

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

### Results of Operations

#### *FISCAL 2002 COMPARED TO FISCAL 2001*

##### Sales

Fiscal 2002 net sales were approximately \$1.5 billion, an increase of \$219 million, or 17% compared to the previous year. Generac Portable Products (GPP), included for a full fiscal year first time, added \$186 million in sales the fiscal year. Our engine unit volume increase of 8%, offset by an unfavorable sales mix weighted towards lower priced engines accounts for the majority of the remaining increase.

##### Gross Profit

The total Company gross profit rate of approximately 18% was comparable with fiscal 2001. The Engine segment gross profit rate remained approximately 18% in fiscal 2002. Reductions in manufacturing costs of \$25 million (primarily, repairs and maintenance, processing supplies, utilities and warranty) were offset by \$17 million of increased costs (primarily, fringe benefits which included rising healthcare costs). GPP margins were approximately 9% for fiscal 2002, similar to their results for the 12 months ended June, 2001.

##### Engineering, Selling, General and Administrative Costs

Engineering, selling, general and administrative costs increased \$16 million or 12% compared to fiscal 2001. The increase is entirely attributable to the inclusion of \$18 million of GPP engineering, selling, general, and administrative costs for a full year. The Engine segment Engineering, Selling and Administrative cost category experienced increased salaries and fringe benefit expenses of approximately \$8 million, but these increases were offset by a \$6 million impact of lower bad debt write-off experience and a bad debt recovery, and \$3 million of lower marketing expenses.

##### Interest Expense

Interest expense increased \$14 million in fiscal 2002 compared to fiscal 2001, essentially the impact of increased borrowings associated with the GPP acquisition.

##### Other Income

Other income increased \$3 million in fiscal 2002 compared to fiscal 2001. This increase is attributable to a \$9 million increase in foreign currency transaction gains offset by \$5 million in derivative

losses and \$1 million in amortization of deferred financing costs from the GPP acquisition.

##### Provision for Income Taxes

The effective tax rate increased to 34.0% in fiscal 2002 from 33.2%. The effective rates both reflect a refund on Foreign Sales Corporation tax benefits, however, the fiscal 2001 refund was larger.

#### *FISCAL 2001 COMPARED TO FISCAL 2000*

##### Acquisition

On May 15, 2001, Briggs & Stratton acquired GPP for net cash of \$267 million. Refer to Note 3 to the Consolidated Financial Statements for additional information on the acquisition.

##### Sales

Net sales for fiscal 2001 totaled approximately \$1.3 billion, a decrease of \$281 million or 18% compared to the preceding year. The primary factors were a 10% decline in engine unit volume, 15% lower sales of service components due to Briggs & Stratton's distributors having an adequate stock of parts, and an unfavorable sales mix as the entire 10% engine unit decline was made up of larger horsepower engines. Inventories of riding equipment at the OEMs and retailers were more than adequate to address soft demand for riding lawn and garden equipment.

The other major factor adversely affecting the fiscal year was the weak Euro which lowered revenues by \$24 million. Additionally, these revenues decreased because Briggs & Stratton's pricing reflected the need to remain competitive in the European market.

The acquisition of GPP added \$30 million in sales.

##### Gross Profit

The gross profit rate decreased to 18% from 21% in fiscal 2000. The major reasons for the decrease were lower plant utilization having a \$32 million impact and the weak Euro of \$24 million. Offsetting these factors was the favorable pension income impact of \$12 million. Pension income included in gross profit totaled \$24 million in fiscal 2001.

##### Engineering, Selling, General and Administrative Expenses

Engineering, selling, general and administrative expenses increased \$5 million or 4% compared to fiscal 2000. Expenses in this category increased almost \$20 million. The majority of the increase was due to the following factors: a \$16 million planned expansion of staff and expenditures for business development and introduction of new product, a

\$3 million bad debt write-off, and \$3 million of GPP's operating costs incurred since the acquisition. The increased costs were offset by \$14 million of lower employee benefit costs for profit sharing and increased pension income. Pension income in this category was \$4 million in fiscal 2001.

