UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Form 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2004 **Commission file number: 1-15603**

NATCO Group Inc.

(Exact name of registrant as specified in its charter)

Delaware **(State or other jurisdiction of incorporation or organization)**	**22-2906892** **(I.R.S. Employer Identification No.)**

2950 N. Loop West, 7th Floor, Houston, Texas 77092

(Address of principal executive offices) (zip code)

Registrant s telephone number, including area code: (713) 683-9292

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $0.01 par value per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

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 x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes x No ¨

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity as of the last business day of the registrant s most recently completed second fiscal quarter.

As of June 30, 2004	$72,943,300

Indicate the number of shares outstanding of each of the registrant s classes of common stock, as of the latest practicable date.

As of March 11, 2005	Common Stock, $0.01 par value per share	16,166,584 shares

Pursuant to Rule 12b-25 of the Securities Exchange Act of 1934, as amended, this Form 10-K does not include disclosures for Part II, Items 6, 7, 7A, 8, 9 and 9A. These items, omitted information in Parts I and IV and certain exhibits, including the complete certifications by the Chief Executive Officer and Chief Financial Officer pursuant to Rule 13a-14, will be filed by amendment.

Documents Incorporated by Reference (to the extent indicated in this report)

Specified portions of the 2005 Notice of Annual Meeting of Stockholders and Proxy Statement (Part III)

Table of Contents

NATCO Group Inc.

10-K for the Year Ended December 31, 2004

TABLE OF CONTENTS

Table of Contents

Explanatory Note

Pursuant to Rule 12b-25 under the Securities Exchange Act of 1934, as amended, our Company, NATCO Group Inc., is today filing only those parts of this Annual Report on Form 10-K that it is able to file without unreasonable effort or expense. The Company was not able to prepare complete financial statements, a management s discussion and analysis or selected financial data within the necessary period of time in order to meet the 10-K filing deadline. We are preparing financial statements, management s discussion and analysis and selected data in an effort to amend this annual report within 15 days after the date of this filing in order to include the selected financial data, management s discussion and analysis of financial condition and results of operations, financial statements and other information required by Items 1, 6, 7, 7A, 8, 9, 9A and 15 of Form 10-K, as well as certain exhibits to the filing, and thereby deem the annual report, as so amended, to have been timely filed.

Table of Contents

PART I

Item 1. *Business*

Our Business

NATCO Group Inc. is a Delaware corporation formed in 1988. Through our subsidiaries, we have designed, manufactured and marketed production equipment and systems for more than 75 years, and we are a leading provider of equipment, systems and services used in the production of crude oil and natural gas to separate oil, gas and water within a production stream and to remove contaminants. Our products and services are used in onshore and offshore fields in most major oil and gas producing regions in the world. Separation and decontamination of a production stream is needed at almost every producing well in order to meet the specifications of transporters and end users.

We design and manufacture a diverse line of production equipment including, among other items: separators, which separate wellhead production streams into oil, gas and water; heaters, which prevent hydrates from forming in gas streams and reduce the viscosity of oil; dehydration and desalting units, which remove water and salt from oil and gas; gas conditioning units and membrane separation systems, which remove carbon dioxide and other contaminants from gas streams; water processing systems, which include systems for water re-injection, oily water treatment and other treatment applications; and control systems, which monitor and control production equipment.

We operate four primary manufacturing facilities located in the US and Canada and 36 sales and service facilities, 34 of which are located in the US and Canada, and two of which are located outside of the US and Canada. We have engineering offices in the US, Canada and the UK, as well as engineered systems sales offices in the US, the UK and other international locations. We also have offices in the US and internationally from which we supply control systems, equipment and services. We believe that, among our competitors, we have one of the larger installed bases of production equipment in the industry. We have achieved our position in the industry by maintaining technological leadership, capitalizing on our strong brand name recognition and offering a broad range of quality products and services.

Recent Developments

In July 2004, the Board of Directors announced the resignation of the Company s then Chief Executive Officer effective in September 2004, and named John U. Clarke, then an independent director of the Company, as Chairman and interim CEO. The Board of Directors conducted a search for a replacement and appointed Mr. Clarke as Chief Executive Officer in December 2004.

We restructured our organization effective as of January 1, 2005 in order to improve our execution and customer focus. By organizing our business segments to better concentrate our proprietary technologies on specific end-use markets, we believe we can be more responsive to our customers needs as well as to new market opportunities. In addition, we expect to establish clearer roles and responsibilities for our senior management team with appropriate levels of accountability and performance metrics to improve execution while at the same time increasing financial transparency for our shareholders. For financial reporting purposes, commencing in 2005, we also will be allocating corporate and other expenses to each of the segments, rather than segregating these costs on a standalone basis. The new segments are Oil & Water Technologies, Gas Technologies and Automation & Controls.

The Oil & Water Technologies group includes our traditional oil and gas separation and dehydration equipment sales and related services, our extensive North American branch distribution network, and our worldwide engineered systems group, all of which are focused primarily on oil and water production and processing systems.

