

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

Acquisitions

On July 7, 2004, Briggs & Stratton Corporation and its subsidiary, Briggs & Stratton Power Products Group, LLC, acquired Simplicity Manufacturing, Inc. ("Simplicity") for \$227 million plus certain transaction related expenses. Simplicity designs, manufactures and markets a wide variety of premium yard and garden tractors, lawn tractors, riding mowers, snow throwers, attachments, and other lawn and garden products like rototillers and chipper shredders. On February 11, 2005, Briggs & Stratton Corporation and its subsidiaries Briggs & Stratton Power Products Group, LLC and Briggs & Stratton Canada Inc. acquired certain assets of Murray, Inc. and Murray Canada Co (collectively "Murray") for \$121 million and entered into a transition supply agreement ("TSA"). The TSA gave Briggs & Stratton the right to purchase finished lawn, garden and snow products from Murray for a period up to eighteen months. Briggs & Stratton has reached an agreement with Murray to end the TSA effective September 30, 2005. See Note 3 of the Notes to Consolidated Financial Statements for detailed information on these acquisitions.

Results of Operations

FISCAL 2005 COMPARED TO FISCAL 2004

Net Sales

Fiscal 2005 consolidated net sales were approximately \$2.7 billion, an increase of \$708 million, or 36% compared to the previous year. The increase is attributable almost entirely to growth within the Power Products Segment.

Engine Segment net sales were \$1.7 billion versus \$1.6 billion in the prior year, an improvement of \$122 million or 8%. The improvement was the result of a 10% engine unit shipment increase, which contributed \$148 million; and \$35 million from pricing and a favorable Euro exchange rate. The increase in Engine unit shipments was driven by market share gains as well as \$119 million in increased shipments to our Power Products Segment, that were eliminated in consolidation. These favorable items were offset by: a mix of product that favored lower priced units and \$22 million of lower service and component sales.

Power Products net sales were \$1.2 billion versus \$489 million in the prior year, a \$704 million increase. The acquisition of Simplicity and Murray contributed \$389 and \$214 million respectively to the Segment's growth. In addition, increased generator demand sparked by unprecedented hurricane activity early in the year, as well as Florida legislation that provided for a tax holiday on purchases of hurricane related supplies late in the fiscal year, resulted in increased segment sales of \$102 million.

Gross Profit

Consolidated gross profit increased \$65 million between years. The acquisition of Simplicity added \$69 million. The sales of Murray branded products and components added \$2 million. These increases along with other volume and price improvements in both segments were offset by significant cost increases, which led to margin percentage decreases in both segments.

Engine Segment margins decreased from 24% in fiscal 2004 to 21% in fiscal 2005. Pricing improvements, including the impact of the Euro, added \$35 million to the Engine Segment margin. Manufacturing cost reduction programs contributed an additional \$12 million. These positive margin enhancers were not enough to overcome a \$59 million increase in manufacturing costs, primarily overhead, raw materials and component costs, and a \$19 million decrease from a mix of lower margined product. Consistent with the prior year, the cost increases reflect initiatives by many vendors to pass along higher costs due to price pressures on scrap aluminum and steel. We currently anticipate that our 4.5% price increase and continued manufacturing cost reduction efforts should offset these costs in fiscal 2006.

The Power Products Segment margin decreased to 11% in fiscal 2005 from 12% in fiscal 2004. The acquisition of Simplicity contributed 9% gross margin in fiscal 2005 after the application of purchase accounting on acquired inventory. Murray sales were essentially at a zero margin after the application of purchase accounting, which reduced the overall segment margin by 3%. The margins on generators and pressure washers declined between years as the \$10 million impact of pricing improvements was offset by component and freight costs on expedited shipments to meet generator demand early in the year. In addition, Euro purchases reduced the gross margin of the Power Products Segment by \$4 million. Under the Company's foreign currency management program, this negative impact on margins was offset by the positive impact of the Euro discussed for the Engine Segment.

Engineering, Selling, General and Administrative Costs

Engineering, selling, general and administrative costs increased \$108 million or 53% compared to fiscal 2004. The write-off of a trade receivable from Murray, Inc. accounts for \$39 million of the increase. The acquisition of Simplicity added another \$56 million to the category. The remaining increase is attributable to planned increases in advertising expenses, increased salaries and fringe benefits, and increased international variable selling costs, including \$1 million from the impact of a stronger Euro.

Interest Expense

Interest expense decreased approximately \$1 million in fiscal 2005 compared to fiscal 2004. The decrease is attributable to lower borrowings between years.

