FLOWSERVE CORP
Form 10-Q
October 27, 2011

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

FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2011**

OR

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

Commission File No. 1-13179

FLOWSERVE CORPORATION

(Exact name of registrant as specified in its charter)

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

(972) 443-6500

(Registrant s telephone number, including area code)

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

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

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

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

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

As of October 21, 2011, there were 55,557,695 shares of the issuer s common stock outstanding.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

FLOWSERVE CORPORATION
(Unaudited)

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Amounts in thousands, except per share data)	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010
Sales	$ 1,121,813	$ 971,681
Cost of sales	(745,227)	(638,183)
Gross profit	376,586	333,498
Selling, general and administrative expense	(225,996)	(207,741)
Net earnings from affiliates	4,367	3,439
Operating income	154,957	129,196
Interest expense	(8,544)	(8,266)
Interest income	216	430
Other (expense) income, net	(6,621)	18,578
Earnings before income taxes	140,008	139,938
Provision for income taxes	(32,052)	(35,713)
Net earnings, including noncontrolling interests	107,956	104,225
Less: Net earnings attributable to noncontrolling interests	(185)	(306)
Net earnings attributable to Flowserve Corporation	$ 107,771	$ 103,919
Net earnings per share attributable to Flowserve Corporation common shareholders:		
Basic	$ 1.94	$ 1.86
Diluted	1.92	1.84
Cash dividends declared per share	$ 0.32	$ 0.29

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Amounts in thousands)	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010
Net earnings, including noncontrolling interests	$ 107,956	$ 104,225
Other comprehensive (expense) income:		
Foreign currency translation adjustments, net of tax	(107,740)	96,435
Pension and other postretirement effects, net of tax	2,797	(906)
Cash flow hedging activity, net of tax	(516)	342
Other comprehensive (expense) income	(105,459)	95,871

Comprehensive income, including noncontrolling interests		2,497		200,096
Comprehensive loss (income) attributable to noncontrolling interests		110		(495)
Comprehensive income attributable to Flowserve Corporation	$	2,607	$	199,601

See accompanying notes to condensed consolidated financial statements.

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FLOWSERVE CORPORATION
(Unaudited)

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Amounts in thousands, except per share data)	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Sales	$ 3,244,772	$ 2,891,683
Cost of sales	(2,151,153)	(1,866,510)
Gross profit	1,093,619	1,025,173
Selling, general and administrative expense	(681,618)	(620,311)
Net earnings from affiliates	13,314	12,537
Operating income	425,315	417,399
Interest expense	(26,684)	(25,942)
Interest income	1,100	1,170
Other income (expense), net	7,852	(15,259)
Earnings before income taxes	407,583	377,368
Provision for income taxes	(103,908)	(101,133)
Net earnings, including noncontrolling interests	303,675	276,235
Less: Net earnings attributable to noncontrolling interests	(191)	(448)
Net earnings attributable to Flowserve Corporation	$ 303,484	$ 275,787
Net earnings per share attributable to Flowserve Corporation common shareholders:		
Basic	$ 5.45	$ 4.94
Diluted	5.40	4.89
Cash dividends declared per share	$ 0.96	$ 0.87

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Amounts in thousands)	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Net earnings, including noncontrolling interests	$ 303,675	$ 276,235
Other comprehensive (expense) income:		
Foreign currency translation adjustments, net of tax	(31,625)	(1,922)
Pension and other postretirement effects, net of tax	3,256	3,255
Cash flow hedging activity, net of tax	(945)	2,126
Other comprehensive (expense) income	(29,314)	3,459
Comprehensive income, including noncontrolling interests	274,361	279,694

Comprehensive income attributable to noncontrolling interests	(322)	(600)
Comprehensive income attributable to Flowserve Corporation	$ 274,039	$ 279,094

See accompanying notes to condensed consolidated financial statements.

