STARBUCKS CORP
Form DEF 14A
December 10, 2004

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SCHEDULE 14A INFORMATION

PROXY STATEMENT PURSUANT TO SECTION 14(a) OF THE SECURITIES EXCHANGE ACT OF 1934

(AMENDMENT NO.__)

Filed by the Registrant [X]

Filed by a Party other than the Registrant [ ]

Check the appropriate box:

[ ] Preliminary Proxy Statement
[ ] Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
[X] Definitive Proxy Statement
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[ ] Soliciting Material Pursuant to sec. 240.14a-12

Starbucks Corporation

(Name of Registrant as Specified In Its Charter)

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Payment of Filing Fee (Check the appropriate box):

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(1) Amount Previously Paid:

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Seattle, Washington

December 10, 2004

Dear Shareholders:

You are cordially invited to attend the Starbucks Corporation Annual Meeting of Shareholders on Wednesday, February 9, 2005, at 10 a.m. (Pacific Time). The meeting will be held at Marion Oliver McCaw Hall at the Seattle Center, located on Mercer Street, between Third and Fourth Avenues, in Seattle, Washington. Directions to McCaw Hall and transportation information appear on the back cover of this Notice of Annual Meeting and Proxy Statement.

As always, we anticipate a large number of attendees at our Annual Meeting of Shareholders. To ensure a pleasant experience for shareholders, we are implementing a new ticketing process. ***In order to obtain seats at this year s Annual Meeting, shareholders must request a complimentary ticket through Ticketmaster.*** Instructions as to how to obtain an admission ticket to the Annual Meeting are included on the back cover of this Notice of Annual Meeting and Proxy Statement. ***Each attendee must present an admission ticket in order to be admitted to the Annual Meeting.***

The matters to be acted upon are described in the accompanying Notice of Annual Meeting and Proxy Statement. At the meeting, we will also report on Starbucks Corporation s operations and respond to any questions you may have.

While we will make every effort to accommodate all attendees, we cannot guarantee seating availability. We strongly recommend that shareholders request tickets early, beginning January 3, 2005. Please bring one admission ticket for each attendee. Doors will open at 8:00 a.m. the day of the event.

YOUR VOTE IS VERY IMPORTANT. Whether or not you plan to attend the Annual Meeting of Shareholders, we urge you to vote and submit your proxy by telephone, the Internet or by mail in order to ensure the presence of a quorum. If you attend the meeting, you will, of course, have the right to revoke the proxy and vote your shares in person. If you hold your shares through an account with a brokerage firm, bank or other nominee, please follow the instructions you receive from them to vote your shares.

Very truly yours,

Howard Schultz
chairman and
chief global strategist

Orin C. Smith
president and
chief executive officer

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STARBUCKS CORPORATION

2401 Utah Avenue South
Seattle, Washington 98134

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS
to be held
February 9, 2005

The Annual Meeting of Shareholders of Starbucks Corporation (the Company) will be held at Marion Oliver McCaw Hall at the Seattle Center, located on Mercer Street, between Third and Fourth Avenues, in Seattle, Washington, on Wednesday, February 9, 2005, at 10 a.m. (Pacific Time) for the following purposes:

1. To elect four Class 3 directors to serve until the 2008 Annual Meeting of Shareholders;

2. To approve the Starbucks Corporation 2005 Long-Term Equity Incentive Plan, including the reservation of an additional 24,000,000 shares of common stock that may be issued as awards under the plan;

3. To ratify the selection of Deloitte & Touche LLP as the Company s independent registered public accounting firm for the fiscal year ending October 2, 2005; and

4. To act on a shareholder proposal requiring the Board of Directors of the Company to establish a policy and goal of purchasing all or substantially all of its coffee as Fair Trade Certified™ coffee by 2010, if properly presented at the meeting.

Only shareholders of record at the close of business on December 2, 2004 will be entitled to notice of and to vote at the Annual Meeting of Shareholders and any adjournments thereof.

The Company s Proxy Statement is attached hereto. Financial and other information concerning the Company is contained in the Company s Annual Report to Shareholders for the fiscal year ended October 3, 2004.

By Order of the Board of Directors,

Paula E. Boggs
secretary

Seattle, Washington
December 10, 2004

YOUR VOTE IS IMPORTANT

WHETHER OR NOT YOU PLAN TO ATTEND THE ANNUAL MEETING OF SHAREHOLDERS, WE URGE YOU TO VOTE AND SUBMIT YOUR PROXY BY TELEPHONE, THE INTERNET OR BY MAIL AS PROMPTLY AS POSSIBLE TO ENSURE THE PRESENCE OF A QUORUM FOR THE MEETING. FOR ADDITIONAL INSTRUCTIONS ON VOTING BY TELEPHONE OR THE INTERNET, PLEASE REFER TO YOUR PROXY CARD. TO VOTE AND SUBMIT YOUR PROXY BY MAIL, PLEASE COMPLETE, SIGN AND DATE THE ENCLOSED PROXY CARD AND RETURN IT IN THE ENCLOSED POSTAGE PRE-PAID ENVELOPE. IF YOU ATTEND THE MEETING, YOU MAY, OF COURSE, REVOKE THE PROXY AND VOTE IN PERSON. IF YOU HOLD YOUR SHARES THROUGH AN ACCOUNT WITH A BROKERAGE FIRM, BANK OR OTHER NOMINEE, PLEASE FOLLOW THE INSTRUCTIONS YOU RECEIVE FROM THEM TO VOTE YOUR SHARES.

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STARBUCKS CORPORATION

2401 Utah Avenue South
Seattle, Washington 98134

PROXY STATEMENT

for the
ANNUAL MEETING OF SHAREHOLDERS

This Proxy Statement is furnished by and on behalf of the board of directors (the Board of Directors or Board) of Starbucks Corporation, a Washington corporation (Starbucks or the Company), in connection with the solicitation of proxies for use at the Annual Meeting of Shareholders of the Company to be held at 10 a.m. (Pacific Time) on Wednesday, February 9, 2005 (the Annual Meeting), at Marion Oliver McCaw Hall (McCaw Hall) at the Seattle Center, located on Mercer Street, between Third and Fourth Avenues, in Seattle, Washington, and at any adjournment thereof. Directions to McCaw Hall and a map are provided on the back cover of this Proxy Statement. This Proxy Statement and the enclosed proxy card will be first mailed on or about January 3, 2005 to the Company s shareholders of record on December 2, 2004 (the Record Date).

A shareholder who delivers an executed proxy pursuant to this solicitation may revoke it at any time before it is exercised by (i) executing and delivering a later dated proxy card to the secretary of the Company prior to the Annual Meeting, (ii) delivering written notice of revocation of the proxy to the secretary of the Company prior to the Annual Meeting, or (iii) attending and voting in person at the Annual Meeting. Attendance at the Annual Meeting, in and of itself, will not constitute a revocation of a proxy. Proxies will be voted as instructed by the shareholder or shareholders granting the proxy. Unless contrary instructions are specified, if the enclosed proxy is executed and returned (and not revoked) prior to the Annual Meeting, the shares of common stock, $0.001 par value per share (the Common Stock), of the Company represented thereby will be voted: (1) FOR the election of the four director candidates nominated by the Board of Directors; (2) FOR approval of the Starbucks Corporation 2005 Long-Term Equity Incentive Plan, including the reservation of an additional 24,000,000 shares of common stock that may be issued as awards under the plan; (3) FOR the ratification of the selection of Deloitte & Touche LLP as the Company s independent registered public accounting firm for the fiscal year ending October 2, 2005; (4) AGAINST the proposal requiring the Board of Directors to establish a policy and goal of purchasing all or substantially all of the Company s coffee as Fair Trade Certified™ coffee by 2010; and (5) in accordance with the best judgment of the named proxies on any other matters properly brought before the Annual Meeting.

The presence, in person or by proxy, of holders of a majority of the outstanding shares of Common Stock is required to constitute a quorum for the transaction of business at the Annual Meeting. Abstentions and broker non-votes (shares held by a broker or nominee that does not have the authority, either express or discretionary, to vote on a particular matter) are counted for purposes of determining the presence or absence of a quorum for the transaction of business at the Annual Meeting. Under Washington law, if a quorum is present, a nominee for election to a position on the Board of Directors will be elected as a director if the votes cast for the nominee exceed the votes cast against the nominee and exceed the votes cast for any other nominee for that position. If a quorum is present, approval of all other matters that properly come before the meeting requires that the votes cast in favor of such actions exceed the votes cast against such actions. Abstentions and broker non-votes will not be counted either in favor of or against the election of nominees for director or other proposals. Proxies and ballots will be received and tabulated by Mellon Investor Services LLC, the Company s transfer agent and the inspector of elections for the Annual Meeting.

The expense of preparing, printing and mailing this Proxy Statement and the proxies solicited hereby will be borne by the Company. Proxies will be solicited by mail and may also be solicited by directors, officers and other employees of the Company, without additional remuneration, in person or by telephone or facsimile transmission. In addition, the Company has retained The Altman Group, Inc. to act as a proxy solicitor in conjunction with the Annual Meeting. The Company has agreed to pay that firm $15,000, plus reasonable out

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of pocket expenses, for proxy solicitation services. The Company will also request brokerage firms, banks, nominees, custodians and fiduciaries to forward proxy materials to the beneficial owners of shares of Common Stock as of the Record Date and will reimburse such persons for the cost of forwarding the proxy materials in accordance with customary practice. Your cooperation in promptly voting your shares and submitting your proxy by telephone, the Internet or by completing and returning the enclosed proxy card will help to avoid additional expense.

At the close of business on December 8, 2004, there were 399,976,509 shares of Common Stock outstanding and there were no outstanding shares of any other class of stock. Holders of shares of Common Stock are entitled to cast one vote per share on all matters.

PROPOSAL 1 ELECTION OF DIRECTORS

In accordance with the Company s Amended and Restated Bylaws, by resolution the Board of Directors has set the size of the Board at twelve members. The Amended and Restated Articles of Incorporation of the Company provide that the Board of Directors shall be divided into three groups, with such groups to be as equal in number as possible. Upon the expiration of the term of a class of directors, nominees for such class are elected to serve for a term of three years and until their respective successors have been elected and qualified. The terms of the current Class 3 directors, Ms. Bass and Messrs. Foley, Lee and Schultz, expire upon the election and qualification of the Class 3 directors to be elected at the Annual Meeting. Mr. Foley has notified the Board that he will retire from the Board, effective immediately prior to the Annual Meeting, and so is not standing for reelection. The Board of Directors has nominated Ms. Bass and Messrs. Lee and Schultz for reelection, and Ms. Mellody Hobson for election, to the Board of Directors as Class 3 directors at the Annual Meeting, to serve until the 2008 Annual Meeting of Shareholders and until their respective successors have been elected and qualified. The terms of the Class 1 and Class 2 directors expire at the 2006 and 2007 Annual Meeting of Shareholders, respectively.

Unless otherwise directed, the persons named in the proxy intend to vote all proxies FOR the election of Ms. Bass and Hobson and Messrs. Lee and Schultz to the Board of Directors. The nominees have consented to serve as directors of the Company if elected. If, at the time of the Annual Meeting, any of the nominees is unable or declines to serve as a director, the discretionary authority provided in the enclosed proxy will be exercised to vote for a substitute candidate designated by the Board of Directors. The Board of Directors has no reason to believe any of the nominees will be unable or will decline to serve as a director.

Set forth below is certain information furnished to the Company by the director nominees and by each of the incumbent directors whose terms will continue following the Annual Meeting. There are no family relationships among any directors or executive officers of the Company. None of the corporations or other organizations referenced in the biographical information below is a parent, subsidiary or other affiliate of the Company.

Class 3 Directors

Terms expire at the Annual Meeting

BARBARA BASS, 53, has been a director of the Company since January 1996. Since 1993, Ms. Bass has been the president of Gerson Bakar Foundation. From 1989 to 1992, Ms. Bass was president and chief executive officer of the Emporium Weinstock Division of Carter Hawley Hale Stores, Inc. Ms. Bass also serves on the board of directors of DFS Group Limited, a retailer of luxury branded merchandise, and bebe stores, inc., a retailer of contemporary sportswear and accessories.

OLDEN LEE, 63, has been a director of the Company since June 2003. Mr. Lee worked with PepsiCo, Inc. for 28 years in a variety of positions, including serving as senior vice president of human resources of its Taco Bell division and senior vice president and chief personnel officer of its KFC division.

HOWARD SCHULTZ, 51, is the founder of the Company, the chairman of the Board and has served as chief global strategist since June 2000. From the Company s inception, he served as chairman of the board and chief executive officer. From 1985 to June 1994, Mr. Schultz was also the Company s president. From January

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1986 to July 1987, Mr. Schultz was the chairman of the board, chief executive officer and president of Il Giornale Coffee Company, a predecessor to the Company. From September 1982 to December 1985, Mr. Schultz was the director of retail operations and marketing for Starbucks Coffee Company, a predecessor to the Company. Mr. Schultz also serves on the board of directors of DreamWorks Animation SKG, Inc.

Class 3 Director Nominee

MELLODY HOBSON, 35, was nominated by the Board as a Class 3 Director in November 2004. Ms. Hobson has served as the president and a director of Ariel Capital Management, LLC/Ariel Mutual Funds, a Chicago-based investment management firm, since 2000. She previously served as senior vice president and director of marketing at Ariel Capital Management, Inc. from 1994 to 2000, and as vice president of marketing at Ariel Capital Management, Inc. from 1991 to 1994. Ms. Hobson works with a variety of civic and professional institutions, including serving as a director of the Chicago Public Library as well as its foundation and as a board member of the Field Museum and the Chicago Public Education Fund. In 2004, the *Wall Street Journal* named her as one of its 50 Women to Watch . Ms. Hobson also serves on the board of directors of Tellabs, Inc., DreamWorks Animation SKG, Inc. and The Estee Lauder Companies Inc.

Class 1 Directors

Terms expire at the 2006 Annual Meeting

HOWARD P. BEHAR, 60, has been a director of the Company since January 1996. Mr. Behar came out of retirement to serve as the Company s president, North America from September 2001 through December 2002. Prior to serving in that capacity, Mr. Behar served as president of Starbucks Coffee International, Inc. from June 1994 until his retirement in late 1999. From February 1993 to June 1994, Mr. Behar served as the Company s executive vice president, Sales and Operations. From February 1991 to February 1993, Mr. Behar served as the Company s senior vice president, Retail Operations and from August 1989 to January 1991, he served as the Company s vice president, Retail Stores. Mr. Behar also serves on the board of directors of The Gap, Inc. and Shurgard Storage Centers, Inc.

JAMES G. SHENNAN, JR., 63, has been a director of the Company since March 1990. Mr. Shennan has served as a general partner of Trinity Ventures, a venture capital organization, since September 1989. Prior to that time, he served as the chief executive of Addison Consultants, Inc., an international marketing services firm, and two of its predecessor companies. Mr. Shennan also serves on the board of directors of P.F. Chang s China Bistro, Inc.

MYRON E. ULLMAN, III, 58, has been a director since January 2003. Mr. Ullman has served as the chairman of the board of directors and chief executive officer of J.C. Penney Company, Inc. since December 2004. Mr. Ullman served as directeur general, group managing director of LVMH Möet Hennessy Louis Vuitton, a luxury goods manufacturer and retailer from July 1999 to January 2002. From January 1995 to June 1999, Mr. Ullman served as group chairman and chief executive officer of DFS Group Limited, a retailer of luxury branded merchandise. From 1992 to 1995, Mr. Ullman served as chairman and chief executive officer of R.H. Macy & Co., Inc. Mr. Ullman also serves on the board of directors of Polo Ralph Lauren Corporation, Segway, LLC, and the board of advisors of Kendall-Jackson Wine Estates, Ltd.

CRAIG E. WEATHERUP, 59, has been a director of the Company since February 1999. From March 1999 to January 2003, Mr. Weatherup served as the chairman and chief executive officer of The Pepsi Bottling Group, Inc. Prior to the initial public offering of The Pepsi Bottling Group, Inc. in early 1999, Mr. Weatherup worked with PepsiCo, Inc. for 24 years and served as chief executive officer of its worldwide Pepsi-Cola business. Mr. Weatherup also serves on the board of directors of Federated Department Stores, Inc.

Class 2 Directors

Terms expire at the 2007 Annual Meeting

WILLIAM W. BRADLEY, 61, has been a director of the Company since June 2003. Mr. Bradley is a managing director of Allen & Company LLC. From 2001 until 2004, he acted as chief outside advisor to

McKinsey & Company s non-profit practice. In 2000, Mr. Bradley was a candidate for the Democratic nomination for President of the United States. Mr. Bradley also served as a senior advisor and vice chairman of the International Council of JP Morgan & Co., Inc. from 1997 through 1999. During that time, Mr. Bradley also worked as an essayist for *CBS Evening News*, a visiting professor at Stanford University, Notre Dame University and the University of Maryland. Mr. Bradley served in the U.S. Senate from 1979 until 1997 representing the State of New Jersey. Prior to serving in the U.S. Senate, Mr. Bradley was an Olympic gold medalist in 1964, and from 1967 through 1977 he played professional basketball for the New York Knicks, during which time they won two world championships. Mr. Bradley also serves on the board of directors of Willis Group Holdings Limited and Seagate Technology.

GREGORY B. MAFFEI, 44, has been a director of the Company since February 1999. Mr. Maffei is chairman and chief executive officer of 360networks Corporation, a telecommunications service provider. Previously, Mr. Maffei served as the chief financial officer of Microsoft Corporation from 1997 to 2000, and as its vice president, corporate development and treasurer from 1994 to 1997. Mr. Maffei also serves on the board of directors of Electronic Arts Inc.

ORIN C. SMITH, 62, has been a director of the Company since January 1996. Mr. Smith has served as president and chief executive officer of the Company since June 2000. From June 1994 to May 2000, Mr. Smith served as the Company s president and chief operating officer, and from March 1990 to June 1994, he was the Company s vice president and chief financial officer and later its executive vice president and chief financial officer. Mr. Smith has announced his intention to retire as president and chief executive officer, and intends to retire from the Board effective March 31, 2005. Mr. Smith also serves on the board of directors of NIKE, Inc.

THE BOARD OF DIRECTORS RECOMMENDS THAT SHAREHOLDERS VOTE FOR THE ELECTION OF MS. BASS AND HOBSON AND MESSRS. LEE AND SCHULTZ TO THE BOARD OF DIRECTORS.

The Company s Director Nominations Process

The Company s Board of Directors has, by resolution of the Board, adopted a Director Nominations Policy (the Nominations Policy), which is available at *www.starbucks.com/aboutus/ corporate_governance.asp*. The purpose of the Nominations Policy is to describe the process by which candidates for possible inclusion in the Company s recommended slate of director nominees (the Candidates) are selected. The Nominations Policy is administered by the Nominating and Corporate Governance Committee (the Nominating Committee) of the Company.

Minimum Criteria for Board Members

Each Candidate must possess at least the following specific minimum qualifications:

Each Candidate shall be prepared to represent the best interests of all of the Company s shareholders and not just one particular constituency.

Each Candidate shall be an individual who has demonstrated integrity and ethics in his/her personal and professional life and has established a record of professional accomplishment in his/her chosen field.

No Candidate, or family member (as defined in the Marketplace Rules of The Nasdaq Stock Market, Inc. (Nasdaq)), or affiliate or associate (each as defined in Rule 405 under the Securities Act of 1933, as amended) of a Candidate, shall have any material personal, financial or professional interest in any present or potential competitor of the Company.

Each Candidate shall be prepared to participate fully in Board activities, including active membership on at least one Board committee and attendance at, and active participation in, meetings of the Board and the committee of which he or she is a member, and not have other

personal or professional commitments that would, in the Nominating Committee s sole judgment, interfere with or limit his or her ability to do so.

Each Candidate shall be willing to make, and financially capable of making, the required investment in the Company s stock in the amount and within the timeframe specified in the Company s Corporate Governance Principles and Practices.

Desirable Qualities and Skills

In addition, the Nominating Committee also considers it desirable that Candidates possess the following qualities or skills:

Each Candidate should contribute to the Board s overall diversity diversity being broadly construed to mean a variety of opinions, perspectives, personal and professional experiences and backgrounds, such as gender, race and ethnicity differences, as well as other differentiating characteristics.

Each Candidate should contribute positively to the existing chemistry and collaborative culture among Board members.

Each Candidate should possess professional and personal experiences and expertise relevant to the Company s goal of being one of the world s leading consumer brands. At this stage of the Company s development, relevant experiences might include, among other things, large company CEO experience, senior level international experience, senior level multi-unit small box retail or restaurant experience and relevant senior level expertise in one or more of the following areas finance, accounting, sales and marketing, organizational development, information technology and public relations.

Internal Process for Identifying Candidates

The Nominating Committee has two primary methods for identifying Candidates (other than those proposed by the Company s shareholders, as discussed below). First, on a periodic basis, the Nominating Committee solicits ideas for possible Candidates from a number of sources members of the Board; senior level Company executives; individuals personally known to the members of the Board; and research, including database and Internet searches.

Second, the Nominating Committee may from time to time use its authority under its charter to retain at the Company s expense one or more search firms to identify Candidates (and to approve such firms fees and other retention terms). If the Nominating Committee retains one or more search firms, they may be asked to identify possible Candidates who meet the minimum and desired qualifications expressed in the Nominations Policy, to interview and screen such candidates (including conducting appropriate background and reference checks), to act as a liaison among the Board, the Nominating Committee and each Candidate during the screening and evaluation process and thereafter to be available for consultation as needed by the Nominating Committee.

The Nominations Policy divides the process for Candidates proposed by shareholders into the general nomination right of all shareholders and proposals by Qualified Shareholders (as defined below).

General Nomination Right of All Shareholders

Any shareholder of the Company may nominate one or more persons for election as a director of the Company at an annual meeting of shareholders if the shareholder complies with the notice, information and consent provisions contained in the Company s Amended and Restated Bylaws. The Company has an advance notice bylaw provision. In order for the director nomination to be timely, a shareholder s notice to the Company s executive vice president, general counsel and secretary must be delivered to the Company s principal executive offices not less than 120 days prior to the anniversary of the date of the Company s proxy statement released to shareholders in connection with the previous year s annual meeting. In the event that the

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Company sets an annual meeting date that is not within 30 days before or after the anniversary of the date of the immediately preceding annual shareholders meeting, notice by the shareholder must be received no later than the close of business on the tenth day following the day on which notice of the date of the annual meeting was mailed or public disclosure of the date of the annual meeting was made, whichever occurs first. The procedures described in the next paragraph are meant to establish an additional means by which certain shareholders can have access to the Company s process for identifying and evaluating Candidates, and is not meant to replace or limit shareholders general nomination rights in any way.

Proposals by Qualified Shareholders

In addition to those Candidates identified through its own internal processes, in accordance with the Nominations Policy, the Nominating Committee will evaluate a Candidate proposed by any single shareholder or group of shareholders that has beneficially owned more than 5% of the Common Stock for at least one year (and will hold the required number of shares through the annual shareholders meeting) and that satisfies the notice, information and consent provisions in the Nominations Policy (a Qualified Shareholder). All Candidates (whether identified internally or by a Qualified Shareholder) who, after evaluation, are then recommended by the Nominating Committee and approved by the Board, will be included in the Company s recommended slate of director nominees in its proxy statement.

