

# SECURITIES AND EXCHANGE COMMISSION

## FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

Filing Date: **2004-08-06** | Period of Report: **2004-06-30**  
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### FILER

#### SAUER DANFOSS INC

CIK: **865754** | IRS No.: **363482074** | State of Incorpor.: **DE** | Fiscal Year End: **1231**  
Type: **10-Q** | Act: **34** | File No.: **001-14097** | Film No.: **04956638**  
SIC: **3590** Misc industrial & commercial machinery & equipment

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AMES IA 50010

Business Address  
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5152396000

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

**FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

For the quarterly period ended **June 30, 2004**

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number **333-48299**

**SAUER-DANFOSS INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**36-3482074**

(IRS Employer  
Identification No.)

**250 Parkway Drive, Suite 270, Lincolnshire, Illinois**

(Address of principal executive office)

**60069**

(Zip Code)

Registrant's telephone number, including area code **(515) 239-6000**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

As of July 30, 2004, 47,445,768 shares of Sauer-Danfoss Inc. common stock, \$.01 par value, were outstanding.

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## Table of Contents

### **PART I FINANCIAL INFORMATION**

Item 1. Financial Statements:

[Consolidated Statements of Income:  
Three and Six Months Ended June 30, 2004 and 2003](#)

[Consolidated Balance Sheets:  
As of June 30, 2004 and December 31, 2003](#)

[Consolidated Statements of Stockholders' Equity and Comprehensive Income:  
As of June 30, 2004 and December 31, 2003](#)

[Consolidated Statements of Cash Flows:  
Six Months Ended June 30, 2004 and 2003](#)

[Notes to Consolidated Financial Statements](#)

Item 2. [Management's Discussion and Analysis of Financial Condition and Results of Operations](#)

Item 3. [Quantitative and Qualitative Disclosures About Market Risks](#)

Item 4. [Controls and Procedures](#)

### **PART II OTHER INFORMATION**

Item 4. [Submission of Matters to a Vote of Security Holders](#)

Item 6. [Exhibits and Reports on Form 8-K](#)

[SIGNATURES](#)

CERTIFICATIONS

**Sauer-Danfoss Inc. and Subsidiaries**  
**Consolidated Statements of Income**  
**(in thousands, except per share data)**  
**(Unaudited)**

|                  | <u>Three Months Ended June 30,</u> |                   | <u>Six Months Ended June 30,</u> |                   |
|------------------|------------------------------------|-------------------|----------------------------------|-------------------|
|                  | <u>2004</u>                        | <u>2003</u>       | <u>2004</u>                      | <u>2003</u>       |
| <b>Net Sales</b> | <b>\$ 379,117</b>                  | <b>\$ 308,462</b> | <b>\$ 740,171</b>                | <b>\$ 608,887</b> |

|  |           |           |           |           |
|--|-----------|-----------|-----------|-----------|
| <b>Costs and Expenses:</b>   |           |           |           |           |
| Cost of sales  | 272,930   | 231,167   | 546,307   | 459,918   |
| Selling, general and administrative  | 50,006    | 38,252    | 97,229    | 74,759    |
| Research and development   | 12,907    | 10,953    | 26,120    | 21,333    |
| Total costs and expenses   | 335,843   | 280,372   | 669,656   | 556,010   |
| Operating income   | 43,274    | 28,090    | 70,515    | 52,877    |
| <b>Nonoperating Income (Expenses):</b>   |           |           |           |           |
| Interest expense, net  | (4,332)   | (4,412)   | (8,866)   | (8,529)   |
| Other, net   | (52)      | (2,053)   | 446       | (3,402)   |
| Nonoperating expenses, net   | (4,384)   | (6,465)   | (8,420)   | (11,931)  |
| <b>Income Before Income Taxes and Minority Interest and Equity Income, net</b> |           |           |           |           |
|  | 38,890    | 21,625    | 62,095    | 40,946    |
| <b>Minority Interest and Equity Income, net</b>                                | (7,490)   | (4,963)   | (13,313)  | (9,450)   |
| <b>Income Before Income Taxes</b>  | 31,400    | 16,662    | 48,782    | 31,496    |
| <b>Income Tax Expense</b>  | (9,793)   | (5,400)   | (16,152)  | (10,069)  |
| Net income   | \$ 21,607 | \$ 11,262 | \$ 32,630 | \$ 21,427 |
| Basic net income per common share  | \$ 0.46   | \$ 0.24   | \$ 0.69   | \$ 0.45   |
| Diluted net income per common share  | \$ 0.46   | \$ 0.24   | \$ 0.69   | \$ 0.45   |
| Dividends declared per common share  | \$ 0.07   | \$ 0.07   | \$ 0.14   | \$ 0.14   |

See accompanying notes to consolidated financial statements.

**Sauer-Danfoss Inc. and Subsidiaries**  
**Consolidated Balance Sheets**  
(in thousands, except per share data)

|  | (Unaudited) |              |
|--|-------------|--------------|
|  | June 30,    | December 31, |
|  | 2004        | 2003         |
| <b>Assets</b>                          |             |              |
| <b>Current Assets:</b>                 |             |              |
| Cash and cash equivalents              | \$ 15,801   | \$ 15,086    |
| Accounts receivable, net of allowances | 249,823     | 186,293      |
| Inventories                            | 191,031     | 198,870      |

|  |                     |                     |
|--|---------------------|---------------------|
| Other current assets   | 37,927              | 32,965              |
| Total current assets   | <u>494,582</u>      | <u>433,214</u>      |
| <b>Property, Plant and Equipment, net</b>  | <u>435,597</u>      | <u>452,913</u>      |
| <b>Other Assets:</b>   |                     |                     |
| Goodwill   | 123,056             | 119,654             |
| Other intangible assets, net   | 30,401              | 35,265              |
| Deferred income taxes  | 38,266              | 39,258              |
| Other  | 16,660              | 21,450              |
| Total other assets   | <u>208,383</u>      | <u>215,627</u>      |
|  | <u>\$ 1,138,562</u> | <u>\$ 1,101,754</u> |
| <b>Liabilities and Stockholders' Equity</b>  |                     |                     |
| <b>Current Liabilities:</b>  |                     |                     |
| Notes payable and bank overdrafts  | \$ 51,195           | \$ 65,453           |
| Long-term debt due within one year   | 218,985             | 159,590             |
| Accounts payable   | 103,814             | 93,793              |
| Accrued salaries and wages   | 36,039              | 28,558              |
| Accrued warranty   | 16,436              | 17,196              |
| Other accrued liabilities  | 52,829              | 36,208              |
| Total current liabilities  | <u>479,298</u>      | <u>400,798</u>      |
| <b>Long-Term Debt</b>  | <u>56,092</u>       | <u>130,408</u>      |
| <b>Other Liabilities:</b>  |                     |                     |
| Long-term pension liability  | 40,961              | 41,937              |
| Postretirement benefits other than pensions  | 17,885              | 17,779              |
| Deferred income taxes  | 55,582              | 56,126              |
| Other  | 25,363              | 25,139              |
| Total other liabilities  | <u>139,791</u>      | <u>140,981</u>      |
| <b>Minority Interest in Net Assets of Consolidated Companies</b>   | <u>41,251</u>       | <u>32,353</u>       |
| <b>Stockholders' Equity:</b>   |                     |                     |
| Common stock, par value \$.01 per share, authorized 75,000 shares in 2004 and 2003; issued and outstanding 47,446 in 2004 and 47,432 in 2003 | 474                 | 474                 |
| Additional paid-in capital   | 317,255             | 314,319             |
| Retained earnings  | 71,191              | 45,202              |
| Accumulated other comprehensive income   | 33,519              | 37,376              |
| Unamortized restricted stock compensation  | (309)               | (157)               |
| Total stockholders' equity   | <u>422,130</u>      | <u>397,214</u>      |
|  | <u>\$ 1,138,562</u> | <u>\$ 1,101,754</u> |

See accompanying notes to consolidated financial statements.

**Sauer-Danfoss Inc. and Subsidiaries**  
**Consolidated Statement of Stockholders' Equity and Comprehensive Income**  
(in thousands, except per share data)

|  | Number of<br>Shares<br>Outstanding | Common<br>Stock | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income | Unamortized<br>Restricted<br>Stock<br>Compensation | Total             |
|--|------------------------------------|-----------------|----------------------------------|----------------------|---|--|-------------------|
| <b>Beginning Balance, December 31, 2003</b>              | 47,432                             | \$ 474          | \$ 314,319                       | \$ 45,202            | \$ 37,376                                       | \$ (157)   | \$ 397,214        |
| <b>Period Ended June 30, 2004</b>                        |                                    |                 |                                  |                      |   |  |                   |
| <b>(Unaudited):</b>                                      |                                    |                 |                                  |                      |   |  |                   |
| Comprehensive income:                                    |                                    |                 |                                  |                      |   |  |                   |
| Net income   | -                                  | -               | -                                | 32,630               | -   | -  | -                 |
| Unrealized losses on foreign currency exchange contracts | -                                  | -               | -                                | -                    | (67)  | -  | -                 |
| Translation adjustment                                   | -                                  | -               | -                                | -                    | (3,790)   | -  | -                 |
| Total comprehensive income                               | -                                  | -               | -                                | -                    | -   | -  | 28,773            |
| Restricted stock grant                                   | 14                                 | -               | 208                              | -                    | -   | (208)  | -                 |
| Restricted stock and performance unit compensation       | -                                  | -               | 2,728                            | -                    | -   | 56   | 2,784             |
| Cash dividends, (\$ .14 per share)                       | -                                  | -               | -                                | (6,641)              | -   | -  | (6,641)           |
| Ending balance   | <u>47,446</u>                      | <u>\$ 474</u>   | <u>\$ 317,255</u>                | <u>\$ 71,191</u>     | <u>\$ 33,519</u>                                | <u>\$ (309)</u>                                    | <u>\$ 422,130</u> |

See accompanying notes to consolidated financial statements.

**Sauer-Danfoss Inc. and Subsidiaries**  
**Consolidated Statements of Cash Flows**  
(in thousands)  
(Unaudited)

|   | Six Months Ended June 30, |           |
|---|---------------------------|-----------|
|   | 2004                      | 2003      |
| <b>Cash Flows From Operating Activities:</b>                                      |                           |           |
| Net income  | \$ 32,630                 | \$ 21,427 |
| Adjustments to reconcile net income to net cash provided by operating activities: |                           |           |
| Depreciation and amortization   | 41,156                    | 41,303    |
| Minority interest and equity income, net  | 13,313                    | 9,450     |
| Changes in working capital:   |                           |           |
| Accounts receivable, net  | (59,754)                  | (44,730)  |
| Inventories   | 4,946                     | 11,599    |
| Accounts payable  | 5,770                     | 3,249     |

|   |                  |                  |
|---|------------------|------------------|
| Accrued liabilities                                 | 23,338           | 17,956           |
| Change in deferred income taxes                     | 1,220            | 925              |
| Other   | 7,046            | (889)            |
| Net cash provided by operating activities           | <u>69,665</u>    | <u>60,290</u>    |
| <b>Cash Flows From Investing Activities:</b>        |                  |                  |
| Purchases of property, plant and equipment          | (29,537)         | (25,181)         |
| Proceeds from sale of property, plant and equipment | 405              | 171              |
| Payments for acquisitions, net of cash acquired     | (4,156)          | (5,824)          |
| Net cash used in investing activities               | <u>(33,288)</u>  | <u>(30,834)</u>  |
| <b>Cash Flows From Financing Activities:</b>        |                  |                  |
| Net repayments on notes payable and bank overdrafts | (14,680)         | (6,437)          |
| Net repayments on revolving credit facility         | (6,496)          | (8,750)          |
| Net repayments of long-term debt                    | (3,830)          | (3,120)          |
| Cash dividends                                      | (6,641)          | (6,640)          |
| Distributions to minority interest partners         | (4,840)          | (3,841)          |
| Net cash used in financing activities               | <u>(36,487)</u>  | <u>(28,788)</u>  |
| <b>Effect of Exchange Rate Changes</b>              | <u>825</u>       | <u>1,454</u>     |
| <b>Cash and Cash Equivalents:</b>                   |                  |                  |
| Net increase during the period                      | 715              | 2,122            |
| Beginning balance                                   | <u>15,086</u>    | <u>12,397</u>    |
| Ending balance                                      | <u>\$ 15,801</u> | <u>\$ 14,519</u> |
| <b>Supplemental Cash Flow Disclosures:</b>          |                  |                  |
| Interest paid                                       | \$ 8,906         | \$ 5,069         |
| Income taxes paid                                   | \$ 3,317         | \$ 5,352         |

See accompanying notes to consolidated financial statements.

**Sauer-Danfoss Inc. and Subsidiaries**  
**Notes To Consolidated Financial Statements**  
(in thousands except per share data)  
(Unaudited)

1) **Summary of Significant Accounting Policies -**

*Basis of Presentation and Principles of Consolidation -*

The consolidated financial statements of Sauer-Danfoss Inc. and subsidiaries (the Company) included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission, and represent the consolidation of all companies in which the Company has a controlling interest. Certain information and disclosures normally included in comprehensive financial statements, prepared in accordance with accounting principles generally accepted in the United States of America, have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the

disclosures are adequate to make the information presented not misleading. In the opinion of management, the financial statements reflect all adjustments, which are of a normal recurring nature, necessary to present fairly the Company's consolidated financial position, results of operations and cash flows for the periods presented. It is suggested that these interim financial statements be read in conjunction with the consolidated financial statements and notes thereto included in the Company's latest annual report on Form 10-K as filed with the Securities and Exchange Commission on March 15, 2004.

#### *Use of Estimates -*

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results may differ from those estimates.

#### *New Accounting Principles -*

The FASB issued Interpretation (FIN) No. 46R, "Consolidation of Variable Interest Entities" in December 2003, which requires variable interest entities to be consolidated by the party determined to be the primary beneficiary. A primary beneficiary of a variable interest entity (VIE) is the party that absorbs a majority of the entity's expected losses, receives a majority of its expected residual returns, or both, as a result of holding the variable interest. The Company adopted FIN No. 46R in the first quarter of 2004, consolidating one entity which was previously accounted for under the equity method of accounting, with no material effect on the financial statements.

In May 2004 the FASB issued Staff Position (FSP) 106-2 "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug Improvement and Modernization Act of 2003" (the Act), which superseded FSP 106-1 of the same name. The Act introduced a prescription drug benefit under Medicare Part D, as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. The post retirement benefit liability on the consolidated balance sheets does not reflect any amount associated with the subsidy under the Act as FSP 106-2 is not effective for the Company until the third quarter of 2004. The Company is in the process of determining the effect, if any, of adopting FSP 106-2.

#### *Reclassifications -*

Certain previously reported amounts have been reclassified to conform to the current period presentation.

## **2) *Business Combinations -***

During the second quarter 2004, the Company exercised its option to acquire the remaining 15% of Comatrol S.p.A, for approximately \$4,300. In the second quarter 2003 the Company purchased 40% of the outstanding shares of Comatrol, raising its ownership percentage to 85%, and therefore began to consolidate the financial results of the business. Prior to purchasing the controlling interest in Comatrol, the Company accounted for the results of its ownership interest under the equity method of accounting. The total purchase price paid to acquire Comatrol was approximately \$22,100. The Company recognized intangible assets of approximately \$600 and \$2,200 for technology and customer relationships, respectively, in connection with the Comatrol acquisition. The transactions also resulted in recognizing approximately \$14,500 of goodwill. Located in Reggio Emilia, Italy, Comatrol has approximately 100 employees and \$22,000 in annual sales.

## **3) *Basic and Diluted Per Share Data -***

Basic net income per common share data has been computed by dividing net income by the weighted average number of shares of common stock outstanding for the period, excluding restricted stock shares issued in connection with the Company's long-term incentive plan which are subject to risk of forfeiture. The dilutive effect of the stock options, restricted stock shares and performance

units is calculated using the treasury stock method. The treasury stock method assumes the balance of the unamortized compensation expense as of the balance sheet date is used to repurchase shares of common stock. The reconciliation of basic net income per common share to diluted net income per common share is shown in the following table for the three and six month periods ended June 30, 2004 and 2003:

|                                | June 30, 2004 |        |         | June 30, 2003 |        |         |
|--------------------------------|---------------|--------|---------|---------------|--------|---------|
|                                | Net Income    | Shares | EPS     | Net Income    | Shares | EPS     |
| <b>Three Months:</b>           |               |        |         |               |        |         |
| Basic net income               | \$ 21,607     | 47,409 | \$ 0.46 | \$ 11,262     | 47,400 | \$ 0.24 |
| Effect of dilutive securities: |               |        |         |               |        |         |
| Stock options                  | -             | -      | -       | -             | 227    | -       |
| Restricted stock               | -             | 14     | -       | -             | 9      | -       |
| Performance units              | -             | 39     | -       | -             | -      | -       |
| Diluted net income             | \$ 21,607     | 47,462 | \$ 0.46 | \$ 11,262     | 47,636 | \$ 0.24 |
| <b>Six Months:</b>             |               |        |         |               |        |         |
| Basic net income               | \$ 32,630     | 47,407 | \$ 0.69 | \$ 21,427     | 47,398 | \$ 0.45 |
| Effect of dilutive securities: |               |        |         |               |        |         |
| Stock options                  | -             | -      | -       | -             | 115    | -       |
| Restricted stock               | -             | 16     | -       | -             | 38     | -       |
| Performance units              | -             | 20     | -       | -             | -      | -       |
| Diluted net income             | \$ 32,630     | 47,443 | \$ 0.69 | \$ 21,427     | 47,551 | \$ 0.45 |

#### 4) **Long-Term Incentive Plans -**

Under the 1998 Long-Term Incentive Plan (the Plan), the Board of Directors is authorized to grant non-qualified stock options, incentive stock options, performance units, stock appreciation rights, restricted stock and performance shares to employees. Refer to Note 12 in the Notes to Consolidated Financial Statements in the Company's 2003 annual report filed on Form 10-K for additional information.

On February 25, 2004, the Board of Directors approved granting 323 performance units under the Plan to replace all performance units and stock options outstanding, as the original targets established for those grants were no longer reasonable due to unforeseen economic conditions. In addition, on that date, the Board of Directors approved granting an additional 385 performance units under the Plan. The performance units vest over one to three years. The settlement of performance units is in shares of company stock or cash as determined by the Board of Directors. The Company has no prior experience of such awards being paid out, but estimates that it will settle one-third of the units in cash and two-thirds of the units by distributing stock. Compensation expense for the portion expected to be settled in cash is recognized over the vesting period, with the offsetting accrued liability adjusted based on fluctuations in the market price of shares over the vesting period. Compensation expense for the portion estimated to be settled in stock is also recognized over the vesting period, but is measured based on

the market price of the stock at date of grant, with an offsetting increase to additional paid in capital. The performance units also entitle the participants to receive an amount equal to the Company's dividends during the vesting period.

#### 5) **Pension Plans -**

The Company has noncontributory defined benefit plans covering a significant number of its employees. The benefits under these plans are based primarily on years of service and compensation levels. Pension expense for the three and six month periods ended June 30, 2004 and 2003 for the defined benefit plans consists of the following components:

|                                    | Three months ended June 30, |                 | Six months ended June 30, |                 |
|------------------------------------|-----------------------------|-----------------|---------------------------|-----------------|
|                                    | 2004                        | 2003            | 2004                      | 2003            |
| Service cost                       | \$ 1,079                    | \$ 956          | \$ 2,153                  | \$ 1,908        |
| Interest cost                      | 2,341                       | 2,182           | 4,675                     | 4,356           |
| Expected return on plan assets     | (1,854)                     | (1,637)         | (3,701)                   | (3,266)         |
| Amortization of prior service cost | 136                         | 159             | 272                       | 316             |
| Amortization of net loss           | 295                         | 154             | 588                       | 308             |
| Net periodic pension expense       | <u>\$ 1,997</u>             | <u>\$ 1,814</u> | <u>\$ 3,987</u>           | <u>\$ 3,622</u> |

6) **Segment and Geographic Information -**

The Company's operating segments are organized around its various product lines of Propel, Work Function and Controls. Propel products include hydrostatic transmissions and related products that transmit the power from the engine to the wheel to propel a vehicle. Work Function products include steering motors, as well as gear pumps and motors, that transmit power for the work functions of the vehicle. Controls products include electrohydraulic controls, microprocessors, electric drives and valves that control and direct the power of a vehicle.