The Gas Technologies group includes our CO_2 membrane business, the assets and operating relationship related to our gas processing facilities in West Texas, H_2S removal technologies including Shell

Table of Contents

Paques and all other gas-related technologies that focus on removing contaminants from the gas stream.

The Automation & Controls group remains unchanged, focusing on sales of new control panels and systems which monitor and control oil and gas production, as well as field service activities including repair, maintenance, testing and inspection services for existing systems.

As a result of these changes and others, we expect to benefit from greater efficiencies and revenue growth while immediately pursuing cost reduction initiatives designed to reduce expenses by at least $10 million over the next 12-18 months, half of which are expected to be realized in 2005. These initiatives include:

The strategic repositioning of our UK-based subsidiary, Axsia part of the Oil & Water Technologies group following the restructuring and efficiency gains due to better integration of Axsia s engineering capabilities with those of NATCO s Houston-based engineering group. Approximately 50 positions are expected to be eliminated from the Axsia organization as part of this effort. As a result, we expect to be better positioned to service expanding markets in Russia, the Middle East, Latin America, Africa and Asia.

Rationalization of our manufacturing assets and North American branch network both part of the Oil & Water Technologies group following the restructuring. Manufacturing efficiencies will be achieved at our primary manufacturing facilities and elsewhere through the application of lean management techniques designed to eliminate excess manufacturing capacity, increase capacity utilization and improve productivity.

A reduction in operating expenses within the branch network will be accomplished through higher field personnel utilization rates and a general reduction of overhead costs. Additionally, we expect to achieve revenue enhancements from greater product pull through and the identification of new customer market sales opportunities.

A reduction in operating, interest and general and administrative expenses arising from improved procurement practices, inventory management, overhead reductions and working capital discipline.

As a result of these initiatives, we recorded severance and other costs in the fourth quarter of 2004, and we expect to record additional severance and other cost related to these initiatives in the first quarter of 2005. See Note 5. Closure, Severance and Other, of the Notes to our Consolidated Financial Statements included in Item 8 of this annual report. We may incur additional severance and other expenses in future periods as these initiatives become fully implemented.

During 2004 and prior years, we offered our products and services as either integrated systems or individual components primarily through three business segments:

North American Operations, also known as Traditional Production Equipment and Services, which provided standardized components, replacement parts and used components and equipment servicing, primarily in North America, and operated domestic CO_2 processing facilities;

Engineered Systems, which provided customized, large scale integrated oil, gas and water production and processing systems; and

Automation & Control Systems, which provided and serviced control panels and systems that monitor and control oil and gas production, as well as repair, testing and inspection services for existing systems.

We also separately reported corporate and other expenses in 2004 and prior periods. Because the business segment restructuring was not effective until January 1, 2005, the descriptions of our business and the financial reporting of these business segments in this report will be based on the segments in effect during 2004 (that is, North American Operations (or Traditional Production Equipment and Services), Engineered Systems and Automation & Control Systems).

Table of Contents

Our Recent History

The following summarizes our general development for the past five years.

In January 2000, we completed our initial public offering of common stock, resulting in the issuance of 5.2 million shares of common stock with net proceeds of $46.7 million. In the first and second quarters of 2000 we completed three acquisitions for a total of $17.1 million, acquiring a manufacturer of centrifugal devices used to enhance the effectiveness of separation equipment, a designer and manufacturer of water treatment separation systems specializing in hydrocyclone technology and a provider of proprietary technologies for oily water treatment and heavy metals removal from production at or near the wellhead.

In the first quarter of 2001, we acquired the shares of Axsia Group Limited, a privately held process and design company based in the United Kingdom, for approximately $42.8 million, net of cash acquired. Axsia, which specializes in the design and supply of water re-injection systems for oil and gas fields, oily water treatment, oil separation, hydrocyclone technology, hydrogen production and other process equipments systems, became part of our Engineered Systems segment. This acquisition was financed with borrowings under our 2001 term loan and revolving credit facility. This business is currently being repositioned, as indicated above.

Commencing in the fourth quarter of 2002 and continuing through 2005, we streamlined certain of our operations to decrease excess capacity and be more responsive to market trends, including the closure and consolidation of manufacturing and other facilities in Edmonton, Alberta, Canada, Covington, Louisiana and Redruth, Cornwall, UK. Furthermore, we reallocated certain internal resources, realigned our worldwide marketing group, consolidated certain engineered systems operations in the UK, and closed an engineered systems business development office in Singapore.

In December 2003, we placed into service an expansion of our gas-processing facilities in West Texas. This expansion increased our operating capacity at these facilities from 180 million cubic feet, or mmcf, per day to 367 mmcf per day. Our operating agreements for these facilities provide for daily processing minimums and annual escalations. This operation contributed significantly to earnings and cash flows in 2003 and 2004, with the increased throughput from the expansion contributing a larger percentage of our revenues and margins in 2004, compared to 2003. Our CO_2 gas-processing business, which was a component of our North American Operations segment prior to our restructuring, became a component of our Gas Technologies group in January 2005.