#### Interest Expense

Interest expense increased \$9 million or 44% in fiscal 2001 compared to fiscal 2000 because the level of borrowings was greater in fiscal 2001. The increased level of borrowings resulted from increased seasonal working capital needs and the funding of the GPP acquisition.

#### Other Income

Other income decreased \$13 million in fiscal 2001 compared to fiscal 2000. This decrease is attributed primarily to an \$8 million reduction in equity income from joint ventures and investments and \$5 million in foreign currency transaction losses.

#### Provision for Income Taxes

The effective tax rate decreased to 33.2% in fiscal 2001 from 37.0% in the previous year. The majority of the decrease was the result of the finalization and approval by the Congressional Joint Committee on Taxation of a refund on our Federal taxes related to Foreign Sales Corporation tax benefits.

### **Liquidity and Capital Resources**

#### *FISCAL YEARS 2002, 2001 AND 2000*

Cash flow from operating activities was \$200 million, \$68 million and \$77 million, in fiscal 2002, 2001 and 2000, respectively.

The fiscal 2002 cash flow from operating activities increased \$132 million, which was driven primarily by a reduction in inventory and an increase in accounts payable and accrued liabilities. The decrease in inventory levels was achieved through increased sales volume, while holding production levels consistent between years.

The fiscal 2001 cash flow from operating activities decreased \$10 million, which reflects lower gains on the disposition of plant and equipment of \$16 million. The lower gains from disposition of plant and equipment were because fiscal 2000 contained the disposition of the foundry assets. The increase in inventories was \$114 million less in fiscal 2001 compared to the fiscal 2000 increase. This decrease was the result of planned inventory increases in fiscal 2000 to replenish abnormally low inventories to more normal levels. The change in accounts payable and accrued liabilities was \$48 million less in fiscal 2001 due to timing of payments and lack of accruals for

profit sharing due to lower performance. The \$18 million increase in pension income is attributable to Briggs & Stratton's over funded pension plan.

The fiscal 2000 cash flow from operating activities decreased \$38 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 \$41 million caused by increases in inventories at the end of fiscal 2000 offset by lower accounts receivable.

Net cash used in investing activities amounted to \$38 million, \$318 million and \$43 million in fiscal 2002, 2001 and 2000, respectively. These cash flows include capital expenditures of \$44 million, \$61 million and \$71 million in fiscal 2002, 2001 and 2000, respectively. These capital expenditures relate primarily to reinvestment in equipment, capacity additions and new products.

The fiscal 2001 cash used in investing activities includes \$267 million of cash paid for the GPP acquisition, net of cash acquired. The fiscal 2000 cash used in investing activities is net of \$24 million of proceeds received on disposition of plant and equipment.

Briggs & Stratton used cash in financing activities totalling \$38 million and \$77 million in fiscal 2002 and 2000, respectively. Briggs & Stratton provided cash through financing activities totalling \$324 million in fiscal 2001. During fiscal 2002 Briggs & Stratton repaid \$10 million of its 7.25% Senior Notes due 2007. Financing activities in fiscal 2001 included \$399 million of proceeds received from issuing the 5.00% Convertible Senior Notes due 2006 and the 8.875% Senior Notes due 2011, in order to fund the acquisition of GPP and payment of short term borrowings. During fiscal 2000, Briggs & Stratton repaid the remaining \$30 million on the 9.21% Senior Notes due 2001. Briggs & Stratton repurchased \$6 million and \$69 million of common shares in fiscal 2001 and 2000, respectively. There were no common shares repurchased in fiscal 2002.

Briggs & Stratton's significant contractual obligations are its pension plans, post retirement benefit obligations and deferred compensation arrangements. All of these obligations are recorded on our Balance Sheets and disclosed more fully in the Notes to the Consolidated Financial Statements. In addition, Briggs & Stratton is subject to certain financial and operating restrictions under its domestic debt agreements. As is fully disclosed in Note 6 of the notes to consolidated financial statements, these restrictions limit our ability to: pay dividends; incur further indebtedness; create liens; enter into sale and/or leaseback transactions; consolidate, sell or

lease all or substantially all of our assets; and dispose of assets or the proceeds of our assets, in addition to certain financial covenants. We believe we will remain in compliance with these covenants in fiscal 2003.

