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New Rec: Hanover Compressor (HC-\$26.10) August 29, 2001

Position: Sell Target: \$13 Timing: 2 (1=aggressive; 5=cautious)

\$000	Q2 01a	Q3 01e	Q4 01e	Q1 02e	FY 01e	FY 02e
Revs	263,078	261,020	315,453	323,853	1,059,315	1,344,394
EPS\$	0.31	0.36	0.41	0.40	1.36	1.71
Y/Y%	56%	56%	53%	43%	54%	26%
PE					19.22	15.26
PSR					1.95	1.54
Consensus	NA	0.36	0.41	0.43	1.36	1.71

Shares Out: 79.2M

Market Cap: \$2.1B

FYE: Dec.

Summary: Hanover Compressor owns and operates a fleet of compressors that are used during the natural gas gathering and delivery cycle. Rental of equipment is the company's main business, but it also fabricates and sells units and parts. Hanover is by far the largest player focused on gas compression. Compression

growth is higher when marginal, low pressure wells are being exploited due to high prices, as has been the case recently. Hanover's rental business has been boosted additionally by the trend toward outsourcing of the compression function by gas producers.

Gas compression is capital intensive. Equipment is expensive and needs frequent maintenance and rebuilding about every five to seven years. Many companies have been willing to offload their compression needs to Hanover and others in order to preserve capital. An analysis of Hanover's cash flow statements helps explain the trend toward outsourcing.

In fiscal 2000 Hanover reported \$59M in net income, \$7M in operating cash flow, and a negative \$260M in free cash flow. In just the first half of 2001. Hanover reported \$42M of income, \$20M of operating cash flow, and a negative \$165M in free cash flow. From 1995 to 2000 the company used \$796M in cash to generate reported income of just \$157M. It appears that Hanover's business requires about \$4 to \$5 of cash to generate each \$1 of reported net income.

Hanover's consistent negative free cash flow raises an important issue. Does Hanover make money? The answer appears to be that it does not. It appears that the only way that investors would ever see any money out of their investment in HC would be if the company liquidated. However, the company is such a large player and its inventory of equipment is so large that it would be difficult to realize its book value. Hanover is a classic cash trap for investors. No wonder that production companies are so willing to divest this equipment and the function and to give the business to Hanover instead. This is not a good use of their money.

Nevertheless, Hanover does report earnings, even if it does not make money. However, even in the reporting of earnings there appears to be a serious problem. Because Hanover must constantly raise cash to fund its equipment and its operations, the company needs financing. Since 1998 the company has used sale-leaseback arrangements to fund equipment needs and operations. Under the terms of these sale-leaseback arrangements the company sells the equipment to an entity created for the purpose at a price that is in excess of the book value of the equipment. At the same time, the company guarantees the residual value of the equipment to the entity. In recent transactions the lease term is about five years and the residual guarantee is about 83% of the sales price and about 103% of book value.

The benefit of the sale-leaseback versus financing the equipment and keeping it on the balance sheet is substantial to the company. Sale-leasebacks do not require the company to record the depreciation on the equipment. If the equipment remained on the books it would have the depreciation expense. We

estimate that the difference to the company's reported earnings is that reported earnings are about 20% higher than they would be if Hanover had to record the depreciation, as we explain in detail below.

The problem is that Hanover's use of sale-leasebacks does not appear to qualify for sale-leaseback treatment under generally accepted accounting rules, in our opinion. We go into the accounting literature in detail below, but, fundamentally, the test of whether a sale-leaseback is appropriate is whether the risks and rewards of ownership have been transferred to the buyer. If it has not been transferred to the buyer, then the transaction does not qualify as a sale-leaseback and is a financing arrangement. An analysis of the sale-leaseback terms used by Hanover, including the residual guarantee at about 83% of the sale price and 103% of book after five years, would seem to preclude Hanover's use of sale-leasebacks. The risks and rewards of ownership do not appear to have been transferred to the new owner.

It is also notable that for tax purposes in 1999 and in 2000 Hanover has paid the government only about 5% of its reported provision for taxes for financial purposes. In other words, there is a huge gap between income for tax purposes and income reported to investors. Which is the real result?

There are other problems. About \$725M of debt is off balance sheet. There are huge off balance sheet liabilities as a result of the sale-leaseback deals. These are, in effect, large balloon payments that will soon come due. It is hardly conceivable that Hanover will not have to buy these assets back or refinance them. We estimate balloon payments of \$167M in 2002, \$166M in 2004 and \$308M in 2005. Where will the money come from?

Gas prices are under pressure. Gas prices as we write are down to about \$2.40, and many knowledgeable industry consultants are predicting gas prices around \$2.80 for the next couple of years. They could even be too optimistic. The impact of lower gas prices on Hanover should be quite negative. The reason is that, as we pointed out earlier, compression is needed when natural gas pressure is not adequate to move the gas. This is a far more prevalent problem in marginal wells that are in fields where pressure is low and in wells that are depleted. These marginal wells will be the first to be shuttered as a result of lower gas prices. Large recent finds have plenty of pressure. As result of lower gas prices we should see less demand for gas compression. In addition, rental prices, which had increased in the last couple of years, should now decrease.

As a result, in addition to all its other problems, we expect that Hanover will be unable to meet top line revenue expectations, and will miss even the low quality earnings estimates that are prevalent. We expect earnings shortfalls early in

2002.

In our view, the shares should sell at no more than 1X sales, or at about 12X earnings adjusted to take into account depreciation. By way of comparison, United Rentals (NYSE: URI) sells at 0.78X sales, at 1.12X book, at 12X FY 01 and 10X FY 02 consensus EPS. Were HC shares to sell in line with URI, the share price would be less than \$13. Book value of HC shares is \$10.24.

Discussion:

Background:

Hanover Compressor operates a fleet of gas compression equipment with an aggregate capacity of approximately 2.5 million horsepower as of June 30, 2001. The company also sells compressor parts, services, and equipment as well as oil and gas production products.

Compression Rentals and Fabrication: Typically, compression is required during the natural gas gathering, transportation, and production cycles. Overall, the amount of compression deployed is driven by both gas demand growth and by the incremental amount of compression required to produce gas. As wells deplete, more compression is required to maintain production, primarily in marginal wells. These marginal wells are less profitable to operate and, as a result, may be taken offline in the event gas prices decline.

Growth of rental compression capacity in the US market is driven by the trend toward outsourcing compression services by energy companies, increasing gas demand, and the deterioration of well pressure. As gas wells deplete, more wells must be tapped to maintain production levels, leading to more demand for compression equipment. Recently, gas prices attained historic highs and producers have been running at maximum capacity, significantly increasing the amount of marginal low pressure wells in operation.

