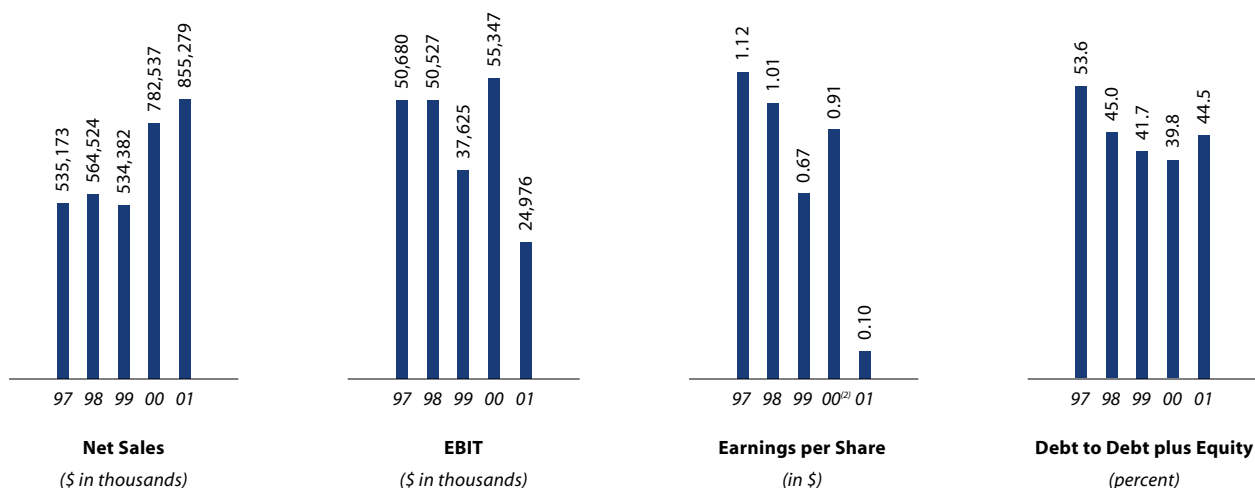


## Financial Highlights

(in thousands except  
per share and employee data)

	2001	2000 <sup>(1)</sup>	1999	1998	1997
<b>Operating Data:</b>					
Net sales	\$ 855,279	\$782,537	\$534,382	\$564,524	\$535,173
Earnings before interest and taxes	\$ 24,976	\$ 55,347	\$ 37,625	\$ 50,527	\$ 50,680
Net income	\$ 4,730	\$ 26,925	\$ 18,120	\$ 26,334	\$ 27,129
<b>Per Share Data:</b>					
Diluted earnings per share	\$ 0.10	\$ 0.91 <sup>(2)</sup>	\$ 0.67	\$ 1.01	\$ 1.12
Dividends per share	\$ 0.28	\$ 0.28	\$ 0.28	\$ 0.29	\$ 0.32
Book value per share	\$ 7.39	\$ 8.73	\$ 5.54	\$ 5.69	\$ 3.52
<b>Ratios:</b>					
Return on sales	3.8%	9.1% <sup>(2)</sup>	8.3%	10.6%	11.1%
Return on average net assets	4.8%	16.2% <sup>(2)</sup>	13.5%	20.3%	25.8%
Debt to debt plus equity	44.5%	39.8%	41.7%	45.0%	53.6%
<b>Other:</b>					
Backlog (at year-end)	\$ 319,905	\$375,052	\$252,400	\$261,700	\$227,500
Capital expenditures	\$ 69,697	\$ 67,931	\$ 57,149	\$ 98,582	\$ 66,750
EBITDA*	\$ 94,450	\$108,685	\$ 73,163	\$ 81,162	\$ 76,515
Cash flows from (used in):					
Operating activities	\$ 67,266	\$ 81,859	\$ 77,786	\$ 63,535	\$ 42,744
Investing activities	\$(110,143)	\$(62,305)	\$(56,779)	\$(98,950)	\$(70,311)
Financing activities	\$ 33,497	\$ 5,406	\$(22,940)	\$ 35,077	\$ 23,351
Number of employees (at year-end)	6,790	6,733	3,836	3,710	3,751
Sales/total compensation expense	3.22X	3.32X	3.49X	3.68X	3.66X



\*EBITDA – represents net income, plus provision for income taxes and net interest expense, plus depreciation and amortization. EBITDA may not be comparable to similarly titled measures reported by other companies. While EBITDA should not be construed as a substitute for operating income or a better indicator of liquidity than cash flow from operating activities, which is determined in accordance with accounting principles generally accepted in the United States, it is included herein to provide additional information with respect to the ability of Sauer-Danfoss to meet its future debt service, capital expenditures and working capital requirements.

(1) Includes results of Danfoss Fluid Power since May 3, 2000.

(2) Excludes one-time merger-related costs. Reported amounts are \$0.69 per share, 7.1% return on sales and 13.3% return on average net assets.

## Management's Discussion and Analysis of Financial Condition and Results of Operations

### Safe Harbor Statement

*This annual report and other written reports as well as oral statements made from time to time by the Company may contain "forward-looking statements," statements regarding matters that are not historical facts, but rather are subject to risks and uncertainties. All statements regarding future performance, growth, sales and earnings projections, conditions or developments are forward-looking statements. These statements are based on current financial and economic conditions and rely heavily on the Company's interpretations of what it considers to be key economic assumptions. Actual future results may differ materially depending on a variety of factors, including, but not limited to, changes in: global economic factors, including foreign currency movements; general economic conditions, including interest rates; specific economic conditions in the agriculture, construction, road building, turf care and specialty vehicle markets and the impact of such conditions on the Company's customers in such markets; major customers' product and program development plans and the Company's role in such plans; business relationships with major customers and suppliers; energy prices; difficulties entering new markets; pricing and product initiatives and other actions taken by competitors; ability of suppliers to provide materials as needed and the Company's ability to recover any price increases for materials in product pricing; labor relations; the Company's execution of internal performance plans; and other business conditions.*

### Overview

Sauer-Danfoss Inc. and subsidiaries (the Company) is a leading international supplier of components and systems that generate, transmit and control fluid power in mobile equipment. The Company's products are used by original equipment manufacturers (OEMs) of mobile equipment, including construction, road building, agricultural, turf care and specialty equipment. The Company designs, manufactures and sells its products in North America, Europe and the Asia-Pacific Region, and sells its products throughout the rest of the world either directly or through distributors. The Company also manufactures and sells its products in South America through its manufacturing plant and sales office in Caxias do Sul and São Paulo, Brazil.

