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 July 3, 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 (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Indicate by check mark 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 August 3, 2004
Common Stock, $.01 par value	14,054,128

PART I - Financial Information

Item 1 - Financial Statements

KADANT INC.

Condensed Consolidated Balance Sheet
(Unaudited)

Assets

(In thousands)	July 3, 2004	January 3, 2004
Current Assets:		
Cash and cash equivalents	$ 81,588	$ 74,451
Accounts receivable, less allowances of $1,767 and $1,680	32,096	32,507
Unbilled contract costs and fees	11,704	10,755
Inventories (Note 5)	32,445	33,203
Deferred tax asset	7,714	7,710
Other current assets	3,365	3,187
	168,912	161,813
Property, Plant, and Equipment, at Cost	74,987	77,458
Less: Accumulated depreciation and amortization	51,150	51,631
	23,837	25,827
Other Assets	9,969	10,537
Goodwill	73,815	73,536
	$276,533	$271,713

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

KADANT INC.

Condensed Consolidated Balance Sheet (continued)
(Unaudited)

Liabilities and Shareholders' Investment

(In thousands, except share amounts)	July 3, 2004	January 3, 2004
Current Liabilities:		
Current maturities of long-term obligations	$ -	$ 598
Accounts payable	25,336	23,896
Accrued payroll and employee benefits	9,332	11,356
Accrued warranty costs	4,931	4,530
Customer deposits	3,780	2,406
Accrued income taxes	3,014	1,040
Other current liabilities	8,615	10,983
	55,008	54,809
Deferred Income Taxes	1,271	1,617
Other Long-Term Liabilities	3,180	3,178
Minority Interest	58	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; 14,562,854 and 14,309,892 shares issued	146	143
Capital in excess of par value	98,044	94,454
Retained earnings	134,990	128,519
Treasury stock at cost, 495,326 and 208,226 shares	(14,525)	(8,788)
Deferred compensation	(151)	(31)
Accumulated other comprehensive loss (Note 2)	(1,488)	(2,539)
	217,016	211,758
	$276,533	$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 Income
(Unaudited)

(In thousands, except per share amounts)	Three Months Ended July 3, 2004	Three Months Ended June 28, 2003
Revenues	$57,782	$55,784
Costs and Operating Expenses:		
Cost of revenues	36,652	35,086
Selling, general, and administrative expenses	15,566	13,382
Research and development expenses	693	1,310
Restructuring and unusual items (Note 6)	-	(180)
	52,911	49,598
Operating Income	4,871	6,186
Interest Income	318	214
Interest Expense	(4)	(11)
Income Before Provision for Income Taxes and Minority Interest	5,185	6,389
Provision for Income Taxes	1,428	2,428
Minority Interest Expense	14	72
Net Income	$ 3,743	$ 3,889
Earnings per Share (Note 3):		
Basic	$ .26	$ .29
Diluted	$ .26	$ .28
Weighted Average Shares (Note 3):		
Basic	14,218	13,601
Diluted	14,555	13,908

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

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KADANT INC.

Condensed Consolidated Statement of Income
(Unaudited)

(In thousands, except per share amounts)	Six Months Ended July 3, 2004	Six Months Ended June 28, 2003
Revenues	$109,509	$107,159
Costs and Operating Expenses:		
Cost of revenues	68,617	67,294
Selling, general, and administrative expenses	30,434	26,894
Research and development expenses	1,711	2,353
Restructuring and unusual items (Note 6)	-	(180)
	100,762	96,361
Operating Income	8,747	10,798
Interest Income	647	450
Interest Expense	(12)	(28)
Income Before Provision for Income Taxes and Minority Interest	9,382	11,220
Provision for Income Taxes	2,897	4,264
Minority Interest Expense	14	72
Net Income	$ 6,471	$ 6,884
Earnings per Share (Note 3):		
Basic	$ .46	$ .51
Diluted	$ .44	$ .50
Weighted Average Shares (Note 3):		
Basic	14,220	13,588
Diluted	14,579	13,837