Other Income

Other income increased \$12 million between fiscal years 2005 and 2004. The increase is due to the receipt of \$12 million in cash dividends from an equity investment in preferred stock of Metal Technologies, Inc., the entity that acquired two ductile foundries from the Company in August of 1999. Refer to Note 9 of the Notes to Consolidated Financial Statements for the details of the components of other income.

Provision for Income Taxes

The effective tax rate decreased from 34% in fiscal 2004 to 33% in fiscal 2005. The decrease is primarily attributable to a tax benefit on dividend income in the current year.

Extraordinary Gain

The extraordinary gain represents the difference between the estimated fair value of the selected assets acquired from Murray and the cash paid, after all tax considerations. See Note 3 of the Notes to Consolidated Financial Statements for additional information on this acquisition.

FISCAL 2004 COMPARED TO FISCAL 2003

Net Sales

Fiscal 2004 consolidated net sales were approximately \$1.9 billion, an increase of \$290 million, or 17% compared to the previous year. The improvement was driven primarily by increased sales volume in both Segments.

Engine Segment net sales were \$1.6 billion in fiscal 2004, an increase of \$189 million or 13% compared to the prior year. Engine Segment increases were driven by an 11% increase in unit volume resulting in \$163 million in net sales. \$59 million or 4% of the increase in engine unit volume is attributable to sales to our Power Products Segment. Lawn and garden sales volume gains were driven by a strong selling season at retail. Inventory levels were low at the major original equipment manufacturers going into this fiscal year. As a result, the demand for engines was high all year long in anticipation of a strong season, which materialized. We believe the volume increase is reflective of market growth and market penetration in the U.S. While our European sales unit volume was down due to the drought conditions in Europe during much of fiscal 2004, the Euro exchange rate drove a \$26 million increase in net sales.

Power Products net sales were \$489 million in fiscal 2004, an increase of \$160 million, or 48%, over fiscal 2003. Generator volume benefited significantly by the wide spread power outages that occurred in the first quarter of fiscal 2004, as a result of the eastern electrical grid failure and the landfall of a major hurricane. There were no major power outages in fiscal 2003. These events, along with increased marketing efforts, increased consumer awareness which continued to drive the demand for generators higher in fiscal 2004. Pressure washer net sales gains were driven by continued advertising and promotions at major retailers, consistent with programs launched in the prior year and increased placement at a major retailer.

Gross Profit

Consolidated gross profit increased \$112 million between years. Volume increases generated \$76 million of the improvement; with approximately \$60 million from increases in the Engine Segment and the remainder from the Power Products Segment. The remaining \$36 million of gross margin increases came from gross margin percentage improvements in the Engine Segment.

Engine Segment margins improved from 20% to 24%. Pricing improvement due to the impact of a stronger Euro on European sales contributed \$26 million to the improvement. A 14% increase in production volume contributed \$18 million in absorption benefits and our manufacturing cost reduction programs contributed an additional

\$14 million to the improvement. These positive margin enhancers were partially offset by a \$22 million net increase in manufacturing costs, primarily overhead, raw materials and component costs. These cost increases reflect initiatives by many vendors to pass along higher costs due to price pressures on scrap aluminum and steel.

The Power Products Segment margin was at 12% in both fiscal 2004 and fiscal 2003. A 55% production volume improvement and manufacturing cost reduction efforts were offset by increased purchased component costs. The Power Products Segment purchases a major pressure washer component from a European supplier in Euros. In fiscal 2004 the Euro purchases reduced gross margins of the Power Products Segment by approximately \$12 million. Under the Company's foreign currency management program, this negative impact on margins was offset by the positive impact of the Euro discussed for the Engine Segment.

Engineering, Selling, General and Administrative Costs

Engineering, selling, general and administrative costs increased \$28 million or 15% compared to fiscal 2003. Increases in this category include salaries and fringe benefit cost increases of approximately \$6 million, professional services of \$6 million, marketing cost increases of \$5 million and international variable selling cost increases of \$6 million. In addition, \$2 million of the increase is attributable to bad debt expense associated with a prior fiscal year customer bankruptcy. The increases in salaries and fringe benefits reflect increased incentive compensation awards in the current year, as well as increased employee benefit costs, essentially pension and health care. The increase in professional services is attributable to several consulting projects related to our distributor channels, emissions regulations and Sarbanes-Oxley compliance efforts. Increased marketing costs were driven by increased spending on Power Products' market expansion and international marketing efforts. Increases in international variable selling costs include \$2 million attributable to translating Euro denominated expenditures by a stronger Euro.

