New accounting pronouncements In January 2003, the Financial Accounting Standards Board (FASB) issued Interpretation (FIN) No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51," which was revised in December 2003. FIN No. 46R requires that the assets, liabilities and results of the activity of variable interest entities be consolidated into the financial statements of the entity that has the controlling financial interest. FIN No. 46R also provides the framework for determining whether a variable interest entity should be consolidated. For the Company, this Interpretation, as revised, was effective January 1, 2004. The Company has no variable interest entities required to be consolidated as a result of adopting FIN No. 46R.

In December 2003, the Medicare Prescription Drug Improvement and Modernization Act of 2003 (Medicare Act) introduced a prescription drug benefit under Medicare, as well as a federal subsidy to sponsors of retiree health care benefit plans. In January 2004, the FASB issued FASB Staff Position (FSP) No. 106-1, "Accounting Disclosure Requirements Related to the Medicare Prescription Drug, Improvement, and Modernization Act of 2003." FSP 106-1 permits a sponsor of a post retirement health care plan that provides a prescription drug benefit to make a one-time election to defer accounting for the effects of the Medicare Act if there is insufficient data, time or guidance available to ensure appropriate accounting. The Company is a sponsor of post retirement health care plans that provide prescription benefits and, in accordance with the one-time election under FSP 106-1, elected to defer accounting for the Medicare Act. In May 2004, the FASB issued FSP No. 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003," which supersedes FSP 106-1, to address the accounting and disclosure requirements related to the Medicare Act. The FSP was effective for the Company beginning with its third quarter ended September 30, 2004. The effect of the adoption was to reduce the Company's 2004 post retirement benefits expense by $6.8 million.

In November 2004, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 151, "Inventory Costs" which is an amendment of ARB No.43, Chapter 4. This statement provides clarification of accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material. Generally, this statement requires that those items be recognized as current period charges. SFAS 151 will be effective for the Company on January 1, 2006. The Company is currently evaluating the impact that the adoption of SFAS 151 will have on its consolidated financial position, results of operations and cash flows.

In December 2004, the FASB issued FSP 109-1, "Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004" (AJCA), and FAS 109-2 "Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the AJCA". These two FSPs provide guidance on the application of the new provisions of the AJCA, which was signed into law on October 22, 2004.

The AJCA provides a deduction for income from qualified domestic production activities, which will be phased in from 2005 through 2010. In return, the AJCA provides for a two-year phase-out of the existing extra-territorial income exclusion (ETI) for foreign sales that was viewed to be inconsistent with international trade protocols by the European Union. Under the guidance in FSP 109-1, the deduction will be treated as a "special deduction" as described in SFAS 109. As such, the special deduction has no effect on deferred tax assets and liabilities existing at the enactment date. Rather, the impact of this deduction will be reported in the period in which the deduction is claimed on our tax return. The Company expects the net effect of the phase out of the ETI and the phase in of this new deduction will not have a material impact on its effective tax rate.

FSP 109-2 provides guidance on the accounting for the deduction of 85% of certain foreign earnings that are repatriated, as defined in the AJCA. The Company may elect to apply this provision to qualifying earnings repatriations in 2005. Under guidance set forth in FAS 109-2, the Company is allowed time beyond the financial reporting period of enactment to evaluate the effect of the AJCA on its plan for reinvestment or repatriation of foreign. The Company has started an evaluation of the effects of the repatriation provision; however, the Company does not expect to be able to complete this evaluation until after the U.S. Congress or the Treasury Department provides additional clarifying language on key elements of the provision. The Company expects to complete its evaluation of the effects of the repatriation provision within a reasonable period of time following the publication of the additional clarifying language. The range of possible amounts that the Company is considering for repatriation under this provision is between zero and $74 million. The related range of income tax effects of such repatriation cannot be reasonably estimated until guidance is issued by Congress or the Treasury Department.