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)	Six Months Ended July 3, 2004	Six Months Ended June 28, 2003
Operating Activities:		
Net income	$ 6,471	$ 6,884
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on sale of property (Note 6)	(140)	(649)
Depreciation and amortization	2,419	2,607
Provision for losses on accounts receivable	218	77
Minority interest expense	14	72
Other non-cash items	312	172
Changes in current accounts:		
Accounts receivable	(993)	(4,259)
Unbilled contract costs and fees	(878)	(7,725)
Inventories	911	(1,440)
Other current assets	(117)	(208)
Accounts payable	1,261	4,809
Other current liabilities	(601)	2,718
Net cash provided by operating activities	8,877	3,058
Investing Activities:		
Purchases of property, plant, and equipment	(1,146)	(1,448)
Proceeds from sale of property, plant, and equipment	1,279	940
Acquisition of minority interest in subsidiary	(318)	-
Other, net	(94)	(125)
Net cash used in investing activities	(279)	(633)
Financing Activities:		
Net proceeds from issuance of Company common stock	4,598	791
Purchases of Company common stock	(6,159)	-
Repayments of long-term obligations	(598)	(567)
Net cash (used in) provided by financing activities	(2,159)	224
Exchange Rate Effect on Cash	698	5,404
Increase in Cash and Cash Equivalents	7,137	8,053
Cash and Cash Equivalents at Beginning of Period	74,451	44,429
Cash and Cash Equivalents at End of Period	$81,588	$52,482

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," "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 July 3, 2004, its results of operations for the three- and six-month periods ended July 3, 2004, and June 28, 2003, and cash flows for the six-month periods ended July 3, 2004, and June 28, 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 consolidated financial statements and related notes of the Company. The condensed consolidated financial statements and notes included herein should be read in conjunction with the consolidated 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

Comprehensive income combines net income and "other comprehensive items," which represents 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. During the second quarters of 2004 and 2003, the Company had comprehensive income of $2,780,000 and $8,870,000, respectively. During the first six months of 2004 and 2003, the Company had comprehensive income of $7,522,000 and $15,616,000, respectively.

The components of comprehensive income were as follows:

(In thousands)	Three Months Ended July 3, 2004	Three Months Ended June 28, 2003	Six Months Ended July 3, 2004	Six Months Ended June 28, 2003
Net Income	$3,743	$3,889	$6,471	$ 6,884
Other Comprehensive (Loss) Income				
Foreign Currency Translation Adjustments	(949)	5,119	1,087	8,866
Deferred Loss on Foreign Currency Contracts	(14)	(138)	(36)	(134)
	(963)	4,981	1,051	8,732
Comprehensive Income	$2,780	$8,870	$7,522	$15,616

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KADANT INC.

Notes to Condensed Consolidated Financial Statements
(Unaudited)

3. Earnings per Share

Basic and diluted earnings per share were calculated as follows:

(In thousands, except per share amounts)	Three Months Ended July 3, 2004	Three Months Ended June 28, 2003	Six Months Ended July 3, 2004	Six Months Ended June 28, 2003
Basic				
Net Income	$ 3,743	$ 3,889	$ 6,471	$ 6,884
Weighted Average Shares	14,218	13,601	14,220	13,588
Basic Earnings per Share	$ 0.26	$ 0.29	$ 0.46	$ 0.51
Diluted				
Net Income	$ 3,743	$ 3,889	$ 6,471	$ 6,884
Weighted Average Shares	14,218	13,601	14,220	13,588
Effect of Stock Options	337	307	359	249
Weighted Average Shares, as Adjusted	14,555	13,908	14,579	13,837
Diluted Earnings per Share	$ 0.26	$ 0.28	$ 0.44	$ 0.50

Options to purchase approximately 222,400 and 345,700 shares of common stock for the second quarters of 2004 and 2003, respectively, and 234,700 and 369,500 shares of common stock for the first six 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 antidilutive.

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 (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. The composite building products business experienced an increase in warranty claims versus historical claim rates in the latter half of 2003 and the first six months of 2004. The Company increased its estimated costs for product warranties for this business and recorded related warranty expenses of $1,330,000 in the first six months of 2004 versus $477,000 in the first six months of 2003. While the Company engages in extensive product quality programs and processes, its warranty obligation is affected by product failure rates, repair costs, service delivery costs incurred in correcting product failures, 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.

KADANT INC.