The following table presents the significant items by operating segment for the results of operations for the three and six month periods ended June 30, 2004 and 2003 and balance sheet data as of these dates:

**Three Months Ended:**

|                             | Work       |            |           |          | Total      |
|-----------------------------|------------|------------|-----------|----------|------------|
|                             | Propel     | Function   | Controls  | Other    |            |
| <b><u>June 30, 2004</u></b> |            |            |           |          |            |
| Trade sales                 | \$ 182,045 | \$ 107,935 | \$ 89,137 | \$ -     | \$ 379,117 |
| Segment income (expense)    | 35,521     | 10,112     | 8,604     | (11,015) | 43,222     |
| Depreciation expense        | 9,293      | 5,759      | 3,539     | 1,573    | 20,164     |
| Capital expenditures        | 4,828      | 6,910      | 3,214     | 3,751    | 18,703     |
| <b><u>June 30, 2003</u></b> |            |            |           |          |            |
| Trade sales                 | \$ 141,262 | \$ 90,700  | \$ 76,500 | \$ -     | \$ 308,462 |
| Segment income (expense)    | 22,390     | 6,047      | 5,636     | (8,036)  | 26,037     |
| Depreciation expense        | 9,061      | 6,008      | 3,714     | 1,768    | 20,551     |
| Capital expenditures        | 3,624      | 2,887      | 4,017     | 6,735    | 17,263     |

**Six Months Ended:**

|                             | Work       |            |            |          | Total      |
|-----------------------------|------------|------------|------------|----------|------------|
|                             | Propel     | Function   | Controls   | Other    |            |
| <b><u>June 30, 2004</u></b> |            |            |            |          |            |
| Trade sales                 | \$ 353,379 | \$ 213,892 | \$ 172,900 | \$ -     | \$ 740,171 |
| Segment income (expense)    | 56,615     | 16,369     | 16,601     | (18,624) | 70,961     |
| Depreciation expense        | 18,042     | 11,558     | 6,884      | 3,156    | 39,640     |
| Capital expenditures        | 8,957      | 8,852      | 4,718      | 7,010    | 29,537     |
| Total assets                | 384,198    | 310,106    | 250,987    | 193,271  | 1,138,562  |

**June 30, 2003**

|                          |            |            |            |          |            |
|--------------------------|------------|------------|------------|----------|------------|
| Trade sales              | \$ 283,703 | \$ 179,130 | \$ 146,054 | \$ -     | \$ 608,887 |
| Segment income (expense) | 36,830     | 15,031     | 12,560     | (14,946) | 49,475     |
| Depreciation expense     | 17,524     | 11,697     | 7,042      | 3,766    | 40,029     |
| Capital expenditures     | 6,743      | 5,237      | 5,878      | 7,323    | 25,181     |
| Total assets (1)         | 354,024    | 293,496    | 237,965    | 160,478  | 1,045,963  |

- (1) Reflects restatement described in Note 17 in the Notes to the Consolidated Financial Statements in the Company's 2003 annual report filed on Form 10-K.

A summary of the Company's net sales and long-lived assets by geographic area is presented below:

|                 | Net sales (1)              |                   |                          |                   | Long-Lived Assets (2) |                   |
|-----------------|----------------------------|-------------------|--------------------------|-------------------|-----------------------|-------------------|
|                 | Three Months Ended June 30 |                   | Six Months Ended June 30 |                   | June 30,              |                   |
|                 | 2004                       | 2003              | 2004                     | 2003              | 2004                  | 2003 (4)          |
| United States   | \$ 166,566                 | \$ 124,641        | \$ 316,630               | \$ 257,485        | \$ 172,901            | \$ 205,288        |
| Germany         | 34,646                     | 32,971            | 70,627                   | 62,719            | 65,727                | 64,067            |
| Italy           | 27,528                     | 23,660            | 54,678                   | 45,197            | 31,260                | 25,313            |
| France          | 20,657                     | 17,492            | 40,996                   | 32,229            | 491                   | 568               |
| United Kingdom  | 13,721                     | 12,903            | 28,938                   | 25,362            | 22,526                | 24,243            |
| Japan           | 15,783                     | 7,186             | 28,555                   | 15,613            | 3,979                 | 410               |
| Denmark (3)     | 5,557                      | 7,861             | 11,536                   | 16,393            | 185,826               | 183,078           |
| Slovakia (3)    | 273                        | 267               | 567                      | 492               | 50,998                | 48,154            |
| Other countries | 94,386                     | 81,481            | 187,644                  | 153,397           | 72,006                | 60,280            |
| <b>Total</b>    | <b>\$ 379,117</b>          | <b>\$ 308,462</b> | <b>\$ 740,171</b>        | <b>\$ 608,887</b> | <b>\$ 605,714</b>     | <b>\$ 611,401</b> |

- (1) Net sales are attributed to countries based on location of customer.
- (2) Long-lived assets include property, plant and equipment net of accumulated depreciation, intangible assets net of accumulated amortization, and certain other long-term assets.
- (3) Majority of this country's sales are shipped outside of the home country where the product is produced.
- (4) Reflects restatement described in Note 17 in the Notes to the Consolidated Financial Statements in the Company's 2003 annual report filed on Form 10-K.

No single customer accounted for 10% or more of total consolidated sales in any period presented.

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATIONS  
Sauer-Danfoss Inc. and Subsidiaries (the Company)**

**Safe Harbor Statement** - This Management's Discussion and Analysis of Financial Condition and Results of Operations, as well as other portions of this quarterly report, contain statements that constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements provide current expectations of future events based on certain assumptions and include any statement that does not directly relate to any historical or current fact. All statements regarding future performance, growth, sales and earnings projections, conditions or developments are forward-looking statements. Words such as "anticipates," "in the opinion," "believes," "intends," "expects," "may," "will," "should," "could," "plans," "forecasts," "estimates," "predicts," "projects," "potential," "continue," and similar expressions may be intended to identify forward-looking statements.

Actual future results may differ materially from those described in the forward-looking statements due to a variety of factors, including the fact that the U.S. economy generally, and the agriculture, construction, road building, turf care and specialty vehicle markets specifically, has been improving over the past several months, making it difficult to determine if past experience is a good guide to the future. While the economy in the U.S. has been improving, the economic situation in the rest of the world has not necessarily followed the trend in the U.S. Any downturn in the Company's business segments could adversely affect the Company's revenues and results of operations. Other factors affecting forward-looking statements include, but are not limited to, the following: specific economic conditions in the agriculture, construction, road building, turf care and specialty vehicle markets and the impact of such conditions on the Company's customers in such markets; the cyclical nature of some of the Company's businesses; the ability of the Company to win new programs and maintain existing programs with its original equipment manufacturer (OEM) customers; the highly competitive nature of the markets for the Company's products as well as pricing pressures that may result from such competitive conditions; business relationships with significant customers and suppliers; the continued operation and viability of the Company's significant customers; the Company's execution of internal performance plans; difficulties or delays in manufacturing; cost-reduction and productivity efforts; competing technologies and difficulties entering new markets, both domestic and foreign; changes in the Company's product mix; future levels of indebtedness and capital spending; claims, including, without limitation, warranty claims, field retrofit claims, product liability claims, charges or dispute resolutions; ability of suppliers to provide materials as needed and the Company's ability to recover any price increases for materials and product pricing; the Company's ability to attract and retain key technical and other personnel; labor relations; the failure of customers to make timely payment; any inadequacy of the Company's intellectual property protection or the potential for third-party claims of infringement; global economic factors, including currency exchange rates; general economic conditions, including interest rates, the rate of inflation, and commercial and consumer confidence; energy prices; governmental laws and regulations affecting domestic and foreign operation, including tax obligations; changes in accounting standards; worldwide political stability; the effects of terrorist activities and resulting political or economic instability, U.S. military action overseas; and the effect of acquisitions, divestitures, restructurings, product withdrawals, and other unusual events.

The Company cautions the reader that these lists of cautionary statements and risk factors may not be exhaustive. The Company expressly disclaims any obligation or undertaking to release publicly any updates or changes to these forward-looking statements that may be made to reflect any future events or circumstances.

### About the Company

Sauer-Danfoss Inc. and subsidiaries (the Company) is a leading international supplier of components and systems that generate, transmit and control fluid power in mobile equipment. The Company's products are used by original equipment manufacturers (OEMs) of mobile equipment, including construction, road building, agricultural, turf care and specialty equipment. The Company designs, manufactures and markets its products in the Americas, Europe and the Asia-Pacific region, and markets its products throughout the rest of the world either directly or through distributors.

### Executive Summary - Three months ended June 30, 2004

The nature of the Company's operations as a global producer and supplier in the fluid power industry means the Company is impacted by changes in the local economies, including currency exchange rate fluctuations. The following table summarizes the Company's second quarter 2004 and 2003 results from operations on a comparable basis, by excluding the impact of acquisitions and currency fluctuations, to allow the financial statement user to gain a better understanding of the Company's results. This analysis is more consistent with how the Company internally evaluates its results.

| (in millions) | Three months ended |                      | Three months ended June 30, 2003 | Comparable basis change | Percent change |
|---------------|--------------------|----------------------|----------------------------------|-------------------------|----------------|
|               | June 30, 2004      |                      |                                  |                         |                |
|               | As reported        | Comparable basis (1) |                                  |                         |                |
| Net sales     | \$ 379.1           | \$ 365.6             | \$ 308.5                         | \$ 57.1                 | 18%            |

|                                     |       |       |       |      |    |
|-------------------------------------|-------|-------|-------|------|----|
| Gross profit                        | 106.2 | 102.3 | 77.3  | 25.0 | 32 |
| % of Sales                          | 28.0% | 28.0% | 25.1% |      |    |
| Selling, general and administrative | 50.0  | 48.1  | 38.3  | 9.8  | 26 |
| Research & development              | 12.9  | 12.5  | 11.0  | 1.5  | 14 |
| Total operating costs               | 62.9  | 60.6  | 49.3  | 11.3 | 23 |
| Operating income                    | 43.3  | 41.7  | 28.0  | 13.7 | 49 |
| % of Sales                          | 11.4% | 11.4% | 9.1%  |      |    |

(1) Excludes the impact of currency fluctuations and entity previously accounted for under the equity method of accounting.

Net sales for the second quarter 2004 increased 18 percent over 2003, on a comparable basis. The significant sales increase is driven by the strong markets in which the Company operates and an increase in market share. Margins on overall net sales improved by almost 3 percentage points as a result of spreading the fixed production costs over a higher volume of units produced, reduced costs from restructurings undertaken in recent years, and from other cost reductions realized through the use of lean manufacturing activities.

The 26 percent increase in selling, general and administrative costs is partially due to incentive plan expense resulting from the improved financial performance of the Company in the current year, costs of implementing the requirements of Section 404 of the Sarbanes-Oxley Act of 2002, and increased costs related to the European sales and distribution operations restructuring. Operating income, as reported, for the second quarter 2004 increased 55 percent compared to the second quarter 2003. Excluding the effect of currency and acquisitions, operating income increased 49 percent.

### Operating Results - Comparison of Three Month Periods Ended June 30, 2004 and 2003

Following is a discussion of the Company's operating results by market, region, and business segment.

#### Sales Growth by Market

The following table summarizes the Company's sales growth by market for the three months ended June 30, 2004 compared to the three months ended June 30, 2003. The table and following discussion is on a comparable basis, which excludes acquisitions and currency fluctuations.

|               | Americas | Asia-Pacific | Europe | Total |
|---------------|----------|--------------|--------|-------|
| Agriculture   | 27%      | 45%          | (6)%   | 3%    |
| Construction  | 30       | (5)          | 21     | 22    |
| Road building | 48       | 34           | 0      | 18    |
| Turf care     | 33       | -            | -      | 33    |
| Specialty     | 23       | 20           | 18     | 19    |
| Distribution  | 25       | 22           | 12     | 19    |

#### *Agriculture*

The agricultural market in the Americas has seen strong growth during the second quarter, which is expected to continue throughout 2004. The growth experienced in the Asia-Pacific region is driven mainly by export sales out of the region. The demand for tractors and combines continues to be low in Europe, as the agriculture market has not recovered from the drought of 2003.

#### *Construction*

The growth for construction markets throughout the Americas and Europe has continued in the second quarter. Sales volumes for several customers in the Americas region have increased due to market growth, which is expected to remain strong into 2005. The growth in the European region was due to increasing market share, in addition to growth in the general market. The governmental intervention in China to slow down the run-away economy has resulted in reduced sales in the Asia-Pacific region. However, this decrease is partially offset by growth in the skid steer loader export market from Japan.

### *Road Building*

Sales growth in the second quarter, in the Americas, occurred due to the major OEMs increasing their inventory levels of road building equipment, which had been depleted over the last few years. Sales in the Americas are expected to remain strong as several customers are increasing their production schedules. The increased sales growth in the Asia-Pacific region was heavily influenced by strong export business experienced by customers in the region. The overall road building market in the European region is expected to remain level with 2003, as the growth in the road roller business is being offset by decreased demand for pavers.

### *Turf Care*

The Company's primary business within this market comes from products produced for the consumer and commercial turf care markets in the Americas region. The significant growth has been led by the strong market demand for the consumer zero-turn radius machines and the new zero-turn transaxle product.

### *Specialty Vehicles*

All regions experienced strong sales growth in the specialty vehicles market due to growth, mainly in the aerial lift and forklift markets. The growth in specialty vehicle market is resulting from increased sales to several customers and a variety of products.

### *Distribution*

Products related to all of the above markets are sold to distributors, who then serve smaller OEMs.

### Business Segment Results

The following discussion of operating results by reportable segment relates to information as presented in Note 6 in the Notes to the Consolidated Financial Statements. Segment income is defined as the respective segment's portion of the total Company's net income, excluding net interest, income taxes, minority interest, equity in net earnings of affiliates, and corporate expenses. Propel products include hydrostatic transmissions and related products that transmit the power from the engine to the wheel to propel a vehicle. Work Function products include steering motors, as well as gear pumps and motors, that transmit power for the work functions of the vehicle. Controls products include electrohydraulic controls, microprocessors, electric drives and valves that control and direct the power of a vehicle. The following table provides a summary of each segment's sales and segment income on a comparable basis, excluding acquisitions and currency fluctuations for the three month periods ended June 30, 2004 and 2003.

| (in millions)    | Three months ended June 30, |                         |          |                         |                |
|------------------|-----------------------------|-------------------------|----------|-------------------------|----------------|
|                  | 2004 - As reported          | 2004 - Comparable basis | 2003     | Comparable basis change | Percent change |
| <b>Net sales</b> |                             |                         |          |                         |                |
| Propel           | \$ 182.1                    | \$ 177.1                | \$ 141.3 | \$ 35.8                 | 25%            |
| Work Function    | 107.9                       | 103.0                   | 90.7     | 12.3                    | 14             |

|   |    |        |    |        |    |       |    |      |  |     |
|---|----|--------|----|--------|----|-------|----|------|--|-----|
| Controls                                |    | 89.1   |    | 85.5   |    | 76.5  |    | 9.0  |  | 12  |
| <b>Segment income (loss)</b>            |    |        |    |        |    |       |    |      |  |     |
| Propel                                  | \$ | 35.5   | \$ | 34.9   | \$ | 22.4  | \$ | 12.5 |  | 56% |
| Work Function                           |    | 10.1   |    | 9.7    |    | 6.0   |    | 3.7  |  | 62  |
| Controls                                |    | 8.6    |    | 8.0    |    | 5.6   |    | 2.4  |  | 43  |
| Global Services and other expenses, net |    | (11.0) |    | (10.8) |    | (8.0) |    | 2.8  |  | 35  |

### *Propel Segment*

The Propel segment continued to experience strong sales growth in second quarter 2004 compared to 2003 with all regions contributing to the increase. The U.S. economy continues to lead the recovery and contributed the majority of the sales growth in this segment in the second quarter.

The Propel segment continues to be impacted by increased price pressures, including a significant surcharge applied to the price of metals used to manufacture the products. In the second quarter, the Company began to charge customers a metals surcharge due to the increased cost for these materials. Efforts to control costs also contributed to the higher percentage increase in segment income compared to the first quarter. The \$12.5 million increase in segment income, on a comparable basis, is in line with management's expectations based on the \$35.8 million increase in net sales.

### *Work Function Segment*

Sales increased 14 percent during the second quarter of 2004; with a 62 percent increase in segment income for the Work Function segment. During the second quarter of 2003, the Work Function segment incurred \$0.7 million of expense related to closing a facility in Sturtevant, Wisconsin. Excluding this charge, the increase in segment income, on a comparable basis was \$3.0 million, or 45 percent. The segment income growth is a significant improvement over the first quarter, as the segment is beginning to experience the benefits of the restructuring of operations, which occurred in 2003 and early 2004.

Demand for Work Function product remains strong, particularly related to the turf care market in the U.S., and production is expected to continue near full capacity into the third quarter.

### *Controls Segment*

Net sales in the Controls segment increased 12 percent in the second quarter 2004, with a 43 percent increase in segment income for the quarter. Contributing to the growth for the quarter were strong sales of both joysticks and electric motors. The PLUS 1 vehicle architecture was introduced during the second quarter, and although sales were not significant during the quarter, the introduction of the product has been well received.

### *Global Services and other expenses, net*

Segment costs in Global Services and other expenses, net relate to internal global service departments, along with the operating costs of the Company's executive office. Worldwide services include such costs as consulting for special projects, tax and accounting fees paid to outside third parties, certain insurance premiums, and the amortization of intangible assets from certain business combinations. The majority of the increases in global service costs are due to increased costs associated with the Company's incentive plans driven by the improved financial performance of the Company in 2004. The Company incurred \$0.3 million of outside service costs in the second quarter related to implementing the new requirements to document and test internal controls under Section 404 of the Sarbanes-Oxley Act of 2002.

## Income Taxes

The Company's effective tax rate of 31.2 percent in the second quarter of 2004 compared to the 32.5 percent rate in the second quarter of 2003. The Company generated a taxable loss in the U.S. for the first quarter 2004, however there was no tax benefit recognized as the full year results for the U.S. operations was forecasted to be a loss at that time. In the second quarter 2004, the Company generated taxable income in the U.S. Based on forecasted results the U.S. operations are expected to generate taxable income, so tax expense was recorded in the second quarter.

### *Executive Summary - Six months ended June 30, 2004*

The following table summarizes the Company's results from operations for the six month periods ended June 30, 2004 and 2003, by excluding the impact of acquisitions and currency fluctuations. This analysis is more consistent with how the Company internally evaluates its results.

| (in millions)                       | Six months ended<br>June 30, 2004 |                         | Six months<br>ended June 30, |                            | Percent<br>change |
|-------------------------------------|-----------------------------------|-------------------------|------------------------------|----------------------------|-------------------|
|                                     | As reported                       | Comparable<br>basis (1) | 2003 - As<br>Reported        | Comparable<br>basis change |                   |
| Net sales                           | \$ 740.2                          | \$ 691.7                | \$ 608.9                     | \$ 82.8                    | 14%               |
| Gross profit                        | 193.8                             | 180.1                   | 149.0                        | 31.1                       | 21                |
| % of Sales                          | 26.2%                             | 26.0%                   | 24.5%                        |                            |                   |
| Selling, general and administrative | 97.2                              | 90.9                    | 74.8                         | 16.1                       | 22                |
| Research & development              | 26.1                              | 24.6                    | 21.3                         | 3.3                        | 15                |
| Total operating costs               | 123.3                             | 115.5                   | 96.1                         | 19.4                       | 20                |
| Operating income                    | 70.5                              | 64.6                    | 52.9                         | 11.7                       | 22                |
| % of Sales                          | 9.5%                              | 9.3%                    | 8.7%                         |                            |                   |

- (1) Excludes first quarter results of Comatrol, which was acquired in April 2003; entity previously accounted for under the equity method of accounting; and the impact of currency fluctuations.