Available Information and Required Certifications

We are a reporting company under the Securities Exchange Act of 1934, as amended, and file reports, proxy statements and other information with the Securities and Exchange Commission. Copies of these reports, proxy statements and other information may be inspected and copied at the SEC s Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. You may also access our filings on the SEC s website at *www.sec.gov*. Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and proxy statements, as well as any amendments and exhibits to those documents, are available free of charge through our website, *www.natcogroup.com*, as soon as reasonably practicable after we file them with, or furnish them to, the SEC. We also make available, free of charge on our website and in print to any stockholder who requests, our corporate governance guidelines, the charters of our board committees and our business ethics policies. Requests for copies can be directed to Investor Relations, telephone: 713-683-9292. The information contained on our website is not incorporated by reference into this Annual Report on Form 10-K and should not be considered part of this report.

We have attached to this report, or will file by amendment, the required certifications under Section 302 of the Sarbanes-Oxley Act of 2002 regarding the quality of our public disclosures as Exhibits 31.1 and 31.2.

We have filed with the New York Stock Exchange the 2004 annual CEO certification regarding our compliance with the NYSE s corporate governance standards as required by NYSE rule 303A.12(a), as well as

Table of Contents

several interim certifications since the date of our 2004 annual filing. In our 2004 annual filing, we noted two qualifications to our certification: (1) that there was a discrepancy between the number of shares for which applications had been filed and those available for issuance and (2) that certain options had been inadvertently issued to an officer pursuant to an individual, non-stockholder approved plan. Both of these qualifications were remedied in July 2004. Our interim certifications related to changes in the Board of Directors and the composition of its committees due to the departure of our former CEO, the naming of an interim, then permanent, CEO and the naming of a new director. There were no qualifications to the most recently filed interim certification dated December 7, 2004.

Industry

Demand for oil and gas production equipment and services is driven primarily by the following: levels of production of oil and gas in response to worldwide demand; the changing production profiles of existing fields (meaning the mix of oil, gas and water in the production stream and the level of contaminants); the discovery of new oil and gas fields; the quality of new hydrocarbon production; and investment in exploration and production efforts by oil and gas producers.

We believe our oil and gas production equipment and services market continues to have significant growth potential due to the following:

Increasing demand for oil and natural gas. According to the US Department of Energy, petroleum and natural gas consumption in the United States are projected to increase through 2025, with higher consumption rates expected worldwide, driven by demand for refined products and the use of natural gas to power plants that generate electricity.

Long-term demand for oil and gas products should lead to increases in drilling activity. The number of drilling rigs operating in North America and internationally has fluctuated in recent years, depending on market conditions. The average North American rig count for 2004 was 1,559 versus 1,404 for 2003 and 1,097 for 2002, as published by Baker Hughes Incorporated. The average international rig count for 2004, 2003 and 2002 was 836, 771 and 732, respectively, as published by Baker Hughes Incorporated. We believe rig counts will increase over the intermediate term as demand for oil and gas products and services increases. With such increases, we anticipate increased demand for oil and gas production equipment and services.

Changing profile of existing production. The production profile of existing fields changes over time, either naturally or due to implementation of enhanced recovery techniques. Consequently, the mix of oil, gas, water and contaminants changes, and the production stream requires additional, more sophisticated processing equipment. Changing production profiles often require retrofitting and debottlenecking of existing production equipment, which is an area of our expertise.

Increasing focus on large-scale equipment packages and integrated systems projects. Due to the increased demand for oil and gas, oil companies are pursuing larger and more complex development projects that often require specialized production equipment. These projects may be in remote, deepwater or harsh environments, may involve complex production profiles and operations and typically involve more sophisticated equipment.

Increasing need for technology solutions. Higher specification and performance standards, environmental regulation, cost reduction requirements, desire to reduce space and weight of equipment and other similar considerations have increased demand for technology in production equipment. We believe we are a leader in process technology for upstream applications.

Table of Contents

Competitive Strengths

We believe our key competitive strengths are:

Market leadership and industry reputation. We have designed, manufactured and marketed production equipment and systems for more than 75 years. We believe that, among our competitors, we have one of the larger installed bases of production equipment in the industry. We will continue to enhance our products and services in order to meet the demands of our customers.

Technological leadership. We believe we have established a position of global technological leadership by pioneering the development of innovative separation technologies. We continue to be a technological leader in areas such as carbon dioxide separation using membrane technology, oil-water emulsion treatment using the latest electrostatic technology, seawater injection systems, complex produced oily water treatment systems and a variety of specialty applications. We hold 56 active US and equivalent foreign patents and continue to invest in research and development. Applications have been filed for eight additional patents in the US.