Notes to Condensed Consolidated Financial Statements
(Unaudited)

4. Warranty Obligations (continued)

The changes in the carrying amount of the Company's consolidated product warranties for the three- and six- month periods ended July 3, 2004 and June 28, 2003, are as follows:

	Three Months Ended	
(In thousands)	July 3, 2004	June 28, 2003
Balance at Beginning of Period	$4,922	$4,564
Provision charged to income	1,408	640
Usage	(1,375)	(454)
Other, net (a)	(24)	167
Balance at End of Period	$4,931	$4,917

	Six Months Ended	
(In thousands)	July 3, 2004	June 28, 2003
Balance at Beginning of Period	$4,530	$4,310
Provision charged to income	2,703	1,243
Usage	(2,321)	(924)
Other, net (a)	19	288
Balance at End of Period	$4,931	$4,917

(a) Represents the effects of currency translation.

5. Inventories

The components of inventories are as follows:

(In thousands)	July 3, 2004	January 3, 2004
Raw Materials and Supplies	$13,341	$13,049
Work in Process	7,391	7,806
Finished Goods (includes $725 and $860 at customer locations)	11,713	12.348
	$32,445	$33,203

6. Restructuring and Unusual Items

During the second quarter of 2003, the Company recorded net restructuring costs and unusual income of $180,000, including $469,000 of restructuring costs and $649,000 of unusual income as detailed hereafter. The restructuring costs of $469,000, which were accounted for in accordance with Statement of Financial Accounting Standards No. 112 (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. These actions were taken in an effort to improve profitability and were in response to a continued weak market environment and reduced demand for the Company's products. The unusual income resulted from a gain of $649,000 from the sale of property, for approximately $921,000 in cash, at the same subsidiary.

KADANT INC.

Notes to Condensed Consolidated Financial Statements
(Unaudited)

6. Restructuring and Unusual Items (continued)

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)	Severance
Balance at January 3, 2004	$200
Usage	(46)
Currency translation	5
Balance at July 3, 2004	$159

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

	Three Months Ended		Six Months Ended	
(In thousands)	July 3, 2004	June 28, 2003	July 3, 2004	June 28, 2003
Revenues:				
Pulp and Papermaking Equipment and Systems	$50,933	$50,674	$ 96,497	$ 96,231
Composite and Fiber-based Products	6,849	5,110	13,012	10,928
	$57,782	$55,784	$109,509	$107,159
Income Before Provision for Income Taxes and Minority Interest:				
Pulp and Papermaking Equipment and Systems (a)	$ 6,152	$ 6,691	$ 12,495	$ 11,931
Composite and Fiber-based Products (b)	104	571	(532)	983
Corporate (c)	(1,385)	(1,076)	(3,216)	(2,116)
Total Operating Income	4,871	6,186	8,747	10,798
Interest Income, Net	314	203	635	422
	$ 5,185	$ 6,389	$ 9,382	$ 11,220
Capital Expenditures:				
Pulp and Papermaking Equipment and Systems	$ 505	$ 359	$ 835	$ 561
Composite and Fiber-based Products	190	228	300	876
Corporate	8	8	11	11
	$ 703	$ 595	$ 1,146	$ 1,448

(a) Includes a gain of $971 in the six-month period ending July 3, 2004, which resulted from renegotiating a series of agreements with one of the Company's licensees, and net restructuring costs and unusual income of $180 in the three- and six-month periods ended June 28, 2003 (Note 6).

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KADANT INC.

Notes to Condensed Consolidated Financial Statements
(Unaudited)

7. Business Segment Information (continued)

(b) Includes operating losses from the composite building products business of $370 and $1,302 in the three- and six-month periods ended July 3, 2004, respectively, and operating income of $26 and $110 in the three- and six-month periods ended June 28, 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 (APB) 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:

	Three Months Ended		Six Months Ended	
(In thousands, except per share amounts)	July 3, 2004	June 28, 2003	July 3, 2004	June 28, 2003
Net Income:				
As reported	$3,743	$3,889	$6,471	$6,884
Deduct: Total stock-based employee compensation expense determined under the fair-value-based method for all awards, net of tax	(623)	(616)	(1,129)	(1,285)
Pro forma	$3,120	$3,273	$5,342	$5,599
Basic Earnings per Share:				
As reported	$ .26	$ .29	$ .46	$ .51
Pro forma	$ .22	$ .24	$ .38	$ .41
Diluted Earnings Per Share:				
As reported	$ .26	$ .28	$ .44	$ .50
Pro forma	$ .21	$ .24	$ .37	$ .40

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 table below in "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.