Hanover's most significant segment is its compression equipment rental unit. Rental revenue grew from \$193M in 1999 to \$255M in 2000, significantly supplemented by acquisitions. In the first six months of 2001, this segment accounted for \$170M of the company's \$483M of revenues and \$113M of the company's \$190M of gross margin. This segment generally generates gross margins around 65%. Note, however, that Hanover excludes depreciation when calculating its cost of sales for the rental segment.

About 67% of Hanover's rental revenues and 81% of its horsepower are in the US. The international market is growing, but still accounts for a small portion

of total compression. It is also very difficult to grow the international business consistently as local areas must be aggressively staffed with personnel to operate and maintain rental compressor equipment.

Compressor Fabrication: Revenues have increased from \$53M in 1999, to \$97M in 2000, and to \$112M for the first six months of 2001. Sales of compressors are dependent on the need for compressors in the field, offset by additional rental units deployed. Growth in this segment has been fueled by acquisition as well as by organic growth.

Due to its technical nature, a dedicated local parts inventory, a diversified fleet of natural gas compressors, and a highly trained staff of field service personnel are necessary to run compression equipment. These requirements have typically proven to be an inefficient use of capital and manpower for natural gas producers and have caused companies to increasingly outsource their non-core compression activities to companies such as Hanover and Universal Compression.

Compression Parts & Services: This business is dependent on the need to repair and service compressors in the field. Hanover has grown Parts & Services revenues significantly from \$43M in 1999 to \$152M in 2000. Revenues for Parts & Services are continuing to increase and the division provided \$104M of revenue in the first six months of 2001. Revenues from this business are lumpy as the company sometime experiences large amounts of pass through revenues. Over time, we expect this business to grow consistent with the growth of compression in the field. Revenues from this segment have been fueled by both acquisition and organic growth.

Oil & Gas Production Equipment Products: Most oil and gas must be refined before it can be transported to market. Oil and gas production equipment is utilized to separate and treat such oil and gas immediately after it is produced in order to facilitate further processing, transportation, and sale of such fuels. The primary driver of demand for oil and gas production equipment is the growing consumption of natural gas. Natural gas demand growth averages 2%-3% per year. Results from this segment appears to be highly dependent on commodity prices.

1. Poor quality of earnings

a. "Sale leaseback" accounting treatment does not appear to reflect the substance of the transactions nor does it appear to comply with US GAAP, in our opinion.

Schedule of sale-leasebacks (5 year terms):

Lease Date	Sales price	Book basis	Deferred gain	Residual Value Guarantee	Residual Value % of proceeds	Residual value % of book
July 1998	200,000	158,007	41,993	167,000	83.5%	105.7%
June 1999	200,000	162,014	37,986	166,000	83.0%	102.5%
March 2000	200,000	162,522	37,478	166,000	83.0%	102.1%
October 2000	172,589	134,918	37,671	142,299	82.4%	105.5%
Total	772,589	617,461	155,128	641,299	83.0%	103.9%

HC sells its rental assets to Hanover Equipment Trust(s) (buyer-lessor or “Trusts”), then leases the assets back, treating them as operating leases for financial statement purposes and capital leases for tax purposes. In conjunction with the sale-leasebacks, HC guarantees the Trusts an approximate 83% residual value at the end of these five year leases. These leases effectively allows Hanover to avoid financial statement depreciation expense during the lease period, boosting reported profits. We calculate the P&L benefit as follows:

Analysis of sale leaseback impact on P&L:

Lease date	A Sale leaseback proceeds	B Guaranteed residual value	Estimated annual avoided depreciation expense	Annual operating lease principle pay-down (in P&L)= (A-B)/5	Annual Favorable P&L impact
*Jun-98	200,000	167,000	12,698	6,600	6,098
Jul-99	200,000	166,000	12,698	6,800	5,898
Mar-00	200,000	166,000	12,698	6,800	5,898
Oct-00	172,589	142,299	10,958	6,058	4,900
1-Aug	550,000	641,299	34,921	18,700	16,221

*- this lease will be refinanced with the August 1st lease.

** - assumes equal contributions in each year to principle financed.

Earnings impact of sale-leaseback transactions:

	1998	1999	2000	Q1 00	Q2 00	Q3 00	Q4 00	Q1 01	Q2 01
Reported pre-tax income	49,636	63,586	93,470	17,555	20,083	25,015	30,817	30,312	37,736
Pre-tax impact of sale leasebacks	3,557	9,539	18,137	3,491	4,474	4,474	5,699	5,699	5,699
Pre-tax adjusted net income	46,079	54,047	75,333	14,064	15,609	20,541	25,118	24,613	32,037
Transactions contributed an extra	8%	18%	24%	25%	29%	22%	23%	23%	18%

*- based on OWS estimates and available information- impact straight-lined over life of transactions for purposes of this calculation.

As is shown above, we estimate that “sale leasebacks” allowed Hanover to boost its pre-tax income by 8% in 1998, 18% in 1999, 24% in 2000, 20% for the

first six months of 2001. These transactions will continue to impact results through the end of the lease terms. The company has also recently announced another sale-leaseback transaction, which will generate \$550M of “sale” proceeds. The terms of the new transactions are expected to be for 7 and 10 years. Based on similar residual value guarantees and use of the proceeds, we estimate that these transactions will boost HC's pre-tax income by a \$15M per year annual rate in the last six months of 2001.

Overall, we estimate that the company's use of “sale leaseback” transactions will allow it to boost pre-tax earnings by \$26M, or by \$0.20 per share in 2001 and by \$33M, or by \$0.25 per share in 2002. These estimates appear to be in line with at least one bullish analyst's estimates that these transactions benefit earnings by about 20%.

In our opinion, in substance, these assets are still owned by Hanover. Our research of the applicable accounting literature identified multiple instances of guidance that appear to preclude Hanover from treating these transactions as “sale-leasebacks”.

According to SFAS 98 “Sale Leaseback Transactions”, a sale-leaseback does not qualify for sale-leaseback accounting by the seller lessee if the seller lessee has any kind of continuing involvement. For purposes of these transactions, continuing involvement can mean, among other things, that 1) the buyer-lessor can compel the seller-lessee to repurchase the property, 2) the seller-lessee guarantees the buyer-lessor's return on investment, or 3) the seller-lessee is required to pay the buyer-lessor at the end of the lease term for a decline in the fair value of the property below the estimated residual value. Based on this, Hanover has continuing involvement in conjunction with the “sales” of these assets.