In order to be considered by the Nominating Committee for an upcoming annual meeting of shareholders, a notice from a Qualified Shareholder regarding a potential Candidate must be received by the Nominating Committee not less than 120 calendar days before the anniversary of the date of the Company s proxy statement released to shareholders in connection with the previous year s annual meeting. If the Company changes its annual meeting date by more than 30 days from year to year, the notice must be received by the Nominating Committee no later than the close of business on the tenth day following the day on which notice of the date of the upcoming annual meeting is publicly disclosed.

Any Candidate proposed by a Qualified Shareholder must be independent of the Qualified Shareholder in all respects as determined by the Nominating Committee or by applicable law. Any Candidate submitted by a Qualified Shareholder must also meet the definition of an independent director under Nasdaq rules.

Evaluation of Candidates

The Nominating Committee will consider all Candidates identified through the processes described above, and will evaluate each of them, including incumbents, based on the same criteria.

If, based on the Nominating Committee s initial evaluation, a Candidate continues to be of interest to the Nominating Committee, the Chair of the Nominating Committee will interview the Candidate and communicate the Chair s evaluation to the other Nominating Committee members, the chairman of the Board and chief global strategist, and the president and chief executive officer. Later reviews will be conducted by other members of the Nominating Committee and senior management. Ultimately, background and reference checks will be conducted and the Nominating Committee will meet to finalize its list of recommended Candidates for the Board s consideration.

Timing of the Identification and Evaluation Process

The Company s fiscal year ends each year on the Sunday closest to September 30. The Nominating Committee usually meets in September and November to consider, among other things, Candidates to be recommended to the Board for inclusion in the Company s recommended slate of director nominees for the next annual meeting and the Company s proxy statement. The Board usually meets each November to vote on, among other things, the slate of director nominees to be submitted to and recommended for election by shareholders at the annual meeting, which is typically held in February or March of the following calendar year.

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Future Revisions to the Nominations Policy

The Nominations Policy is intended to provide a flexible set of guidelines for the effective functioning of the Company s director nominations process. The Nominating Committee intends to review the Nominations Policy at least annually and anticipates that modifications will be necessary from time to time as the Company s needs and circumstances evolve, and as applicable legal or listing standards change. The Nominating Committee may amend the Nominations Policy at any time, in which case the most current version will be available on the Company s web site.

Affirmative Determinations Regarding Director Independence and Other Matters

The Board has determined that each of the following directors is an independent director as such term is defined in Nasdaq Marketplace Rule 4200(a)(15):

Barbara Bass
William W. Bradley
Craig J. Foley
Olden Lee
Gregory B. Maffei
James G. Shennan
Myron E. Ullman, III
Craig E. Weatherup

In this proxy statement the directors who have been affirmatively determined by the Board to be independent directors under this rule are referred to individually as an Independent Director and collectively as the Independent Directors.

The Board of Directors has also determined that each member of the three committees of the Board meets the independence requirements applicable to those committees prescribed by Nasdaq, the Securities and Exchange Commission (SEC) and/or the Internal Revenue Service. The Board of Directors has further determined that Gregory B. Maffei, a member of the Audit and Compliance Committee of the Board of Directors, is an audit committee financial expert as such term is defined in Item 401(h) of Regulation S-K promulgated by the SEC. If elected by shareholders at the Annual Meeting, it is expected that Ms. Hobson will be appointed to the Audit and Compliance Committee of the Board (the Audit Committee).

With the assistance of legal counsel to the Company, the Nominating Committee reviewed the applicable legal standards for Board member and Board committee independence and the criteria applied to determine audit committee financial expert status, as well as the answers to annual questionnaires completed by each of the Independent Directors. On the basis of this review, the Nominating Committee delivered a report to the full Board of Directors and the Board made its independence and audit committee financial expert determinations based upon the Nominating Committee s report and each member s review of the information made available to the Nominating Committee.

Presiding Director

Bi-annually, at the first meeting of the Board following the annual meeting of shareholders, the Independent Directors select from their group an Independent Director to preside at all meetings of the Independent Directors. Mr. Shennan was selected after the 2004 Annual Meeting of Shareholders as Presiding Director. The Independent Directors meet in executive session at each Board meeting.

Compensation of Directors

Only non-employee directors are compensated for serving as directors of the Company. In May 2003, the Board of Directors, on recommendation from the Nominating Committee, adopted new guidelines for the compensation of the Company s non-employee directors. Under these guidelines, for each fiscal year of service non-employee directors receive a retainer of $100,000 and $100,000 in equity compensation. Non-employee

directors may elect to receive the $100,000 retainer in cash or in the form of deferred stock units under the Starbucks Corporation Directors Deferred Compensation Plan, as amended and restated effective September 29, 2003 (the NED Deferral Plan), or options to acquire Common Stock under the Starbucks Corporation Amended and Restated 1989 Stock Option Plan for Non-Employee Directors (the NED Option Plan). Non-employee directors may elect to receive the $100,000 in equity compensation in the form of either deferred stock units under the NED Deferral Plan or options granted under the NED Option Plan. Elections regarding the form of compensation to be received for a fiscal year must be made prior to the beginning of the fiscal year, and non-employee directors receive their compensation in accordance with those elections in November.

Upon first joining the Board of Directors, non-employee directors are granted options to acquire 30,000 shares of Common Stock under the NED Option Plan. These options vest in equal annual installments over a three-year period and have an exercise price equal to the fair market value of the Common Stock on the date of grant. New non-employee directors first become eligible to receive the retainer and equity compensation described above in respect of the first full fiscal year after they join the Board of Directors. In accordance with these guidelines, if elected by shareholders at the Annual Meeting, Ms. Hobson will be granted an option to purchase 30,000 shares of the Common Stock and will first be eligible to receive the annual retainer and equity compensation in fiscal 2006.

Non-employee directors may elect to receive all or a portion of their $100,000 retainer and $100,000 in equity compensation in the form of options to acquire Common Stock granted under the NED Option Plan. The number of options granted under the NED Option Plan is determined by dividing the dollar amount of compensation elected to be received in that form by the fair market value of the Common Stock on a predetermined date, multiplied by three. These options vest one year after the date of grant and have an exercise price equal to the last quoted price of the Common Stock on the National Market Tier of Nasdaq on the grant date.

Under the NED Deferral Plan, non-employee directors have the option of deferring all or a portion of their $100,000 retainer and $100,000 in equity compensation by electing to receive deferred stock units instead. The number of deferred stock units credited to a director s account under the NED Deferral Plan is determined by dividing the amount elected to be deferred by the fair market value of the Common Stock on a predetermined date. Upon ceasing to serve on the Board of Directors, non-employee directors participating in the plan receive cash or shares of Common Stock equal to the value or number of deferred stock units with which they have been credited.

As has been described above, prior to the first day of fiscal 2004, each of the non-employee directors made an election with respect to how to receive his or her retainer for fiscal 2004 and how to receive his or her equity compensation. Messrs. Foley, Lee, Ullman and Weatherup elected to receive all of their respective compensation, both retainer and equity compensation, in the form of stock options, and therefore in November 2003 each received an option to purchase 19,698 shares of Common Stock at an exercise price of $30.46 per share under the NED Option Plan. Mr. Maffei elected to receive his compensation, both retainer and equity compensation, in the form of deferred stock units, and therefore in November 2003 he deferred 6,566 stock units based on a value of $30.46 per unit under the NED Deferral Plan. Ms. Bass and Mr. Bradley elected to receive their retainers in cash and their equity compensation in the form of deferred stock units, and therefore in November 2003 each received a cash payment of $100,000 and deferred 3,283 stock units based on a value of $30.46 per unit under the NED Deferral Plan. Each of, Arlen I. Prentice, who retired from the Board during fiscal 2004, and Mr. Shennan elected to receive his retainer in cash and his equity compensation in the form of stock options, and therefore in November 2003 each received a cash payment of $100,000 and an option to purchase 9,849 shares of Common Stock at an exercise price of $30.46 per share under the NED Option Plan. During fiscal 2004, Mr. Behar received an option to purchase 10,000 shares of Common Stock at an exercise price of $30.46 per share vesting in one annual installment under the Starbucks Corporation Amended and Restated Key Employee Stock Option Plan 1994 (the Key Employee Plan) for services rendered as a director.

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Board and Committee Meetings

During fiscal 2004, the Board of Directors had three standing committees: the Compensation and Management Development (the Compensation Committee), the Audit Committee, and the Nominating Committee. Committee and committee chair assignments are made annually by the Board at its meeting immediately following the annual meeting of shareholders. The Board of Directors held five meetings, the Compensation Committee held five meetings, the Audit Committee held seven meetings and the Nominating Committee held four meetings. It is the policy of the Board of Directors and each of the Board s committees to hold an executive session without management present at each Board meeting. During fiscal 2004, each director attended at least 75% of all meetings of the Board of Directors and Board committees on which he or she served. The report of each of the committees is set forth below.

Audit and Compliance Committee Report

During fiscal 2004, Messrs. Foley, Maffei, Shennan and Weatherup served on the Audit Committee. On November 16, 2004, Mr. Foley announced his decision to retire from the Board and the Audit Committee effective immediately prior to the Annual Meeting. If elected by shareholders at the Annual Meeting, Ms. Hobson will be appointed to the Audit Committee. Each of Messrs. Foley, Maffei, Shennan and Weatherup meets the independence criteria prescribed by applicable law and the rules of the SEC for audit committee membership and is an independent director as defined in Nasdaq Marketplace Rule 4200(a)(15). Each of Messrs. Foley, Maffei, Shennan and Weatherup meets Nasdaq s financial knowledge requirements, and Mr. Maffei, designated by the Board of Directors as the audit committee financial expert under SEC rules, meets Nasdaq s professional experience requirements as well. The Audit Committee operates pursuant to a written charter, which complies with the applicable provisions of the Sarbanes-Oxley Act of 2002 and related rules of the SEC and Nasdaq. The charter is available on the Company s web site at www.starbucks.com/aboutus/corporate governance.asp. As more fully described in its charter, the Audit Committee is responsible for overseeing the Company s accounting and financial reporting processes, including the quarterly review and the annual audit of the Company s consolidated financial statements by Deloitte & Touche LLP (Deloitte), the Company s independent registered public accounting firm. As part of fulfilling its responsibilities, the Audit Committee reviewed and discussed the audited consolidated financial statements for fiscal 2004 with management and the Company s independent registered public accounting firm and discussed those matters required by Statement on Auditing Standards No. 61 (Communication with Audit Committees), as amended, with the Company s independent registered public accounting firm. The Audit Committee received the written disclosures and the letter required by Independent Standards Board Statement No. 1 (Independence Discussions with Audit Committee) from Deloitte, and discussed that firm s independence with representatives of the firm.

Based upon the Audit Committee s review of the audited consolidated financial statements and its discussions with management, the internal audit function and the Company s independent registered public accounting firm, the Audit Committee recommended that the Board of Directors include the audited consolidated financial statements for the fiscal year ended October 3, 2004 in the Company s Annual Report on Form 10-K filed with the SEC.

Respectfully submitted,

Craig J. Foley (Chair)
Gregory B. Maffei
James G. Shennan, Jr.
Craig E. Weatherup

Compensation and Management Development Committee Report

During fiscal 2004, Ms. Bass and Messrs. Prentice, Ullman and Lee served on the Compensation Committee, with Ms. Bass serving as Chair. Mr. Prentice retired from the Board and the Compensation Committee effective March 29, 2004, immediately prior to the 2004 Annual Meeting of Shareholders. Each director who served on the Compensation Committee during fiscal 2004 qualified as an outside director under Section 162(m) of the Internal Revenue Code (the Code), a non-employee director as such term is defined in Rule 16b-3 promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act), and an independent director as such term is defined in Nasdaq Marketplace Rule 4200(a)(15). The Compensation Committee is responsible for conducting an annual review of the Company s compensation packages for executive officers, including the president and chief executive officer, and the chairman of the Board and chief global strategist. In connection therewith, the Compensation Committee reviews and recommends to the Independent Directors (i) the annual base salary level, (ii) the annual cash bonus opportunity level, and (iii) the long-term incentive opportunity for each executive officer. The Compensation Committee s recommendations are reviewed and approved by the Independent Directors.

The Compensation Committee reviews and makes recommendations to the Independent Directors on remuneration of certain executive officers of the Company, including the executive officers named in the Summary Compensation Table set forth in the Executive Compensation section of this Proxy Statement (such named executives, the Named Executive Officers). The Compensation Committee reviews (and makes recommendations to the Independent Directors on), payments of bonuses under the Company s Executive Management Bonus Plan (the EMB Plan).

The president and chief executive officer and chairman and chief global strategist may participate in the discussions by the Independent Directors regarding compensation of the Company s executive officers, but they may not be present when the Independent Directors vote whether to approve the Compensation Committee s recommendations with respect to their own compensation.

Compensation Components: The Board of Directors believes that compensation paid to executive officers should be closely aligned with the performance of the Company on both a short-term and long-term basis, and that such compensation should assist the Company in attracting and retaining key executives critical to its long-term success. To that end, it is the view of the Board that the compensation packages for executive officers should consist of three components: (i) annual base salary; (ii) incentive bonuses, the amount of which is dependent on both Company and individual performance during the prior fiscal year; and (iii) stock option awards designed to align executive officers interests with those of shareholders by rewarding outstanding performance and providing long-term incentives.

The Compensation Committee reviews and makes recommendations to the Independent Directors on total annual compensation for the chairman and chief global strategist, the president and chief executive officer and certain other executive officers after reviewing each component of such executive s compensation against executive compensation surveys prepared by an outside compensation consultant selected and retained by the Compensation Committee. The surveys used for comparison reflect compensation levels and practices for persons holding comparable positions at targeted peer group companies. The compensation comparator group is not limited to companies listed on the National Market tier of Nasdaq, and includes an array of companies in specialty retail and other industries with high growth and strong brand image characteristics. In addition to reviewing executive officers compensation against the comparator group, the Compensation Committee also solicits appropriate input from the Company s president and chief executive officer regarding total compensation for those executives reporting directly to him. Management provides to the Compensation Committee, at its request, a breakdown of material total compensation components for each executive officer, both historical and prospective. The Compensation Committee makes this information available to the Independent Directors, who determine the compensation of these executive officers after considering recommendations received from the Compensation Committee.

Total Compensation: Based on the Company s fiscal 2004 performance, the Compensation Committee recommended that total compensation for executive officers for fiscal 2004 (the sum of base salary, incentive bonus and long-term compensation delivered through stock option awards) should be positioned around the

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90th percentile of selected peer group companies. Based on the most recent data available, Starbucks ranked in the top three among selected peer companies in one- and three-year total shareholder return and revenue growth, and three-year compounded annual net income growth.

Base Salary: Base salaries for executive officers are reviewed on an annual basis and at the time of promotion or other increase in responsibilities. Increases in salary are based on subjective evaluation of such factors as the level of responsibility, individual performance, level of pay and Company peer group pay levels. In fiscal 2004, Mr. Smith s base salary was determined in accordance with the factors above. In fiscal 2004, Mr. Smith s base salary was $1,190,000 (although the amount actually paid and reflected in the Summary Compensation Table is less because the salary was effective December 1, 2003, approximately two months into the fiscal year), an amount at the competitive target of the 50th percentile of salaries paid by targeted peer companies.

Incentive Bonus: Incentive bonuses are generally granted based on a percentage of each executive officer s base salary. During fiscal 2004, the president and chief executive officer, the chairman and chief global strategist, the segment presidents and the executive vice presidents of the Company participated in the EMB Plan. The EMB Plan, as in effect during fiscal 2004, was designed to enable at least 80% of the target amounts of incentive bonuses paid to executive officers to qualify as performance-based compensation (as defined in Section 162(m) of the Code) and therefore be deductible by the Company for tax purposes. It is the Company s intention and general practice to pay performance-based compensation that is deductible, but the Company may from time to time pay amounts that are not deductible to meet hiring, retention or other compensation objectives.

The Compensation Committee recommends to the Independent Directors the objective performance measure or measures, bonus target percentages and other terms and conditions of awards under the EMB Plan. During fiscal 2004, target bonus amounts under the EMB Plan were expressed as a percentage of base salary and were established according to the overall intended competitive position and competitive survey data for comparable positions in peer group companies. For fiscal 2004, the bonus targets for participating officers ranged from 50% to 100% of base salary depending on position. For Messrs. Smith and Schultz, the EMB Plan provided a bonus target of approximately $1,190,000, or 100% of base salary, for achievement of 100% of the objective performance goal. After the end of the fiscal year, the Compensation Committee determined the extent to which the performance goals were achieved and recommended to the Independent Directors the amount of the award to be paid to each participant.

Under the EMB Plan as in effect during fiscal 2004, 80% of the target bonus was based on the achievement of the specified objective performance goal recommended by the Compensation Committee (and approved by the Independent Directors) for the fiscal year (other than for Messrs. Schultz and Smith, for whom 100% of the target bonus was based on the objective performance goal). In fiscal 2004, an earnings per share target was the objective performance measure upon which the objective performance goal was based. The terms of the objective performance goal permit bonus payouts of up to 200% of the target bonus in the event (as was the case in fiscal 2004) that the Company s actual financial performance is better than the earnings per share target based on a scale approved by the Independent Directors upon recommendation from the Compensation Committee. Twenty percent (20%) of the target bonus for each officer other than Messrs. Schultz and Smith was based on specific individual performance, which changes somewhat each year according to strategic plan initiatives and the responsibilities of the positions. Relative weights assigned to each individual performance goal typically range from 5% to 35% of the 20% target bonus based on specific individual performance. All performance goals were established and approved by the Independent Directors within the first 90 days of fiscal 2004.

The total bonus award is determined according to the level of achievement of both the objective performance and individual performance goals. Below a threshold level of performance, no awards may be granted pursuant to the objective performance goal and the Independent Directors, acting on the recommendation of the Compensation Committee may, in their discretion, reduce the awards pursuant to either objective or individual performance goals. Under the terms of the EMB Plan, Mr. Smith earned the maximum allowable bonus of $2,380,000 for fiscal 2004, based on the achievement of the objective

performance goal. Because the Company achieved earnings per share greater than that required to obtain 100% of the target bonus amount attributed to the objective performance goal, the bonus paid to Mr. Smith was above his annual base salary and above the competitive target of the 50th percentile of bonuses paid by target peer group companies. Mr. Smith also received a discretionary bonus of $110,000 paid in recognition of extraordinary performance during the first quarter of fiscal 2004.

Stock Options: In fiscal 2004, long-term performance based compensation of executive officers took the form of option awards under the Key Employee Plan. The Board of Directors believes that equity-based compensation ensures that the Company s executive officers have a continuing stake in the long-term success of the Company. All options granted by the Company have been granted as non-qualified stock options with an exercise price equal to the closing price of the Common Stock on the date of grant and, accordingly, will have value only if the market price of the Common Stock increases after that date.

In determining the size of stock option grants to executive officers under the Key Employee Plan, the Compensation Committee bases its recommendations to the Independent Directors on such considerations as the value of options awarded to comparable positions in peer group companies, Company and individual performance against the strategic plan, the number of options currently held by the officer, the allocation of overall share usage attributed to executive officers and the relative proportion of long-term incentives within the total compensation mix. In fiscal 2004, Mr. Smith was granted an option to purchase 550,000 shares of Common Stock. Mr. Smith s option, like the stock options granted to the other executive officers, was granted on November 20, 2003 and reflects the Company s and such officers performance for fiscal 2003.

Respectfully submitted,

Barbara Bass (Chair)
Olden Lee
Myron E. Ullman, III

Nominating and Corporate Governance Committee Report

During fiscal 2004, Messrs. Weatherup, Shennan and Bradley and Ms. Bass served on the Nominating Committee, with Mr. Weatherup serving as Chair. Each of the members of the Nominating Committee has been affirmatively determined by the Board of Directors to be an independent director as defined in Nasdaq Marketplace Rule 4200(a)(15).

The Nominating Committee is responsible for developing and implementing policies and procedures that are intended to constitute and organize appropriately the Board of Directors to meet its fiduciary obligations to the Company and its shareholders on an ongoing basis. Among its specific duties, the Nominating Committee makes recommendations to the Board of Directors about the Company s corporate governance processes, assists in identifying and recruiting candidates for the Board, administers the Director Nominations Policy, considers nominations to the Board received from shareholders, makes recommendations to the Board regarding the membership and chairs of the Board s committees, oversees the annual evaluation of the effectiveness of the organization of the Board and of each of its committees, bi-annually recommends to the other Independent Directors for their selection the Independent Director who will preside at all meetings of the Independent Directors for the following two years, periodically reviews the type and amount of Board compensation for Independent Directors and makes recommendations to the full Board regarding such compensation.

Together with the Chair of the Compensation Committee, the Chair of the Nominating Committee at the direction of the full Board annually reviews the performance of the Company s chairman and chief global strategist and its president and chief executive officer and meets with each such officer to share the findings of such review. The Nominating Committee also annually reports findings of fact to the Board of Directors that

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permit the Board to make affirmative determinations regarding each Board and committee member with respect to independence and expertise criteria established by Nasdaq, IRS and SEC rules and applicable law.

Respectfully submitted,

Craig E. Weatherup (Chair)
Barbara Bass
William W. Bradley
James G. Shennan, Jr.

Independent Registered Public Accounting Firm Fees

The following table sets forth the aggregate fees billed to the Company for fiscal 2004 and fiscal 2003 by Deloitte:

	Fiscal 2004	Fiscal 2003
Audit Fees	$1,578,000	$1,364,000
Audit-Related Fees	28,000	107,000
Tax Fees	95,000	98,000
All Other Fees		
Total	$1,701,000	$1,569,000

Audit-Related Fees consist of fees for assurance and related services that are reasonably related to the performance of the audit or review of the Company s financial statements and are not reported under *Audit Fees.* This category includes fees related to audit and attest services not required by statute or regulations, due diligence related to mergers, acquisitions and investments and consultations concerning financial accounting and reporting standards.

Tax Fees consist of fees for professional services for tax compliance, tax advice and tax planning. These services include assistance regarding federal, state and international tax compliance, return preparation, tax audits and customs and duties.

The Audit Committee has considered whether the provision of non-audit services is compatible with maintaining the independence of Deloitte and has concluded that it is.

Policy on Audit Committee Pre-Approval of Audit and Permissible Non-Audit Services of the Independent Registered Public Accounting Firm

The Audit Committee is responsible for appointing, setting compensation for and overseeing the work of the independent registered public accounting firm. The Audit Committee has established a policy requiring its pre-approval of all audit and permissible non-audit services provided by the independent registered public accounting firm. The policy is available at www.starbucks.com/aboutus/corporate governance.asp. The policy provides for the general pre-approval of specific types of services and gives detailed guidance to management as to the specific services that are eligible for general pre-approval and provides specific cost limits for each such service on an annual basis. The policy requires specific pre-approval of all other permitted services. For both types of pre-approval, the Audit Committee considers whether such services are consistent with the rules of the SEC on auditor independence. The Audit Committee s charter delegates to its Chair the authority to address any requests for pre-approval of services between Audit Committee meetings, and the Chair must report any pre-approval decisions to the Audit Committee at its next scheduled meeting. The policy prohibits the Audit Committee from delegating to management the Audit Committee s responsibility to pre-approve permitted services of the independent registered public accounting firm.

Requests for pre-approval for services that are eligible for general pre-approval must be detailed as to the services to be provided and the estimated total cost and are submitted to the Company s controller. The controller then determines whether the services requested fall within the detailed guidance of the Audit Committee in the policy as to the services eligible for general pre-approval. The independent registered public

accounting firm and management must report to the Audit Committee on a timely basis regarding the services provided by the independent registered public accounting firm in accordance with general pre-approval.