The Company began 2001 with high expectations of reaping the benefits of bringing Sauer and Danfoss Fluid Power (DFP) together, but instead ended the year disappointed with its overall financial performance. The year began with a steep downturn in the U.S. markets that the Company serves, which eventually spread to Europe later in the year. Overall, the Company's sales declined 9.5% from the prior year after adjusting for the effects of acquisitions made in both years. Although this decline is less than the decline experienced by the overall industry that the Company serves, the financial results were further impacted by unexpected nonrecurring costs associated with the merger of DFP and the continued commitment to future customer programs. These items will be discussed further in sections below.

The Company now turns its attention immediately to 2002 by taking several substantial actions to return to more acceptable levels of profitability, including reducing fixed costs in both the factories and offices, not hiring for open positions, having selected layoffs, reducing the use of outside contractors and consultants, and redirecting a portion of its engineering resources towards increasing plant productivity and further harvesting operational synergies. The Company feels that it can take these actions and still be well prepared for the expected upturn in its markets.

### Results of Operations 2001 Compared to 2000

**Net Sales** – Sales for 2001 of \$855.3 million increased by \$72.8 million, or 9.3%, from the prior year. However, all of this increase was due to the impact of acquisitions, both from having a full year effect of acquisitions made in 2000, and the effect of acquisitions made during 2001. On a comparable basis, including a full year of 2000 sales from DFP and excluding the effects of acquisitions made during 2001, net sales decreased 7.9% in local currencies, and were down 9.5% as reported in U.S. dollars. Further comparisons of the Company's markets are very difficult due to acquisitions, however, by including DFP for the full year of 2000, the Company experienced decreases in most of its markets as follows: construction declined 6.9%, road building was down 6.1%, turf care declined 5.1% and the distributor area was down 8.3%. The only bright spots were in agriculture, which increased a modest 4.9% compared to significantly lower levels in the past couple of years, and in the specialty market which was essentially flat with the prior year.

## Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

The following table sets forth the Company's net sales by market, including DFP for the full year 2000, in millions of dollars and as a percentage of total net sales, for the years ended December 31, 2001 and 2000:

	2001		December 31,	
	(Dollars)	% of Total	(Dollars)	2000 % of Total
Agriculture	\$162.9	19.0%	\$155.3	17.5%
Specialty	145.2	17.0%	144.8	16.3%
Turf care	135.6	15.9%	142.9	16.1%
Construction	116.4	13.6%	125.0	14.1%
Road building	75.3	8.8%	80.2	9.0%
Distribution and aftermarket	219.9	25.7%	239.9	27.0%
	\$855.3	100.0%	\$888.1	100%

**Gross Profit** – Gross profit for 2001 of \$193.2 million, or 22.6% of sales, was down from the reported \$201.0 million of gross profit in 2000, which was 25.7% of sales. The lower gross profit experienced in 2001 was due in large part to lower plant utilization experienced from the dramatic decline in sales in North America with a slightly lower impact in Europe. Coupled with this effect was a pretax charge of \$8.3 million of unexpected additional costs associated with the final closure of the Racine, Wisconsin, plant and associated move to the Company's West Branch, Iowa, plant. In addition, the Company took a bad debt write-off of \$1.4 million before taxes relating to a customer in the aerial lift market filing for bankruptcy during the second quarter. During 2001 the Company took several actions to reduce manufacturing expenses including reductions in factory headcount commensurate with the volume reduction, several weeklong plant shutdowns and other cost reduction activities. However, these measures were not enough to completely offset the effects of the above-mentioned items.

**Selling, General and Administrative Expenses** – Selling, general and administrative expenses for 2001 of \$122.8 million increased by \$24.6 million, or 25.1%, from the same period of 2000. The inclusion of four additional months in 2001 of DFP results accounts for \$13.7 million of this increase. An additional \$3.5 million of expense was incurred due to a full year's amortization of goodwill from DFP and additional amortization from other intangibles established from the final appraisals related to the DFP and other acquisitions. The Company anticipates that ongoing amortization will be reduced by approximately \$2.8 million per year for 2002 and beyond due to the implementation of Statement of Financial Accounting Standard No. 142. See "Other Matters" below for further discussion on this new accounting pronouncement. The majority of the remaining \$7.4 million increase is due to acquisitions.

**Research and Development Expenses** – Research and development expenses of \$38.1 million increased by \$8.2 million, or 27.4%, from 2000 and represent 4.5% of total net sales for 2001 compared to 3.8% of net sales in 2000. The additional four months of DFP in 2001 accounts for \$1.7 million of the increase. The remaining increase reflects the effects of acquisitions made during 2001 and the Company's ongoing development of new customer programs, such as the recent introduction of the hydro-mechanical transmission for the agriculture tractor market.