Also, according to EITF 95-1 “Revenue recognition on sales with a guaranteed minimum resale value”, “a manufacturer is precluded from recognizing a sale of equipment if the manufacturer guarantees the resale value of the equipment to the purchaser. Rather, the manufacturer should account for the transaction as a lease”. “A guaranteed residual value, for purposes of consideration, can consist of either obligations to reacquire the equipment at the guaranteed price at specified time periods, or to pay the purchaser for the deficiency, if any, between the sales proceeds received for the equipment and the guaranteed minimum resale value”.

By guaranteeing the residual value, it seems clear that the risks and rewards of ownership are not transferred to the Trusts. One recent confirmation of this assertion was the refinancing of the 1998 lease. Hanover has clearly retained the fiduciary benefits and control that come with asset ownership. As such, we think

that Hanover should be precluded from recognizing these transactions as sale-leasebacks.

Hanover benefits from its treatment of these transactions in three major ways. The company 1) avoids depreciating its equipment, 2) creates the perception of a more positive free cash flow, and 3) avoids showing its real debt obligation on its balance sheet. Hanover plans to record a gain on these transactions at the end of the term. The guaranteed residual value is on average, 104% higher than the book basis of the equipment. In addition, we think that proceeds from these transactions should be included in the financing section of the cash flow, instead of the investment section. Basically, in our opinion, these transactions should not allow Hanover to either recognize income statement benefits or gross down its balance sheet.

There are certain accounting standards that allow sale-leaseback transactions with certain qualifying special purpose entities. However, companies should be held to high standards with respect to accounting for transactions with such entities. In addition, these entities should be consolidated unless they meet stringent guidelines under the accounting standards. It is unclear as to whether Hanover considers the Hanover Equipment Trusts to be special purpose entities. However, based on the information we have, we think that these would not meet the criteria for qualifying as special purpose entities. In any event, Hanover would still have to meet the applicable criteria for the transactions to be treated as sale-leasebacks before the substance of the entity would even be considered.

We think the applicable specific accounting literature would preclude Hanover from recognizing these transactions as sale-leasebacks. Even more important, at a higher level of accounting, the substance of the transactions should take precedent over the form. According to Accounting Principles Board Statement 4, Substance Over Form, “although financial accounting is concerned with both the legal and economic effects of transactions and other events and many of its conventions are based on legal rules, the economic substance of transactions and other events are usually emphasized when economic substance differs from legal form”.

b. Free cash flow:

For press release purposes, the company presents cash flow as income before taxes, interest expense, leasing expense, distributions on preferred stock, and depreciation. In our opinion, this is an inappropriate way to view cash flow, especially in such a capital intensive business.

Free cash:

	1996	1997	1998	1999	2000	2001 cr	Total
Net income	10,223	17,642	30,529	39,978	58,699	84,066	241,137
Company definition of cash flow	44,269	67,852	104,679	132,077	206,678	288,106	843,661
Operating cash	20,276	32,219	31,147	68,222	7,133	38,966	197,963
CapEx	(83,598)	(150,995)	(169,498)	(282,940)	(268,103)	(368,170)	(1,323,304)
Free Cash	(63,322)	(118,776)	(138,351)	(214,718)	(260,970)	(329,204)	(1,125,341)
Diluted shares	44,046	54,690	60,182	61,054	71,192	77,557	NA
Free cash/share	(1.44)	(2.17)	(2.30)	(3.52)	(3.67)	(4.24)	NA

*- 2001 projected at current net income and cash flow information for first 6 months of 2001.

Since 1996, HC has consistently increased its reported net income, even while being increasingly free-cash negative. While net income increased from \$10M in 1996 to \$59M in 2000, negative free cash has increased from a negative \$63M in 1996 to a negative \$261M in 2000. In effect, comparing 2000 to 1996 it took an additional \$195M in cash out of pocket to produce a reported increase in net income of \$49M

During the five year period from 1996 to 2000, the company used \$796M of cash to generate only \$157M of net income. For every dollar of net income reported, five dollars were actually expended. Free cash per share declined from negative \$1.44 in 1996 to negative \$3.67 in 2000. Based on the net income and cash flow information for the first six months of 2001, the company is on track to generate negative free cash of \$329M, or \$4.24 per share in order to report \$84M of net income. In 2001, HC is on track to spend \$4 in cash for every dollar in net income it can report. HC must expend cash to run its business and is not able to return cash to its shareholders. The ratio of actual cash used to net income reported is about four or five to one. In effect, HC is a classic "cash trap" which can never return money to investors unless it ceases operations and liquidates.

As Hanover's cash flow has deteriorated rapidly, it has turned to such transactions as sale-leasebacks to fund operations. However, with these sale-leasebacks, Hanover will be forced to pay a balloon payment at the ends of the lease terms to reacquire the equipment. It would be unreasonable to think that the financial institution will keep these assets at the end of the leases. Unless HC repurchases the equipment, its fleet size will be significantly affected, reducing its revenue generating potential. In addition, financial institutions do not have the capabilities to either restore the assets to saleable condition (these assets require massive overhauls every 5-7 years), or to divest such massive amounts of equipment. In reality, there would be no market other than Hanover itself for the huge amount of equipment except at fire sale prices. In substance, in our opinion, these transactions are financing arrangements and not sales.

Based on the residual values of the assets under “sale-leaseback” transactions (excluding the new sale-leaseback transaction- terms are unknown), Hanover’s cash obligations to repurchase the assets appear to be \$167M in 2003, \$166M in 2004, and \$308M in 2005.

Balloon payment schedule based on current sale-leasebacks:

Date of Transaction	Sales proceeds	Estimated balloon payment	Estimated payment date
*July 1998	200,000	167,000	July 2003
June 1999	200,000	166,000	June 2004
March 2000	200,000	166,000	March 2005
October 2000	172,589	142,299	October 2005
Total	772,589	641,299	

*- Hanover has announced a refinancing of this lease, which will push back the payment terms to 2007 and 2010, see further analysis below.

The company announced more “sale-leasebacks” on August 17, 2001. These transactions will generate \$550M in proceeds to Hanover. The company has announced that \$300M will be used to fund the cash portion of the Schlumberger Production Operators acquisition, \$200M of the proceeds will “replace older debt in the form of its 1998 synthetic lease that matures 2003”, and \$50M will be used for general corporate purposes. However, we estimate that the buy-out of the lease for \$200M should only require around \$185M and the cash amount of the acquisition has been announced as \$270M. This leaves an additional \$45M of unallocated cash.

Note the unallocated \$45M and the \$50M to be used to fund general corporate purposes. In effect, Hanover is funding its operations with loans, and is repaying old loans with new loans. It seems clear that Hanover can not fund its balloon payment for the lease coming due in 2003, so it is relying on another “sale-leaseback” transaction to extend the payment terms. Not only can the company not fund the balloon payment, but it also does not appear to have the ability to fund everyday operations.

