UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(mark one)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended October 2, 2004
or
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ________ to ________

Commission File Number 1-11406

KADANT INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	52-1762325
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
One Acton Place, Suite 202 Acton, Massachusetts	01720
(Address of Principal Executive Offices)	(Zip Code)

Registrant's Telephone Number, Including Area Code: (978) 776-2000

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 and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Indicate by check mark whether or not the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes [X] No [ ]

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

Class	Outstanding at November 2, 2004
Common Stock, $.01 par value	13,863,961

PART I - Financial Information

Item 1 - Financial Statements

KADANT INC.

Condensed Consolidated Balance Sheet
(Unaudited)

Assets

(In thousands)	October 2, 2004	January 3, 2004
Current Assets:		
Cash and cash equivalents	$ 77,101	$ 74,451
Accounts receivable, less allowances of $1,753 and $1,680	34,593	32,507
Unbilled contract costs and fees	10,409	10,755
Inventories (Note 5)	30,436	33,203
Deferred tax asset	7,685	7,710
Other current assets	3,565	3,187
	163,789	161,813
Property, Plant, and Equipment, at Cost	74,964	77,458
Less: Accumulated depreciation and amortization	51,752	51,631
	23,212	25,827
Other Assets	10,656	10,537
Goodwill	73,571	73,536

	$271,228	$271,713
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The accompanying notes are an integral part of these condensed consolidated financial statements.

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Condensed Consolidated Balance Sheet (continued)
(Unaudited)

Liabilities and Shareholders' Investment

(In thousands, except share amounts)	October 2, 2004	January 3, 2004
Current Liabilities:		
Current maturities of long-term obligations	$ -	$ 598
Accounts payable	23,877	23,896
Accrued payroll and employee benefits	10,273	11,356
Accrued warranty costs	8,256	4,530
Accrued income taxes	2,911	1,040
Customer deposits	2,017	2,406
Other current liabilities	7,668	10,983
	55,002	54,809
Deferred Income Taxes	1,261	1,617
Other Long-Term Liabilities	3,090	3,178
Minority Interest	-	351
Shareholders' Investment:		
Preferred stock, $.01 par value, 5,000,000 shares authorized; none issued	-	-
Common stock, $.01 par value, 150,000,000 shares authorized; 14,571,187 and 14,309,892 shares issued	146	143
Capital in excess of par value	98,178	94,454
Retained earnings	134,497	128,519
Treasury stock at cost, 707,226 and 208,226 shares	(18,627)	(8,788)
Deferred compensation	(100)	(31)
Accumulated other comprehensive loss (Note 2)	(2,219)	(2,539)
	211,875	211,758
	$271,228	$271,713

The accompanying notes are an integral part of these condensed consolidated financial statements.

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KADANT INC.

Condensed Consolidated Statement of Operations
(Unaudited)

(In thousands, except per share amounts)	Three Months Ended October 2, 2004	Three Months Ended September 27, 2003
Revenues	$ 53,277	$ 45,906
Costs and Operating Expenses:		
Cost of revenues	38,671	27,768
Selling, general, and administrative expenses	15,254	12,775
Research and development expenses	922	1,149
Gain on sale of subsidiary	(149)	-
Restructuring and unusual items (Note 6)	-	157
	54,698	41,849
Operating Income (Loss)	(1,421)	4,057
Interest Income	356	243
Interest Expense	(2)	(11)
Income (Loss) Before Income Taxes and Minority Interest	(1,067)	4,289
Provision (Benefit) for Income Taxes	(568)	1,630
Minority Interest Income	(6)	(4)
Net Income (Loss)	$ (493)	$ 2,663
Earnings (Loss) per Share (Note 3):		
Basic	$ (.04)	$ .20
Diluted	$ (.04)	$ .19
Weighted Average Shares (Note 3):		
Basic	13,977	13,632
Diluted	13,977	14,041

The accompanying notes are an integral part of these condensed consolidated financial statements.

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KADANT INC.

Condensed Consolidated Statement of Operations
(Unaudited)

(In thousands, except per share amounts)	Nine Months Ended October 2, 2004	Nine Months Ended September 27, 2003
Revenues	$162,786	$153,065
Costs and Operating Expenses:		
Cost of revenues	107,288	95,062
Selling, general, and administrative expenses	45,688	39,669
Research and development expenses	2,633	3,502
Gain on sale of subsidiary	(149)	-
Restructuring costs and unusual income (Note 6)	-	(23)
	155,460	138,210
Operating Income	7,326	14,855
Interest Income	1,003	693
Interest Expense	(14)	(39)
Income Before Provision for Income Taxes and Minority Interest	8,315	15,509
Provision for Income Taxes	2,329	5,894
Minority Interest Expense	8	68
Net Income	$ 5,978	$ 9,547
Earnings per Share (Note 3):		
Basic	$ .42	$ .70
Diluted	$ .41	$ .69
Weighted Average Shares (Note 3):		
Basic	14,139	13,602
Diluted	14,480	13,905

The accompanying notes are an integral part of these condensed consolidated financial statements.

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KADANT INC.

Condensed Consolidated Statement of Cash Flows
(Unaudited)

(In thousands)	Nine Months Ended October 2, 2004	Nine Months Ended September 27, 2003
Operating Activities:		
Net income	$ 5,978	$ 9,547
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on sale of property (Note 6)	(143)	(649)
Gain on sale of subsidiary	(149)	-
Depreciation and amortization	3,613	3,855
Provision for losses on accounts receivable	330	57
Provision for warranty obligations	7,649	2,036
Minority interest expense	8	68
Other items	(388)	459
Changes in current accounts, excluding the effects of disposition:		
Accounts receivable	(4,011)	1,191
Unbilled contract costs and fees	355	2,460
Inventories	2,793	(329)
Other current assets	(309)	(301)
Accounts payable	(60)	524
Other current liabilities	(6,401)	1,093
Net cash provided by operating activities	9,265	20,011
Investing Activities:		
Sale of subsidiary, net of cash divested	126	-
Acquisition of minority interest in subsidiary	(318)	-
Purchases of property, plant, and equipment	(1,621)	(2,570)
Proceeds from sale of property, plant, and equipment	1,303	942
Other, net	(223)	(202)
Net cash used in investing activities	(733)	(1,830)
Financing Activities:		
Purchases of Company common stock	(10,261)	-
Net proceeds from issuance of Company common stock	4,758	1,165
Repayments of long-term obligations	(598)	(567)
Net cash (used in) provided by financing activities	(6,101)	598
Exchange Rate Effect on Cash	219	2,479
Increase in Cash and Cash Equivalents	2,650	21,258
Cash and Cash Equivalents at Beginning of Period	74,451	44,429
Cash and Cash Equivalents at End of Period	$ 77,101	$ 65,687

The accompanying notes are an integral part of these condensed consolidated financial statements.

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KADANT INC.

Notes to Condensed Consolidated Financial Statements
(Unaudited)

1. General

The interim condensed consolidated financial statements and related notes presented have been prepared by Kadant Inc. (also referred to in this document as "we," "us," "our," "Kadant," "the Company," or "the registrant") without audit and, in the opinion of management, reflect all adjustments of a normal recurring nature necessary for a fair statement of the Company's financial position at October 2, 2004, its results of operations for the three- and nine-month periods ended October 2, 2004, and September 27, 2003, and cash flows for the nine-month periods ended October 2, 2004, and September 27, 2003. Interim results are not necessarily indicative of results for a full year.

The condensed consolidated balance sheet presented as of January 3, 2004, has been derived from the consolidated financial statements that have been audited by the Company's independent auditors. The condensed consolidated financial statements and related notes are presented as permitted by Form 10-Q and do not contain certain information included in the annual financial statements and related notes of the Company. The condensed consolidated financial statements and notes included herein should be read in conjunction with the financial statements and related notes included in the Company's Annual Report on Form 10-K for the fiscal year ended January 3, 2004, filed with the Securities and Exchange Commission.

2. Comprehensive Income (Loss)

Comprehensive income (loss) combines net income (loss) and "other comprehensive items," which represent certain amounts that are reported as components of shareholders' investment in the accompanying condensed consolidated balance sheet, including foreign currency translation adjustments and deferred gains and losses on foreign currency contracts.