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9. Employee Benefit Plans (continued)

The following summarizes the components of the net periodic benefit cost for the pension benefits and other benefits plans in the three- and six-month periods ended July 3, 2004 and June 28, 2003.

(In thousands)	Three Months Ended July 3, 2004		Three Months Ended June 28, 2003	
	Pension Benefits	Other Benefits	Pension Benefits	Other Benefits
Components of Net Periodic Benefit Cost:				
Service cost	$158	$ -	$156	$ -
Interest cost	227	13	257	19
Expected return on plan assets	(342)	-	(317)	-
Recognized net actuarial loss	-	9	12	10
Amortization of prior service cost	11	(15)	11	(11)
Net periodic benefit cost	$ 54	$ 7	$119	$ 18

	Six Months Ended July 3, 2004		Six Months Ended June 28, 2003	
	Pension Benefits	Other Benefits	Pension Benefits	Other Benefits
Components of Net Periodic Benefit Cost:				
Service cost	$320	$ -	$312	$ -
Interest cost	484	26	514	38
Expected return on plan assets	(684)	-	(634)	-
Recognized net actuarial loss	-	18	24	20
Amortization of prior service cost	22	(30)	22	(22)
Net periodic benefit cost	$142	$ 14	$238	$ 36

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.

10. Recent Accounting Pronouncement

Consolidation of Variable Interest Entities

In January 2003, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 46 (FIN 46), "Consolidation of Variable Interest Entities - An Interpretation of Accounting Research Bulletin (ARB) No. 51", which addresses consolidation by business enterprises of variable interest entities (VIEs). In December 2003, the FASB completed deliberations of proposed modifications to FIN 46 (Revised Interpretations) resulting in multiple effective dates based on the nature as well as the creation date of the VIE. The Company does not have interests in special purpose entities and the adoption of the provisions of FIN 46 and the Revised Interpretations in the first quarter of 2004 did not have an effect on its condensed consolidated financial statements.

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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.

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 trades 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. 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;

Overview (continued)

- Paper 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 six months of 2004, approximately 56% 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 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.

Overview (continued)

Industry and Business Outlook

Our products are primarily sold to the pulp and paper industry. Although the paper industry had been in a prolonged downcycle 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 of 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 better control economic growth. These efforts 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 revenue recognition 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.

We have also continued to invest in our composite building products business which, we believe, provides us with an internal growth opportunity. The market for composite building products has grown as consumer awareness of the advantages of these products increases their acceptance as an alternative to traditional wood products. We continue to focus on expanding our distribution network, with numerous wholesale distribution centers and retail lumber yards throughout the U.S. now carrying our composite decking products.

We did, however, experience some problems in the composite building products business that affected our profitability in the first six months of 2004 and will continue to hamper profitability in the second half of 2004. Beginning in mid-2003 and continuing into the first six months of 2004, we experienced an increase in warranty claims over the first six months of 2003, which had an adverse impact on profitability. The majority of these claims were associated with excessive contraction of certain decking products. Although we believe the production problems were corrected in 2003, we are still experiencing a significant level of claims associated with decking products produced and installed before the corrective actions were implemented. In addition, the cost of plastic used in our composite building products has significantly increased recently. The combination of higher warranty expense and plastic costs over last year will continue to have a significant adverse impact on our profitability in the composite building products business for the remainder of 2004. These factors considered, for the third quarter of 2004 we expect our composite building products business to report, on a generally accepted accounting principles (GAAP) basis, in the range of an operating loss of $0.2 million to operating income of $0.1 million, on revenues of $4 to $4.5 million. For the full year, we expect this business to report an operating loss of $1.3 to $1.9 million, compared to our previously announced guidance of an operating loss of $0.8 to $1.2 million, on revenues of $16 to $17 million.

Overview (continued)

For the total company, for the third quarter of 2004, we expect to earn, on a consolidated GAAP basis, $0.17 to $0.20 per diluted share, on revenues of $46 to $48 million. For the full year, we expect to earn, on a consolidated GAAP basis, $0.85 to $0.90 per diluted share on revenues of $205 to $210 million, down from our previously announced guidance of $0.90 to $1.00 per diluted share, on revenues of $205 to $215 million.

Results of Operations

Second Quarter 2004 Compared With Second Quarter 2003

The following table sets forth our unaudited condensed consolidated statement of income expressed as a percentage of total revenues for the second fiscal quarters of 2004 and 2003. The results of operations for the fiscal quarter ended July 3, 2004, are not necessarily indicative of the results to be expected for the full fiscal year.