None of the services related to the *Audit-Related Fees* or *Tax Fees* described above was approved by the Audit Committee pursuant to the waiver of pre-approval provisions set forth in applicable rules of the SEC.

Compensation Committee Interlocks and Insider Participation

During fiscal 2004, Ms. Bass and Messrs. Lee, Prentice and Ullman served on the Compensation Committee. Mr. Prentice retired from the Board and the Compensation Committee effective March 29, 2004. No member of the Compensation Committee was at any time during fiscal 2004 or at any other time an officer or employee of the Company, and no member had any relationship with the Company requiring disclosure as a related-party transaction in the section Certain Transactions and Compensation Arrangements . No executive officer of the Company has served on the board of directors or compensation committee of any other entity that has or has had one or more executive officers who served as a member of the Board of Directors or the Compensation Committee during fiscal 2004.

Corporate Governance

The following materials related to the Company s corporate governance are available publicly on the Company s web site at www.starbucks.com/aboutus/corporate_governance.asp.

- Corporate Governance Principles and Practices
- Amended and Restated Articles of Incorporation, as amended
- Amended and Restated Bylaws
- Audit and Compliance Committee Charter
- Compensation and Management Development Committee Charter
- Nominating and Corporate Governance Committee Charter
- Director Nominations Policy
- Standards of Business Conduct (applicable to directors, officers and employees)
- Code of Ethics for CEO and Senior Finance Leaders
- Procedure for Communicating Complaints or Concerns
- Audit and Compliance Committee Policy for Pre-Approval of Independent Auditor Services

Copies may also be obtained, free of charge, by writing to: executive vice president, general counsel and secretary, Starbucks Corporation, 2401 Utah Avenue South, S-LA1, Seattle, Washington, 98134. Please specify which document you would like to receive.

The Procedure for Communicating Complaints or Concerns (the Complaints or Concerns Procedure) describes the manner in which interested persons can send communications to the Board, the committees of the Board and to individual directors and describes the Company s process for determining which communications will be relayed to Board members. The Complaints or Concerns Procedure provides that interested persons may telephone their complaints or concerns by calling the Starbucks Auditline at 1-800-300-3205 or sending written communications to the Board, committees of the Board and individual directors by mailing those communications to our third party service provider for receiving these communications at:

Starbucks Corporation

[Addressee*]
P.O. Box 34507
Seattle, WA 98124

* Audit and Compliance Committee of the Board of Directors
Compensation and Management Development Committee of the Board of Directors
Nominating and Corporate Governance Committee of the Board of Directors
Name of individual director

The Corporate Governance Principles and Practices require each Board member to attend the Company s annual meeting of shareholders except for absences due to causes beyond the reasonable control of the director. There were 11 directors at the time of the 2004 Annual Meeting of Shareholders and all 11 attended the meeting.

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BENEFICIAL OWNERSHIP OF COMMON STOCK

As of November 15, 2004, there were no persons known by management of the Company to own beneficially more than 5% of the outstanding Common Stock. The following table sets forth information concerning the beneficial ownership of Common Stock of (i) the directors of the Company, (ii) the Named Executive Officers and (iii) all current directors and executive officers of the Company as a group. Such information is provided as of November 15, 2004. Except as otherwise noted, the beneficial owners listed have sole voting and investment power with respect to shares beneficially owned. An asterisk in the percent of class column indicates beneficial ownership of less than 1%.

Name and Address of Beneficial Owner(1)	Amount and Nature of Beneficial Ownership	Percent of Class(2)
Howard Schultz	16,142,138(3)	3.9%
Orin C. Smith	245,952(4)	*
Barbara Bass	350,554(5)	*
Howard P. Behar	346,826(6)	*
William W. Bradley	13,283(7)	*
Craig J. Foley	321,969(8)	*
Olden Lee	29,698(9)	*
Gregory B. Maffei	216,554(10)	*
James G. Shennan, Jr.	463,279(11)	*
Myron E. Ullman, III	39,698(12)	*
Craig E. Weatherup	248,886(13)	*
James L. Donald	350,000(14)	*
Michael Casey	761,638(15)	*
David A. Pace	106,667(16)	*
All Directors and Executive Officers as a Group (18 persons)	20,116,611(17)	4.9%

(1) The address of all persons listed is c/o Starbucks Corporation, 2401 Utah Avenue South, Seattle, Washington 98134.

(2) Based on 399,350,397 shares of Common Stock outstanding on November 15, 2004.

(3) Includes 8,302,348 shares subject to options exercisable within 60 days of November 15, 2004. Also includes the following shares as to which Mr. Schultz disclaims beneficial ownership: 104,922 shares of Common Stock held by the Schultz Family Foundation, of which Mr. Schultz is a co-trustee, and 82,400 shares of Common Stock pledged to the Company in connection with a split-dollar life insurance policy.

(4) Includes 224,234 shares subject to options exercisable within 60 days of November 15, 2004.

(5) Includes 333,271 shares subject to options exercisable within 60 days of November 15, 2004. Also includes 14,000 shares held indirectly by trust.

(6) Includes 326,668 shares subject to options exercisable within 60 days of November 15, 2004.

(7) Includes 10,000 shares subject to options exercisable within 60 days of November 15, 2004.

(8) Includes 312,969 shares subject to options exercisable within 60 days of November 15, 2004.

(9) Includes 29,698 shares subject to options exercisable within 60 days of November 15, 2004.

(10) Includes 213,271 shares subject to options exercisable within 60 days of November 15, 2004.

(11) Includes 48,720 shares held by the Shennan Family Partnership, a partnership of which Mr. Shennan is a general partner, and 311,537 shares subject to options exercisable within 60 days of November 15, 2004.

(12) Includes 29,698 shares subject to options exercisable within 60 days of November 15, 2004.

(13) Includes 228,886 shares subject to options exercisable within 60 days of November 15, 2004.

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(14) Includes 350,000 shares subject to options exercisable within 60 days of November 15, 2004.

(15) Includes 723,063 shares subject to options exercisable within 60 days of November 15, 2004.

(16) Includes 106,667 shares subject to options exercisable within 60 days of November 15, 2004.

(17) Includes 11,924,595 shares subject to options exercisable within 60 days of November 15, 2004.

EXECUTIVE COMPENSATION

The following table sets forth the compensation paid to or earned by (i) the Company s president and chief executive officer and (ii) the Company s four other most highly compensated executive officers in fiscal 2004 during each of the Company s last three fiscal years.

Summary Compensation Table

		Annual Compensation			Long-Term Compensation	
Name and Principal Position	**Fiscal Year**	**Salary ($)**	**Bonus ($)**	**Other Annual Compensation ($)**	**Number of Securities Underlying Options**	**All Other Compensation ($)**
Orin C. Smith	2004	1,179,154	2,490,000(1)		550,000	65,225(2)
president and	2003	1,132,762	1,417,000		512,000	43,341(2)
chief executive officer	2002	1,088,269	1,362,500		715,000	7,583(2)
Howard Schultz	2004	1,179,154	2,490,000(3)		550,000	67,410(4)
chairman and	2003	1,132,762	1,417,000		512,000	19,864(4)
chief global strategist	2002	1,088,269	1,362,500		715,000	2,100(4)
James L. Donald	2004	832,308	1,404,000(5)	16,879(6)	300,000	3,303(7)
ceo designate	2003	744,615	1,200,000(5)	156,468(6)	500,000	969(7)
	2002					
Michael Casey	2004	555,192	585,000(8)		525,000(9)	19,540(10)
executive vice president,	2003	534,584	334,375		175,000	13,674(10)
chief financial officer and	2002	510,600	318,302		165,000	5,460(10)
chief administrative officer						
David A. Pace	2004	424,231	470,000(11)	184,457(12)	80,000	4,240(13)
executive vice president,	2003	400,000	435,000(11)	351,143(12)		2,023(13)
Partner Resources	2002	63,077		57,143(12)	200,000	

(1) The amount shown includes (i) a $2,380,000 annual bonus paid to Mr. Smith for fiscal 2004 performance under the EMB Plan and (ii) a $110,000 discretionary bonus paid in recognition of extraordinary performance during the first quarter of fiscal 2004.

(2) The amounts shown include (i) matching contributions by the Company to the Company s 401(k) Plan on behalf of Mr. Smith of $300, $300 and $300 in fiscal 2004, 2003 and 2002, respectively, (ii) matching contributions by the Company to the Company s Management Deferred Compensation Plan (MDCP) on behalf of Mr. Smith of $11,700 and $1,700 in fiscal 2004 and 2003, respectively, (iii) imputed income of $43,056 and $33,421 during fiscal 2004 and 2003, respectively, for personal use of corporate aircraft, (iv) imputed income of $8,702, $7,920 and $7,283 during fiscal 2004, 2003 and 2002, respectively, for group life insurance premiums paid by the Company, and (v) imputed income of $1,467 during fiscal 2004 for long- term disability premiums paid by the Company.

(3) The amount shown includes (i) a $2,380,000 annual bonus paid to Mr. Schultz for fiscal 2004 performance under the EMB Plan and (ii) a $110,000 discretionary bonus paid in recognition of extraordinary performance during the first quarter of fiscal 2004.

(4) The amounts shown include (i) matching contributions by the Company to the Company s 401(k) Plan on behalf of Mr. Schultz of $300, $300 and $300 in fiscal 2004, 2003 and 2002, respectively, (ii) matching contributions by the Company to the MDCP on behalf of

Mr. Schultz of $2,700 and $200 in fiscal 2004

and 2003, respectively, (iii) imputed income of $60,172 and $16,826 during fiscal 2004 and 2003, respectively, for personal use of corporate aircraft, (iv) imputed income of $3,038, $2,538 and $1,800 during fiscal 2004, 2003 and 2002, respectively, for group life insurance premiums paid by the Company, and (v) imputed income for $1,200 during fiscal 2004 for long-term disability premiums paid by the Company.

(5) The amounts shown include (i) a $1,344,000 annual bonus paid to Mr. Donald for fiscal 2004 performance under the EMB Plan and (ii) a $60,000 discretionary bonus paid in recognition of extraordinary performance during the first quarter of fiscal 2004, (iii) a $400,000 hiring bonus paid to Mr. Donald in fiscal 2003 and (iv) an $800,000 annual bonus for fiscal 2003 performance.

(6) The amounts shown include relocation and temporary housing expenses paid to Mr. Donald of $16,879 and $156,468 in fiscal 2004 and 2003, respectively.

(7) The amounts shown include (i) imputed income for Mr. Donald of $2,460 and $969 during fiscal 2004 and 2003, respectively, for group life insurance premiums paid by the Company and (ii) imputed income of $843 during fiscal 2004 for long-term disability premiums paid by the Company.

(8) The amount shown includes (i) a $560,000 annual bonus paid to Mr. Casey for fiscal 2004 performance under the EMB Plan and (ii) a $25,000 discretionary bonus paid in recognition of extraordinary performance during the first quarter of fiscal 2004.

(9) In fiscal 2004, the Compensation Committee recommended and a panel of Independent Directors approved a grant to Mr. Casey of an option to purchase three times the number of shares he otherwise would have been granted. The Company does not expect to grant Mr. Casey additional stock options prior to fiscal 2007.

(10) The amounts shown include (i) matching contributions to the Company s 401(k) Plan on behalf of Mr. Casey of $300 and $300 in fiscal 2003 and 2002, respectively, (ii) matching contributions by the Company to the MDCP on behalf of Mr. Casey of $5,700 and $2,936 in fiscal 2004 and 2003, respectively, (iii) imputed income of $6,433 and $5,242 during fiscal 2004 and 2003, respectively, for personal use of corporate aircraft, (iv) imputed income of $6,021, $5,196 and $5,160 during fiscal 2004, 2003 and 2002, respectively, for group life insurance premiums paid by the Company, and (v) imputed income of $1,386 during fiscal 2004 for long-term disability premiums paid by the Company.

(11) The amounts shown include (i) a $430,000 annual bonus paid to Mr. Pace for fiscal 2004 performance under the EMB Plan and (ii) a $40,000 discretionary bonus paid in recognition of extraordinary performance during the first quarter of fiscal 2004, (iii) a $185,000 hiring bonus earned by Mr. Pace in fiscal 2003, a portion of which he deferred, and (iv) a $250,000 annual bonus for fiscal 2003 performance. Mr. Pace accepted an offer to join the Company in July 2002; however, his hiring bonus was not finally determined or paid until December 2002 and January 2003, respectively. Because he joined the Company in late fiscal 2002, Mr. Pace did not receive any bonus for fiscal 2002 performance.

(12) The amounts shown include (i) $184,457 paid to Mr. Pace for expenses in fiscal 2004 related to the sale of his house and (ii) relocation and temporary housing expenses of $351,143 and $57,143 paid to Mr. Pace in fiscal 2003 and 2002, respectively.

(13) The amounts shown include (i) a matching contribution to the Company s 401(k) Plan on behalf of Mr. Pace of $300 in fiscal 2004, (ii) matching contributions by the Company to the MDCP on behalf of Mr. Pace of $1,700 and $823 in fiscal 2004 and 2003, respectively, (iii) imputed income of $1,610 and $1,200 during fiscal 2004 and 2003, respectively, for group life insurance premiums paid by the Company, and (iv) imputed income of $630 during fiscal 2004 for long-term disability premiums paid by the Company.

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Stock Option Grants in Fiscal 2004

The following table sets forth information regarding options to purchase shares of Common Stock granted to the Named Executive Officers during fiscal 2004. The Company has no outstanding stock appreciation rights. The amounts shown for each Named Executive Officer below as potential realizable values are based entirely on hypothetical annualized rates of stock appreciation of five percent and ten percent compounded over the full ten-year terms of the options. These assumed rates of growth were selected by the SEC for illustration purposes only and are not intended to predict future stock prices, which will depend upon overall stock market conditions and the Company s future performance and prospects. Consequently, there can be no assurance that the Named Executive Officers will receive the potential realizable values shown in this table.

Option Grants in Fiscal 2004[(1)]

Name	Number of Securities Underlying Options Granted	Percent of Total Options Granted to Employees	Exercise Price Per Share	Expiration Date	Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term	
					Five Percent ($)	Ten Percent ($)
Orin C. Smith	550,000(2)	6.0	$30.46	11/20/13	10,535,872	26,699,967
Howard Schultz	550,000(3)	6.0	$30.46	11/20/13	10,535,872	26,699,967
James L. Donald	300,000(4)	3.3	$30.46	11/20/13	5,746,839	14,563,619
Michael Casey	525,000(5)	5.7	$30.46	11/20/13	10,056,968	25,486,333
David A. Pace	80,000(6)	0.9	$30.46	11/20/13	1,532,490	3,883,632

(1) Stock options granted to the executive officers are typically granted in November of each year and reflect the Company s and such officers performance for the prior fiscal year.

(2) Mr. Smith s options become exercisable in one 183,334-share increment on October 1, 2004 and two 183,333-share increments on October 1, 2005 and 2006.

(3) Mr. Schultz s options become exercisable in one 183,334-share increment on October 1, 2004 and two 183,333-share increments on October 1, 2005 and 2006.

(4) Mr. Donald s options become exercisable in three 100,000-share increments on October 1, 2004, 2005 and 2006.

(5) Mr. Casey s options become exercisable in three 175,000-share increments on October 1, 2004, 2005 and 2006. In fiscal 2004, the Compensation Committee recommended and a panel of Independent Directors approved a grant to Mr. Casey of an option to purchase three times the number of shares he otherwise would have been granted. The Company does not expect to grant Mr. Casey additional stock options prior to fiscal 2007.

(6) Mr. Pace s options become exercisable in two 26,667-share increments on October 1, 2004 and 2005, and one 26,666-share increment on October 1, 2006.

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Exercises of Stock Options

The following table sets forth information regarding stock option exercises during fiscal 2004 by the Named Executive Officers and the value of each Named Executive Officer s exercised and unexercised stock options on October 3, 2004.

Aggregated Option Exercises in Fiscal 2004 and Fiscal Year-End Option Values

Name	Shares Acquired on Exercise (#)	Value Realized[1] ($)	Number of Securities Underlying Unexercised Options at Fiscal Year End		Value of Unexercised In-the-Money Options at Fiscal Year End[2] ($)	
			Exercisable	Unexercisable	Exercisable	Unexercisable
Orin C. Smith	1,000,000	23,595,458	1,978,668	537,332	55,114,538	10,649,385
Howard Schultz	34,872	1,457,050	8,522,348	537,332	303,195,583	10,649,385
James L. Donald	0	0	225,000	575,000	4,850,000	12,880,000
Michael Casey	41,396	774,192	723,063	408,333	19,893,661	7,391,991
David A. Pace	10,000	273,456	116,667	153,333	2,934,739	3,656,661

(1) Value realized is calculated by subtracting the aggregate exercise price of the options exercised from the aggregate market value of the shares of Common Stock acquired on the date of exercise.

(2) The value of unexercised options is calculated by subtracting the aggregate exercise price of the options from the aggregate market value of the shares of Common Stock subject thereto as of October 1, 2004 (the last trading day prior to the Company s fiscal year end on October 3, 2004).

Equity Compensation Plan Information

The following table provides information as of October 3, 2004, regarding shares outstanding and available for issuance under the Company s existing stock option and employee stock purchase plans:

Plan Category	(a) Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	(b) Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	28,889,204	$ 18.4620	18,920,145
Equity compensation plans not approved by security holders	9,546,244	$ 20.8279	12,821,550
Total	38,435,448	$ 19.0496	31,741,695(1)

(1)

Includes 10,631,540 shares remaining available for issuance under employee stock purchase plans and 21,110,155 shares under stock option plans.

The shares to be issued under plans not approved by shareholders relate to the Company s 1991 Company-Wide Stock Option Plan (the Bean Stock Plan), the Company s UK Share Save Plan and the Company s UK Share Incentive Plan, the successor to the UK Share Save Plan. The Bean Stock Plan is the Company s broad-based stock option plan and provides for the annual issuance of stock options to eligible employees. The Bean Stock Plan was approved and adopted by the Board in 1991 and did not require shareholder approval. Generally, options are granted annually under the Bean Stock Plan. These grants require Board approval, are linked to performance goals of the Company and are granted to employees as a percentage of base salary. In fiscal 2004, 39,338 employees were granted options under the Bean Stock Plan.

The Company s UK Share Save Plan, which is a U.K. Inland Revenue approved Save-As-You-Earn plan, allows eligible employees in the United Kingdom to save for a three-year period through payroll deductions toward the purchase of the Common Stock at a discount from the fair market value on the first day

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of business of a three-year offering period. The total number of shares issuable under the plan is 600,000, of which 35,774 were issued as of October 3, 2004. The Compensation Committee accepted the recommendation of management to suspend future offerings under the UK Share Save Plan, and effectively replace the UK Share Save Plan with the UK Share Incentive Plan. The last offering under the UK Share Save Plan was in December 2002 and will mature in February 2006.

The Company s UK Share Incentive Plan, which is a U.K. Inland Revenue approved plan, allows eligible employees in the United Kingdom to purchase shares of the Common Stock through payroll deductions during six-month offering periods at the lower of the price at the beginning and the price at the end of the offering period. The Company awards one matching share for each six shares purchased under the plan. The total number of shares issuable under the plan is 700,000, of which no shares were issued as of October 3, 2004. The initial six-month offering period under the plan ended October 31, 2004, resulting in the issuance of 2,706 shares of Common Stock under the plan on November 1, 2004.

Employment and Severance Arrangements

Messrs. Donald, Casey and Pace have severance arrangements with the Company pursuant to which each of them will be entitled to receive a severance payment in the event he is terminated by the Company without cause, as defined in his original offer letter from the Company. Under those circumstances, Mr. Donald will be entitled to a payment equal to two times his annual base salary plus his targeted bonus at the time of termination, Mr. Casey will be entitled to continued payment of his annual base salary for a period of 12 months after the date of his termination, and Mr. Pace will be entitled to a payment equal to his annual base salary plus his targeted bonus at the time of termination, in each case less lawful deductions.

Mr. Smith and the Company entered into an employment agreement on December 8, 2004. Under the agreement, Mr. Smith will continue to serve as president and chief executive officer of the Company through March 31, 2005. From April 1, 2005 through June 30, 2007, Mr. Smith will have the title of former ceo and will be asked to provide reasonable advisory services from time to time on an as needed basis through the chairman and chief global strategist or through the president and chief executive officer of the Company, or any of their respective designees. Through March 31, 2005, Mr. Smith will continue to receive his current base salary, which annualizes to $1,190,000. From April 1, 2005 through June 30, 2007, Mr. Smith will be paid a salary that annualizes to $25,000. In the event that Mr. Smith dies before July 1, 2007, the Company will pay his estate a single sum equal to the unpaid salary he would have received through the full term of the agreement.

Depending upon the Company s performance and in accordance with the terms of the EMB Plan, Mr. Smith will be eligible for a pro rated bonus for fiscal 2005 based on approximately six months during fiscal 2005 during which Mr. Smith will have served as the Company s president and chief executive officer. Any bonus paid to Mr. Smith for fiscal 2005 under the EMB Plan will be subject to the approval of the Compensation Committee and of the Independent Directors. All stock options held by Mr. Smith will vest in accordance with the terms under which they were originally granted.

The Company may terminate the agreement if Mr. Smith is unable to perform his duties because of physical or mental disability. The agreement may also be terminated for cause to include, but not be limited to, Mr. Smith s unreasonable refusal to perform his duties or any material violation of the Company s Standards of Business Conduct. Mr. Smith may terminate the agreement before July 1, 2007 by providing the Company with written notice of his resignation.

Involvement in Certain Legal Proceedings

Mr. Donald was Chairman, President and Chief Executive Officer of Pathmark Stores, Inc. at the time Pathmark filed for voluntary bankruptcy protection in July 2000. Pathmark emerged from bankruptcy protection in September 2000, and Mr. Donald remained as its Chairman, President and Chief Executive Officer until he joined the Company in October 2002.

Mr. Maffei is chairman and chief executive officer of 360networks Corporation, and was chief executive officer when 360networks and many of its Canadian and U.S. operating subsidiaries filed for voluntary bankruptcy protection in June 2001. 360networks emerged from bankruptcy in October 2002.

Performance Graph

The following graph depicts the Company s total return to shareholders from October 3, 1999 through October 3, 2004, relative to the performance of the Standard & Poor s 500 Index, the Nasdaq Stock Market (U.S. Companies) Index and the Nasdaq Eating and Drinking Establishments Index, a peer group. All indices shown in the graph have been reset to a base of 100 as of October 3, 1999 and assume an investment of $100 on that date and the reinvestment of dividends paid since that date. The Company has never paid cash dividends on its Common Stock. The points represent index levels based on the last trading day of the Company s fiscal year. The chart set forth below was prepared by Research Data Group, Inc., which holds a license to provide the indices used herein.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*

AMONG STARBUCKS CORPORATION, THE S & P 500 INDEX, THE NASDAQ

STOCK MARKET (U.S.) INDEX AND THE NASDAQ SIC CODE 581 EATING AND DRINKING ESTABLISHMENTS

	10/03/99	10/01/00	09/30/01	09/29/02	09/28/03	10/03/04
Starbucks Corporation	$100.00	$167.15	$124.66	$175.23	$246.74	$394.01
S & P 500	$100.00	$113.28	$ 83.13	$ 66.10	$ 82.22	$ 93.63
Nasdaq Stock Market (U.S.)	$100.00	$159.86	$ 56.32	$ 49.18	$ 58.43	$ 65.37
Nasdaq SIC Code 581 Eating and Drinking Establishments	$100.00	$127.55	$123.70	$159.97	$207.16	$284.38

* $100 invested on 10/3/99 in stock or on 9/30/99 in index-including reinvestment of dividends.

