

TIMKEN CO
Form 10-Q
November 07, 2008

Table of Contents

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q**

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

For the quarterly period ended September 30, 2008

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: 1-1169

THE TIMKEN COMPANY

(Exact name of registrant as specified in its charter)

OHIO

(State or other jurisdiction of incorporation or organization)

34-0577130

(I.R.S. Employer Identification No.)

1835 Dueber Ave., SW, Canton, OH

(Address of principal executive offices)

44706-2798

(Zip Code)

330.438.3000

(Registrant's telephone number, including area code)

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

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes 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 September 30, 2008
Common Stock, without par value	96,551,635 shares

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Item 4. Controls and Procedures

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Item 1A. Risk Factors

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

Item 6. Exhibits

SIGNATURES

EX-12

EX-31.1

EX-31.2

EX-32

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****THE TIMKEN COMPANY AND SUBSIDIARIES****Consolidated Statement of Income****(Unaudited)**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
(Dollars in thousands, except per share data)				
Net sales	\$1,482,684	\$1,261,239	\$4,452,903	\$3,894,983
Cost of products sold	1,075,928	1,010,830	3,390,866	3,100,576
Gross Profit	406,756	250,409	1,062,037	794,407
Selling, administrative and general expenses	193,658	170,841	568,207	514,773
Impairment and restructuring charges	3,330	11,840	8,013	32,870
Loss (gain) on divestitures		152	(8)	468
Operating Income	209,768	67,576	485,825	246,296
Interest expense	(11,124)	(10,697)	(33,765)	(30,422)
Interest income	1,494	2,380	4,407	5,536
Other (expense) income, net	(1,241)	(2,950)	11,662	(7,398)
Income from Continuing Operations before Income Taxes	198,897	56,309	468,129	214,012
Provision for income taxes	68,484	15,066	164,308	42,914
Income from Continuing Operations	130,413	41,243	303,821	171,098
Income from discontinued operations, net of income taxes				665
Net Income	\$ 130,413	\$ 41,243	\$ 303,821	\$ 171,763
Earnings Per Share:				
Basic earnings per share				
Continuing operations	\$ 1.36	\$ 0.43	\$ 3.18	\$ 1.81
Discontinued operations				0.01
Net income per share	\$ 1.36	\$ 0.43	\$ 3.18	\$ 1.82
Diluted earnings per share				
Continuing operations	\$ 1.35	\$ 0.43	\$ 3.15	\$ 1.79

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Discontinued operations					0.01			
Net income per share	\$	1.35	\$	0.43	\$	3.15	\$	1.80
Dividends per share	\$	0.18	\$	0.17	\$	0.52	\$	0.49

See accompanying Notes to Consolidated Financial Statements.

Table of Contents**Consolidated Balance Sheet**

	(Unaudited) September 30, 2008	December 31, 2007
(Dollars in thousands)		
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 94,709	\$ 30,144
Accounts receivable, less allowances: 2008 - \$71,381; 2007 - \$42,351	814,702	748,483
Inventories, net	1,297,928	1,087,712
Deferred income taxes	66,451	69,137
Deferred charges and prepaid expenses	16,316	14,204
Other current assets	87,226	95,571
Total Current Assets	2,377,332	2,045,251
Property, Plant and Equipment Net	1,733,445	1,722,081
Other Assets		
Goodwill	273,474	271,784
Other intangible assets	167,736	160,452
Deferred income taxes	80,503	100,872
Other non-current assets	74,629	78,797
Total Other Assets	596,342	611,905
Total Assets	\$4,707,119	\$4,379,237
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities		
Short-term debt	\$ 201,212	\$ 108,370
Accounts payable and other liabilities	535,693	528,052
Salaries, wages and benefits	240,650	212,015
Income taxes payable	55,072	17,087
Deferred income taxes	6,167	4,700
Current portion of long-term debt	16,101	34,198
Total Current Liabilities	1,054,895	904,422
Non-Current Liabilities		
Long-term debt	521,896	580,587
Accrued pension cost	145,619	169,364
Accrued postretirement benefits cost	656,932	662,379
Deferred income taxes	14,912	10,635
Other non-current liabilities	106,163	91,181