	Three Months Ended	
	July 3, 2004	June 28, 2003
Revenues	100%	100%
Costs and Operating Expenses:		
Cost of revenues	64	63
Selling, general, and administrative expenses	27	24
Research and development expenses	1	2
	92	89
Operating Income	8	11
Interest Income, net	1	-
Income Before Provision for Income Taxes and Minority Interest	9	11
Provision for Income Taxes	2	4
Net Income	7%	7%

Revenues

Revenues increased to $57.8 million in the second quarter of 2004 from $55.8 million in the second quarter of 2003, an increase of $2.0 million, or 4%. Revenues in 2004 included the favorable effect of currency translation of $1.7 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 second quarter of 2004 and 2003 were as follows:

	Three Months Ended	
(In thousands)	July 3, 2004	June 28, 2003
Revenues:		
Pulp and Papermaking Equipment and Systems	$50,933	$50,674
Composite and Fiber-based Products	6,849	5,110
	$57,782	$55,784

Results of Operations (continued)

Second Quarter 2004 Compared With Second Quarter 2003 (continued)

Pulp and Papermaking Equipment and Systems Segment. Revenues at the Papermaking Equipment segment increased to $50.9 million in the second quarter of 2004 compared with $50.7 million in the second quarter of 2003, an increase of $0.2 million, or 1%. Revenues in the 2004 period included a $1.7 million, or 3%, increase from the favorable effect of currency translation. Revenues from the Papermaking Equipment segment's stock-preparation equipment product line decreased by $0.5 million, or 2%, in the second quarter of 2004 compared to the second quarter of 2003 as a result of a decrease in sales in North America, which was partially offset by the favorable effect of foreign currency translation from sales in Europe and an increase in sales in China. Sales in North America decreased $1.8 million, or 22%, in the 2004 quarter compared to the 2003 quarter due to the timing of several large orders that shipped in the second quarter of 2003. Sales in Europe increased $0.4 million, or 4%, in the second quarter of 2004 compared to 2003, which included a $1.0 million, or 10%, favorable effect of currency translation. Revenues in the stock-preparation equipment product line from China increased $0.8 million, or 9%, to $10.4 million in the second quarter of 2004 compared to $9.6 million in the second quarter of 2003 due to the timing of several large orders. Revenues from the segment's paper machine accessories product line increased $1.1 million, or 7%, in the second quarter of 2004 compared to 2003 due primarily to a $0.7 million favorable effect of currency translation. Revenues from the segment's water-management product line decreased $0.3 million, or 3%, in 2004, including a $0.1 million favorable effect of currency translation.

Composite and Fiber-Based Products Segment. Revenues at the Composite and Fiber-based Products segment increased to $6.8 million in the second quarter of 2004 from $5.1 million in 2003 as a result of an increase of $1.7 million, or 52%, in sales of our composite building products due to higher demand resulting from continued acceptance of composites as an alternative to wood in the decking market, our increased marketing efforts and expansion of our distribution channels.

Gross Profit Margin

Gross profit margin was 37% in the second quarters of 2004 and 2003.

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

	Three Months Ended July 3, 2004	Three Months Ended June 28, 2003
Gross Profit Margin:		
Pulp and Papermaking Equipment and Systems	38%	37%
Composite and Fiber-based Products	22%	37%
	37%	37%

The gross profit margin at the Papermaking Equipment segment increased to 38% in the second quarter of 2004 from 37% in the second quarter of 2003. The gross profit margin at the Composite and Fiber-based Products segment decreased to 22% in the second quarter of 2004 from 37% in the second quarter of 2003 due primarily to higher warranty costs associated with composite building products. The warranty provision increased to $0.8 million in the second quarter of 2004 compared to $0.3 million in the second quarter of 2003 as the result of an increase in claims associated with excessive contraction of certain decking products. Although we believe the production problems were corrected in 2003, we are still experiencing claims associated with product produced and installed before the corrective actions were implemented. We expect that our gross profit margins in the third quarter of 2004 will continue to be adversely affected by the higher warranty costs. The price of plastic used to produce our composite products has recently increased and we expect this will also adversely affect gross profit margins in the third quarter of 2004.