Net sales for the first six months of 2004 increased 14 percent over 2003, on a comparable basis, which is reflective of the strong economies in the U.S. and Asia. Margins on overall net sales increased from 24.5 percent to 26.0 percent on a comparable basis. The increased margins were due to spreading the fixed production costs over a higher volume of units produced and effective cost reduction activities. The higher gross profit margin, combined with increased sales, resulted in a 21 percent increase in gross profit on a comparable basis.

The Company incurred \$1.3 million of restructuring costs in the first six months of 2004 related to a management reorganization and the relocation of the operations of one location within the Work Function segment that had begun in 2003. The Company also incurred \$1.5 million of costs related to its European sales and distribution operations restructuring. The \$2.8 million of restructuring costs in the first six months of 2004 were \$1.3 million higher than costs incurred for similar or ongoing projects in the first six months of 2003. In addition, the Company incurred \$1.1 million of costs related to implementing the requirements of Section 404 of the Sarbanes-Oxley Act in 2004, which began in mid-2003 and therefore had no impact on costs in the first six months of 2003. Incentive plan expense was \$4.2 million higher in 2004 than in 2003 due to the improved financial performance of the Company in the current year. Excluding these items, operating costs for the six month period ended June 30, 2004 would have increased by only \$12.8 million, or 13 percent, on a comparable basis, over the same period in 2003. Although total operating costs increased by \$19.4 million, the Company had a \$11.7 million, or 22 percent increase, in operating income in 2004, on a comparable basis.

## Operating Results - Comparison of Six Month Periods Ended June 30, 2004 and 2003

Following is a discussion of the Company's operating results by market, region, and business segment.

### Sales Growth by Market

The following table summarizes the Company's sales growth by market for the six month period ended June 30, 2004. The table and following discussion is on a comparable basis, which excludes acquisitions and currency fluctuations.

|               | <u>Americas</u> | <u>Asia-Pacific</u> | <u>Europe</u> | <u>Total</u> |
|---------------|-----------------|---------------------|---------------|--------------|
| Agriculture   | 13%             | 42%                 | (5)%          | 1%           |
| Construction  | 28              | 0                   | 18            | 20           |
| Road building | 28              | 48                  | 1             | 15           |
| Turf care     | 19              | -                   | -             | 19           |
| Specialty     | 15              | 38                  | 10            | 12           |
| Distribution  | 23              | 28                  | 12            | 18           |

### *Agriculture*

Overall sales in the agriculture market for the first half of the year have remained flat with the same time period in 2003. The increase in the agriculture market within the Americas is offset by low demand for tractors and combines in the European market, resulting from the drought in 2003. The Asia-Pacific region, while up significantly due to export sales, is based upon a relatively small sales amount compared to the other regions.

### *Construction*

General improvements in the construction markets have occurred throughout the Americas and European regions. The Asia-Pacific region has experienced growth in Japan, however sales are slowing in China due to acts by the government to slow down the economy. Increased demand for certain products, such as skid steer loaders is offset by decreased demand for other products, such as transit mixers. Continued growth in the overall construction market is expected throughout 2004.

### *Road Building*

Road Building sales to customers in the Americas have increased due to a general improvement in the market and are expected to remain strong throughout 2004. Growth within the Asia-Pacific region is due to customers within the region increasing production to meet export demands. Sales within the European region have remained level with 2003 and are expected to do so through the remainder of 2004.

### *Turf Care*

The Company's primary business within this market comes from products produced for the consumer and commercial turf care markets in the Americas region. Consumers continue to move from mechanical transmissions on these machines to the newer zero-turn radius machines. The sale of the zero-turn radius machines being sold through retail outlets continues to fuel growth in this market.

### *Specialty Vehicles*

All regions experienced sales growth in the specialty vehicles market. Demand for aerial lifts and forklifts have increased resulting in overall sales growth of 12 percent in this market.

Products related to all of the above markets are sold to distributors, who then serve smaller OEMs.

### Business Segment Results

The following discussion of operating results by segment relates to information as presented in Note 6 in the Notes to the Consolidated Financial Statements. Segment income is defined as the respective segment's portion of the total Company's net income, excluding net interest, income taxes, minority interest, equity in net earnings of affiliates, and corporate expenses. The following table provides a summary of each segment's sales and segment income for the six month periods ended June 30, 2004 and 2003 on a comparable basis, excluding acquisitions and currency fluctuations.

| (in millions)                           | Six months ended June 30, |                               |          | Comparable<br>Basis<br>Change | Percent<br>change |
|---|---------------------------|-------------------------------|----------|-------------------------------|-------------------|
|   | 2004 - As<br>Reported     | 2004 -<br>Comparable<br>Basis | 2003     |                               |                   |
| <b>Net sales</b>                        |                           |                               |          |                               |                   |
| Propel                                  | \$ 353.4                  | \$ 339.1                      | \$ 283.7 | \$ 55.4                       | 20%               |
| Work Function                           | 213.9                     | 197.7                         | 179.1    | 18.6                          | 10                |
| Controls                                | 172.9                     | 154.8                         | 146.1    | 8.7                           | 6                 |
| <b>Segment income (loss)</b>            |                           |                               |          |                               |                   |
| Propel                                  | \$ 56.6                   | \$ 54.9                       | \$ 36.8  | \$ 18.1                       | 49%               |
| Work Function                           | 16.4                      | 14.8                          | 15.0     | (0.2)                         | (1)               |
| Controls                                | 16.6                      | 13.8                          | 12.6     | 1.2                           | 10                |
| Global Services and other expenses, net | (18.6)                    | (17.9)                        | (14.9)   | (3.0)                         | (20)              |

#### *Propel Segment*

The Propel segment experienced the strongest growth in sales, 20 percent, in the first half of 2004 compared to 2003. All regions contributed to the increase in sales. The Propel segment continues to be impacted by increased price pressures, including a significant increase in the cost of metals used to manufacture the products. In the second quarter, the Company began to pass the increased metals cost on to its customers. In 2003, the Company incurred \$1.4 million of costs related to a field recall issue. Efforts to control costs, combined with increased sales and no large field recalls, resulted in a 49 percent increase in segment income for 2004, on a comparable basis.

#### *Work Function Segment*

Although the Work Function segment sales increased 10 percent, on a comparable basis, in the first half of the year, segment income actually decreased 1 percent. Customer demand for Work Function segment product has been high throughout 2004 resulting in production running at near full capacity at Work Function locations. The Work Function segment has incurred \$1.1 million of increased airfreight costs in order to meet customer delivery requirements in the first half of 2004, which has had a negative impact on segment income. In late 2003 the Company began relocating the operations from its West Branch, Iowa, facility. In the first half of 2004 the Company incurred \$1.3 million of expenses related to completing the relocation of the assets from this facility, as well as reorganization of the management structure in this segment. In the first half of 2003 the segment incurred \$0.7 million of restructuring costs as discussed above in the three month comparison. Excluding the \$0.6 million of increased restructuring costs in 2004, segment income for the Work Function segment would have increased \$0.4 million,

or 3 percent from the same period in 2003. It is expected the segment income of the Work Function segment will continue to improve throughout 2004 as it begins to realize the benefits of the restructuring incurred in previous periods.

### Controls Segment

Net sales, on a comparable basis, in the Controls segment for first half of 2004 increased 6 percent compared to the first half of 2003. Segment income increased by 10 percent despite being negatively impacted by increased engineering costs related to the support of the recently introduced PLUS 1 vehicle architecture. The PLUS 1 product was introduced to the market in the second quarter of 2004, but has not yet contributed significantly to sales of this segment. Segment income is expected to experience further improvements in future periods as sales of the PLUS 1 product increase.

### Global Services and other expenses, net

Segment costs in Global Services and other expenses, net relate to internal global service departments, along with the operating costs of the Company's executive office. Worldwide services include such costs as consulting for special projects, tax and accounting fees paid to outside third parties, certain insurance premiums, and the amortization of intangible assets from certain business combinations. The Company incurred \$1.1 million of outside service costs in the first half of 2004 related to implementing the new requirements to document and test internal controls under Section 404 of the Sarbanes-Oxley Act of 2002. In addition, incentive plan expense was \$4.2 million higher in 2004 than in 2003 due to the improved financial performance of the Company in the current year. Excluding these items, the Global Services costs actually decreased \$2.3 million in the first half of 2004 compared to 2003 due to an effort to identify and implement cost saving opportunities.

### Income Taxes

The Company's effective tax rate of 33.1 percent in the first half of 2004 is comparable to the 32.0 percent rate in the first half of 2003. The tax rate for the full year is expected to be approximately 33 to 35 percent.

### Order Backlog

The following table shows the Company's order backlog at June 30, 2004 and orders written in the six month periods ended June 30, 2004 and 2003, including 2004 balances on a comparable basis, excluding acquisitions and currency fluctuations. Backlog represents the amount of customer orders that have been received for future shipment.

| (in millions)       | June 30, 2004 |                  | June 30, 2003 | Comparable basis percent change |
|---------------------|---------------|------------------|---------------|---------------------------------|
|                     | As reported   | Comparable Basis |               |                                 |
| <b>Americas</b>     |               |                  |               |                                 |
| Backlog             | \$ 244.0      | \$ 244.3         | \$ 193.8      | 26%                             |
| Orders Written      | 346.4         | 345.6            | 239.7         | 44                              |
| <b>Asia-Pacific</b> |               |                  |               |                                 |
| Backlog             | 25.4          | 23.1             | 22.7          | 2                               |
| Orders Written      | 58.3          | 50.9             | 46.7          | 9                               |
| <b>Europe</b>       |               |                  |               |                                 |

|                |       |       |       |     |
|----------------|-------|-------|-------|-----|
| Backlog        | 146.0 | 133.1 | 144.4 | (8) |
| Orders Written | 346.7 | 307.2 | 292.9 | 5   |
| <b>Total</b>   |       |       |       |     |
| Backlog        | 415.4 | 400.5 | 360.9 | 11  |
| Orders Written | 751.4 | 703.7 | 579.2 | 21  |

Total order backlog at June 30, 2004 was \$415.4 million, compared to \$360.9 million at June 30, 2003, an increase of 15 percent. On a comparable basis, order backlog increased 11 percent. Management has noted that in recent years customers have continued to adjust orders closer to the scheduled production dates, often within the scheduled shipping month. The decreased lead-time from customers may be due to either uncertainty of forecasted demand for their own products or taking advantage of reduced production cycles within the Company's facilities. The increase in backlog at June 30, 2004 reflects the increased customer demand for product, which would indicate stronger sales in the second half of 2004 compared to the second half of 2003.

New sales orders written in the first half of 2004 were \$751.4 million, an increase of 30 percent over the \$579.2 million of orders written in the first half of 2003. Excluding the impact of currencies and acquisitions, total orders written in first half of 2004 increased 21 percent compared to first half of 2003. The strong order activity is a positive signal of continued strong sales in the second half of the year.

### Market Risk

The Company is exposed to various market risks, including changes in foreign currency exchange rates, interest rates, and material purchase prices.

#### *Impact of Foreign currency*

The Company has operations and sells its products in many different countries of the world and therefore, conducts its business in various currencies. The Company's financial statements, which are presented in U.S. dollars, can be impacted by foreign exchange fluctuations through both translation and transaction risk. Translation risk is the risk that the financial statements of the Company, for a particular period or as of a certain date, may be affected by changes in the exchange rates that are used to translate the financial statements of the Company's operations from foreign currencies into U.S. dollars. Transaction risk occurs when the Company receives its sale proceeds or holds its assets in a currency different from which it pays its expenses and holds its liabilities. Exchange rate fluctuations may cause different financial results from those where transaction risk is not present.

Fluctuations of currencies against the U.S. dollar can be substantial and therefore significantly impact comparisons with prior periods. After weakening against most foreign currencies throughout 2003, the U.S. dollar has slightly recovered in the first six months of 2004; however, the U.S. dollar was still substantially weaker at June 30, 2004 compared to June 30, 2003.

#### *Interest Rates*

The Company does not currently manage its interest rate change exposure by entering into any type of interest rate hedging or derivative arrangements.

### Liquidity and Capital Resources

The following table shows condensed balance sheet information for the Company as of June 30, 2004, which has been translated using the same exchange rates as were used for the December 31, 2003 balance sheet. In addition, the entity previously accounted for under the equity method of accounting has been excluded for comparison purposes. This table shows only the changes in balances on a comparable basis; it does not show the actual cash flow impact to the Company.

| (in millions)                               | June 30, 2004     |                     |                      | Comparable<br>basis<br>change | Percent<br>change |
|---|-------------------|---------------------|----------------------|-------------------------------|-------------------|
|   | As Reported       | Comparable<br>Basis | December 31,<br>2003 |                               |                   |
| Cash  | \$ 15.8           | \$ 15.3             | \$ 15.1              | \$ 0.2                        | 1%                |
| Accounts receivable                         | 249.8             | 249.8               | 186.3                | 63.5                          | 34                |
| Inventories                                 | 191.0             | 190.2               | 198.9                | (8.7)                         | (4)               |
| Other current assets                        | 38.0              | 37.0                | 33.0                 | 4.0                           | 12                |
| Total current assets                        | <u>494.6</u>      | <u>492.3</u>        | <u>433.3</u>         | <u>59.0</u>                   | <u>14</u>         |
| Net property, plant and equipment           | 435.6             | 438.6               | 452.9                | (14.3)                        | (3)               |
| Goodwill and other intangibles              | 153.5             | 155.5               | 154.9                | 0.6                           | -                 |
| Other long-term assets (1)                  | 54.9              | 54.8                | 60.7                 | (5.9)                         | (10)              |
| Total assets                                | <u>\$ 1,138.6</u> | <u>\$ 1,141.2</u>   | <u>\$ 1,101.8</u>    | <u>\$ 39.4</u>                | <u>4%</u>         |
| Short-term debt and notes payable           | \$ 270.2          | \$ 273.1            | \$ 225.0             | \$ 48.1                       | 21%               |
| Accounts payable                            | 103.8             | 100.9               | 93.8                 | 7.1                           | 8                 |
| Accrued liabilities                         | 105.3             | 104.7               | 82.0                 | 22.7                          | 28                |
| Total current liabilities                   | <u>479.3</u>      | <u>478.7</u>        | <u>400.8</u>         | <u>77.9</u>                   | <u>19</u>         |
| Long term debt                              | 56.1              | 57.2                | 130.4                | (73.2)                        | (56)              |
| Pension liability                           | 41.0              | 42.1                | 41.9                 | 0.2                           | -                 |
| Deferred taxes                              | 55.6              | 56.2                | 56.1                 | 0.1                           | -                 |
| Other long-term liabilities                 | 43.2              | 44.0                | 43.0                 | 1.0                           | 2                 |
| Minority interest in consolidated companies | 41.3              | 41.3                | 32.4                 | 8.9                           | 27                |
| Total stockholders' equity                  | <u>422.1</u>      | <u>421.7</u>        | <u>397.2</u>         | <u>24.5</u>                   | <u>6</u>          |
| Total liabilities and stockholders' equity  | <u>\$ 1,138.6</u> | <u>\$ 1,141.2</u>   | <u>\$ 1,101.8</u>    | <u>\$ 39.4</u>                | <u>4%</u>         |

(1) The 2003 amount includes \$1.6 million of investment in subsidiary for entity which was accounted for under the equity method at December 31, 2003.

The Company's principal sources of liquidity have been from internally generated funds from operations and from borrowings under various credit facilities, primarily a multicurrency revolving credit facility that permits unsecured borrowings up to \$250.0 million through September 2006. At June 30, 2004 the Company had \$103.8 million borrowed under the revolving credit facility. A portion of the Company's outstanding debt matures in January 2005, and therefore

was reclassified as a current liability in 2004. The Company is in compliance with the financial covenants related to its debt facilities.

#### Cash Flow from Operations -

Cash flow from operations for the first six months of 2004 was a record \$69.7 million, an increase of 16 percent over the same period in 2003. The Company continues to generate a high level of cash from operations, even though the change in working capital was a net cash outflow of \$25.7 million in 2004 compared to a net cash outflow of \$11.9 million in 2003. The change in working capital during the first six months of 2004 was caused by a higher accounts receivable balance at June 30, 2004 due to the increased level of sales in 2004. Increases in the accrued liabilities balance are due to payment timing differences.

#### Cash Used in Investing Activities -

The Company continues to selectively invest in its operations, with total capital expenditures of \$29.5 million in the first half of 2004. This amount includes \$6.5 million invested in the development of a common business system, which began in 2003. The Company expects to invest an additional \$3.5 million in the common business system in 2004, prior to its initial implementation in late 2004.

#### *Cash Used in Financing Activities -*

The Company continues to pay a dividend to its shareholders on a quarterly basis as set by the Company's Board of Directors, with \$6.6 million of dividends paid in the first six months of 2004. The Company has also repaid \$25.0 million of outstanding borrowings in the first half of 2004. In addition, the Company makes varying distributions to its minority interest partners from its various joint venture activities depending on the amount of undistributed earnings of the businesses and the needs of the partners.

#### **Other Matters**

##### *Critical Accounting Estimates*

In preparing its most recent annual report on Form 10-K, the Company disclosed information about critical accounting estimates the Company makes in applying its accounting policies. The Company has made no changes to the methods of application or the assumptions used in applying these policies from what was disclosed in its most recent annual report on Form 10-K.

##### *New Accounting Principles*

The FASB issued Interpretation (FIN) No. 46R, "Consolidation of Variable Interest Entities" in December 2003, which requires variable interest entities to be consolidated by the party determined to be the primary beneficiary. A primary beneficiary of a variable interest entity (VIE) is the party that absorbs a majority of the entity's expected losses, receives a majority of its expected residual returns, or both, as a result of holding the variable interest. The Company adopted FIN No. 46R in the first quarter of 2004, consolidating one entity which was previously accounted for under the equity method of accounting, with no material effect on the financial statements.

In May 2004 the FASB issued Staff Position (FSP) 106-2 "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug Improvement and Modernization Act of 2003" (the Act), which superseded FSP 106-1 of the same name. The Act introduced a prescription drug benefit under Medicare Part D, as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. The post retirement benefit liability on the consolidated balance sheets does not reflect any amount associated with the subsidy under the Act as FSP 106-2 is not effective for the Company until the third quarter of 2004. The Company is in the process of determining the effect, if any, of adopting FSP 106-2.

##### *Business Combination*

During the second quarter 2004, the Company exercised its option to acquire the remaining 15% of Comatrol S.p.A for approximately \$4.3 million. In the second quarter of 2003 the Company purchased 40% of the outstanding shares of Comatrol, raising its ownership to 85%, and therefore began to consolidate the financial results of the business. Prior to purchasing the controlling interest in Comatrol, the Company accounted for the results of its ownership interest under the equity method of accounting. The total purchase price paid to acquire Comatrol was approximately \$22.1 million. The Company recognized intangible assets of approximately \$0.6 million and \$2.2 million for technology and customer relationships, respectively, in connection with the Comatrol acquisition. The transactions also resulted in recognizing approximately \$14.5 million of goodwill. Comatrol is located in Reggio Emilia, Italy, and has approximately 100 employees and \$22.0 million in annual sales.

##### *Non-Audit Services of Independent Auditors*

The Company's auditors, KPMG LLP, perform the following non-audit services that have been approved by the Audit Committee of the Board of Directors: international and U.S. tax planning and compliance services; expatriate tax services; benefit plan audits; statutory audits and related matters; tax and accounting technical support; and the audit of internal controls and management's assessment of their effectiveness.

### *Outlook*

The Company's results from the first half of 2004 were very strong, including record sales, net income and cash flow from operations. Due to the seasonal nature of the markets which the Company serves, the second half of the year can be challenging. However the strong backlog position of the Company at June 30, 2004, combined with the cost savings that are beginning to be realized from recent restructurings, indicate the Company will continue to experience improved financial results in the second half of the year compared to the second half of 2003.