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Certain Transactions and Compensation Arrangements

During fiscal 2003 and 2002, the Company chartered an aircraft operated by Devon Air Holdings, LLC (Devon Air), a limited liability company wholly-owned by Mr. Schultz, the Company s chairman of the Board of Directors and chief global strategist, for executive business travel. The Company paid $133,810 and $475,344 in fiscal 2003 and 2002, respectively, for the charter of this aircraft, based on a discounted rate for actual hours flown.

During fiscal 2003, the Company entered into a series of agreements with Canarsie Holdings, LLC (Canarsie), a limited liability company wholly-owned by Mr. Schultz and his wife. Canarsie operated the aircraft formerly operated by Devon Air until May 2004 when it was sold. Pursuant to an Aircraft Interchange Agreement dated as of October 28, 2002, each of the Company and Canarsie agreed to lease its aircraft to the other on an as-needed basis at prescribed rates with monthly reconciliations of amounts owed. Based on differences in hours flown and cost per flight hour for each aircraft, Canarsie paid the Company net amounts of $0 and $23,400 during fiscal 2004 and 2003, respectively, before applicable taxes under this agreement. The Company and Canarsie agreed to provide use of each other s aircraft on a time-sharing basis under Time-Sharing Agreements dated October 28, 2002. Pursuant to these agreements, during fiscal 2004 and 2003 the Company paid Canarsie $103,200 and $77,000, respectively, before applicable taxes for the use of Canarsie s aircraft, and Canarsie did not use the Company s aircraft and so made no payments to the Company. Pursuant to a lease agreement dated as of April 21, 2003, between the Company and Canarsie, the Company leased to Canarsie the use of a portion of an airplane hangar with office space for the purposes of storing, repairing and maintaining an airplane owned or leased by Canarsie. Canarsie paid the Company rent of $7,000 per month for the use of this leased space, and paid $49,000 and $84,000 in rent to the Company during fiscal 2004 and fiscal 2003, respectively. Canarsie and the Company also equally shared the cost of an office manager for aircraft operations and an aircraft cleaner. Canarsie paid the Company an aggregate of $39,853 and $36,228 during fiscal 2004 and fiscal 2003, respectively, for these personnel costs. The Company and Canarsie also shared certain expenses related to pilot training, with Canarsie paying the Company $8,250 during fiscal 2003 for its share of those expenses. Due to the sale of the aircraft operated by Canarsie in May 2004, the Company does not expect to have any further business dealings with Canarsie.

In April 2001, Mr. Schultz and a group of investors organized as The Basketball Club of Seattle, LLC (the Basketball Club) purchased the franchises for The Seattle Supersonics and The Seattle Storm basketball teams. Upon such purchase, the Basketball Club assumed pre-existing Team Sponsorship Agreements between the former owners and the Company. Pursuant to such agreements, the Company paid the Basketball Club and those franchises an aggregate of $800,164, $777,884 and $739,593 in fiscal 2004, 2003 and 2002, respectively. Mr. Schultz holds a controlling ownership interest in the Basketball Club.

The Company establishes certain compensation arrangements with its executive officers at the time of hire. The arrangements include starting salary, bonus eligibility, initial stock option grants and relocation packages, where appropriate. In addition, most of such arrangements specify that the executive officer will receive an amount equal to twelve months of base salary as severance in the event that he or she is terminated for any reason other than cause. Neither Mr. Schultz nor Mr. Smith has such an arrangement with the Company.

Mr. Behar, a member of the Board of Directors who had previously retired as an executive of the Company in 1999, returned to serve as the Company s president, North America from September 2001 through December 2002. Mr. Behar deferred compensation of (1) $546,154, representing the unpaid portion of Mr. Behar s fiscal 2002 base salary, (2) $623,872, representing Mr. Behar s fiscal 2002 bonus, and (3) $629,974 representing income earned by Mr. Behar during fiscal 2003. In May 2003, Mr. Behar and the Company entered into an eight-year agreement (which superseded an earlier agreement of December 2001) that describes how the Company will pay Mr. Behar these deferred amounts, as well as an additional $25,000 per year for Mr. Behar s services as an advisor to the Company. From November 1, 2002 until October 31, 2010 (the Term), Mr. Behar will be paid bi-weekly an amount that annualizes to $250,000 per year.

In the event that Mr. Behar dies before the Term expires, the Company will pay, or cause an insurer to pay, Mr. Behar s surviving spouse (or Mr. Behar s estate if his wife does not survive him) a single sum equal

to the unpaid amount Mr. Behar would have received through the full Term of the agreement. The Company may terminate the agreement for cause and Mr. Behar may terminate the agreement at any time by providing the Company with written notice of his resignation. A termination of the May 2003 agreement, regardless of the reason for the termination, does not affect the Company s obligation to pay Mr. Behar income he has already earned, but deferred under the agreement. Mr. Behar and his spouse are eligible to receive employee benefits in accordance with the terms of the Company s medical, dental, vision and savings plans for the Term of the agreement. Mr. Behar is not eligible to participate in the NED Option Plan until he ceases to be employed by the Company for at least a year, but in the discretion of the Compensation Committee, Mr. Behar is eligible to receive stock option grants under the Key Employee Plan.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Exchange Act requires the Company s directors and executive officers, and persons who beneficially own more than 10% of the Common Stock, to file with the SEC initial reports of beneficial ownership (Forms 3) and reports of changes in beneficial ownership of Common Stock and other equity securities of the Company (Forms 4). Officers, directors and greater than 10% shareholders of the Company are required by SEC rules to furnish to the Company copies of all Section 16(a) reports that they file. To the Company s knowledge, based solely on a review of the copies of such reports furnished to the Company and written representations that no other reports were required, all Section 16(a) filing requirements applicable to its officers, directors and greater than 10% beneficial owners were complied with for fiscal 2004.

PROPOSAL 2 APPROVAL OF STARBUCKS CORPORATION

2005 LONG-TERM EQUITY INCENTIVE PLAN

General Information

On November 17, 2004, the Board adopted, subject to shareholder approval, the Starbucks Corporation 2005 Long-Term Equity Incentive Plan (the 2005 Equity Incentive Plan). The Board has long believed that employee ownership in the Company serves the best interest of all shareholders, by promoting a focus on long-term increase in shareholder value. The 2005 Equity Incentive Plan continues to support this, by increasing the flexibility the Company has in awarding equity-based compensation that meets the ongoing objective of aligning compensation with shareholder value.

Broad-based equity compensation is an essential and long-standing element of the Company s culture and success. It continues to be a critical element to attract and retain the most talented Partners (employees), officers and directors available to execute Starbucks long-term goal of operating at least 30,000 retail locations worldwide. The Company grants equity-based compensation to Partners at all levels of the organization, including eligible part-time Partners. Historically, the Company has used stock option awards as equity incentives, and in fiscal 2004 granted options at market prices to nearly 40,000 people. Equity-based compensation provides an opportunity for Partners, officers and directors to acquire an interest in our business, and thus provides rewards for exceptional performance and long-term incentives for their future contributions to the Company s success and ultimately shareholder value.

The Company currently awards stock options to Partners through the Starbucks Corporation 1991 Company-Wide Stock Option Plan (Bean Stock); stock options to Company executives through the Starbucks Corporation Amended and Restated Key Employee Stock Option Plan-1994; and stock options to Company non-employee directors through the Starbucks Corporation Amended and Restated 1989 Stock Option Plan for Non-Employee Directors (collectively referred to as the Current Plans).

The 2005 Equity Incentive Plan allows for increased flexibility in the types of equity awards that can be granted in the future, whereas the Current Plans allow for stock options grants only. The greater flexibility of the 2005 Equity Incentive Plan, in types and specific terms of awards, will allow future awards to be based on then-current objectives for aligning compensation with increasing long-term shareholder value. Shareholder

approval of the 2005 Equity Incentive Plan will permit the Company to award long-term equity incentive compensation that achieves these goals.

As of December 1, 2004 and taking into account the shares subject to options that were granted in November 2004, the Company has an aggregate of approximately 14,000,000 shares remaining for future awards under the Current Plans. No further awards will be made pursuant to the Current Plans upon shareholder approval of the 2005 Equity Incentive Plan, and the remaining shares available for future awards will be issued in connection with awards made under the 2005 Equity Incentive Plan. Additionally, the Company is requesting 24,000,000 new shares be approved for future awards under the 2005 Equity Incentive Plan.

The following is a summary of the material terms of the 2005 Equity Incentive Plan and is qualified in its entirety by reference to the 2005 Equity Incentive Plan. A copy of the 2005 Equity Incentive Plan is attached to this proxy statement as *Appendix A*.

Summary of the 2005 Equity Incentive Plan

Administration

The Compensation Committee will administer the 2005 Equity Incentive Plan, with certain actions subject to the review and approval of the full Board or a panel consisting of all of the Independent Directors. The Committee will have full power and authority to determine when and to whom awards will be granted, including the type, amount, form of payment and other terms and conditions of each award, consistent with the provisions of the 2005 Equity Incentive Plan. In addition the Committee has the authority to interpret the 2005 Equity Incentive Plan and the awards granted under the plan, and establish rules and regulations for the administration of the plan. The Committee may delegate the administration of the plan to the Company s officers, including the maintenance of records of the awards and the interpretation of the terms of the awards.

Eligible Participants

Any Partner, officer, consultant or director providing services to the Company or to any affiliate of the Company, who is selected by the Committee, is eligible to receive awards under the 2005 Equity Incentive Plan.

Shares Available for Awards

The aggregate number of shares of the Common Stock that may be issued as awards under the 2005 Equity Incentive Plan will include approximately 14,000,000 shares of Common Stock as of December 1, 2004 that are not subject to a grant or a pending grant or as to which the award granted has been forfeited under the Current Plans, and an additional 24,000,000 shares of Common Stock. The aggregate number of shares of Common Stock which may be granted to any one participant in any one year under the 2005 Equity Incentive Plan is 1,750,000. The maximum aggregate number of shares of Common Stock which may be granted as incentive stock options (ISOs) is 21,000,000. The Committee may adjust the aggregate number of shares reserved for issuance under the plan in the case of a stock dividend or other distribution, including a stock split, merger, extraordinary dividend, or other similar corporate transaction or event, in order to prevent dilution or enlargement of the benefits or potential benefits intended to be provided under the 2005 Equity Incentive Plan.

If any shares of Common Stock subject to any award or to which an award relates, granted under the Current Plans or the 2005 Equity Incentive Plan, are forfeited, become unexercisable, or if any award terminates without the delivery of any shares, the shares of Common Stocoverflow:hidden;font-size:10pt;">

Equity:

Dividends paid
(49,778
)

(45,998
)

Reacquisition of shares on open market
—

(49,991
)
Stock options exercised - net of shares reacquired
24,083

8,426

Excess tax benefit from stock-based compensation
5,787

3,233

Debt:

Change in short-term debt
123,197

—

Repayment of long-term debt
(200,000
)

—

Total used for financing activities
(96,711
)

(84,330
)
Effect of exchange rates on cash and cash equivalents
3,813

4,615

(Decrease) Increase in cash and cash equivalents
(20,543
)

35,447

Cash and cash equivalents at beginning of period
423,947

245,089

Cash and cash equivalents at end of period
$
403,404

$
280,536

Detail of cash used for working capital:

Accounts receivable
$
(42,883
)

$
(65,061
)
Inventories
(9,605
)

(6,205
)
Other current assets
10

(3,799
)
Accounts payable
(5,901
)

(20,891
)
Accrued liabilities
(30,536
)

(8,122
)
U.S. and foreign taxes on income
107

24,756

Total
$
(88,808
)

$
(79,322
)
Supplemental disclosure of cash flow information:

Interest paid
$
20,491

$
19,405

Income taxes paid
$
50,565

$
23,700

See Notes to Condensed Consolidated Financial Statements.
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Note 1 - Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial reporting and the instructions to Form 10-Q and, therefore, reflect all adjustments which are, in the opinion of management, necessary for a fair statement of the results for the interim periods presented. These interim condensed consolidated financial statements should be read in conjunction with the Consolidated Financial Statements and Notes to Consolidated Financial Statements in the Company’s Annual Report on Form 10-K for the year ended December 31, 2012.

Prior period segment data has been restated to reflect the Company's revised reportable segment structure. See Note 2, "Segment Results" for a discussion of the change in reportable segments.

Recent Accounting Pronouncements

In July 2013, the Financial Accounting Standard Board ("FASB") issued amended guidance on the presentation of certain unrecognized tax benefits (“UTBs”) in the financial statements. The amendments require the netting of UTBs against a deferred tax asset for a loss or other carryforward that would apply in settlement of the uncertain tax positions. UTBs will be netted against all available same-jurisdiction loss or other tax carryforwards that would be utilized, rather than only against carryforwards created by the UTBs. The amendments require prospective adoption but allow optional retrospective adoption (for all periods presented). The amendments are effective for fiscal years and interim periods within those years beginning after December 15, 2013. The Company is currently evaluating the impact that the amended guidance will have on its condensed consolidated balance sheets when adopted.

In July 2012, the FASB issued amended guidance to simplify how entities test indefinite-lived intangible assets for impairment. The amendments permit an entity to first assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the indefinite-lived intangible asset is impaired and whether it is necessary to perform the quantitative impairment test for indefinite-lived intangible assets required under current accounting standards. The amendments were effective for annual and interim impairment tests of indefinite-lived intangible assets performed for fiscal years beginning after September 15, 2012, with early adoption permitted. The Company performs its assessment of intangible assets on an annual basis during the fourth quarter and does not expect the amended guidance to have a material impact on its consolidated financial position, results of operations, cash flows and disclosures.

Note 2 - Segment Results

Beginning in the first quarter of 2013, the Controls segment (consisting of the Barksdale and Crane Environmental businesses) is included in the Fluid Handling segment. Prior period amounts have been reclassified to the new reporting structure for comparative purposes.

The Company’s segments are reported on the same basis used internally for evaluating performance and for allocating resources. The Company has four reportable segments: Aerospace & Electronics, Engineered Materials, Merchandising Systems and Fluid Handling. Assets of the reportable segments exclude general corporate assets, which principally consist of cash, deferred tax assets, insurance receivables, certain property, plant and equipment, and certain other assets. Furthermore, Corporate consists of corporate office expenses including compensation, benefits, occupancy, depreciation, and other administrative costs.

Financial information by reportable segment is set forth below:

(in thousands)	Three Months Ended September 30, 2013	2012	Nine Months Ended September 30, 2013	2012
Net sales				
Aerospace & Electronics	$169,771	$171,368	$507,046	$525,127
Engineered Materials	61,956	56,956	179,933	169,603
Merchandising Systems	83,636	92,489	257,927	277,741
Fluid Handling	322,152	325,168	968,926	976,809
Total	$637,515	$645,981	$1,913,832	$1,949,280
Operating profit (loss) from continuing operations				
Aerospace & Electronics	$38,105	$39,833	$115,257	$116,834
Engineered Materials	10,792	7,226	28,538	21,178
Merchandising Systems	7,869	9,496	26,902	23,324
Fluid Handling	46,594	45,736	146,688	119,433
Corporate	(14,351)	(15,707)	(52,630)	(46,511)
Total	89,009	86,584	264,755	234,258
Interest income	337	443	1,488	1,292
Interest expense	(6,688)	(6,618)	(20,651)	(20,114)
Miscellaneous - net	(456)	(6)	(170)	(704)
Income from continuing operations before income taxes	$82,202	$80,403	$245,422	$214,732

(in thousands)	As of September 30, 2013	December 31, 2012
Assets		
Aerospace & Electronics	$512,689	$509,672
Engineered Materials	241,455	237,478
Merchandising Systems	412,629	408,702
Fluid Handling	968,030	993,275
Corporate	723,342	740,751
Total	$2,858,145	$2,889,878

(in thousands)	As of September 30, 2013	December 31, 2012
Goodwill		
Aerospace & Electronics	$202,754	$203,595
Engineered Materials	171,529	171,533
Merchandising Systems	199,368	201,866
Fluid Handling	237,623	236,798
Total	$811,274	$813,792

Note 3 - Discontinued Operations

On June 19, 2012, the Company sold Azonix Corporation ("Azonix") to Cooper Industries for $44.8 million, of which $0.9 million and $0.5 million were recorded in the third and fourth quarters of 2012, respectively, resulting in an after tax gain of $14.5 million. As a result, the Condensed Consolidated Statement of Operations presents Azonix as a discontinued operation.

On June 28, 2012, the Company sold certain assets and operations of the Company's valve service center in Houston, Texas to Furmanite Corporation for $9.3 million, resulting in an after tax gain of $4.6 million. As a result, the Condensed Consolidated Statement of Operations presents the Company's valve service center in Houston, Texas as a discontinued operation.

The operating results of the discontinued operations for the three and nine months ended September 30, 2013 and 2012 were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2013	2012	2013	2012
Net Sales	$—	$—	$—	$25,544
Income from discontinued operations before income taxes	$—	$—	$—	$3,777
Provision for income taxes	—	—	—	1,321
Income from discontinued operations, net of income taxes	$—	$—	$—	$2,456

Note 4 - Earnings Per Share

The Company's basic earnings per share calculations are based on the weighted average number of common shares outstanding during the year. Shares of restricted stock are included in the computation of both basic and diluted earnings per share. Potentially dilutive securities include outstanding stock options, Restricted Share Units, Deferred Stock Units and Performance-based Restricted Share Units. The dilutive effect of potentially dilutive securities is reflected in diluted earnings per common share by application of the treasury method. Diluted earnings per share gives effect to all potentially dilutive common shares outstanding during the year.

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands, except per share data)	2013	2012	2013	2012
Income from continuing operations	$57,483	$56,406	$170,839	$150,217
Less: Noncontrolling interest in subsidiaries' earnings	352	182	1,043	501
Income from continuing operations attributable to common shareholders	57,131	56,224	169,796	149,716
Discontinued operations, net of tax	—	901	—	21,633
Net income attributable to common shareholders	$57,131	$57,125	$169,796	$171,349
Average basic shares outstanding	58,093	57,123	57,814	57,565
Effect of dilutive stock options	942	750	923	870
Average diluted shares outstanding	59,035	57,873	58,737	58,435
Earnings per share - basic: (a)				
Income from continuing operations attributable to common shareholders	$0.98	$0.99	$2.94	$2.61
Discontinued operations, net of tax	—	0.02	—	0.38
Net income attributable to common shareholders	$0.98	$1.00	$2.94	$2.98
Earnings per share - diluted: (a)				
Income from continuing operations attributable to common shareholders	$0.97	$0.97	$2.89	$2.56
Discontinued operations, net of tax	—	0.02	—	0.37

Net income attributable to common shareholders	$0.97	$0.99	$2.89	$2.93

(a) EPS amounts may not add due to rounding

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The computation of diluted earnings per share excludes the effect of the potential exercise of stock options when the average market price of the common stock is lower than the exercise price of the related stock options during the period (13 thousand and 1.9 million average options were excluded for the third quarter of 2013 and 2012, respectively, and 0.9 million and 1.8 million average options for the first nine months of 2013 and 2012, respectively).

Note 5 - Changes in Equity and Comprehensive Income

A summary of the changes in equity for the nine months ended September 30, 2013 and 2012 is provided below:

	Nine Months Ended September 30,					
	2013			2012		
(in thousands)	Total Shareholders' Equity	Noncontrolling Interests	Total Equity	Total Shareholders' Equity	Noncontrolling Interests	Total Equity
Balance, beginning of period	$918,383	$ 8,993	$927,376	$813,553	$ 8,503	$822,056
Dividends	(49,819)	—	(49,819)	(45,998)	—	(45,998)
Reacquisition on open market	—	—	—	(49,991)	—	(49,991)
Exercise of stock options, net of shares reacquired	24,107	—	24,107	7,958	—	7,958
Stock compensation expense	16,299	—	16,299	12,860	—	12,860
Excess tax benefit from stock based compensation	5,787	—	5,787	3,233	—	3,233
Net income	169,796	1,043	170,839	171,349	501	171,850
Other comprehensive income (loss)	14,956	(69)	14,887	11,201	(417)	10,784
Comprehensive income	184,752	974	185,726	182,550	84	182,634
Balance, end of period	$1,099,509	$ 9,967	$1,109,476	$924,165	$ 8,587	$932,752

The table below provides the accumulated balances for each classification of accumulated other comprehensive income (loss), as reflected on the Condensed Consolidated Balance Sheets.

(in thousands)	Defined Benefit Pension and Other Postretirement Items*	Currency Translation Adjustment	Total
Balance as of December 31, 2012	$(197,806)	$69,729	$(128,077)
Other comprehensive income before reclassifications	—	8,084	8,084
Amounts reclassified from accumulated other comprehensive income	6,872	—	6,872
Net current-period other comprehensive income	6,872	8,084	14,956
Balance as of September 30, 2013	$(190,934)	$77,813	$(113,121)

* Net of tax benefit of $86,283 and $89,540 for September 30, 2013 and December 31, 2012, respectively.

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The table below illustrates the amounts (in thousands) reclassified out of each component of accumulated other comprehensive income for the period ended September 30, 2013.

Details of Accumulated Other Comprehensive Income Components	Amount Reclassified from Accumulated Other Comprehensive Income		Affected Line Item in the Statement of Operations
Amortization of defined benefit pension items:			
Prior-service costs	$ 10		$14 and ($4) have been recorded within Cost of Sales and Selling, General & Administrative, respectively
Net loss (gain)	10,330		$14,001 and ($3,671) have been recorded within Cost of Sales and Selling, General & Administrative, respectively
Amortization of other postretirement items:			
Prior-service costs	(177	)	Recorded within Selling, General & Administrative
Net loss (gain)	(34	)	Recorded within Selling, General & Administrative
	$ 10,129		Total before tax
	3,257		Tax benefit
Total reclassifications for the period	$ 6,872		Net of tax

Note 6 - Acquisitions

Acquisitions are accounted for in accordance with the guidance for business combinations. Accordingly, the Company makes an initial allocation of the purchase price at the date of acquisition based upon its understanding of the fair value of the acquired assets and assumed liabilities. The Company obtains this information during due diligence and through other sources. In the months after closing, as the Company obtains additional information about these assets and liabilities, including through tangible and intangible asset appraisals, it is able to refine the estimates of fair value and more accurately allocate the purchase price. Only items identified as of the acquisition date are considered for subsequent adjustment. The Company will make appropriate adjustments to the purchase price allocation prior to completion of the measurement period, as required.

In December 2012, the Company entered into a Stock Purchase Agreement to purchase all of the outstanding equity interests of MEI Conlux Holdings (U.S.), Inc. and its affiliate MEI Conlux Holdings (Japan), Inc. (together "MEI") for a purchase price of $820 million on a cash free and debt free basis. In the course of obtaining required regulatory approvals, the Company agreed to certain conditions imposed by the European Commission ("the Commission"). In July 2013, the Commission cleared the pending acquisition of MEI conditioned upon the Company's entry into agreements satisfactory to the Commission to implement remedies regarding two product lines - divestiture of the B2B bill recycler product line and licensing in Europe for the Currenza C2 coin recycler product line, both manufactured and sold by Crane Co.'s Payment Solutions business, within its Merchandising Systems segment. The remedies would not affect the competing bill and coin recycler product lines of MEI. In connection with these remedies, the Company and the representatives of the owners of MEI reached agreement to revise the purchase price to approximately $804 million on a cash free and debt free basis. The Company also agreed to share in one-third of any refinancing costs incurred by MEI as a result of the delayed closing, up to a maximum of $5 million. Subject to negotiation, execution and approval of agreements implementing the remedies, the acquisition is expected to close in the fourth quarter of 2013. MEI is a leading provider of payment solutions for unattended transaction systems, serving customers in the transportation, gaming, retail, service payment and vending markets. MEI, which had sales of approximately $400 million in 2012, will be integrated into the Company's Payment Solutions business within its Merchandising Systems

segment.

