

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

Results of Operations

FISCAL 2000 COMPARED TO FISCAL 1999

Sales

Net sales for fiscal 2000 totaled \$1,591 million, an increase of \$89 million or 6% compared to the preceding year. The primary factors were a \$104 million increase in sales dollars related to a 6% increase in engine unit shipments, a favorable mix of engines sold amounting to \$24 million, and \$9 million from increased prices. Offsetting these factors was a \$48 million decrease of castings sales resulting from the disposition of the Company's ductile iron foundries in the first quarter of fiscal 2000.

Gross Profit

The gross profit rate increased to 21% in fiscal 2000 from 20% in fiscal 1999. Favorable factors to the gross profit were \$18 million attributed to the benefit of higher production during the year and \$9 million of price increases. Offsetting these improvements were \$6 million of higher costs for purchased items including increased costs for imported engines due to currency exchange rates.

Engineering, Selling, General and Administrative Expenses

Engineering, selling, general and administrative expenses increased \$9 million or 7% compared to fiscal 1999. This increase was primarily from a \$6 million increase in research and development costs and a \$3 million increase in profit sharing expenses due to improved results. These increases were offset by a \$2 million decrease in costs related to the Company's POWERCOM software business that was sold in the first quarter of the preceding year.

Interest Expense

Interest expense increased \$4 million or 25% in fiscal 2000 compared to fiscal 1999. These increases were the result of the Company's higher level of short-term borrowings during the year to fund working capital needs.

Gain on Disposition of Foundry Assets

At the end of August 1999, the Company contributed its two ductile iron foundries to Metal Technologies Holding Company, Inc. (MTHC) in exchange for \$24 million in cash and \$45 million aggregate par value convertible preferred stock which was recorded

at \$22 million. The transaction resulted in a \$17 million gain, and is shown as such on the income statement. The provisions of the preferred stock include a 15% cumulative dividend and conversion rights into a minimum of 31% of the common stock of MTHC. MTHC became the primary supplier to Briggs & Stratton Corporation of iron castings.

Other Income

Other income increased \$9 million in fiscal 2000 compared to fiscal 1999. This increase is primarily attributed to increased equity income from joint ventures.

Provision for Income Taxes

The effective tax rate used in fiscal 2000 was 37.0% compared with 37.5% in fiscal 1999.

FISCAL 1999 COMPARED TO FISCAL 1998

Sales

Net sales for fiscal 1999 totaled \$1,502 million, an increase of \$174 million or 13% when compared to the prior year. This was due to a \$120 million increase in sales dollars resulting from an 8% increase in unit shipments, a favorable mix change in engines sold of \$38 million and \$16 million from increased prices.

Gross Profit

The gross profit margin increased to 20% in the 1999 fiscal year from 19% in the preceding year. This increase resulted primarily from the following factors: \$16 million of price increases, \$15 million attributed to the benefit of higher production during the year and \$14 million in lower costs for purchased parts and engines and raw material. Lower aluminum costs, the major raw material used in engines, accounted for \$8 million of the lower raw material costs. Offsetting these improvements were a mix shift to lower margin engines of \$22 million and inefficiencies of \$3 million caused by operating plants at full capacity.

Engineering, Selling, General and Administrative Expenses

Engineering, selling, general and administrative expenses for fiscal 1999 decreased 4% or \$5 million compared to fiscal 1998. This decrease was primarily due to a \$10 million decrease in costs related to the Company's POWERCOM software business that was sold in the first quarter of this fiscal year. Costs related

to implementing the Company's new enterprise-wide information system decreased \$2 million between the fiscal years. Offsetting these reductions in costs was a \$4 million increase in profit sharing expenses due to improved results and a \$1 million increase in research and development expenses.

Interest Expense

Interest expense decreased 12% or \$2 million for the 1999 fiscal year compared to the 1998 fiscal year. This decrease was the result of a \$15 million repayment of long-term debt at the end of the 1998 fiscal year and lower average interest rates on working capital borrowings throughout the year.

Provision for Income Taxes

The effective tax rate decreased to 37.5% in 1999 from 37.6% in the previous year due to lower state income taxes and reductions in other related items.

Liquidity and Capital Resources

FISCAL YEARS 2000, 1999 AND 1998

Cash flow from operating activities was \$77 million, \$116 million and \$136 million, in fiscal 2000, 1999 and 1998, respectively.