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FLOWSERVE CORPORATION
(Unaudited)
CONDENSED CONSOLIDATED BALANCE SHEETS

(Amounts in thousands, except per share data)	September 30, 2011	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 227,885	$ 557,579
Accounts receivable, net of allowance for doubtful accounts of $21,146 and $18,632, respectively	1,022,897	839,566
Inventories, net	1,076,704	886,731
Deferred taxes	128,909	131,996
Prepaid expenses and other	121,071	107,872
Total current assets	2,577,466	2,523,744
Property, plant and equipment, net of accumulated depreciation of $719,720 and $682,715, respectively	564,759	581,245
Goodwill	1,013,526	1,012,530
Deferred taxes	21,383	24,343
Other intangible assets, net	139,811	147,112
Other assets, net	163,560	170,936
Total assets	$ 4,480,505	$ 4,459,910
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$ 459,900	$ 571,021
Accrued liabilities	769,620	817,837
Debt due within one year	50,033	51,481
Deferred taxes	18,513	16,036
Total current liabilities	1,298,066	1,456,375
Long-term debt due after one year	457,855	476,230
Retirement obligations and other liabilities	417,715	414,272
Shareholders equity:		
Common shares, $1.25 par value	73,664	73,664
Shares authorized 120,000		
Shares issued 58,931 and 58,931, respectively		
Capital in excess of par value	612,744	613,861
Retained earnings	2,098,054	1,848,680
	2,784,462	2,536,205
Treasury shares, at cost 3,927 and 3,872 shares, respectively	(315,389)	(292,210)
Deferred compensation obligation	9,582	9,533
Accumulated other comprehensive loss	(179,951)	(150,506)

Total Flowserve Corporation Shareholders Equity	2,298,704	2,103,022
Noncontrolling interest	8,165	10,011
Total equity	2,306,869	2,113,033
Total liabilities and equity	$ 4,480,505	$ 4,459,910

See accompanying notes to condensed consolidated financial statements.

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FLOWSERVE CORPORATION
(Unaudited)
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in thousands)	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Cash flows Operating activities:		
Net earnings, including noncontrolling interests	$ 303,675	$ 276,235
Adjustments to reconcile net earnings to net cash used by operating activities:		
Depreciation	67,166	64,727
Amortization of intangible and other assets	10,206	7,192
Amortization of deferred loan costs	2,179	2,699
Net gain on disposition of assets	(484)	(97)
Gain on sale of investment	-	(2,618)
Excess tax benefits from stock-based compensation arrangements	(5,201)	(9,971)
Stock-based compensation	23,655	24,295
Net earnings from affiliates, net of dividends received	472	(5,869)
Change in assets and liabilities:		
Accounts receivable, net	(201,636)	(47,883)
Inventories, net	(206,079)	(112,528)
Prepaid expenses and other	(21,606)	(17,034)
Other assets, net	(2,019)	5,812
Accounts payable	(101,671)	(61,960)
Accrued liabilities and income taxes payable	(43,648)	(138,420)
Retirement obligations and other liabilities	13,635	(31,632)
Net deferred taxes	11,271	30,433
Net cash flows used by operating activities	(150,085)	(16,619)
Cash flows Investing activities:		
Capital expenditures	(71,164)	(46,429)
Proceeds from disposal of assets	3,530	6,748
Payments for acquisitions, net of cash acquired	(890)	(199,396)
Affiliate investing activity, net	-	4,326
Net cash flows used by investing activities	(68,524)	(234,751)
Cash flows Financing activities:		
Excess tax benefits from stock-based compensation arrangements	5,201	9,971
Payments on long-term debt	(18,750)	(4,261)
Net (payments) borrowings under other financing arrangements	(1,747)	438
Repurchase of common shares	(41,088)	(34,074)
Payments of dividends	(51,794)	(47,419)
Proceeds from stock option activity	310	5,576
Dividends paid to noncontrolling interests	(2,168)	(259)

Sale of shares to noncontrolling interests	-	1,654
Net cash flows used by financing activities	(110,036)	(68,374)
Effect of exchange rate changes on cash	(1,049)	(23,963)
Net change in cash and cash equivalents	(329,694)	(343,707)
Cash and cash equivalents at beginning of period	557,579	654,320
Cash and cash equivalents at end of period	$ 227,885	$ 310,613

See accompanying notes to condensed consolidated financial statements.