Note 7 - Goodwill and Intangible Assets
The Company’s business acquisitions have typically resulted in the recognition of goodwill and other intangible assets. The Company follows the provisions of Accounting Standards Codification (“ASC”) Topic 350, “Intangibles – Goodwill and Other” (“ASC 350”) as it relates to the accounting for goodwill in the Condensed Consolidated Financial Statements. These provisions require that the Company, on at least an annual basis, evaluate the fair value of the reporting units to which goodwill is assigned and attributed and compare that fair value to the carrying value of the reporting unit to determine if an impairment has occurred. The Company performs its annual impairment testing during the fourth quarter. Impairment testing takes place more often than annually if events or circumstances indicate a change in status that would indicate a potential impairment. The Company believes that there have been no events or circumstances which would more likely than not reduce the fair value for

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its reporting units below its carrying value. A reporting unit is an operating segment unless discrete financial information is prepared and reviewed by segment management for businesses one level below that operating segment (a “component”), in which case the component would be the reporting unit. In certain instances, the Company has aggregated components of an operating segment into a single reporting unit based on similar economic characteristics. At September 30, 2013, the Company had eleven reporting units.

When performing its annual impairment assessment, the Company compares the fair value of each of its reporting units to its respective carrying value. Goodwill is considered to be potentially impaired when the net book value of the reporting unit exceeds its estimated fair value. Fair values are established primarily by discounting estimated future cash flows at an estimated cost of capital which varies for each reporting unit and which, as of the Company’s most recent annual impairment assessment, ranged between 9.5% and 17% (a weighted average of 11%), reflecting the respective inherent business risk of each of the reporting units tested. This methodology for valuing the Company’s reporting units (commonly referred to as the Income Method) has not changed since the adoption of the provisions under ASC 350. The determination of discounted cash flows is based on the businesses’ strategic plans and long-range planning forecasts, which change from year to year. The revenue growth rates included in the forecasts represent best estimates based on current and forecasted market conditions. Profit margin assumptions are projected by each reporting unit based on the current cost structure and anticipated net cost increases/reductions. There are inherent uncertainties related to these assumptions, including changes in market conditions, and management’s judgment in applying them to the analysis of goodwill impairment. In addition to the foregoing, for each reporting unit, market multiples are used to corroborate its discounted cash flow results where fair value is estimated based on earnings multiples determined by available public information of comparable businesses. While the Company believes it has made reasonable estimates and assumptions to calculate the fair value of its reporting units, it is possible a material change could occur. If actual results are not consistent with management’s estimates and assumptions, goodwill and other intangible assets may then be determined to be overstated and a charge would need to be taken against net earnings. Furthermore, in order to evaluate the sensitivity of the fair value calculations on the goodwill impairment test performed during the fourth quarter of 2012, the Company applied a hypothetical, reasonably possible 10% decrease to the fair values of each reporting unit. The effects of this hypothetical 10% decrease would still result in the fair value calculation exceeding the carrying value for each reporting unit.

Changes to goodwill are as follows:

(in thousands)	Nine Months Ended September 30, 2013	Year Ended December 31, 2012
Balance at beginning of period	$813,792	$820,824
Disposals	—	(13,966)
Currency translation	(2,518)	6,934
Balance at end of period	$811,274	$813,792

For the year ended December 31, 2012, the disposals represent goodwill associated with the Company’s divested businesses. See discussion in Note 3, "Discontinued Operations" for further details.

Changes to intangible assets are as follows:

(in thousands)	Nine Months Ended September 30, 2013	Year Ended December 31, 2012
Balance at beginning of period, net of accumulated amortization	$125,913	$146,227
Disposals	—	(3,789)
Amortization expense	(12,290)	(16,907)
Currency translation and other	1,168	382
Balance at end of period, net of accumulated amortization	$114,791	$125,913

For the year ended December 31, 2012, the disposals represent intangible assets associated with the Company’s divested businesses. See discussion in Note 3, "Discontinued Operations" for further details.

As of September 30, 2013, the Company had $114.8 million of net intangible assets, of which $31.4 million were intangibles with indefinite useful lives, consisting of trade names. The Company amortizes the cost of other

intangibles over their estimated useful lives unless such lives are deemed indefinite. Intangibles with indefinite useful lives are tested annually for impairment, or when events or changes in circumstances indicate the potential for impairment. If the carrying amount of an intangible asset

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with an indefinite useful life exceeds the fair value, the intangible asset is written down to its fair value. Fair value is calculated using discounted cash flows.
In addition to annual testing for impairment of indefinite-lived intangible assets, the Company reviews all of its long-lived assets, including intangible assets subject to amortization, for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Examples of events or changes in circumstances could include, but are not limited to, a prolonged economic downturn, current period operating or cash flow losses combined with a history of losses or a forecast of continuing losses associated with the use of an asset or asset group, or a current expectation that an asset or asset group will be sold or disposed of before the end of its previously estimated useful life. Recoverability is based upon projections of anticipated future undiscounted cash flows associated with the use and eventual disposal of the long-lived asset (or asset group), as well as specific appraisal in certain instances. Reviews occur at the lowest level for which identifiable cash flows are largely independent of cash flows associated with other long-lived assets or asset groups and include estimated future revenues, gross profit margins, operating profit margins and capital expenditures which are based on the businesses' strategic plans and long-range planning forecasts, which change from year to year. The revenue growth rates included in the forecasts represent our best estimates based on current and forecasted market conditions, and the profit margin assumptions are based on the current cost structure and anticipated net cost increases/reductions. There are inherent uncertainties related to these assumptions, including changes in market conditions, and management's judgment in applying them to the analysis. If the future undiscounted cash flows are less than the carrying value, then the long-lived asset is considered impaired and a charge would be taken against net earnings based on the amount by which the carrying amount exceeds the estimated fair value. Judgments that the Company makes which impact these assessments relate to the expected useful lives of long-lived assets and its ability to realize any undiscounted cash flows in excess of the carrying amounts of such assets, and are affected primarily by changes in the expected use of the assets, changes in technology or development of alternative assets, changes in economic conditions, changes in operating performance and changes in expected future cash flows. Since judgment is involved in determining the fair value of long-lived assets, there is risk that the carrying value of our long-lived assets may require adjustment in future periods. Historical results to date have generally approximated expected cash flows for the identifiable cash flow generating level. The Company believes that there have been no events or circumstances which would more likely than not reduce the fair value of its indefinite-lived and amortizing intangible assets.

A summary of intangible assets follows:

(dollars in thousands)	Weighted Average Amortization Period of Finite Lived Assets (in years)	September 30, 2013			December 31, 2012		
		Gross Asset	Accumulated Amortization	Net	Gross Asset	Accumulated Amortization	Net
Intellectual property rights	18.8	$88,950	$49,105	$39,845	$88,614	$47,202	$41,412
Customer relationships and backlog	11.7	139,774	81,092	58,682	140,250	73,630	66,620
Drawings	37.9	11,149	9,925	1,224	11,149	9,850	1,299
Other	14.0	51,179	36,139	15,040	51,093	34,511	16,582
Total	14.1	$291,052	$176,261	$114,791	$291,106	$165,193	$125,913

Amortization expense for these intangible assets is currently estimated to be approximately $4.3 million in total for the remainder of 2013, $14.5 million in 2014, $12.7 million in 2015, $11.9 million in 2016, $11.4 million in 2017 and $28.5 million in 2018 and thereafter.

Note 8 - Accrued Liabilities
Accrued liabilities consist of:

(in thousands)	September 30, 2013	December 31, 2012
Employee related expenses	$73,178	$90,911
Warranty	10,005	10,718
Other	106,598	119,049
Total	$189,781	$220,678

The Company accrues warranty liabilities when it is probable that an asset has been impaired or a liability has been incurred and the amount of the loss can be reasonably estimated. Warranty provision is included in cost of sales in the Condensed Consolidated Statements of Operations.

A summary of the warranty liabilities is as follows:

(in thousands)	Nine Months Ended September 30, 2013	Year Ended December 31, 2012
Balance at beginning of period	$10,718	$16,379
Expense	7,810	6,190
Changes due to acquisitions/divestitures	—	(498)
Payments / deductions	(8,558)	(11,426)
Currency translation	35	73
Balance at end of period	$10,005	$10,718

Note 9 - Commitments and Contingencies

Asbestos Liability

Information Regarding Claims and Costs in the Tort System

As of September 30, 2013, the Company was a defendant in cases filed in numerous state and federal courts alleging injury or death as a result of exposure to asbestos. Activity related to asbestos claims during the periods indicated was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,		Year Ended December 31,
	2013	2012	2013	2012	2012
Beginning claims	54,969	57,559	56,442	58,658	58,658
New claims	683	933	2,207	2,720	3,542
Settlements	(234)	(253)	(688)	(800)	(1,030)
Dismissals	(1,596)	(1,467)	(4,139)	(3,983)	(4,919)
MARDOC claims*	—	1	—	178	191
Ending claims	53,822	56,773	53,822	56,773	56,442

* As of January 1, 2010, the Company was named in 36,448 maritime actions which had been administratively dismissed by the United States District Court for the Eastern District of Pennsylvania ("MARDOC claims"), and therefore were not classified as active claims. In addition, the Company was named in 8 new maritime actions in 2010 (also not classified as active claims). Through September 30, 2013, pursuant to an ongoing review process initiated by the Court, 26,562 claims were permanently dismissed, and 3,391 claims were classified as active, of which 810 claims were subsequently dismissed, and 2,581 claims remain active (and have been added to "Ending claims"). The Company expects that more of the remaining 6,503 maritime actions will be activated, or permanently dismissed, as the Court's review process continues. The number on this line reflects the number of previously inactive MARDOC claims that were newly activated in a given period.

Of the 53,822 pending claims as of September 30, 2013, approximately 19,100 claims were pending in New York, approximately 9,700 claims were pending in Texas, approximately 5,300 claims were pending in Mississippi, and approximately 3,000 claims were pending in Ohio, all jurisdictions in which legislation or judicial orders restrict the types of claims that can proceed to trial on the merits.

Substantially all of the claims the Company resolves are either dismissed or concluded through settlements. To date, the Company has paid two judgments arising from adverse jury verdicts in asbestos matters. The first payment, in the amount of $2.54 million, was made on July 14, 2008, approximately two years after the adverse verdict in the Joseph Norris matter in California, after the Company had exhausted all post-trial and appellate remedies. The second payment, in the amount of $0.02 million, was made in June 2009 after an adverse verdict in the Earl Haupt case in Los

Angeles, California on April 21, 2009.

The Company has tried several cases resulting in defense verdicts by the jury or directed verdicts for the defense by the court, one of which, the Patrick O'Neil claim in Los Angeles, was reversed on appeal. In an opinion dated January 12, 2012, the California Supreme Court reversed the decision of the Court of Appeal and instructed the trial court to enter a judgment of nonsuit in favor of the defendants.

On March 14, 2008, the Company received an adverse verdict in the James Baccus claim in Philadelphia, Pennsylvania, with compensatory damages of $2.45 million and additional damages of $11.9 million. The Company's post-trial motions were

denied by order dated January 5, 2009. The case was concluded by settlement in the fourth quarter of 2010 during the pendency of the Company's appeal to the Superior Court of Pennsylvania.

On May 16, 2008, the Company received an adverse verdict in the Chief Brewer claim in Los Angeles, California. The amount of the judgment entered was $0.68 million plus interest and costs. The Company pursued an appeal in this matter, and on August 2, 2012 the California Court of Appeal reversed the judgment and remanded the matter to the trial court for entry of judgment notwithstanding the verdict in favor of the Company on the ground that this claim could not be distinguished factually from the Patrick O'Neil case decided in the Company's favor by the California Supreme Court.

On February 2, 2009, the Company received an adverse verdict in the Dennis Woodard claim in Los Angeles, California. The jury found that the Company was responsible for one-half of one percent (0.5%) of plaintiffs' damages of $16.93 million; however, based on California court rules regarding allocation of damages, judgment was entered against the Company in the amount of $1.65 million, plus costs. Following entry of judgment, the Company filed a motion with the trial court requesting judgment in the Company's favor notwithstanding the jury's verdict, and on June 30, 2009, the court advised that the Company's motion was granted and judgment was entered in favor of the Company. The trial court's ruling was affirmed on appeal by order dated August 25, 2011. The plaintiffs appealed that ruling to the Supreme Court of California, which dismissed the appeal on February 29, 2012; the matter is now finally determined in the Company's favor.

On March 23, 2010, a Philadelphia, Pennsylvania, state court jury found the Company responsible for a 1/11th share of a $14.5 million verdict in the James Nelson claim, and for a 1/20th share of a $3.5 million verdict in the Larry Bell claim. On February 23, 2011, the court entered judgment on the verdicts in the amount of $0.2 million against the Company, only, in Bell, and in the amount of $4.0 million, jointly, against the Company and two other defendants in Nelson, with additional interest in the amount of $0.01 million being assessed against the Company, only, in Nelson. All defendants, including the Company, and the plaintiffs took timely appeals of certain aspects of those judgments. The Company resolved the Bell appeal by settlement, which is reflected in the settled claims for 2012. On September 5, 2013, the Pennsylvania Superior Court, in a 2-1 decision, vacated the Nelson verdict against all defendants, reversing and remanding for a new trial. Plaintiffs have requested a rehearing in the Superior Court, which the defendants, including the Company, have opposed.

On August 17, 2011, a New York City state court jury found the Company responsible for a 99% share of a $32 million verdict on the Ronald Dummitt claim. The Company filed post-trial motions seeking to overturn the verdict, to grant a new trial, or to reduce the damages, which the Company argued were excessive under New York appellate case law governing awards for non-economic losses. The Court held oral argument on these motions on October 18, 2011 and issued a written decision on August 21, 2012 confirming the jury's liability findings but reducing the award of damages to $8 million. At plaintiffs' request, the Court entered a judgment in the amount of $4.9 million against the Company, taking into account settlement offsets and accrued interest under New York law. The Company has appealed.

On March 9, 2012, a Philadelphia, Pennsylvania, state court jury found the Company responsible for a 1/8th share of a $123,000 verdict in the Frank Paasch claim. The Company and plaintiffs filed post-trial motions. On May 31, 2012, on plaintiffs' motion, the Court entered an order dismissing the claim against the Company, with prejudice, and without any payment.

On August 29, 2012, the Company received an adverse verdict in the William Paulus claim in Los Angeles, California. The jury found that the Company was responsible for ten percent (10%) of plaintiffs' non-economic damages of $6.5 million, plus a portion of plaintiffs' economic damages of $0.4 million. Based on California court rules regarding allocation of damages, judgment was entered in the amount of $0.8 million against the Company. The Company filed post-trial motions requesting judgment in the Company's favor notwithstanding the jury's verdict, which were denied. The Company has appealed.

On October 23, 2012, the Company received an adverse verdict in the Gerald Suttner claim in Buffalo, New York. The jury found that the Company was responsible for four percent (4%) of plaintiffs' damages of $3 million. The Company filed post-trial motions requesting judgment in the Company's favor notwithstanding the jury's verdict, which were denied. The court entered a judgment of $0.1 million against the Company. The Company has appealed.

On November 28, 2012, the Company received an adverse verdict in the James Hellam claim in Oakland, CA. The jury found that the Company was responsible for seven percent (7%) of plaintiffs' non-economic damages of $4.5 million, plus a portion of their economic damages of $0.9 million. Based on California court rules regarding allocation of damages, judgment was entered against the Company in the amount of $1.282 million. The Company filed post-trial motions requesting judgment in the Company's favor notwithstanding the jury's verdict and also requesting that settlement offsets be applied to reduce the judgment in accordance with California law. On January 31, 2013, the court entered an order disposing partially of that motion. On March 1, 2013, the Company filed an appeal regarding the portions of the motion that were denied. The court is expected to resolve the remainder of the issues raised shortly, after which the Company will appeal any remaining issues.

On February 25, 2013, a Philadelphia, Pennsylvania, state court jury found the Company responsible for a 1/10th share of a $2.5 million verdict in the Thomas Amato claim and a 1/5th share of a $2.3 million verdict in the Frank Vinciguerra claim, which were consolidated for trial. The Company filed post-trial motions requesting judgments in the Company's favor notwithstanding the jury's verdicts or new trials, and also requesting that settlement offsets be applied to reduce the judgment in accordance with Pennsylvania law. These motions were denied. The Company has appealed.

On March 1, 2013, a New York City state court jury entered a $35 million verdict against the Company in the Ivo Peraica claim. The Company filed post-trial motions seeking to overturn the verdict, to grant a new trial, or to reduce the damages, which the Company argues were excessive under New York appellate case law governing awards for non-economic losses and further were subject to settlement offsets. The plaintiffs have requested judgment against the Company in the amount of $19.3 million. The matters remain pending before the trial court. The Company plans to pursue an appeal if necessary. The Company has taken a separate appeal of the trial court's denial of its summary judgment motion.

On July 31, 2013, a Buffalo, New York, state court jury entered a $3.1 million verdict against the Company in the Lee Holdsworth claim. The Company plans to file post-trial motions seeking to overturn the verdict, to grant a new trial, or to reduce the damages, which the Company argues were excessive under New York appellate case law governing awards for non-economic losses and further were subject to settlement offsets. Post-trial motions are scheduled to be heard in the fourth quarter. The Company plans to pursue an appeal if necessary.

On September 11, 2013, a Columbia, South Carolina, state court jury in the Lloyd Garvin claim entered an $11 million verdict for compensatory damages against the Company and two other defendants jointly, and also awarded exemplary damages against the Company in the amount of $11.0 million. The jury also awarded exemplary damages against both other defendants. The Company has filed post-trial motions seeking to overturn the verdict, to grant a new trial, or to reduce the damages. The Company plans to pursue an appeal if necessary.

On September 17, 2013, a Fort Lauderdale, Florida, state court jury in the Richard DeLisle claim found the Company responsible for 16 percent of an $8 million verdict. The Company has filed post-trial motions seeking to overturn the verdict, to grant a new trial, or to reduce the damages, which the Company argues were excessive under Florida law and further were subject to settlement offsets. Plaintiffs have filed competing post-trial motions challenging the jury's allocation of damages to non-parties. The Company plans to pursue an appeal if necessary.

Such judgment amounts are not included in the Company's incurred costs until all available appeals are exhausted and the final payment amount is determined.

The gross settlement and defense costs incurred (before insurance recoveries and tax effects) for the Company for the nine-month periods ended September 30, 2013 and 2012 totaled $67.9 million and $73.5 million, respectively. In contrast to the recognition of settlement and defense costs, which reflect the current level of activity in the tort system, cash payments and receipts generally lag the tort system activity by several months or more, and may show some fluctuation from quarter to quarter. Cash payments of settlement amounts are not made until all releases and other required documentation are received by the Company, and reimbursements of both settlement amounts and defense costs by insurers may be uneven due to insurer payment practices, transitions from one insurance layer to the next excess layer and the payment terms of certain reimbursement agreements. The Company's total pre-tax payments for settlement and defense costs, net of funds received from insurers, for the nine-month periods ended September 30, 2013 and 2012 totaled $48.3 million and $60.1 million, respectively. Detailed below are the comparable amounts for the periods indicated.

(in millions)	Three Months Ended September 30,		Nine Months Ended September 30,		Year Ended December 31,
	2013	2012	2013	2012	2012
Settlement / indemnity costs incurred (1)	$9.0	$8.4	$23.2	$29.3	$37.5
Defense costs incurred (1)	15.8	15.3	44.7	44.2	58.7
Total costs incurred	$24.8	$23.8	$67.9	$73.5	$96.1
Settlement / indemnity payments	$10.6	$9.8	$29.5	$27.8	$38.0
Defense payments	14.8	13.9	42.6	41.9	59.8
Insurance receipts	(6.1)	(2.8)	(23.8)	(9.7)	(19.8)
Pre-tax cash payments	$19.4	$20.8	$48.3	$60.1	$78.0

(1) Before insurance recoveries and tax effects.

The amounts shown for settlement and defense costs incurred, and cash payments, are not necessarily indicative of future period amounts, which may be higher or lower than those reported.

Cumulatively through September 30, 2013, the Company has resolved (by settlement or dismissal) approximately 95,000 claims, not including the MARDOC claims referred to above. The related settlement cost incurred by the Company and its insurance carriers is approximately $390 million, for an average settlement cost per resolved claim of approximately $4,100. The average settlement cost per claim resolved during the years ended December 31, 2012, 2011 and 2010 was $6,300, $4,123 and $7,036, respectively. Because claims are sometimes dismissed in large groups, the average cost per resolved claim, as well as the number of open claims, can fluctuate significantly from period to period. In addition to large group dismissals, the nature of the disease and corresponding settlement amounts for each claim resolved will also drive changes from period to period in the average settlement cost per claim. Accordingly, the average cost per resolved claim is not considered in the Company’s periodic review of its estimated asbestos liability. For a discussion regarding the four most significant factors affecting the liability estimate, see “Effects on the Condensed Consolidated Financial Statements”.

Effects on the Condensed Consolidated Financial Statements

The Company has retained the firm of Hamilton, Rabinovitz & Associates, Inc. (“HR&A”), a nationally recognized expert in the field, to assist management in estimating the Company’s asbestos liability in the tort system. HR&A reviews information provided by the Company concerning claims filed, settled and dismissed, amounts paid in settlements and relevant claim information such as the nature of the asbestos-related disease asserted by the claimant, the jurisdiction where filed and the time lag from filing to disposition of the claim. The methodology used by HR&A to project future asbestos costs is based largely on the Company’s experience during a base reference period of eleven quarterly periods (consisting of the two full preceding calendar years and three additional quarterly periods to the estimate date) for claims filed, settled and dismissed. The Company's experience is then compared to the results of widely used previously conducted epidemiological studies estimating the number of individuals likely to develop asbestos-related diseases. Those studies were undertaken in connection with national analyses of the population of workers believed to have been exposed to asbestos. Using that information, HR&A estimates the number of future claims that would be filed against the Company and estimates the aggregate settlement or indemnity costs that would be incurred to resolve both pending and future claims based upon the average settlement costs by disease during the reference period. This methodology has been accepted by numerous courts. After discussions with the Company, HR&A augments its liability estimate for the costs of defending asbestos claims in the tort system using a forecast from the Company which is based upon discussions with its defense counsel. Based on this information, HR&A compiles an estimate of the Company’s asbestos liability for pending and future claims, based on claim experience during the reference period and covering claims expected to be filed through the indicated forecast period. The most significant factors affecting the liability estimate are (1) the number of new mesothelioma claims filed against the Company, (2) the average settlement costs for mesothelioma claims, (3) the percentage of mesothelioma claims dismissed against the Company and (4) the aggregate defense costs incurred by the Company. These factors are interdependent, and no one factor predominates in determining the liability estimate. Although the methodology used by HR&A can be applied to show claims and costs for periods subsequent to the indicated period (up to and including

the endpoint of the asbestos studies referred to above), management believes that the level of uncertainty regarding the various factors used in estimating future asbestos costs is too great to provide for reasonable estimation of the number of future claims, the nature of such claims or the cost to resolve them for years beyond the indicated estimate.