Interest Expense

Interest expense decreased \$3 million in fiscal 2004 compared to fiscal 2003. The decrease is essentially the result of reduced working capital borrowings in the current year and the impact of a fixed to variable interest rate swap. On March 16, 2004, the Company called for the redemption of its \$140 million 5% convertible senior notes due in 2006. Substantially all of the holders of the notes exercised their conversion rights prior to the redemption date of May 15, 2004. This resulted in the issuance of approximately three million treasury shares in May 2004 and the write-off of approximately \$2 million in deferred financing costs. The redemption of these bonds eliminated all convertible debt and reduced our long-term debt to approximately \$361 million. The redemption will also eliminate approximately \$7 million in interest expense in fiscal 2005. In April 2004, all interest rate swaps were terminated resulting in a net gain of approximately \$500 thousand.

Other Income

Other income remained at approximately \$9 million in fiscal 2004, consistent with prior years. Refer to Note 9 of the Notes to Consolidated Financial Statements for detail of the components of other income.

Provision for Income Taxes

The effective tax rate increased from 32% in fiscal 2003 to 34% in fiscal 2004. The rate reflects less of a benefit from foreign and state tax credits. Earnings from some of our foreign subsidiaries were down due to market conditions, while the domestic income contribution increased. The impact of lower tax credits was offset by a reduction in the tax provision due to the closing of a tax audit year and recording additional tax benefits related to the filing of our fiscal 2003 income tax return.

Liquidity and Capital Resources

FISCAL YEARS 2005, 2004 AND 2003

Cash flows from operating activities were \$149 million, \$50 million and \$174 million in fiscal 2005, 2004 and 2003 respectively.

The fiscal 2005 cash flows from operations were \$98 million higher than the prior year. Fiscal 2005 did not experience the significant increase in inventories experienced in 2004, resulting in a \$142 million improvement in cash flows in fiscal 2005. During fiscal 2004, inventories for engines and power products were increased to what management believes are a more normal level. Accordingly, no such incremental inventory build-up was required in fiscal 2005. Offsetting the favorable impact of inventory levels on cash flows was a \$27 million reduction in accounts payable and accrued liabilities between years. The decrease is primarily attributable to a \$19 million reduction in incentive compensation accruals between years and \$5 million in lower rebate accruals.

The fiscal 2004 cash flows from operating activities were \$123 million lower than the prior year. Fiscal 2004 experienced a significant increase in inventory levels, which reduced cash flows from operating activities by \$129 million in fiscal 2004 and \$117 million between years. Engine inventories increased \$76 million between years. This increase is attributable to strong production levels through the end of the fiscal year driven by a strong selling season at retail. In addition, we believed that the increased inventory was needed to meet our forecast for fiscal 2005. Our Power Products Segment also experienced an increase in inventory levels of \$53 million between years. This increase in inventory reflects strong production levels throughout the year in order to replenish depleted inventories after the demand creating events for generators in fiscal 2004. Pressure washer inventory levels reflected increasing demand for the product due to significant market growth in the category. Inventory on hand will always reflect demand and our ability to respond to market changes at our production facilities in a timely manner.

Also contributing to the lower cash flows from operating activities in fiscal 2004 were increased receivables growth between years of \$23 million, which reflects our sales growth at both Segments and timing of payments, lower payable increases between years of \$40 million and lower deferred tax provisions between years of \$11 million. Offsetting these reductions in cash flows in fiscal 2004 were increased earnings of \$55 million, a reduction in prepaid expenses between years of \$7 million and lower pension income of \$7 million.

The fiscal 2003 cash flows from operating activities were \$26 million lower than the prior year. Fiscal 2003 did not experience the significant reduction in inventory investment experienced in fiscal 2002, which caused cash flows to be \$134 million less between years. Inventory levels are a function of planned production levels based on anticipated demand, contrasted with actual sell through of product at retail. In fiscal 2001 the market was soft resulting in lower than anticipated sales for the year and increased inventory levels throughout the channel. As a result of the unusually high inventory levels at the end of fiscal 2001, we lowered our planned production in 2002. The 2002 lawn and garden selling season was strong, and we were successful in getting our inventory levels back to a level we considered normal. The fiscal 2003 selling season was also strong resulting in no significant change in our inventory levels.