Extensive line of products and services. We provide a broad range of high quality production equipment and services, ranging from standard processing and control equipment to highly specialized engineered systems and fully integrated solutions, to our customers around the world. By providing a broad range of products and services to the industry, we offer our customers the time and cost savings resulting from the use of a single supplier for process engineering, design, manufacturing and installation of production and related control systems.

Experienced and focused management team. Our senior management team has extensive service in our industry with an average of over 20 years of experience. Additionally, our management team has a substantial financial interest in our continued success through equity ownership or incentives.

Financial underpinning from recurring fee business. We own certain CO_2 processing facilities in West Texas, and we operate and manage both our own facilities and those of a customer at that site. The field operator pays us a fee based on volume throughput, with daily processing minimums and annual escalations, that affords us a predictable and stable level of cash flow.

Business Strategy

Our primary objective is to maximize profitability and cash flow by maintaining and enhancing our position as a leading provider of equipment, systems, services and solutions used in the production of crude oil and natural gas. We intend to achieve this goal by pursuing the following business strategies:

Focusing on customer relationships. We believe our customers prefer to work on a regular basis with a small number of leading suppliers. We believe our size, scope of products, technological expertise and service orientation provide us with a competitive advantage in establishing preferred supplier relationships with customers. We intend to generate growth in revenue and market share by establishing new, and further developing existing, customer relationships.

Being competitively priced in our markets. Our markets are highly competitive and our customers are sensitive to the price of our products relative to those of our competitors. We believe our lean management initiatives to reduce our manufacturing, engineering and distribution costs will allow us to compete more effectively in the markets we serve.

Expanding international presence. We have operated in various international markets for more than 50 years. We intend to continue to expand internationally in targeted geographic regions, such as Latin America, the Middle East, West Africa, Southeast Asia and Russia/Central Asia. Export sales and international operations provided approximately one-third of total revenues for the year ended December 31, 2004.

Introducing new technologies and products. Since our inception, we have developed and acquired leading technologies that enable us to address the global market demand for increasingly sophisticated

Table of Contents

production equipment and systems. We will continue to pursue new technologies through internal development, acquisitions and licenses.

Providing integrated systems and solutions. We believe our integrated design and manufacturing capabilities enable us to reduce our customers production equipment and systems costs and shorten delivery times. Our strategy is to be involved in projects early, to provide the broadest and most complete scope of equipment and services in our industry and to focus on larger, sophisticated and integrated systems.

Pursuing complementary acquisitions. Our industry is fragmented and contains smaller competitors with less extensive product lines and geographic scope. We continue to review potential strategic alternatives involving companies that provide complementary technologies, enhance our ability to offer integrated systems or expand our geographic reach.

Risks Relating to Our Business

Our achievement of projected revenue targets in 2005 and beyond is dependent on our ability to successfully implement our strategic goals. We have embarked on a program to increase our revenues by 10% to be achieved through commercialization of new products, increased market penetration of existing products and greater pull-through in our branch network. If we are unable to effectively execute these plans, our revenues and earnings could be lower than projected. Further, our results of operations could be adversely affected if our business assumptions do not prove to be accurate or if adverse changes occur in our business environment, including the following areas: potential declines or increased volatility in oil and natural gas prices that would adversely affect our customers and the energy industry, reductions in rig activity, reduction in prices or demand for our products and services, general global economic and business conditions, our ability to successfully integrate acquisitions, our ability to generate technological advances and compete on the basis of our technology, the potential for unexpected litigation or regulatory proceedings and potential higher prices for products used by us in our operations.

Our achievement of cost savings targets in 2005 and beyond is dependent on our ability to successfully execute our cost reduction initiatives. In January 2005, NATCO announced cost savings initiatives of $10 million over the next 12-18 months, approximately half of which is expected to be realized in 2005. If we are unable to implement these cost initiatives, or do not achieve the anticipated savings from these initiatives, our expected earnings would be impacted.

A substantial or extended decline in oil or gas prices could result in lower expenditures by the oil and gas industry, thereby negatively affecting our revenue. Our business is substantially dependent on the condition of the oil and gas industry and its willingness to spend capital on the exploration for and development of oil and gas reserves. A substantial or extended decline in these expenditures may result in the discovery of fewer new reserves of oil and gas, adversely affecting the market for our production equipment and services. The level of these expenditures is generally dependent on the industry s view of future oil and gas prices, which have been characterized by significant volatility in recent years. Oil and gas prices are affected by numerous factors, including: the level of exploration activity; worldwide economic activity; interest rates; the cost of capital and currency exchange rate fluctuations; environmental regulation; tax policies; political requirements of national governments; coordination by the Organization of Petroleum Exporting Countries (OPEC); political environment, including the threat of war and terrorism; the cost of producing oil and gas; technological advances; changes in the supply of and demand for oil, natural gas and electricity; and weather conditions.

The dollar amount of our backlog, as stated at any given time, is not necessarily indicative of our future cash flow. Backlog consists of firm customer orders that have satisfactory credit or financing arrangements in place, for which authorization to begin work or purchase materials has been given and for which a delivery date has been indicated. We cannot guarantee the revenues projected in our backlog will be realized, or if realized, will result in profits.