The Company has made progress on some of its strategic initiatives outlined in its most recent annual report filed on Form 10-K. As mentioned earlier, development of a common business system is underway to standardize business processes and provide a single interface to direct OEM customers and suppliers. The investment in the common business system will drive improved operational efficiency, customer service, and financial performance in future years. Reorganization of the Company's sales and distribution operations in Europe is also continuing, which will result in reducing future operating costs by streamlining delivery directly from the manufacturing locations to the customer.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Information disclosing market risk is set forth in the Company's most recent annual report filed on Form 10-K (Item 7A), and is incorporated herein by reference. There has been no material change in this information.

### **Item 4. Controls and Procedures**

Commencing in 2003, the Company undertook a process of identifying and documenting its internal controls over financial reporting and implementing improvements to its policies and procedures that govern the Company's overall internal control environment. The Company engaged Deloitte & Touche LLP to assist the Company and to perform an extensive evaluation of the Company's internal controls to assist management in preparing the Company to comply with the new annual certification regarding internal control over financial reporting that will be required as of December 31, 2004 pursuant to Section 404 of the Sarbanes-Oxley Act of 2002 and related SEC rulemaking.

During the course of these activities, the Company has identified certain internal controls that management believes need to be improved. These control issues are, in large part, the result of the Company's increased size and complexity due to recent acquisitions and the multiple business system platforms in use today. The Company has made many improvements to its internal controls over financial reporting as a result of its review efforts and will continue to do so. The improvements made thus far include formalization of policies and procedures related to information technology in the areas of systems security, employee access control, and the management process to approve changes. In addition, new policies and procedures have been implemented in the accounting area relating to account responsibility and reconciliations, approvals for manual general ledger entries and the need for proper oversight of complex and unusual accounting transactions.

The Company has also established two new positions within the organization. The Information Technology Security Administrator is responsible for implementing the new policies and procedures described above related to information

technology. The other new position is the Company's Corporate Compliance Administrator, who will be responsible for coordinating and monitoring the Company's ongoing compliance with its established internal controls over financial reporting.

At the end of the period covered by this report, the Registrant carried out an evaluation under the supervision and with the participation of the Registrant's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Registrant's disclosure controls and procedures. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that the Registrant's disclosure controls and procedures are effective to ensure that information required to be disclosed in the reports that the Registrant files or submits under the Exchange Act is recorded, processed, summarized, and reported as required and within the time periods specified in the Securities and Exchange Commission's rules and forms. There have been no significant changes in the Registrant's internal controls over financial reporting during the period covered by this report that have materially or are likely to materially affect, the Registrant's internal control over financial reporting, except those noted above.

## PART II. OTHER INFORMATION

### Item 4. Submission of Matters to a Vote of Security Holders.

The Company held its Annual Meeting of Stockholders on May 5, 2004, at which stockholders re-elected ten directors and ratified the appointment of KPMG LLP as the Company's independent auditors for 2004. Results of the voting in connection with each issue were as follows:

|                                    | For        | Withheld  | Total      |
|------------------------------------|------------|-----------|------------|
| <b><u>Voting on Directors:</u></b> |            |           |            |
| Ole Steen Andersen                 | 43,461,512 | 1,922,276 | 45,383,788 |
| David J. Anderson                  | 43,460,431 | 1,923,357 | 45,383,788 |
| Jorgen M. Clausen                  | 42,928,028 | 2,455,760 | 45,383,788 |
| Nicola Keim                        | 43,418,270 | 1,965,518 | 45,383,788 |
| Johannes F. Kirchhoff              | 45,215,701 | 168,087   | 45,383,788 |
| Hans Kirk                          | 43,045,496 | 2,338,292 | 45,383,788 |
| F. Joseph Loughrey                 | 45,215,601 | 168,187   | 45,383,788 |
| Klaus H. Murmann                   | 43,056,754 | 2,327,034 | 45,383,788 |
| Sven Murmann                       | 43,227,452 | 2,156,336 | 45,383,788 |
| Steven H. Wood                     | 45,213,862 | 169,926   | 45,383,788 |

### **Ratification of Independent Auditors:**

|              |                   |
|--------------|-------------------|
| For          | 45,020,181        |
| Against      | 354,727           |
| Abstain      | 8,880             |
| <b>Total</b> | <b>45,383,788</b> |

### Item 6. Exhibits and Reports on Form 8-K.

#### (a) Exhibits

| Exhibit No. | Description of Document  |
|-------------|--|
| 3.1         | The Amended and Restated Certificate of Incorporation of the Company dated May 3, 2000, is attached as Exhibit 3.1 to the Company's Form 10-Q filed on August 16, 2000, and is incorporated herein by reference.                                   |
| 3.2         | The Amended and Restated Bylaws of the Company dated May 5, 2004, is attached hereto   |
| 4           | The form of Certificate of the Company's Common Stock, \$.01 Par Value, is attached as Exhibit 4 to the Company's Form 10-Q filed on August 16, 2000 and is incorporated herein by reference.  |
| 10.1(a)     | The Termination Agreement and Release dated May 3, 2000 relating to the termination of a Silent Partnership Agreement is attached as Exhibit 10.1(a) to the Company's Form 10-Q filed on August 16, 2000, and is incorporated herein by reference. |
| 10.1(b)     | The Registration Rights Agreement is attached as Exhibit 10.1(b) to Amendment No. 1 to the Company's Form S-1 Registration Statement filed on April 23, 1998, and is incorporated herein by reference.   |

10.1(c) The form of Indemnification Agreement entered into between the Company and each of its directors and certain officers is attached as Exhibit 10.1(c) to Amendment No. 1 to the Company's Form S-1 Registration Statement filed on April 23, 1998, and is incorporated herein by reference.

- 10.1(d) The Lease Agreement for the Company's Dubnica nad Váhom, Slovakia facility is attached as Exhibit 10.1(f) to Amendment No. 1 to the Company's Form S-1 Registration Statement filed on April 23, 1998, and is incorporated herein by reference.
- 10.1(e) The Lease Agreement for the Company's Swindon, England facility is attached as Exhibit 10.1(g) to Amendment No. 1 to the Company's Form S-1 Registration Statement filed on April 23, 1998, and is incorporated herein by reference.
- 10.1(f) The Lease Agreement for the Company's Minneapolis, Minnesota, facility is attached as Exhibit 10.1(h) to Amendment No. 1 to the Company's Form S-1 Registration Statement filed on April 23, 1998, and is incorporated herein by reference.
- 10.1(g) The Lease Agreement for the Company's Berching, Germany, facility dated November 15, 1996, is attached as Exhibit 10.1(g) to the Company's Form 10-K filed on March 12, 2003, and is incorporated herein by reference.
- 10.1(h) The Lease Agreement for the Company's Shanghai/Pudong, China, facility is attached as Exhibit 10.1(j) to Amendment No. 1 to the Company's Form S-1 Registration Statement filed on April 23, 1998, and is incorporated herein by reference.
- 10.1(i) The Lease Agreement for the Company's Odense, Denmark, facility dated November 15, 1996, is attached as Exhibit 10.1(h) to the Company's Form 10-K filed on March 12, 2003, and is incorporated herein by reference.
- 10.1(j) The Indenture of Lease agreement for the Company's Nordborg, Denmark, facility effective May 3, 2000, is attached as Exhibit 10.1(ah) to the Company's Form 10-K filed on March 30, 2001, and is incorporated herein by reference.
- 10.1(k) The Lease Agreement for the Company's Hillsboro, Oregon, facility effective January 19, 2001, is attached as Exhibit 10.1(ai) to the Company's Form 10-K filed on March 30, 2001, and is incorporated herein by reference.
- 10.1(l) The Lease Agreement for the Company's leased facility in Ames, Iowa, effective April 1, 2002, is attached as Exhibit 10.1(am) to the Company's Form 10-Q filed on May 15, 2002, and is incorporated herein by reference.
- 10.1(m) The Office Lease for the Company's Chicago, Illinois, Executive Office effective June 1, 2002, is attached as Exhibit 10.1(an) to the Company's Form 10-Q filed on May 15, 2002, and is incorporated herein by reference.
- 10.1(n) The Executive Employment Agreement with David J. Anderson dated January 1, 2003, is attached as Exhibit 10.1(m) to the Company's Form 10-K filed on March 12, 2003, and is incorporated herein by reference.
- 10.1(o) The Executive Employment Agreement with Karl J. Schmidt dated January 1, 2003, is attached as Exhibit 10.1(n) to the Company's Form 10-K filed on March 12, 2003, and is incorporated herein by reference.
- 10.1(p) The Executive Employment Agreement with James R. Wilcox dated January 1, 2003, is attached as Exhibit 10.1(o) to the Company's Form 10-K filed on March 12, 2003, and is incorporated herein by reference.
- 10.1(q) The Executive Employment Agreement with Hans J. Cornett dated January 1, 2003, is attached as Exhibit 10.1(p) to the Company's Form 10-K filed on March 12, 2003, and is incorporated herein by reference.
- 10.1(r) The Executive Employment Agreement with Thomas Kittel dated January 1, 2003, is attached as Exhibit 10.1(q) to the Company's Form 10-K filed on March 12, 2003, and is incorporated herein by reference.
- 10.1(s) The Addendum to Executive Employment Agreement, dated December 1, 2002, relating to the Executive Employment Agreement referred to in 10.1(r) above with Thomas Kittel is attached as Exhibit 10.1(r) to the Company's Form 10-K filed on March 12, 2003, and is incorporated herein by reference.
- 10.1(t) The Executive Employment Agreement with Finn Lyhne dated January 1, 2003, is attached as Exhibit 10.1(s) to the Company's Form 10-K filed on March 12, 2003, and is incorporated herein by reference.
- 10.1(u) The Addendum to Executive Employment Agreement, dated December 1, 2002, relating to the Executive Employment Agreement referred to in 10.1(t) above with Finn Lyhne is attached as Exhibit 10.1(t) to the Company's Form 10-K filed on March 12, 2003, and is incorporated herein by reference.
- 10.1(v) The Executive Employment Agreement with Henrik Krabsen dated January 1, 2003, is attached as Exhibit 10.1(v) to the Company's Form 10-K filed on March 12, 2003, and is incorporated herein by reference.
- 10.1(w) The Executive Employment Agreement with Kenneth D. McCuskey dated January 1, 2003, is attached as Exhibit 10.1(w) to the Company's Form 10-K filed on March 12, 2003, and is incorporated herein by reference.
- 10.1(x) The Executive Employment Agreement with Albert Zahalka dated January 1, 2003, is attached as Exhibit 10.1(x) to the Company's Form 10-K filed on March 12, 2003, and is incorporated herein by reference.

- 10.1(y) The Executive Employment Agreement with Ronald C. Hanson dated July 1, 2003, is attached as Exhibit 10.1(z) to the Company's Form 10-K filed on March 15, 2004, and is incorporated herein by reference.
- 10.1(z) The Consulting Agreement with Klaus Murmann, dated May 5, 2004, is attached hereto.
- 10.1(aa) The Amended and Restated Post-Retirement Care Agreement for Klaus Murmann, effective May 3, 2000, is attached as Exhibit 10.1 (s) to the Company's Form 10-Q filed on August 16, 2000, and is incorporated herein by reference.
- 10.1(ab) The Sauer-Danfoss Inc. Annual Management Performance Incentive Plan amended and restated as of March 4, 2003, is attached hereto.

- 10.1(ac) The Sauer-Sundstrand Company Supplemental Retirement Benefit Plan for Certain Key Executives is attached as Exhibit 10.1(t) to Amendment No. 1 to the Company's Form S-1 Registration Statement filed on April 23, 1998, and is incorporated herein by reference.
- 10.1(ad) The First Amendment to the Sauer-Sundstrand Company Supplemental Retirement Benefit Plan for Certain Key Executives referred to in Exhibit 10.1(ac) above, which renames the Plan to the Sauer-Danfoss Inc. Supplemental Retirement Benefit Plan for Certain Key Executives, is attached hereto.
- 10.1(ae) The Sauer-Sundstrand Company Supplemental Retirement Benefit Plan for Certain Key Executives Previously Employed by the Sundstrand Corporation is attached as Exhibit 10.1(u) to Amendment No. 1 to the Company's Form S-1 Registration Statement filed on April 23, 1998, and is incorporated herein by reference.
- 10.1(af) The Sauer-Sundstrand Employees' Savings & Retirement Plan is attached as Exhibit 10.1(v) to Amendment No. 1 to the Company's Form S-1 Registration Statement filed on April 23, 1998, and is incorporated herein by reference.
- 10.1(ag) The Amendment Number One, effective December 15, 2000, to the Sauer-Sundstrand Employees' Savings and Retirement Plan referred to in Exhibit 10.1(af) above, is attached as Exhibit 10.1(aj) to the Company's Form 10-Q filed on August 15, 2001, and is incorporated herein by reference.
- 10.1(ah) The Amendment Number Two, effective January 1, 2002, to the Sauer-Danfoss Employees' Savings Plan, (formerly the Sauer-Sundstrand Employees' Savings and Retirement Plan), referred to in Exhibit 10.1(af) above, is attached as Exhibit 10.1(t) to the Company's Form 10-K filed on March 29, 2002, and is incorporated herein by reference.
- 10.1(ai) Amendment No. 1 to the Compact Controls, Inc. 401(k) Plan and Amendment No. 3 to the Sauer-Danfoss Employees' Savings Plan, effective December 23, 2001, is attached as Exhibit 10.1(ah) to the Company's Form 10-K filed on March 15, 2004, and is incorporated herein by reference.
- 10.1(aj) Amendment Number Four to the Sauer-Danfoss Employees' Savings Plan, effective February 8, 2002, is attached as Exhibit 10.1(ai) to the Company's Form 10-K filed on March 15, 2004, and is incorporated herein by reference.
- 10.1(ak) The Fifth Amendment to the Sauer-Danfoss Employees' Savings Plan, effective February 25, 2002, is attached as Exhibit 10.1(aj) to the Company's Form 10-K filed on March 15, 2004, and is incorporated herein by reference.
- 10.1(al) Amendment Number 6 to the Sauer-Danfoss Employees' Savings Plan, effective July 24, 2002, is attached as Exhibit 10.1(ak) to the Company's Form 10-K filed on March 15, 2004, and is incorporated herein by reference.
- 10.1(am) Amendment Number 7 to the Sauer-Danfoss Employees' Savings Plan, effective January 20, 2003, is attached as Exhibit 10.1(al) to the Company's Form 10-K filed on March 15, 2004, and is incorporated herein by reference.
- 10.1(an) Amendment Number Eight to the Sauer-Danfoss Employees' Savings Plan, effective January 24, 2003, is attached as Exhibit 10.1(am) to the Company's Form 10-K filed on March 15, 2004, and is incorporated herein by reference.
- 10.1(ao) Amendment Number 9 to the Sauer-Danfoss Employees' Savings Plan, effective December 18, 2003, is attached as Exhibit 10.1(an) to the Company's Form 10-K filed on March 15, 2004, and is incorporated herein by reference.
- 10.1(ap) The European Employees' Pension Plan is attached as Exhibit 10.1(y) to Amendment No. 1 to the Company's Form S-1 Registration Statement filed on April 23, 1998, and is incorporated herein by reference.
- 10.1(aq) The Sauer-Danfoss Inc. 1998 Long-Term Incentive Plan is attached as Exhibit 10.1(p) to Amendment No. 1 to the Company's Form S-1 Registration Statement filed on April 23, 1998, and is incorporated herein by reference.
- 10.1(ar) The Amendment, effective May 3, 2000, to the Sauer-Danfoss Inc. 1998 Long-Term Incentive Plan referred to in 10.1(aq) above is attached as Exhibit 10.1 (v) to the Company's Form 10-Q filed on August 16, 2000, and is incorporated herein by reference.

- 10.1(as) The Amendment to the Sauer-Danfoss Inc. 1998 Long-Term Incentive Plan effective December 4, 2002, is attached as Exhibit 10.1(bd) to the Company' s Form 10-K filed on March 12, 2003, and is incorporated herein by reference.
- 10.1(at) The Sauer-Danfoss Inc. Non-employee Director Stock Option and Restricted Stock Plan is attached as Exhibit 10.1(q) to Amendment No. 1 to the Company' s Registration Statement filed on April 23, 1998, and is incorporated herein by reference.
- 10.1(au) The Amendment, effective May 3, 2000, to the Sauer-Danfoss Inc. Non-Employee Director Stock Option and Restricted Stock Plan referred to in 10.1(at) above is attached as Exhibit 10.1 (x) to the Company' s Form 10-Q filed on August 16, 2000, and is incorporated herein by reference.
- 10.1(av) The Amendment to the Sauer-Danfoss Inc. Non-Employee Director Stock Option and Restricted Stock Plan effective December 4, 2002, is attached as Exhibit 10.1 (ak) to the Company' s Form 10-K filed on March 12, 2003, and is incorporated herein by reference.

- 10.1(aw) The Trademark and Trade Name Agreement dated May 3, 2000, between the Company and Danfoss A/S is attached as Exhibit 10.1 (ac) to the Company' s Form 10-Q filed on August 16, 2000, and is incorporated herein by reference.
- 10.1(ax) The Stock Exchange Agreement dated January 22, 2000, by and among the Registrant, Danfoss A/S, Danfoss Murmann Holding A/S. and K. Murmann Verwaltungsgesellschaft mbH is attached as Annex A to the Company' s Proxy Statement filed on March 28, 2000, and is incorporated herein by reference.
- 10.1(ay) The Sauer-Danfoss Employees' Retirement Plan as amended and restated, effective January 1, 2000, and renamed as of May 3, 2000, is attached as Exhibit 10.1(ah) to the Company' s Form 10-Q filed on November 15, 2000, and is incorporated herein by reference.
- 10.1(az) The Amendment Number One, effective December 15, 2000, to the Sauer-Danfoss Employees' Retirement Plan referred to in Exhibit 10.1(ay) above, is attached as Exhibit 10.1(ai) to the Company' s Form 10-Q filed on August 15, 2001, and is incorporated herein by reference.
- 10.1(ba) The Second Amendment, effective March 26, 2001, to the Sauer-Danfoss Employees' Retirement Plan, (formerly the Sauer-Sundstrand Employees' Savings and Retirement Plan), referred to in Exhibit 10.1(ay) above, is attached as Exhibit 10.1(ak) to the Company' s Form 10-Q filed on August 15, 2001, and is incorporated herein by reference.
- 10.1(bb) The Third Amendment to the Sauer-Danfoss LaSalle Factory Employee Savings Plan, effective January 1, 2001, is attached as Exhibit 10.1(al) to the Company' s Form 10-Q filed on November 14, 2001, and is incorporated herein by reference.
- 10.1(bc) Amendment Number Four to the Sauer-Danfoss LaSalle Factory Employee Savings Plan, effective February 8, 2002, is attached as Exhibit 10.1(ap) to the Company' s Form 10-K filed on March 29, 2002, and is incorporated herein by reference.
- 10.1(bd) The Fifth Amendment to the Sauer-Danfoss LaSalle Factory Employee Savings Plan, effective February 25, 2002, is attached as Exhibit 10.1(aq) to the Company' s Form 10-K filed on March 29, 2002, and is incorporated herein by reference.
- 10.1(be) Amendment Number 6 to the Sauer-Danfoss LaSalle Factory Employee Savings Plan, effective January 20, 2003, is attached as Exhibit 10.1(bd) to the Company' s Form 10-K filed on March 15, 2004, and is incorporated herein by reference.
- 10.1(bf) The Seventh Amendment to the Sauer-Danfoss LaSalle Factory Employee Savings Plan, effective January 1, 2004, is attached as Exhibit 10.1(be) to the Company' s Form 10-K filed on March 15, 2004, and is incorporated herein by reference.
- 10.1(bg) The Sauer-Danfoss Racine Employees' Savings Plan, effective December 1, 2000, is attached as Exhibit 10.1(am) to the Company' s Form 10-Q filed on November 14, 2001, and is incorporated herein by reference.
- 10.1(bh) The Sauer-Danfoss Inc. Annual Officer Performance Incentive Plan amended and restated as of March 4, 2003, is attached as Exhibit 10.1(bc) to the Company' s Form 10-K filed on March 12, 2003, and is incorporated herein by reference.
- 10.1(bi) The Separation Agreement and Release of All Claims entered into as of January 27, 2003 with Don O' Grady, is attached as Exhibit 10.1(ay) to the Company' s Form 10-K filed on March 12, 2003, and is incorporated herein by reference.
- 10.1(bj) The Sauer-Danfoss Inc. Deferred Compensation Plan for Selected Employees dated December 9, 2003, is attached as Exhibit 10.1(bk) to the Company' s Fork 10-K filed on March 15, 2004, and is incorporated herein by reference.
- 10.1(bk) The Sauer-Danfoss Inc. Supplemental Executive Savings & Retirement Plan, effective January 1, 2004, is attached hereto.
  - 31.1 Certification by the Chief Executive Officer Pursuant to Rule 13a-14(a).
  - 31.2 Certification by the Chief Financial Officer Pursuant to Rule 13a-14(a).
  - 32.1 Certification by the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350.
  - 32.2 Certification by the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350.