#### Future Liquidity and Capital Resources

Briggs & Stratton has a three-year \$300 million revolving credit facility. This credit facility is used to fund seasonal working capital requirements and other financing needs. This facility and Briggs & Stratton's other indebtedness contain certain restrictive covenants. Refer to Note 6 to the Consolidated Financial Statements.

Briggs & Stratton expects capital expenditures to be \$60 million for fiscal 2003. These anticipated expenditures are for continued investments in equipment and new products.

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 Briggs & Stratton's capital requirements for the foreseeable future.

#### **Financial Strategy**

Management believes that the value of Briggs & Stratton is enhanced if the capital invested in operations yields a cash return that is greater than the cost of capital. In addition, Management believes that when capital cannot be invested for returns greater than the cost of capital, they should return the capital to the capital providers. Briggs & Stratton 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. Examples of the above beliefs are the repurchase of common stock from fiscal 1997 to 2001 when capital was not required for operational expansion and the fiscal 2001 increase of capital through debt for an acquisition. Briggs & Stratton believes 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.

Briggs & Stratton has remaining authorization to buy up to 1.8 million shares of its stock in open market or private transactions under the June 2000 Board of Directors' authorization to repurchase up to 2.0 million shares. Briggs & Stratton did not repurchase shares in fiscal 2002 and does not anticipate any repurchases in fiscal 2003.

Also as a part of its financial strategy, subject to the discretion of its Board of Directors and the requirements of applicable law and debt covenants, Briggs & Stratton currently intends to increase future

cash dividends per share at a rate approximating the inflation rate.

#### **Other Matters**

##### Early Retirement Incentive Program

In the second quarter of fiscal 2002, Briggs & Stratton offered and finalized an early retirement incentive program. The net reduction in the global salaried workforce was approximately 7%.

The impact for fiscal year 2002 was a reduction in net income on an after-tax basis of \$2.5 million, after consideration of approximately \$3 million in savings for lower salary related expenditures. The majority of the impact on net income was the result of recognizing the cost of the special termination benefits, which reduced net periodic pension income. The anticipated net income impact of salary related savings for fiscal 2003 is projected to be approximately \$6 million on an after-tax basis.

##### General

In July 2001, Briggs & Stratton extended its collective bargaining agreement with one of its unions. This agreement expires in 2006, and contains provisions for future wage increases, medical cost sharing and increased pension benefits.

##### Emissions

Briggs & Stratton implemented a supplemental compliance plan for model years 2000 and 2001 with the California Air Resources Board (CARB), as required of companies that sold more than a threshold number of Class I engines into California. The objective of the plan was to achieve additional reductions in extreme non-attainment areas. While CARB's aggressive program resulted in a reduced product offering by Briggs & Stratton in California, the California program did not have a material effect on Briggs & Stratton's financial condition or results of operations.

The U.S. Environmental Protection Agency (EPA) has developed national emission standards under a two phase process for small air cooled engines. Briggs & Stratton currently has a complete product offering which complies with the EPA's Phase I engine emission standards. The Phase II program imposes more stringent standards over the useful life of the engine and is being 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. Briggs & Stratton does not believe compliance with the new standards will have a material adverse effect on its financial position or results of operations.

### Critical Accounting Policies

Briggs & Stratton's accounting policies are more fully described in Note 1 of the Notes to the Consolidated Financial Statements. As discussed in Note 1, the preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions about future events that affect the amounts reported in the financial statements and accompanying notes. Future events and their effects cannot be determined with absolute certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results inevitably will differ from those estimates, and such difference may be material to the financial statements.

The most significant accounting estimates inherent in the preparation of our financial statements include estimates as to the recovery of accounts receivable, as well as those used in the determination of liabilities related to customer rebates, pension obligations, warranty, product liability, group health insurance and taxation. Various assumptions and other factors underlie the determination of these significant estimates. The process of determining significant estimates is fact specific and takes into account factors such as historical experience, current and expected economic conditions, product mix, and in some instances actuarial techniques. Briggs & Stratton reevaluates these significant factors as facts and circumstances change. Historically, actual results have not differed significantly from our estimates.