The components of comprehensive income (loss) were as follows:

	Three Months Ended		Nine Months Ended	
(In thousands)	October 2, 2004	September 27, 2003	October 2, 2004	September 27, 2003
Net Income (Loss)	$ (493)	$ 2,663	$ 5,978	$ 9,547
Other Comprehensive Income (Loss)				
Foreign Currency Translation Adjustments	(721)	(3,421)	366	5,445
Unrealized Loss on Foreign Currency Contracts	(10)	(35)	(46)	(169)
	(731)	(3,456)	320	5,276
Comprehensive Income (Loss)	$(1,224)	$ (793)	$ 6,298	$14,823

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3. Earnings (Loss) per Share

Basic and diluted earnings (loss) per share were calculated as follows:

(In thousands, except per share amounts)	Three Months Ended October 2, 2004	Three Months Ended September 27, 2003	Nine Months Ended October 2, 2004	Nine Months Ended September 27, 2003
Basic				
Net Income (Loss)	$ (493)	$ 2,663	$ 5,978	$ 9,547
Weighted Average Shares	13,977	13,632	14,139	13,602
Basic Earnings (Loss) per Share	$ (.04)	$ .20	$ .42	$ .70
Diluted				
Net Income (Loss)	$ (493)	$ 2,663	$ 5,978	$ 9,547
Weighted Average Shares	13,977	13,632	14,139	13,602
Effect of Stock Options	-	409	341	303
Weighted Average Shares, as Adjusted	13,977	14,041	14,480	13,905
Diluted Earnings (Loss) per Share	$ (.04)	$ .19	$ .41	$ .69

Due to the net loss in the third quarter of 2004, approximately 304,900 potential common shares were excluded from the computation of diluted earnings per share as their inclusion would have had an anti-dilutive effect.

Options to purchase approximately 217,600 and 304,200 shares of common stock for the third quarters of 2004 and 2003, respectively, and 229,000 and 347,800 shares of common stock for the first nine months of 2004 and 2003, respectively, were not included in the computation of diluted earnings per share because the options' exercise prices were greater than the average market price for the common stock and the effect of their inclusion would have been anti-dilutive.

4. Warranty Obligations

The Company provides for the estimated cost of product warranties, primarily using historical information and estimated repair costs, at the time product revenue is recognized. In the Pulp and Papermaking Equipment and Systems segment (Papermaking Equipment segment), the Company typically negotiates the terms regarding warranty coverage and length of warranty depending on the products and applications. In the Composite and Fiber-based Products segment, the Company offers a standard limited warranty on its composite building products restricted to repair or replacement of the defective product or refund of the original purchase price.

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4. Warranty Obligations (continued)

The composite building products business (the "composites business") experienced a significant increase in warranty claims in the latter half of 2003 and the first nine months of 2004 versus historical claim rates associated with excessive contraction of certain decking products. In addition, in the third quarter of 2004, the Company increased its warranty reserve primarily as a result of a significant number of claims associated with a new problem concerning excessive oxidation that affects the integrity of the plastic used in some of the Company's decking products. Included in this provision is the cost of exchanging material held by our distributors with new material and our best estimate of costs related to future potential valid claims arising from installed product. Primarily as a result of this new problem, the Company increased its estimated costs of product warranties for this business and recorded related warranty expense of $4,576,000 and $5,906,000 in the three- and nine-month periods ended October 2, 2004, respectively, versus $621,000 and $1,098,000 in the three- and nine-month periods ended September 27, 2003, respectively.

In total, the Company recorded consolidated warranty expense of $4,946,000 and $7,649,000 in the three- and nine-month periods ended October 2, 2004, respectively, associated with all of its product lines. While the Company engages in product quality programs and processes, the Company's warranty obligation is affected by product failure rates, repair costs, service delivery costs incurred in correcting a product failure, and supplier warranties on parts delivered to the Company. Should actual product failure rates, repair costs, service delivery costs, or supplier warranties on parts differ from the Company's estimates, revisions to the estimated warranty liability would be required.

The changes in the carrying amount of the Company's consolidated product warranties for the three- and nine-month periods ended October 2, 2004 and September 27, 2003, are as follows:

	Three Months Ended		Nine Months Ended	
(In thousands)	October 2, 2004	September 27, 2003	October 2, 2004	September 27, 2003
Beginning Balance	$ 4,931	$ 4,917	$ 4,530	$ 4,310
Provision charged to income	4,946	793	7,649	2,036
Usage	(1,582)	(658)	(3,903)	(1,582)
Other, net (a)	(39)	(118)	(20)	170
Ending Balance	$ 8,256	$ 4,934	$ 8,256	$ 4,934

(a) Primarily represents the effects of currency translation.

5. Inventories

The components of inventories are as follows:

(In thousands)	October 2, 2004	January 3, 2004
Raw Materials and Supplies	$ 12,665	$ 13,049
Work in Process	7,955	7,806
Finished Goods (includes $376 and $860 at customer locations)	9,816	12,348
	$ 30,436	$ 33,203

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KADANT INC.

Notes to Condensed Consolidated Financial Statements
(Unaudited)

6. Restructuring and Unusual Items

During the second quarter of 2003, the Company recorded restructuring costs of $469,000, which were accounted for in accordance with Statement of Financial Accounting Standards (SFAS) No. 112, "Employers' Accounting for Postemployment Benefits - an amendment of SFAS No. 5 and 43", related to severance costs for seven employees across all functions at the Papermaking Equipment segment's Kadant Lamort subsidiary. During the third quarter of 2003, the Company recorded an additional $157,000 of costs related to this restructuring activity. During the second quarter of 2003, unusual income resulted from a gain of $649,000 from the sale of property, for approximately $921,000 in cash, at the same subsidiary.

A summary of the changes in accrued restructuring costs, which are included in other current liabilities in the accompanying condensed consolidated balance sheet, are as follows:

(In thousands)	Accrued Restructuring Costs
Balance at January 3, 2004	$ 200
Usage	(168)
Currency translation	1
Balance at October 2, 2004	$ 33

The specific restructuring measures and associated estimated costs are based on the Company's best judgments under prevailing circumstances. The Company believes that the restructuring reserve balance is adequate to carry out its restructuring activities and anticipates that all actions related to these liabilities will be completed by the end of 2004.

7. Business Segment Information

(In thousands)	Three Months Ended October 2, 2004	Three Months Ended September 27, 2003	Nine Months Ended October 2, 2004	Nine Months Ended September 27, 2003
Revenues:				
Pulp and Papermaking Equipment and Systems	$ 47,669	$ 42,023	$144,166	$138,254
Composite and Fiber-based Products	5,608	3,883	18,620	14,811
	$ 53,277	$ 45,906	$162,786	$153,065
Income (Loss) Before Income Taxes and Minority Interest:				
Pulp and Papermaking Equipment and Systems (a)	$ 5,595	$ 5,702	$ 18,090	$ 17,633
Composite and Fiber-based Products (b)	(5,611)	(669)	(6,143)	314
Corporate (c)	(1,405)	(976)	(4,621)	(3,092)
Total Operating Income (Loss)	(1,421)	4,057	7,326	14,855
Interest Income, Net	354	232	989	654
	$ (1,067)	$ 4,289	$ 8,315	$ 15,509

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KADANT INC.

Notes to Condensed Consolidated Financial Statements
(Unaudited)

7. Business Segment Information (continued)

(In thousands)	Three Months Ended October 2, 2004	Three Months Ended September 27, 2003	Nine Months Ended October 2, 2004	Nine Months Ended September 27, 2003
Capital Expenditures:				
Pulp and Papermaking Equipment and Systems	$ 291	$ 537	$ 1,126	$ 1,098
Composite and Fiber-based Products	179	585	479	1,461
Corporate	5	-	16	11
	$ 475	$ 1,122	$ 1,621	$ 2,570

(a) Includes a gain of $971 in the nine-month period ending October 2, 2004, which resulted from renegotiating a series of agreements with one of the Company's licensees, a gain on sale of subsidiary of $149 in the three- and nine-month periods ended October 2, 2004, restructuring costs of $157 in the three-month period ended September 27, 2003 and restructuring costs and unusual income of $23 in the nine-month period ended September 27, 2003 (Note 6).
(b) Includes operating losses from the composite building products business of $5,689 and $6,991 in the three- and nine-month periods ended October 2, 2004, respectively, and $771 and $661 in the three- and nine-month periods ended September 27, 2003, respectively.
(c) Primarily general and administrative expenses.