Offsetting this reduction in cash flows in fiscal 2003 were improved cash flows related to increased earnings of \$28 million, a lower accounts receivable increase between years of \$51 million and higher current liabilities of \$19 million. Accounts receivable levels increased in fiscal 2002 because of strong fourth quarter sales versus the prior year. Sales strength in the fourth quarter was similar between fiscal 2003 and 2002 resulting in an accounts receivable balance that did not change significantly. Current liabilities, primarily accruals for profit sharing were greater between years because better performance in fiscal 2003 resulted in larger bonus awards than the prior year.

Cash used in investing activities was \$437 million, \$47 million and \$33 million in fiscal 2005, 2004 and 2003, respectively. These cash flows include capital expenditures of \$86 million, \$53 million and \$40 million in fiscal 2005, 2004 and 2003, respectively. The capital expenditures relate primarily to reinvestment in equipment, capacity additions and new products.

In fiscal 2005, cash used in investing activities also includes \$232 million in cash paid for the Simplicity acquisition and \$122 million for the acquisition of certain Murray assets.

In fiscal 2004, Briggs & Stratton received \$6 million as a refund of a portion of the cash paid for the BSPPG acquisition in fiscal 2001. The amount was to adjust the original purchase price for the actual value received in acquired receivables and inventory.

In fiscal 2003, Briggs & Stratton increased its investment in its China joint venture from 52% to 90%. This increase in ownership interest gave Briggs & Stratton control over the joint venture. Accordingly, its operating results are now reflected in Briggs & Stratton's consolidated financial statements. The actual cash outlay in fiscal 2003 for the restructuring was \$343 thousand; however, the consolidation resulted in an increase in cash of approximately \$4 million.

Briggs & Stratton provided cash from financing activities totaling \$106 million and \$13 million in fiscal 2005 and 2004 respectively. Briggs & Stratton used \$37 million of cash in financing activities in fiscal 2003. Early in fiscal 2005 the Company used its available cash to finance the acquisition of Simplicity. To finance the acquisition of the Murray assets the Company issued \$125 million in term notes in fiscal 2005. The Company incurred \$1 million in fees in fiscal 2005 negotiating the term notes and an amendment to its revolving credit facility. During fiscal 2004, Briggs & Stratton did not use its revolver to finance working capital needs. In fiscal 2003 the Company used available cash to pay off its short-term loans and notes payable of \$15 million.

During fiscal 2005, the Company received \$20 million from the exercise of stock options compared to \$45 million in fiscal 2004 and \$5 million in fiscal 2003. The stock and option activity is a direct reflection of the market value of the Company's stock and option strike prices that encourage the exercise of the options.

During fiscal 2003, the Company paid down \$15 million of its short-term loans and notes payable. These loans were primarily used to fund the short-term working capital needs of Briggs & Stratton's foreign operations. Given the level of cash flows the last two fiscal years and the available cash on hand, Briggs & Stratton made the decision to pay off these borrowings and fund these operations with available cash. Briggs & Stratton did not use its revolver to finance working capital needs during fiscal 2004. In fiscal 2004, Briggs & Stratton also incurred \$2 million to negotiate a new revolving credit agreement.

Future Liquidity and Capital Resources

Briggs & Stratton has a \$350 million revolving credit facility that expires in May 2009. This credit facility will be used to fund seasonal working capital requirements and other financing needs. This facility and Briggs & Stratton's other indebtedness contain certain restrictive covenants described in Note 8 of the Notes to Consolidated Financial Statements.

Briggs & Stratton expects capital expenditures to be \$80 million in fiscal 2006. These anticipated expenditures reflect our plans to continue to reinvest in equipment, new products, and capacity enhancements.

Management believes that available cash, the credit facility, cash generated from future 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. Consequently, management's first priority is to reinvest capital into physical assets and products that maintain or grow the global cost leadership and market positions that Briggs & Stratton has achieved, and drive the economic value of the Company. Management's next financial objective is to identify strategic acquisitions or alliances that enhance revenues and provide a superior economic return. Several successful joint ventures and the acquisition of Generac Portable Products, Inc. and Simplicity are examples of our successful execution of this strategy. Finally, management believes that when capital cannot be invested for returns greater than the cost of capital, we should return capital to the capital providers through dividends and/or stock buy-back.

Off-Balance Sheet Arrangements

Briggs & Stratton has no off-balance sheet arrangements or significant guarantees to third parties not fully recorded in our Balance Sheets or fully disclosed in our Notes to Consolidated Financial Statements. Briggs & Stratton's significant contractual obligations include our debt agreements and certain employee benefit plans.