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In the Company's view, the forecast period used to provide the best estimate for asbestos claims and related liabilities and costs is a judgment based upon a number of trend factors, including the number and type of claims being filed each year; the jurisdictions where such claims are filed, and the effect of any legislation or judicial orders in such jurisdictions restricting the types of claims that can proceed to trial on the merits; and the likelihood of any comprehensive asbestos legislation at the federal level. In addition, the dynamics of asbestos litigation in the tort system have been significantly affected over the past five to ten years by the substantial number of companies that have filed for bankruptcy protection, thereby staying any asbestos claims against them until the conclusion of such proceedings, and the establishment of a number of post-bankruptcy trusts for asbestos claimants, which are estimated to provide $36 billion for payments to current and future claimants. These trend factors have both positive and negative effects on the dynamics of asbestos litigation in the tort system and the related best estimate of the Company's asbestos liability, and these effects do not move in a linear fashion but rather change over multi-year periods. Accordingly, the Company's management continues to monitor these trend factors over time and periodically assesses whether an alternative forecast period is appropriate.

Each quarter, HR&A compiles an update based upon the Company's experience in claims filed, settled and dismissed during the updated reference period (consisting of the preceding eleven quarterly periods) as well as average settlement costs by disease category (mesothelioma, lung cancer, other cancer and non-malignant conditions including asbestosis) during that period. In addition to this claims experience, the Company also considers additional quantitative and qualitative factors such as the nature of the aging of pending claims, significant appellate rulings and legislative developments, and their respective effects on expected future settlement values. As part of this process, the Company also takes into account trends in the tort system such as those enumerated above. Management considers all these factors in conjunction with the liability estimate of HR&A and determines whether a change in the estimate is warranted.

Liability Estimate. With the assistance of HR&A, effective as of December 31, 2011, the Company updated and extended its estimate of the asbestos liability, including the costs of settlement or indemnity payments and defense costs relating to currently pending claims and future claims projected to be filed against the Company through 2021. The Company's previous estimate was for asbestos claims filed or projected to be filed through 2017. As a result of this updated estimate, the Company recorded an additional liability of $285 million as of December 31, 2011. The Company's decision to take this action at such date was based on several factors which contribute to the Company's ability to reasonably estimate this liability for the additional period noted. First, the number of mesothelioma claims (which although constituting approximately 8% of the Company's total pending asbestos claims, have accounted for approximately 90% of the Company's aggregate settlement and defense costs) being filed against the Company and associated settlement costs have recently stabilized. In the Company's opinion, the outlook for mesothelioma claims expected to be filed and resolved in the forecast period is reasonably stable. Second, there have been favorable developments in the trend of case law which has been a contributing factor in stabilizing the asbestos claims activity and related settlement costs. Third, there have been significant actions taken by certain state legislatures and courts over the past several years that have reduced the number and types of claims that can proceed to trial, which has been a significant factor in stabilizing the asbestos claims activity. Fourth, the Company has now entered into coverage-in-place agreements with almost all of its excess insurers, which enables the Company to project a more stable relationship between settlement and defense costs paid by the Company and reimbursements from its insurers. Taking all of these factors into account, the Company believes that it can reasonably estimate the asbestos liability for pending claims and future claims to be filed through 2021. While it is probable that the Company will incur additional charges for asbestos liabilities and defense costs in excess of the amounts currently provided, the Company does not believe that any such amount can be reasonably estimated beyond 2021. Accordingly, no accrual has been recorded for any costs which may be incurred for claims which may be made subsequent to 2021.

Management has made its best estimate of the costs through 2021 based on the analysis by HR&A completed in January 2012. Through September 30, 2013, the Company's actual experience during the updated reference period for mesothelioma claims filed and dismissed generally approximated the assumptions in the Company's liability estimate. In addition to this claims experience, the Company considered additional quantitative and qualitative factors such as the nature of the aging of pending claims, significant appellate rulings and legislative developments, and their respective effects on expected future settlement values. Based on this evaluation, the Company determined that no

change in the estimate was warranted for the period ended September 30, 2013. Nevertheless, if certain factors show a pattern of sustained increase or decrease, the liability could change materially; however, all the assumptions used in estimating the asbestos liability are interdependent and no single factor predominates in determining the liability estimate. Because of the uncertainty with regard to and the interdependency of such factors used in the calculation of its asbestos liability, and since no one factor predominates, the Company believes that a range of potential liability estimates beyond the indicated forecast period cannot be reasonably estimated.

A liability of $894 million was recorded as of December 31, 2011 to cover the estimated cost of asbestos claims now pending or subsequently asserted through 2021, of which approximately 80% is attributable to settlement and defense costs for future claims projected to be filed through 2021. The liability is reduced when cash payments are made in respect of settled claims and

defense costs. The liability was $724 million as of September 30, 2013. It is not possible to forecast when cash payments related to the asbestos liability will be fully expended; however, it is expected such cash payments will continue for a number of years past 2021, due to the significant proportion of future claims included in the estimated asbestos liability and the lag time between the date a claim is filed and when it is resolved. None of these estimated costs have been discounted to present value due to the inability to reliably forecast the timing of payments. The current portion of the total estimated liability at September 30, 2013 was $92 million and represents the Company's best estimate of total asbestos costs expected to be paid during the twelve-month period. Such amount is based upon the HR&A model together with the Company's prior year payment experience for both settlement and defense costs.
Insurance Coverage and Receivables. Prior to 2005, a significant portion of the Company's settlement and defense costs were paid by its primary insurers. With the exhaustion of that primary coverage, the Company began negotiations with its excess insurers to reimburse the Company for a portion of its settlement and/or defense costs as incurred. To date, the Company has entered into agreements providing for such reimbursements, known as "coverage-in-place", with eleven of its excess insurer groups. Under such coverage-in-place agreements, an insurer's policies remain in force and the insurer undertakes to provide coverage for the Company's present and future asbestos claims on specified terms and conditions that address, among other things, the share of asbestos claims costs to be paid by the insurer, payment terms, claims handling procedures and the expiration of the insurer's obligations. Similarly, under a variant of coverage-in-place, the Company has entered into an agreement with a group of insurers confirming the aggregate amount of available coverage under the subject policies and setting forth a schedule for future reimbursement payments to the Company based on aggregate indemnity and defense payments made. In addition, with ten of its excess insurer groups, the Company entered into policy buyout agreements, settling all asbestos and other coverage obligations for an agreed sum, totaling $82.5 million in aggregate. Reimbursements from insurers for past and ongoing settlement and defense costs allocable to their policies have been made in accordance with these coverage-in-place and other agreements. All of these agreements include provisions for mutual releases, indemnification of the insurer and, for coverage-in-place, claims handling procedures. With the agreements referenced above, the Company has concluded settlements with all but one of its solvent excess insurers whose policies are expected to respond to the aggregate costs included in the updated liability estimate. That insurer, which issued a single applicable policy, has been paying the shares of defense and indemnity costs the Company has allocated to it, subject to a reservation of rights. There are no pending legal proceedings between the Company and any insurer contesting the Company's asbestos claims under its insurance policies.
In conjunction with developing the aggregate liability estimate referenced above, the Company also developed an estimate of probable insurance recoveries for its asbestos liabilities. In developing this estimate, the Company considered its coverage-in-place and other settlement agreements described above, as well as a number of additional factors. These additional factors include the financial viability of the insurance companies, the method by which losses will be allocated to the various insurance policies and the years covered by those policies, how settlement and defense costs will be covered by the insurance policies and interpretation of the effect on coverage of various policy terms and limits and their interrelationships. In addition, the timing and amount of reimbursements will vary because the Company's insurance coverage for asbestos claims involves multiple insurers, with different policy terms and certain gaps in coverage. In addition to consulting with legal counsel on these insurance matters, the Company retained insurance consultants to assist management in the estimation of probable insurance recoveries based upon the aggregate liability estimate described above and assuming the continued viability of all solvent insurance carriers. Based upon the analysis of policy terms and other factors noted above by the Company's legal counsel, and incorporating risk mitigation judgments by the Company where policy terms or other factors were not certain, the Company's insurance consultants compiled a model indicating how the Company's historical insurance policies would respond to varying levels of asbestos settlement and defense costs and the allocation of such costs between such insurers and the Company. Using the estimated liability as of December 31, 2011 (for claims filed or expected to be filed through 2021), the insurance consultant's model forecasted that approximately 25% of the liability would be reimbursed by the Company's insurers. While there are overall limits on the aggregate amount of insurance available to the Company with respect to asbestos claims, those overall limits were not reached by the total estimated liability currently recorded by the Company, and such overall limits did not influence the Company in its determination of the asset amount to record. The proportion of the asbestos liability that is allocated to certain insurance coverage years,

however, exceeds the limits of available insurance in those years. The Company allocates to itself the amount of the asbestos liability (for claims filed or expected to be filed through 2021) that is in excess of available insurance coverage allocated to such years. An asset of $225 million was recorded as of December 31, 2011 representing the probable insurance reimbursement for such claims expected through 2021. The asset is reduced as reimbursements and other payments from insurers are received. The asset was $182 million as of September 30, 2013.

The Company reviews the aforementioned estimated reimbursement rate with its insurance consultants on a periodic basis in order to confirm its overall consistency with the Company's established reserves. The reviews encompass consideration of the performance of the insurers under coverage-in-place agreements and the effect of any additional lump-sum payments under policy buyout agreements. Since December 2011, there have been no developments that have caused the Company to change

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the estimated 25% rate, although actual insurance reimbursements vary from period to period, and will decline over time, for the reasons cited above.

Uncertainties. Estimation of the Company's ultimate exposure for asbestos-related claims is subject to significant uncertainties, as there are multiple variables that can affect the timing, severity and quantity of claims and the manner of their resolution. The Company cautions that its estimated liability is based on assumptions with respect to future claims, settlement and defense costs based on past experience that may not prove reliable as predictors. A significant upward or downward trend in the number of claims filed, depending on the nature of the alleged injury, the jurisdiction where filed and the quality of the product identification, or a significant upward or downward trend in the costs of defending claims, could change the estimated liability, as would substantial adverse verdicts at trial that withstand appeal. A legislative solution, structured settlement transaction, or significant change in relevant case law could also change the estimated liability.

The same factors that affect developing estimates of probable settlement and defense costs for asbestos-related liabilities also affect estimates of the probable insurance reimbursements, as do a number of additional factors. These additional factors include the financial viability of the insurance companies, the method by which losses will be allocated to the various insurance policies and the years covered by those policies, how settlement and defense costs will be covered by the insurance policies and interpretation of the effect on coverage of various policy terms and limits and their interrelationships. In addition, due to the uncertainties inherent in litigation matters, no assurances can be given regarding the outcome of any litigation, if necessary, to enforce the Company's rights under its insurance policies or settlement agreements.

Many uncertainties exist surrounding asbestos litigation, and the Company will continue to evaluate its estimated asbestos-related liability and corresponding estimated insurance reimbursement as well as the underlying assumptions and process used to derive these amounts. These uncertainties may result in the Company incurring future charges or increases to income to adjust the carrying value of recorded liabilities and assets, particularly if the number of claims and settlement and defense costs change significantly, or if there are significant developments in the trend of case law or court procedures, or if legislation or another alternative solution is implemented; however, the Company is currently unable to estimate such future changes and, accordingly, while it is probable that the Company will incur additional charges for asbestos liabilities and defense costs in excess of the amounts currently provided, the Company does not believe that any such amount can be reasonably determined beyond 2021. Although the resolution of these claims may take many years, the effect on the results of operations, financial position and cash flow in any given period from a revision to these estimates could be material.

Other Contingencies

Environmental Matters

For environmental matters, the Company records a liability for estimated remediation costs when it is probable that the Company will be responsible for such costs and they can be reasonably estimated. Generally, third party specialists assist in the estimation of remediation costs. The environmental remediation liability as of September 30, 2013 is substantially related to the former manufacturing site in Goodyear, Arizona (the "Goodyear Site") discussed below.

The Goodyear Site was operated by UniDynamics/Phoenix, Inc. ("UPI"), which became an indirect subsidiary of the Company in 1985 when the Company acquired UPI's parent company, UniDynamics Corporation. UPI manufactured explosive and pyrotechnic compounds, including components for critical military programs, for the U.S. government at the Goodyear Site from 1962 to 1993, under contracts with the Department of Defense and other government agencies and certain of their prime contractors. No manufacturing operations have been conducted at the Goodyear Site since 1994. The Goodyear Site was placed on the National Priorities List in 1983, and is now part of the Phoenix-Goodyear Airport North Superfund Site. In 1990, the U.S. Environmental Protection Agency ("EPA") issued administrative orders requiring UPI to design and carry out certain remedial actions, which UPI has done. Groundwater extraction and treatment systems have been in operation at the Goodyear Site since 1994. A soil vapor extraction system was in operation from 1994 to 1998, was restarted in 2004, and is currently in operation. The Company recorded a liability in 2004 for estimated costs to remediate the Goodyear Site. On July 26, 2006, the Company entered into a consent decree with the EPA with respect to the Goodyear Site providing for, among other things, a work plan for further investigation and remediation activities (inclusive of a supplemental remediation

investigation and feasibility study). During the fourth quarter of 2007, the Company and its technical advisors determined that changing groundwater flow rates and contaminant plume direction at the Goodyear Site required additional extraction systems as well as modifications and upgrades of the existing systems. In consultation with its technical advisors, the Company prepared a forecast of the expenditures required for these new and upgraded systems as well as the costs of operation over the forecast period through 2014. Taking these additional costs into consideration, the Company estimated its liability for the costs of such activities through 2014 to be $41.5 million as of December 31, 2007. During the fourth quarter of 2008, based on further consultation with the Company’s advisors and the EPA and in response to groundwater monitoring results that reflected a continuing migration in contaminant plume direction during the year, the Company revised its forecast of remedial activities to

increase the level of extraction systems and the number of monitoring wells in and around the Goodyear Site, among other things. As of December 31, 2008, the revised liability estimate was $65.2 million which resulted in an additional charge of $24.3 million during the fourth quarter of 2008. During the fourth quarter of 2011, additional remediation activities were determined to be required, in consultation with the Company's advisors, to further address the migration of the contaminant plume. As a result, the Company recorded a charge of $30.3 million during the fourth quarter of 2011, extending the accrued costs through 2016. The total estimated gross liability was $37.0 million as of September 30, 2013, and as described below, a portion is reimbursable by the U.S. Government. The current portion of the total estimated liability was approximately $16 million and represents the Company's best estimate, in consultation with its technical advisors, of total remediation costs expected to be paid during the twelve-month period.

Estimates of the Company's environmental liabilities at the Goodyear Site are based on currently available facts, present laws and regulations and current technology available for remediation, and are recorded on an undiscounted basis. These estimates consider the Company's prior experience in the Goodyear Site investigation and remediation, as well as available data from, and in consultation with, the Company's environmental specialists. Estimates at the Goodyear Site are subject to significant uncertainties caused primarily by the dynamic nature of the Goodyear Site conditions, the range of remediation alternatives available, together with the corresponding estimates of cleanup methodology and costs, as well as ongoing, required regulatory approvals, primarily from the EPA. Accordingly, it is likely that upon completing the supplemental remediation investigation and feasibility study and reaching a final work plan in or before 2016, an adjustment to the Company's liability estimate may be necessary to account for the agreed upon additional work as further information and circumstances regarding the Goodyear Site characterization develop. While actual remediation cost therefore may be more than amounts accrued, the Company believes it has established adequate reserves for all probable and reasonably estimable costs.

It is not possible at this point to reasonably estimate the amount of any obligation in excess of the Company's current accruals through the 2016 forecast period because of the aforementioned uncertainties, in particular, the continued significant changes in the Goodyear Site conditions and additional expectations of remediation activities experienced in recent years.

On July 31, 2006, the Company entered into a consent decree with the U.S. Department of Justice on behalf of the Department of Defense and the Department of Energy pursuant to which, among other things, the U.S. Government reimburses the Company for 21% of qualifying costs of investigation and remediation activities at the Goodyear Site. As of September 30, 2013, the Company has recorded a receivable of $9.3 million for the expected reimbursements from the U.S. Government in respect of the aggregate liability as at that date. The receivable is reduced as reimbursements and other payments from the U.S. Government are received.

The Company has been identified as a potentially responsible party ("PRP") with respect to environmental contamination at the Crab Orchard National Wildlife Refuge Superfund Site (the "Crab Orchard Site"). The Crab Orchard Site is located near Marion, Illinois, and consists of approximately 55,000 acres. Beginning in 1941, the United States used the Crab Orchard Site for the production of ordnance and other related products for use in World War II. In 1947, the Crab Orchard Site was transferred to the United States Fish and Wildlife Service ("FWS"), and about half of the Crab Orchard Site was leased to a variety of industrial tenants whose activities (which continue to this day) included manufacturing ordnance and explosives. A predecessor to the Company formerly leased portions of the Crab Orchard Site, and conducted manufacturing operations at the Crab Orchard Site from 1952 until 1964.

General Dynamics Ordnance and Tactical Systems, Inc. ("GD-OTS") is in the process of conducting a remedial investigation and feasibility study for the Additional and Uncharacterized Sites Operable Unit ("AUS-OU") at the Crab Orchard Site, pursuant to an Administrative Order on Consent between GD-OTS and the FWS, the EPA and the Illinois Environmental Protection Agency. The Company is not a party to that agreement, and has not been asked by any agency of the United States Government to participate in any investigative or remedial activity relative to the Crab Orchard Site. The Company has been informed that GD-OTS completed a Phase I remedial investigation in 2008, and a Phase II remedial investigation in 2010. Additionally, FWS completed its human health and baseline ecological risk assessments in 2010, and submitted a revised human health risk assessment in December 2011. GD-OTS is in the process of responding to agency comments on a revised draft remedial investigation report, and in connection with its efforts is awaiting additional technical information from the agencies. In GD-OTS's most recent

summary of developments related to the AUS-OU, it reported that it and the agencies had discussed a target date of August 2013 for submission of a final revised remedial investigation report; it is unclear whether that target date has been met. Work on interim deliverables for the feasibility study is underway. GD-OTS and the agencies project the draft FS report to be submitted in August 2014, with final FS report approval by January 2015, issuance of a Preliminary Remedial Plan by late spring 2015, and issuance of a final Record of Decision by December 2015. In light of the pace of agency activities to date, it is unclear whether those targets will be met.

GD-OTS has asked the Company to participate in a voluntary cost allocation/mediation exercise with respect to response costs it has incurred or will incur with respect to the AUS-OU. To date, the Company, along with a number of other PRPs that were contacted, have declined, citing the absence of certain necessary parties as well as an underdeveloped environmental record. In

light of the ongoing investigative activities, and the apparent willingness of the U.S. government to participate in a mediation proceeding, it is possible that an allocation or mediation proceeding may go forward, and may commence as early as late 2013. The Company at present cannot predict when any determination of the allocable share of the various PRPs, including the U.S. Government, is likely to be completed. Although a loss is probable, it is not possible at this time to reasonably estimate the amount of any obligation for remediation of the Crab Orchard Site because the extent of the environmental impact, allocation among PRPs, remediation alternatives, and concurrence of regulatory authorities have not yet advanced to the stage where a reasonable estimate can be made. The Company has notified its insurers of this potential liability and will seek coverage under its insurance policies.

On a related matter, the United States has brought suit against GD-OTS and Schlumberger Technology Corporation ("Schlumberger"), seeking to recover response costs that the United States has allegedly incurred in connection with alleged environmental contamination at a portion of the Crab Orchard Site known as "Site 36," which is within the Site's Miscellaneous Areas Operable Unit. This area, reported to be the wastewater treatment plant formerly serving the Crab Orchard Site, is not a part of the AUS-OU, as discussed above. On June 1, 2012, GD-OTS and Schlumberger filed a third-party complaint against the Company and seven other third-party defendants, seeking to shift a portion of any costs that GD-OTS and Schlumberger are held liable to pay to other entities formerly conducting activities at Site 36. GD-OTS and Schlumberger have also counterclaimed against the United States, seeking to compel the United States to bear a share of the response costs the United States allegedly has incurred. The United States, GD-OTS, Schlumberger, the Company, and all remaining third-party defendants have resolved in principle their claims against each other and have finalized the terms of a consent decree, which is awaiting approval from senior management in the Department of Justice. Pursuant to the agreement in principle, the Company has paid into escrow $166,667 to resolve all past and future claims for response costs relating to Site 36. The Company's obligation does not become final until the consent decree has been approved by Department of Justice management, lodged for public comment, and entered by the Court. We project that this will take place late in the fourth quarter of 2013 or early in the first quarter of 2014. The Company notified its insurers of this liability and has obtained an agreement for coverage for the settlement amount referenced above.

Other Proceedings

On January 8, 2010, a lawsuit related to the acquisition of Merrimac was filed in the Superior Court of the State of New Jersey. The action, brought by a purported stockholder of Merrimac, names Merrimac, each of Merrimac's directors, and Crane Co. as defendants, and alleges, among other things, breaches of fiduciary duties by the Merrimac directors, aided and abetted by Crane Co., that resulted in the payment to Merrimac stockholders of an allegedly unfair price of $16.00 per share in the acquisition and unjust enrichment of Merrimac's directors. The complaint seeks certification as a class of all Merrimac stockholders, except the defendants and their affiliates, and unspecified damages. Simultaneously with the filing of the complaint, the plaintiff filed a motion that sought to enjoin the transaction from proceeding. After a hearing on January 14, 2010, the court denied the plaintiff's motion. All defendants thereafter filed motions seeking dismissal of the complaint on various grounds. After a hearing on March 19, 2010, the court denied the defendants' motions to dismiss and ordered the case to proceed to pretrial discovery. All defendants have filed their answers and deny any liability. The Court certified the class, and the parties engaged in pre-trial discovery. Fact discovery closed in July 2012, and expert discovery, including the exchange of expert reports and depositions of expert witnesses, closed on November 30, 2012. Summary judgment motions were due to be submitted on or before January 15, 2013. However, on December 26, 2012, plaintiff's counsel proposed a settlement figure that was substantially less than had previously been proposed. This led to negotiations which culminated, on January 11, 2013, in an agreement, in principle, to resolve the case on the following terms, which are subject to Court approval. In consideration of the establishment of a settlement fund in the amount of $2 million, to be funded almost entirely from the insurance policy covering the former officers and directors of Merrimac, and with a single contribution of $150,000 by Crane Co., the plaintiffs agreed (1) to withdraw the single claim asserted in the Complaint against Crane Co., (2) that all plaintiff's attorney's fees and expenses associated with the case will come from the settlement amount, and (3) that all costs of notification of the settlement to the members of the class, costs related to the distribution of pro rata amounts to class members, and any other administrative costs, will also come from the settlement amount. In addition, all defendants, including Crane Co., will receive full class-wide releases. On January 15, 2013, with the consent of counsel for Crane Co. and the other defendants, plaintiff's counsel notified the

Court that the parties had reached a provisional agreement to resolve the case, subject to court approval, and asked that the case be stayed for all purposes except for settlement-related proceedings. On July 1, 2013, the settlement of this case received final approval by the Superior Court for Essex County. All claims against all defendants, including the single claim alleged against Crane, have been dismissed with prejudice.