8. Stock-Based Compensation

As permitted by SFAS No. 148, "Accounting for Stock-based Compensation - Transition and Disclosure," and SFAS No. 123, "Accounting for Stock-based Compensation," the Company has elected to continue to apply Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations to account for its stock-based compensation plans. No stock-based employee compensation cost related to stock option awards is reflected in net income, as all options granted under the plans had an exercise price equal to the market value of the underlying common stock on the date of grant. Had compensation cost for awards granted after 1994 under the Company's stock-based compensation plans been determined based on the fair value at the grant dates consistent with the method set forth under SFAS No. 123, the effect on certain of the Company's financial results would have been as follows:

(In thousands, except per share amounts)	Three Months Ended October 2, 2004	Three Months Ended September 27, 2003	Nine Months Ended October 2, 2004	Nine Months Ended September 27, 2003
Net Income (Loss):				
As reported	$ (493)	$ 2,663	$ 5,978	$ 9,547
Deduct: Total stock-based employee compensation expense determined under the fair-value-based method for all awards, net of tax	(557)	(617)	(1,686)	(1,902)
Pro forma	$(1,050)	$ 2,046	$ 4,292	$ 7,645
Basic Earnings (Loss) per Share:				
As reported	$ (.04)	$ .20	$ .42	$ .70
Pro forma	$ (.08)	$ .15	$ .30	$ .56
Diluted Earnings (Loss) Per Share:				
As reported	$ (.04)	$ .19	$ .41	$ .69
Pro forma	$ (.08)	$ .15	$ .30	$ .55

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9. Employee Benefit Plans

One of the Company's U.S. subsidiaries has a noncontributory defined benefit retirement plan. Benefits under the plan are based on years of service and employee compensation. Funds are contributed to a trustee as necessary to provide for current service and for any unfunded projected benefit obligation over a reasonable period. The same subsidiary has a post-retirement welfare benefits plan (reflected in the tables below under the column entitled "Other Benefits"). No future retirees are eligible for the post-retirement welfare benefits plan, and the plan includes a limit on the subsidiary's contributions.

The following summarizes the components of the net periodic benefit cost for the pension benefits and other benefit plans in the three- and nine-month periods ended October 2, 2004 and September 27, 2003.

(In thousands)	Three Months Ended October 2, 2004		Three Months Ended September 27, 2003	
	Pension Benefits	Other Benefits	Pension Benefits	Other Benefits
Components of Net Periodic Benefit Cost:				
Service cost	$ 160	$ -	$ 156	$ -
Interest cost	242	13	257	19
Expected return on plan assets	(343)	-	(317)	-
Recognized net actuarial loss	-	9	12	10
Amortization of prior service cost	12	(14)	11	(11)
Net periodic benefit cost	$ 71	$ 8	$ 119	$ 18

	Nine Months Ended October 2, 2004		Nine Months Ended September 27, 2003	
	Pension Benefits	Other Benefits	Pension Benefits	Other Benefits
Components of Net Periodic Benefit Cost:				
Service cost	$ 480	$ -	$ 468	$ -
Interest cost	726	39	771	57
Expected return on plan assets	(1,027)	-	(951)	-
Recognized net actuarial loss	-	27	36	30
Amortization of prior service cost	34	(44)	33	(33)
Net periodic benefit cost	$ 213	$ 22	$ 357	$ 54

The weighted-average assumptions used to determine net periodic benefit cost were as follows:

Discount rate	6.25%	6.25%	6.75%	6.75%
Expected long-term return on plan assets	8.50%	-	8.75%	-
Rate of compensation increase	4.00%	-	5.00%	-

No cash contributions are expected for the pension and post-retirement welfare benefits plans in 2004.

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10. Composites Business

Pursuant to SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," the impairment of tangible and intangible assets is assessed when changes in circumstances indicate that their carrying values may not be fully recoverable. To analyze recoverability, the Company projects undiscounted net future cash flows over the remaining life of such assets. If these projected cash flows are less than the carrying amount, an impairment loss would be recognized, resulting in a write-down of the assets with a corresponding charge to earnings. The impairment loss is measured based on the difference between the carrying amount and fair value of the assets or asset group. The estimated fair value of the Company's composites business under this accounting standard is based on an estimated purchase price or, in the absence of a known purchase price, an estimate of future cash flows associated with the asset group.

As outlined in Note 4 to the condensed consolidated financial statements, the Company continued to experience problems in the composites business that affected its profitability. In addition, the Company experienced a substantial increase in warranty claims that affected its profitability in the three-month period ending October 2, 2004. The claims were associated with a new problem concerning excessive oxidation that affects the integrity of the plastic used in some of its decking products. As a result of the increase in warranty claims and in accordance with SFAS No. 144, the Company evaluated the long-lived assets of its composites business for impairment. The Company performed an impairment assessment of these long-lived assets as of October 2, 2004, based on the most current information available regarding the estimated fair value of the composites business and concluded that no impairment loss was required at that time.

On October 27, 2004, the Company's board of directors approved a plan and management committed to sell its composites business after making a determination that the business no longer aligns with the Company's long-term strategy. The Company intends to sell the composites business as a going concern and is presently evaluating potential buyers for the composites business, as well as the costs that may be incurred in selling the business. Under the plan approved by the board of directors, the Company plans to sell the composites business within the next year at a price that is reasonable compared to its current fair value. As a result of the decision to sell the composites business, the Company evaluated whether the composites business should be classified as a discontinued operation under SFAS No. 144. The Company will be presenting the composites business in its financial statements as a discontinued operation starting in the fourth quarter of 2004, as all the criteria under SFAS No. 144 have been met.

The composites business, which is included in the Composites and Fiber-based Products segment, had total assets and liabilities of $11,301,000 and $6,881,000, respectively, as of October 2, 2004. Included in total assets as of October 2, 2004, was $6,737,000 of property, plant, and equipment, net of accumulated depreciation, and $95,000 of intangibles. Revenues and operating loss for the nine-months ended October 2, 2004 were $13,751,000 and $6,991,000, respectively. Going forward, the Company will continue to assess any potential impairment loss or other costs associated with the sale of the business and record a loss, if any, when required.

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

This Quarterly Report on Form 10-Q includes forward-looking statements that are not statements of historical fact, and may include statements regarding possible or assumed future results of operations. Forward-looking statements are subject to risks and uncertainties and are based on the beliefs and assumptions of our management, using information currently available to our management. When we use words such as "believes," "expects," "anticipates," "intends," "plans," "estimates," "should," "likely," "will," "would," or similar expressions, we are making forward-looking statements.

Forward-looking statements are not guarantees of performance. They involve risks, uncertainties, and assumptions. Our future results of operations may differ materially from those expressed in the forward-looking statements. Many of the important factors that will determine these results and values are beyond our ability to control or predict. You should not put undue reliance on any forward-looking statements. We undertake no obligation to publicly update any forward-looking statement, whether as a result of new information, future events, or otherwise. For a discussion of important factors that may cause our actual results to differ materially from those suggested by the forward-looking statements, you should read carefully the section captioned "Risk Factors" in this Report.

Overview

Company Background

We operate in two segments: the Pulp and Papermaking Equipment and Systems (Papermaking Equipment) segment and the Composite and Fiber-based Products segment. Through our Papermaking Equipment segment, we develop, manufacture, and market a range of equipment and products for the domestic and international papermaking and paper recycling industries. We have a large, stable customer base that includes most of the world's major paper manufacturers. As a result, we have one of the largest installed bases of equipment in the pulp and paper industry. Our installed base provides us with a spare parts and consumables business that yields higher margins than our capital equipment business and which, we believe, is less susceptible to the cyclical trends in the paper industry.

Through our Composite and Fiber-based Products segment, we develop, manufacture, and market composite products made from recycled fiber and plastic, primarily for the building industry, and manufacture and sell granules derived from pulp fiber for use as carriers for agricultural, home lawn and garden, and professional lawn, turf and ornamental applications. On October 27, 2004, the Company's board of directors approved a plan to sell its composite building products business (the "composites business"), which is included in the Composites and Fiber-based Products segment, after making a determination that the business no longer aligns with the Company's long-term strategy. As a result of the decision to sell the composites business, we will be presenting the composites business in our financial statements as a discontinued operation for accounting purposes beginning in the fourth quarter of 2004.