### New Accounting Pronouncements

The Emerging Issues Task Force (EITF) issued EITF Abstract No. 01-09, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of Vendor's Products)". This was adopted during fiscal 2002. Pursuant to EITF No. 01-09, Briggs & Stratton was required to reclassify co-op advertising expense previously reported as selling expense to a reduction in net sales. The impact of adopting EITF 01-09 was to reduce net sales by \$7.2 million, \$2.3 million and \$1.3 million in fiscal 2002, 2001 and 2000, respectively.

In June 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets". SFAS No. 141 provides for the elimination of the pooling-of-interests method of accounting for business combinations with an acquisition date of July 1, 2001 or later. SFAS No. 142 prohibits the amortization of goodwill and other intangible assets with indefinite lives and requires periodic reassessment of the underlying value of such assets for impairment. SFAS No. 142 is effective for fiscal years beginning after December 15, 2001. On July 2, 2001, Briggs & Stratton adopted SFAS No. 142. Application of the nonamortization provision of SFAS No. 142 resulted in an increase in net income of approximately \$.7 million in fiscal 2002.

In August 2001, the Financial Accounting Standards Board issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of." SFAS No. 144 also supersedes the accounting and reporting provisions of APB Opinion No. 30, related to the disposal of a segment of a business. Briggs & Stratton adopted SFAS No. 144 on July 1, 2002. Management does not expect that SFAS No. 144 will have a material impact on Briggs & Stratton's consolidated financial statements.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities". SFAS No. 146 nullifies Emerging Issues Task Force Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)" and requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. SFAS No. 146 is effective for exit or disposal activities that are initiated after December 31, 2002. Briggs & Stratton does not expect that the adoption of this statement will have a material impact on its results of operations or financial position.

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

### Foreign Currency

Briggs & Stratton's earnings are affected by fluctuations in the value of the U.S. dollar against the Japanese Yen and Euro. The Yen is used to purchase engines from Briggs & Stratton's joint venture, while Briggs & Stratton receives Euros for certain products sold to European customers. Briggs & Stratton'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 June 30, 2002, Briggs & Stratton had the following forward foreign exchange contracts outstanding with the Fair Value Gains (Losses) shown (in thousands):

Hedge Currency	Notional Value	Fair Market Value	Conversion Currency	(Gain)/Loss at Fair Value
Japanese Yen	239,485	2,008	U.S.	(158)
Euro	100,900	99,203	U.S.	5,554
Japanese Yen	26,881	399	Australian	10
Australian Dollars	1,950	1,086	U.S.	(11)
Canadian Dollars	900	592	U.S.	6
British Pounds	622	1,691	Australian	(26)
U.S. Dollars	421	748	Australian	26

All of the above contracts expire within twelve months.

Fluctuations in currency exchange rates may also impact the shareholders' investment in Briggs & Stratton. Amounts invested in Briggs & Stratton's non-U.S. subsidiaries are translated into U.S. dollars at the exchange rates in effect at fiscal year end. The

resulting translation adjustments are recorded in shareholders' investment as cumulative translation adjustments. The cumulative translation adjustments component of shareholders' investment increased \$4 million during the year. Using the year-end exchange rates, the total amount invested in non-U.S. subsidiaries on June 30, 2002 was \$26.8 million.

### Interest Rates

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

On June 30, 2002, Briggs & Stratton had the following short-term loans outstanding (amounts in thousands):

Currency	Amount	Weighted Average Interest Rate
Euro	15,074	5.46%
U.S. Dollars	2,625	4.00%
Canadian Dollars	493	3.10%

These loans carry variable interest rates. Assuming borrowings are outstanding for an entire year an increase (decrease) of one percentage point in the weighted average interest rate, would increase (decrease) interest expense by \$.2 million.

Long-term loans, net of unamortized discount, consisted of the following (amounts in thousands):

Description	Amount	Maturity
5.00% Convertible Notes	\$ 140,000	2006
7.25% Notes	\$ 89,031	2007
8.875% Notes	\$ 269,991	2011

These loans carry fixed rates of interest.