**Nonoperating Expenses, Net** – Net nonoperating expenses for 2001 of \$16.9 million were \$9.0 million higher than 2000 net nonoperating expenses of \$7.9 million. Net interest expense for 2001 of \$17.4 million increased by \$6.2 million from the 2000 net interest expense of \$11.2 million. Despite overall declines in the Company's floating borrowing rates during 2001, (see discussion of the Company's borrowing rates in Note 12 of the Notes to the Consolidated Financial Statements), the higher overall bank borrowings used to fund acquisitions during the year have driven the net interest expense significantly higher along with the additional four months of borrowings in 2001 for the DFP acquisition in May 2000. Other income, net for 2001 of \$0.5 million decreased by \$2.8 million from 2000's other income of \$3.3 million related primarily to currency exchange gains. In addition, the Company realized \$0.4 million less royalty income from its Japanese licensee, Daikin Industries, Ltd., due to the formation of a joint venture with Daikin as of October 1, 2001. The license agreement was terminated as of that date, and the Company will no longer receive royalties from Daikin.

**Provision for Income Taxes** – Provision for income taxes for 2001 of \$2.9 million decreased \$14.3 million from the 2000 provision for income taxes of \$17.2 million. The decrease is a direct result of the decrease in income before income taxes of \$36.6 million coupled with a slight decrease in the effective tax rate for 2001 of 37.8% compared to an effective tax rate for 2000 of 39.0%.

**Net Income** – The Company ended 2001 with net income of \$4.7 million, down \$22.2 million from the \$26.9 million of net income in 2000. The economic downturn experienced by most of the Company's markets, coupled with the nonrecurring plant shutdown costs, bad debt write-off discussed above, and higher interest expense contributed to this decline.

**Order Backlog** – Total order backlog at the end of 2001 was \$319.9 million, compared to \$375.0 million at the end of 2000, a decrease of 14.7%. On a comparable basis, excluding the effects of acquisitions, order backlog declined 17.1% from the year-end 2000 levels, or 15.2% excluding the impact of currency fluctuations. During the fourth quarter of 2001, \$229.8 million in new orders were written, a decrease of 5.2% compared to the fourth quarter of 2000. Excluding the impact of acquisitions, orders written in the fourth quarter were \$207.1 million, which was 14.5% less than the orders written in the fourth quarter of 2000, or a decrease of 13.6% excluding the impact of currency fluctuations.

### Results of Operations 2000 Compared to 1999

**Net Sales** – Net sales for 2000 of \$782.5 million increased by \$248.1 million, or 46.4%, from 1999 net sales of \$534.4 million. On a comparable basis, net sales increased 12.6% in local currency, and at \$579.6 million, were up 8.5% from 1999 as reported in U.S. dollars. On a comparable basis, the Company experienced increases in all of its primary markets with the exception of road building, which decreased \$6.2 million, or 8.9%, from 1999. Turf care sales increased \$26.8 million or 24.2%, agriculture increased \$9.4 million or 11.1%, specialty increased \$4.7 million, or 10.3%, and construction increased \$4.7 million, or 5.5%, over 1999. Each of the Company's product lines experienced increased sales levels from 1999 with hydrostatics up \$32.7 million, open circuit gear products and piston pumps up \$3.6 million and electrohydraulics and controls up \$9.0 million.

The following table sets forth the Company's Sauer-only net sales by market for comparison purposes, in millions dollars and as a percentage of total Sauer-only net sales for the years ended December 31, 2000 and 1999:

	2000		December 31,		1999	
	(Dollars)	% of Total	(Dollars)	% of Total	(Dollars)	% of Total
Turf care	\$137,357	23.7	\$110,585	20.7		
Agriculture	94,525	16.3	85,087	15.9		
Construction	89,904	15.5	85,218	16.0		
Road building	63,294	10.9	69,494	13.0		
Specialty	50,308	8.7	45,556	8.5		
Distribution and aftermarket	144,211	24.9	138,442	25.9		
	\$579,599	100.0	\$534,382	100.0		

**Gross Profit** – Gross profit for 2000 of \$201.0 million was 25.7% of net sales, slightly higher than the 23.6% of net sales for 1999. The higher gross profit percentage in relation to sales reflects the higher absorption rates of expenses from increased plant utilization experienced during the year from the higher sales levels. Gross profit as a percentage of net sales for the former DFP companies was comparable to that of Sauer for the year.

**Selling, General and Administrative Expenses** – Selling, general and administrative expenses for 2000 of \$98.2 million increased by \$39.8 million, or 68.2%, from 1999 expenses of \$58.4 million. The inclusion of eight months of DFP results accounts for \$32.1 million of this increase. An additional \$1.2 million of expense was incurred due to goodwill amortization related to the DFP acquisition. The Company anticipates that ongoing amortization of goodwill and other intangibles will equal approximately \$2.7 million per year on a pretax basis. The majority of the remaining \$6.5 million increase is due to merger-related integration costs and higher spending on information technology.

## Consolidated Statements of Income

<i>(in thousands, except per share data)</i>	<i>For The Years Ended December 31,</i>		
	<b>2001</b>	2000	1999
<b>Net Sales</b>	<b>\$855,279</b>	\$782,537	\$534,382
<b>Costs and Expenses:</b>			
Cost of sales	<b>662,046</b>	581,526	408,450
Selling, general and administrative	<b>122,803</b>	98,176	58,382
Research and development	<b>38,054</b>	29,874	23,311
Restructuring charges and impairments	—	11,232	—
Total costs and expenses	<b>822,903</b>	720,808	490,143
Operating income	<b>32,376</b>	61,729	44,239
<b>Nonoperating Income (Expenses):</b>			
Interest expense	<b>(21,151)</b>	(15,499)	(8,844)
Interest income	<b>3,774</b>	4,305	278
Royalty income	<b>881</b>	1,255	976
Other, net	<b>(399)</b>	2,023	(1,064)
Nonoperating expenses, net	<b>(16,895)</b>	(7,916)	(8,654)
<b>Income Before Income Taxes and Minority Interest</b>	<b>15,481</b>	53,813	35,585
<b>Minority Interest in Income of Consolidated Companies</b>	<b>(7,882)</b>	(9,660)	(6,526)
<b>Income Before Income Taxes</b>	<b>7,599</b>	44,153	29,059
<b>Provision for Income Taxes</b>	<b>(2,869)</b>	(17,228)	(10,939)
Net income	<b>\$ 4,730</b>	\$ 26,925	\$ 18,120
Basic and diluted net income per common share	<b>\$ 0.10</b>	\$ 0.69	\$ 0.67
Weighted average basic shares outstanding	<b>46,977</b>	39,216	27,225
Weighted average diluted shares outstanding	<b>46,980</b>	39,217	27,240

See accompanying notes to consolidated financial statements.