We were incorporated in Delaware in November 1991 to be the successor-in-interest to several papermaking equipment businesses of Thermo Electron Corporation (Thermo Electron). In November 1992, we completed an initial public offering of a portion of our outstanding common stock. On July 12, 2001, we changed our name to Kadant Inc. from Thermo Fibertek Inc. In August 2001, Thermo Electron disposed of its remaining equity interest in Kadant by means of a stock dividend to its shareholders. In May 2003, we moved the listing of our common stock to the New York Stock Exchange, where it continues to trade under the symbol "KAI".

Pulp and Papermaking Equipment and Systems Segment

Our Papermaking Equipment segment designs and manufactures stock-preparation systems and equipment, paper machine accessory equipment, and water-management systems for the paper and paper recycling industries.

Overview (continued)

Principal products include:

- Stock-preparation systems and equipment: custom-engineered systems and equipment, as well as standard individual components, for pulping, de-inking, screening, cleaning, and refining recycled and virgin fibers in preparation for entry into the paper machine during the production of recycled paper;

- Papermaking machine accessory equipment: doctoring systems and related consumables that continuously clean papermaking rolls to keep paper machines running efficiently; doctor blades made of a variety of materials to perform functions including cleaning, creping, web removal, and application of coatings; and profiling systems that control moisture, web curl, and gloss during paper production; and

- Water-management systems: systems and equipment used to continuously clean paper machine fabrics and to drain, purify, and recycle process water during paper sheet formation.

Composite and Fiber-based Products Segment

Our Composite and Fiber-based Products segment consists of two product lines: composite building products and fiber-based granular products. Our principal products include:

- Composite building products: decking and railing systems and roof tiles produced from recycled fiber, plastic, and other materials, and marketed through distributors primarily to the building industry; and

- Fiber-based granular products: biodegradable, absorbant granules made from papermaking byproducts for use primarily as carriers in agricultural, home lawn and garden, and professional lawn, turf and ornamental applications.

International Sales

During the first nine months of 2004, approximately 55% of our sales were to customers outside the United States, principally in Europe and Asia. We generally seek to charge our customers in the same currency in which our operating costs are incurred. However, our financial performance and competitive position can be affected by currency exchange rate fluctuations affecting the relationship between the U.S. dollar and foreign currencies. We seek to reduce our exposure to currency fluctuations through the use of forward currency exchange contracts. We may enter into forward contracts to hedge certain firm purchase and sale commitments denominated in currencies other than our subsidiaries' functional currencies. These contracts hedge transactions principally denominated in U.S. dollars.

Application of Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of our financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies are defined as those that reflect significant judgments and uncertainties, and could potentially result in materially different results under different assumptions and conditions. We believe that our most critical accounting policies, upon which our financial condition depends and which involve the most complex or subjective decisions or assessments, are those described in "Management's Discussion and Analysis of Financial Condition and Results of Operations" under the section captioned "Application of Critical Accounting Policies and

Overview (continued)

Estimates" in Item 7 of our Annual Report on Form 10-K for the fiscal year ended January 3, 2004, filed with the Securities and Exchange Commission. There have been no material changes to these critical accounting policies and estimates since year-end 2003 that warrant further disclosure.

Industry and Business Outlook

Our products are primarily sold to the pulp and paper industry. Although the paper industry had been in a prolonged down cycle for the past several years, the performance of paper producers, especially in North America, has been gradually improving over the past few quarters. Increased operating rates and improved pricing has helped to increase the profitability of paper producers during this period. Nevertheless, paper companies are still cautious about increasing their capital and operating spending in the current market environment. We expect, however, that as the market recovers, paper companies will increase their capital and operating spending, which will have a positive effect on paper company suppliers, such as Kadant, although the timing of such effect is difficult to predict. We continue to concentrate our efforts on several initiatives intended to improve our operating results, including: (i) expanding our business in China, (ii) increasing our higher-margin parts and consumables businesses across all our product lines, (iii) sourcing the manufacture of non-proprietary components from third-party suppliers, (iv) shifting more production to our lower-cost manufacturing facilities, and (v) lowering our manufacturing overhead costs throughout the business. In addition, we continue to focus our efforts on managing our operating costs, capital expenditures, and working capital.

We continue to pursue market opportunities outside North America. In the last several years, China has become a significant market for our stock-preparation equipment. To capitalize on this growing market, we have established a wholly owned subsidiary that will operate a manufacturing and assembly facility in China for this equipment and related aftermarket products, as well as for our accessories and water-management products in the future. Revenues from China are primarily derived from large capital orders, the timing of which is often difficult to predict. Recently, our customers in China have experienced delays in obtaining financing for their capital addition and expansion projects due to efforts by the Chinese government to control economic growth, which are reflected in a slowdown in financing approvals in China's banking system. This has caused delays in receiving orders and, as a result, will delay our recognizing revenue on these projects to periods later than originally expected. We plan to use our new facility in China as a base for increasing our aftermarket business, which we believe will be more predictable.

In the composites business, we experienced a substantial increase in warranty claims that affected our profitability in the three-month period ending October 2, 2004. The claims were associated with a new problem concerning excessive oxidation that affects the integrity of the plastic used in some of our decking products. As a result of the increased claims in the third quarter of 2004 and our estimated future claims, we increased our warranty expense to $4.6 million and $5.9 million in the three- and nine-month periods ended October 2, 2004, respectively, compared to $0.6 million and $1.1 million in the three- and nine-month periods ended September 27, 2003, respectively. Included in the increased warranty expense is the cost of exchanging material held by our distributors with new material and our best estimate of costs related to future potential valid claims arising from installed product. The composites business had operating losses of $5.7 million and $7.0 million in the three- and nine-month periods ended October 2, 2004, respectively, compared to operating losses of $0.8 million and $0.7 million in the three- and nine-month periods ended September 27, 2003, respectively.

On October 27, 2004, our board of directors approved a plan to sell our composites business after making a determination that the business no longer aligns with the Company's long-term strategy. We intend to sell the composites business as a going concern and are presently evaluating potential buyers for the composites business as well as the costs that may be incurred in selling the business. As a result of the decision to sell the composites business, it will be presented in our financial statements as a discontinued operation for accounting purposes beginning in the fourth quarter of 2004.

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Overview (continued)

Going forward, our guidance will include only the results from our continuing operations, which will exclude the discontinued operations for the composites business. We expect to report, from continuing operations, for the fourth quarter of 2004 on a GAAP basis, $0.06 to $0.08 per diluted share, on revenues of $40 to $42 million. For the full year for continuing operations, we expect to report, on a GAAP basis, $0.79 to $0.81 per diluted share on revenues of $189 to $191 million.

Results of Operations

Third Quarter 2004 Compared With Third Quarter 2003

The following table sets forth our unaudited condensed consolidated statement of operations expressed as a percentage of total revenues for the third quarters of 2004 and 2003. The results of operations for the fiscal quarter ended October 2, 2004 are not necessarily indicative of the results to be expected for the full fiscal year.

	Three Months Ended	
	October 2, 2004	September 27, 2003
Revenues	100%	100%
Costs and Operating Expenses:		
Cost of revenues	73	60
Selling, general, and administrative expenses	29	28
Research and development expenses	2	3
Gain on sale of subsidiary	(1)	-
	103	91
Operating Income (Loss)	(3)	9
Interest Income, net	1	-
Income (Loss) Before Income Taxes and Minority Interest	(2)	9
Provision (Benefit) for Income Taxes	(1)	3
Net Income (Loss)	(1)%	6%

Revenues

Revenues increased to $53.3 million in the third quarter of 2004 from $45.9 million in the third quarter of 2003, an increase of $7.4 million, or 16%. Revenues in 2004 include the favorable effect of currency translation of $1.3 million due to a weaker U.S. dollar relative to most of the functional currencies in countries in which we operate.