Briggs & Stratton is subject to financial and operating restrictions in addition to certain financial covenants under its domestic debt agreements. As is fully disclosed in Note 8 of the Notes to Consolidated Financial Statements, these restrictions could 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. We believe we will remain in compliance with these covenants in fiscal 2006. Briggs & Stratton has obligations concerning certain employee benefits including 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 Consolidated Financial Statements.

Contractual Obligations

A summary of the Company's expected payments for significant contractual obligations as of July 3, 2005 is as follows (in thousands):

	<u>2006</u>	<u>2007-2008</u>	<u>2009-2010</u>	<u>Thereafter</u>	<u>Total</u>
Long-Term Debt	\$ -	\$215,000	\$ -	\$275,000	\$ 490,000
Interest on Long-Term Debt	36,530	63,327	48,813	17,288	165,958
Capital Leases	758	1,539	-	-	2,297
Operating Leases	11,508	16,578	9,609	7,019	44,714
Consulting Agreement	288	175	-	-	463
Transition Supply Agreement	92,513	-	-	-	92,513
	<u>\$141,597</u>	<u>\$296,619</u>	<u>\$ 58,422</u>	<u>\$299,307</u>	<u>\$ 795,945</u>

As of July 3, 2005, the Company had no material purchase obligations other than those created in the ordinary course of business related to inventory and property, plant and equipment which generally have terms of less than 90 days.

Other Matters

Labor Agreement

Briggs & Stratton has collective bargaining agreements with its unions. These agreements expire at various times ranging from 2006-2008.

Emissions

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 has been phased in for Class II (225 or greater cubic centimeter) displacement engines and will be phased in through 2008 for Class I (under 225 cubic centimeter) displacement engines. The majority of Briggs & Stratton's engines are certified to be compliant with the EPA's Phase II standards. Accordingly, Briggs & Stratton does not believe compliance with the new standards will have a material adverse effect on its financial position or results of operations.

EPA is also evaluating the development of Phase III standards to further reduce engine exhaust emissions and to control evaporative emissions from small off-road engines and equipment they are used in. A draft regulation is scheduled for publication in early calendar year 2006. We cannot predict the scope of any proposal or of the final regulations that EPA may ultimately adopt, and accordingly cannot estimate what, if any, impact such regulations could have on future financial performance.

The California Air Resources Board (CARB) staff issued a revised proposed Tier 3 regulation requiring additional reductions to engine exhaust emissions and also requiring new controls on evaporative emissions from small engines. The CARB staff proposal is phased in between 2006 and 2008 depending upon the size of the engine and type of control. While Briggs & Stratton believes the cost of the proposed regulation on a per engine basis may be significant, Briggs & Stratton does not believe the CARB staff proposal will have a material effect on its financial condition or results of operations. This assessment is based on a number of factors, including federal regulation, which precludes other states from opting into the California standard, revisions CARB made to its proposal from that published in September 2003 in response to recommendations from Briggs & Stratton and others in the regulated category, the fact that California represents a relatively small percentage of Briggs & Stratton's engine sales and our ability and intention to pass increased costs associated with the CARB regulation on to California consumers.

The European Commission adopted an engine emission Directive regulating exhaust emissions from engines manufactured by Briggs & Stratton. The Directive parallels the regulation previously promulgated by the U.S. EPA. Stage 1 was effective in February, 2004 and Stage 2 will be phased in from 2005 to 2007, with some limited extensions available for specific size and type engines until 2010. Briggs & Stratton's full European product line has been compliant with Stage 1 since 2004. Briggs & Stratton intends to have a full European product line compliant with Stage 2. Briggs & Stratton does not believe compliance with the Directive will have a material adverse effect on its financial position or results of operations.

Critical Accounting Policies

Briggs & Stratton's critical accounting policies are more fully described in Note 2 and Note 14 of the Notes to Consolidated Financial Statements. As discussed in Note 2, 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 differences 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 and inventory reserves, as well as those used in the determination of liabilities related to customer rebates, pension obligations, postretirement benefits, warranty, product liability, litigation and taxation.

The reserves for customer rebates, warranty, product liability, inventory reserves and doubtful accounts are fact specific and take into account such factors as specific customer situations, historical experience, and current and expected economic conditions. Changes in these reserves may be required if actual experience differs from the original estimates.