Results of Operations (continued)

Second Quarter 2004 Compared With Second Quarter 2003 (continued)

Operating Expenses

Selling, general, and administrative expenses as a percentage of revenues increased to 27% in the second quarter of 2004 compared with 24% in the second quarter of 2003. Selling, general, and administrative expenses increased $2.2 million, or 16%, to $15.6 million in the second quarter of 2004 from $13.4 million in 2003. This increase included a $0.7 million, or 8%, increase in selling expenses, a $0.5 million increase from the unfavorable effect of foreign currency translation at the Papermaking Equipment segment, a $0.4 million increase related to severance costs associated with one of our European operations and a $0.2 million increase in costs associated with the implementation of the internal control requirements of the Sarbanes-Oxley Act.

Research and development expenses decreased $0.6 million to $0.7 million, or 1% of revenues, in the second quarter of 2004 compared with $1.3 million, or 2% of revenues, in the second quarter of 2003 due, in part, to the timing of material purchases for research and development projects.

Restructuring and Unusual Items

During the second quarter of 2003, we recorded net restructuring costs and unusual income of $0.2 million. Restructuring costs of $0.5 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. These actions were taken in an effort to improve profitability and were in response to a continued weak market environment and reduced demand for our products. 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

Interest income increased to $0.3 million in the second quarter of 2004 from $0.2 million in the second quarter of 2003 primarily due to higher average invested balances.

Income Taxes

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

Results of Operations (continued)

First Six Months 2004 Compared With First Six Months 2003

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

	Six Months Ended	
	July 3, 2004	June 28, 2003
Revenues	100%	100%
Costs and Operating Expenses:		
Cost of revenues	63	63
Selling, general, and administrative expenses	28	25
Research and development expenses	1	2
	92	90
Operating Income	8	10
Interest Income, net	1	-
Income Before Provision for Income Taxes and Minority Interest	9	10
Provision for Income Taxes	3	4
Net Income	6%	6%

Revenues

Revenues increased to $109.5 million in the first six months of 2004 from $107.2 million in the first six months of 2003, an increase of $2.3 million, or 2%. Revenues in the 2004 period included the favorable effect of currency translation of $4.7 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 six months of 2004 and 2003 were as follows:

	Six Months Ended	
(In thousands)	July 3, 2004	June 28, 2003
Revenues:		
Pulp and Papermaking Equipment and Systems	$ 96,497	$ 96,231
Composite and Fiber-based Products	13,012	10,928
	$ 109,509	$ 107,159

Pulp and Papermaking Equipment and Systems Segment. Revenues at the Papermaking Equipment segment increased to $96.5 million in the first six months of 2004 compared with $96.2 million in the first six months of 2003, an increase of $0.3 million. Revenues in the 2004 period included a $4.7 million, or 5%, increase from the favorable effect of currency translation. Revenues from the Papermaking Equipment segment's stock-preparation equipment product line decreased by $3.0 million, or 6%, in the first six months of 2004 compared to the first six months of 2003 due primarily to a decrease in sales in North America and China. Sales in North America decreased $2.8 million, or 18%, in the first six months of 2004 compared to 2003 due to the timing of several large orders that shipped in 2003. Revenues in the stock-preparation equipment product line from China decreased $0.8 million, or 4%, to $17.1 million in the first six months of 2004 from $17.9 million in the first six months of 2003. Sales in Europe increased $0.7

Results of Operations (continued)

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

million, or 4%, in the first six months of 2004 compared to 2003, which included a $2.4 million, or 13%, favorable effect of currency translation. Revenues from the segment's paper machine accessories product line increased $2.7 million, or 9%, including a $1.9 million favorable effect of currency translation, in the first six months of 2004 compared to the first six months of 2003. Revenues from the segment's water-management product line increased $0.5 million, or 4%, in the first six months of 2004, due primarily to a $0.5 million favorable effect of currency translation.

Composite and Fiber-Based Products Segment. Revenues at the Composite and Fiber-based Products segment increased $2.1 million, or 19%, to $13.0 million in the first six months of 2004 from $10.9 million in 2003 primarily as a result of a $1.6 million, or 21%, increase in sales of our composite building products due to higher demand resulting from continued acceptance of composites as an alternative to wood in the decking market, as well as, our increased marketing efforts and expansion of our distribution channels. Revenues from our fiber-based granular products increased $0.5 million, or 14%, in the first six months of 2004 compared with the first six months of 2003.