Revenues by segment for the third quarter of 2004 and 2003 were as follows:

	Three Months Ended	
(In thousands)	October 2, 2004	September 27, 2003
Revenues:		
Pulp and Papermaking Equipment and Systems	$ 47,669	$ 42,023
Composite and Fiber-based Products	5,608	3,883
	$ 53,277	$ 45,906

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Third Quarter 2004 Compared With Third Quarter 2003 (continued)

Pulp and Papermaking Equipment and Systems Segment. Revenues at the Papermaking Equipment segment increased to $47.7 million in the third quarter of 2004 compared with $42.0 million in the third quarter of 2003, an increase of $5.7 million, or 13.6%, due primarily to an increase in revenues from our stock-preparation equipment product line. The 2004 quarterly revenue increase includes a $1.3 million, or 3%, favorable effect from foreign currency translation. Revenues from the segment's stock-preparation equipment product line increased $7.2 million, or 38%, in 2004 primarily as a result of a $4.0 million, or 58%, increase in revenues from North America due to several large capital shipments and strong sales of spare parts and a $2.5 million, or 64%, increase in revenues from China, primarily as a result of the timing of large orders. Revenues from the segment's water-management product line decreased by $1.9 million, or 24%, in 2004 primarily due to decreased sales of capital equipment in North America. The segment's accessories product line revenues increased $0.3 million, or 2%, in 2004 including a $0.7 million, or 5%, increase from the favorable effect of currency translation.

Composite and Fiber-Based Products Segment. Revenues at the Composite and Fiber-based Products segment increased $1.7 million, or 44%, to $5.6 million in the third quarter of 2004 from $3.9 million in the third quarter of 2003 due primarily to a 72% increase in sales of our composite building products resulting from continued acceptance of composites as an alternative to wood in the decking market and expansion of our distribution network.

Gross Profit Margin

Gross profit margin for the third quarters of 2004 and 2003 by segment was as follows:

	Three Months Ended	
	October 2, 2004	September 27, 2003
Gross Profit Margin:		
Pulp and Papermaking Equipment and Systems	39%	42%
Composite and Fiber-based Products	(75%)	11%
	27%	40%

Gross profit margin decreased to 27% in the third quarter of 2004 from 40% in the third quarter of 2003. The gross profit margin at the Papermaking Equipment segment decreased to 39% in 2004 from 42% in 2003 primarily due to lower profit margins from sales of capital equipment and, to a lesser extent, an overall change in product mix to a larger proportion of revenues coming from capital equipment sales compared to last year. The gross margin at the Composite and Fiber-based Products segment was negative 75% in the third quarter of 2004 compared to a gross profit margin of 11% in the third quarter of 2003. The negative gross margin in 2004 was primarily the result of warranty costs of $4.6 million and, to a lesser extent, higher production costs. The composite building products business experienced a significant increase in warranty costs for our decking products in the third quarter of 2004. The majority of this increase was associated with a new problem concerning excessive oxidation that affects the integrity of the plastic used in some of our decking products.

Operating Expenses

Selling, general, and administrative expenses as a percentage of revenues increased to 29% in the third quarter of 2004 compared with 28% in the third quarter of 2003. Selling, general, and administrative expenses increased $2.5 million, or 19%, to $15.3 million in the third quarter of 2004 from $12.8 million in the third quarter of 2003. This increase included a $1.5 million, or 28%, increase in general and administrative expenses and a $1.0 million, or 13%, increase in selling expenses. The increase in general and administrative expenses includes a $0.4 million increase in the costs associated with the implementation of the internal control requirements of the Sarbanes-Oxley Act and a $0.2 million increase from the unfavorable effect of foreign currency translation at the Papermaking Equipment segment.

Third Quarter 2004 Compared With Third Quarter 2003 (continued)

The increase in selling expenses includes $0.3 million in severance costs associated with our European operations and a $0.2 million increase from the unfavorable effect of foreign currency translation.

Research and development expenses decreased to $0.9 million, or 2% of revenues, in the third quarter of 2004 compared with $1.1 million, or 3% of revenues, in the third quarter of 2003.

Gain on Sale of Subsidiary

During the third quarter of 2004, we recognized a gain of $0.1 million from the sale of a subsidiary in Latin America for $0.4 million.

Restructuring and Unusual Items

During the third quarter of 2003, we recorded additional restructuring costs of $0.2 million related to the restructuring actions taken during the second quarter of 2003 (Note 6).

Interest Income and Expense

Interest income increased to $0.4 million in the third quarter of 2004 from $0.2 million in the third quarter of 2003 primarily due to higher average invested balances.

Income Taxes

Our effective tax rate was 53% and 38% in the third quarters of 2004 and 2003, respectively. The effective tax rate for the third quarter of 2004 was a 53% income tax benefit, which was based on our 35% recurring effective tax rate on pre-tax losses and a $0.2 million reduction in reserves for foreign tax credits associated with the filing of the 2003 federal tax return. The 38% effective tax rate in the third quarter of 2003 exceeded the statutory federal income tax rate primarily due to the impact of state income taxes and nondeductible expenses.

First Nine Months 2004 Compared With First Nine Months 2003

The following table sets forth our unaudited condensed consolidated statement of operations expressed as a percentage of total revenues for the first nine months of 2004 and 2003. The results of operations for the first nine months of 2004 are not necessarily indicative of the results to be expected for the full fiscal year.

	Nine Months Ended	
	October 2, 2004	September 27, 2003
Revenues	100%	100%
Costs and Operating Expenses:		
Cost of revenues	66	62
Selling, general, and administrative expenses	28	26
Research and development expenses	2	2
	96	90
Operating Income	4	10
Interest Income, net	1	-
Income Before Provision for Income Taxes and Minority Interest	5	10
Provision for Income Taxes	1	4
Net Income	4%	6%

Revenues

Revenues increased to $162.8 million in the first nine months of 2004 from $153.1 million in the first nine months of 2003, an increase of $9.7 million, or 6%. Revenues in 2004 include the favorable effect of currency translation of $6.1 million due to a weaker U.S. dollar relative to most of the functional currencies in countries in which we operate.

Revenues by segment for the first nine months of 2004 and 2003 were as follows:

	Nine Months Ended	
(In thousands)	October 2, 2004	September 27, 2003
Revenues:		
Pulp and Papermaking Equipment and Systems	$144,166	$138,254
Composite and Fiber-based Products	18,620	14,811
	$162,786	$153,065

Pulp and Papermaking Equipment and Systems Segment. Revenues at the Papermaking Equipment segment increased to $144.2 million in the first nine months of 2004 compared with $138.3 million in the first nine months of 2003, an increase of $5.9 million, or 4%. The increase in revenues in 2004 includes a $6.1 million, or 4%, increase from the favorable effect of currency translation. Revenues from the segment's stock-preparation equipment product line increased $4.2 million, or 6%, in 2004. The revenue increase was the result of a $3.0 million, or 4%, increase from the favorable effect of currency translation, a $1.7 million, or 8%, increase in sales from China and a $1.2 million increase in sales from North America, offset in part by a $1.6 million decrease in sales from Europe due to continued market weakness. Revenues from the segment's water-management product line decreased $1.4 million, or 6%, in

First Nine Months 2004 Compared With First Nine Months 2003 (continued)

2004 primarily due to a $1.7 million, or 7%, decrease in sales from North America, offset in part by a $0.5 million, or 2%, increase from the favorable effect of currency translation. Revenues from the segment's accessories product line increased by $3.0 million, or 7%, in 2004 due to a $2.6 million, or 6%, increase from the favorable effect of currency translation and a $1.8 million increase in sales from North America, which was largely offset by a $1.4 million decrease in Europe due to lower demand.

Composite and Fiber-Based Products Segment. Revenues at the Composite and Fiber-based Products segment increased $3.8 million, or 26%, to $18.6 million in the first nine months of 2004 from $14.8 million in the first nine months of 2003 due primarily to a $3.5 million, or 34%, increase in sales of our composite building products in the first nine months of 2004 resulting from continued acceptance of composites as an alternative to wood in the decking market and expansion of our distribution network.