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FLOWSERVE CORPORATION
(Unaudited)

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation and Accounting Policies

Basis of Presentation

The accompanying condensed consolidated balance sheet as of September 30, 2011, the related condensed consolidated statements of income and comprehensive income for the three and nine months ended September 30, 2011 and 2010, and the condensed consolidated statements of cash flows for the nine months ended September 30, 2011 and 2010, of Flowserve Corporation, are unaudited. In management s opinion, all adjustments comprising normal recurring adjustments necessary for a fair presentation of such condensed consolidated financial statements have been made.

The accompanying condensed consolidated financial statements and notes in this Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2011 (Quarterly Report) are presented as permitted by Regulation S-X and do not contain certain information included in our annual financial statements and notes thereto. Accordingly, the accompanying condensed consolidated financial information should be read in conjunction with the consolidated financial statements presented in our Annual Report on Form 10-K for the year ended December 31, 2010 (2010 Annual Report).

Ongoing Events in North Africa, Middle East and Japan Ongoing political and economic conditions in North Africa have caused us to experience shipment delays to this region. We estimate that the shipments to this region that have been delayed resulted in lost or delayed opportunities for operating income of $3.9 million and $9.0 million for the three months and nine months ended September 30, 2011, respectively. We are closely monitoring the conditions in the Middle East and North Africa, and, while there are many potential outcomes in each individual country that are difficult to estimate, based on current facts and circumstances as we understand them, it is possible that delayed shipments and bookings could continue throughout the remainder of the year. If the current conditions in North Africa persist, we estimate that the unfavorable impact on bookings for 2011 could approximate $25 million. The preponderance of our physical assets in the region are located in the Kingdom of Saudi Arabia and the United Arab Emirates and have, to date, not been significantly affected by the unrest elsewhere in the region.

We continue to assess the conditions and potential adverse impacts of the earthquake and tsunami in Japan earlier in the year, in particular as they relate to our customers and suppliers in the impacted regions, as well as announced and potential regulatory impacts to the global nuclear power market. During the nine months ended September 30, 2011, we did not experience any significant adverse impacts due to shipment delays, collection issues or supply chain disruptions. We are also closely monitoring the effects of the Japan crisis on the global nuclear power industry. While it is difficult to estimate the effect of the Fukushima plant shutdown on the global nuclear power market, we have continued to ship nuclear orders in our backlog without significant disruption. We believe that there has been a related reduction in nuclear orders that could continue in the near term, though other parts of our overall power generation business could benefit as nuclear priorities are revaluated.

Venezuela As previously disclosed in our 2009 and 2010 Annual Reports, effective January 11, 2010, the Venezuelan government devalued its currency (Bolivar) and moved to a two-tier exchange structure. The official exchange rate moved from 2.15 to 4.30 Bolivars to the United States (U.S.) dollar for non-essential items and to 2.60 Bolivars to the U.S. dollar for essential items. Additionally, effective January 1, 2010, Venezuela was designated as hyperinflationary, and as a result, we began to use the U.S. dollar as our functional currency in Venezuela. On December 30, 2010, the Venezuelan government announced its intention to eliminate the favorable essential items rate effective January 1, 2011. Our operations in Venezuela generally consist of a service center that both imports equipment and parts from certain of our other locations for resale to third parties within Venezuela and performs service and repair activities. Our Venezuelan subsidiary s sales for the nine months ended September 30, 2011 and 2010 and total assets at September 30, 2011 represented approximately 1% or less of our consolidated sales and total assets for the same periods.

Although approvals by Venezuela s Commission for the Administration of Foreign Exchange have slowed, we have historically been able to remit dividends and other payments at the official rate, and we currently anticipate doing so in the future. Accordingly, we used the official rate of 4.30 Bolivars to the U.S. dollar for re-measurement of our Venezuelan financial statements into U.S. dollars for all periods presented. As a result of the currency devaluation, we recognized a net loss of $8.4 million during the nine months ended September 30, 2010. The loss was reported in other income (expense), net in our condensed consolidated statement of income and resulted in no tax benefit. The elimination of the favorable essential items rate, effective January 1, 2011, had no impact on our consolidated financial position or results of operations for the three and nine months ended September 30, 2011.