Based on the available information, we think that the following schedule may reflect more accurately Hanover’s revised balloon payment schedule, considering the sale-leaseback recently announced:

Estimated balloon payment schedule based on recently announced sale-leaseback:

Date of transaction	Sales proceeds	Estimated balloon payment	Estimated payment date
Jul-99	200,000	166,000	July-01
Mar-00	200,000	166,000	March-01
Oct-00	172,589	142,299	October-01

1-Aug	550,000	419,100	Aug 08 & 11
Total	1,122,589	893,399	

The company appears to be getting more aggressive with its use of these transactions. By extending the lease terms, it extends its cash obligations and may be further decreasing its depreciation expense as discussed in section 1a above.

c. Effective tax rate versus taxes paid:

Tax schedule:

	2000	1999	1998	1997	1996	1995	Total
Financial statement tax provision	34,771	23,145	19,259	11,043	6,730	3,498	98,446
Inc-taxes paid	1,639	12,065	2,249	3,857	2,541	4,790	27,141
Variance	33,132	11,080	17,010	7,186	4,189	(1,292)	71,305
Cash paid/provision	4.7%	5.2%	11.7%	34.9%	37.8%	136.9%	27.6%

While reporting income taxes for the six year period from 1995 to 2000 for its financial statements of \$98M, Hanover has paid only \$27M of income taxes to the government. The percentage of taxes paid to the company's effective tax rate has declined dramatically since 1995. In 2000, the company paid only about 5% of its tax provision to the government. The company's numerous acquisitions may have impacted this ratio slightly. However, there are other factors that affect this metric.

We think that the significant differences in Hanover's case are caused by the application of different depreciable periods to the equipment for tax vs. book purposes and also due to treating the assets under "sale-leaseback" arrangements as capital leases for tax purposes. Companies often apply different depreciable periods to assets for financial statement purposes than for tax purposes. It is not unusual for a company to have a variance between taxes paid and income tax provision, but the large size of HC's variance again raises issues. Does the company really make money? When considering the tax losses the company generates as well as its treatment of the sale-leasebacks, perhaps not. Who is getting the more accurate income statement, the government or investors?

For tax purposes, at the least, it appears that the company has been recording net losses for the past few years and is probably paying the alternative minimum tax. When considering this in conjunction with the company's free cash flows, it appears that this company does not make money.

d. Poor balance sheet.

Hanover's balance sheet is poor and deteriorating. The company only has \$33M of cash, a trivial amount for a company that generated negative free cash flow of \$165M for the first six months of 2001. A/R comprises 16% of the company's assets and A/R only turned just once in Q2. In addition, estimated earnings and costs in excess of billings has increased from \$39M at December 2000 to \$78M at June 30 2001. This increase of 100% occurred on a total sales increase of just 13%. Accounts such as these can often be used to manage earnings as the revenues and earnings from them are based on estimates.

The company is carrying a very significant inventory of \$185M, which seems odd considering the current demand for compressors and parts. PP&E is currently 49% of the company's \$1.7B of assets. Any decrease in fleet utilization rates could significantly impair the value of these assets.

Current liabilities have remained relatively consistent at \$188M and \$199M at December 31, 2000 and June 30, 2001. However, long term liabilities have increased substantially from \$563M at December 31, 2000 to \$759M at June 30, 2001. Specifically, long term debt has increased \$159M from \$111M at December 31, 2000 to \$269M at June 30, 2001. It seems odd that a company supposedly doing so well would need to grow its long term liabilities so much.

In addition to its on balance sheet obligations, we estimate that Hanover has approximately \$725M on off balance sheet obligations associated with its sale leaseback arrangements. See the sale-leaseback discussion for details. As a result total debt, on and off balance sheet, is nearly \$1B versus total equity of about \$800M.

e. Purchase accounting

Hanover has grown significantly through acquisition and organic growth. The company has probably also benefited from its purchase accounting. Purchase accounting allows companies to establish accruals and is conducive to providing subsequent fiscal periods with strong margins and controlled expenses. Companies often benefit from the opportunity to charge off expenses through certain accruals. This occasionally allows companies to manage their earnings. The potential impact of purchase accounting should be considered when evaluating any company that has grown significantly through acquisition.

2. The company may not make aggressive EPS growth estimates of 36%

Consensus estimates for Hanover are \$0.71 for the remaining six months of 2001, \$1.36 for 2001, and \$1.85 for 2002. The company appears near to closing the acquisition of Production Operators (POI, as discussed below). Analysts' estimates for 2002 earnings accretion from POI appear to be between 7% and 10%. Despite this accretion, it is interesting to note that earnings estimates have been unchanged. To attain the expected earnings growth, bulls are projecting aggressive revenue growth for the remainder of 2001 and 2002. Based on discussions with industry insiders and consultants, we think that Hanover's top line growth will slow and that the company will begin to miss earnings expectations by Q1 02. We project that reported earnings growth will slow to 11% in 2003 versus 2002.

a. Organic rental revenue growth should decline

The primary driver of the company's earnings is its compressor rental segment, which accounts for 35% of the company's revenues and 60% of its gross margin. Analysts appear to be projecting revenue of up to \$650M from the rental segment in 2002, an increase of \$135M, or 26% over estimated 2001 revenue of \$515M (estimate of Hanover combined with Schlumberger organic growth). If the company does not attain this rental revenue growth, it should miss earnings.

Domestic rentals account for about two-thirds of rental revenue, but international revenues are becoming a larger percentage of the total due to a higher growth rate. Hanover has fueled a significant amount of its growth through acquisition. Based on our analysis of Hanover and its acquisitions, it appears that both domestic and international organic revenue growth are slowing.

Based on discussions with energy consultants and industry insiders, the total rental compression market grew about 14% per year from 1996 through 2001. Several factors contributed to this high average growth rate. Rental revenue growth was very high at around 20% in 1997 and 1998. Rental revenue growth rates then slowed to about 8% in 1999 and 11% in 2000. We estimate around 15% growth for 2001. The growth in compression rental revenue is driven by several factors. Among them are a trend toward renting instead of owning compression equipment, increasing gas demand, rental price fluctuations, expanding markets, and other one time occurrences.

1998 was a tough year for gas prices and as a result E&P companies sold assets for cash. Rental companies, in turn, purchased compression assets from E&P companies and then leased them back to such companies. This trend continued into 1999, a year with estimated top line industry growth of less than 10%. The trend toward renting equipment instead of buying continues, but it appears to have slowed since 1998. One analyst recently estimated that domestic rental compression as a percent of total domestic compression deployed has increased from 20% in 1993 to 35% in 2000. A sales representative for a compressor company estimated that 35% was too low and could be higher. About two thirds of the compressors currently being fabricated are estimated to be going into rental fleets.