Gross Profit Margin

Gross profit margin for the first nine months of 2004 and 2003 by segment was as follows:

	Nine Months Ended	
	October 2, 2004	September 27, 2003
Gross Profit Margin:		
Pulp and Papermaking Equipment and Systems	39%	39%
Composite and Fiber-based Products	(9%)	28%
	34%	38%

Gross profit margin decreased to 34% in the first nine months of 2004, compared to 38% in the first nine months of 2003. The gross profit margin at the Papermaking Equipment segment remained constant at 39% in 2004 and 2003. The gross margin at the Composite and Fiber-based Products segment was negative 9% in the first nine months of 2004 compared with gross profit margin of 28% in the first nine months of 2003. The negative gross margin in 2004 was due primarily to warranty costs in the composite building products business of $5.9 million compared to $1.1 million in 2003 as discussed in the results of operations for the third quarter of 2004.

Operating Expenses

Selling, general, and administrative expenses as a percentage of revenues were 28% in the first nine months of 2004 compared with 26% in the first nine months of 2003. Selling, general, and administrative expenses increased $6.0 million, or 15%, to $45.7 million in 2004 from $39.7 million in 2003. This increase included a $3.0 million, or 13%, increase in selling expenses and a $3.0 million, or 19%, increase in general and administrative expenses. The increase in selling expenses includes a $1.1 million increase from the unfavorable effect of foreign currency translation and a $0.3 million increase in severance costs associated with our European operations. The increase in general and administrative expenses includes a $0.7 million increase in the costs associated with the implementation of the internal control requirements of the Sarbanes-Oxley Act, a $0.5 million increase from the unfavorable effect of foreign currency translation at the Papermaking Equipment segment and a $0.4 million increase in severance costs associated with our European operations. In addition, general and administrative expenses included increased expenses of $0.4 million associated with several projects underway to further streamline our international organization, initial expenses of $0.2 million related to the establishment of our wholly owned subsidiary in China and a $0.2 million increase in audit-related fees. Also included in general and administrative expenses, offsetting the expenses noted above, was a gain of approximately $1.0 million in the first quarter of 2004, which resulted from renegotiating a series of agreements with one of our licensees.

First Nine Months 2004 Compared With First Nine Months 2003 (continued)
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Research and development expenses as a percentage of revenues were 2% in the first nine months of 2004 and 2003.

Gain on Sale of Subsidiary

During the first nine months of 2004, we recognized a gain of $0.1 million from the sale of a subsidiary in Latin America for $0.4 million.

Restructuring and Unusual Items

During the first nine months of 2003, we recorded net restructuring costs and unusual income of $23,000. Restructuring costs of $0.6 million, which were accounted for in accordance with SFAS No. 112, related to severance costs for seven employees across all functions at the Papermaking Equipment segment's Kadant Lamort subsidiary. Unusual income resulted from a gain of $0.6 million from the sale of property, for approximately $0.9 million in cash, at the same subsidiary (Note 6).

Interest Income and Expense

Interest income increased to $1.0 million in the first nine months of 2004 from $0.7 million in the first nine months of 2003 primarily due to higher average invested balances.

Income Taxes

Our effective tax rate was 28% and 38% in the first nine months of 2004 and 2003, respectively. The 28% effective tax rate in 2004 was lower than the statutory federal income tax rate primarily due to a reduction of $0.4 million in the first nine months of 2004 in tax reserves primarily associated with our foreign operations, as the reserves were no longer required and a $0.2 million reduction in reserves for foreign tax credits associated with the filing of the 2003 federal tax return. The 38% effective tax rate in the third quarter of 2003 exceeded the statutory federal income tax rate primarily due to the impact of state income taxes and nondeductible expenses.

Recently, Congress passed new tax legislation, the American Jobs Creation Act, for which the U.S. Treasury has not yet issued any regulations or guidance. In addition, the accounting profession will be exposing for comment new interpretations which may affect income tax accounting for calendar year companies. It is too early to evaluate the impact of these pending changes.

Liquidity and Capital Resources

Consolidated working capital was $108.8 million at October 2, 2004, compared with $107.0 million at January 3, 2004. Included in working capital are cash and cash equivalents of $77.1 million at October 2, 2004, compared with $74.5 million at January 3, 2004. At October 2, 2004, $45.9 million of cash and cash equivalents was held by our foreign subsidiaries.

During the first nine months of 2004, cash of $9.3 million was provided by operating activities, compared with $20.0 million in the first nine months of 2003. The cash provided by operating activities in 2004 was primarily the result of $6.0 million of net income, a non-cash charge of $3.6 million for depreciation and amortization expense and a $7.6 million provision for warranty obligations. In addition, a decrease in other current liabilities used cash of $6.4 million, an increase in accounts receivable used cash of $4.1 million and a decrease in inventory provided a source of cash of $2.8 million in 2004.

Our investing activities used cash of $0.7 million in the first nine months of 2004, compared with $1.8 million in the first nine months of 2003. During the first nine months of 2004, we purchased property, plant, and equipment for

Liquidity and Capital Resources (continued)

$1.6 million and received proceeds of $1.3 million from the sale of property, plant, and equipment.

Our financing activities used cash of $6.1 million in the first nine months of 2004, compared with $0.6 million of cash provided in the first nine months of 2003. During the first nine months of 2004, we purchased 509,000 shares of our common stock on the open market for $10.3 million (see Part II - Item 2 for further discussion). In addition, we received proceeds of $4.8 million from the issuance of our common stock in connection with our employee stock option and stock purchase plans and used cash to repay $0.6 million of long-term notes payable in the first nine months of 2004.

In May 2004, our board of directors authorized the repurchase of up to $30.0 million of our equity securities in the open market or in negotiated transactions through May 18, 2005. As of October 2, 2004, we had repurchased 460,400 shares under this authorization for $9.4 million. Under a previous authorization, we repurchased an additional 48,600 shares for $0.9 million prior to the third quarter of 2004.

At October 2, 2004, we had $55.4 million of unremitted foreign earnings that could be subject to tax if remitted to the U.S. Our practice is to reinvest indefinitely the earnings of our international subsidiaries. We do not expect that this will have a material adverse effect on our current liquidity.

Although we currently have no material commitments for capital expenditures, we plan to make expenditures during the remainder of 2004 for property, plant, and equipment of approximately $0.9 million.

In the future, our liquidity position will be primarily affected by the level of cash flows from operations and the amount of cash expended on capital expenditures and stock repurchases, or acquisitions, if any. We believe that our existing resources, together with the cash we expect to generate from operations, are sufficient to meet the capital requirements of our current operations for the foreseeable future.

Risk Factors

In connection with the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995, we wish to caution readers that the following important factors, among others, in some cases have affected, and in the future could affect, our actual results and could cause our actual results in 2004 and beyond to differ materially from those expressed in any forward-looking statements made by us, or on our behalf.

Our business is dependent on the condition of the pulp and paper industry.

We sell products primarily to the pulp and paper industry, which is a cyclical industry. Generally, the financial condition of the global pulp and paper industry corresponds to the condition of the general economy, as well as to a number of other factors, including pulp and paper production capacity relative to demand. In recent years, the industry in certain geographic regions, notably North America, has been in a prolonged downcycle resulting in depressed pulp and paper prices, decreased spending, mill closure, consolidations, and bankruptcies, all of which have adversely affected our business. As paper companies consolidate in response to market weakness, they frequently reduce capacity and postpone or even cancel capacity addition or expansion projects. These cyclical downturns can cause our sales to decline and adversely affect our profitability.

Risk Factors (continued)

Our business is subject to economic, currency, political, and other risks associated with international sales and operations.

During the first nine months of 2004, approximately 55% of our sales were to customers outside the United States, principally in Europe and Asia. International revenues are subject to a number of risks, including the following:

- agreements may be difficult to enforce and receivables difficult to collect through a foreign country's legal system;
- foreign customers may have longer payment cycles;
- foreign countries may impose additional withholding taxes or otherwise tax our foreign income, impose tariffs, or adopt other restrictions on foreign trade; and
- the protection of intellectual property in foreign countries may be more difficult to enforce.

Although we seek to charge our customers in the same currency in which our operating costs are incurred, fluctuations in currency exchange rates may affect product demand and adversely affect the profitability in U.S. dollars of products we provide in international markets where payment for our products and services is made in their local currencies. Any of these factors could have a material adverse impact on our business and results of operations.

An increasing portion of our international sales has, and may in the future, come from China. An increase in revenues, as well as our planned operation of a manufacturing and assembly facility in China, will expose us to increased risk in the event of changes in the policies of the Chinese government, political unrest, unstable economic conditions, or other developments in China or in U.S.-China relations that are adverse to trade, including enactment of protectionist legislation or trade restrictions. Orders from customers in China, particularly for large systems that have been tailored to a customer's specific requirements, involve increased credit risk due to payment terms that are applicable to doing business in China. In addition, the timing of these orders is often difficult to predict.