Table of Contents

Occasionally, a customer will cancel or delay a project for reasons beyond our control. In the event of a project cancellation, we are generally reimbursed for our costs but typically have no contractual right to the total revenues expected from any such project as reflected in our backlog. In addition, projects may remain in our backlog for extended periods of time. If we were to experience significant cancellations or delays of projects in our backlog, our results of operations and financial condition could be materially adversely affected.

Our ability to secure and retain necessary financing may be limited. Our ability to execute our growth strategies may be limited by our ability to secure and retain reasonably priced financing. From time to time, we have utilized significant amounts of letters of credit to secure our performance, bids or milestone payments on large projects, and to provide guarantees or warranties to our customers. Outstanding letters of credit can consume a significant portion of our available liquidity under our revolving credit facilities. Some of our competitors are larger companies with better access to capital, which could give them a competitive advantage over us should our access to capital be limited. Additionally, the industry in which we compete is often characterized by significant cyclical fluctuations in activity levels that can adversely impact our financial results. Our revolving credit and term loan facilities contain restrictive loan covenants with which we are required to comply. There is no assurance our financial results will be adequate to ensure we remain in compliance with these covenants in the future, nor is there any assurance we can obtain amendments to or waivers of these covenants should we not be in compliance.

Our quarterly sales and cash flow may fluctuate significantly. Our revenues are substantially derived from significant contracts that are often performed over periods of two to six or more quarters. As a result, our revenues and cash flow may fluctuate significantly from quarter to quarter, depending upon our ability to replace existing contracts with new orders and upon the extent of any delays in completing existing projects.

Most of our contracts are fixed-price contracts that are subject to gross profit fluctuations, which may impact our margin expectations. Most of our projects, including larger engineered systems projects, are performed on a fixed-price basis. We are responsible for all cost overruns, other than any resulting from customer-approved change orders. Our costs and any gross profit realized on our fixed-price contracts will often vary from the estimated amounts on which these contracts were originally based. This may occur for various reasons, including: errors in estimates or bidding; changes in availability and cost of labor and material; and variations in productivity from our original estimates. These variations and the risks inherent in engineered systems projects may result in reduced profitability or losses on our projects. Depending on the size of a project, variations from estimated contract performance can have a significant negative impact on our operating results or our financial condition.

Our international operations may experience interruptions due to political and economic risks. We operate our business and market our products and services throughout the world. We are, therefore, subject to the risks customarily attendant to international operations and investments in foreign countries. Moreover, oil and gas producing regions in which we operate include many countries in the Middle East, Venezuela and other parts of the world, where risks have increased significantly in the recent past. We cannot accurately predict whether these risks will increase or abate. These risks include: nationalization; expropriation; war, terrorism and civil disturbances; restrictive actions by local governments; limitations on repatriation of earnings; changes in foreign tax laws; changes in banking regulations; and changes in currency exchange rates.

The occurrence of any of these risks could have an adverse effect on regional demand for our products and services or our ability to provide them. Further, we may experience restrictions in travel to visit customers or start-up projects, and may we incur added costs by implementing security precautions. An interruption of our international operations could have a material adverse effect on our results of operations and financial condition.

The occurrence of some of these risks, such as changes in foreign tax laws and changes in currency exchange rates, may have extended consequences.

7

Table of Contents

Our UK-based operations, our Japanese subsidiary and our Canadian subsidiary have made sales (as part of their ongoing businesses) and have informed us that they expect to continue making sales of equipment and services to customers in certain countries that are subject to US government trade sanctions (Embargoed Countries). In the past, these included sales to the Iraqi national oil companies permitted under the United Nations Food-for-Oil Program and to Libya. Certain US sanctions on doing business in Iraq and Libya were lifted during 2004. Sales to customers in Embargoed Countries were approximately 2% of our consolidated revenue in 2004, approximately 1% in 2003 and approximately 3.5% in 2002.

We have relied and we expect to continue to rely on a limited number of customers for a significant portion of our revenues. There have been and are expected to be periods where a substantial portion of our revenues is derived from a single customer or a small group of customers. In 2004, Kinder Morgan Energy Partners, LP and affiliates, and ChevronTexaco Corp. and affiliates respectively accounted for between 5% and 10% of our total sales, with no other customer contributing 5% or more of total sales for the year ended December 31, 2004. We had revenues of $24.2 million, or 9% of total revenues, provided by ChevronTexaco Corp. and affiliates, $18.7 million, or 7% of total revenues, provided by ExxonMobil Corporation and affiliates and $14.6 million, or 5% of total revenues, provided by BP and affiliates for the year ended December 31, 2003. We also have a number of ongoing relationships with major oil companies, national oil companies and large independent producers. The loss of one or more of these ongoing relationships could have an adverse effect on our business and results of operations.