We have evaluated the carrying value of related assets and concluded that there is no current impairment. We are continuing to assess and monitor the ongoing impact of the currency devaluation on our Venezuelan operations and imports into the market, including the Venezuelan subsidiary s ability to remit cash for dividends and other payments at the official rate, as well as further actions of the Venezuelan government and economic conditions in Venezuela that may adversely impact our future consolidated financial condition or results of operations.

Accounting Policies

Effective January 1, 2011, we adopted Accounting Standards Update (ASU) No. 2009-13, Revenue Recognition (Accounting Standards Codification (ASC) 605): Multiple-Deliverable Revenue Arrangements a consensus of the Financial Accounting Standards Board (FASB) Emerging Issues Task Force, which resulted in expanded disclosure requirements regarding our revenue recognition policy (see Revenue Recognition below). Our adoption of ASU No. 2009-13, effective January 1, 2011, had no impact on our consolidated financial condition or results of operations.

Except for the incremental revenue recognition policy disclosure included below, no other changes have occurred to our significant accounting policies in the nine months ended September 30, 2011. Our significant accounting policies are detailed in Note 1 to our consolidated financial statements included in our 2010 Annual Report.

Revenue Recognition

Revenues for product sales are recognized when the risks and rewards of ownership are transferred to the customers, which is typically based on the contractual delivery terms agreed to with the customer and fulfillment of all but inconsequential or perfunctory actions. In addition, our policy requires persuasive evidence of an arrangement, a fixed or determinable sales price and reasonable assurance of collectability. We defer the recognition of revenue when advance payments are received from customers before performance obligations have been completed and/or services have been performed. Freight charges billed to customers are included in sales and the related shipping costs are included in cost of sales in our consolidated statements of income. Our contracts typically include cancellation provisions that require customers to reimburse us for costs incurred up to the date of cancellation, as well as any contractual cancellation penalties.

We enter into certain contracts with multiple deliverables that may include any combination of designing, developing, manufacturing, modifying, installing and commissioning of flow management equipment and providing services related to the performance of such products. Delivery of these products and services typically occurs within a one to two-year period, although many arrangements, such as book and ship type orders, have a shorter timeframe for delivery. We aggregate or separate deliverables into units of accounting based on whether the deliverable(s) have standalone value to the customer and when no general right of return exists. Contract value is allocated ratably to the units of accounting in the arrangement based on their relative selling prices determined as if the deliverables were sold separately.

Revenues for long-term contracts, including separate units of accounting from multiple-deliverable contracts, that exceed certain internal thresholds regarding the size, complexity and duration of the project and provide for the receipt of progress billings from the customer are recorded on the percentage of completion method with progress measured on a cost-to-cost basis. Percentage of completion revenue represented approximately 7% and 9% of our consolidated sales for the nine months ended September 30, 2011 and 2010, respectively.

Revenue on service and repair contracts is recognized after services have been agreed to by the customer and rendered. Revenues generated under fixed fee service and repair contracts are recognized on a ratable basis over the term of the contract. These contracts can range in duration, but generally extend for up to five years. Revenue on fixed fee service contracts represented approximately 1% of our consolidated sales for the three and nine months ended September 30, 2011 and 2010.

In certain instances, we provide guaranteed completion dates under the terms of our contracts. Failure to meet contractual delivery dates can result in late delivery penalties or non-recoverable costs. In instances where the payment of such costs are deemed to be probable, we perform a project profitability analysis, accounting for such costs as a reduction of realizable revenues, which could potentially cause estimated total project costs to exceed projected total revenues realized from the project. In such instances, we would record reserves to cover such excesses in the period they are determined. In circumstances where the total projected revenues still exceed total projected costs, the incurrence of unrealized incentive fees or non-recoverable costs generally reduces profitability of the project at the time of subsequent revenue recognition. Our reported results would change if different estimates were used for contract costs or if different estimates were used for contractual contingencies.

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Accounting Developments

Pronouncements Implemented

In January 2010, the FASB issued ASU No. 2010-06, Fair Value Measurements and Disclosures (ASC 820): Improving Disclosures about Fair Value Measurements, which requires additional disclosures on transfers in and out of Level I and Level II and on activity for Level III fair value measurements. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures of Level III activity, which are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. Our adoption of ASU No. 2010-06 had no material impact on our consolidated financial condition or results of operations.