We are subject to intense competition in all our markets.

We believe that the principal competitive factors affecting the markets for our products include quality, price, service, technical expertise, and product innovation. Our competitors include a number of large multinational corporations that may have substantially greater financial, marketing, and other resources than we do. As a result, they may be able to adapt more quickly to new or emerging technologies and changes in customer requirements, or to devote greater resources to the promotion and sale of their services and products. Competitors' technologies may prove to be superior to ours. Our current products, those under development, and our ability to develop new technologies may not be sufficient to enable us to compete effectively. Competition, especially in China, could increase if new companies enter the market or if existing competitors expand their product lines or intensify efforts within existing product lines. In addition, our composite building products business is subject to intense competition, particularly in the decking market, from traditional wood products and other composite lumber manufacturers, many of whom have greater financial, technical, and marketing resources than we do. As a result, we may be unable to compete successfully in this market.

Our inability to successfully identify and complete acquisitions or successfully integrate any new or previous acquisitions could have a material adverse effect on our business.

Our strategy includes the acquisition of technologies and businesses that complement or augment our existing products and services. Promising acquisitions are difficult to identify and complete for a number of reasons, including competition among prospective buyers and the need for regulatory, including antitrust, approvals. Any acquisition we may complete may be made at a substantial premium over the fair value of the net assets of the acquired company. We may not be able to complete future acquisitions, integrate any acquired businesses successfully into our existing businesses, make such businesses profitable, or realize anticipated cost savings or synergies, if any, from these acquisitions. In addition, we have previously acquired several companies and businesses. As a result of these

Risk Factors (continued)

acquisitions, we have recorded significant goodwill on our balance sheet, and in conjunction with the adoption of SFAS No. 142, "Goodwill and Other Intangible Assets," in 2002, we recorded a transitional impairment charge upon the adoption of this standard. Any future impairment losses identified will be recorded as reductions to operating income, which could have a material adverse effect on our results of operations. Our ability to realize the value of the goodwill that we have recorded will depend on the future cash flows of these businesses. These cash flows depend, in part, on how well we have integrated these businesses.

We may not be successful in selling the composite building products business.

On October 27, 2004, our board of directors approved a plan to sell the composite building products business. We cannot predict on what terms we may sell the business or if we will be successful in selling this business at all. Under applicable accounting rules, the results of the composite building products business will be reported as a discontinued operation; however, we will continue to report these results in our consolidated totals. For so long as we continue to own the composite building products business, our consolidated performance will continue to be subject to the risks and uncertainties related to that business, which are identified in the following Risk Factors.

Our performance in the market for composite building products will depend on our ability to manufacture and distribute our composite building products.

Development, manufacturing, and commercialization of our composite building products require significant testing and technical expertise in the formulation and manufacture of the products, and our efforts may not be successful. Growth of our composite building products business requires ongoing market acceptance. We have limited experience manufacturing these products at volume, cost, and quality levels sufficient to satisfy expected demand, and we have in the past and continue to encounter difficulties in connection with any large-scale manufacturing or commercialization of these new products. Our capacity may not be sufficient to meet demand without significant additional investment. In addition, the majority of our production is dependant upon a single piece of equipment. If that equipment were to fail for an extended period of time, it would have a material adverse effect on our revenues from this business in that period. We rely on distributors in the building products industry to market, distribute, and sell our products. We may be unable to produce our products in sufficient quantity to interest or retain these distributors or to add new distributors. In addition, the announcement of our proposed sale of the composites business and warranty problems may impact our relationship with our existing and proposed new distributors and may cause them to reduce their purchases of our products. If we are unable to distribute our products effectively, our revenues will decline and we will have to incur additional expenses to market these products directly.

The failure of our composite building products to perform over long periods of time could result in potential liabilities.

Our composite building products are new, have not been on the market for long periods of time, and may be used in applications about which we may have little knowledge or limited experience. Because we have limited historical experience, we may be unable to predict the potential liabilities related to product warranty or product liability issues. If our products fail to perform over their warranty periods, we may not have the ability to protect ourselves adequately against this potential liability, which could adversely affect our operating results. In the second half of 2003 and the first nine months of 2004, we have experienced a significant increase in warranty claims and warranty expense related to our composite decking products including, but not limited to, excessive contraction of certain deck boards. Although we believe we corrected these problems in 2003, claims relating to these production problems continue for boards produced prior to implementation of the corrective manufacturing changes. In addition, we experienced a significant number of warranty claims and associated warranty expense in the third quarter of 2004 associated with a new problem concerning excessive oxidation that affects the integrity of the plastic used in some of our decking products. Included in the increased warranty expense is the cost of exchanging material held by our distributors with new material that, we believe, is not susceptible to this oxidation issue and our best estimate of costs related to future potential valid claims arising from installed product. Although we increased the warranty provisions accordingly, we cannot guarantee that the reserves established will be sufficient if we incur warranty claims higher than anticipated. In addition, there can be no assurance that other problems will not develop. A continued high level of warranty claims or expenses and/or failure of our products to perform or to be accepted in the marketplace would have an adverse impact on the profitability of our business and our ability to sell the composites business on favorable terms.

Economic conditions could adversely affect demand for our composite building products.

Demand for our composite building products is affected by several factors beyond our control, including economic conditions. Recent demand for our products has been driven, in part, by the availability of low-interest mortgage and home equity loans. An increase in interest rates or tightened credit could adversely affect demand for home remodeling projects, including demand for our products.

Seasonality and weather conditions could adversely affect our business.

In general, the building products industry experiences seasonal fluctuations in sales, particularly in the fourth and first quarters, when holidays and adverse weather conditions in some regions usually reduce the level of home improvement and new construction activity. In addition, our composite building products are used or installed in outdoor construction applications, and our sales volume, bookings, gross margins, and operating income can be negatively affected by adverse weather. Operating results will tend to be lower in quarters with lower sales, which are not entirely offset by a corresponding reduction in operating costs. In addition, we may also experience lower gross profit margins in the fourth and first quarters due to seasonal incentive discounts offered to our distributors. As a result of these factors, we believe sequential period-to-period comparisons of our operating results are not reliable indicators of future performance, and the operating results for any one quarterly period may not be indicative of operating results to be expected for a full year.

We are dependent on a single mill for the raw material used in our fiber-based granules, and we may not be able to obtain raw material on commercially reasonable terms. In addition, the manufacture of our composite building products and fiber-based granules is subject to commodity price risks.

We are dependent on a single paper mill for the fiber used in the manufacture of our fiber-based granules and composite building products. This mill has the exclusive right to supply the papermaking byproducts used in our process to manufacture the granules. Although we believe our relationship with the mill is good, the mill could decide not to renew its contract with us at the end of 2005, or may not agree to renew on commercially reasonable terms. If this were to occur, we would be forced to find an alternative supply for this raw material. We may be unable to find an alternative supply on commercially reasonable terms or could incur excessive transportation costs if an alternative supplier were found, which would increase our manufacturing costs and might prevent prices for our products from being competitive.

In addition, we use natural gas in the production of our fiber-based granular products. We may manage our exposure to natural gas price fluctuations by entering into short-term forward contracts to purchase specified quantities of natural gas from a supplier. We may not be able to effectively manage our exposure to natural gas price fluctuations.

Our composite building products also contain plastics, which are subject to wide fluctuations in pricing and availability. Higher energy costs can increase the price of plastic significantly and rapidly. We may be unable to obtain sufficient quantities at reasonable prices, which would adversely affect our profitability and ability to produce a sufficient quantity of our products or to produce our products at competitive prices.

Risk Factors (continued)

Our inability to protect our intellectual property could have a material adverse effect on our business. In addition, third parties may claim that we infringe their intellectual property, and we could suffer significant litigation or licensing expense as a result.