The fiscal 2000 cash flow from operating activities decreased \$39 million. This reflects increased net income of \$30 million offset by the gain on disposition of foundry assets of \$17 million and an increased requirement for operating capital of \$43 million caused by increases in inventories at the end of fiscal 2000 offset by lower accounts receivable. The increase in inventories was planned as inventories at the end of fiscal 1999 were unusually low. Lower accounts receivable was caused by lower sales in June 2000 compared to June 1999.

The fiscal 1999 cash flow from operating activities declined \$20 million. This reflects improved net income of \$35 million, offset by an increased requirement for operating capital of \$53 million, caused primarily by strong fourth quarter business which increased year-end receivables and a restoration of inventories to higher year-end levels.

The fiscal 1998 cash flow from operating activities reflects a \$7 million increase in accounts receivable and an \$18 million decrease in inventories resulting from increased sales late in the last fiscal quarter.

Net cash used in investing activities amounted to \$43 million, \$67 million and \$45 million in fiscal 2000, 1999 and 1998, respectively. These cash flows included additions to plant and equipment of

\$71 million, \$66 million and \$46 million in fiscal 2000, 1999 and 1998, respectively. The fiscal 2000 capital expenditures related primarily to reinvestment in equipment, capacity additions and new products. The fiscal 1999 capital expenditures related primarily to reinvestment in equipment and new products. The fiscal 1998 capital expenditures principally related to reinvestment in equipment. The fiscal 2000 cash used in investing activities is net of \$24 million of proceeds received on the disposition of plant and equipment.

Net cash used in financing activities amounted to \$77 million, \$73 million and \$119 million in fiscal 2000, 1999 and 1998, respectively. These financing activities included the repurchase of the Company's common stock, totaling \$69 million in 2000, \$75 million in 1999 and \$86 million in 1998. During fiscal 2000, the Company repaid the remaining \$30 million on the 9.21% Senior Notes due 2001. There was no gain or loss associated with this repayment. In fiscal 1999 and 1998, the Company paid \$15 million on these notes. These uses of cash resulted in higher borrowings at July 2, 2000 of \$44 million. Proceeds from the exercise of stock options amounted to \$45 million in 1999, substantially higher than in fiscal 2000 and 1998 due to increased option activities.

Future Liquidity and Capital Resources

The Company has in place a \$250 million revolving credit facility to be used to fund seasonal working capital requirements and other financing needs. This credit facility expires in April 2002 and contains certain restrictive covenants.

In April 2000, the Company's Board of Directors approved capital expenditures of \$76 million for fiscal 2001. These anticipated expenditures include capacity increases, continuing investment in equipment and new products.

In May 1997, the Company filed a shelf registration for \$175 million of debt securities to be issued periodically. Of this, \$75 million has not yet been issued on the registration statement. The Company may decide to offer all or part of the remaining securities depending on many factors, including general economic conditions or cash required for operations.

Management believes that available cash, the credit facility, cash generated from operations, existing lines of credit and access to debt markets will be adequate to fund the Company's capital requirements for the foreseeable future.

Financial Strategy

Management of the Company subscribes to the premise that the value of the Company is enhanced if the capital invested in the Company's operations yields a cash return that is greater than the Company's cost of capital. Given this belief, the Company implemented this financial strategy by means of a "dutch auction" tender offer and a public debt offering in fiscal 1997. The Company also continued the repurchase of its outstanding common stock in the open market in fiscal 2000, 1999 and 1998. The Company believes this will provide a capital structure that makes greater use of financial leverage without imposing excessive risk on either the Company's shareholders or creditors. The Company also believes that the substitution of lower (after-tax) cost debt for equity in its permanent capital structure will reduce its overall cost of capital and that its profitability and strong cash flows will accommodate the increased use of debt without impairing its ability to finance growth or increase cash dividends per share on its common stock.

The share repurchase program authorized by the Board of Directors in fiscal 1997 for \$300 million of its common stock was completed in the second quarter of fiscal 1999. Subsequent to this, the Company has repurchased an additional 2.3 million shares. In June 2000, the Board of Directors authorized additional purchases of up to 2 million shares.

Also as a part of its financial strategy, subject to the discretion of its Board of Directors and the requirements of applicable law, the Company currently intends to increase future cash dividends per share at a rate approximating the inflation rate.