## Consolidated Balance Sheets

<i>(in thousands, except per share data)</i>	<i>As of December 31,</i>	
	<b>2001</b>	<b>2000</b>
<b>Assets</b>		
<b>Current Assets:</b>		
Cash and cash equivalents	<b>\$ 14,324</b>	\$ 24,754
Accounts receivable (net of allowance for doubtful accounts of \$5,570 and \$3,588 in 2001 and 2000, respectively)	<b>134,586</b>	134,349
Inventories	<b>141,652</b>	146,232
Other current assets	<b>23,066</b>	9,823
Total current assets	<b>313,628</b>	315,158
<b>Property, Plant and Equipment, net</b>	<b>423,195</b>	422,986
<b>Other Assets:</b>		
Goodwill, net	<b>88,907</b>	85,317
Other intangible assets, net	<b>38,433</b>	3,023
Investments in unconsolidated affiliates	<b>1,391</b>	—
Deferred income taxes	<b>11,639</b>	7,786
Other	<b>7,788</b>	6,693
Total other assets	<b>148,158</b>	102,819
	<b>\$884,981</b>	\$840,963
<b>Liabilities and Stockholders' Equity</b>		
<b>Current Liabilities:</b>		
Notes payable and bank overdrafts	<b>\$ 53,046</b>	\$ 42,902
Long-term debt due within one year	<b>9,727</b>	4,205
Accounts payable	<b>57,096</b>	73,814
Accrued salaries and wages	<b>18,212</b>	19,535
Accrued warranty	<b>8,472</b>	12,026
Other accrued liabilities	<b>23,293</b>	36,417
Total current liabilities	<b>169,846</b>	188,899
<b>Long-Term Debt</b>	<b>236,026</b>	198,632
<b>Other Liabilities:</b>		
Long-term pension liability	<b>31,608</b>	29,828
Postretirement benefits other than pensions	<b>16,337</b>	15,687
Deferred income taxes	<b>42,991</b>	25,956
Other	<b>15,408</b>	9,711
Total other liabilities	<b>106,344</b>	81,182
<b>Minority Interest in Net Assets of Consolidated Companies</b>	<b>25,581</b>	29,853
<b>Stockholders' Equity:</b>		
Preferred stock, par value \$.01 per share, authorized 4,500 shares, no shares issued or outstanding	—	—
Common stock, par value \$.01 per share, authorized 75,000 shares in 2001 and 2000; issued 47,411 in 2001 and 46,483 in 2000; outstanding 47,411 in 2001 and 45,312 in 2000	<b>474</b>	465
Additional paid-in capital	<b>313,662</b>	303,304
Retained earnings	<b>48,803</b>	57,348
Accumulated other comprehensive loss	<b>(15,663)</b>	(10,654)
Unamortized restricted stock compensation	<b>(92)</b>	(57)
Common stock in treasury (at cost), 0 shares in 2001 and 1,171 shares in 2000	—	(8,009)
Total stockholders' equity	<b>347,184</b>	342,397
Commitments and contingencies	—	—
	<b>\$884,981</b>	\$840,963

See accompanying notes to consolidated financial statements.

## Notes to Consolidated Financial Statements

December 31, 2001, 2000 and 1999 (in thousands, except per share data)

**(1) Summary of Significant Accounting Policies:**

**The Company and Its Operations** – Sauer-Danfoss Inc., a U.S. Delaware corporation, and subsidiaries (the Company) is a leading international manufacturer of components and systems that generate, transmit and control fluid power in mobile equipment. The Company's products are used by original equipment manufacturers of mobile equipment including construction, road building, agricultural and turf care equipment. The Company's products are sold throughout the world either directly or through distributors.

The Company, which is a holding company, conducts its business in North America as Sauer-Danfoss (US) Company (the U.S. Operating Company), and in Germany as Sauer-Danfoss (Neumünster) GmbH & Co. (the German Operating Company), as well as through various other operating companies throughout the world. The Company has manufacturing plants in Brazil, China, Denmark, Germany, Italy, Japan, Poland, Slovakia, Sweden the United Kingdom and the United States, as well as sales companies in other locations. Sauer-Danfoss GmbH (the German Holding Company), which is wholly owned by the Company, functions as a management and holding company on behalf of the Company.

The Company is majority owned by Danfoss Murmann Holding A/S (the Holding Company). The Holding Company is a Danish company owned by entities and persons under the control of Klaus H. Murmann, the Chairman of the Company, and Danfoss A/S.

**Basis of Presentation and Principles of Consolidation** – The consolidated financial statements represent the consolidation of all companies in which the Company has a controlling interest and are stated in accordance with accounting principles generally accepted in the United States of America. The Company records its investment in each unconsolidated affiliated company (generally 20 to 50 percent owner) at its related equity in the net assets of such affiliate. All significant intercompany balances, transactions and profits have been eliminated in the consolidated financial statements.

**Use of Estimates** – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates, but management believes that such differences are immaterial.