Competition could result in reduced profitability and loss of market share. Contracts for our products and services are generally awarded on a competitive basis. Historically, the existence of overcapacity in our industry has caused increased price competition in many areas of our business. The most important factors considered by our customers in awarding contracts include: the availability and capabilities of our equipment; our ability to meet the customer s delivery schedule; price; our reputation; our technology; our experience; and our safety record.

In addition, we may encounter obstacles in our international operations that impair our ability to compete in individual countries. These obstacles may include: subsidies granted in favor of local companies; taxes, import duties and fees imposed on foreign operators; lower wage rates in foreign countries; and fluctuations in the exchange value of the United States dollar compared with the local currency. Any or all these factors could adversely affect our ability to compete and thus adversely affect our results of operations.

Liability to customers under warranties may materially and adversely affect our cash flow. We typically warrant the workmanship and materials used in the equipment we manufacture. At the request of our customers, we occasionally warrant the operational performance of the equipment we manufacture. Failure of this equipment to operate properly or to meet specifications may increase our costs by requiring additional engineering resources, replacement of parts and equipment or service or monetary reimbursement to a customer. Our warranties are often backed by letters of credit. At December 31, 2004, we had provided to our customers approximately $9.4 million in letters of credit related to performance and warranties. We have received warranty claims in the past, and we expect to continue to receive them in the future. To the extent that we should incur warranty claims in any period substantially in excess of our warranty reserve, our results of operations and financial condition could be materially and adversely affected.

Our ability to attract and retain skilled labor is crucial to our profitability. Our ability to succeed depends in part on our ability to attract and retain skilled manufacturing workers, equipment operators, engineers and other technical personnel. Our ability to expand our operations depends primarily on our ability to increase our labor force. Demand for these workers can fluctuate in line with overall activity levels within our industry. A significant increase in the wages paid by competing employers could result in a reduction in our skilled labor force, increases in the rates of wages we must pay or both. If this were to occur, the immediate effect would be a reduction in our profits and the extended effect would diminish our production capacity and profitability and impairment of our growth potential.

Table of Contents

Future acquisitions, if any, may be difficult to integrate, disrupt our business and adversely affect our operating results. We intend to consider and, if feasible, to make strategic acquisitions of other companies, assets and product lines that complement or expand our existing businesses. We cannot assure you we will be able to successfully identify suitable acquisition opportunities or to finance and complete any particular acquisition. Furthermore, acquisitions involve a number of risks and challenges, including: the diversion of our management s attention to the assimilation of the operations and personnel of the acquired business; possible adverse effects on our operating results during the integration process; potential loss of key employees and customers of the acquired companies; potential lack of experience operating in a geographic market of the acquired business; an increase in our expenses and working capital requirements; and the possible inability to achieve the intended objectives of the combination. Any of these factors could adversely affect our ability to achieve anticipated levels of cash flow from an acquired business or realize other anticipated benefits of an acquisition.

Our insurance policies may not cover all claims against us or may be insufficient in amount to cover such claims. Some of our products are used in potentially hazardous production applications that can cause personal injury; loss of life; damage to property, equipment or the environment; and suspension of operations. We maintain insurance coverage against these and other risks associated with our business in accordance with standard industry practice. This insurance may not protect us against liability for some kinds of events, including events involving pollution, losses resulting from business interruption or acts of terrorism or damages from breach of contract by the Company or based on alleged fraud or deceptive trade practices. We cannot assure you our insurance will be adequate in risk coverage or policy limits to cover all losses or liabilities that we may incur. Moreover, we cannot assure you we will be able in the future to maintain insurance at levels of risk coverage or policy limits that we deem adequate. Any future damages caused by our products or services that are not covered by insurance or are in excess of policy limits could have a material adverse effect on our business, results of operations and financial condition.

We may incur substantial costs to comply with our environmental obligations. In our equipment fabrication and refurbishing operations, we generate and manage hazardous wastes. These include: waste solvents; waste paint; waste oil; wash-down wastes; and sandblasting wastes. We attempt to identify and address environmental issues before acquiring properties and to utilize industry accepted operating and disposal practices regarding the management and disposal of hazardous wastes. Nevertheless, either others or we may have released hazardous materials on our properties or in other locations where hazardous wastes have been taken for disposal. We may be required by federal, state or foreign environmental laws to remove hazardous wastes or to remediate sites where they have been released. We could also be subjected to civil and criminal penalties for violations of those laws. Our costs to comply with these laws may adversely affect our earnings.

Post-retirement health care benefits that we provide to certain retirees of a predecessor company expose us to potential increases in future cash outlays that we may not recoup through increased premiums. We are obligated to provide post-retirement health care benefits to a group of retirees of a predecessor company who retired before June 21, 1989. For the year ended December 31, 2004, our cash costs related to these benefits were $1.9 million. At that date, there were 751 retirees and surviving eligible dependents covered by the specified post-retirement benefit obligations. As of December 31, 2004, our accumulated pre-tax post-retirement benefit obligation was calculated to be approximately $13.5 million as determined by actuarial calculations. The costs of the actual benefits could exceed those projected, and future actuarial assessments of the extent of those costs could exceed the current assessment. Inflationary trends in medical costs may outpace our ability to recoup these increases through higher premium charges, benefit design changes or both. As a result, our actual cash costs of providing this benefit may increase in the future and could have a negative impact on our future cash flow.

