstanding share capital of Axsia Group Limited ("Axsia"), a privately held company based in the United Kingdom, for approximately \$42.8 million, net of cash acquired. Axsia specializes in the design and supply of water re-injection systems for oil and gas fields, oily water treatment, oil separation, hydrogen production and other process equipment systems. This acquisition was financed with borrowings under our term loan facility, and was accounted for using the purchase method of accounting. Results of operations for Axsia have been included in our condensed consolidated financial statements since the date of acquisition. The excess of the purchase price over the fair values of the net assets acquired was being amortized over a twenty-year period, prior to the adoption of SFAS No. 142. Goodwill and accumulated amortization related to the Axsia acquisition were \$48.4 million and \$1.9 million, respectively, at September 30, 2002.

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### INDUSTRY AND BUSINESS ENVIRONMENT

We are a leading provider of equipment, systems and services used in the production of crude oil and natural gas, primarily at the wellhead, to separate oil and gas within a production stream and to remove contaminants. Our products and services are used in onshore and offshore fields in most major oil and gas producing regions of the world. Separation and decontamination of a production stream is needed at almost every producing well in order to meet the specifications of transporters and end users.

Our revenues and results of operations are closely tied to demand for oil and gas products and spending by oil and gas companies for exploration and development of oil and gas reserves. During periods of lower demand, revenues for service providers such as NATCO generally decline, as existing projects are completed and new projects are postponed. During periods of recovery, revenues for service providers can lag behind the industry due to the timing of new project awards.

Changes in commodity prices have impacted our business over the past several years. The following table summarizes the price of domestic crude oil per barrel and the wellhead price of natural gas per thousand cubic feet ("mcf") for the years ended December 31, 2001 and 2000, as well as data related to the nine-month periods ended September 30, 2002 and 2001, derived from published reports by the U.S. Department of Energy, and the rotary rig count, as published by Baker Hughes Incorporated.

	NINE MONTHS ENDED SEPTEMBER 30,		YEAR DECEMBER 31,
	2002	2001	2001
Average price of crude oil per barrel in the U.S. . .	\$ 22 (a)	\$ 24	\$ 22
Average wellhead price of natural gas per mcf in the U.S. ....	\$ 3	\$ 5	\$ 4
Average North American rig count.....	1,081	1,569	1,497

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(a) Data projected for September 2002 using the historical average deviation between published wellhead and West Texas Intermediate crude prices for the period January 1, 2001 to August 31, 2002.

The spot price of West Texas intermediate crude oil per barrel as of September 30, 2002 was above \$30 per barrel, but declined to approximately \$27 per barrel as of November 1, 2002. The spot price of Henry Hub natural gas at September 30, 2002, was approximately \$4 per mcf. The rotary rig count for North America, as published by Baker Hughes Incorporated, was 1,109 operating rigs, as of November 1, 2002.

Average commodity future price quotes for crude oil per barrel and Henry Hub natural gas per mcf on the New York Mercantile Exchange for delivery throughout the twelve months ended November 30, 2003 were approximately \$25 and \$4, respectively, as of November 6, 2002.

The following discussion of our historical results of operations and financial condition should be read in conjunction with our condensed consolidated financial statements and notes thereto.

### RESULTS OF OPERATIONS

In the first quarter of 2001, we changed the presentation of our reportable segments by combining the traditional production equipment and services business segment with the NATCO Canada business segment, to form the North American operations business segment.

Three Months Ended September 30, 2002 Compared to Three Months Ended September 30, 2001

Revenues. Revenues of \$66.6 million for the three months ended September 30, 2002 decreased \$8.0 million, or 11%, from \$74.5 million for the three months ended September 30, 2001. The following table summarizes revenues by business segment for the quarters ended September 30, 2002 and 2001, respectively.

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	THREE MONTHS ENDED SEPTEMBER 30,			PERCENTAGE CHANGE
	2002	2001	CHANGE	CHANGE
	(UNAUDITED)			
	(IN THOUSANDS, EXCEPT PERCENTAGE CHANGE)			
North American Operations.....	\$ 32,067	\$ 38,628	\$ (6,561)	(17%)
Engineered Systems.....	23,694	27,560	(3,866)	(14%)
Automation and Control Systems....	12,865	11,074	1,791	16%
Corporate and Other.....	(2,063)	(2,740)	677	(25%)
Total.....	\$ 66,563	\$ 74,522	\$ (7,959)	(11%)

North American operations revenues decreased \$6.6 million, or 17%, for the quarter ended September 30, 2002, as compared to the quarter ended September 30, 2001, due to an overall market decline in the U.S. and Canada. North American

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rig counts declined 24% from 1,472 operating rotary rigs as of September 28, 2001 to 1,112 operating rotary rigs as of September 27, 2002. As a result, we experienced lower revenues for traditional equipment, finished goods and our domestic parts and services. Third-party revenues for Canadian operations continued to decline due to similar poor market conditions, as Canadian rig counts remained low at 237 operating rigs as of September 30, 2002. Inter-company revenues for this business segment were \$837,000 for the quarter ended September 30, 2002, as compared to \$1.3 million for the quarter ended September 30, 2001.

Revenues for the engineered systems business segment decreased \$3.9 million, or 14%, for the quarter ended September 30, 2002, as compared to the quarter ended September 30, 2001. This decrease was primarily due to a decline in revenues contributed by our European operations, which provided \$17.9 million of revenues for the quarter ended September 30, 2001 as compared to \$12.0 million for the quarter ended September 30, 2002. Offsetting this decline was an increase in other engineered systems projects, primarily in West Africa and Southeast Asia. Engineered systems revenues of \$23.7 million for the quarter ended September 30, 2002 included approximately \$210,000 of inter-company revenues, as compared to \$580,000 of inter-company revenues for the quarter ended September 30, 2001.