2000 and 2001 have proven to be stronger than average growth years. It appears that top line revenue growth for the industry will approach an estimated 15% for 2001, an increase from about 11% in 2000. High prices have led producers to look anywhere possible to extract natural gas. In the last 18 months, producers have been going back into areas where they hadn't drilled many wells

over the last decade. Line pressures in these areas were very low. Producers drilled wells in these low pressure areas and put in high pressure compression that flowed into low pressure gathering systems. This tended to knock old wells offline because had insufficient pressure for the new pressure level. As a result, more compression was needed at the old wells to get the gas into the gathering system. One energy consultant recently estimated that this may explain up to 50% of 2001's abnormal 15% top line growth.

In addition to infrastructure improvements as discussed above, compressor companies were able to raise rental prices in 2001. Estimates of price increases vary anywhere between 3% and 10%. Based on our analysis, we estimate that price increased have been about 4%-5% in 2001.

Hanover's organic growth has been impressive during the past 18 months. The company has capitalized on not only the high natural gas prices in the US, but it has also expanded its international operations. This has provided the company with good organic revenue growth, both year over year, and sequentially.

Estimated consolidated organic rental revenue growth:

	3/31/00	6/30/00	9/30/00	12/31/00	3/31/01	6/30/01
Revenue reported	56,104	57,797	66,309	74,305	80,057	90,068
Estimated Acquisition impact*	3,130	3,205	9,450	17,200	19,200	25,810
Adjusted organic revenue	52,974	54,592	56,859	57,105	60,857	64,258
Sequential growth	1,158	1,618	2,267	246	3,752	3,401
Sequential growth %	2%	3%	4%	0%	7%	6%
Y/Y growth	10,540	9,319	8,817	5,289	7,883	9,666
Y/Y growth %	25%	21%	18%	10%	15%	18%

* acquisition impact considers growth of acquired companies

However, based on our analysis of acquisitions and their effects on revenue, and considering current market conditions, we think that both domestic and international organic revenue growth will decline, both sequentially and year over year, commencing in the last six months of 2001.

Estimated domestic rental organic rental revenue growth:

	3/31/00	6/30/00	9/30/00	12/31/00	3/31/01	6/30/01
Revenue reported	38,208	39,020	45,533	50,434	53,729	60,060
Estimated Acquisition impact*	3,130	3,205	7,450	10,900	12,300	17,810
Adjusted organic revenue	35,078	35,815	38,083	39,534	41,429	42,250
Sequential growth	252	737	2,268	1,451	1,895	821
Sequential growth %	1%	2%	6%	4%	5%	2%
Y/Y growth	4,878	3,278	4,306	4,708	6,351	6,435
Y/Y growth %	16%	10%	13%	14%	18%	18%

* acquisition impact considers growth of acquired companies

In an ordinary year, we estimate that domestic compression rental revenue should grow 6%-7%. Domestically, gas compression is a play on the 2%-3% gas demand growth. However, compression tends to grow about 2X-3X faster than gas demand growth. Compression has a higher growth rate than gas demand because well depletion requires more compression to produce equivalent amounts of gas. This is also a result of companies drilling more shallow gas wells, as opposed to deeper and larger finds. The industry has experienced several growth years in which revenue growth was significantly above the normalized 7%. We have previously discussed the various factors that appear to be diminishing that have contributed to these high growth rates.

Gas drilling is currently slowing and the outlook for 2002 is becoming increasingly dim. With gas priced at around \$2.50, some gas wells are becoming unprofitable to operate. Specifically, we have recently heard that shallow gas wells in some areas are becoming unprofitable, such as in the Bossier Sand area of East Texas. The rig count in this area appears to have also peaked. We have also heard that gas drilling is slowing around the Gulf of Mexico. With the declining gas prices, producers appear to be targeting large finds, which are still on schedule.

Based on discussions with industry consultants, gas well abandonments were approaching record lows because of high natural gas prices. This trend has contributed to increased demand for compression because fewer compressors came off of wells. As this trend reverses, more compressors will become available, potentially causing rental fleet utilization rates to deteriorate. One industry consultant estimated that a significant amount of the future gas demand growth will be satisfied by larger finds that will not require compression for many years.

Based on discussions with energy consultants and industry insiders, decreased drilling in shallow areas, increasing well abandonments, and declining gas prices will all contribute to less domestic market opportunity for compressor companies late in 2001 and into 2002. These factors could put pressure on the 7% normalized domestic compression rental revenue growth rate. Based on these factors as well as the recent declining sequential organic growth rate, we estimate that Hanover will attain 7% organic domestic top line growth, at best, in 2002.

Estimated international organic rental revenue growth:

	3/31/00	6/30/00	9/30/00	12/31/00	3/31/01	6/30/01
Revenue reported	17,896	18,777	20,776	23,871	26,328	30,008
Estimated Acquisition impact*	-	-	2,000	5,000	6,200	7,440
Adjusted organic revenue	17,896	18,777	18,776	18,871	20,128	22,568

Sequential growth	906	881	-1	95	1,257	2,440
Sequential growth %	5%	5%	0%	1%	7%	12%
Y/Y growth	5,662	6,041	4,511	1,881	2,232	3,791
Y/Y growth %	46%	47%	32%	11%	12%	20%

* acquisition impact considers growth of acquired companies

Hanover has experienced significant international revenue growth. International organic revenue year over year growth spiked in 2000, recording increases of 46%, 47%, 32%, and 11% for the four quarters. We estimate that international revenue growth will continue, but at a lesser rate. We are estimating that Hanover will continue to experience strong international organic growth in 2001 of about 60%, continuing with a 33% organic increase in 2002 over 2001. This appears consistent with "street" expectations. There are several factors that could limit this growth.

Based on disclosures and "street" reports, Hanover's international rental fleet appears to be focused in Canada, South America, and Mexico.

Based on our discussions with energy consultants, a significant portion of the international growth appears to be related to expanding operations in South America. South American countries have expanded production capacity very quickly. Significant amounts of gas have been found, but there is no infrastructure to transport or use the gas. This is the circumstance in Bolivia, Argentina, Brazil, and several other South American countries. Basically, supply expanded to fulfill the anticipated gas power needs in Brazil. However, the economy in South America has been disappointing and much of the power expansion has been put on hold. This led to a gas bubble. Current plans are being developed for more LNG export and pipeline infrastructure, but the timeline for these types of projects is probably at least 3-5 years.