Gross Profit Margin

Gross profit margin was 37% in the first six months of 2004 and 2003.

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

	Six Months Ended	
	July 3, 2004	June 28, 2003
Gross Profit Margin:		
Pulp and Papermaking Equipment and Systems	39%	38%
Composite and Fiber-based Products	19%	35%
	37%	37%

The gross profit margin at the Papermaking Equipment segment increased to 39% in the first six months of 2004 from 38% in 2003. The gross profit margin at the Composite and Fiber-based Products segment decreased to 19% in the first six months of 2004 from 35% in the first six months of 2003 due primarily to higher warranty costs associated with composite building products. The warranty provision increased to $1.3 million in the first six months of 2004 compared to $0.5 million in the first six months of 2003 as the result of an increase in claims associated with excessive contraction of certain decking products. Although we believe the production problems were corrected in 2003, we are still experiencing claims associated with product produced and installed before the corrective actions were implemented. We expect that our gross profit margins in the third quarter of 2004 will continue to be adversely affected by higher warranty costs. The price of plastic used to produce our composite products has recently increased and we expect this will also adversely affect gross profit margins in the third quarter of 2004.

Operating Expenses

Selling, general, and administrative expenses as a percentage of revenues were 28% in the first six months of 2004 compared with 25% in the first six months of 2003. Selling, general, and administrative expenses increased $3.5 million, or 13%, to $30.4 million in the first six months of 2004 from $26.9 million in the first six months of 2003 primarily due to a $1.2 million, or 11%, increase in general and administrative expenses, an increase of $1.2 million from the unfavorable effects of foreign currency translation at the Papermaking Equipment segment and a $1.1 million, or 7%, increase in selling expenses. Also included in selling, general and administrative expenses 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.

Results of Operations (continued)

First Six Months 2004 Compared With First Six Months 2003 (continued)
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Operating Expenses (continued)

Research and development expenses as a percentage of revenues were 1% and 2% in the first six months of 2004 and 2003, respectively.

Restructuring and Unusual Items

During the first six months of 2003, we recorded net restructuring costs and unusual income of $0.2 million due to the reasons discussed in the results of operations for the second quarter of 2004.

Interest Income

Interest income increased to $0.6 million in the first six months of 2004 from $0.5 million in the first six months of 2003 primarily due to higher average invested balances.

Income Taxes

Our effective tax rate was 31% and 38% in the first six months of 2004 and 2003, respectively. The 31% effective tax rate in the first six months of 2004 was lower than the statutory federal income tax rate due mainly to a reduction of $0.4 million in the second quarter of 2004 in tax reserves primarily associated with our foreign operations, as the reserves were no longer required. The 38% effective tax rate in the first six months of 2003 exceeded the statutory federal income tax rate primarily due to the impact of state income taxes and nondeductible expenses.

Liquidity and Capital Resources

Consolidated working capital was $113.9 million at July 3, 2004, compared with $107.0 million at January 3, 2004. Included in working capital are cash and cash equivalents of $81.6 million at July 3, 2004, compared with $74.5 million at January 3, 2004. At July 3, 2004, $45.7 million of cash and cash equivalents was held by our foreign subsidiaries.

During the first six months of 2004, cash of $8.9 million was provided by operating activities, compared with $3.1 million in the first six months of 2003. The cash provided by operating activities in 2004 was primarily the result of net income and non-cash charges for depreciation and amortization expense. In addition, an increase in accounts payable provided a source of cash of $1.3 million in 2004 primarily at the Papermaking Equipment segment due to the timing of payments.

Our investing activities used $0.3 million of cash in the first six months of 2004, compared with $0.6 million in the first six months of 2003. During the first six months of 2004, we purchased property, plant, and equipment for $1.1 million and received proceeds of $1.3 million from the sale of property, plant, and equipment.

Our financing activities used cash of $2.2 million in the first six months of 2004, compared with $0.2 million of cash provided in the first six months of 2003. During the first six months of 2004, we purchased 297,100 shares of our common stock on the open market for $6.2 million. (See Part II - Item 2 for further discussion.) In addition, we received proceeds of $4.6 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 six months of 2004.

Liquidity and Capital Resources (continued)

At July 3, 2004, we had $53.8 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 certain of our international subsidiaries. We do not expect that this will have a material adverse effect on our current liquidity.