Revenues for the automation and control systems business segment increased \$1.8, or 16%, for the quarter ended September 30, 2002, as compared to the quarter ended September 30, 2001. This increase in revenues was the result of an increase in the number of jobs in progress in 2002 relative to 2001, including deep-water projects in the Gulf of Mexico, several projects in Africa and certain inter-company projects that resulted in slightly higher inter-company sales. Inter-company sales increased from \$858,000 for the quarter ended September 30, 2001 to \$1.0 million for the quarter ended September 30, 2002.

The change in revenues for corporate and other represents the elimination of inter-company revenues as discussed above.

**Gross Profit.** Gross profit for the quarter ended September 30, 2002 decreased \$5.7 million, or 28%, to \$14.9 million, compared to \$20.6 million for the quarter ended September 30, 2001. As a percentage of revenue, gross margins declined from 28% for the quarter ended September 30, 2001 to 22% for the quarter ended September 30, 2002. The following table summarizes gross profit by business segment for the quarters then ended:

	THREE MONTHS ENDED SEPTEMBER 30,			PERCENTAGE
	2002	2001	CHANGE	CHANGE
	(UNAUDITED)			
	(IN THOUSANDS, EXCEPT PERCENTAGE CHANGE)			
North American Operations.....	\$ 8,092	\$ 9,019	\$ (927)	(10%)
Engineered Systems.....	4,599	9,543	(4,944)	(52%)
Automation and Control Systems....	2,217	2,055	162	8%
Total.....	\$ 14,908	\$20,617	\$ (5,709)	(28%)

Gross profit for the North American operations business segment decreased \$927,000, or 10%, for the quarter ended September 30, 2002, as compared to the

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respective period in 2001. This decrease in margin was due primarily to a 17% decline in revenues, partially offset by favorable margins on sales of traditional equipment and domestic parts and services. As a percentage of revenue, gross margins were 25% and 23% for the quarters ended September 30, 2002 and 2001, respectively.

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Gross profit for the engineered systems business segment for the quarter ended September 30, 2002 decreased \$4.9 million, or 52%, primarily due to a 14% decline in revenues for the engineered systems business segment, and the completion of several higher margin projects during the quarter ended September 30, 2001. In addition, we experienced an increase in the under-absorption of engineering overhead expense during the quarter ended September 30, 2002. Gross margin as a percentage of revenues for engineered systems was 19% and 35% for the quarters ended September 30, 2002 and 2001, respectively.

Gross profit for the automation and control systems business segment increased \$162,000, or 8%, for the quarter ended September 30, 2002, as compared to the quarter ended September 30, 2001, due to a 16% increase in revenues for the respective period. Gross margin as a percentage of revenue for the quarters ended September 30, 2002 and 2001, was 17% and 19%, respectively.

**Selling, General and Administrative Expense.** Selling, general and administrative expense of \$13.3 million decreased \$529,000, or 4%, for the quarter ended September 30, 2002, as compared to the quarter ended September 30, 2001. This decrease was primarily related to a decline in research and development expenditures and lower management incentive accruals tied to profitability. Partially offsetting this decrease in expense was the cost incurred during the quarter ended September 30, 2002, associated with our Mexico office, opened in late 2001.

**Depreciation and Amortization Expense.** Depreciation and amortization expense of \$1.3 million for the quarter ended September 30, 2002, decreased \$888,000, or 41%, compared to \$2.2 million for the quarter ended September 30, 2001. Depreciation expense of \$1.3 million for the quarter ended September 30, 2002, increased \$258,000, or 25%, as compared to the respective period for 2001. This increase was primarily due to the addition of capital assets purchased and constructed during late 2001 and early 2002, including a significant expansion of the Sacroc gas processing facility. Amortization expense for the quarter ended September 30, 2002 was \$17,000, as compared to \$1.2 million for the quarter ended September 30, 2001. This decline in amortization expense was attributable to a change in accounting method prescribed by SFAS No. 142, "Goodwill and Other Intangible Assets." This pronouncement, adopted on January 1, 2002, requires that goodwill no longer be amortized over a prescribed period but rather intangible assets not assigned a useful life be evaluated annually for impairment. See "Recent Accounting Pronouncements." Therefore, no goodwill amortization was recorded for the quarter ended September 30, 2002, compared to \$1.1 million for the quarter ended September 30, 2001. The results for the third quarter of 2001 also include amortization expense associated with certain employment contracts that were fully amortized as of December 31, 2001.

**Interest Expense.** Interest expense was \$1.3 million for the quarter ended September 30, 2002, as compared to \$1.5 million for the respective period in 2001. This decrease of \$176,000, or 12%, was due primarily to a decline in the weighted average interest rate on outstanding debt from 6.03% at September 30, 2001 to 4.44% at September 30, 2002.

**Other, net.** Other, net increased from a gain of \$61,000 for the quarter ended September 30, 2001, to a gain of \$271,000 for the quarter ended September 30, 2002. The increase was primarily attributable to realized gains on foreign currency exchange transactions associated with our Canadian operations.

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Provision for Income Taxes. Income tax benefit for the quarter ended September 30, 2002 was \$427,000 compared to income tax expense of \$1.5 million for the quarter ended September 30, 2001. The primary reason for this decrease in tax expense was a decline in income before income taxes, which was a loss of \$763,000 for the quarter ended September 30, 2002, as compared to income of \$3.2 million for the respective period in 2001. The effective tax rate increased from 45.2% for the third quarter of 2001 to 56.0% for the third quarter of 2002.

Nine Months Ended September 30, 2002 Compared to Nine Months Ended September 30, 2001

Revenues. Revenues of \$214.5 million for the nine months ended September 30, 2002 decreased \$5.5 million, or 2%, from \$220.0 million for the nine months ended September 30, 2001. The following table summarizes revenues by business segment for the nine-month periods ended September 30, 2002 and 2001, respectively.