Based on our research, we also think that Hanover, along with other rental companies, experienced an abnormal growth year in Canada. Typically, companies in Canada are more likely to buy equipment versus renting. This is due to tax credits that are available for companies that own equipment. According to an industry expert, preferential tax treatment is not afforded to companies that rent equipment. As compression equipment was in its highest demand in 2000 and 2001, Canadian companies were probably forced to rent, instead of buy because of the lack of available equipment.

Gas production in Mexico appears static. PEMEX, the sole company with the rights to produce gas from Mexican territory, is focusing its efforts on offshore oil. As a result, no money is being expended for gas exploration. However, incremental compression may be needed to maintain production and as wells deplete.

It is unclear in which international geographies Hanover's international revenue is concentrated. We only know that the company has operations in the three regions described above. We think that a 33% organic growth rate for international revenues is generous, if not high. As discussed, there are significant factors in Canada, Mexico, and South America that could hinder 33% international organic revenue growth.

b. Acquisition growth should slow or cease, after the POI transaction

Hanover is in the process of acquiring Schlumberger's compression business, Production Operators (POI). This acquisition will add 900,000 horsepower to Hanover's current fleet of 2,533,000 horsepower. The total acquisition price is \$761M, consisting of \$270M in cash, \$150M in a long term note, \$283M worth of Hanover shares, and \$58M interest in certain joint ventures. The amount of shares is estimated to be between 6.8 and 8.7 million. The price is set based on the 30 day average closing price of Hanover stock immediately preceding the close of the transaction. Based on the recent decline of Hanover's stock price, the company will probably have to provide Schlumberger with the maximum 8.7M shares.

This acquisition is expected to bring about \$37M of rental revenue and \$8M of fabrication revenue per quarter. In addition, it brings interests in several joint ventures. Bullish analysts assert that the transaction will be as much as 10% accretive to 2002 earnings, yet some of these same analysts have not adjusted their earnings projections for the transaction. This may be an indication that bulls estimate that Hanover would not make current earnings without this accretive acquisition.

Based on our analysis and assuming a similar cost structure to Hanover, we estimate that this acquisition will be accretive to Hanover's EPS by about \$0.03 in Q4 2001 and \$0.15 in 2002 (assuming the transaction closes September 30). Hanover had 79M diluted shares outstanding at June 30, 2001. This acquisition will add approximately 9M shares to the diluted shares number.

The industry insiders with whom we spoke asserted that Hanover paid a premium for POI. We agree. It looks like Hanover paid about 4X revenue for POI. This is higher than Hanover's current PSR of 2.0X and UCO's PSR of 1.6. Now that companies are not forced to amortize goodwill, they may tend to pay too much for acquisitions. This could be an example.

After the acquisition of Schlumberger, potential acquisition targets are minimal. Universal Compressor is the second largest compression company and

Hanover's only real competitor. Together, these companies control about 75% of the compressor rental market. Other than these two companies, there are no other significant players in the compressor rental business that compare on a horsepower or revenue basis. The third and fourth largest companies together control less than 10% of the rental market.

Hanover's acquisition opportunities should not provide it with its traditional significant growth through acquisition.

c. Gross margins may decline

2000 and 2001 have been years of record compression demand. During these times, compressor companies have been able to raise rental and sales prices. This has been the result not only of updating price lists, but also of not extending discounts to customers. According to a sales representative at a major compressor company, backlog has recently peaked at around 24 weeks for some compressors. We think, based on our research, that margins will not increase and may be subject to a slight decrease in the upcoming quarters.

d. Hanover's other segments' revenues could be hindered by market conditions.

Parts Service & Used Equipment revenue depends on the maintenance and reworking requirements for compressors in operation. 2000 and 2001 were record years for parts and service. We think that a significant driver of the growth in this market was due to companies neglecting old equipment for years. When gas prices spiked, the companies probably expended a large amount of capital to rework compressors that had previously been idle or inefficient. However, compressors will continue to require parts and services if they are to continue to run. Depending on the actual equipment that was reworked during this recent boom, this segment could trend down, then stay on a growth track similar to that of rental compression.

According to an energy consultant, revenues for equipment sales, including compressors, could decline as much as 35%. He also opined that whether they have announced it or not, E&P companies are decreasing their capital spending plans for late 2001 and 2002. Like rental revenues, this segment probably benefited greatly from the re-pressurization of previously low pressure gathering systems and increased production from marginal wells. This segment could come under growth pressure, and perhaps see a revenue decline.

The Production Equipment Fabrication segment is Hanover's segment most susceptible to commodity price swings. This segment is a play on E&P capital

spending for oil and gas production and processing equipment. This is not a play on gas demand like the rental segment. As E&P capital spending decreases, as we think it will, this segment could be the most susceptible to not only revenue growth declines, but actual dollar revenue declines as well.

For purposes of our projections, we will assume that results of these smaller segments approximate "street" expectations. We are doing this because the rental revenue is the significant earnings growth driver for this company. However, many of the pressures to which the rental companies are subject also affect these segments. We think that along with the rental segment, these segments will be adversely affected by the slow down in rental revenue growth and declining gas prices. Gas prices have been declining recently and are currently under \$2.50.

3. Valuation

In reviewing rental and leasing companies to find a strong comparison, it was difficult to identify companies that trade even at market multiples. The fact is, that every rental company reviewed had a poor cash flow, perhaps explaining their low earnings multiples. Investors' do not appear to strictly rely on EPS for judging these companies' performance. The market perceives that a consistent user of cash can not return cash to its investors. Hanover is a particularly egregious example of the problem. This is highlighted by its need to execute such transactions as sale-leasebacks in each year since 1998.

The company to which we think Hanover might be compared is United Rentals (URI). URI rents industrial equipment, a type of asset that probably requires the same capital intensive attention and rework. Upon further analysis, we found that URI, like Hanover, also has a similar negative free cash flow. URI closed on August 28, 2001 at \$23.64, or 12.6X 2001 estimates. We think that Hanover should trade at best at a similar multiple.

Based on \$1.06 2001 earnings estimates adjusted for sale leasebacks and a P/E of 12.6X, we think Hanover should trade at \$13. Based on its free cash flow and the capital intensive nature of its business, we think that this multiple is even far too generous. Still, this gives HC a theoretical market capitalization of \$1.0B, or 1.65X tangible book value and 1.2X total book value. This \$1B market valuation would also render a price to sales ratio of around 1X, which we think is more than appropriate considering all factors. URI shares at \$23.50, their current price, would still be less expensive than HC at \$13 based on price to sales, and price to book values. More importantly, it is hard to understand why anyone would actually want to own a company that is a consistent and large net user of cash. Considering the off balance sheet debt of around \$750M, which is about to

increase, HC has an enterprise value of \$1.75B, or around 2.5X tangible book value.