Pursuant to recently enacted environmental regulations in New Jersey, the Company performed certain tests of the indoor air quality of approximately 40 homes in a residential area surrounding a former manufacturing facility in Roseland, New Jersey, to determine if any contaminants (volatile organic compound vapors from groundwater) from the facility were present in those

homes. The Company installed vapor mitigation equipment in three homes where contaminants were found. On April 15, 2011, those three homeowners, and the tenants in one of those homes, filed separate suits against the Company seeking unspecified compensatory and punitive damages for their lost property value and nuisance. In addition, a homeowner in the testing area, whose home tested negative for the presence of contaminants, filed a class action suit against the Company on behalf of himself and 141 other homeowners in the surrounding area, claiming damages in the nature of loss of value on their homes due to their proximity to the facility. The plaintiffs in these cases recently amended their complaints to assert claims under New Jersey's Environmental Rights Act for the Company's alleged failure to properly remediate the site. It is not possible at this time to reasonably estimate the amount of a loss and therefore, no loss amount has been accrued for the claims because among other things, the extent of the environmental impact, and consideration of other factors affecting value have not yet advanced to the stage where a reasonable estimate can be made.

A number of other lawsuits, claims and proceedings have been or may be asserted against the Company relating to the conduct of its business, including those pertaining to product liability, patent infringement, commercial, employment, employee benefits, environmental and stockholder matters. While the outcome of litigation cannot be predicted with certainty, and some of these other lawsuits, claims or proceedings may be determined adversely to the Company, the Company does not believe that the disposition of any such other pending matters is likely to have a material impact on its financial condition or liquidity, although the resolution in any reporting period of one or more of these matters could have a significant impact on the Company's results of operations and cash flows for that period.

Other Commitments

The Company entered into a seven year operating lease for an airplane in the first quarter of 2007 which includes a maximum residual value guarantee of $14.1 million by the Company if the fair value of the airplane is less than $22.1 million. This commitment is secured by the leased airplane and the residual value guarantee liability is $8.2 million as of September 30, 2013.

Note 10 - Pension and Other Postretirement Benefit Plans

The components of net periodic cost are as follows:

	Three Months Ended September 30,				Nine Months Ended September 30,			
(in thousands)	Pension Benefits		Other Postretirement Benefits		Pension Benefits		Other Postretirement Benefits	
	2013	2012	2013	2012	2013	2012	2013	2012
Service cost	$1,513	$3,131	$22	$29	$4,540	$10,121	$67	$87
Interest cost	9,144	9,525	93	127	27,433	28,193	279	381
Expected return on plan assets	(12,970)	(12,832)	—	—	(38,909)	(38,492)	—	—
Amortization of prior service cost	3	102	(59)	(59)	10	302	(177)	(177)
Amortization of net loss (gain)	3,444	4,794	(11)	(21)	10,330	14,417	(34)	(63)
Net periodic cost	$1,134	$4,720	$45	$76	$3,404	$14,541	$135	$228

The Company expects, based on current actuarial calculations, to contribute approximately $15 million to its defined benefit plans and $1 million to its other postretirement benefit plans in 2013, of which $12.8 million and $0.4 million have been contributed during the first nine months of 2013, respectively. The Company contributed $4 million to its defined benefit plans and $1 million to its other postretirement benefit plans in 2012. Cash contributions for subsequent years will depend on a number of factors, including the impact of the Pension Protection Act signed into law in 2006, changes in minimum funding requirements, long-term interest rates, the investment performance of plan assets and changes in employee census data affecting the Company’s projected benefit obligations.

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Note 11 - Income Taxes

Effective Tax Rates

The Company's effective tax rates attributable to income from continuing operations are as follows:

	2013	2012
Three months ended September 30,	30.1%	29.9%
Nine months ended September 30,	30.4%	30.1%

The Company’s effective tax rates attributable to income from continuing operations for the three and nine months ended September 30, 2013 are higher than the prior year’s comparable periods primarily as a result of income earned in jurisdictions with higher statutory tax rates and certain statutorily non-deductible expenses, partially offset by the U.S. federal research credit, which lapsed during 2012, and a greater U.S. federal tax benefit on domestic manufacturing activities.

The Company’s effective tax rates attributable to continuing operations for the three and nine months ended September 30, 2013 are lower than the statutory U.S. federal tax rate of 35% primarily as a result of income earned in jurisdictions with tax rates lower than the U.S. statutory rate, the U.S. federal tax benefit for domestic manufacturing activities and the U.S. federal research credit. These items are partially offset by U.S. state taxes, and certain statutorily non-deductible expenses.

Unrecognized Tax Benefits

During the three and nine months ended September 30, 2013, the Company's gross unrecognized tax benefits increased by $1.1 million and $4.4 million, respectively, primarily as a result of tax positions taken in both the current and prior periods. During the three and nine months ended September 30, 2013, the total amount of unrecognized tax benefits that, if recognized, would affect the Company's effective tax rate increased by $1.1 million and $4.4 million, respectively.

The Company recognizes interest and penalties related to unrecognized tax benefits as a component of its income tax expense. During the three and nine months ended September 30, 2013, the Company recognized $0.1 million and $0.7 million, respectively, of interest and penalty expense related to unrecognized tax benefits in its condensed consolidated statements of operations. At September 30, 2013 and December 31, 2012, the Company had recorded $1.6 million and $1.0 million, respectively, of accrued interest and penalty expense related to unrecognized tax benefits in its condensed consolidated balance sheets.

During the next twelve months, it is reasonably possible that the Company's unrecognized tax benefits may decrease by approximately $0.4 million due to a combination of tax positions expected to be taken during the remainder of the current year, the expiration of the statute of limitations on assessment, and settlements with tax authorities.

Income Tax Examinations

The Company's income tax returns are subject to examination by U.S. federal, U.S. state and local, and non-U.S. tax authorities.

The Company’s consolidated U.S. federal income tax returns for 2010 through 2012 remain subject to examination, as do certain tax carryforwards generated before 2010. Acquired subsidiaries’ U.S. federal income tax returns for 2009 and 2010 also remain subject to examination.

With few exceptions, the Company is no longer subject to U.S. state and local or non-U.S. income tax examinations for years before 2008. As of September 30, 2013, the Company and it is subsidiaries are under examination in various jurisdictions, including Germany (2006 through 2011), Hungary (2009 and 2010), and California (2007 and 2008). In addition, the Company's appeal of certain Canadian tax assessments (2007 through 2009) is on-going. Overall, the Company believes that adequate accruals have been provided for all jurisdictions' open years.

Note 12 - Long-Term Debt and Notes Payable
The following table summarizes the Company’s debt as of September 30, 2013 and December 31, 2012:

(in thousands)	September 30, 2013	December 31, 2012
Long-term debt consists of:		
5.50% notes due 2013	$—	$199,898
6.55% notes due 2036	199,220	199,194
Total long-term debt	$199,220	$399,092
Short-term borrowings	$124,672	$1,123

The 5.5% senior unsecured notes having an aggregate principal amount of $200 million matured in the third quarter of 2013. The notes were repaid using $90 million of cash and $110 million of borrowings under the multi-year credit facility which are classified as short-term. There are no other significant debt maturities coming due until 2036.

Note 13 - Derivative Instruments and Hedging Activities
The Company is exposed to certain risks related to its ongoing business operations, including market risks related to fluctuation in currency exchange. The Company uses foreign exchange contracts to manage the risk of certain cross-currency business relationships to minimize the impact of currency exchange fluctuations on the Company’s earnings and cash flows. The Company does not hold or issue derivative financial instruments for trading or speculative purposes. As of September 30, 2013, the foreign exchange contracts designated as hedging instruments did not have a material impact on the Company’s condensed consolidated statement of operations, balance sheets or cash flows. Foreign exchange contracts not designated as hedging instruments which primarily pertain to foreign exchange fluctuation risk of intercompany positions, had a notional value of $295 million and $178 million as of September 30, 2013 and December 31, 2012, respectively. The settlement of derivative contracts for the nine months ended September 30, 2013 and 2012 resulted in a net cash inflow of $4.9 million and a net cash outflow of $13.0 million, respectively, and is reported with “Total provided by operating activities” on the Condensed Consolidated Statements of Cash Flows. As of September 30, 2013 and December 31, 2012, the Company's receivable position for the foreign exchange contracts was $1.7 million and $2.6 million, respectively. As of September 30, 2013 and December 31, 2012, the Company's payable position for the foreign exchange contracts was $3.2 million and $0.2 million, respectively.

Note 14 - Fair Value Measurements
Accounting standards define fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements are to be considered from the perspective of a market participant that holds the asset or owes the liability. The standards also establish a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.
The standards describe three levels of inputs that may be used to measure fair value:
Level 1: Quoted prices in active markets for identical or similar assets and liabilities.
Level 2: Quoted prices for identical or similar assets and liabilities in markets that are not active or observable inputs other than quoted prices in active markets for identical or similar assets and liabilities. Level 2 assets and liabilities include over-the-counter derivatives, principally forward foreign exchange contracts, whose value is determined using pricing models with inputs that are generally based on published foreign exchange rates and exchange traded prices, adjusted for other specific inputs that are primarily observable in the market or can be derived principally from or corroborated by observable market data.
Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The following table summarizes assets and liabilities measured at fair value on a recurring basis at the dates indicated:

	September 30, 2013				December 31, 2012			
	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs		Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs	
(in thousands)	Level 1	Level 2	Level 3	Total Fair Value	Level 1	Level 2	Level 3	Total Fair Value
Assets:								
Derivatives - foreign exchange contracts	$—	$ 1,703	$ —	$ 1,703	$—	$ 2,617	$ —	$ 2,617
Liabilities:								
Derivatives - foreign exchange contracts	$—	$ 3,173	$ —	$ 3,173	$—	$ 172	$ —	$ 172

Valuation Technique - The Company’s derivative assets and liabilities include foreign exchange contract derivatives that are measured at fair value using internal models based on observable market inputs such as forward rates and interest rates. Based on these inputs, the derivatives are classified within Level 2 of the valuation hierarchy.
The carrying value of the Company’s financial assets and liabilities, including cash and cash equivalents, accounts receivable, accounts payable and short-term loans payable approximate fair value, without being discounted, due to the short periods during which these amounts are outstanding. Long-term debt rates currently available to the Company for debt with similar terms and remaining maturities are used to estimate the fair value for debt issues that are not quoted on an exchange. The estimated fair value of long-term debt is measured using Level 2 inputs and was $215.5 million and $431.1 million at September 30, 2013 and December 31, 2012, respectively.

Note 15 - Restructuring
In 2012, the Company recorded pre-tax restructuring charges of $18.5 million, of which $16.5 million was associated with repositioning actions designed to improve profitability largely beginning in 2013, primarily in the European portion of the Fluid Handling segment and $2.0 million were related to the completion of previous restructuring actions.
The repositioning actions included $14.6 million of severance and other cash-related restructuring costs and $1.9 million of non-cash restructuring costs related to asset write-downs. The severance and other costs pertain to the closure of two small European plants, the transfer of certain manufacturing operations from higher cost to lower cost Company facilities and other staff reduction actions. These actions resulted in workforce reductions of approximately 200 employees, or about 2% of the Company's global workforce and were substantially completed in 2012. The Company expects the payments related to the repositioning actions to be substantially completed in 2013, which will be funded with cash generated from operations.
Related to the repositioning actions, the Company also recorded $1.6 million of additional charges related to the write-down of inventory resulting from the closure of a product line which was recorded in cost of sales and a $0.5 million pension curtailment charge which was recorded in selling, general and administrative expenses in 2012.
The following table summarizes the accrual balances related to these restructuring charges:

(in millions)	December 31, 2012	Expense	Utilization	September 30, 2013
Severance	$4.6	$(0.2)	$(3.9)	$0.5
Other	1.7	0.1	(1.8)	—
	$6.3	$(0.1)	$(5.7)	$0.5

Part I – Financial Information

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Quarterly Report on Form 10-Q contains information about Crane Co., some of which includes "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are statements other than historical information or statements about our current condition. You can identify forward-looking statements by the use of terms such as "believes," "contemplates," "expects," "may," "could," "should," "wou "anticipates," other similar phrases, or the negatives of these terms.

Reference herein to "Crane", "we", "us", and, "our" refer to Crane Co. and its subsidiaries unless the context specifically states or implies otherwise. References to "core business" or "core sales" in this report include sales from acquired businesses starting from and after the first anniversary of the acquisition, but exclude currency effects. Amounts in the following discussion are presented in millions, except employee, share and per share data, or unless otherwise stated.

We have based the forward-looking statements relating to our operations on our current expectations, estimates and projections about us and the markets we serve. We caution you that these statements are not guarantees of future performance and involve risks and uncertainties. In addition, we have based many of these forward-looking statements on assumptions about future events that may prove to be inaccurate. There are a number of other factors that could cause actual results or outcomes to differ materially from those addressed in the forward-looking statements. The factors that we currently believe to be material are detailed in Part II, Item 1A of this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012 filed with the Securities and Exchange Commission and are incorporated by reference herein.

Overview

We are a diversified manufacturer of highly engineered industrial products. Our business consists of four segments: Aerospace & Electronics, Engineered Materials, Merchandising Systems and Fluid Handling. Our primary markets are aerospace, defense electronics, non-residential construction, recreational vehicle ("RV"), transportation, automated merchandising, chemical, pharmaceutical, oil, gas, power, nuclear, building services and utilities.

Our strategy is to grow the earnings and cash flows of niche businesses with leading market shares, acquire businesses that fit strategically with existing businesses, successfully develop new products, aggressively pursue operational and strategic linkages among our businesses, build a performance culture focused on productivity and continuous improvement, continue to attract and retain a committed management team whose interests are directly aligned with those of our shareholders and maintain a focused, efficient corporate structure.

Outlook – Continuing Operations

Our sales depend heavily on industries that are cyclical in nature, or are subject to market conditions which may cause customer demand for our products to be volatile. These industries are subject to fluctuations in domestic and international economies as well as to currency fluctuations, inflationary pressures, and commodity costs.

The global economic outlook remains uncertain due, in part, to continued high unemployment in the U.S. and Europe, a slow recovery in the U.S. and European housing markets and undetermined government budget reduction plans. Notwithstanding, we believe we are well positioned to achieve increased profitability and continued strong cash flow in 2013. While we have realized a 13% year-to-date improvement in earnings and continued expansion in our operating margins, we remain generally cautious on the global economy. We continue to expect a combination of repositioning savings (approximately $12 million expected in 2013), continued cost management actions and gains in market share to drive earnings growth in 2013.

Aerospace & Electronics

We continue to believe market conditions in the aerospace industry will remain generally positive and, accordingly, we expect original equipment manufacturers ("OEM") sales growth in our Aerospace Group for the full year, as we benefit from increasing build rates across a broad range of platforms, primarily for large aircraft manufacturers. In addition, while total Aerospace Group sales were down 2.4% during the first nine months of 2013, we reported our first year-over-year improvement as well as sequential quarter improvement in aftermarket spares in the third quarter, and we are cautiously optimistic about a modest improvement in the fourth quarter of 2013. Revenues in our Electronics Group continue to be impacted by delays in defense-related programs and based on modest cost actions taken in our Electronics Group during the second quarter, together with higher shipments expected in the fourth

quarter, we expect continued improvement in both our sales and operating profit in the fourth quarter. Considering all of the foregoing, the slower commercial aftermarket recovery in our Aerospace year-to-date,

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together with the impact of the continued delays in defense-related programs at Electronics, we expect modestly lower sales in the segment compared to 2012.

Engineered Materials

We expect solid revenue growth in our Engineered Materials segment for 2013, as significantly higher sales to RV manufacturers resulting from improved industry build rates will more than offset lower sales to our building products customers. Through the first nine month of 2013, sales to RV manufacturers are 20.9% higher than last year. We believe the stronger RV industry build rates reflect a recovering U.S. economy and corresponding increase in consumer confidence. The modestly weaker sales of building products reflect the continuing soft commercial construction market. Operating profit in our Engineered Materials segment is expected to increase as we benefit from the higher RV-related sales, continued cost management initiatives and the impact of the repositioning actions completed in 2012.

Merchandising Systems

We expect a sales decline in our Merchandising Systems segment compared to 2012, reflecting a decrease in Vending Solutions sales, partially offset by a modest improvement in sales for our Payment Solutions products. The reduction in vending sales reflects a shortfall in sales in vending machines to certain U.S. bottler customers and weak market conditions in Europe. Reflecting the impact of lower segment sales through the first nine months, we expect operating profit in 2013 for the segment to decline compared to 2012, but operating margins to remain at prior year levels, reflecting continued strong productivity.

Fluid Handling

In our Fluid Handling segment, we expect modest core sales growth reflecting slight increases across most business units, with the exception of our Canadian distribution business. The slight core sales growth expected reflects strength in product sales within our Valve Group, primarily in our ChemPharma / Energy and nuclear services businesses. With respect to key end markets for our process valves in our ChemPharma / Energy business, despite ongoing market uncertainty in Europe, order and quote activity continued to be solid during the quarter and our European-based customers remain committed to projects on a global basis. While chemical industry demand in North America remains soft, investments in the Middle East and China continue to move forward. U.S. refineries continue their turnaround and upgrade activities; and demand from power markets in China and Europe is relatively strong, while the Americas and India remain soft. With respect to our commercial valves business, non-residential construction and mining activity in Canada continues to be soft and while we are seeing some improvement in Europe, the markets remain generally uncertain. We expect continued improvement in both operating profit and operating margins over 2012 levels driven by the modest sales growth, strong productivity and savings from previously announced repositioning actions.

Results from Continuing Operations – Three Month Periods Ended September 30
All comparisons below refer to the third quarter 2013 versus the third quarter 2012, unless otherwise specified.
Third quarter of 2013 compared with third quarter of 2012

	Third Quarter		Change	
(dollars in millions)	2013	2012	$	%
Net sales	$637.5	$646.0	$(8.5)	(1.3)%
Operating profit from continuing operations	89.0	86.6	2.4	2.8%
Restructuring and related charges *		1.4		
Operating margin from continuing operations	14.0%	13.4%		
Other income (expense):				
Interest income	0.3	0.4	(0.1)	(23.9)%
Interest expense	(6.7)	(6.6)	(0.1)	1.1%
Miscellaneous - net	(0.5)	—	(0.5)	NM
	(6.8)	(6.2)	(0.6)	10.1%
Income from continuing operations before income taxes	82.2	80.4	1.8	2.2%
Provision for income taxes	24.7	24.0	0.7	3.0%
Income from continuing operations	57.5	56.4	1.1	1.9%

* Restructuring charges are included in operating profit and operating margin

Third quarter 2013 sales decreased $8.5 million, or 1.3%, compared to the third quarter of 2012. Core business sales for the third quarter decreased approximately $6.2 million, or 1.0%. The impact of currency translation decreased reported sales by approximately $2.3 million, or 0.3%, as the U.S. dollar strengthened against other major currencies in the third quarter of 2013 compared to the third quarter of 2012. Net sales related to operations outside the U.S. were 42.0% and 41.2% of total net sales for the quarters ended September 30, 2013 and 2012, respectively.
Operating profit from continuing operations was $89.0 million in the third quarter 2013 compared to $86.6 million in the same period of 2012. The increase in operating profit reflected improved performance in our Engineered Materials and Fluid Handling segments, partially offset by decreases in our Aerospace & Electronics and Merchandising Systems segments. Operating profit margins were 14.0% in the third quarter of 2013, compared to 13.4% in the comparable period in 2012. Operating profit in the third quarter of 2013 included transaction costs of $2.9 million related to the pending acquisition of MEI Conlux Holdings (U.S.), Inc. and its affiliate MEI Conlux Holdings (Japan), Inc. (together "MEI"). Operating profit in the third quarter of 2012 included restructuring and related charges of $1.4 million associated with repositioning actions designed to improve profitability beginning in 2013.

Our effective tax rate is affected by a number of items, both recurring and discrete, including the amount of income we earn in different jurisdictions and their respective statutory tax rates, acquisitions and dispositions, changes in the valuation of our deferred tax assets and liabilities, changes in tax laws, regulations and accounting principles, the continued availability of statutory tax credits and deductions, the continued reinvestment of our overseas earnings, and examinations initiated by tax authorities around the world.

Our effective tax rate attributable to income from continuing operations was 30.1% during the third quarter of 2013 compared to 29.9% during the third quarter of 2012 primarily as a result of income earned in jurisdictions with higher statutory tax rates and certain statutorily non-deductible expenses, partially offset by the U.S. federal research credit, which lapsed during 2012, and a greater U.S. federal tax benefit on domestic manufacturing activities.

Results from Discontinued Operations – Three Month Periods Ended September 30

(dollars in millions)	Three Months Ended September 30, 2013	2012
Income from Continuing Operations	$57.5	$56.4
Discontinued Operations:		
Income from Discontinued Operations, net of tax	—	—
Gain from Sales of Discontinued Operations, net of tax	—	0.9
Discontinued Operations, net of tax	—	0.9
Net income before allocation to noncontrolling interests	$57.5	$57.3

For the three months ended June 30, 2012, we reported two divested businesses as discontinued operations on our Condensed Consolidated Statement of Operations. On June 19, 2012, we sold Azonix Corporation (“Azonix”) to Cooper Industries for $44.8 million, of which $0.9 million and $0.5 million were recorded in the third and fourth quarters of 2012, respectively, resulting in an after tax gain of $14.5 million. On June 28, 2012, we sold certain assets and operations of the Company’s valve service center in Houston, Texas to Furmanite Corporation for $9.3 million, resulting in an after tax gain of $4.6 million.

Segment Results of Continuing Operations Three Month Periods Ended September 30

The following information should be read in conjunction with our condensed consolidated financial statements and related notes. The segment results exclude the operating results of discontinued operations for all periods presented.

Aerospace & Electronics

(dollars in millions)	Third Quarter 2013	2012	Change	
Sales	$169.8	$171.4	$(1.6)	(0.9)%
Operating profit	$38.1	$39.8	$(1.7)	(4.3)%
Operating margin	22.4%	23.2%		

The third quarter 2013 sales decrease of $1.6 million reflected a sales increase of $0.8 million in the Aerospace Group and a sales decrease of $2.4 million in the Electronics Group. The segment’s operating profit decreased $1.7 million, or 4.3%, in the third quarter of 2013 when compared to the same period in the prior year, as lower operating profits in the Aerospace Group more than offset higher profits in the Electronics Group.

Aerospace Group sales of $107.2 million increased $0.8 million, or 0.8%, from $106.3 million in the prior year period. OEM product sales increased $5.0 million, or 8%, primarily reflecting an increase in commercial and military OEM sales. The increase in commercial OEM sales was driven by strong sales to large aircraft manufacturers as passenger air travel continues to increase, requiring OEM investment across various platforms. Aftermarket sales decreased $4.1 million, or 9%, compared to the prior year reflecting a decline in military aftermarket sales, partially offset by an increase in commercial aftermarket sales. The decline in military aftermarket sales of $5.2 million, or 38.1%, was primarily driven by lower modernization and upgrade ("M&U") product sales reflecting the completion in 2012 of the carbon brake control upgrade program for the U.S. Air Force C-130 aircraft which had $3.0 million of sales in the third quarter of 2012 (the upgrade program was completed in the fourth quarter of 2012). Commercial aftermarket sales increased $1.1 million, or 3.6%, with modest improvement in spares, M&U and repair and overhaul ("R&O") shipments. This represented the first year-over-year quarterly increase in 2013; we expect a similar modest improvement during the fourth quarter. During the third quarter of 2013, sales to OEMs and sales to aftermarket customers were 63.2% and 36.8%, respectively, of total sales, compared to 59.0% and 41.0%, respectively, in the same period last year. Aerospace operating profit decreased by $1.9 million in the third quarter of 2013, compared to the third quarter of 2012, primarily due to the aforementioned unfavorable OEM and aftermarket product mix, which more than offset slightly lower engineering spending of $0.5 million resulting from the completion of certain development programs. Engineering expense will increase or decrease from time-to-time depending on the nature and timing of program wins requiring engineering resources.