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	NINE MONTHS ENDED SEPTEMBER 30,			PERCENTAGE CHANGE
	2002	2001	CHANGE	
	-----			
	(UNAUDITED)			
	(IN THOUSANDS, EXCEPT PERCENTAGE CHANGE)			
	-----	-----	-----	-----
North American Operations.....	\$104,386	\$110,790	\$(6,404)	(6%)
Engineered Systems.....	79,113	79,968	(855)	(1%)
Automation and Control Systems....	37,860	36,172	1,688	5%
Corporate and Other.....	(6,822)	(6,939)	117	2%
	-----	-----	-----	
Total.....	\$214,537	\$219,991	\$(5,454)	(2%)
	-----	-----	-----	

North American operations revenues decreased \$6.4 million, or 6%, from \$110.8 million for the nine months ended September 30, 2001 to \$104.4 million for the nine months ended September 30, 2002. This decrease was due to an overall market decline in the U.S. and Canada, as rig counts dropped from an average of 1,569 operating rotary rigs for the nine months ended September 30, 2001 to an average of 1,081 operating rotary rigs for the nine months ended September 30, 2002. This decrease in activity resulted in a decline in revenues for sales of our traditional equipment, finished goods and domestic parts and services. Third-party revenues for Canadian operations continued to decline due to similar poor market conditions and certain project delays. Inter-company revenues for this business segment were \$2.4 million for the nine months ended September 30, 2002, as compared to \$3.6 million for the nine months ended September 30, 2001.

Revenues for the engineered systems business segment remained relatively constant for the nine months ended September 30, 2002, as compared to the nine months ended September 30, 2001, as the completion of several projects in North Africa and Southeast Asia were offset by bookings of new projects in late 2001 and early 2002. Engineered systems revenues of \$79.1 million for the nine months ended September 30, 2002 included approximately \$923,000 of inter-company revenues, as compared to \$618,000 of inter-company revenues for the nine months

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ended September 30, 2001.

Revenues for the automation and control systems business segment increased \$1.7 million, or 5%, from \$36.2 million for the nine months ended September 30, 2001 to \$37.9 million for the nine months ended September 30, 2002, primarily due to an increase in the number of jobs in progress in 2002 relative to 2001, including deep-water projects in the Gulf of Mexico, several projects in Africa and certain inter-company projects which resulted in higher inter-company sales. Inter-company sales increased from \$2.8 million for the nine months ended September 30, 2001 to \$3.5 million for the nine months ended September 30, 2002.

The change in revenues for corporate and other represents the elimination of inter-company revenues as discussed above.

**Gross Profit.** Gross profit for the nine months ended September 30, 2002 decreased \$6.1, or 11%, to \$50.8 million, compared to \$56.9 million for the nine months ended September 30, 2001. As a percentage of revenue, gross margins declined from 26% for the nine months ended September 30, 2001, to 24% for the nine months ended September 30, 2002. The following table summarizes gross profit by business segment for the periods then ended:

	NINE MONTHS ENDED SEPTEMBER 30,			PERCENTAGE CHANGE
	2002	2001	CHANGE	
(UNAUDITED)				
(IN THOUSANDS, EXCEPT PERCENTAGE CHANGE)				
North American Operations.....	\$ 26,972	\$26,555	\$ 417	2%
Engineered Systems.....	16,923	23,297	(6,374)	(27%)
Automation and Control Systems....	6,938	7,063	(125)	(2%)
	-----	-----	-----	
Total.....	\$ 50,833	\$56,915	\$(6,082)	(11%)
	-----	-----	-----	

Gross profit for the North American operations business segment increased \$417,000, or 2%, for the nine months ended September 30, 2002, as compared to the respective period in 2001, despite a 6% decline in revenues for the business segment. These margin improvements were attributable primarily to our Latin American operations and favorable margins on domestic parts and services. As a percentage of revenue, gross margins were 26% and 24% for the nine-month periods ended September 30, 2002 and 2001, respectively.

Gross profit for the engineered systems business segment for the nine months ended September 30, 2002 decreased \$6.4 million, or 27%, compared to the nine months ended September 30, 2001. This decrease was due to a 1% decline in revenues for this business segment and a change in the sales mix for the respective quarters, as several large higher-margin projects were nearing completion in late 2001 and new project awards in 2002 were at more traditional margin levels. Gross margin for engineered systems represented 21% and 29% of the segment's revenues for the nine-month periods ended September 30, 2002 and 2001, respectively.

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Gross profit for the automation and control systems business segment decreased \$125,000, or 2%, for the nine months ended September 30, 2002, as compared to the nine months ended September 30, 2001, despite a 5% increase in revenues earned by the business segment for the respective period. This decline was attributable to an increase in lower-margin projects in 2002 and higher inter-company sales. Gross margin as a percentage of revenue for the nine-month periods ended September 30, 2002 and 2001, was 18% and 20%, respectively.

**Selling, General and Administrative Expense.** Selling, general and administrative expense of \$39.9 million increased \$1.4 million, or 4%, for the nine months ended September 30, 2002, as compared to the nine months ended September 30, 2001. This increase was largely related to the following factors: (1) nine months of operating expenses at Axsia during 2002 compared to less than seven months operating expenses from the acquisition date through September 30, 2001, (2) start-up costs related to the Singapore office opened in March 2001 to increase marketing efforts in Southeast Asia, and (3) start-up costs related to the Mexico office opened in late-2001. Partially offsetting these increases was a decline in management incentive accruals tied to profitability.

**Depreciation and Amortization Expense.** Depreciation and amortization expense of \$3.6 million for the nine months ended September 30, 2002, decreased \$2.3 million, or 39%, compared to \$6.0 million for the nine months ended September 30, 2001. Depreciation expense of \$3.6 million for the nine months ended September 30, 2002, increased \$536,000, or 18%, as compared to the respective period for 2001. This increase was primarily due to the acquisition of Axsia in March 2001 and the addition of capital assets purchased and constructed during late 2001 and early 2002, including the expansion of the Sacroc gas processing facility. Amortization expense for the nine months ended September 30, 2002 was \$70,000, as compared to \$2.9 million for the nine months ended September 30, 2001. This decline in amortization expense was attributable to a change in accounting method prescribed by SFAS No. 142, "Goodwill and Other Intangible Assets." This pronouncement, adopted on January 1, 2002, requires that goodwill no longer be amortized over a prescribed period but rather intangible assets not assigned a useful life be evaluated annually for impairment. See "Recent Accounting Pronouncements." Therefore, no goodwill amortization was recorded for the nine months ended September 30, 2002, compared to \$2.6 million for the nine months ended September 30, 2001. The results for the nine months ended September 30, 2001 also include amortization expense associated with certain employment contracts that were fully amortized as of December 31, 2001.