Total Non-Current Liabilities	1,445,522	1,514,146
Shareholders Equity		
Class I and II Serial Preferred Stock without par value: Authorized - 10,000,000 shares each class, none issued		
Common stock without par value: Authorized - 200,000,000 shares		
Issued (including shares in treasury) (2008 - 96,891,501 shares; 2007 - 96,143,614 shares)		
Stated capital	53,064	53,064
Other paid-in capital	834,595	809,759
Earnings invested in the business	1,633,614	1,379,876
Accumulated other comprehensive loss	(303,070)	(271,251)
Treasury shares at cost (2008 - 339,866 shares; 2007 - 335,105 shares)	(11,501)	(10,779)
Total Shareholders Equity	2,206,702	1,960,669
Total Liabilities and Shareholders Equity	\$4,707,119	\$4,379,237

See accompanying Notes to Consolidated Financial Statements.

Table of Contents**Consolidated Statement of Cash Flows**

(Unaudited)

	Nine Months Ended September 30,	
	2008	2007
(Dollars in thousands)		
CASH PROVIDED (USED)		
Operating Activities		
Net income	\$ 303,821	\$ 171,763
Net (income) from discontinued operations		(665)
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	178,085	160,595
Impairment charges	1,068	11,620
(Gain) loss on disposals of property, plant and equipment	(14,086)	2,084
Gain on divestiture		(666)
Deferred income tax benefit	21,878	16,168
Stock-based compensation expense	13,171	12,671
Pension and other postretirement expense	64,479	90,792
Pension and other postretirement benefit payments	(57,121)	(138,984)
Changes in operating assets and liabilities:		
Accounts receivable	(70,152)	(39,937)
Inventories	(222,560)	(34,766)
Accounts payable and accrued expenses	95,338	(38,084)
Other net	(15,857)	(27,077)
Net Cash Provided by Operating Activities - Continuing Operations	298,064	185,514
Net Cash Provided by Operating Activities - Discontinued Operations		665
Net Cash Provided By Operating Activities	298,064	186,179
Investing Activities		
Capital expenditures	(186,298)	(196,374)
Proceeds from disposals of property, plant and equipment	30,079	11,809
Acquisitions	(57,178)	(1,523)
Divestitures		698
Other	3,984	1,088
Net Cash Used by Investing Activities	(209,413)	(184,302)
Financing Activities		
Cash dividends paid to shareholders	(50,083)	(46,682)
Net proceeds from common share activity	16,879	36,987
Accounts receivable securitization financing borrowings	225,000	
Accounts receivable securitization financing payments	(130,000)	
Proceeds from issuance of long-term debt	773,301	40,054
Payments on long-term debt	(846,987)	(48,423)

Short-term debt activity net	(852)	(6,490)
Net Cash Used by Financing Activities	(12,742)	(24,554)
Effect of exchange rate changes on cash	(11,344)	9,372
Increase (Decrease) In Cash and Cash Equivalents	64,565	(13,305)
Cash and cash equivalents at beginning of year	30,144	101,072
Cash and Cash Equivalents at End of Period	\$ 94,709	\$ 87,767

See accompanying Notes to Consolidated Financial Statements.

4

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

(Dollars in thousands, except per share data)

Note 1 Basis of Presentation

The accompanying Consolidated Financial Statements (unaudited) for The Timken Company (the Company) have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and footnotes required by the accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) and disclosures considered necessary for a fair presentation have been included. For further information, refer to the Consolidated Financial Statements and footnotes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2007. Certain amounts in the 2007 Consolidated Financial Statements have been reclassified to conform to the 2008 presentation.

Effective January 1, 2008, the Company began operating under new reportable segments. Refer to Note 11 Segment Information for further discussion.

Note 2 New Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 157, Fair Value Measurements. SFAS No. 157 establishes a framework for measuring fair value that is based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information to develop those assumptions. Additionally, the standard expands the disclosures about fair value measurements to include separately disclosing the fair value measurements of assets or liabilities within each level of the fair value hierarchy.

In February 2008, the FASB issued FASB Staff Position (FSP) FAS 157-2, Effective Date of FASB Statement No. 157. FSP FAS 157-2 delays the effective date of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities to fiscal years beginning after November 15, 2008. The Company's significant nonfinancial assets and liabilities that could be impacted by this deferral include assets and liabilities initially measured at fair value in a business combination and goodwill tested annually for impairment.