4. Financial projections: \$000

Revenues:	Q1 01	Q2 01	Q3 01e	Q4 01e
Rental revenues	\$80,057	\$90,068	\$103,520	\$142,453
Parts, service and used equipment	38,330	66,125	48,000	50,500
Compressor fabrication	54,651	57,839	61,000	70,500
Production and processing equipment	43,591	45,342	46,500	47,000
Gain on sale of other assets	0	0	0	0
Equity earnings	0	1313	0	0
Other	3,135	2,391	2,000	5,000
Total revenues	219,764	263,078	261,020	315,453
Expenses:				
Rentals	26,712	30,561	33,644	47,010
Parts, service and used equipment	21,886	48,524	31,680	33,835
Compressor fabrication	46,284	48,734	49,715	57,810
Production and processing equipment	35,149	35,297	35,805	36,660
SG&A	19,977	22,658	22,187	30,757
Depreciation and amortization	16,867	19,061	20,500	26,000
Lease expense	15,288	15,639	15,639	15,639
Incremental benefit from 8/01 lease	0	0	(843)	(2,530)
Interest expense	2,704	3,259	6,492	9,679
Distributions on preferred stock	1,593	1,594	1,594	1,594
Other	2,992	15	0	0
Total operating expenses	189,452	225,342	216,413	256,454
Income before income taxes	30,312	37,736	44,607	59,000
Provision for income taxes	11,519	14,332	16,951	22,420
Net income	18,793	23,404	27,657	36,580
Effects of distribution	871.45	1036.1	1036.1	1036.1
Diluted net income	19,664	24,440	28,693	37,616
Diluted shares	75,904	79,205	80,705	90,905
Diluted EPS	0.28	0.31	0.36	0.41
Consensus	NA	NA	0.36	0.41

As a % of Revenue	Q1 01	Q2 01	Q3 01	Q4 01
Rental revenues	36%	34%	40%	45%
Parts, service and used equipment	17%	25%	18%	16%
Compressor fabrication	25%	22%	23%	22%
Production and processing equipment	20%	17%	18%	15%
Gain on sale of other assets	0%	0%	0%	0%
Equity earnings	0%	0%	0%	0%
Other	1%	1%	1%	2%
Total revenues	100%	100%	100%	100%
Expenses:	0%	0%	0%	0%
Rentals	12%	12%	13%	15%
Parts, service and used equipment	10%	18%	12%	11%
Compressor fabrication	21%	19%	19%	18%
Production and processing equipment	16%	13%	14%	12%
SG&A	9%	9%	9%	10%
Depreciation and amortization	8%	7%	8%	8%
Lease expense	7%	6%	6%	5%
Incremental benefit from 8/01 lease	0%	0%	0%	-1%

Interest expense	1%	1%	2%	3%
Total operating expenses	86%	86%	83%	81%
Income before income taxes	14%	14%	17%	19%
Provision for income taxes	5%	5%	6%	7%
Diluted net income	9%	9%	11%	12%

Y/Y Growth	Q1 01	Q2 01	Q3 01	Q4 01
Revenues:				
Rental revenues	43%	56%	56%	92%
Parts, service and used equipment	239%	173%	67%	-42%
Compressor fabrication	285%	286%	97%	92%
Production and processing equipment	636%	199%	42%	35%
Gain on sale of other assets	NA	NA	-100%	NA
Equity earnings	NA	176%	NA	NA
Other	4%	-46%	-10%	912%
Total revenues	143%	125%	61%	35%
Expenses:				
Rentals	47%	48%	45%	82%
Parts, service and used equipment	167%	202%	76%	-45%
Compressor fabrication	306%	290%	90%	81%
Production and processing equipment	684%	196%	40%	34%
SG&A	119%	108%	53%	53%
Depreciation and amortization	63%	55%	45%	62%
Lease expense	89%	55%	36%	-2%
Incremental benefit from 8/01 lease	NA	NA	NA	NA
Interest expense	66%	224%	122%	232%
Distributions on preferred stock	0%	0%	0%	0%
Other	NA	NA	NA	NA
Total operating expenses	160%	132%	57%	26%
Income before income taxes	73%	88%	78%	91%
Provision for income taxes	80%	96%	76%	96%
Net income	68%	83%	79%	89%
Diluted net income	76%	91%	75%	85%
Diluted shares	22%	23%	12%	21%
Diluted EPS	56%	56%	56%	53%

Revenues:	Q1 02e	Q2 02e	Q3 02e	Q4 02e
Rental revenues	\$147,913	\$152,926	\$158,195	\$163,419
Parts, service and used equipment	51,510	52,540	53,591	54,663
Compressor fabrication	71,910	73,348	74,815	76,311
Production and processing equipment	47,470	47,945	48,424	48,908
Gain on sale of other assets	0	0	0	0
Equity earnings	0	0	0	0
Other	5,050	5,101	5,152	5,203
Total revenues	323,853	331,859	340,176	348,505
Expenses:				
Rentals	50,291	50,848	52,995	54,745
Parts, service and used equipment	35,284	35,202	35,906	36,624
Compressor fabrication	58,966	60,146	61,348	62,575
Production and processing equipment	37,027	37,397	37,771	38,149
SG&A	31,576	31,601	31,296	31,365
Depreciation and amortization	26,780	27,583	28,411	29,263
Lease expense	15,639	15,639	15,639	15,639
Incremental benefit from 8/01 lease	(2,530)	(2,530)	(2,530)	(2,530)
Interest expense	11,156	11,688	12,219	12,750
Distributions on preferred stock	1,594	1,594	1,594	1,594
Other	0	0	0	0
Total operating expenses	265,783	269,167	274,649	280,175
Income before income taxes	58,071	62,692	65,527	68,330
Provision for income taxes	22,067	23,823	24,900	25,965
Net income	36,004	38,869	40,627	42,364
Effects of distribution	1036.1	1036.1	1036.1	1036.1
Diluted net income	37,040	39,905	41,663	43,401
Diluted shares	92,405	93,905	95,405	96,905
Diluted EPS	0.40	0.42	0.44	0.45
Consensus	0.43	0.44	0.46	0.48