(b) *Reports on Form 8-K*

On May 3, 2004, the Company filed a Current Report on Form 8-K for the purpose of disclosing one press release dated May 3, 2004 announcing its financial results for the first quarter ended March 28, 2004.

On May 7, 2004, the Company filed a Current Report on Form 8-K for the purpose of disclosing one press release dated May 5, 2004 announcing the election of Chairman and Vice Chairman of the Company.

25

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**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.

Sauer-Danfoss Inc.

By /s/ Kenneth D. McCuskey  
Kenneth D. McCuskey  
Vice President and Chief Accounting Officer and Secretary

August 6, 2004

26

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AMENDED AND  
RESTATED  
BYLAWS  
OF  
SAUER-DANFOSS INC.

EFFECTIVE MAY 5, 2004

ARTICLE I

Offices

Section 1. The registered office shall be at 1209 Orange Street, in the City of Wilmington, County of New Castle, State of Delaware.

Section 2. The corporation may also have offices at such other places both within and without the State of Delaware, as the Board of Directors may from time to time determine or the business of the corporation may require.

ARTICLE II

Meetings of Stockholders

Section 1. All meetings of the stockholders shall be held at such place within or without the State of Delaware as may be designated from time to time by the Board of Directors.

Section 2. Annual meetings of stockholders shall be held on the third Tuesday in April if not a legal holiday, and if a legal holiday, then on the next business day following, at 9:00 a.m., or at such other date and time as shall be designated from time to time by the Board of Directors and stated in the notice of the meeting, at which they shall elect by a plurality vote the Board of Directors, and transact such other business as may properly be brought before the meeting.

Section 3. Written notice of the annual meeting stating the place, date and hour of the meeting shall be given to each stockholder entitled to vote at such meeting not less than ten nor more than sixty days before the date of the meeting.

Section 4. No business may be transacted at an annual meeting of stockholders, other than business that is either (a) specified in the notice of meeting (or any supplement thereto) given by or at the direction of the Board of Directors (or any duly authorized committee thereof), (b) otherwise properly brought before the annual meeting by or at the direction of the Board of Directors (or any duly authorized committee thereof), or (c) otherwise properly brought before the annual meeting by any stockholder of the Company (i) who is a stockholder of record on the date of the giving of the notice provided for in this Section 4 and on the record date for the determination of stockholders entitled to vote at such annual meeting and (ii) who complies with the notice procedure set forth in this Section 4.

In addition to any other applicable requirements, for business to be properly brought before an annual meeting by a stockholder, such stockholder must have given timely notice thereof in

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proper written form to the Secretary of the corporation. To be timely, a stockholder proposal to be presented at an annual meeting shall be received at the corporation's principal executive offices not less than 120 calendar days in advance of the date that the corporation's proxy statement was released to stockholders in connection with the previous year's annual meeting of stockholders, except that if no annual meeting was held in the previous year or the date of the annual meeting has been changed by more than 30 calendar days from the date contemplated at the time of the previous year's proxy statement, notice by the stockholder to be timely must be received not later than the close of business on the tenth day following the day on which such notice of the date of the meeting was mailed or such public disclosure was

made. To be in proper written form, a stockholder's notice to the Secretary shall set forth as to each matter the stockholder proposes to bring before the annual meeting (a) a brief description of the business desired to be brought before the annual meeting, (b) the name and address, as they appear on the corporation's books, of the stockholder proposing such business, (c) the class and number of shares of the Corporation which are beneficially owned by the stockholder, (d) any material interest of the stockholder in such business, and (e) a representation that such stockholder intends to appear in person or by proxy at the annual meeting to bring such business before the meeting.

No business shall be conducted at the annual meeting of shareholders except business brought before the annual meeting in accordance with the procedures set forth in this Section 4; provided, however, that, once business has been properly brought before the annual meeting in accordance with such procedures, nothing in this Section 4 shall be deemed to preclude discussion by any stockholder of any such business. If the Chairman, or other officer presiding at a meeting in the absence of the Chairman, determines that business was not properly brought before the meeting in accordance with the foregoing procedures, the Chairman, or other officer presiding at a meeting in the absence of the Chairman, shall declare to the meeting that the business was not properly brought before the meeting and such business shall not be transacted.

Section 5. The officer who has charge of the stock ledger of the corporation shall prepare and make, at least ten days before every meeting of stockholders, a complete list of the stockholders entitled to vote at the meeting, arranged in alphabetical order, and showing the address of each stockholder and the number of shares registered in the name of each stockholder.

Such list shall be open to the examination of any stockholder, for any purpose germane to the meeting, during ordinary business hours, for a period of at least ten days prior to the meeting, either at a place within the city where the meeting is to be held, which place shall be specified in the notice of the meeting, or, if not so specified, at the place where the meeting is to be held. The list shall also be produced and kept at the time and place of the meeting during the whole time thereof, and may be inspected by any stockholder who is present.

Section 6. Special meetings of the stockholders, for any purpose or purposes, unless otherwise prescribed by statute or by the Certificate of Incorporation, may only be called by the Chairman, by the Vice-Chairman, by the Chief Executive Officer and President, at the request in writing of a majority of the stock issued and outstanding and entitled to vote thereat, or at the request in writing of a majority of the Board of Directors. Any such written request delivered pursuant to this Section 6 of Article II shall state the purpose or purposes of the proposed meeting.

Section 7. Written notice of a special meeting stating the place, date and hour of the meeting and the purpose or purposes for which the meeting is called, shall be given not less than ten nor more than sixty days before the date of the meeting, to each stockholder entitled to vote at such meeting.

Section 8. Business transacted at any special meeting of stockholders shall be limited to the purposes stated in the notice.

Section 9. The holders of a majority of the stock issued and outstanding and entitled to vote thereat, present in person or represented by proxy, shall constitute a quorum at all meetings of the stockholders for the transaction of business, except as otherwise provided by statute or by the Certificate of Incorporation. If, however, such quorum shall not be present or represented at any meeting of the stockholders, the stockholders entitled to vote thereat, present in person or represented by proxy, shall have power to adjourn the meeting from time to time, without notice other than announcement at the meeting, until a quorum shall be present or represented. At such adjourned meeting at which a quorum shall be present or represented any business may be transacted which might have been transacted at the meeting as originally notified. If the adjournment is for more than thirty days, or if after the adjournment a new record date is fixed for the adjourned meeting, a notice of the adjourned meeting shall be given to each stockholder of record entitled to vote at the meeting.

Section 10. When a quorum is present at any meeting, the vote of the holders of a majority of the stock having voting power present in person or represented by proxy shall decide any question brought before such meeting, unless the question is one upon which by express provision of the statutes or of the Certificate of Incorporation, a different vote is required in which case such express provision shall govern and control the decision of such question.

Section 11. Unless otherwise provided in the Certificate of Incorporation, each stockholder shall at every meeting of the stockholders be entitled to one vote in person or by proxy for each share of the capital stock having voting power held by such stockholder, but no proxy shall be voted on after three years from its date, unless the proxy provides for a longer period.

## ARTICLE III

### Board of Directors

Section 1. The property, business and affairs of the corporation shall be controlled and managed by a Board of Directors. The number of directors to constitute the Board of Directors shall be ten. Vacancies on the Board of Directors may be filled by a majority of the directors then in office, although less than a quorum.

Section 2. The business of the corporation shall be managed by its Board of Directors, which may exercise all such powers of the corporation and do all such lawful acts and things as are not by statute or by the Certificate of Incorporation or by these bylaws directed or required to be exercised or done by the stockholders.

Section 3. Except as provided in this Section 3, no director shall be eligible to serve after the annual meeting of stockholders following his or her seventieth birthday. Klaus Murmann shall

3

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be eligible to serve until the second annual meeting of stockholders following the date when he no longer serves as Chairman.

### Meetings of the Board of Directors

Section 4. The Board of Directors of the corporation may hold meetings, both regular and special, either within or without the State of Delaware.

Section 5. The first meeting of each newly elected Board of Directors shall be held at such time and place as shall be fixed by the vote of the stockholders at the annual meeting and no notice of such meeting shall be necessary to the newly elected directors in order legally to constitute the meeting, provided a quorum shall be present. In the event of the failure of the stockholders to fix the time or place of such first meeting of the newly elected Board of Directors, or in the event such meeting is not held at the time and place so fixed by the stockholders, the meeting may be held at such time and place as shall be specified in a notice given as hereinafter provided for special meetings of the Board of Directors, or as shall be specified in a written waiver signed by all of the directors.

Section 6. Regular meetings of the Board of Directors may be held without notice at such time and at such place as shall from time to time be determined by the Board.

Section 7. Special meetings of the Board may be called by the Chairman, by the Vice-Chairman or by the Chief Executive Officer and President on two days' notice to each director, either personally or by mail, telegram, telex, telecopy, or other form of facsimile transmission setting forth the time, place and purpose of the meeting; special meetings shall be called by the Chairman, by the Vice-Chairman, by the Chief Executive Officer and President, or by the Secretary in like manner and on like notice on the written request of two directors.

Section 8. (a) At all meetings of the Board a majority of directors shall constitute a quorum for the transaction of business and, the act of a majority of the directors present at any meeting at which there is a quorum shall be the act of the Board of Directors, except as may otherwise be specifically provided by statute, by the Certificate of Incorporation or by these bylaws. If a quorum shall not be present at any meeting of the Board of Directors, the directors present thereat may adjourn the meeting from time to time, without notice other than announcement at the meeting, until a quorum shall be present.

(b) Notwithstanding Section 8(a) above, the following acts shall require the approval of at least 80% of the fully constituted Board of Directors in order for such act to be an act of the Board of Directors:

(i) the acquisition or sale of any entity or the businesses, operations or assets thereof, for consideration having a value in excess of 1% of net sales for the immediately preceding fiscal year;

(ii) the issuance by the corporation of any common stock or other voting securities or any incurrence of in excess of \$10,000,000 principal amount of debt, other than borrowings under previously approved credit facilities;

4

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- (iii) any modification or amendment to these bylaws or any recommendation by the Board of Directors to the stockholders of the corporation with respect to a proposed modification or amendment to the Certificate of Incorporation;
- (iv) any action having a material adverse effect on the Nordborg operations;
- (v) any other material change in the lines of business operated by the corporation;
- (vi) any increase or decrease in the number of directors comprising the Board of Directors;
- (vii) election or removal of the director members, or alternative director members, of the nominating committee;
- (viii) election or removal of the Chairman and election or removal of the Vice-Chairman;
- (ix) election or removal of the Chief Executive Officer and President, the Chief Financial Officer and one or more Chief Operating Officers; and
- (x) approval of the Annual Business Plan (as defined below) or any action that materially deviates from the Annual Business Plan.

(c) Prior to January 1 of each calendar year, the Chief Executive Officer and President shall submit to the Board of Directors a business plan (the "Annual Business Plan") for the corporation for the calendar year immediately following such calendar year. The Annual Business Plan shall include, without limitation, the overall corporate strategy, detailed operating assumptions relating to pricing and product costing, proposed major investments, innovations and other development decisions, capital requirements and all other appropriate or significant items. The Annual Business Plan shall be approved in its entirety, and only in its entirety, by the Board of Directors by the affirmative vote of at least 80% of the fully constituted Board of Directors. In the event that 80% of the fully constituted Board of Directors does not approve of the Annual Business Plan as submitted by the Chief Executive Officer and President, then the entire Annual Business Plan shall be rejected and disapproved and, within the number of calendar days determined by the Board of Directors, a revised Annual Business Plan shall be submitted to the Board of Directors by the Chief Executive Officer and President for approval as described above. In the event that the Annual Business Plan is not approved by the affirmative vote of at least 80% of the Board of Directors prior to December 31 of the calendar year immediately preceding the calendar year to which such Annual Business Plan pertains, then the corporation shall continue to operate thereafter in accordance with the Annual Business Plan then in effect until such time as a revised Annual Business Plan is approved by the affirmative vote of at least 80% of the fully constituted Board of Directors.

Section 9. Unless otherwise restricted by the Certificate of Incorporation, any action required or permitted to be taken at any meeting of the Board of Directors or of any committee thereof may be taken without a meeting, if all members of the Board or committee, as the case may be, consent thereto in writing, and the writing or writings are filed with the minutes of proceedings of the Board or committee.

Section 10. Unless otherwise restricted by the Certificate of Incorporation, members of the Board of Directors or of any committee thereof, may participate in a meeting of the Board or committee by means of conference telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other, and participation in a meeting by use of such equipment shall constitute presence in person at such meeting.

#### Committees of Directors

Section 11. Subject to Section 11 below, the Board of Directors may, by resolution passed by a majority of the fully constituted Board of Directors, designate one or more committees, each committee to consist of one or more of the directors of the corporation. The Board may designate one or more directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee. In the absence or disqualification of a member of a committee, the member or members thereof present at any meeting and not disqualified from voting, whether or not he or they constitute a quorum, may unanimously appoint another member of the Board of Directors to act at the meeting in the place of any such absent or disqualified member. Any such committee, to the extent provided in the resolution of the Board of Directors, shall have and may exercise all the powers and authority of the Board of Directors in the management

of the business and affairs of the corporation, and may authorize the seal of the corporation to be affixed to all papers which may require it; but no such committee shall have the power or authority in reference to amending the Certificate of Incorporation, adopting an agreement of merger or consolidation, recommending to the stockholders the sale, lease or exchange of all or substantially all of the corporation's property and assets, recommending to the stockholders a dissolution of the corporation or a revocation of a dissolution, or amending the bylaws of the corporation; and, unless the resolution or the Certificate of Incorporation expressly so provide, no such committee shall have the power or authority to declare a dividend or to authorize the issuance of stock. Such committee or committees shall have such name or names as may be determined from time to time by resolution adopted by the Board of Directors.

Section 12. The Board of Directors, in addition to any committees established pursuant to Section 11 of this Article IV, shall establish a standing nominating committee. The nominating committee shall have exclusive power and authority to evaluate and recommend all director candidates to the Board of Directors. The nominating committee shall be comprised of two directors; each such director member requiring approval of at least 80% of the fully constituted Board of Directors. The Board of Directors may designate alternate directors as members of the nominating committee; provided, however, that any alternate director must be approved by at least 80% of the fully constituted Board of Directors. The number of directors comprising the nominating committee shall be neither increased nor decreased. All acts of the nominating committee must be unanimous. Members of the nominating committee shall hold office until their successors are chosen and qualify and shall not be removed by the Board of Directors without the affirmative vote of at least 80% of the fully constituted Board of Directors.

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6

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Section 13. Each committee shall keep regular minutes of its meetings and report the same to the Board of Directors when required.

#### Compensation of Directors

Section 14. Unless otherwise restricted by the Certificate of Incorporation, the Board of Directors shall have the authority to fix the compensation of directors. The directors may be paid their expenses, if any, of attendance at each meeting of the Board of Directors and may be paid a fixed sum for attendance at each meeting of the Board of Directors and a stated salary as a director. No such payment shall preclude any director from serving the corporation in any other capacity and receiving compensation therefor. Members of special or standing committees may be allowed like compensation for attending committee meetings.

#### Nomination of Directors

Section 15. Subject to the rights of holders of any class or series of Preferred Stock then outstanding, nominations for the election of Directors shall be made by the Board of Directors from the director candidates recommended by the nominating committee or by any stockholder entitled to vote in the election of directors generally. However, any stockholder entitled to vote in the election of directors generally may nominate one or more persons for election as directors at a meeting only if timely notice of such stockholder's intent to make such nomination or nominations has been given in writing to the Secretary of the corporation. To be timely, a stockholder nomination for a director to be elected at an annual meeting shall be received at the corporation's principal executive offices not less than 120 calendar days in advance of the date that the corporation's proxy statement was released to stockholders in connection with the previous year's annual meeting of stockholders, except that if no annual meeting was held in the previous year or the date of the annual meeting has been changed by more than 30 calendar days from the date contemplated at the time of the previous year's proxy statement, or in the event of a nomination for director to be elected at a special meeting, notice by the stockholders to be timely must be received not later than the close of business on the tenth day following the day on which such notice of the date of the special meeting was mailed or such public disclosure was made. Each such notice shall set forth (a) the name and address of the stockholder who intends to make the nomination and of the person or persons to be nominated, (b) a representation that the stockholder is a holder of record of stock of the corporation entitled to vote for the election of directors on the date of such notice and intends to appear in person or by proxy at the meeting to nominate the person or persons specified in the notice, (c) a description of all arrangements or understandings between the stockholder and each nominee and any other person or persons (naming such person or persons) pursuant to which the nomination or nominations are to be made by the stockholder, (d) such other information regarding each nominee proposed by such stockholder as would be required to be included in a proxy statement filed pursuant to the proxy rules of the Securities and Exchange Commission, had the nominee been nominated, or intended to be nominated, by the Board of Directors, and (e) the consent of each nominee to serve as a director of the corporation if so elected.

No person shall be eligible for election as a director of the Company unless nominated in accordance with the procedures set forth in this Section 15. If the Chairman, or other officer presiding at a meeting in

the absence of the Chairman, determines that a nomination was not made in accordance with the foregoing procedures, the Chairman, or other officer presiding at a meeting in the absence of the Chairman, shall declare to the meeting that the nomination was defective and such defective nomination shall be disregarded.

#### Chairman and Vice Chairman

Section 16. The Board of Directors at its first meeting after each annual meeting of stockholders shall elect one of its members to be Chairman and one other of its members to be Vice Chairman. The Chairman and Vice Chairman positions shall be non-executive, non-officer positions of the corporation and the directors elected Chairman and Vice Chairman shall not hold any officer position with the corporation or be employed in any capacity by the corporation. Accordingly, the Board of Directors retains the right to determine that such a non-executive Chairman or Vice Chairman is an independent director under the applicable rules of the Securities and Exchange Commission and the New York Stock Exchange. The Board of Directors shall fill any vacancy in the position of Chairman or Vice Chairman at such time and in such manner as the Board of Directors shall determine.

#### Duties of Chairman and Vice Chairman

Section 17. The Chairman shall preside at , and determine the agenda for, all meetings of the stockholders and at all meetings of the Board of Directors. The Chairman shall also preside at all meetings of the independent members of the Board of Directors. The Chairman shall exercise and perform all the duties incident to the office of Chairman and such other duties as from time to time may be assigned by the Board of Directors or as may be prescribed by these bylaws. In the absence of the Chairman, the Vice Chairman shall preside at all meetings of the Board of Directors and stockholders and shall also preside at all meetings of the independent directors of the Board of Directors. The Vice Chairman shall exercise and perform all the duties incident to the office of Vice Chairman and such other duties as from time to time may be assigned by the Board of Directors or as may be prescribed by these bylaws. Prior to determining the agenda for any meeting of stockholders or any meeting of the Board of Directors, the Chairman shall consult with the Vice-Chairman with respect to such agenda.