**New Accounting Principles** – During 2001, the Financial Accounting Standards Board (FASB) issued Statements of Financial Accounting Standards (SFAS) No. 141, "Business Combinations," and No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 eliminates the pooling-of-interests method of accounting for business combinations effective June 30, 2001, and requires the purchase method. SFAS No. 142 changes the accounting for goodwill from an amortization approach to a non-amortization approach, under which goodwill would be periodically tested for impairment. The Statement requires amortization of goodwill recorded in connection with previous business combinations to cease upon adoption of the Statement by calendar year companies on January 1, 2002, and that all goodwill created from acquisitions after June 30, 2001, is not amortized. The Company's amortization of goodwill during 2001 was \$2,800; the Company's 2002 earnings are expected to increase by \$0.06 per share as compared to 2001 due to the cessation of goodwill amortization. The Company is currently undertaking the initial impairment analysis of intangible assets at its various reporting units, as required, and expects to complete this analysis during the first two quarters of 2002.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." This Statement addresses the conditions under which an impairment charge should be recorded related to long-lived assets to be held and used, except goodwill, and those to be disposed of by sale or otherwise. The Statement is effective on January 1, 2002, for calendar year companies and replaces SFAS No. 121. At this time, the Company does not expect this Statement to have a material impact on its results of operations, liquidity or financial position.

During January, 2001, the Company acquired all of the assets and business operations of portions of the fluid power business of Danfoss A/S. Sauer Inc. and Danfoss A/S agreed to the asset acquisition in principle when Sauer Inc. purchased eleven companies comprising the DFP group on May 3, 2000. The operations are located in Australia, Belgium, Japan, Latin America, Netherlands, Portugal, Singapore, and Spain. The Company issued 2,091 shares of its common stock valued at \$18,298. The transaction resulted in approximately \$7,000 of goodwill.

During July, 2001, the Company completed the acquisition of Hidrover Válvulas S.A. for approximately \$3,500 in an all-cash transaction. This resulted in approximately \$2,500 being recognized as goodwill. Hidrover develops and manufactures directional control valves and other hydraulic valves primarily serving the application areas of agriculture, material handling, and utility machinery. The company, located in Caxias do Sul, Brazil, has approximately 80 employees and annual sales of approximately \$4,000.

During January, 2000, the Company paid \$3,600 and issued 103 shares of its common stock to acquire all of the assets of Custom Design Electronics of Sweden AB (CDE) and its subsidiary NOB Electronik AB, which manufactures and sells electronic control panels and related software. The acquisition resulted in approximately \$3,000 of goodwill being recognized.

On May 3, 2000, the Company issued 16,150 shares of its common stock in exchange for all of the outstanding shares of Danfoss Fluid Power Companies (DFP), which designs, manufactures and sells orbital motors, hydrostatic steering units, proportional load-sensing valves, gear pumps and electrohydraulics for use by OEMs of mobile equipment. The assets acquired and liabilities assumed were recorded at estimated fair values as determined by the Company's management based on information currently available and on current assumptions as to future operations. The Company has obtained independent appraisals of the fair values of acquired property, plant and equipment, and identifiable intangible assets, and their remaining useful lives. The proper adjustments to record these assets at their fair market value have been made and the related depreciation and amortization expense is reflected in the consolidated financial statements.

#### (4) Unusual Charges:

As a result of the acquisition of DFP, the Company incurred acquisition integration expenses for the incremental costs to exit and consolidate activities at former DFP locations, to involuntarily terminate employees, and for other costs to integrate operating locations and other activities of DFP with the Company. Accounting principles generally accepted in the United States require that these acquisition integration expenses, which are not associated with the generation of future revenues and have no future economic benefit, be reflected as assumed liabilities in the allocation of the purchase price to the net assets acquired. On the other hand, accounting principles require that acquisition integration expenses which are associated with the generation of future revenues and have future economic benefit, and those associated with integrating former Sauer locations into DFP locations, must be recorded as expenses. The components of the acquisition liabilities included in the purchase price allocation for DFP are as follows:

	<i>Original Costs Estimated</i>	<i>Utilized</i>	<i>Portion Unutilized</i>	<i>Balance Remaining at December 31, 2001</i>
Workforce reductions	\$ 3,902	\$ 3,902	\$ —	\$—
Asset impairments	3,522	2,716	806	—
Other	4,653	3,953	700	—
	\$12,077	\$10,571	\$1,506	\$—

The acquisition integration liabilities were based on the Company's integration plan which focused on three key areas of integration: 1) manufacturing process and supply chain rationalization, including plant closings, 2) elimination or consolidation of redundant administrative overhead and support activities, and 3) restructuring and consolidating the sales and marketing organizations in Europe to eliminate redundancies in these activities.

## Notes to Consolidated Financial Statements (continued)

The workforce reductions represented the termination of 158 DFP employees, primarily production personnel. As of December 31, 2001, all 158 had been terminated. The above amounts were funded through cash flows from the combined operations.

Under accounting principles generally accepted in the United States of America, adjustments to the estimated acquisition integration liabilities are to be included in the allocation of the purchase price of DFP, if the adjustment is determined within the purchase price allocation period. Adjustments that are determined after the end of the purchase price allocation period are to be 1) recorded as a reduction of net income, if the ultimate amount of the liability exceeds the estimate, or 2) recorded as a reduction of goodwill, if the amount of the liability is less than the estimate. During 2001, the Company finalized its adjustments and had a balance of \$1,506 of unused liability that had been recorded as of December 31, 2000. Accordingly, this balance was recorded as a reduction of goodwill related to the DFP acquisition.

During 2000, the Company recorded restructuring charges of \$11,232 (\$6,852 after tax, or \$0.17 per share) associated with the integration of the DFP acquisition. These charges related to plant consolidation and other expenses, liability for workforce reductions, severance and other related employee benefits, building lease termination, and relocation of inventory and equipment and are included in the Consolidated Statements of Income. Included in the restructuring charge was \$1,500 recorded for the expected termination of 70 employees, primarily manufacturing personnel. As of December 31, 2000, all of these employees had been terminated.