**Unusual Charges.** Unusual charges for the nine months ended September 30, 2001 were \$1.6 million, of which approximately \$920,000 related to certain restructuring costs to streamline activities and consolidate offices in connection with our acquisition of Axsia in March 2001, and an additional \$680,000 related to our decision to withdraw a proposed private placement of debt.

**Interest Expense.** Interest expense was \$3.4 million for the nine months ended September 30, 2002, as compared to \$3.7 million for the respective period in 2001. This decrease of \$322,000, or 9%, was due primarily to a decline in the weighted average interest rate on outstanding debt balanced from approximately 6.03% as of September 30, 2001 to approximately 4.44% as of September 30, 2002.

**Interest Cost on Postretirement Benefit Liability.** Interest cost on postretirement benefit liability, related to a plan that provides medical and dental coverage to retirees of a predecessor company, decreased \$399,000, or 52%, from \$766,000 for the nine months ended September 30, 2001 to \$367,000 for the nine months ended September 30, 2002. This decrease in interest cost was due to a June 2001 amendment of this plan whereby retirees bear more cost for coverage, reducing our projected liability and the related interest cost.



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Other, net. Other, net increased from a gain of \$46,000 for the nine months ended September 30, 2001, to a gain of \$236,000 for the nine months ended September 30, 2002. The increase was primarily attributable to realized gains on foreign currency exchange transactions associated with our Canadian operations.

Provision for Income Taxes. Income tax expense of \$1.4 million for the nine months ended September 30, 2002, decreased \$1.6 from \$3.0 million for the nine months ended September 30, 2001. The primary reason for this decrease in tax expense was a decrease in income before income taxes, which was \$4.0 million for the nine months ended September 30, 2002, as compared to \$6.6 million for the respective period in 2001. The effective tax rate declined from 44.8% for the nine months ended September 30, 2001 to 34.9% for the nine months ended September 30, 2002, due to the impact of eliminating non-deductible goodwill amortization as per SFAS No. 142, "Goodwill and Other Intangible Assets." See "Recent Accounting Pronouncements."

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### LIQUIDITY AND CAPITAL RESOURCES

As of September 30, 2002, we had cash and working capital of \$2.4 million and \$42.7 million, respectively, as compared to cash and working capital of \$3.1 million and \$37.1 million, respectively, at December 31, 2001.

Net cash provided by operating activities for the nine months ended September 30, 2002 was \$1.1 million, compared to \$15.0 million for the nine months ended September 30, 2001. Factors that contributed to the decrease in cash provided by operating activities during 2002 included an increase in trade accounts receivable and a decline in customer advance payments.

Net cash used in investing activities for the nine months ended September 30, 2002 was \$4.3 million, of which \$3.9 million was used for capital expenditures. During the nine months ended September 30, 2001, \$54.0 million was used for investing activities primarily related to the acquisition of Axsia, which required \$48.2 million, and capital expenditures of \$6.4 million.

Net cash provided by financing activities for the nine months ended September 30, 2002 and 2001, was \$2.0 million and \$40.3 million, respectively. The primary source of funds for financing activities for the nine months ended September 30, 2002 was net borrowings of \$6.6 million under long-term revolving credit facilities and borrowings of \$1.5 million under a new long-term debt arrangement, offset by repayments of \$5.3 million under long term facilities. The primary source of funds for financing activities during the nine months ended September 30, 2001 was borrowings of \$50.0 million under the term loan facility, partially offset by net repayments of \$6.6 million under long-term revolving credit facilities, repayments of \$3.5 million under the term loan facility and repayments of \$1.0 million under short-term note arrangements.

We borrowed \$1.5 million under a long-term promissory note arrangement on February 6, 2002. This note accrues interest at the 90-day London Interbank Offered Rate ("LIBOR") plus 3.25% per annum, and requires quarterly payments of principal of approximately \$24,000 and interest for five years beginning May 2002. This promissory note is collateralized by our manufacturing facility in Magnolia, Texas that we purchased in the fourth quarter of 2001.

On March 16, 2001, we entered into a credit facility that consisted of a \$50.0 million term loan, a \$35.0 million U.S. revolving facility, a \$10.0 million Canadian revolving facility and a \$5.0 million U.K. revolving facility. The term loan matures on March 15, 2006, and each of the revolving facilities matures on March 15, 2004. In October 2001, we amended this revolving credit

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agreement to reduce the borrowing capacity in the U.S. from \$35.0 million to \$30.0 million, and to increase our borrowing capacity in the U.K. from \$5.0 million to \$10.0 million. No other material modifications were made to the agreement.

In July 2002, our lenders approved the amendment of various provisions of the term loan and revolving credit facility agreement, effective April 1, 2002. This amendment revised certain restrictive debt covenants, modified certain defined terms, allowed for future capital investment in our CO2 processing facility in West Texas, facilitates the issuance of \$7.5 million of subordinated debt, increased the aggregate amount of operating lease expense allowed during a fiscal year and permitted an increase in borrowings under the export sales credit facility, without further consent, up to a maximum of \$20.0 million. These modifications will result in higher commitment fee percentages and interest rates if the Funded Debt to EBITDA ratio, as defined, exceeds 3 to 1.

Amounts borrowed under the term loan facility bear interest at 4.26% per annum as of September 30, 2002. Amounts borrowed under the revolving facilities bear interest at a rate based upon the ratio of funded debt to EBITDA (as defined in the credit facility) and ranging from, at our election, (1) a high of LIBOR plus 3.00% to a low of LIBOR plus 1.75% or, (2) a high of a base rate plus 1.50% to a low of a base rate plus 0.25%.