#### Emeritus Positions

Section 18. From time to time, the Board of Directors may designate an individual to serve as a Director Emeritus, as a Chairman Emeritus or as a Vice Chairman Emeritus. These positions shall be honorary positions and persons appointed to such positions shall be entitled to attend meetings of the Board of Directors. An individual holding an emeritus position shall not receive compensation for serving in such capacity, shall not be an officer of the corporation, and, unless such person is a regularly elected or appointed director, shall have no vote at a directors' meeting. An individual designated to hold an emeritus position may be so designated for any reason deemed appropriate by the Board of Directors, including, without limitation, such individual' s experience with and contributions to the corporation. Any person may be removed from an emeritus position by the Board of Directors, either with or without cause, at any time

### ARTICLE IV

#### Notices

Section 1. Whenever, under the provisions of the statutes or of the Certificate of Incorporation or of these bylaws, notice is required to be given to any director or stockholder, it shall not be construed to mean personal notice, but such notice may be given in writing, by mail, addressed to such director or stockholder at his address as it appears on the records of the corporation, with postage thereon prepaid, and such notice shall be deemed to be given three days after the time when the same shall be deposited in the United States mail. Notice to directors may also be given by telegram, telex, teletype or other form of facsimile transmission if not given later than two days before the meeting of the directors or stockholders is to be held.

Section 2. Whenever any notice is required to be given under the provisions of the statutes or of the Certificate of Incorporation or of these bylaws, a waiver thereof in writing, signed by the person or persons entitled to said notice, whether before or after the time stated therein, shall be deemed equivalent thereto.

### ARTICLE V

## Officers

Section 1. The officers of the corporation shall be chosen by the Board of Directors and shall be a Chief Executive Officer and President, a Vice President, a Chief Financial Officer, a Secretary and a Treasurer and such other officers as the Board of Directors deems necessary or appropriate. The Board of Directors may also choose additional Vice Presidents, and one or more Assistant Secretaries and Assistant Treasurers. Any number of offices may be held by the same person, unless the Certificate of Incorporation or these bylaws otherwise provide.

Section 2. The Board of Directors at its first meeting after each annual meeting of stockholders shall choose a Chief Executive Officer and President, one or more Vice Presidents, a Chief Financial Officer, a Secretary and a Treasurer.

Section 3. The Board of Directors may appoint such other officers and agents as it shall deem necessary who shall hold their offices for such terms and shall exercise such powers and perform such duties as shall be determined from time to time by the Board.

Section 4. The salaries of all officers and agents of the corporation shall be fixed by the Board of Directors. Any payments made to an officer of the corporation as compensation, salary, commission, bonus, interest, or rent, or in reimbursement of entertainment or travel expense incurred by him, which shall be disallowed in whole or in part as a deductible expense of the corporation for federal income tax purposes for the reason that it does not constitute an ordinary and necessary business expense, shall be reimbursed by such officer to the corporation to the full extent of such disallowance. The Board of Directors shall enforce payment of each such amount disallowed. In lieu of payment by the officer, subject to the discretion of the Board of Directors, proportionate amounts may be withheld from the officer's future compensation payments until the amount owed to the corporation has been recovered.

Section 5. The officers of the corporation shall hold office until their successors are chosen and qualify. Except as otherwise provided in Section 7(b) of Article III of these bylaws, any officer elected or appointed by the Board of Directors may be removed at any time by the affirmative

vote of a majority of the Board of Directors. Any vacancy occurring in any office of the corporation shall be filled by the Board of Directors.

### The Chief Executive Officer and President

Section 6. The Chief Executive Officer and President shall be the chief executive and administrative officer of the corporation, shall have general supervision of the business of the corporation, shall see that all orders and resolutions of the Board of Directors are carried into effect and shall, in the absence of the Chairman and the Vice-Chairman, preside at all meetings of the stockholders and directors subject, however, to the right of the directors to delegate any specific powers to any other officer or officers of the corporation except such as may be by statute exclusively conferred upon the Chief Executive Officer and President. The Chief Executive Officer and President may execute all bonds, deeds, mortgages, conveyances, contracts and other instruments, except in cases where the signing and execution thereof shall be expressly delegated by the Board of Directors or by these bylaws to some other officer or agent of the corporation, or shall be required by law otherwise to be signed or executed. He shall have the power to appoint, determine the duties and fix the compensation of such agents and employees as in his judgment may be necessary or proper for the transaction of the business of the corporation. In general, he shall perform all authorized duties incident to the office of Chief Executive Officer and President and such other duties as may from time to time be assigned to him by the Board of Directors.

### The Vice Presidents

Section 7. The Vice Presidents shall perform such duties as shall be assigned to them and shall exercise such powers as may be granted to them by the Board of Directors or by the Chief Executive Officer and President of the corporation. In the absence of the Chief Executive Officer and President, the Vice Presidents, in order of their seniority (the Executive Vice President and Chief Operating Officer, if any, being deemed for this purpose to be the senior Vice President), may perform the duties and exercise the powers of the Chief Executive Officer and President with the same force and effect as if performed by the Chief Executive Officer and President. Any Vice President may sign and execute in the name of the corporation deeds, mortgages, bonds, contracts or other instruments authorized by the Board of Directors or by any duly authorized committee of directors, except in cases where the signing and execution thereof shall be expressly delegated by the Board of Directors or by any duly authorized committee of directors or by these bylaws to some other officer or agent of the corporation, or shall be required by law otherwise to be signed or executed.

## The Chief Financial Officer

Section 8. The Chief Financial Officer shall be responsible for supervision of the finances of the corporation, including all accounting matters, and shall perform such other duties and exercise such other powers as may be granted to him by the Board of Directors or by the Chief Executive Officer and President of the corporation. The Chief Financial Officer may sign all bonds, deeds, mortgages, conveyances, contracts and other instruments to the extent authorized by the Chief Executive Officer and President, or the Board of Directors, except in cases where the signing thereof shall be expressly delegated by the Board of Directors or these bylaws to some other officer or agent of the corporation, or shall be required by law otherwise to be signed.

10

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## The Secretary and Assistant Secretary

Section 9. The Secretary shall attend all meetings of the Board of Directors and all meetings of the stockholders and record all the proceedings of the meetings of the corporation and of the Board of Directors in a book to be kept for that purpose and shall perform like duties for the standing committees when required. He shall give, or cause to be given, notice of all meetings of the stockholders and special meetings of the Board of Directors, and shall perform such other duties as may be prescribed by the Board of Directors or Chief Executive Officer and President, under whose supervision he shall be. He shall have custody of the corporate seal of the corporation and he, or an Assistant Secretary, shall have authority to affix the same to any instrument requiring it and when so affixed, it may be attested by his signature or by the signature of such Assistant Secretary. The Board of Directors may give general authority to any other officer to affix the seal of the corporation and to attest the affixing by his signature.

Section 10. The Assistant Secretary, or if there be more than one, the Assistant Secretaries in the order determined by the Board of Directors (or if there be no such determination, then in the order of their election), shall, in the absence of the Secretary or in the event of his inability or refusal to act, perform the duties and exercise the powers of the Secretary and shall perform such other duties and have such other powers as the Board of Directors may from time to time prescribe.

## The Treasurer and Assistant Treasurers

Section 11. The Treasurer shall have the custody of the corporate funds and securities and shall keep full and accurate accounts of receipts and disbursements in books belonging to the corporation and shall deposit all moneys and other valuable effects in the name and to the credit of the corporation in such depositories as may be designated by the Board of Directors.

Section 12. He shall disburse the funds of the corporation as may be ordered by the Board of Directors, taking proper vouchers for such disbursements, and shall render to the Chief Financial Officer, Chairman, Vice-Chairman, Chief Executive Officer and President, and the Board of Directors, at its regular meetings, or when the Board of Directors so requires, an account of all his transactions as Treasurer and of the financial condition of the corporation.

Section 13. If required by the Board of Directors, he shall give the corporation a bond (which shall be renewed every six years) in such sum and with such surety or sureties as shall be satisfactory to the Board of Directors for the faithful performance of the duties of his office and for the restoration to the corporation, in case of his death, resignation, retirement or removal from office, of all books, papers, vouchers, money and other property of whatever kind in his possession or under his control belonging to the corporation.

Section 14. The Assistant Treasurer, or if there shall be more than one, the Assistant Treasurers in the order determined by the Board of Directors (or if there be no such determination, then in the order of their election), shall, in the absence of the Treasurer or in the event of his inability or refusal to act, perform the duties and exercise the powers of the Treasurer and shall perform such other duties and have such other powers as the Board of Directors may from time to time prescribe.

11

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## ARTICLE VI

### Capital Stock

Section 1. The shares of the corporation shall be represented by certificates, provided that the Board of Directors of the corporation may provide by resolution that some or all of any or all classes or series of its stock shall be uncertificated shares. Any such resolution shall not apply to shares represented by a certificate until such certificate is surrendered to the corporation. Notwithstanding the adoption of such a resolution by the Board of Directors, every holder of stock represented by certificates and upon request of every holder of uncertificated shares shall be entitled to have a certificate signed by, or in the name of the corporation by the Chairman or the Vice-Chairman, or the Chief Executive Officer and President or a Vice President and the Treasurer or an Assistant Treasurer, or the Secretary or an Assistant Secretary of the corporation, representing the number of shares registered in certificate form. Any or all of the signatures on the certificate may be a facsimile.

Section 2. In case any officer, transfer agent or registrar who has signed or whose facsimile signature has been placed upon a certificate shall have ceased to be such officer, transfer agent or registrar before such certificate is issued, it may be issued by the corporation with the same effect as if he were such officer, transfer agent or registrar at the date of issue.

#### Lost Certificates

Section 3. The Board of Directors may direct a new certificate of stock or uncertificated shares to be issued in place of any certificate theretofore issued by the corporation alleged to have been lost, stolen or destroyed, upon the making of an affidavit of that fact by the person claiming the certificate of stock to be lost, stolen or destroyed. When authorizing such issue of a new certificate, the Board of Directors may, in its discretion and as a condition precedent to the issuance thereof, require the owner of such lost, stolen or destroyed certificate, or his legal representative, to advertise the same in such manner as it shall require and/or to give the corporation a bond in such sum as it may direct as indemnity against any claim that may be made against the corporation with respect to the alleged loss, theft or destruction of such certificate or the issuance of such new certificate or uncertificated shares.

#### Transfers of Stock

Section 4. Transfers of shares of stock of the corporation shall be made on the record of stockholders of the corporation only upon authorization by the registered holder thereof, or by an attorney authorized by power of attorney duly executed and filed with the Secretary or with a transfer agent or transfer clerk, or upon surrender to the corporation or the transfer agent of the corporation of a certificate for shares duly endorsed or accompanied by proper evidence of succession, assignment, or authority to transfer; provided, however, that the corporation shall refuse to register any transfer of shares purchased pursuant to an exemption from registration under Regulation S unless such transfer is made in accordance with the provisions of Regulation S or pursuant to a registration statement under the Securities Act of 1933 or other exemption from registration and the corporation receives an opinion of counsel to such effect reasonably satisfactory to it.

#### Fixing Record Date

Section 5. In order that the corporation may determine the stockholders entitled to notice of or to vote at any meeting of stockholders or any adjournment thereof, or to express consent to corporate action in writing without a meeting, or entitled to receive payment of any dividend or other distribution or allotment of any rights, or entitled to exercise any rights in respect of any change, conversion or exchange of stock or for the purpose of any other lawful action, the Board of Directors may fix, in advance, a record date, which shall not be more than sixty nor less than ten days before the date of such meeting, nor more than sixty days prior to any other action. A determination of stockholders of record entitled to notice of or to vote at a meeting of stockholders shall apply to any adjournment of the meeting; provided, however, that the Board of Directors may fix a new record date for the adjourned meeting.

#### Registered Stockholders

Section 6. The corporation shall be entitled to recognize the exclusive right of a person registered on its books as the owner of shares to receive dividends, and to vote as such owner, and to hold liable for calls and assessments a person registered on its books as the owner of shares, and shall not be bound to recognize any equitable or other claim to or interest in such share or shares on the part of any other person, whether or not it shall have express or other notice thereof, except as otherwise provided by the laws of Delaware.

### ARTICLE VII

#### General Provisions

## Dividends

Section 1. Dividends upon the capital stock of the corporation, subject to the provisions of the Certificate of Incorporation, if any, may be declared by the Board of Directors at any regular or special meeting, pursuant to law. Dividends may be paid in cash, in property, or in shares of the capital stock, subject to the provisions of the Certificate of Incorporation.

Section 2. Before payment of any dividend, there may be set aside out of any funds of the corporation available for dividends such sum or sums as the directors from time to time, in their absolute discretion, think proper as a reserve or reserves to meet contingencies, or for equalizing dividends, or for repairing or maintaining any property of the corporation, or for such other purpose as the directors shall think conducive to the interest of the corporation, and the directors may modify or abolish any such reserve in the manner in which it was created.

## Annual Statement

Section 3. The Board of Directors shall present at each annual meeting, and at any special meeting of the stockholders when called for by vote of the stockholders, a full and clear statement of the business and condition of the corporation.

13

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## Checks and Deposits

Section 4. All checks or demands for money and notes of the corporation shall be signed by such officer or officers or such other person or persons as the Board of Directors may from time to time designate. All funds of the corporation not otherwise employed may be deposited to the credit of the corporation in such banks, trust companies or other depositories as the Board of Directors may from time to time select.

## Fiscal Year

Section 5. The fiscal year of the corporation shall be fixed by resolution of the Board of Directors.

## Seal

Section 6. The corporate seal shall have inscribed thereon the name of the corporation and the words "Corporate Seal, Delaware." The seal may be used by causing it or a facsimile thereof to be impressed or affixed or reproduced or otherwise.

## ARTICLE VIII

### Amendments

Section 1. These bylaws may be altered, amended or repealed or new bylaws may be adopted by the stockholders (by the affirmative vote of the holders of not less than 80% of the outstanding shares of the capital stock of the Corporation entitled to vote generally in the election of directors, considered for this purpose as one class) or by the Board of Directors, when such power is conferred upon the Board of Directors by the Certificate of Incorporation and in accordance with these bylaws, at any regular meeting of the stockholders or of the Board of Directors or at any special meeting of the stockholders or of the Board of Directors if notice of such alteration, amendment, repeal or adoption of new bylaws be contained in the notice of such special meeting.

/s/ Kenneth D. McCuskey

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Kenneth D. McCuskey, Secretary

DATED: May 5, 2004

## CONSULTING AGREEMENT

This Consulting Agreement (this "Agreement") is made as of 5 May 2004, by and between **SAUER-DANFOSS INC.**, a Delaware corporation (the "Company") and **KLAUS H. MURMANN** (the "Consultant").

The Consultant was the founder of the Company and served for many years as its Chief Executive Officer. Although the Consultant is no longer an active employee of the Company and has retired this date from Chairman of the Board of Directors to Chairman Emeritus and Director of the Company, the Consultant has considerable and valuable knowledge and experience relating to the business of the Company as a result of his prior service to the Company as an officer and employee and the Company desires to be assured of the continued availability of the advice, wisdom and management experience of the Consultant. The Consultant desires to aid and assist the Company as a consultant by providing certain limited advisory services to the Company on a standby basis.

**NOW, THEREFORE**, in consideration of the foregoing, of the mutual promises herein set forth, and of other good and valuable consideration the receipt and sufficiency of which are hereby acknowledged, the parties hereto hereby unconditionally agree as follows:

1. The Company does hereby appoint and engage the Consultant as its consultant and advisor with respect to the matters specified in Section 2 of this Agreement for the consideration hereinafter set forth. The Consultant hereby accepts his appointment and engagement by the Company as a Consultant and advisor to the Company with respect to the matters specified in Section 2 of this Agreement for the consideration hereinafter set forth.

2. During the term of this Agreement specified in Section 4 hereof (the "Term"), the Consultant shall undertake for and on behalf of, and to the extent specifically requested by the Company, subject to the availability of the Consultant and the other limitations set forth herein, to advise the Company, by telephone or in person at the Consultant's sole discretion, with respect to its business and with respect to past matters or transactions of the Company of which he has actual knowledge. The Consultant shall not be required to render any written reports to the Company with regard to the foregoing service, unless, in his sole discretion, the Consultant deems written reports to be necessary. In no event shall the Consultant be required to engage in the foregoing activity for more than twenty (20) hours in any calendar month, unless the Consultant, in his sole discretion, deems that more hours are necessary. In furnishing such advisory and consulting services, the Consultant shall not be an employee of the Company but shall act in the capacity of an independent contractor.

3. In consideration for the agreement of the Consultant to provide advisory services described in Section 2 of this Agreement, the Company shall, during the Term, at no expense to the Consultant:

(a) Provide the Consultant with the use of his current office space, furnishings and its amenities in the Company's Neumünster, Germany facilities or with equivalent office space, furnishings and amenities in the event the Company shall remodel its existing Neumünster,

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Germany facility resulting in a change of such office space or move its operations from the current facility to a new location;

(b) Provide the Consultant with secretarial support for up to 32 hours per week; and

(c) Pay or promptly reimburse the Consultant for all reasonable expenses paid or incurred by the Consultant in connection with the performance of his activities, responsibilities and services under this Agreement, upon presentation of expense statements, vouchers or other evidence of expense according to the prescribed procedure for processing expenses incurred by members of the Company's Board of Directors.

4. The Term shall commence as of the date hereof and shall terminate as of the date of the Consultant's death or in the event that he is incapable of performing his advisory services pursuant to this Agreement because of physical or mental incapacity for a period of 270 consecutive days in any twelve-month period, provided, however, that the Consultant may terminate this Agreement at any time upon giving 30 days prior written notice to the President of the Company.

5. This Agreement shall be binding upon, and shall enure to the benefit of, the Consultant and the Company and their respective successors, assigns, heirs and legal representatives, including any entity with which the Company may merge or consolidate or to which all or substantially all of its assets may be transferred.

6. This Agreement will be governed by the laws of the State of Delaware without regard to conflicts of law principles.

7. This Agreement contains the entire agreement between the parties with respect to the subject matter hereof.

8. This Agreement may be executed in one or more counterparts, each of which will be deemed to be an original copy of this Agreement and all of which, when taken together, will be deemed to constitute one and the same Agreement.

**IN WITNESS WHEREOF**, the parties have executed and delivered this Agreement as of the date first written above.

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**SAUER-DANFOSS INC.**

By: /s/ Kenneth D. McCuskey  
Kenneth D. McCuskey  
Vice President & Chief Accounting  
Officer

Print Name and Title

/s/ Klaus H. Murmann

Klaus H. Murmann

3

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**SAUER-DANFOSS INC.**

**ANNUAL MANAGEMENT PERFORMANCE  
INCENTIVE PLAN**

Amended and Restated as of March 4, 2003

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**SAUER-DANFOSS INC.**

**ANNUAL MANAGEMENT PERFORMANCE INCENTIVE PLAN**

**Amended and Restated as of March 4, 2003**

The Sauer-Danfoss Inc. Annual Management Performance Incentive Plan is designed to achieve the following objectives:

- a) Link variable pay to strategic business objectives;
- b) Create a more balanced focus on profitability and growth;
- c) Create a better line-of-sight on the measures of performance and, therefore, improve the motivational qualities of the Plan;
- d) Reward the on-going demonstration of alignment with the Company culture;
- e) Facilitate the attraction and retention of talent; and
- f) Provide a competitive compensation opportunity.

**ARTICLE I  
DEFINITIONS**

For the purposes of this Plan, the following words and phrases shall have the meaning indicated, unless a different meaning is clearly required by the context:

1. The "Plan" means this Sauer-Danfoss Inc. Annual Management Performance Incentive Plan with all amendments and supplements hereafter made.
2. The "Company" means Sauer-Danfoss Inc., a Delaware corporation, its successors, and the surviving companies or corporations resulting from any merger or consolidation of Sauer-Danfoss Inc. with any other corporation or partnership.
3. A "Subsidiary" means any corporation, partnership, limited liability company, joint venture, affiliate or other entity in which the Company, directly or indirectly, has a majority voting interest.
4. The "Executive Office" means the Executive Office of Sauer-Danfoss Inc., as the same shall from time to time exist.
5. An "Employee" shall mean any person employed by the Company or a Subsidiary in a non-officer, high executive or management position.
6. A "Participant" shall mean any Employee who is eligible to participate in the Plan as provided in Article II.

7. The "Plan Year" means the fiscal year of the Company, which as of January 1, 2002 coincides with the calendar year.
8. An "Incentive Compensation Award" shall mean the cash payment that may be awarded to a Participant pursuant to the Plan with respect to any Plan Year.