Movement of the various components of the restructuring liabilities follows:

	<i>Employees</i>	<i>Workforce Reductions</i>	<i>Inventory and Other Asset Write-downs</i>	<i>Plant Consolidation and Other</i>	<i>Total</i>
2000	70	\$1,500	\$5,590	\$4,142	\$11,232
Utilized in 2000	70	1,500	4,090	2,479	8,069
Utilized in 2001	—	—	1,500	1,532	3,032
Balance remaining at December 31, 2001	—	\$ —	\$ —	\$ 131	\$ 131

**(5) Minority Interests:**

Minority interest in net assets and income reflected in the accompanying consolidated financial statements consists of:

- A 40% minority interest held by Agri-Fab, Inc. in Hydro-Gear Limited Partnership, a U.S. limited partnership, for 2001, 2000 and 1999.
- The Murmann Limited Partners, as holders of limited partnership interests, in the results of the German Operating Company equal to 7.6% of the income of Sauer Inc. and subsidiaries before taxes and the Murmann Limited Partnership Interests through May 3, 2000 for 2000, and 7.6% for 1999.
- A 40% minority interest held by Shanghai Hydraulics and Pneumatics in Sauer Shanghai Hydraulic Transmission Company Ltd., a Chinese equity business venture for 2001, 2000, and 1999.
- A minority interest held by ZTS, a.s. in Sauer-Danfoss (Dubnica) a.s., a Slovakian corporation, equal to 10.4% for 2001, 11.6% for 2000, and 12.2% for 1999.
- A 35% minority interest held by Daikin Industries Ltd. In Sauer-Danfoss Daikin, Ltd., a Japanese corporation, since October 1, 2001.
- A 49.9% minority interest held by Topcon Laser Systems in Topcon Sauer-Danfoss, a U.S. limited partnership, for the period from April 1, 2001 through December 31, 2001.

The following tables set forth the components of minority interest in the consolidated balance sheets and consolidated statements of income:

### Minority Interest Reflected in Consolidated Balance Sheets

	<i>December 31,</i>	
	<b>2001</b>	2000
Hydro-Gear Limited Partnership	<b>\$20,703</b>	\$26,514
Sauer Shanghai Hydraulic Transmission Company	<b>2,546</b>	2,470
Sauer-Danfoss (Dubnica) a.s.	<b>832</b>	869
Sauer-Danfoss Daikin, Ltd.	<b>1,181</b>	—
Topcon Sauer-Danfoss	<b>319</b>	—
<b>Total</b>	<b>\$25,581</b>	\$29,853

### Minority Interest in (Income) Loss Reflected in Consolidated Statements of Income

	<b>2001</b>	<i>Years Ended December 31,</i>	
		2000	1999
Hydro-Gear Limited Partnership	<b>\$(7,690)</b>	\$(9,180)	\$(4,914)
German Operating Company	—	(1,486)	(2,387)
Sauer Shanghai Hydraulic Transmission Company	<b>(76)</b>	1,042	417
Sauer-Danfoss (Dubnica) a.s.	<b>57</b>	(36)	358
Sauer-Danfoss Daikin, Ltd.	<b>96</b>	—	—
Topcon Sauer-Danfoss	<b>(269)</b>	—	—
<b>Total</b>	<b>\$(7,882)</b>	\$(9,660)	\$(6,526)

Until May 3, 2000, the Company was the general partner and 80% owner of the German Operating Company. The Murmann Limited Partners had certain rights which included an annual cash payment equal to 7.6% of the income of Sauer Inc. and subsidiaries before taxes and the Murmann Limited Partnership Interests and the right to consent to certain actions of the German Operating Company. However, the Company had the right to elect by the action of its independent directors or the holders of its common stock other than the Murmann family to terminate the Murmann Limited Partnership Interests in exchange for 2,250 shares of common stock of Sauer Inc. As such, the Company controlled and consolidated the German Operating Company.

As a result of the DFP acquisition, the Company elected, by the action of its independent directors, to terminate the limited partnership interests. Pursuant to the terms of the agreement creating the limited partnership, in exchange for the termination of the limited partnership interests, the Company issued 2,250 shares of its common stock and paid the balance of the current accounts of the Limited Partners of \$3,873. The difference between the fair market value of the shares issued and the historical basis of the limited partnership interest was considered to be a deemed dividend of \$17,337 under common control accounting. In addition, the agreement required the Company to pay an amount in cash equal to the income tax payable as a result of the exchange of the shares of common stock of the Company for the limited partnership interests, but not to exceed 23,354 deutsche marks or \$10,577 at December 31, 2001 using an exchange rate of 2.208 deutsche marks to the U.S. dollar. As of December 31, 2001, the Company has paid \$3,254 toward this tax liability. However, the Murmann Limited Partners are currently in dispute in the German tax courts over the total amount of tax liability related to this transaction. Although the Company may ultimately be liable for additional tax liability related to the termination of this agreement, there is no reasonable way to estimate the future outcome, therefore, no further accrual has been made at this time. However, the Company believes that the outcome of this matter will not have a materially adverse effect on its results of operations, liquidity or financial position.

The funded status of the Company-sponsored plans was as follows:

	<i>December 31,</i>	
	<b>2001</b>	<b>2000</b>
Reconciliation of benefit obligation:		
Accumulated postretirement benefit liability at January 1	<b>\$(17,629)</b>	\$(16,440)
Accumulated postretirement benefit assumed by acquisition	—	(556)
Service cost	<b>(438)</b>	(413)
Interest cost	<b>(1,258)</b>	(1,186)
Actuarial gain (loss)	<b>(1,115)</b>	114
Benefit payments	<b>1,072</b>	852
Accumulated postretirement benefit liability at December 31	<b>(19,368)</b>	(17,629)
Reconciliation of fair value of plan assets:		
Fair value of plan assets at January 1	—	—
Employer contributions	<b>1,072</b>	852
Benefit payments	<b>(1,072)</b>	(852)
Fair value of plan assets at December 31	—	—
Funded status	<b>(19,368)</b>	(17,629)
Unrecognized actuarial loss	<b>3,031</b>	1,942
Postretirement benefit liability	<b>(16,337)</b>	\$(15,687)

The assumed weighted average annual rate of increase in the per capita cost of medical benefits is 9.0% for 2002 and is assumed to decrease ratably in 2003 through 2005 and remain level at 5.5% thereafter.