As of September 30, 2002, the weighted average interest rate of our borrowings under the revolving credit facilities was 4.75%.

We will pay commitment fees of 0.30% to 0.625% per year, depending upon the ratio of funded debt to EBITDA, on the undrawn portion of the facility.

The revolving credit facility is guaranteed by all of our domestic subsidiaries and is secured by a first priority lien on substantially all inventory, accounts receivable and other material tangible and intangible assets. We have also pledged 65% of the voting stock of our active foreign subsidiaries.

On March 19, 2001, we borrowed the entire \$50.0 million available under the term loan portion of the facility and used \$45.0 million to purchase all the outstanding share capital of Axsia. The remaining borrowings of \$5.0 million, along with additional borrowings under the revolving credit facility, were used to repay \$16.5 outstanding under a predecessor revolving credit and term loan facility. As of September 30, 2002, we had borrowings of \$39.5 million outstanding under the term loan facility.

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As of September 30, 2002, we were in compliance with all restrictive debt covenants. We had letters of credit outstanding under the revolving credit facilities totaling \$16.6 million at September 30, 2002. These letters of credit constitute contract performance and warranty collateral and expire at various dates through September 2005.

We maintain a working capital facility for export sales that provides for aggregate borrowings of \$10.0 million, subject to borrowing base limitations, under which borrowings of \$5.7 million were outstanding as of September 30, 2002. Letters of credit outstanding under this facility at September 30, 2002 totaled \$548,000. The export sales credit facility is secured by specific project inventory and receivables, and is partially guaranteed by the EXIM Bank. The export sales credit facility loans mature in July 2004.

We had unsecured letters of credit, guarantees and bonds outstanding at

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September 30, 2002 of \$180,000.

Our sales backlog at September 30, 2002 was \$108.3 million compared to \$95.7 million at September 30, 2001. Backlog increased primarily due to new project bookings for engineered systems in late 2001 and throughout 2002, which offset a decline in bookings for traditional equipment and electrical equipment and instrumentation products.

At September 30, 2002, borrowing base limitations and outstanding letters of credit reduced our available borrowing capacity under the term loan and revolving credit agreement and export sales credit agreement to \$25.3 million and \$440,000, respectively. We are actively considering a capital investment at our CO2 processing plant in West Texas that would require additional cash outlays beginning in late 2002. We are currently reviewing financing alternatives and may consider, for instance, asset-backed debt related to the Sacroc gas processing operation and various forms of subordinated debt, some of which might include stock purchase warrants. Each of these alternatives will require the approval of our senior secured lenders. Additionally, there is no assurance we will remain in compliance with existing restrictive loan covenants and, therefore, may be required to request amendments or waivers of some or all of these covenants in the future. We believe these amendments or waivers can be obtained, if necessary, on reasonable terms. Although no assurances can be given, we believe that our operating cash flow, supported by our borrowing capacity and additional financing obtained for capital investment, will be adequate to fund operations for at least the next twelve months. Should we decide to pursue acquisition opportunities, the determination of our ability to finance these acquisitions will be a critical element of the analysis of the opportunities.

### RELATED PARTY TRANSACTIONS

As previously agreed during 2001, we loaned an employee who is an executive officer and director of the Company \$216,000 on April 15, 2002, under a full-recourse note arrangement which accrues interest at 6% per annum and matures on July 31, 2003. The funds were used to pay tax burdens associated with stock options exercised during 2001. Effective July 1, 2002, the note was amended to extend the maturity date to July 31, 2004, and to require interest to be calculated at an annual rate based on LIBOR plus 300 basis points, adjusted quarterly, applied to the note balance as of June 30, 2002, including previously accrued interest.

As of June 30, 2002, we had several outstanding notes receivable from an employee who is an executive officer and director of the Company, with principal and accrued interest totaling \$3.4 million. The maturity of these loans, which are full-recourse note arrangements, was July 31, 2003, and interest accrued at rates ranging from 6% to 7.8% per annum. Effective July 1, 2002, the notes were amended to extend the maturity dates to July 31, 2004, and to require interest to be calculated at an annual rate based on LIBOR plus 300 basis points, adjusted quarterly, applied to the notes balances as of June 30, 2002, including previously accrued interest.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

#### QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our operations are conducted around the world in a number of different countries. Accordingly, future earnings are exposed to changes in foreign

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currency exchange rates. The majority of our foreign currency transactions relate to operations in Canada and the U.K. In Canada, most contracts are denominated in Canadian dollars, and most of the costs incurred are in Canadian dollars, thereby mitigating risks associated with currency fluctuations. In the U.K., many of our sales contracts and material purchases are denominated in a currency other than British pounds sterling, primarily U.S. dollars and euros, whereas our engineering and overhead costs are principally denominated in British pounds sterling. Consequently, we have currency risk in our U.K. operations. No forward contracts or other derivative arrangements existed at September 30, 2002, and we do not currently intend to enter into forward contracts or other derivative arrangements as part of our currency risk management strategy.

Our financial instruments are subject to change in interest rates, including our revolving credit and term loan facility and our working capital facility for export sales. At September 30, 2002, we had borrowings of \$39.5 million outstanding under the term loan portion of the revolving credit and term loan facility, at an interest rate of 4.26%. Borrowings, which bear interest at floating rates, outstanding under the revolving credit agreement at September 30, 2002, totaled \$14.8 million. As of September 30, 2002, the weighted average interest rate of our borrowings under revolving credit facilities was 4.75%. Borrowings under the working capital facility for export sales at September 30, 2002 totaled \$5.7 million and accrued interest at 4.75%. Borrowings under the long-term arrangement secured by our Magnolia manufacturing facility totaled \$1.4 million at September 30, 2002, and accrued interest at 5.00%.