In September 2009, the FASB issued ASU No. 2009-13, Revenue Recognition (ASC 605): Multiple-Deliverable Revenue Arrangements a consensus of the FASB Emerging Issues Task Force, which addresses the accounting for multiple-deliverable arrangements to enable vendors to account for products or services separately rather than as a combined unit and requires expanded revenue recognition policy disclosures. This amendment addresses how to separate deliverables and how to measure and allocate arrangement consideration to one or more units of accounting. As noted above, our adoption of ASU No. 2009-13, effective January 1, 2011, had no impact on our consolidated financial condition or results of operations.

In December 2010, the FASB issued ASU No. 2010-28, Intangibles Goodwill and Other (ASC 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts a consensus of the FASB Emerging Issues Task Force, which modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. This amendment requires an entity to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists and to consider whether there are any adverse qualitative factors indicating that an impairment may exist. Our adoption of ASU No. 2010-28, effective January 1, 2011, had no impact on our consolidated financial condition or results of operations.

In December 2010, the FASB issued ASU No. 2010-29, Business Combinations (ASC 805): Disclosure of Supplementary Pro Forma Information for Business Combinations a consensus of the FASB Emerging Issues Task Force, which specifies that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. This amendment also expands the supplemental pro forma disclosures under ASC 805 to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. Our adoption of ASU No. 2010-29, effective January 1, 2011, had no material impact on our consolidated financial condition or results of operations.

Pronouncements Not Yet Implemented

In June 2011, the FASB issued ASU No. 2011-05, Comprehensive Income (ASC 220): Presentation of Comprehensive Income, which specifies that an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This amendment requires an entity to present on the face of the financial statements reclassification adjustments for items that are reclassified from other comprehensive income to net income. ASU No. 2011-05 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The presentation and disclosure requirements shall be applied retrospectively for all periods presented. The adoption of ASU No. 2011-05 will not have an impact on our consolidated financial condition and results of operations.

In September 2011, the FASB issued ASU No. 2011-08, Intangibles Goodwill and Other (ASC 350): Testing Goodwill for Impairment, which specifies that an entity has the option to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. An entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. ASU No. 2011-08 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. We do not expect the adoption of ASU No. 2011-08 to have a material impact on our consolidated financial condition and results of operations.

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2. Acquisition

Valbart Srl

As discussed in Note 2 to our consolidated financial statements included in our 2010 Annual Report, effective July 16, 2010, we acquired for inclusion in Flow Control Division (FCD), Valbart Srl (Valbart), a privately-owned Italian valve manufacturer, for $199.4 million, which included $33.8 million of existing Valbart net debt (third party debt less cash on hand) that was repaid at closing. Valbart manufactures trunnion-mounted ball valves used primarily in upstream and midstream oil and gas applications, and its acquisition is to improve our ability to provide a more complete valve portfolio to oil and gas projects. Prior to acquisition, Valbart generated approximately 81 million ($104 million, at then-current exchange rates) in sales (unaudited) during its fiscal year ended May 31, 2010. No pro forma information was provided due to immateriality.

3. Stock-Based Compensation Plans

We established the Flowserve Corporation Equity and Incentive Compensation Plan (the 2010 Plan) effective January 1, 2010. This shareholder-approved plan authorizes the issuance of up to 2,900,000 shares of our common stock in the form of incentive stock options, non-statutory stock options, restricted shares, restricted share units and performance-based units (collectively referred to as Restricted Shares), stock appreciation rights and bonus stock. Of the 2,900,000 shares of common stock authorized under the 2010 Plan, 2,432,259 remain available for issuance as of September 30, 2011. In addition to the 2010 Plan, we also maintain the Flowserve Corporation 2004 Stock Compensation Plan (the 2004 Plan), which was established on April 21, 2004. The 2004 Plan authorized the issuance of up to 3,500,000 shares of common stock through grants of Restricted Shares, stock options and other equity-based awards. No stock options have been granted in recent years. Of the 3,500,000 shares of common stock authorized under the 2004 Plan, 482,265 remain available for issuance as of September 30, 2011.