In May 2004, our board of directors authorized the repurchase of up to $30 million of our equity securities in the open market or in negotiated transactions through May 18, 2005. As of July 3, 2004, we purchased 248,500 shares of our common stock on the open market for $5.2 million under this authorization. In addition, during the second quarter of 2004, we purchased 48,600 shares of our common stock on the open market for $1.0 million under a previous authorization to purchase up to $25 million of our common stock, which expired on May 15, 2004.

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 $2.9 million, including $1.0 million for our manufacturing and assembly facility in China.

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 closures, 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.

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

During the first six months of 2004, approximately 56% 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.

Risk Factors (continued)

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

In 2000, we began to develop, produce, market, and sell composite products primarily for the building industry. 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. Further, growth of our composite building products business requires ongoing market acceptance. We expect to incur significant branding and distribution expenses to successfully market and distribute these products and our strategy may not be successful. We have limited experience manufacturing these products at volume, cost, and quality levels sufficient to satisfy expected demand, and we may 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 dependent 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. 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.

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Risk Factors (continued)

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.

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 for 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 six months of 2004, we experienced a significant increase in warranty claims and warranty expense related to our composite decking products including, but not limited to, excessive contraction of our 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. 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.

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 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.

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 previously acquired several companies and businesses. As a result of these acquisitions, we 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.

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.

Risk Factors (continued)

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 No. 104, "Revenue Recognition" (SAB No. 104) 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;
- 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;
- 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.

KADANT INC.

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 of 1934, as amended) as of July 3, 2004. Based on this evaluation, our CEO and CFO concluded that, as of July 3, 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

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended) occurred during the fiscal quarter ended July 3, 2004 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 2 - Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities

The following table provides information about purchases by us of our common stock during the three months ended July 3, 2004:

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans (2)	Remaining Funds Available to Repurchase Shares Under the Plans
4/4/04 - 4/30/04	-	-	-	$ 25,000,000
5/1/04 - 5/31/04	154,800	$20.09	154,800	$ 27,819,338
6/1/04 - 7/3/04	142,300	$21.43	142,300	$ 24,763,256
Total:	297,100	$20.73	297,100	

(1) We repurchased an aggregate of 48,600 and 248,500 shares of our common stock pursuant to the repurchase programs that we publicly announced on May 16, 2003 ("2003 Repurchase Program") and May 18, 2004 ("2004 Repurchase Program"), respectively. Of the 297,100 shares repurchased, all shares were purchased on the open market.

(2) Our board of directors approved the repurchase by us of up to $25 million of our common stock pursuant to the 2003 Repurchase Program and up to $30 million of our common stock pursuant to the 2004 Repurchase Program. The repurchases may be made in the open market or in negotiated transactions, from time to time, depending on market conditions. The expiration date of the 2003 Repurchase Program was May 15, 2004. On May 18, 2004, our board of directors authorized the 2004 Repurchase Program, which provides for the repurchase of up to $30 million of our equity securities in the open market or in negotiated transactions through May 18, 2005. As of July 3, 2004, 248,500 shares of our common stock had been repurchased for $5.2 million under the 2004 Repurchase Program.

Item 4 - Submission of Matters to a Vote of Security Holders

On May 18, 2004, at the annual meeting of shareholders, the shareholders elected one incumbent director, Mr. William A. Rainville, to the class of directors whose three-year term expires at Kadant's annual meeting of shareholders in 2007. Mr. Rainville received 13,060,781 shares voted in favor of his election and 438,910 shares voted against.

Item 6 - Exhibits and Reports on Form 8-K

(a) Exhibits

See Exhibit Index on the page immediately preceding exhibits.

(b) Reports on Form 8-K

On April 29, 2004, we furnished a Current Report on Form 8-K furnishing (pursuant to Item 12) the text of our press release dated April 28, 2004, announcing our first quarter 2004 financial results.

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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 10th day of August, 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 July 3, 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) [Paragraph omitted in accordance with SEC transition instructions contained in SEC Release 34-47986]

   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: August 10, 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 July 3, 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) [Paragraph omitted in accordance with SEC transition instructions contained in SEC Release 34-47986]

   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: August 10, 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 July 3, 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: August 10, 2004

/s/ William A. Rainville

William A. Rainville
Chief Executive Officer

/s/ Thomas M. O'Brien

Thomas M. O'Brien
Chief Financial Officer