Based on past market movements and possible near-term market movements, we do not believe that potential near-term losses in future earnings, fair values or cash flows from changes in interest rates are likely to be material. Assuming our current level of borrowings, a 100 basis point increase in interest rates under our variable interest rate facilities would increase our current quarter net loss and cash flow from operations by approximately \$100,000. In the event of an adverse change in interest rates, we could take action to mitigate our exposure. However, due to the uncertainty of actions that could be taken and the possible effects, this calculation assumes no such actions. Furthermore, this calculation does not consider the effects of a possible change in the level of overall economic activity that could exist in such an environment.

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### ITEM 4. CONTROLS AND PROCEDURES

#### CONTROLS AND PROCEDURES

Members of our management team, including our chief executive officer and chief financial officer, have reviewed our disclosure controls and procedures, as defined by the Securities and Exchange Commission in Rule 13a-14(c) of the Securities Exchange Act of 1934, within 90 days of this Quarterly Report on Form 10-Q, in an effort to evaluate the effectiveness of the design and operation of these controls. Based upon this review, our management has determined that disclosure controls and procedures operate such that important information is collected in a timely manner, provided to management and made known to our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding disclosure in our public filings.

In addition, no significant changes have been made to our internal controls and procedures subsequent to September 30, 2002, and no corrective actions are anticipated as we noted no significant deficiencies or material weaknesses in our control structure.

PART II

ITEM 1. LEGAL PROCEEDINGS

We are a party to various routine legal proceedings that are incidental to our business activities. We insure against the risk of these proceedings to the extent deemed prudent, but we offer no assurance that the type or value of this insurance will meet the liabilities that may arise from any pending or future legal proceedings related to our business activities. We do not, however, believe the pending legal proceedings, individually or taken together, will have a material adverse effect on our results of operations or financial condition.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

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

None.

ITEM 5. OTHER INFORMATION

The certifications by our chief executive officer and chief financial officer required by Section 906 of the Sarbanes-Oxley Act of 2002 have been provided to the Securities and Exchange Commission accompanying this Quarterly Report on Form 10-Q.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

- (a) See Index of Exhibits for a list of those exhibits filed herewith, which index includes and identifies management contracts or compensatory plans or arrangements required to be filed as exhibits to this Form 10-Q by Item 601(10)(iii) of Regulation S-K.
- (b) Reports on Form 8-K. We filed no reports on Form 8-K during the three months ended September 30, 2002.
- (c) Index of Exhibits

EXHIBIT NO. -----	DESCRIPTION -----
2.1	-- Amended and Restated Agreement and Plan of Merger dated November 17, 1998 but effective March 26, 1998 among the Company, NATCO Acquisition Company, National Tank Company and The Cynara Company (incorporated by reference to Exhibit 2.1 of the Company's Registration Statement No. 333-48851 on Form S-1).

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- 3.1 -- Restated Certificate of Incorporation of the Company, as amended by Certificate of Amendment dated November 18, 1998 and Certificate of Amendment dated November 29, 1999 (incorporated by reference to Exhibit 3.1 of the Company's Registration Statement No. 333-48851 on Form S-1).
- 3.2 -- Certificate of Designations of Series A Junior Participating Preferred Stock (incorporated by reference to Exhibit 3.2 of the Company's Registration Statement No. 333-48851 on Form S-1).
- 3.3 -- Amended and Restated Bylaws of the Company, as amended (incorporated by reference to Exhibit 3.3 of the Company's Quarterly Report on Form 10-Q for the period ended March 31, 2000).
- 4.1 -- Specimen Common Stock certificate (incorporated by reference to Exhibit 4.1 of the Company's Registration Statement No. 333-48851 on Form S-1).

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EXHIBIT NO.	DESCRIPTION
4.2	-- Rights Agreement dated as of May 15, 1998 by and among the Company and ChaseMellon Shareholder Services, L.L.C., as Rights Agent (incorporated by reference to Exhibit 4.2 of the Company's Registration Statement No. 333-48851 on Form S-1).
4.3	-- Registration Rights Agreement dated as of November 18, 1998 among the Company and Capricorn Investors, L.P. and Capricorn Investors II, L.P. (incorporated by reference to Exhibit 4.3 of the Company's Registration Statement No. 333-48851 on Form S-1).
10.1**	-- Directors Compensation Plan (incorporated by reference to Exhibit 10.1 of the Company's Registration Statement No. 333-48851 on Form S-1).
10.2**	-- Form of Nonemployee Director's Option Agreement (incorporated by reference to Exhibit 10.2 of the Company's Registration Statement No. 333-48851 on Form S-1).
10.3**	-- Employee Stock Incentive Plan (incorporated by reference to Exhibit 10.3 of the Company's Registration Statement No. 333-48851 on Form S-1).
10.4**	-- Form of Nonstatutory Stock Option Agreement (incorporated by reference to Exhibit 10.24 to the Company's Registration Statement No. 333-48851 on Form S-1).
10.6	-- Service and Reimbursement Agreement dated as of July 1,

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- 1997 between the Company and Capricorn Management, G.P. (incorporated by reference to Exhibit 10.6 of the Company's Registration Statement No. 333-48851 on Form S-1).
- 10.7\*\* -- Form of Indemnification Agreement between the Company and its officers and directors (incorporated by reference to Exhibit 10.0 of the Company's Registration Statement No. 333-48851 on Form S-1).
- 10.9 -- Stockholders' Agreement by and among the Company, Capricorn Investors, L.P. and Capricorn Investors II, L.P. (incorporated by reference to Exhibit 10.11 of the Company's Registration Statement No. 333-48851 on Form S-1).
- 10.10\*\* -- Employment Agreement dated as of July 31, 1997 between the Company and Nathaniel A. Gregory, as amended as of July 12, 1999 (incorporated by reference to Exhibit 10.12 of the Company's Registration Statement No. 333-48851 on Form S-1).
- 10.12\*\* -- Change of Control Policy dated as of September 28, 1999 (incorporated by reference to Exhibit 10.20 of the Company's Registration Statement No. 333-48851 on Form S-1).
- 10.13\*\* -- Severance Pay Summary Plan Description (incorporated by reference to Exhibit 10.21 of the Company's Registration Statement No. 333-48851 on Form S-1).
- 10.15 -- International Revolving Loan Agreement dated as of June 30, 1997 between National Tank Company and Texas Commerce Bank, National Association, as amended (incorporated by reference to Exhibit 10.23 to the Company's Registration Statement No. 333-48851 on Form S-1).