We recorded stock-based compensation expense of $4.9 million ($7.4 million pre-tax) and $6.2 million ($9.2 million pre-tax) for the three months ended September 30, 2011 and 2010, respectively. We recorded stock-based compensation expense of $15.9 million ($23.7 million pre-tax) and $16.4 million ($24.3 million pre-tax) for the nine months ended September 30, 2011 and 2010, respectively.

Restricted Shares Awards of Restricted Shares are valued at the closing market price of our common stock on the date of grant. The unearned compensation is amortized to compensation expense over the vesting period of the restricted shares. We had unearned compensation of $33.1 million and $31.6 million at September 30, 2011 and December 31, 2010, respectively, which is expected to be recognized over a weighted-average period of approximately one year. These amounts will be recognized into net earnings in prospective periods as the awards vest. The total fair value of Restricted Shares vested during both the three months ended September 30, 2011 and 2010 was $0.2 million. The total fair value of Restricted Shares vested during the nine months ended September 30, 2011 and 2010 was $35.0 million and $31.8 million, respectively.

The following table summarizes information regarding Restricted Shares:

	Nine Months Ended September 30, 2011	
	Shares	**Weighted Average Grant-Date Fair Value**
Number of unvested shares:		
Outstanding - January 1, 2011	1,259,377	$ 77.05
Granted	216,644	130.51
Vested	(394,849)	88.73
Cancelled	(49,742)	84.52
Outstanding - September 30, 2011	1,031,430	$ 83.45

Unvested Restricted Shares outstanding as of September 30, 2011, includes 427,000 units with performance-based vesting provisions. Performance-based units are issuable in common stock and vest upon the achievement of pre-defined performance targets, primarily based on our average annual return on net assets over a three-year period as compared with the same measure for a defined peer group for the same period. Most units were granted in three annual grants since January 1, 2009 and have a vesting percentage between 0% and 200% depending on the achievement of the specific performance targets. Compensation expense is recognized ratably over a cliff vesting period of 36 months, based on the fair market value of our common stock on the date of grant, as adjusted for anticipated forfeitures. During the performance period, earned and unearned compensation expense is adjusted based on changes in the expected achievement of the performance targets. Vesting provisions range from 0 to 829,000 shares based on performance targets. As of September 30, 2011, we estimate vesting of approximately 734,000 shares based on expected achievement of performance targets.

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4. Derivative Instruments and Hedges

Our risk management and derivatives policy specifies the conditions under which we may enter into derivative contracts. See Notes 1 and 6 to our consolidated financial statements included in our 2010 Annual Report and Note 7 of this Quarterly Report for additional information on our purpose for entering into derivatives not designated as hedging instruments and our overall risk management strategies. We enter into forward exchange contracts to hedge our cash flow risks associated with transactions denominated in currencies other than the local currency of the operation engaging in the transaction. At September 30, 2011 and December 31, 2010, we had $506.6 million and $358.5 million, respectively, of notional amount in outstanding forward exchange contracts with third parties. At September 30, 2011, the length of forward exchange contracts currently in place ranged from 7 days to 22 months. Also as part of our risk management program, we enter into interest rate swap agreements to hedge exposure to floating interest rates on certain portions of our debt. At September 30, 2011 and December 31, 2010, we had $335.0 million and $350.0 million, respectively, of notional amount in outstanding interest rate swaps with third parties. All interest rate swaps are highly effective. At September 30, 2011, the maximum remaining length of any interest rate swap contract in place was approximately 33 months.

We are exposed to risk from credit-related losses resulting from nonperformance by counterparties to our financial instruments. We perform credit evaluations of our counterparties under forward exchange contracts and interest rate swap agreements and expect all counterparties to meet their obligations. If material, we would adjust the values of our derivative contracts for our or our counterparties   credit risks. We have not experienced credit losses from our counterparties.

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

(Amounts in thousands)	**September 30, 2011**	**December 31, 2010**
Current derivative assets	$ 5,181	$ 4,397
Noncurrent derivative assets	-	50
Current derivative liabilities	8,657	2,949
Noncurrent derivative liabilities	1,130	473

The fair value of interest rate swaps in cash flow hedging relationships are summarized below:

(Amounts in thousands)	**September 30, 2011**	**December 31, 2010**