While we believe we currently have adequate internal control procedures in place, we are still exposed to increased costs and risks associated with complying with corporate governance and disclosure standards. We are evaluating our internal controls systems in order to allow management to report on, and our

Table of Contents

Registered Independent Public Accounting Firm to attest to, our internal controls, as required by Section 404 of the Sarbanes-Oxley Act. We prepared a plan of action for our 2004 compliance and we performed the system and process evaluation and testing required in an effort to address the management certification and auditor attestation requirements of Section 404. To that end, we have incurred significant added expenses and diverted a substantial amount of management s time. We also are developing a sustainment program for future Section 404 compliance. We believe we have implemented the requirements relating to internal controls and all other aspects of Section 404 for 2004, and are evaluating our internal control procedures. We cannot be certain the result of any of these actions will be adequate to assure our compliance with the applicable requirements, given that there is not precedent available by which to measure compliance adequacy. If we are not able to implement the requirements of Section 404 with adequate compliance, we might be subject to punitive actions by regulatory authorities, such as the Securities and Exchange Commission or the New York Stock Exchange. The effect of any action by the regulatory authorities on us is unknown at this time.

Operations

We restructured our organization effective as of January 1, 2005 in order to improve our execution and customer focus. The new business segments are Oil & Water Technologies, Gas Technologies and Automation & Controls. The Oil & Water Technologies group includes our traditional oil and gas separation and dehydration equipment sales and related services, its extensive branch distribution network, and NATCO s worldwide engineered systems group, all of which are focused primarily on oil and water production and processing systems. The Gas Technologies group includes our CO_2 membrane business, the assets and operating relationship related to our gas processing facilities in West Texas, H_2S removal technologies including Shell Paques and other gas-related technologies that focus on removing contaminants from the gas stream. The Automation & Controls group remains unchanged, focusing on sales of new control panels and systems which monitor and control oil and gas production, as well as field service activities including repair, maintenance, testing and inspection services for existing systems. For financial reporting purposes, beginning in 2005, we also will be allocating corporate and other expenses to each of the segments, rather than segregating these costs on a standalone basis.

During 2004 and prior years, we offered our products and services primarily through three business segments: North American Operations, Engineered Systems and Automation & Controls. We also reported corporate and other expenses in 2004 and prior periods on a standalone basis, rather than allocating these expenses to the business segments. The North American Operations segment provided standardized components, replacement parts and used components and equipment servicing, primarily in North America, and operated domestic CO_2 separation facilities. The Engineered Systems segment provided customized, large scale integrated oil, gas and water production and processing systems. The Automation & Control Systems segment provided and serviced control panels and systems that monitor and control oil and gas production, as well as repair, testing and inspection services for existing systems.

Because the segment restructuring did not become effective until January 1, 2005, the descriptions of our business and the financial reporting of our segments in this report will be based on the segments as in effect during 2004. For financial data relating to our business segments, see Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations. For a discussion of each segment s revenues from external customers, profit (loss) and total assets for the past three fiscal years, see Note 19, Industry Segments and Geographic Information in the Notes to our Consolidated Financial Statements included in Item 8 of this report.

North American Operations

North American Operations consists of production equipment, replacement parts, and used equipment refurbishing and servicing, which is sold primarily onshore in North America and in the Gulf of Mexico. Through our NATCO Canada subsidiary, we provide traditional production equipment with modifications to

Table of Contents

operate in a cold weather environment. The equipment built for the North American oil and gas industry are off the shelf items or are customized variations of standardized equipment requiring limited engineering. We market traditional production equipment and services through 34 sales and service centers in the United States and Canada, one in Mexico and one in Venezuela.

Our production equipment includes:

Separators. Separators are used for the primary separation of a hydrocarbon stream into oil, water and gas. In addition to traditional separator solutions, we offer customers new separation technologies like the Whirly Scrub Recycling Separators and Revolution Inlet Devices. The new separation technologies use proprietary devices inside vessels to achieve more efficient separation. This translates into smaller and lighter process equipment, including the ability to retrofit existing facilities to increase processing throughput. Customers benefit from the use of Porta-Test® Revolution tubes, perforated baffles and other proprietary internals that allow separation systems to be designed for specific needs, reduce size and weight, improve separation efficiency, and eliminate process problems like foaming. Our separator product line includes:

Horizontal separators, used to separate hydrocarbon streams with large volumes of gas, liquids or foam;

Vertical separators, used to separate hydrocarbon streams containing contaminants including salt and wax;

Filter separators, used to remove particulate contaminants from gas streams and/or to coalesce liquids;

Thermo Pak Units, used for the combined heating and separating of production in cold climates; and

Whirly Scrub V centrifugal separators, used as state-of-the-art compact scrubbers.