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EXHIBIT NO. -----	DESCRIPTION -----
10.16	-- Loan Agreement (\$35,000,000 U.S. Revolving Loan Facility, \$10,000,000 Canadian Revolving Loan Facility, \$5,000,000 U.K. Revolving Loan Facility and \$50,000,000 Term Loan Facility) dated as of March 16, 2001 among NATCO Group Inc., NATCO Canada, Ltd., Axsia Group Limited, The Chase Manhattan Bank, Royal Bank of Canada, Chase Manhattan International Limited, Bank One, N.A. (Main Office Chicago, Illinois), Wells Fargo Bank Texas, National Association, JP Morgan, a Division of Chase Securities, Inc., and the other lenders now or hereafter Parties hereto (incorporated by reference to Exhibit 10.16 of the Company's Annual Report on Form 10-K for the period ended December 31, 2000).
10.17	-- First Amendment to Loan Agreement (\$35,000,000 U.S. Revolving Loan Facility, \$10,000,000 Canadian Revolving Loan Facility, \$5,000,000 U.K. Revolving Loan Facility and \$50,000,000 Term Loan Facility) dated as of March 16, 2001 among NATCO Group Inc., NATCO Canada, Ltd., Axsia Group

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Limited, The Chase Manhattan Bank, Royal Bank of Canada, Chase Manhattan International Limited, Bank One, N.A. (Main Office Chicago, Illinois), Wells Fargo Bank Texas, National Association, JP Morgan, a Division of Chase Securities, Inc., and the other lenders now or hereafter Parties hereto (incorporated by reference to Exhibit 10.17 of the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2002).

- 10.18 -- Second Amendment to Loan Agreement (\$35,000,000 U.S. Revolving Loan Facility, \$10,000,000 Canadian Revolving Loan Facility, \$5,000,000 U.K. Revolving Loan Facility and \$50,000,000 Term Loan Facility) dated as of March 16, 2001 among NATCO Group Inc., NATCO Canada, Ltd., Axsia Group Limited, The Chase Manhattan Bank, Royal Bank of Canada, Chase Manhattan International Limited, Bank One, N.A. (Main Office Chicago, Illinois), Wells Fargo Bank Texas, National Association, JP Morgan, a Division of Chase Securities, Inc., and the other lenders now or hereafter Parties hereto (incorporated by reference to Exhibit 10.18 of the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2002).
- 10.19 -- Second Amended Single Installment Note Between Nathaniel A. Gregory and NATCO Group Inc., effective July 1, 2002 (incorporated by reference to Exhibit 10.19 of the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2002).
- 10.20 -- Amended Single Installment Note Between Nathaniel Gregory and NATCO Group Inc., effective July 1, 2002 (incorporated by reference to Exhibit 10.20 of the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2002).
- 10.21 -- Amended Single Installment Note Between Nathaniel Gregory and NATCO Group Inc., effective July 1, 2002 (incorporated by reference to Exhibit 10.21 of the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2002).
- 10.22 -- Amended Single Installment Note Between Nathaniel Gregory and NATCO Group Inc., effective July 1, 2002 (incorporated by reference to Exhibit 10.22 of the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2002).
- 10.23 -- Amended Single Installment Note Between Patrick M. McCarthy and NATCO Group Inc., effective July 1, 2002 (incorporated by reference to Exhibit 10.23 of the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2002).

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\*\* Management contracts or compensatory plans or arrangements.

### SIGNATURES

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



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NATCO Group Inc.  
(Registrant)

By: /s/ J. MICHAEL MAYER

-----  
Name: J. Michael Mayer  
Senior Vice President and  
Chief Financial Officer

Date: November 13, 2002

By: /s/ RYAN S. LILES

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Name: Ryan S. Liles  
Vice President and Controller  
(Principal Accounting Officer)

Date: November 13, 2002

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### CERTIFICATIONS

I, Nathaniel A. Gregory, certify that:

1. I have reviewed this quarterly report on Form 10-Q of NATCO Group Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c. presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the

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audit committee of registrant's board of directors (or persons performing the equivalent function):

- a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 13, 2002  
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/s/ NATHANIEL A. GREGORY  
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Nathaniel A. Gregory  
Chief Executive Officer

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### CERTIFICATIONS

I, J. Michael Mayer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of NATCO Group Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this

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quarterly report is being prepared;

- b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c. presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
- a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 13, 2002

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/s/ J. MICHAEL MAYER

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J. Michael Mayer  
Chief Financial Officer

EXHIBIT INDEX

EXHIBIT NO. -----	DESCRIPTION -----
2.1	-- Amended and Restated Agreement and Plan of Merger dated November 17, 1998 but effective March 26, 1998 among the Company, NATCO Acquisition Company, National Tank Company and The Cynara Company (incorporated by reference to Exhibit 2.1 of the Company's Registration Statement No. 333-48851 on Form S-1).
3.1	-- Restated Certificate of Incorporation of the Company, as

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amended by Certificate of Amendment dated November 18, 1998 and Certificate of Amendment dated November 29, 1999 (incorporated by reference to Exhibit 3.1 of the Company's Registration Statement No. 333-48851 on Form S-1).