9. A “Beneficiary” shall mean the person or persons designated by a Participant in accordance with the Plan to receive payment of the Participant’s Incentive Compensation Award in the event of the death of the Participant prior to payment of the Participant’s Incentive Compensation Award.
10. The “Target Incentive Opportunity” means the percentage of the Participant’s base salary paid from the Participant’s effective date of participation through the end of the Plan Year, which will be paid if the Performance Targets are achieved. Should a Participant have periods of illness or injury during the Plan Year, payments such as sick leave or disability pay, which are paid to the Participant in lieu of base salary during those periods, will be considered as base salary for the purpose of computing Incentive Compensation Awards.
11. “Actual Market Composite Growth” shall mean the actual sales growth achieved at the end of the Plan Year for each of the market segments the Company serves as determined by external market references and approved by the Executive Office.
12. “Assumed Market Composite Growth” shall mean the projected sales growth for each Plan Year for each of the market segments the Company serves as determined at the beginning of the Plan Year and approved by the Executive Office.
13. “Performance Measures” shall mean the measurements of Profitability (Earnings Before Interest and Taxes (“EBIT”) Margin) and Sales Growth upon which a Participant’s Incentive Compensation Award will be based. These measures will be part of a performance matrix that will be communicated to Plan Participants on an annual basis.
14. “Performance Targets” shall mean the financial performance targets determined through the annual budgeting process for any Plan Year as approved by the Executive Office.
15. “EBIT Margin” (Earnings Before Interest and Taxes Margin) for the Company or for any Global Business Unit (“GBU”) shall be defined as net income adjusted to remove any income tax expense or benefit and to remove any Net Interest Expense; divided by gross revenue for the Company or the corresponding GBU.
16. “Company EBIT Margin” (Company Earnings Before Interest and Taxes Margin) is defined as EBIT Margin for the Company as determined from the year-end, audited consolidated financial statements or from the quarter-end unaudited consolidated financial statements as appropriate.

17. “GBU EBIT Margin” (Global Business Unit Earnings Before Interest and Taxes Margin) for any GBU is defined as GBU EBIT Margin for the fiscal year of the GBU as determined from internal, consolidated financial statements, which support the quarter-end and year-end audited financial statements for the Company.
18. “Sales Growth” will be measured as sales growth on a comparable basis, for the Plan Year as compared to the previous Plan Year. Sales means total third party trade sales for the Company or the GBU, as the case may be, less effects of any acquisitions.
19. “Company Sales Growth” is defined as Sales Growth for the Company as determined from the year-end, audited consolidated financial statements or from the quarter-end unaudited consolidated financial statements as appropriate.
20. “GBU Sales Growth” (Global Business Unit Sales Growth) for any GBU is defined as Sales Growth for the fiscal year of the GBU as determined from internal, consolidated financial statements, which support the quarter-end and year-end audited financial statements for the Company.
21. “Net Interest Expense” for Sauer-Danfoss Inc. or for any Global Business Unit shall be defined as interest expense, net of interest income, on interest bearing indebtedness plus minority interest expense, net of minority interest income.
22. “Participant’s Company Factor” shall mean a total Company-weighting factor, from 0% to 100%, assigned by the Executive Office to the Participant for the Plan Year. The sum of the Participant’s Company Factor plus the Participant’s GBU factor shall equal 100%.
23. “Participant’s GBU Factor” shall mean a GBU weighting factor, from 0% to 100% assigned by the Executive Office to the Participant for the Plan Year. The sum of the Participant’s Company Factor plus the Participant’s GBU Factor shall equal 100%.
24. “Permanent and Total Disability” shall have the meaning ascribed to such term in the Participant’s governing long-term disability plan.

25. "Retirement" shall mean the normal retirement date on which a Participant qualifies for full retirement benefits under the Company's qualified retirement plan, as identified by the Executive Office.

## **ARTICLE II ELIGIBILITY AND MEASUREMENT BASIS**

The Executive Office shall, in its discretion, select the Employees who are to participate in the Plan and the Chief Executive Officer shall notify such selected Employees of their selection in writing. Participation for each Employee shall be determined on an annual basis.

4

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The Executive Office shall also select the Global Business Unit, if any, that will be used to determine each Participant's Incentive Compensation Award. The Executive Office will also select the Participant's Company Factor and the Participant's GBU Factor, as defined above. Once determined by the Executive Office, in its discretion, the applicable Global Business Unit, the Participant's Company Factor and the Participant's GBU Factor will be communicated to each Participant at the same time as the selection notification.

If a Participant transfers between Global Business Units during the course of a Plan Year, the Executive Office will determine, on a case-by-case basis, the Incentive Compensation Award for such Participant for the Plan Year.

## **ARTICLE III INCENTIVE COMPENSATION AWARDS**

1. The annual Incentive Compensation Award will be determined based on a combination of Profitability and Sales Growth measures.
2. At the beginning of the Plan Year, Performance Targets are established by the Executive Office for Company EBIT Margin, GBU EBIT Margin, Company Sales Growth and GBU Sales Growth.
3. Sales Growth Performance Targets are established at the beginning of the Plan Year based on the Assumed Composite Market Growth for both the Company and GBU. At the end of the Plan Year, Actual Composite Market Growth will be determined, and Performance Targets adjusted. For example, if the Company Sales Growth Performance Target set at the beginning of the year was 10% (with an Assumed Composite Market Growth of 5%) and the Actual Composite Market Growth for the year, as determined following the end of the Plan Year, was only 1%, then the Company revenue growth performance target for the Plan Year in question shall be reduced to 6%.

The purpose of the year-end adjustment feature is to take into consideration the external market factors that may influence Sales Growth Performance for the Plan Year. It is the Company's belief that Plan Participants should not be penalized as a result of unforeseen negative conditions in the marketplace, nor should Participants receive a windfall when an unforeseen upturn in the market occurs during the Plan Year.

4. Achievement of Performance Targets will result in an Incentive Compensation Award for the Plan Year to which it relates equal to the Target Incentive Opportunity.
5. Achievement of Performance Measures exceeding target will result in an Incentive Compensation Award for the Plan Year to which it relates up to 200% of the Target Incentive Opportunity.

5

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6. Achievement of Performance Measures results below Performance Targets will result in an Incentive Compensation Award for the Plan Year to which it relates from 0% - 100% of the Target Incentive Opportunity.
7. The Incentive Compensation Target Award may be increased or decreased by as much as 20% on a discretionary basis. The degree to which the incentive awards will be adjusted, if at all, shall be determined by the Executive Office, in its discretion.

8. The Incentive Compensation Award granted to a Participant shall, based upon the extent Performance Measures are achieved in relation to Performance Targets, be paid in cash to the Participant on or before May 1 of the year following the Plan Year with respect to which such Incentive Compensation Award is granted.
9. Notwithstanding anything to the contrary contained in the Plan, subject to the approval of the Executive Office, the right of a Participant to receive an Incentive Compensation Award which has been granted but which has not been paid will be forfeited in the event the Participant's employment with the Company or any Subsidiary is terminated under circumstances other than death, Permanent and Total Disability, Retirement or other retirement under conditions of eligibility for a retirement benefit. Furthermore, if the Executive Office, in its sole discretion, determines that a Participant has engaged in activities constituting gross misconduct, the right of such Participant to be granted an Incentive Compensation Award will be forfeited.

In the event of termination due to death, Permanent and Total Disability, Retirement or other retirement under conditions of eligibility for retirement benefits, any Incentive Compensation Award which has been granted but which has not been paid will be paid to the Participant's Beneficiary or the Participant, as the case may be, on a pro rata basis as soon as practicable after the end of the Plan Year following the determination of the amount of the Incentive Compensation Award that would have been paid to the Participant had he survived or remained an employee of the Company or any Subsidiary for the entire Plan Year.

#### **ARTICLE IV ADMINISTRATION**

The Executive Office shall be responsible for the general administration of the Plan and for carrying out the provisions hereof and shall have all such powers, authorities and responsibilities expressly retained by it herein and as may be necessary to carry out the provisions of the Plan, including the power to determine all questions relating to eligibility for and the amount of an Incentive Compensation Award, all questions pertaining to claims for benefits and procedures for claim review, and the power to resolve any and all other questions arising under the Plan, including any questions of construction. The Executive Office may designate such person or persons as it shall determine to carry out any such powers, authorities or responsibilities.

6

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The actions taken and the decisions made by the Executive Office hereunder shall be final and binding upon all interested parties. The Executive Office may, as to all questions of accounting, rely conclusively upon any determination made by the independent public accountants for the Company.

#### **ARTICLE V AMENDMENT AND TERMINATION**

The Executive Office reserves the right to amend or terminate the Plan at any time by written action of the Executive Office; provided, however, that no such action shall adversely affect any Participant or Beneficiary with respect to the amount of an Incentive Compensation Award theretofore granted.

#### **ARTICLE VI MISCELLANEOUS**

1. **Nonalienation.** No Participant or Beneficiary shall in any manner encumber or dispose of the right to receive any payment of an Incentive Compensation Award hereunder. If a Participant or Beneficiary attempts to assign, transfer, alienate or encumber the right to receive the amount of an Incentive Compensation Award hereunder or permits the same to be subject to alienation, garnishment, attachment, execution or levy of any kind, then the Executive Office in its sole discretion may hold or apply such amount or any part thereof to or for the benefit of such Participant or Beneficiary, the Participant's or Beneficiary's spouse, children, blood relatives or other dependents, or any of them in such manner and in such proportions as the Executive Office may consider proper. Any such application of the amount of an Incentive Compensation Award may be made without the intervention of a guardian. The receipt by the payee shall constitute a complete acquittance to the Company with respect thereto and neither the Company nor any Subsidiary nor the Executive Office shall have any responsibility for the proper application thereof.

2. **Plan Noncontractual.** Nothing herein contained shall be construed as a commitment or agreement on the part of any person employed by the Company or a Subsidiary to continue such person's employment with the Company or Subsidiary, and nothing herein contained shall be construed as a commitment or agreement on the part of the Company or any Subsidiary to continue the employment or the annual rate of compensation of any such person for any period, and all Participants shall remain subject to discharge to the same extent as if the Plan had never been put into effect.
  3. **Interest of Participant and Beneficiary.** The obligation of the Company under the Plan to make payments of an Incentive Compensation Award merely constitutes the unsecured promise of the Company to make payments from its general assets as provided therein, and no Participant or Beneficiary shall have any interest, or a lien or prior claim upon any property of the Company or any Subsidiary.
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7

4. **Claims of other Persons.** The provisions of the Plan shall in no event be construed as giving any person, firm or corporation any legal or equitable right as against the Company or any Subsidiary, their officers, employees, or directors, except any such rights as are especially provided for in the Plan or are hereafter created in accordance with the terms and provisions of the Plan.
  5. **Facility of Payment.** If any person to whom an Incentive Compensation Award is payable is unable to care for his affairs because of illness or accident, any payment due (unless prior claim therefore shall have been made by a duly qualified guardian or other legal representative) may be paid to the spouse, parent, child, brother or sister, or any other individual deemed by the Executive Office to be maintaining or responsible for the maintenance of such person. Any payment made in accordance with the provisions of this Section 5 shall be a complete discharge of any liability of the Plan with respect to such payment.
  6. **Absence of Liability.** No member of the Board of Directors of the Company or of a Subsidiary, no member of the Executive Office, or the Chairman and Chief Executive Officer, or any officers of the Company or a Subsidiary shall be liable for any act or action hereunder, whether of commission or omission, taken by any other member, or by any officer, agent, or employee, or except in circumstances involving his bad faith, for anything done or omitted to be done by him.
  7. **Severability.** The invalidity or unenforceability of any particular provision of the Plan shall not affect any other provision hereof, and the Plan shall be construed in all respects as if such invalid or unenforceable provision were omitted herefrom.
  8. **Governing Law.** The provisions of the Plan shall be governed and construed in accordance with the laws of the State of Iowa, U.S.A.
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8

**FIRST AMENDMENT TO THE  
SAUER-SUNDSTRAND COMPANY  
SUPPLEMENTAL RETIREMENT BENEFIT PLAN  
FOR CERTAIN KEY EXECUTIVES**

**WHEREAS**, Sauer-Sundstrand Company previously adopted the Sauer-Sundstrand Company Supplemental Retirement Benefit Plan for Certain Key Executives (the "Plan"); and

**WHEREAS**, Sauer-Danfoss Inc. (the "Company") assumed sponsorship of the Plan; and

**WHEREAS**, the Company desires to amend the Plan to change the name thereof and to make certain design changes thereto;

**NOW, THEREFORE**, the Plan is hereby amended as follows, effective as of January 1, 2004:

1. The Plan is hereby renamed as the "Sauer-Danfoss Inc. Supplemental Retirement Benefit Plan for Certain Key Executives."
2. Section 2(a) of the Plan is hereby amended in its entirety to read as follows:

"(a) "Company" shall mean Sauer-Danfoss Inc. (including the predecessor Sundstrand-Sauer Company or any successor of Sauer-Sundstrand Company) or any subsidiary or other entity which, together with Sauer-Danfoss Inc., would constitute a single employer under Code Section 414, as amended."

3. Section 3 of the Plan is hereby amended in its entirety to read as follows:

"3. Supplemental Retirement Benefit.

FIRST, the benefit(s) to which the Executive is entitled under the Company Retirement Plans, exclusive of any benefits derived under the Cash Balance Account portion of the Sauer-Danfoss Employees' Retirement Plan, shall be determined.

SECOND, such benefit(s), exclusive of any benefits derived under the Cash Balance Account portion of the Sauer-Danfoss Employees' Retirement Plan, shall be determined as if the limitations of Code Sections 415 and 401(a)(17) and any provisions of such Plan incorporating such limitations, were inapplicable to those Company Retirement Plans which are defined benefit Plans.

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THIRD, the amount of the Supplemental Retirement Benefit shall be determined by subtracting the amounts determined under the second paragraph above from the amount determined under the first paragraph above.

IN WITNESS WHEREFORE, the undersigned has caused this First Amendment to be executed this 18<sup>th</sup> day of May, 2004.

SAUER-DANFOSS INC.

By: /s/ Ron Hanson

Its: VP Human Resources

**SAUER-DANFOSS INC.  
SUPPLEMENTAL EXECUTIVE SAVINGS & RETIREMENT PLAN**

**Effective January 1, 2004**

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**SAUER-DANFOSS INC.  
SUPPLEMENTAL EXECUTIVE SAVINGS & RETIREMENT PLAN**

**I. PURPOSE AND EFFECTIVE DATE.**

- 1.1. **Purpose.** The Sauer-Danfoss Inc. Supplemental Executive Savings & Retirement Plan has been established by Sauer-Danfoss Inc. to attract and retain certain key employees by supplementing such employee's retirement income, available under the Sauer-Danfoss Employees' Retirement Plan (the "ERP") and the Sauer-Danfoss Employees' Savings Plan (the "ESP"), which is otherwise limited by Sections 415 and 401(a)(17) of the Internal Revenue Code of 1986, as amended, and the regulations issued thereunder.
- 1.2. **Effective Date.** The Plan shall be effective January 1, 2004 and shall remain in effect until terminated in accordance with Article VIII.

**II. DEFINITIONS.**

When used in the Plan and initially capitalized, the following words and phrases shall have the meanings indicated:

- 2.1. **"Accounts"** means the recordkeeping accounts established for each Participant in the Plan for purposes of accounting for the amount of the Participant's Supplemental Benefit Amounts determined and credited in accordance with Article IV each year, if any, and all adjusted periodically to reflect the interest earnings or hypothetical investment return on such amounts in accordance with Article V.
- 2.2. **"Administrator"** means the Committee or such individual or committee appointed by the Committee to administer the Plan in accordance with Article VII. The Committee shall take such actions it deems necessary or desirable to ensure that such individual or committee has sufficient and appropriate authority for carrying out the intent and purpose of the Plan.
- 2.3. **"Affiliate"** means:
- (a) any corporation, partnership, joint venture, trust, association or other business enterprise which is a member of the same controlled group of corporations, trades or businesses as the Company (within the meaning of Code Section 414), and
  - (b) any other entity that is designated as an Affiliate by the Committee.
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- 2.4. **"Beneficiary"** means the person or entity designated by the Participant to receive the Participant's Supplemental Benefits Amounts in the event of the Participant's death. If the Participant does not designate a Beneficiary, or if the Participant's designated Beneficiary predeceases the Participant, the Participant's estate shall be the Beneficiary under the Plan.
- 2.5. **"Board"** means the Board of Directors of the Company.

- 2.6. **“Cash Balance Employee”** means an employee of the Company or an Affiliate whose retirement benefit under the ERP is accrued, on and after January 1, 2001, in whole or in part, under the Cash Balance Formula (as defined under the terms of the ERP).
- 2.7. **“Code”** means the Internal Revenue Code of 1986, as amended.
- 2.8. **“Committee”** means the Compensation Committee of the Board of Directors of the Company.
- 2.9. **“Company”** means Sauer-Danfoss Inc. and any successor thereto.
- 2.10. **“Compensation”** means either:
- (a) “Compensation” as that term is specifically defined under the ESP, or
  - (b) “Pay” as that term is specifically defined under the ERP,
- as the case may be, depending on the context in which it is being used under this Plan.
- 2.11. **“Eligible Employee”** means a key employee of the Company or an Affiliate who (i) is a Cash Balance Employee, and (ii) during a Plan Year is expected to have Compensation from the Company or any Affiliate in excess of the Code Section 401(a)(17) limit for such Plan Year.
- 2.12. **“ERP”** means the Sauer-Danfoss Employees’ Retirement Plan.
- 2.13. **“ESP”** means the Sauer-Danfoss Employees’ Savings Plan.
- 2.14. **“Investment Fund or Funds”** means the investment funds designated by the Administrator as the basis for determining the hypothetical investment return to be credited in accordance with Article V to Participants’ Supplemental ESP Accounts. The Investment Funds shall mirror the available investment funds under the ESP.
- 2.15. **“Participant”** means an Eligible Employee who has become a participant in the Plan in accordance with Section 3.1.

- 2.16. **“Plan”** means the Sauer-Danfoss Inc. Supplemental Executive Savings & Retirement Plan, as set forth herein and as amended from time to time.
- 2.17. **“Plan Year”** means each calendar year commencing on and after January 1, 2004.
- 2.18. **“Supplemental Benefit Amounts”** means the amounts accrued on behalf of the Participant under the Plan, if any, and represents the sum of the Participant’ s Supplemental ERP Amounts and Supplemental ESP Amounts credited to his or her Account in accordance with Article IV.
- 2.19. **“Supplemental ERP Account”** means the bookkeeping account established for purposes of accounting for the amount of the Participant’ s Supplemental ERP Amounts determined and credited in accordance with Article IV each year, if any, as adjusted periodically to reflect the interest earnings on such amounts in accordance with Article V.
- 2.20. **“Supplemental ERP Amount”** means that portion of the Supplemental Benefit Amounts determined under Section 4.1(a) of the Plan specifically pertaining to the ERP and credited to the Participant’ s Supplemental ERP Account in accordance with Article IV.
- 2.21. **“Supplemental ESP Account”** means the bookkeeping account established for purposes of accounting for the amount of the Participant’ s Supplemental ESP Amounts determined and credited in accordance with Article IV each year, if any, as adjusted periodically to reflect the hypothetical investment return or hypothetical investment loss on such amounts in accordance with Article V.

- 2.22. **“Supplemental ESP Amount”** means that portion of the Supplemental Benefit Amounts determined under Section 4.1(b) of the Plan specifically pertaining to the ESP and credited to the Participant’s Supplemental ESP Account in accordance with Article IV.
- 2.23. **“Valuation Date”** means a date on which the Investment Funds are valued and the Participant’s Account is adjusted for any resulting gains or losses. The Administrator shall determine the Valuation Date and such date shall be at least once every calendar year.