Heaters. Heaters are used to reduce the viscosity of oil to improve flow rates and to prevent hydrates from forming in gas streams. We manufacture both standardized and customized direct and indirect fired heaters. In each system, heat is transferred to the hydrocarbon stream through a medium such as water, water/glycol, steam, salt or flue gas. Our heater product line includes:

Indirect fired water bath heaters;

Vaporizers used to vaporize propane and other liquefied gases;

Salt bath heaters used to heat high pressure natural gas streams to elevated temperatures above that obtained with indirect heaters;

Steam bath heaters; and

Controlled Heat Flux (CHF) heaters, which use flue gas to create a heat transfer medium.

Oil Dehydration Equipment. Oil dehydrators are used to remove water from oil. Our oil dehydration product line includes:

- Horizontal PERFORMAX® treaters, which separate oil and water mixtures using gravity and proprietary technology;

- Dual Polarity® and Electrodynamic Desalting electrostatic treaters, which dehydrate oil using high voltage electrical coalescence;

- Vertical treaters, which separate oil and water using gravity and heat;

- Vertical Flow Horizontal (VFH) processors, which combine the advantages of horizontal and vertical vessels to remove gas and water from oil streams; and

- Heater-treaters, which use heat to accelerate the dehydration process.

Table of Contents

Gas Conditioning Equipment. Gas conditioning equipment removes contaminants from hydrocarbon and gas streams. Our gas conditioning equipment includes:

Cynara® membranes, which extract carbon dioxide from gas streams;

Glycol dehydration equipment, which uses glycol to absorb water vapor from gas streams;

Amine systems, which use amine to remove acidic gases such as hydrogen sulfide and carbon dioxide from gas streams;

Glymine® units, which combine the effects of glycol equipment and amine systems;

Paques and Shell-Paques licensed desulfurization technology, which utilizes a biological system to efficiently take hydrogen sulfide out of gas streams; and

DESI-DRI® Systems, which use highly compressed drying agents to remove water vapor from gas streams.

Gas Processing Equipment. We offer standard and custom processing equipment for the extraction of liquid hydrocarbons to meet feed gas and liquid product requirements. We manufacture several standard mechanical refrigeration units for the recovery of salable hydrocarbon liquids from gas streams. Low Temperature Extractor (LTX®) units are mechanical separation systems designed for handling high-pressure gas at the wellhead. These systems remove liquid hydrocarbons from gas streams more efficiently and economically than other methods.

Carbon Dioxide Field Operations. We also provide gas-processing facilities for the removal of carbon dioxide from hydrocarbon streams. These facilities use our proprietary Cynara® membrane technology that provides one of the more effective separation solutions for hydrocarbon streams containing carbon dioxide. The primary market for these facilities is production from wells such as those located in West Texas in which carbon dioxide injection is used to enhance the recovery of oil reserves. Utilizing this technology, we have entered into separate service agreements with Kinder Morgan CO_2 Company, L.P. relative to gas processing of production at the Sacroc field in West Texas. Each contract has a term of ten years and is automatically renewed for successive one-year periods, unless either Kinder Morgan or we provide the other party with prior written notification of cancellation. Currently the earliest contract expiration date is set for July 2012.

Water Treatment Equipment. We offer a complete line of water treatment and conditioning equipment for the removal of contaminants from water extracted during oil and gas production. Our water treatment equipment includes:

VersaFlo single cell flotation, used to reduce oil and gas emissions from water;

TriPack Corrugated Plate Interceptors, used to remove oil and salable hydrocarbons from water;

Oilspin AV and AV*i* liquid/liquid hydrocyclones, compact centrifugal separation devices used in primary water treatment applications;

Tridair Sparger Gas Flotation units, used as secondary water cleanup systems;

PowerClean Nutshell Filters, used where tertiary water cleanup is required; and

PERFORMAX® Matrix Plate Coalescers, used both in primary separation and final skimming applications.

Equipment Refurbishment. We source, refurbish and integrate used oil and gas production equipment. Customers that purchase this equipment benefit from reduced delivery times and lower equipment costs relative to new equipment. The used equipment market is focused primarily in North America, both onshore and offshore, although we have observed a growing interest internationally. We believe that we have one of the larger databases in the North American oil and gas industry of available surplus production equipment. This database, coupled with our extensive refurbishing facilities and experience, enables us to respond to customer requests for refurbished equipment quickly and efficiently.

Table of Contents

Parts, Service and Training. We provide replacement parts for our own equipment and for equipment manufactured by others. Each branch of our marketing network also serves as a local parts and service business. We offer operational and safety training to the oil and gas production industry, which provides a marketing tool for our other products and services.

Engineered Systems

We design, engineer and manufacture engineered systems for large production development projects throughout the world and provide start-up services for our engineered products. Engineered systems typically require a significant amount of technology, engineering and project management.

We market engineered systems through our direct sales forces