- 3.2 -- Certificate of Designations of Series A Junior Participating Preferred Stock (incorporated by reference to Exhibit 3.2 of the Company's Registration Statement No. 333-48851 on Form S-1).
- 3.3 -- Amended and Restated Bylaws of the Company, as amended (incorporated by reference to Exhibit 3.3 of the Company's Quarterly Report on Form 10-Q for the period ended March 31, 2000).
- 4.1 -- Specimen Common Stock certificate (incorporated by reference to Exhibit 4.1 of the Company's Registration Statement No. 333-48851 on Form S-1).
- 4.2 -- Rights Agreement dated as of May 15, 1998 by and among the Company and ChaseMellon Shareholder Services, L.L.C., as Rights Agent (incorporated by reference to Exhibit 4.2 of the Company's Registration Statement No. 333-48851 on Form S-1).
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- 10.1\*\* -- Directors Compensation Plan (incorporated by reference to Exhibit 10.1 of the Company's Registration Statement No. 333-48851 on Form S-1).
- 10.2\*\* -- Form of Nonemployee Director's Option Agreement (incorporated by reference to Exhibit 10.2 of the Company's Registration Statement No. 333-48851 on Form S-1).
- 10.3\*\* -- Employee Stock Incentive Plan (incorporated by reference to Exhibit 10.3 of the Company's Registration Statement No. 333-48851 on Form S-1).
- 10.4\*\* -- Form of Nonstatutory Stock Option Agreement (incorporated by reference to Exhibit 10.24 to the Company's Registration Statement No. 333-48851 on Form S-1).
- 10.6 -- Service and Reimbursement Agreement dated as of July 1, 1997 between the Company and Capricorn Management, G.P. (incorporated by reference to Exhibit 10.6 of the Company's Registration Statement No. 333-48851 on Form S-1).
- 10.7\*\* -- Form of Indemnification Agreement between the Company and its officers and directors (incorporated by reference to Exhibit 10.0 of the Company's Registration Statement No. 333-48851 on Form S-1).
- 10.9 -- Stockholders' Agreement by and among the Company, Capricorn Investors, L.P. and Capricorn Investors II, L.P. (incorporated by reference to Exhibit 10.11 of the

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Company's Registration Statement No. 333-48851 on Form S-1).

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EXHIBIT NO. -----	DESCRIPTION -----
10.10**	-- Employment Agreement dated as of July 31, 1997 between the Company and Nathaniel A. Gregory, as amended as of July 12, 1999 (incorporated by reference to Exhibit 10.12 of the Company's Registration Statement No. 333-48851 on Form S-1).
10.12**	-- Change of Control Policy dated as of September 28, 1999 (incorporated by reference to Exhibit 10.20 of the Company's Registration Statement No. 333-48851 on Form S-1).
10.13**	-- Severance Pay Summary Plan Description (incorporated by reference to Exhibit 10.21 of the Company's Registration Statement No. 333-48851 on Form S-1).
10.15	-- International Revolving Loan Agreement dated as of June 30, 1997 between National Tank Company and Texas Commerce Bank, National Association, as amended (incorporated by reference to Exhibit 10.23 to the Company's Registration Statement No. 333-48851 on Form S-1).
10.16	-- Loan Agreement (\$35,000,000 U.S. Revolving Loan Facility, \$10,000,000 Canadian Revolving Loan Facility, \$5,000,000 U.K. Revolving Loan Facility and \$50,000,000 Term Loan Facility) dated as of March 16, 2001 among NATCO Group Inc., NATCO Canada, Ltd., Axsia Group Limited, The Chase Manhattan Bank, Royal Bank of Canada, Chase Manhattan International Limited, Bank One, N.A. (Main Office Chicago, Illinois), Wells Fargo Bank Texas, National Association, JP Morgan, a Division of Chase Securities, Inc., and the other lenders now or hereafter Parties hereto (incorporated by reference to Exhibit 10.16 of the Company's Annual Report on Form 10-K for the period ended December 31, 2000).
10.17	-- First Amendment to Loan Agreement (\$35,000,000 U.S. Revolving Loan Facility, \$10,000,000 Canadian Revolving Loan Facility, \$5,000,000 U.K. Revolving Loan Facility and \$50,000,000 Term Loan Facility) dated as of March 16, 2001 among NATCO Group Inc., NATCO Canada, Ltd., Axsia Group Limited, The Chase Manhattan Bank, Royal Bank of Canada, Chase Manhattan International Limited, Bank One, N.A. (Main Office Chicago, Illinois), Wells Fargo Bank Texas, National Association, JP Morgan, a Division of Chase Securities, Inc., and the other lenders now or hereafter Parties hereto (incorporated by reference to Exhibit 10.17 of the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2002).
10.18	-- Second Amendment to Loan Agreement (\$35,000,000 U.S. Revolving Loan Facility, \$10,000,000 Canadian Revolving Loan Facility, \$5,000,000 U.K. Revolving Loan Facility and \$50,000,000 Term Loan Facility) dated as of March 16, 2001 among NATCO Group Inc., NATCO Canada, Ltd., Axsia Group

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Limited, The Chase Manhattan Bank, Royal Bank of Canada, Chase Manhattan International Limited, Bank One, N.A. (Main Office Chicago, Illinois), Wells Fargo Bank Texas, National Association, JP Morgan, a Division of Chase Securities, Inc., and the other lenders now or hereafter Parties hereto (incorporated by reference to Exhibit 10.18 of the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2002).

- 10.19 -- Second Amended Single Installment Note Between Nathaniel A. Gregory and NATCO Group Inc., effective July 1, 2002 (incorporated by reference to Exhibit 10.19 of the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2002).
- 10.20 -- Amended Single Installment Note Between Nathaniel Gregory and NATCO Group Inc., effective July 1, 2002 (incorporated by reference to Exhibit 10.20 of the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2002).
- 10.21 -- Amended Single Installment Note Between Nathaniel Gregory and NATCO Group Inc., effective July 1, 2002 (incorporated by reference to Exhibit 10.21 of the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2002).
- 10.22 -- Amended Single Installment Note Between Nathaniel Gregory and NATCO Group Inc., effective July 1, 2002 (incorporated by reference to Exhibit 10.22 of the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2002).
- 10.23 -- Amended Single Installment Note Between Patrick M. McCarthy and NATCO Group Inc., effective July 1, 2002 (incorporated by reference to Exhibit 10.23 of the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2002).

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\*\* Management contracts or compensatory plans or arrangements.