As a % of Revenue	Q1 02e	Q2 02e	Q3 02e	Q4 02e
Rental revenues	46%	46%	47%	47%
Parts, service and used equipment	16%	16%	16%	16%
Compressor fabrication	22%	22%	22%	22%
Production and processing equipment	15%	14%	14%	14%
Gain on sale of other assets	0%	0%	0%	0%
Equity earnings	0%	0%	0%	0%
Other	2%	2%	2%	1%
Total revenues	100%	100%	100%	100%
Expenses:	0%	0%	0%	0%
Rentals	16%	15%	16%	16%
Parts, service and used equipment	11%	11%	11%	11%
Compressor fabrication	18%	18%	18%	18%
Production and processing equipment	11%	11%	11%	11%
SG&A	10%	10%	9%	9%
Depreciation and amortization	8%	8%	8%	8%
Lease expense	5%	5%	5%	4%
Incremental benefit from 8/01 lease	-1%	-1%	-1%	-1%

Interest expense	3%	4%	4%	4%
Total operating expenses	82%	81%	81%	80%
Income before income taxes	18%	19%	19%	20%
Provision for income taxes	7%	7%	7%	7%
Diluted net income	11%	12%	12%	12%

Y/Y Growth	Q1 02	Q2 02	Q3 02	Q4 02
Revenues:				
Rental revenues	85%	70%	53%	15%
Parts, service and used equipment	34%	-21%	12%	8%
Compressor fabrication	32%	27%	23%	8%
Production and processing equipment	9%	6%	4%	4%
Gain on sale of other assets	NA	NA	NA	NA
Equity earnings	NA	NA	NA	NA
Other	61%	113%	158%	4%
Total revenues	47%	26%	30%	10%
Expenses:				
Rentals	88%	66%	58%	16%
Parts, service and used equipment	61%	-27%	13%	8%
Compressor fabrication	27%	23%	23%	8%
Production and processing equipment	5%	6%	5%	4%
SG&A	58%	39%	41%	2%
Depreciation and amortization	59%	45%	39%	13%
Lease expense	2%	0%	0%	0%
Incremental benefit from 8/01 lease	NA	NA	200%	0%
Interest expense	313%	259%	88%	32%
Distributions on preferred stock	0%	0%	0%	0%
Other	-100%	-100%	NA	NA
Total operating expenses	40%	19%	27%	9%
Income before income taxes	92%	66%	47%	16%
Provision for income taxes	92%	66%	47%	16%
Net income	92%	66%	47%	16%
Diluted net income	88%	63%	45%	15%
Diluted shares	22%	19%	18%	7%
Diluted EPS	43%	38%	23%	8%

Revenues:	FY 00	FY 01e	FY 02e	FY 03e
Rental revenues	254,515	416,098	622,453	711,915
Parts, service and used equipment	151,707	202,955	212,304	229,805
Compressor fabrication	96,838	243,990	296,385	320,816
Production and processing equipment	88,572	182,433	192,747	200,574
Gain on sale of other assets	4,113	-	-	-
Equity earnings	864	1,313	-	-
Other	7,220	12,526	20,505	21,338
Total revenues	603,829	1,059,315	1,344,394	1,484,447
Expenses:				
Rentals	87,992	137,927	208,879	234,932
Parts, service and used equipment	103,276	135,925	143,016	153,969
Compressor fabrication	81,996	202,543	243,036	263,070
Production and processing equipment	69,281	142,911	150,343	156,447
SG&A	54,606	95,578	125,839	133,600
Depreciation and amortization	52,882	82,428	112,038	126,099
Lease expense	45,484	62,205	62,556	62,556
Incremental benefit from 8/01 lease	-	(3,373)	(10,120)	(10,120)
Interest expense	8,473	22,134	47,813	56,313
Distributions on preferred stock	6,369	6,375	6,376	6,376
Other	0	3,007	-	-
Total operating expenses	510,359	887,660	1,089,774	1,183,242
Income before income taxes	93,470	171,655	254,619	301,205
Provision for income taxes	34,771	65,222	96,755	114,458
Net income	58,699	106,433	157,864	186,747
Effects of distribution	4140	3,980	4,144	4,144
Diluted net income	62,839	110,413	162,008	190,892
Diluted shares	71,192	81,312	94,722	100,687
Diluted EPS	0.88	1.36	1.71	1.90
Consensus	NA	1.36	1.81	NA

As a % of Revenue	FY 00	FY 01	FY 02	FY 03
Rental revenues	42%	39%	46%	48%
Parts, service and used equipment	25%	19%	16%	15%
Compressor fabrication	16%	23%	22%	22%
Production and processing equipment	15%	17%	14%	14%
Gain on sale of other assets	1%	0%	0%	0%
Equity earnings	0%	0%	0%	0%
Other	1%	1%	2%	1%
Total revenues	100%	100%	100%	100%
Expenses:	0%	0%	0%	0%
Rentals	15%	13%	16%	16%
Parts, service and used equipment	17%	13%	11%	10%
Compressor fabrication	14%	19%	18%	18%
Production and processing equipment	11%	13%	11%	11%
SG&A	9%	9%	9%	9%
Depreciation and amortization	9%	8%	8%	8%
Lease expense	8%	6%	5%	4%
Incremental benefit from 8/01 lease	0%	0%	-1%	-1%

Interest expense	1%	2%	4%	4%
Total operating expenses	85%	84%	81%	80%
Income before income taxes	15%	16%	19%	20%
Provision for income taxes	6%	6%	7%	8%
Diluted net income	10%	10%	12%	13%

Y/Y Growth	FY 00	FY 01	FY 02	FY 03
Revenues:				
Rental revenues	32%	63%	50%	14%
Parts, service and used equipment	257%	34%	5%	8%
Compressor fabrication	84%	152%	21%	8%
Production and processing equipment	216%	106%	6%	4%
Gain on sale of other assets	1%	-100%	NA	NA
Equity earnings	NA	52%	-100%	NA
Other	111%	73%	64%	4%
Total revenues	87%	75%	27%	10%
Expenses:				
Rentals	35%	57%	51%	12%
Parts, service and used equipment	270%	32%	5%	8%
Compressor fabrication	88%	147%	20%	8%
Production and processing equipment	233%	106%	5%	4%
SG&A	62%	75%	32%	6%
Depreciation and amortization	42%	56%	36%	13%
Lease expense	106%	37%	1%	0%
Incremental benefit from 8/01 lease	NA	NA	200%	0%
Interest expense	-4%	161%	116%	18%
Distributions on preferred stock	2191%	0%	0%	0%
Other	NA	NA	-100%	NA
Total operating expenses	97%	74%	23%	9%
Income before income taxes	47%	84%	48%	18%
Provision for income taxes	50%	88%	48%	18%
Net income	45%	81%	48%	18%
Diluted net income	55%	76%	47%	18%
Diluted shares	17%	14%	16%	6%
Diluted EPS	33%	54%	26%	11%