U.S. employees retiring after March 1, 1993, and hired prior to January 1, 1993, will receive the standard health benefits up to age 65 and then will be eligible for a Medicare reimbursement allowance based on years of service. U.S. employees hired after January 1, 1993, will only be eligible after age 65 for a Medicare reimbursement allowance based on years of service.

A one percent increase or decrease in the annual health care trend rates would have increased or decreased the accumulated postretirement benefit obligation at December 31, 2001, by \$1,539, and increased or decreased postretirement benefit expense for 2001 by \$189. The weighted average discount rate used to estimate the accumulated postretirement benefit obligation was 7.5% for 2001 and 2000.

#### **(10) Long-Term Incentive Plan:**

The Company's Long-Term Incentive Plan provides for the grant of stock options, stock appreciation rights, restricted stock, performance units, performance shares and other incentive awards to officers and key employees and for the reimbursement to certain participants for the personal income tax liability resulting from such awards. The total number of shares of common stock that may be subject to awards or be issued under the Long-Term Incentive Plan will not exceed 2,400 shares, of which no more than 1,200 shares may be issued as restricted stock.

The Company also has a Non-employee Director Stock Option and Restricted Stock Plan which permits the granting of non-qualified stock options and restricted common stock to directors of the Company who are not also employees of the Company. The total number of shares of common stock to be issued under this plan shall not exceed 250 shares.

During 2001 and 2000, the Company awarded 8 shares of restricted stock in each of the years to non-employee directors and 220 and 165, respectively, of performance units to employees. The restricted stock awards entitle the participants to full dividend and voting rights. Unvested shares are restricted as to disposition and subject to forfeiture under certain circumstances. The value of each award was established based on the market value of the stock as of the grant date. The shares vest over three years. The performance units entitle the participants to an amount equal to the Company's dividends and vest after three years.

## Notes to Consolidated Financial Statements (continued)

Unearned compensation related to the restricted stock is shown as a reduction of stockholders' equity in the accompanying consolidated balance sheets and is being amortized ratably over the life of the grants. Unearned compensation was computed based on the market value of the restricted shares. Compensation expense recognized in conjunction with the restricted stock outstanding in 2001 and 2000 amounted to \$43 and \$1,735, respectively. The majority of the compensation expense recognized in 2000 was the result of grants awarded prior to 2000 vesting 100% due to the change in control occurring with the acquisition of DFP on May 3, 2000.

**(11) Income Taxes:**

The Company's income before income taxes is as follows:

	2001	Years Ended December 31, 2000	1999
United States	<b>\$ (8,104)</b>	\$17,693	\$24,265
European and other	<b>15,703</b>	26,460	4,794
Total	<b>\$ 7,599</b>	\$44,153	\$29,059

The Company's primary German operation is treated as a flow-through entity for United States tax purposes. The above analysis of pretax income and the following analysis of the income tax provision by taxing jurisdiction are therefore not directly related.

The (provision) benefit for income taxes by taxing jurisdiction location is as follows:

	2001	Years Ended December 31, 2000	1999
Current:			
United States			
Federal	<b>\$ 6,009</b>	\$ (6,544)	\$ (4,936)
State	<b>1,026</b>	(346)	(625)
European and other	<b>(8,405)</b>	(9,154)	(2,733)
Total current	<b>(1,370)</b>	(16,044)	(8,294)
Deferred:			
United States			
Federal	<b>(2,158)</b>	(554)	(2,283)
State	<b>(576)</b>	445	95
European and other	<b>1,235</b>	(1,075)	(457)
Total deferred	<b>(1,499)</b>	(1,184)	(2,645)
Total income tax provision	<b>\$(2,869)</b>	\$(17,228)	\$(10,939)

A reconciliation of the U.S. statutory and effective income tax provision (benefit) based on the Company's income before income taxes is as follows:

	2001	Years Ended December 31, 2000	1999
U.S. statutory tax rate	<b>35.0%</b>	35.0%	35.0%
Deferred tax benefit not previously recognized	<b>(18.2)</b>	(0.6)	(6.4)
Goodwill and nondeductible expenses	<b>16.5</b>	2.7	1.7
European and Asian locations' losses not tax benefited	<b>14.3</b>	1.2	7.0
U.S. tax on distributed foreign earnings	<b>—</b>	1.8	—
Taxes on European locations' income at rates which differ from the U.S. rate	<b>(7.5)</b>	(1.9)	—
State income taxes	<b>(2.9)</b>	0.8	2.1
Other	<b>0.6</b>	—	(1.8)
Effective income tax rate	<b>37.8%</b>	39.0%	37.6%

## Report of Management

The management of Sauer-Danfoss Inc. is responsible for the integrity and accuracy of the financial information contained in this annual report. Management believes that the consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and that the other information in this annual report is consistent with those statements. In preparing the financial statements, management makes informed judgments and estimates, where necessary, to reflect the expected effects of events and transactions that have not been completed. In management's opinion, the financial statements present fairly the financial position, results of operations and cash flows of the Company in conformity with accounting principles generally accepted in the United States of America.