Electronics Group sales of $62.6 million decreased $2.4 million, or 3.7%, from $65.0 million in the prior year period. The sales decrease reflects lower sales of our Microwave Solutions products primarily reflecting delays in defense-related programs. Operating profit increased by $0.1 million compared to the third quarter of 2012 despite a $0.9 million unfavorable impact from

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the lower sales volume. In addition, strong productivity gains offset an unfavorable sales mix shift toward lower margin product sales.

Engineered Materials

	Third Quarter		Change	
(dollars in millions)	2013	2012		
Sales	$62.0	$57.0	$5.0	8.8 %
Operating profit	$10.8	$7.2	$3.6	49.3 %
Restructuring and related charges*	$—	$1.1		
Operating margin	17.4 %	12.7 %		

* Restructuring and related charges are included in operating profit and operating margin.

Third quarter 2013 sales of $62.0 million increased $5.0 million, or 8.8%, reflecting significantly higher sales to our RV customers of $6.4 million, or 25.8%. This increase was partially offset by modestly lower sales to our building products and transportation customers of $1.1 million. The increase in shipments to our traditional RV manufacturers reflected continuing strong demand for our RV-related applications as RV OEM build rates strengthened. We believe this to be in direct response to increased consumer confidence in North America as the U.S. economy continues to recover. Sales to our building product customers declined reflecting a continuing soft commercial construction market. Sales to our transportation customers declined reflecting soft markets and difficult competitive conditions. Operating profit in the third quarter of 2013 increased $3.6 million, or 49.3%, driven by a $1.4 million impact from the higher sales, the absence of a $1.1 million repositioning charge taken in 2012 related to closing a small manufacturing facility in England and $0.7 million of associated repositioning savings realized in the quarter. Productivity gains related to improving material yield coupled with targeted pricing actions offset higher raw material costs (primarily resin and styrene).

Merchandising Systems

	Third Quarter		Change	
(dollars in millions)	2013	2012		
Sales	$83.6	$92.5	$(8.9)	(9.6)%
Operating profit	$7.9	$9.5	$(1.6)	(17.1)%
Operating margin	9.4 %	10.3 %		

Third quarter 2013 sales decreased $8.9 million, or 9.6%, reflecting a core sales decrease of $8.1 million, or 8.8%, and unfavorable foreign currency translation of $0.7 million, or 0.8%. The decrease in core sales reflected lower sales in our Vending Solutions business of $9.7 million, or 18.6%, partially offset by slightly higher core sales in our Payment Solutions business of $1.6 million, or 3.7%. Sales decreased in our Vending Solutions business reflecting lower capital spending by certain U.S. bottler customers, as well as continued weak market conditions in Europe. The higher sales in our Payment Solutions business were driven by continued strength in the vending and gaming vertical end markets, particularly in Europe. Operating profit in the third quarter of 2013 decreased $1.6 million, or 17.1%, driven by an approximate $5 million impact from the lower volumes. This unfavorable impact was partially offset by continued productivity gains and cost control of approximately $2.5 million, driven largely on efforts to reduce material cost across both businesses.

Fluid Handling

	Third Quarter		Change	
(dollars in millions)	2013	2012		
Sales	$322.2	$325.2	$(3.0)	(0.9)%
Operating profit	$46.6	$45.7	$0.9	1.9 %
Restructuring and related charges*	$—	$0.2		
Operating margin	14.5 %	14.1 %		

* Restructuring and related charges are included in operating profit
and operating margin.

Third quarter 2013 sales decreased by $3.0 million from $325.2 million in third quarter 2012 to $322.2 million, including a core sales decrease of $1.3 million, or 0.4%, and unfavorable foreign currency translation of $1.7 million, or 0.5%. The decrease in core sales reflected lower sales in our ChemPharma / Energy business, driven by project delays and, to a lesser extent, lower sales in certain short cycle book and ship businesses. This was partially offset by slight increases across most other end

markets. We expect revenues and operating profit to increase modestly in the fourth quarter, primarily reflecting increases in shipments in our ChemPharma / Energy and Nuclear Valve Services businesses. Operating profit in the third quarter of 2013 increased $0.9 million, or 1.9%, primarily reflecting $2.5 million of savings associated with European repositioning actions taken in 2012, partially offset by the impact of the lower sales volume.

Results from Continuing Operations – Nine Month Periods Ended September 30
All comparisons below refer to the first nine months of 2013 versus the first nine months of 2012, unless otherwise specified
Year-to-date period ended September 30, 2013 compared to year-to-date period ended September 30, 2012

	Year-to-Date				Change			
(dollars in millions)	2013		2012		$		%	
Net sales	$1,913.8		$1,949.3		$(35.4	)	(1.8	)%
Operating profit from continuing operations	264.8		234.3		30.5		13.0	%
Restructuring charge *	—		14.9					
Operating margin from continuing operations	13.8	%	12.0	%				
Other income (expense):								
Interest income	1.5		1.3		0.2		15.2	%
Interest expense	(20.7	)	(20.1	)	(0.5	)	2.7	%
Miscellaneous - net	(0.2	)	(0.7	)	0.5		(75.9	)%
	(19.3	)	(19.5	)	0.2		(1.0	)%
Income from continuing operations before income taxes	245.4		214.7		30.7		21.5	%
Provision for income taxes	74.6		64.5		10.1		23.1	%
Income from continuing operations	170.8		150.2		20.6		20.8	%

* Restructuring charges are included in operating profit and operating margin

Year to date 2013 sales decreased $35.4 million, or 1.8%, over the same period in 2012. Year to date 2013 core business sales decreased approximately $27.6 million, or 1.4% while the impact of currency translation decreased sales by approximately $7.8 million, or 0.4%, as the U.S. dollar strengthened against other major currencies in the first nine months of 2013 compared to the same period in 2012. Net sales related to operations outside the U.S. for the nine month periods ended September 30, 2013 and 2012 were 41.3% and 41.1% of total net sales, respectively.
Operating profit was $264.8 million in the first nine months of 2013, compared to $234.3 million in the comparable period of 2012. The increase in operating profit reflected improved performance in our Fluid Handling, Engineered Materials and Merchandising Systems segments, partially offset by a decrease in our Aerospace & Electronics segments. Operating profit margins were 13.8% in the first nine months of 2013, compared to 12.0% in the comparable period of 2012. Operating profit in the first nine months of 2013 included transaction costs of $12.6 million related to the pending acquisition of MEI. Operating profit in the first nine months of 2012 included restructuring charges of $14.9 million associated with repositioning actions designed to improve profitability beginning in 2013.

Our effective tax rate is affected by a number of items, both recurring and discrete, including the amount of income we earn in different jurisdictions and their respective statutory tax rates, acquisitions and dispositions, changes in the valuation of our deferred tax assets and liabilities, changes in tax laws, regulations and accounting principles, the continued availability of statutory tax credits and deductions, the continued reinvestment of our overseas earnings, and examinations initiated by tax authorities around the world.

Our effective tax rate attributable to income from continuing operations was 30.4% during the first nine months of 2013 compared to 30.1% during the first nine months of 2012 primarily as a result of income earned in jurisdictions with higher statutory tax rates and certain statutorily non-deductible expenses, partially offset by the U.S. federal research credit, which lapsed during 2012, and a greater U.S. federal tax benefit on domestic manufacturing activities.

Results from Discontinued Operations – Nine Month Periods Ended September 30

(dollars in millions)	Nine Months Ended September 30, 2013	2012
Income from Continuing Operations	$170.8	$150.2
Discontinued Operations:		
Income from Discontinued Operations, net of tax	—	2.5
Gain from Sales of Discontinued Operations, net of tax	—	19.2
Discontinued Operations, net of tax	—	21.6
Net income before allocation to noncontrolling interests	$170.8	$171.8

For the six months ended June 30, 2012, we reported two divested businesses as discontinued operations on our Condensed Consolidated Statement of Operations. On June 19, 2012, we sold Azonix to Cooper Industries for $44.8 million, of which $0.9 million and $0.5 million were recorded in the third and fourth quarters of 2012, respectively, resulting in an after tax gain of $14.5 million. On June 28, 2012, we sold certain assets and operations of the Company's valve service center in Houston, Texas to Furmanite Corporation for $9.3 million, resulting in an after tax gain of $4.6 million.

Segment Results of Continuing Operations Nine Month Periods Ended September 30

The following information should be read in conjunction with our condensed consolidated financial statements and related notes. The segment results exclude the operating results of discontinued operations for all periods presented.

Aerospace & Electronics

(dollars in millions)	Year-To-Date 2013	2012	Change	
Sales	$507.0	$525.1	$(18.1)	(3.4)%
Operating profit	$115.3	$116.8	$(1.6)	(1.3)%
Operating margin	22.7%	22.2%		

The year to date 2013 sales decrease of $18.1 million reflected sales decreases of $7.8 million and $10.3 million in the Aerospace Group and Electronics Group, respectively. The segment's operating profit decreased $1.6 million, or 1.3%, in the first nine months of 2013 when compared to the same period in the prior year, driven by an operating profit decrease in the Electronics Group which was partially offset by an improvement in the Aerospace Group.

Year to date Aerospace Group sales of $318.1 million decreased $7.8 million, or 2.4%, from $325.9 million in the prior year period. The decrease was largely attributable to a $14.1 million, or 10.6%, decline in aftermarket product sales, partially offset by a $6.3 million, or 3.3%, increase in OEM product sales. The aftermarket sales decrease primarily reflects a decline in both military aftermarket sales of $11.5 million, or 28.8% and commercial aftermarket sales of $2.6 million, or 2.8%. The decrease in military aftermarket sales was primarily driven by lower modernization and upgrade ("M&U") product sales reflecting the completion in 2012 of the carbon brake control upgrade program for the U.S. Air Force C-130 aircraft which had $8.6 million of sales in the first nine months of 2012 (the upgrade program was completed in the fourth quarter of 2012). The commercial aftermarket sales decrease was primarily due to a decline in commercial spares. The OEM sales increase primarily reflects an increase in commercial OEM sales, driven by higher commercial product sales to large aircraft manufacturers, which have benefited from increased passenger air travel and higher air cargo volumes. During the first nine months of 2013, sales to OEMs and sales to aftermarket customers were 62.7% and 37.3%, respectively, of total sales, compared to 59.3% and 40.7%, respectively, in the same period last year. Aerospace operating profit increased by $2.0 million in the first nine months of 2013, compared to the first nine months of 2012, primarily due to productivity gains and solid cost management, as well as lower engineering spending resulting in part from the timing of certain development programs, partially offset by the aforementioned unfavorable OEM and aftermarket product mix. Engineering expense will increase or decrease from time-to-time depending on the nature and timing of program wins requiring engineering resources.

Year to date Electronics Group sales of $188.9 million decreased $10.3 million, or 5.1%, from $199.2 million in the prior year period. The sales decrease reflects lower sales of our Power and Microwave Solutions products primarily reflecting delays in defense-related programs. Operating profit decreased by $3.6 million in the first nine months of

2013, compared to the first nine months of 2012, primarily reflecting the $3.7 million impact on the lower sales volume. In addition, strong productivity gains offset an unfavorable sales mix shift toward lower margin product sales.

The Aerospace & Electronics segment backlog was $382 million at September 30, 2013, compared with $378 million at December 31, 2012 and $393 million at September 30, 2012.

Engineered Materials

	Year-To-Date		Change	
(dollars in millions)	2013	2012		
Sales	$179.9	$169.6	$10.3	6.1 %
Operating profit	$28.5	$21.2	$7.4	34.8 %
Restructuring and related charges*	$—	$2.2		
Operating margin	15.9 %	12.5 %		

* Restructuring and related charges are included in operating profit and operating margin.

Year to date 2013 sales of $179.9 million increased $10.3 million, or 6.1%, reflecting higher sales to our RV customers of $15.1 million, or 20.9%, partially offset by lower sales to our transportation-related and building products customers of $3.0 million. Sales to our traditional RV manufacturers increased reflecting higher demand for our RV-related applications as RV OEM build rates strengthened. We believe this to be in direct response to increased consumer confidence in North America as the U.S. economy continues to recover. Transportation-related sales declined, reflecting soft markets and difficult competitive conditions. Sales to our building product customers decreased, reflecting a generally soft commercial construction market. Operating profit in the first nine months of 2013 increased $7.4 million, or 34.8%, driven by a $3.2 million impact from the higher sales, the absence of a $2.2 million repositioning charge taken in 2012 and $2.2 million of repositioning savings realized in the first nine months of 2013. Productivity gains related to improving material yield coupled with targeted pricing actions offset higher raw material costs (primarily resin and styrene).

The Engineered Materials segment backlog was $13 million at September 30, 2013, compared with $13 million at December 31, 2012 and $11 million at September 30, 2012.

Merchandising Systems

	Year-To-Date		Change	
(dollars in millions)	2013	2012		
Sales	$257.9	$277.7	$(19.8)	(7.1)%
Operating profit	$26.9	$23.3	$3.6	15.3 %
Restructuring and related charges*	$—	$2.3		
Operating margin	10.4 %	8.4 %		

* Restructuring and related charges are included in operating profit and operating margin.

Year to date 2013 sales decreased $19.8 million, or 7.1%, reflecting a core sales decrease of $18.2 million, or 6.5%, and unfavorable foreign currency translation of $1.6 million, or 0.6%. The decrease in core sales reflected a decline in our Vending Solutions business of $26.6 million, or 17.1%, partially offset by higher core sales in our Payment Solutions business of $8.4 million, or 6.6% . Sales decreased in our Vending Solutions business reflecting lower capital spending by certain U.S. bottler customers, as well as, continued weak market conditions in Europe. Sales increased in our Payment Solutions business reflecting higher sales in the retail and vending vertical markets. The increase in the retail market was driven by higher sales to self check-out OEM customers. The increase in the vending market was driven primarily by share gains, particularly in Europe and Asia/Pacific. Operating profit in the first nine months of 2013 increased $3.6 million, or 15.3%, reflecting productivity gains of $6 million, driven by focused efforts to reduce material and headcount costs in our North American Vending business, the absence of repositioning charges recorded in 2012 of $2.3 million, $1.5 million of repositioning savings realized in the first nine months of 2013 and, to a lesser extent, the absence of a legal settlement charge which occurred in Vending Solutions in 2012. These favorable

changes were partially offset by an $8.0 million impact from the lower sales volume.

The Merchandising Systems segment backlog was $24 million at September 30, 2013, compared with $15 million at December 31, 2012 and $20 million at September 30, 2012.

Fluid Handling

	Year-To-Date		Change	
(dollars in millions)	2013	2012		
Sales	$968.9	$976.8	$(7.9)	(0.8)%
Operating profit	$146.7	$119.4	$27.3	22.8%
Restructuring and related charges*	$—	$11.6		
Operating margin	15.1%	12.2%		

* Restructuring and related charges are included in operating profit and operating margin.

Year to date 2013 sales decreased by $7.9 million, or 0.8% from $976.8 million in 2012 to $968.9 million in 2013, including unfavorable foreign currency translation of 6.3 million, or 0.6% and a core sales decrease of $1.6 million, or 0.2%. The decrease in core sales was driven by project delays in our ChemPharma/Energy businesses as well as weak orders in our short cycle book and ship business in Canada, partially offset by higher sales in our Nuclear Valve Services businesses. Operating profit in the first nine months of 2013 increased $27.3 million, or 22.8%, primarily reflecting the absence of repositioning charges of $11.6 million recorded in 2012, $7.3 million of repositioning savings realized in the first nine months of 2013 and productivity gains of $8 million.

The Fluid Handling segment backlog was $355 million at September 30, 2013, compared with $343 million at December 31, 2012 and $348 million at September 30, 2012.

Liquidity and Capital Resources

Our operating philosophy is to deploy cash provided from operating activities, when appropriate, to provide value to shareholders by reinvesting in existing businesses, by making acquisitions that will complement our portfolio of businesses, by paying dividends and/or repurchasing shares.
Cash and cash equivalents decreased by $21 million to $403 million at September 30, 2013, compared with $424 million at December 31, 2012. Our current cash balance, together with cash we expect to generate from future operations and the ability to utilize our existing committed revolving credit facilities, is expected to be sufficient to finance our short- and long-term capital requirements, as well as fund payments associated with our asbestos and environmental liabilities, restructuring activities and expected pension contributions. In addition, we believe our credit ratings afford us adequate access to public and private markets for debt.
In the first quarter of 2013, we amended our Second Amended and Restated Credit Agreement, which expires in May 2017, to allow for borrowings of up to $500 million from $300 million previously. In addition, we entered into a $400 million 364-day revolving credit agreement which expires on December 31, 2013, to support the pending acquisition of MEI. We have $110 million of borrowings outstanding under the multi-year facility as of September 30, 2013 and classified as current due to our expectation to pay down a portion of that facility in the fourth quarter of 2013. We also expect to use approximately $210 million of cash to fund the balance of the pending MEI acquisition purchase price. Additionally, short-term credit facilities were put in place in the U.K., Canada and Germany to support operating activities in anticipation of cash previously held at those locations being used to support the funding of the pending MEI acquisition. The total amount available under those facilities was $42 million, with $13 million outstanding as of September 30, 2013.
Senior unsecured notes having an aggregate principal amount of $200 million matured in the third quarter of 2013. These notes were repaid using $90 million of cash and $110 million of multi-year credit facility borrowings. There are no other significant debt maturities coming due until 2036.
We have approximately $377 million of cash held by our non-U.S. subsidiaries as of September 30, 2013, which is subject to additional tax upon repatriation to the U.S. We anticipate using $210 million of this cash to acquire MEI's business in Japan. Our intent is to permanently reinvest the earnings of our non-U.S. operations, and current plans do not anticipate that we will need funds generated from our non-U.S. operations to fund our U.S. operations. In the event we were to repatriate the cash balances of our non-U.S. subsidiaries, we would provide for and pay additional U.S. and non-U.S. taxes in connection with such repatriation.
Operating Activities
Cash provided by operating activities was $91.0 million in the first nine months of 2013, a decrease of $11.7 million of cash provided compared to the first nine months of 2012. The decrease resulted primarily from higher working capital requirements, partially offset by lower net asbestos-related payments. Net asbestos-related payments in the first nine months of 2013 and 2012 were $48.3 million and $60.1 million, respectively.
Investing Activities
Cash flows relating to investing activities consist primarily of cash provided by divestitures of businesses or assets and cash used for acquisitions and capital expenditures. Cash used for investing activities was $18.6 million in the first nine months of 2013, compared to cash provided by investing activities of $35.9 million in the comparable period of 2012. The increase in cash used for investing activities was primarily due to the absence in 2013 of proceeds received from divestitures in 2012. Capital expenditures are made primarily for increasing capacity, replacing equipment, supporting new product development and improving information systems. We expect our capital expenditures to approximate $25 to $30 million for the full year in 2013.
Financing Activities
Financing cash flows consist primarily of payments of dividends to shareholders, share repurchases and proceeds from the issuance of common stock. Cash used by financing activities was $96.7 million during the first nine months of 2013, compared to $84.3 million used during the first nine months of 2012. The increase of cash used for financing activities during the first nine months of 2013 was driven by the repayment of long-term debt, partially offset by a net increase in short-term debt and the absence of open market share repurchases. The first nine months of 2012 included a repurchase of 772,335 shares of our common stock at a cost of $30 million. An increase in cash used for financing

activities was also due to $15.7 million of higher net proceeds received from employee stock option exercises during the period.

Recent Accounting Pronouncements

Information regarding new accounting pronouncements is included in Note 2 to the Condensed Consolidated Financial Statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes in the information called for by this item since the disclosure in our Annual Report on Form 10-K for the year ended December 31, 2012.

Item 4. Controls and Procedures

Disclosure Controls and Procedures. The Company's Chief Executive Officer and Vice President, Finance and Chief Financial Officer have evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the period covered by this quarterly report. The Company's disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in the reports that are filed or submitted under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that the information is accumulated and communicated to the Company's Chief Executive Officer and Vice President, Finance and Chief Financial Officer to allow timely decisions regarding required disclosure. Based on this evaluation, the Company's Chief Executive Officer and Vice President, Finance and Chief Financial Officer have concluded that these controls are effective as of the end of the period covered by this quarterly report.

Changes in Internal Control over Financial Reporting. During the fiscal quarter ended September 30, 2013, there have been no changes in the Company's internal control over financial reporting, identified in connection with our evaluation thereof, that have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting.

Item 6. Exhibits

Exhibit 31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or 15d-14(a)
Exhibit 31.2	Certification of Principal Financial Officer pursuant to Rule 13a-14(a) or 15d-14(a)
Exhibit 32.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(b) or 15d-14(b)
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Exhibit 101.INS	XBRL Instance Document
Exhibit 101.SCH	XBRL Taxonomy Extension Schema Document
Exhibit 101.CAL	XBRL Taxonomy Calculation Linkbase Document
Exhibit 101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
Exhibit 101.LAB	XBRL Taxonomy Label Linkbase Document
Exhibit 101.PRE	XBRL Taxonomy Presentation Linkbase Document

Notes to Exhibits List:
Attached as Exhibit 101 to this Quarterly Report on Form 10-Q are the following documents formatted in XBRL (Extensible Business Reporting Language): (i) the Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2013 and 2012, respectively; (ii) the Condensed Consolidated Balance Sheets at September 30, 2013 and December 31, 2012; and (iii) the Condensed Consolidated Statements of Cash Flows for the three and nine months ended September 30, 2013 and 2012, respectively. Users of this data are advised that, pursuant to Rule 406T of Regulation S-T, this interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, is not deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

Part II : Other Information

Item 1. Legal Proceedings
Discussion of legal matters is incorporated by reference from Part 1, Item 1, Note 9, “Commitments and Contingencies”, of this Quarterly Report on Form 10-Q, and should be considered an integral part of Part II, Item 1, “Legal Proceedings”.

Item 1A. Risk Factors
Information regarding risk factors appears in Item 1A of Crane Co.’s Annual Report on Form 10-K for the year ended December 31, 2012. There has been no significant change to the risk factors disclosed in the Company’s Annual Report on Form 10-K for the year ended December 31, 2012.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds
(c) Share Repurchases

	Total number of shares repurchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Maximum number (or approximate dollar value) of shares that may yet be purchased under the plans or programs
July 1 - 31, 2013	—	$—	—	—
August 1 - 31, 2013			—	—
September 1 - 30, 2013			—	—
Total			—	—

The table above only relates to the open-market repurchases of our common stock during the quarter. We routinely receive shares of our common stock as payment for stock option exercises and the withholding taxes due on stock option exercises and the vesting of restricted stock awards from stock-based compensation program participants.

Item 4. Mine Safety Disclosures
Not applicable

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

		CRANE CO. REGISTRANT
Date November 4, 2013	By	/s/ Eric C. Fast Eric C. Fast Chief Executive Officer
Date November 4, 2013	By	/s/ Richard A. Maue Richard A. Maue Vice President, Finance and Chief Financial Officer

Exhibit Index

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