The Company's estimate of income taxes payable, deferred income taxes, and the effective tax rate is based on a complex analysis of many factors including interpretations of Federal, state and foreign income tax laws, the difference between tax and financial reporting bases of assets and liabilities, estimates of amounts currently due or owed in various jurisdictions, and current accounting standards. We review and update our estimates on a quarterly basis as facts and circumstances change and actual results are known. In addition, Federal, state and foreign taxing authorities periodically review the Company's estimates and interpretation of income tax laws. Adjustments to the effective income tax rate and recorded assets and liabilities may occur in future periods if actual results differ significantly from original estimates and interpretations.

The pension benefit obligation and related pension income are calculated in accordance with Statement of Financial Accounting Standard (SFAS) No. 87, "Employer's Accounting for Pensions", and are impacted by certain actuarial assumptions, including the discount rate and the expected rate of return on plan assets. These rates are evaluated on an annual basis considering such factors as market interest rates and historical asset performance. Actuarial valuations at July 3, 2005 used a discount rate of 5.25% and an expected rate of return on plan assets of 8.75%. Our discount rate was selected using a benchmark approach against the Moody's Aa Corporate Bond rate and the Citigroup Pension Liability Index. A .25% decrease in the discount rate would increase annual pension expense by approximately \$1.2 million. A .25% decrease in the expected return on plan assets would increase our annual pension expense by approximately \$2.0 million.

The other postretirement benefits obligation and related expense charge are calculated in accordance with SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" and are impacted by certain actuarial assumptions, including the health care trend rate. An increase of one percentage point in health care costs would increase the accumulated postretirement benefit obligation by \$22.2 million and would increase the service and interest cost by \$1.7 million. A corresponding decrease of one percentage point, would decrease the accumulated postretirement benefit by \$20.3 million and decrease the service and interest cost by \$1.5 million.

New Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board ("FASB") issued revised Statement 123R, "Share-Based Payment," to be effective for annual periods beginning after June 15, 2005; thereby, becoming effective for Briggs & Stratton in the first quarter of fiscal 2006. Statement 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized as compensation expense in the income statement. The cost is recognized over the requisite service period based on fair values measured on grant dates. The new standard may be adopted using either the modified prospective transition method or the modified retrospective method. We are currently evaluating our share-based employee compensation programs, the potential impact of this statement on our consolidated financial position and results of operations, and the alternative adoption methods.

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs – an amendment of ARB No. 43, Chapter 4." SFAS No. 151 seeks to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material (spoilage) in the determination of inventory carrying costs. The statement requires such costs to be treated as a current period expense. This statement is effective for the company on July 2, 2006. The company does not believe the adoption of SFAS No. 151 will have a material impact on its Consolidated Financial Statements.

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 the Euro. The Yen is used to purchase engines from Briggs & Stratton's joint venture. Briggs & Stratton purchases components in Euros from third parties and 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 July 3, 2005, Briggs & Stratton had the following forward foreign exchange contracts outstanding with the Fair Value (Gains) Losses shown (in thousands):

<u>Hedge Currency</u>	<u>Notional Value</u>	<u>Fair Market Value</u>	<u>Conversion Currency</u>	<u>(Gain)/Loss at Fair Value</u>
Japanese Yen	2,550,000	\$ 23,240	U.S.	\$ 1,221
Euro	35,000	\$ 42,319	U.S.	\$ (1,585)
Australian Dollars	2,391	\$ 1,781	U.S.	\$ (11)

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 and joint ventures are translated into U.S. dollars at the exchange rates in effect at fiscal year-end. The resulting cumulative translation adjustments are recorded in Shareholders' Investment as Accumulated Other Comprehensive Income. The cumulative translation adjustments component of Shareholders' Investment increased \$0.9 million during the year. Using the year-end exchange rates, the total amount invested in non-U.S. subsidiaries on July 3, 2005 was \$87.3 million.

Interest Rates

Briggs & Stratton is exposed to interest rate fluctuations on its borrowings, depending on general economic conditions.

On July 3, 2005, Briggs & Stratton had the following short-term loans outstanding (in thousands):

<u>Currency</u>	<u>Amount</u>	<u>Weighted Average Interest Rate</u>
Australian Dollars	250	7.19%
Euro	214	5.00%

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 \$5 thousand.

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

<u>Description</u>	<u>Amount</u>	<u>Maturity</u>
7.25% Senior Notes	\$ 89,589	2007
8.875% Senior Notes	\$ 271,732	2011
Variable Rate Term Notes	\$ 125,000	2008

The Senior Notes carry fixed rates of interest and are therefore not subject to market fluctuation. The Variable Rate Term Note is subject to interest rate fluctuations, therefore an increase (decrease) of one percentage point in the weighted average interest rate would increase (decrease) interest expense by \$1.25 million.