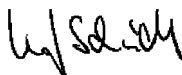
Management of the Company is also responsible for maintaining a system of internal accounting controls and procedures designed to provide reasonable assurance at reasonable cost that assets are safeguarded against loss or unauthorized use and that financial records are adequate and can be relied upon to produce financial statements in accordance with accounting principles generally accepted in the United States of America. This system is augmented by written policies and procedures, careful selection and training of financial management personnel, a continuing management commitment to the integrity of the system, and through examinations by an internal audit department which coordinates its activities with the Company's independent accountants.

KPMG LLP has been retained to conduct an audit of the Company's consolidated financial statements in accordance with auditing standards generally accepted in the United States of America and to provide an independent assessment that helps ensure fair presentation of the Company's consolidated results of operations, financial position and cash flows.

The Audit Committee of the Board of Directors is composed entirely of independent outside directors. The Committee meets periodically with management, internal auditors and the independent accountants, both separately and jointly, to discuss internal accounting controls and the quality of financial reporting. To ensure complete independence, the internal auditors and representatives of KPMG LLP have full access to meet with the Audit Committee, with or without management representatives present, to discuss the results of their audits and their opinions on the adequacy of internal controls and the quality of financial reporting.



David L. Pfeifle  
President and Chief Executive Officer



Karl J. Schmidt  
Executive Vice President and Chief Financial Officer

## Independent Auditors' Report

To the Shareholders of Sauer-Danfoss Inc.:

We have audited the accompanying consolidated balance sheets of SAUER-DANFOSS INC. (a Delaware corporation) AND SUBSIDIARIES as of December 31, 2001 and 2000, and the related consolidated statements of income, stockholders' equity and comprehensive income and cash flows for each of the years in the two year period ended December 31, 2001. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. The consolidated statements of income, stockholders' equity and comprehensive income and cash flows of SAUER-DANFOSS INC. (formerly SAUER INC. and SUBSIDIARIES) for the year ended December 31, 1999, were audited by other auditors whose report thereon dated February 16, 2000, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2001 and 2000 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of SAUER-DANFOSS INC. AND SUBSIDIARIES as of December 31, 2001 and 2000, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.



KPMG LLP  
Des Moines, Iowa  
February 14, 2002

## Selected Financial Data

*(in thousands except per share and employee data)*

	2001	2000 <sup>(1)</sup>	1999	1998	1997
<b>Operating Data:</b>					
Net sales	\$855,279	\$782,537	\$534,382	\$564,524	\$535,173
Gross profit	193,233	201,011	125,932	136,213	131,108
Marketing	63,318	40,874	24,727	24,942	23,256
Research and development	38,054	29,874	23,311	22,089	20,655
Administration	59,485	57,302	33,655	29,571	29,319
Total operating expenses	160,857	128,050	81,693	76,602	73,230
Earnings before interest and taxes	24,976	55,347	37,625	50,527	50,680
Total interest expense, net	17,377	11,194	8,566	8,814	7,607
Net income	4,730	26,925	18,120	26,334	27,129
<b>Per Share Data:</b>					
Income per common share, basic and diluted	\$ 0.10	\$ 0.69	\$ 0.67	\$ 1.01	\$ 1.12
Cash dividends per share	\$ 0.28	\$ 0.28	\$ 0.28	\$ 0.29	\$ .32
Weighted average basic shares outstanding	46,977	39,216	27,225	26,148	24,225
Weighted average diluted shares outstanding	46,980	39,217	27,240	26,150	24,225
<b>Balance Sheet Data:</b>					
Inventories	\$141,652	\$146,232	\$ 73,977	\$ 89,195	\$ 89,031
Property, plant & equipment, net	423,195	422,986	269,485	262,527	191,690
Total assets	884,981	840,963	442,515	459,771	388,735
Total debt	298,799	245,739	131,855	151,027	136,428
Stockholders' equity	347,184	342,397	150,752	148,904	85,301
Debt to debt plus equity	44.5%	39.8%	41.7%	45.0%	53.6%
<b>Other Data:</b>					
Backlog (at year-end)	\$319,905	\$375,052	\$252,400	\$261,700	\$227,500
Depreciation and amortization	69,474	53,338	35,538	30,635	25,835
Capital expenditures	69,697	67,931	57,149	98,582	66,750
EBITDA*	94,450	108,685	73,163	81,162	76,515
Cash flows from (used in):					
Operating activities	68,005	81,721	77,786	63,535	42,744
Investing activities	(110,143)	(62,167)	(56,779)	(98,950)	(70,311)
Financing activities	33,497	5,406	(22,940)	35,077	23,351
Number of employees (at year-end)	6,790	6,733	3,836	3,710	3,751
Sales/total compensation expense	3.22x	3.32x	3.49x	3.68x	3.66x

\* EBITDA – represents net income, plus provision for income taxes and net interest expense, plus depreciation and amortization. EBITDA may not be comparable to similarly titled measures reported by other companies. While EBITDA should not be construed as a substitute for operating income or a better indicator of liquidity than cash flow from operating activities, which is determined in accordance with accounting principles generally accepted in the United States, it is included herein to provide additional information with respect to the ability of Sauer-Danfoss to meet its future debt service, capital expenditures and working capital requirements.

(1) Includes results of Danfoss Fluid Power since May 3, 2000.

**NYSE Price Range, Dividends by Quarter**

	1st	2nd	3rd	4th	Full Year
2001 High	\$10.29	\$ 9.95	\$ 9.43	\$ 8.48	\$10.29
Low	\$ 8.41	\$ 7.27	\$ 7.37	\$ 6.64	\$ 6.64
Dividends	\$ 0.07	\$ 0.07	\$ 0.07	\$ 0.07	\$ 0.28
2000 High	\$ 11.70	\$ 11.00	\$ 10.91	\$ 10.05	\$ 11.70
Low	\$ 7.28	\$ 8.19	\$ 8.80	\$ 6.76	\$ 6.76
Dividends	\$ 0.07	\$ 0.07	\$ 0.07	\$ 0.07	\$ 0.28