In December 2004, the FASB issued SFAS No. 123R, "Shared-Based Payment" which requires companies to measure and recognize compensation expense for all share-based payments at fair value. Share-based payments include stock option grants and certain transactions under other Company stock plans. The Company grants options to purchase common stock of the Company to some of its employees and directors under various plans at prices equal to the market value of the stock on the dates the options are granted. SFAS 123R will be effective for the Company beginning July 1, 2005. The Company is currently evaluating the impact that the adoption of SFAS 123R will have on its consolidated financial position, results of operations and cash flows.

Reclassification Certain prior period amounts have been reclassified to conform to the current year's presentation and are not material to the Company's Consolidated Financial Statements.

NOTE 2
RESEARCH AND DEVELOPMENT COSTS

The Company spent approximately $123.1 million, $118.2 million, and $109.1 million in 2004, 2003 and 2002, respectively, on research and development (R&D) activities. R&D costs are included primarily in the selling, general, and administrative expenses of the Consolidated Statements of Operations. Not included in these amounts were customer-sponsored R&D activities of approximately $31.8 million, $22.3 million, and $14.2 million in 2004, 2003, and 2002, respectively.

NOTE 3
OTHER INCOME

Items included in other income consist of:

millions of dollars Year Ended December 31,	2004	2003	2002
Gain on sale of business	**$ —**	$ 0.5	$ —
Interest income	**0.7**	0.8	1.7
Loss on asset disposals, net	**(3.5)**	(1.7)	(1.5)
Other	**(0.2)**	0.5	0.7
	$(3.0)	$ 0.1	$0.9

NOTE 4
INCOME TAXES

Earnings before income taxes and the provision for income taxes are presented in the following table. The earnings before income taxes amounts for 2003 and 2002 have been presented to conform to the 2004 U.S. versus non-U.S. presentation.

	2004			2003			2002		
millions of dollars	U.S.	Non-U.S.	Total	U.S.	Non-U.S.	Total	U.S.	Non-U.S.	Total
Earnings before taxes	**$117.8**	**$190.8**	**$308.6**	$120.5	$136.2	$256.7	$163.7	$70.1	$233.8
Provision for income taxes:									
Current:									
Federal/foreign	**1.4**	**63.8**	**65.2**	18.5	13.1	31.6	11.1	10.6	21.7
State	**2.2**	**—**	**2.2**	1.6	—	1.6	3.1	—	3.1
	3.6	**63.8**	**67.4**	20.1	13.1	33.2	14.2	10.6	24.8
Deferred	**11.1**	**2.7**	**13.8**	18.5	21.5	40.0	44.8	7.6	52.4
Total provision for income taxes	**$ 14.7**	**$ 66.5**	**$ 81.2**	$ 38.6	$ 34.6	$ 73.2	$ 59.0	$18.2	$ 77.2
Effective tax rate	**12.4%**	**34.9%**	**26.3%**	32.0%	25.4%	28.5%	36.0%	26.0%	33.0%

The provision for income taxes resulted in an effective tax rate for 2004 of 26.3% compared with rates of 28.5% in 2003 and 33.0% in 2002. Our effective tax rates have been lower than the standard federal and state tax rates due to the realization of certain R&D and foreign tax credits; foreign rates, which differ from those in the U.S.; and offset by non-deductible expenses. In addition, the Company made an $11.4 million year-end adjustment to various tax accounts due to changes in circumstances related to various tax items, including changes in tax laws. The year-end adjustment resulted in a reduction in the U.S. effective tax rate for 2004.

The analysis of the variance of income taxes as reported from income taxes computed at the U.S. statutory rate for consolidated operations is as follows:

millions of dollars	2004	2003	2002
Income taxes at U.S. statutory rate of 35%	**$108.0**	$ 89.8	$81.8
Increases (decreases) resulting from:			
Income from non-U.S. sources including withholding taxes	**3.6**	(8.5)	(2.2)
Business tax credits, net	**(6.2)**	(6.3)	(4.7)
Affiliate earnings	**(10.2)**	(7.0)	(6.8)
Non-temporary differences and other	**(14.0)**	5.2	9.1
Provision for income taxes as reported	**$ 81.2**	$ 73.2	$77.2