Other Matters

Emissions

The U.S. Environmental Protection Agency (EPA) has developed national emission standards under a

two phase process for small air cooled engines. The Company currently has a complete product offering which complies with EPA's Phase I engine emission standards. The EPA finalized its Phase II emission standards in March of 1999. The Phase II program will impose more stringent standards over the useful life of the engine and will be phased in from 2001 to 2005 for Class II (225 or greater cubic centimeter displacement) engines and from 2003 to 2008 for Class I (under 225 cubic centimeter displacement) engines. The Company does not believe compliance with the new standards will have a material adverse effect on its financial position or results of operations.

The Company implemented a supplemental compliance plan for model year 2000 with the California Air Resources Board (CARB), as required of companies which sell more than a threshold number of Class I engines into California. A second plan for model year 2001 has been submitted to CARB. The objective of the plans is to achieve additional reductions in extreme non-attainment areas. While CARB's aggressive program will result in a reduced product offering by the Company in California, the Company does not believe the California program will have a material effect on the financial condition or results of operations of the Company.

New Accounting Pronouncements

In June 1998 the Financial Accounting Standards Board issued Financial Accounting Standard (FAS) No. 133 "Accounting for Derivative Instruments and Hedging Activities". This new standard as amended will be effective for the Company in fiscal 2001, and requires companies to record derivatives on the balance sheet as assets or liabilities, measured at fair value. Any fair value changes will be recorded in net income or comprehensive income. The adoption of this standard will not have a material effect on the Company's financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risk from changes in foreign exchange and interest rates. To reduce the risk from changes in foreign exchange rates, the Company selectively uses financial instruments. The Company does not hold or issue financial instruments for trading purposes.

Foreign Currency

The Company's earnings are affected by fluctuations in the value of the U.S. dollar against foreign currencies primarily as a result of purchasing engines from its Japanese joint venture. The Company's foreign subsidiaries' earnings are also influenced by fluctuations of the local currency against the U.S. dollar as these subsidiaries purchase inventory from the parent in U.S. dollars. Forward foreign exchange contracts are used to partially hedge against the earnings effects of such fluctuations. At July 2, 2000, the Company had the following forward foreign exchange contracts outstanding with the Fair Value Gains and (Losses) ("FV") shown (in thousands):

Currency	Notional Value	Currency		FV
		Amount	Type	
Japanese Yen	1,952,789	18,732	U.S.	\$(404)
U.S. Dollars	3,721	5,760	Australian	\$ 283
British Pounds	739	1,052	U.S.	\$ 69

All of the above contracts expire within thirteen months.

Although the Company sells its domestically produced engines to foreign customers in U.S. dollars, the Company has shared some of the currency risk with customers for certain sales transactions. Accordingly, the Company is exposed to fluctuations in foreign exchange rates, primarily related to the U.S. dollar/Euro rate. Historically, the Company has managed these risks through limitations on the amount of sharing provided to customers. These programs were terminated in fiscal 2000.

Beginning in fiscal 2001, the Company began selling certain products to European customers for which the

Company will receive Euro currency. The Company plans to manage this exposure to foreign currency fluctuations using foreign exchange contracts.

Fluctuations in currency exchange rates may also impact the shareholders' investment in the Company. Amounts invested in the Company's non-U.S. subsidiaries are translated into U.S. dollars at the exchange rates in effect at year end. The resulting translation adjustments are recorded in shareholders' investment as cumulative translation adjustments. The cumulative translation adjustments component of shareholders' investment decreased \$1.8 million during the year. Using the year-end exchange rates, the total amount invested in subsidiaries at July 2, 2000 was approximately \$21.5 million.

Interest Rates

The Company is exposed to interest rate fluctuations on its borrowings. The Company manages its interest rate exposure through a combination of fixed and variable rate debt. Depending on general economic conditions, the Company has typically used variable rate debt for short-term borrowings and fixed rate debt for longer-term borrowings.

At July 2, 2000, the Company had the following short-term loans outstanding (amount in thousands):

Currency	Amount	Average Annual Interest Rate
German Mark	22,684	5.25%
Dutch Guilder	1,399	5.00%
Canadian Dollars	2,480	6.50%
U.S. Dollars	48,809	6.16%

All of the above loans carry variable interest rates.

Long-term loans consisted of the following (amounts in thousands):

Description	Amount	Maturity
7.25% Notes	\$98,512	2007

The above loan carries a fixed rate of interest.