### III. PARTICIPATION.

- 3.1. **Participation.** An Eligible Employee shall become a Participant in the Plan when he or she has had credited to his or her Accounts, by the Company, Supplemental Benefit Amounts in accordance with Article IV.
- 3.2. **ERISA Exemption.** It is the intent of the Company that the Plan be exempt from Parts 2, 3 and 4 of Subtitle B of Title I of the Employee Retirement Income

Security Act of 1974, as amended (“ERISA”), as an unfunded plan that is maintained by the Company primarily for the purpose of providing deferred compensation for a select group of management and highly compensated employees (the “ERISA Exemption”). Notwithstanding anything to the contrary in Section 3.1 or in any other provision of the Plan, the Administrator may, in its sole discretion, exclude any one or more employees from eligibility to participate or from participation in the Plan, exclude any Participant from continued participation in the Plan, and take any further action (including the immediate payment of the Participant’s entire interest under the Plan in a lump-sum) it considers necessary or appropriate if the Administrator reasonably determines in good faith that such exclusion or further action is necessary in order for the Plan to qualify for, or to continue to qualify for, the ERISA Exemption.

### IV. SUPPLEMENTAL BENEFIT AMOUNTS.

- 4.1. **Computation of Supplemental Benefit Amounts.** An Eligible Employee shall be entitled to Supplemental Benefit Amounts for each Plan Year that he or she is an Eligible Employee. Such Supplemental Benefit Amount shall be equal to the sum of:
- (a) **Supplemental ERP Amount:** the excess, if any, of:
- (i) the benefit the Eligible Employee otherwise would have been entitled to have credited to his or her Cash Balance Account (as defined under the ERP) for his or her benefit under the ERP for a given year if such benefit was calculated without regard to the following:
    - 1. Code Section 415, and
    - 2. Code Section 401(a)(17), **over**
  - (ii) the benefit which the Eligible Employee is entitled to have credited to his Cash Balance Account (as defined under the ERP) for his or her benefit for such given year under the ERP, **plus**
- (b) **Supplemental ESP Amount:** the excess, if any, of:
- (i) the benefit the Eligible Employee otherwise would have been entitled to have credited to his or her Employer Contribution Account (as defined in the ESP), if any, and his or her Matching Contribution Account (as defined under the ESP), if any, for a given year if such benefit(s) was calculated without regard to the following:

- (1) Code Section 415,
  - (2) Code Section 401(a)(17),
  - (3) Code Section 401(m)(2), and
  - (4) Code Section 402(g); **over**
- (ii) the actual benefit which the Eligible Employee is entitled to have credited to a separate account for his benefit for such given year under the ESP with respect to such Employer Contributions and Matching Contributions.

Notwithstanding the foregoing, an Eligible Employee shall not be entitled to Supplemental Benefit Amounts attributable to amounts that would have been credited to his Matching Contribution Account for a Plan Year unless the Eligible Employee had elected Participant Contributions (as defined in the ESP) for such Plan Year equal to the lesser of four percent (4%) of Compensation or the limitation in effect under Code Section 402(g) for such Plan Year.

- 4.2. **Vesting.** A Participant's Supplemental Benefit Amounts calculated by the Company in accordance with Sections 4.1 above shall vest in accordance with the same vesting schedules that may exist, from time to time, in the ERP and the ESP, as the case may be.
- 4.3. **Special One Time Supplemental Benefit Amounts For Certain Participants.** Certain Eligible Employees, but for the January 1, 2004 effective date of this Plan, would have had amounts credited to their Accounts as Supplemental Benefit Amounts for certain years prior to 2004. To reflect this fact, special, one-time Supplemental ERP amounts and/or Supplemental ESP amounts will be credited to the Accounts of certain Eligible Employees. The eligibility for, timing and amount of such special, one-time Supplemental Benefit amounts pursuant to this Section 4.3 are to be determined solely at the discretion of the Administrator.
- 4.4. **Crediting of Supplemental Benefit Amounts.** The Supplemental Benefit Amounts computed in Section 4.1 above for each Plan Year shall be credited by the Company to the Participant's Accounts as soon as reasonably practicable after the close of the Plan Year to which the Supplement Benefit Amounts relate.

## V. ACCOUNTS AND INVESTMENTS.

- 5.1. **Valuation of Accounts.** The Administrator shall establish a Supplemental ERP Account and a Supplemental ESP Account for each Participant who has been credited with a Supplemental ERP Amount or Supplemental ESP Amount,

5

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respectively. Such Accounts shall be credited with a Participant's Supplemental Benefit Amounts as set forth in Sections 4.4. As of each Valuation Date, the Participant's Accounts shall be adjusted upward or downward to reflect:

- (a) the interest earnings or investment return to be credited as of such Valuation Date pursuant to Section 5.3 below,
- (b) the amount of distributions, if any, to be debited as of that Valuation Date under Article VI.

- 5.2. **Earnings and Investments.**

- (a) **Supplemental Benefit Relating to the ERP.** Supplemental ERP Accounts shall be credited with interest annually. Such interest credit shall mirror the interest credit on Cash Balance Accounts (as defined by the terms of the ERP) under the ERP. For each Plan Year, the amount credited to the Eligible Employee's Supplemental ERP Account shall be determined by multiplying the balance of such Supplemental ERP Account on the first day of the

Plan Year by the one-year Treasury bill rate in effect as of the first business day of such Plan Year, as published in the Wall Street Journal on such business day.

- (b) **Supplemental Benefit Relating to the ESP.** Each Participant generally may direct the manner in which his or her Supplemental ESP Amounts, if any, shall be deemed invested in and among the Investment Funds; provided, however, that each investment election made by a Participant shall, notwithstanding anything to the contrary in the Plan, be strictly subject to the consent of the Administrator which, in its sole discretion, may elect to honor the Participant's request or have the Supplement ESP Account deemed invested in another manner. Such deemed investment election shall be made in accordance with such procedures as the Administrator shall establish and any such election shall be made in whole percentages. The investment authority shall remain at all times with the Administrator. The selection of Investment Funds by a Participant shall be for the sole purpose of determining the rate of return to be credited to his or her Supplement ESP Account and shall not be treated or interpreted in any manner whatsoever as a requirement or direction to actually invest assets in any Investment Fund or any other investment media.

5.3. **Crediting of Interest and Investment Return.**

- (a) **Supplemental ERP Account.** As provided for in Section 5.2(a) above, interest shall be credited, on the last day of each Plan Year, to the Supplemental ERP Account of each Participant who had a Supplemental ERP Account as of the first day of such Plan Year. A Participant's Supplemental ERP Account shall continue to be credited with such

interest credits until the date on which the Participant's Accounts are paid out in accordance with Article VI.

If the date on which the Participant's Accounts are paid occurs during the applicable Plan Year, the interest credit shall be prorated on a monthly basis for that portion of the Plan Year before such payment date.

- (b) **Supplemental ESP Account.** Each Participant's Supplemental ESP Account shall be credited on each Valuation Date with his or her allocable share of investment gains or losses of each Investment Fund in which his or her Supplemental ESP Amounts, if any, are hypothetically invested. The Administrator shall adopt a protocol for allocating the deemed investment gains and losses similar to that used in the ESP.

- 5.4. **Changing Investment Fund Options for the Supplemental ESP Account.** A Participant may, as provided by the Administrator, make a new election with respect to the hypothetical Investments Funds in which his or her Supplemental ESP Amounts, if any, shall be deemed invested in the future. Any such election shall be made in the form specified by the Administrator.

**VI. PAYMENT OF BENEFITS.**

- 6.1. **Distribution Upon Termination of Employment.** If a Participant terminates employment with the Company and/or an Affiliate for reasons other than death, the vested portion of the Participant's Accounts shall be paid in a lump sum payment as soon as practicable following the Valuation Date coincident with or next following the date of such Participant's termination of employment.
- 6.2. **Distribution of Insignificant Account Balances.** The vested portion of the Participant's Accounts may be paid out in a lump sum payment at any time prior to termination of employment, if the Administrator determines, in its sole discretion, that the balances of such accounts are insignificant.
- 6.3. **Distribution Upon Death.** If a Participant dies prior to commencement of payment of his or her Accounts, the Participant's Beneficiary shall receive a survivor benefit in an amount equal to the vested portion of the Participant's Accounts to be paid in a single lump sum as soon as practicable following the Valuation Date coincident with or next following the date of the Participant's death. Notwithstanding the foregoing, a Beneficiary may request that the Administrator approve an alternate form of payment of survivor benefits under this Section 6.3, which request may be granted in the sole discretion of the Administrator.

- 6.4. **Form of Payment and Withholding.** All payments under the Plan shall be made in cash and are subject to the withholding of all applicable federal, state and local and foreign governmental taxes.

## VII. ADMINISTRATION.

- 7.1. **Authority of Administrator.** The Administrator shall have full power and authority to carry out the terms of the Plan. The Administrator may establish such rules and regulations as it may consider necessary or desirable for the effective and efficient administration of the Plan. The Administrator's interpretation, construction and administration of the Plan, including any adjustment of the amount or recipient of the payments to be made, shall be binding and conclusive on all persons for all purposes. None of the Company, the Administrator, the Board or the Committee, or any employee, director or member thereof, shall be liable to any person for any action taken or omitted in connection with the interpretation, construction and administration of the Plan.
- 7.2. **Participant's Duty to Furnish Information.** Each Participant shall furnish to the Administrator such information as it may from time to time request for the purpose of the proper administration of this Plan.
- 7.3. **Interested Employee of Administrator.** If any employee serving as Administrator is also a Participant in the Plan, he or she may not decide or determine any matter or question concerning his or her benefits unless such decision or determination could be made by him or her under the Plan if he or she were not the Administrator.
- 7.4. **Indemnification.** No person (including any present or former employee of the Administrator, and any present or former officer or employee of the Company or any Affiliate) shall be personally liable for any act done or omitted to be done in good faith in the administration of the Plan. Each present or former officer or employee of the Company or any Affiliate to whom the Administrator has delegated any portion of its responsibilities under the Plan and each present or former employee serving as Administrator shall be indemnified and saved harmless by the Company (to the extent not indemnified or saved harmless under any liability insurance or other indemnification arrangement with respect to the Plan) from and against any and all claims of liability to which they are subjected by reason of any act done or omitted to be done in good faith in connection with the administration of the Plan, including all expenses reasonably incurred in their defense if the Company fails to provide such defense. No individual serving as the Administrator shall be liable for any act or omission of any other employee serving as Administrator, nor for any act or omission upon his or her own part, excepting his or her own willful misconduct or gross neglect.
- 7.5. **Claims Procedure.**
- (a) Claims for benefits under the Plan shall be made in writing to the Administrator or its duly authorized delegate. If the Administrator or such delegate wholly or partially denies a claim for benefits, the Administrator or, if applicable, its delegate shall, within a reasonable period of time, but

no later than ninety (90) days after receipt of the claim, notify the claimant in writing or electronically of the adverse benefit determination. Notice of an adverse benefit determination shall be written in a manner calculated to be understood by the claimant and shall contain:

- (i) the specific reason or reasons for the adverse benefit determination,
- (ii) a specific reference to the pertinent Plan provisions upon which the adverse benefit determination is based,
- (iii) a description of any additional material or information necessary for the claimant to perfect the claim, together with an explanation of why such material or information is necessary, and

- (iv) an explanation of the Plan's review procedure and the time limits applicable to such procedure *including* a statement of the claimant's right to bring a civil action under section 502(a) of ERISA following an adverse benefit determination.

If the Administrator or its delegate determines that an extension of time is necessary for processing the claim, the Administrator or its delegate shall notify the claimant in writing of such extension, the special circumstances requiring the extension and the date by which the Administrator expects to render the benefit determination. In no event shall the extension exceed a period of ninety (90) days from the end of the initial ninety (90) day period. If notice of the denial of a claim is not furnished in accordance with this paragraph (a) within ninety (90) days after the Administrator or its duly authorized delegate receives it (or within one hundred and eighty (180) days after such receipt if the Administrator or its delegate determines an extension is necessary), the claim shall be deemed denied and the claimant shall be permitted to proceed to the review stage described in paragraph (b) below.

- (b) Within sixty (60) days after the claimant receives the written or electronic notice of an adverse benefit determination, or the date the claim is deemed denied pursuant to paragraph (a) above, or such later time as shall be deemed reasonable in the sole discretion of the Administrator taking into account the nature of the benefit subject to the claim and other attendant circumstances, the claimant may file a written request with the Administrator that it conduct a full and fair review of the adverse benefit determination, including the holding of a hearing, if deemed necessary by the Administrator. In connection with the claimant's appeal of the adverse benefit determination, the claimant may review pertinent documents and may submit issues and comments in writing. The Administrator shall render a decision on the appeal promptly, but not later than sixty (60) days

after the receipt of the claimant's request for review, unless special circumstances (such as the need to hold a hearing, if necessary) require an extension of time for processing, in which case the sixty (60) day period may be extended to one hundred and twenty (120) days. The Administrator shall notify the claimant in writing of any such extension, the special circumstances requiring the extension, and the date by which the Administrator expects to render the determination on review. The claimant shall be notified of the Administrator's decision in writing or electronically. In the case of an adverse determination, such notice shall:

- (i) include specific reasons for the adverse determination,
- (ii) be written in a manner calculated to be understood by the claimant,
- (iii) contain specific references to the pertinent Plan provisions upon which the benefit determination is based,
- (iv) contain a statement that the claimant is entitled to receive upon request and free of charge, reasonable access to, and copies of, all documents, records, and other information relevant to the claimant's claim for benefits, and
- (v) contain a statement of the claimant's right to bring an action under section 502(a) of ERISA.

## VIII. AMENDMENT AND TERMINATION.

The Committee may amend or terminate the Plan at any time; provided, however, that no such amendment or termination shall have a material adverse effect on any Participant's rights under the Plan accrued as of the date of such amendment or termination without such Participant's written consent. Upon termination of the Plan, the Committee may make a lump-sum payment of all benefits for all Participants at substantially the same time.

## IX. MISCELLANEOUS.

- 9.1. **No Implied Rights; Rights on Termination of Service.** Neither the establishment of the Plan nor any amendment thereof shall be construed as giving any Participant, Beneficiary or any other person, individually or as a employee of a group, any

legal or equitable right unless such right shall be specifically provided for in the Plan or conferred by specific action of the Committee or the Administrator in accordance with the terms and provisions of the Plan. Except as expressly provided in this Plan, neither the Company nor any of its Affiliates shall be required or be liable to make any payment under the Plan.

- 9.2. **No Employment Rights.** Nothing herein shall constitute a contract of employment or of continuing service or in any manner obligate the Company or any Affiliate to continue the services of any Participant, or obligate any Participant to continue in the service of the Company or Affiliate, or as a limitation of the right of the Company or Affiliates to discharge any of their employees, with or without cause.
- 9.3. **Unfunded Plan.** Nothing herein contained shall require or be deemed to require the Company to segregate, earmark or otherwise set aside any funds or other assets to provide for any payments made hereunder. Benefits hereunder shall be paid from assets which shall continue, for all purposes, to be part of the general, unrestricted assets of the Company and its Affiliates. The obligations of the Company hereunder shall be an unfunded and unsecured promise to pay money in the future. However, the Company may establish one or more trusts to assist in meeting its obligations under the Plan, the assets of which shall be subject to the claims of the Company's general creditors. No current or former Participant, Beneficiary or other person, individually or as a employee of a group, shall have any right, title or interest in any account, fund, grantor trust, or any asset that may be acquired by the Company in respect of its obligations under the Plan (other than as a general creditor of the Company with an unsecured claim against its general assets).
- 9.4. **Nontransferability.** Prior to payment thereof, no benefit under the Plan shall be assignable or subject to any manner of alienation, sale, transfer, claims of creditors, pledge, attachment or encumbrances of any kind.
- 9.5. **Successors and Assigns.** The rights, privileges, benefits and obligations under the Plan are intended to be, and shall be treated as legal obligations of and binding upon the Company, its successors and assigns, including successors by merger, consolidation, reorganization or otherwise.
- 9.6. **Payment with Respect to Incapacitated Persons.** Any amounts payable hereunder to any person who is a minor or under a legal disability, as determined under applicable state law, or who is unable to manage properly his or her financial affairs may be paid (a) to the legal representative of such person, (b) to anyone acting as the person's agent under a durable power of attorney, (c) to an adult relative or friend of the person or (d) to anyone with whom the person is residing. Any payment of a benefit made in accordance with the provisions of this section shall be a complete discharge of any liability for the making of such payment under the Plan. The Administrator's reliance on the written power of attorney or other instrument of agency governing a relationship between the person entitled to benefit the person to whom the Administrator directs payment of the benefit shall be fully protected at least to the same extent as though the Administrator had dealt directly with the person entitled to the benefit as a fully competent person. In the absence of actual knowledge to the contrary, the Administrator may assume that the instrument of agency was validly executed,

that the person was competent at the time of execution and that at the time of reliance, the agency had not been terminated or amended.

- 9.7. **Arbitration.** Any controversy or claim arising out of or relating to this Plan, or breach hereof, shall be settled by arbitration in the City of Ames in accordance with the laws of the State of Iowa with an arbitrator appointed by the Company. The arbitration shall be conducted in accordance with the rules of the American Arbitration Association, except with respect to the selection of an arbitrator. The arbitrator's determination shall be final and binding upon all parties and judgment upon the award rendered by the arbitrator may be entered in any court having jurisdiction thereof.
- 9.8. **Gender and Number.** Except when otherwise indicated by the context, words in the masculine gender shall include the feminine and neuter genders, the plural shall include the singular, and the singular shall include the plural.
- 9.9. **Headings.** The headings of the various Articles and Sections in the Plan are solely for convenience and shall not be relied upon in construing any provisions hereof. Any reference to a Section shall refer to a Section of the Plan unless specified otherwise.

- 9.10. **Severability.** Whenever possible, each provision of the Plan shall be interpreted in such manner as to be effective and valid under applicable law, but if any provision of the Plan is held to be invalid, illegal or unenforceable in any respect under any applicable law or rule in any jurisdiction, such invalidity, illegality or unenforceability shall not affect any other provision or any other jurisdiction, and the Plan shall be reformed, construed and enforced in such jurisdiction so as to best give effect to the intent of the Company under the Plan.
- 9.11. **Effect on Other Employee Benefit Plans.** Any benefit paid or payable under this Plan shall not be included in a Participant' s compensation for purposes of computing benefits under any employee benefit plan maintained or contributed by the Company or any Affiliate except as may otherwise be required under the specific terms of such employee benefit plan.
- 9.12. **Non-U.S. Participants.** With respect to any Affiliate which employs Participants who reside outside the United States, and notwithstanding anything herein to the contrary, the Administrator may, in its sole discretion, amend the terms of the Plan in order to conform such terms with the requirements of local law or to meet the objectives of the Plan, and may, where appropriate, establish one or more sub-plans to reflect such amended provisions.
- 9.13. **Applicable Law.** This Plan is established under and will be construed according to the laws of the State of Iowa, to the extent not preempted by the laws of the United States.

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12

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IN WITNESS WHEREOF, the undersigned has caused this Plan to be executed this 18<sup>th</sup> day of May, 2004.

**SAUER-DANFOSS INC.**

By: /s/ Ronald C. Hanson

Its: VP Human Resources

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13

**Certification**

I, David J. Anderson, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Sauer-Danfoss Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors:
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 6, 2004

/s/ David J. Anderson

David J. Anderson

President and Chief Executive Officer

**Certification**

I, Karl J. Schmidt, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Sauer-Danfoss Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant' s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Evaluated the effectiveness of the registrant' s disclosure controls and procedures, and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) Disclosed in this report any change in the registrant' s internal control over financial reporting that occurred during the registrant' s most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect the registrant' s internal control over financial reporting; and
5. The registrant' s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant' s auditors and the audit committee of registrant' s board of directors:
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant' s ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant' s internal control.

Date: August 6, 2004

/s/ Karl J. Schmidt

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Karl J. Schmidt

Executive Vice President and Chief Financial Officer and  
Treasurer

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CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Sauer-Danfoss Inc. (the "Company") on Form 10-Q for the period ended June 30, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, David J. Anderson, Chief Executive Officer of the Company, hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 6, 2004

/s/ David J. Anderson

David J. Anderson

President and Chief Executive Officer

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CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Sauer-Danfoss Inc. (the "Company") on Form 10-Q for the period ended June 30, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Karl J. Schmidt, Chief Financial Officer of the Company, hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: August 6, 2004

/s/ Karl J. Schmidt

Karl J. Schmidt  
Executive Vice President and Chief Financial Officer  
and Treasurer

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