We place considerable emphasis on obtaining patent and trade secret protection for significant new technologies, products, and processes because of the length of time and expense associated with bringing new products through the development process and into the marketplace. Our success depends in part on our ability to develop patentable products and obtain and enforce patent protection for our products both in the United States and in other countries. We own numerous U.S. and foreign patents, and we intend to file additional applications, as appropriate, for patents covering our products. Patents may not be issued for any pending or future patent applications owned by or licensed to us, and the claims allowed under any issued patents may not be sufficiently broad to protect our technology. Any issued patents owned by or licensed to us may be challenged, invalidated, or circumvented, and the rights under these patents may not provide us with competitive advantages. A patent relating to our fiber-based granular products expired in the second quarter of 2004. As a result, we could be subject to increased competition in this market, which could have an adverse effect on this business. In addition, competitors may design around our technology or develop competing technologies. Intellectual property rights may also be unavailable or limited in some foreign countries, which could make it easier for competitors to capture increased market position. We could incur substantial costs to defend ourselves in suits brought against us or in suits in which we may assert our patent rights against others. An unfavorable outcome of any such litigation could have a material adverse effect on our business and results of operations. In addition, as our patents expire, we rely on trade secrets and proprietary know-how to protect our products. We cannot be sure the steps we have taken or will take in the future will be adequate to deter misappropriation of our proprietary information and intellectual property.

We seek to protect trade secrets and proprietary know-how, in part, through confidentiality agreements with our collaborators, employees, and consultants. These agreements may be breached, we may not have adequate remedies for any breach, and our trade secrets may otherwise become known or be independently developed by our competitors.

Third parties may assert claims against us to the effect that we are infringing on their intellectual property rights. We could incur substantial costs and diversion of management resources in defending these claims, which could have a material adverse effect on our business, financial condition, and results of operations. In addition, parties making these claims could secure a judgment awarding substantial damages, as well as injunctive or other equitable relief, which could effectively block our ability to make, use, sell, distribute, or market our products and services in the United States or abroad. In the event that a claim relating to intellectual property is asserted against us, or third parties not affiliated with us hold pending or issued patents that relate to our products or technology, we may seek licenses to such intellectual property or challenge those patents. However, we may be unable to obtain these licenses on commercially reasonable terms, if at all, and our challenge of the patents may be unsuccessful. Our failure to obtain the necessary licenses or other rights could prohibit the sale, manufacture, or distribution of our products and, therefore, could have a material adverse effect on our business, financial condition, and results of operations.

Fluctuations in our quarterly operating results may cause our stock price to decline.

Given the nature of the markets in which we participate and the effect of Staff Accounting Bulletin (SAB) No. 104, "Revenue Recognition", we may not be able to reliably predict future revenues and profitability, and unexpected changes may cause us to adjust our operations. A large proportion of our costs are fixed, due in part to our significant selling, research and development, and manufacturing costs. Thus, small declines in revenues could disproportionately affect our operating results. Other factors that could affect our quarterly operating results include:

- failure of our products to pass contractually agreed upon acceptance tests, which would delay or prohibit recognition of revenues under SAB No. 104;
- adverse changes in demand for and market acceptance of our products;
- competitive pressures resulting in lower sales prices of our products;
- adverse changes in the pulp and paper industry;
- delays or problems in our introduction of new products;

Risk Factors (continued)

- our competitors' announcements of new products, services, or technological innovations;
- contractual liabilities incurred by us related to guarantees of our product performance;
- increased costs of raw materials or supplies, including the cost of energy; and
- changes in the timing of product orders.

Anti-takeover provisions in our charter documents, under Delaware law, and in our shareholder rights plan could prevent or delay transactions that our shareholders may favor.

Provisions of our charter and by-laws may discourage, delay, or prevent a merger or acquisition that our shareholders may consider favorable, including transactions in which shareholders might otherwise receive a premium for their shares. For example, these provisions:

- authorize the issuance of "blank check" preferred stock without any need for action by shareholders;
- provide for a classified board of directors with staggered three-year terms;
- require supermajority shareholder voting to effect various amendments to our charter and by-laws;
- eliminate the ability of our shareholders to call special meetings of shareholders;
- prohibit shareholder action by written consent; and
- establish advance notice requirements for nominations for election to our board of directors or for proposing matters that can be acted on by shareholders at shareholder meetings.

In addition, our board of directors has adopted a shareholder rights plan intended to protect shareholders in the event of an unfair or coercive offer to acquire our company and to provide our board of directors with adequate time to evaluate unsolicited offers. Preferred stock purchase rights have been distributed to our common shareholders pursuant to the rights plan. This rights plan may have anti-takeover effects. The rights plan will cause substantial dilution to a person or group that attempts to acquire us on terms that our board of directors does not believe are in our best interests and those of our shareholders and may discourage, delay, or prevent a merger or acquisition that shareholders may consider favorable, including transactions in which shareholders might otherwise receive a premium for their shares.

Item 3 - Quantitative and Qualitative Disclosures About Market Risk

Our exposure to market risk from changes in interest rates and foreign currency exchange rates has not changed materially from our exposure at year-end 2003.

Item 4 - Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer (CEO) and chief financial officer (CFO), evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act) as of October 2, 2004. Based on this evaluation, our CEO and CFO concluded that, as of October 2, 2004, our disclosure controls and procedures were (1) designed to ensure that material information relating to us, including our consolidated subsidiaries, is made known to our CEO and CFO by others within those entities, particularly during the period in which this report was being prepared, and (2) effective, in that they provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

(b) Changes in Internal Controls Over Financial Reporting

During the period ended October 2, 2004, there were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act) that materially affected, or were reasonably likely to materially affect, our internal control over financial reporting.

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PART II - OTHER INFORMATION

Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds

The following table provides information about purchases by us of our common stock during the three months ended October 2, 2004:

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans (2)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans
7/4/04 - 7/31/04	-	-	-	$ 24,763,256
8/1/04 - 8/31/04	148,300	$19.41	148,300	$ 21,876,638
9/1/04 - 10/2/04	63,600	$19.23	63,600	$ 20,650,526
Total:	211,900	$19.36	211,900	

(1) During the third quarter of 2004, we repurchased an aggregate of 211,900 shares of our common stock on the open market pursuant to a repurchase program that we publicly announced on May 18, 2004.

(2) On May 18, 2004, our board of directors approved the repurchase by us of up to $30 million of our equity securities through May 18, 2005. The repurchases may be made in the open market or in negotiated transactions, from time to time, depending on market conditions. As of October 2, 2004, we had repurchased 460,400 shares of our common stock for $9.4 million under this authorization and 48,600 shares of our common stock for $0.9 million under a previous authorization, which expired on May 15, 2004.

Item 6 - Exhibits

See Exhibit Index on the page immediately preceding exhibits.

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KADANT INC.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized as of the 12th day of November 2004.

KADANT INC.

/s/ Thomas M. O'Brien

Thomas M. O'Brien
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)

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KADANT INC.

EXHIBIT INDEX

Exhibit Number	Description of Exhibit
31.1	Certification of the Principal Executive Officer of the Registrant Pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
31.2	Certification of the Principal Financial Officer of the Registrant Pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
32	Certification of the Chief Executive Officer and the Chief Financial Officer of the Registrant Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

EXHIBIT 31.1

CERTIFICATIONS

I, William A. Rainville, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the fiscal quarter ended October 2, 2004 of Kadant Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) [Not applicable];

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 12, 2004

/s/ William A. Rainville

William A. Rainville
Chief Executive Officer

EXHIBIT 31.2

CERTIFICATIONS

I, Thomas M. O'Brien, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the fiscal quarter ended October 2, 2004 of Kadant Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

    a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    b) [Not applicable];

    c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

    a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

    b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 12, 2004

/s/ Thomas M. O'Brien

Thomas M. O'Brien
Chief Financial Officer

Exhibit 32

CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER
AND THE CHIEF FINANCIAL OFFICER

Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to
Section 906 of the Sarbanes-Oxley Act of 2002

Pursuant to 18 U.S.C. Section 1350, the undersigned, William A. Rainville, chief executive officer, and Thomas M. O'Brien, chief financial officer, of Kadant Inc., a Delaware corporation (the "Company"), do hereby certify that:

The Quarterly Report on Form 10-Q for the fiscal quarter ended October 2, 2004 of the Company fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and the information contained in this Quarterly Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: November 12, 2004

/s/ William A. Rainville

William A. Rainville
Chief Executive Officer

/s/ Thomas M. O'Brien

Thomas M. O'Brien
Chief Financial Officer