The implementation of SFAS No. 157 for financial assets and financial liabilities, effective January 1, 2008, did not have a material impact on the Company's results of operations and financial condition. The adoption of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities is not expected to have a material impact on the Company's results of operations and financial condition.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations (SFAS No. 141(R)). SFAS No. 141(R) provides revised guidance on how acquirers recognize and measure the consideration transferred, identifiable assets acquired, liabilities assumed, noncontrolling interests, and goodwill acquired in a business combination. SFAS No. 141(R) also expands required disclosures surrounding the nature and financial effects of business combinations. SFAS No. 141(R) is effective, on a prospective basis, for fiscal years beginning after December 15, 2008. The adoption of SFAS No. 141(R) is not expected to have a material impact on the Company's results of operations and financial condition.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements. SFAS No. 160 establishes requirements for ownership interests in subsidiaries held by parties other than the Company (sometimes called minority interests) be clearly identified, presented, and disclosed in the consolidated statement of financial position within equity, but separate from the parent's equity. All changes in the parent's ownership interests are required to be accounted for consistently as equity transactions and any noncontrolling equity investments in deconsolidated subsidiaries must be measured initially at fair value. SFAS No. 160 is effective, on a prospective basis, for fiscal years beginning after December 15, 2008. However, presentation and disclosure requirements must be retrospectively applied to comparative financial statements. The adoption of SFAS No. 160 is not expected to have a material impact on the Company's results of operations and financial condition.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133. SFAS No. 161 requires entities to provide greater transparency through additional disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133, Accounting for Derivative Instruments and Hedging

Activities, and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, results of operations and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. Upon adoption, the Company will include additional disclosures of its derivative instruments to comply with this standard.

Table of Contents

Note 3 Inventories

	September 30, 2008	December 31, 2007
Inventories:		
Manufacturing supplies	\$ 86,985	\$ 81,716
Work in process and raw materials	590,980	484,580
Finished products	619,963	521,416
Inventories	\$1,297,928	\$1,087,712

An actual valuation of the inventory under the last-in, first-out (LIFO) method can be made only at the end of each year based on the inventory levels and costs at that time. Accordingly, interim LIFO calculations must be based on management's estimates of expected year-end inventory levels and costs. Because these are subject to many forces beyond management's control, annual results may differ from interim results as they are subject to the final year-end LIFO inventory valuation. The LIFO reserve at September 30, 2008 and December 31, 2007 was \$270,984 and \$228,707, respectively.

The Company's Steel segment recognized income of \$17,939 for LIFO during the third quarter of 2008, compared to a charge of \$9,325 for LIFO during the third quarter of 2007. The LIFO income recorded during the third quarter of 2008 is a result of expectations of lower steel scrap costs by the end of 2008. Prior to the third quarter of 2008, the Steel segment had recorded a charge of \$45,239 for LIFO during the first six months of 2008 due to escalating steel scrap costs at that time. The Company's Steel segment recognized a charge of \$27,300 for LIFO during the first nine months of 2008, compared to \$12,725 during the first nine months of 2007. The Company recognized a charge of \$42,277 for LIFO during the first nine months of 2008, compared to a LIFO charge of \$21,280 for the first nine months of 2007.

Effective January 1, 2007, the Company changed the method of accounting for certain product inventories for one of its domestic legal entities from the first-in, first-out (FIFO) method to the LIFO method. This change affected approximately 8% of the Company's total gross inventory at December 31, 2006. As a result of this change, substantially all domestic inventories are stated at the lower of cost, as determined on a LIFO basis, or market. The change is preferable because it improves financial reporting by supporting the continued integration of the Company's domestic bearing business, as well as providing a consistent and uniform costing method across the Company's domestic operations and reduces the complexity of intercompany transactions. SFAS No. 154, Accounting Changes and Error Corrections, requires that a change in accounting principle be reflected through retrospective application of the new accounting principle to all prior periods, unless it is impractical to do so. The Company determined that retrospective application to a period prior to January 1, 2007 was not practical as the necessary information needed to restate prior periods is not available. Therefore, the Company began to apply the LIFO method to these inventories beginning January 1, 2007. The adoption of the LIFO method for these inventories did not have a material impact on the Company's results of operations or financial position during the first nine months of 2007.

Note 4 Property, Plant and Equipment

The components of property, plant and equipment are as follows:

	September 30, 2008	December 31, 2007
Property, Plant and Equipment:		
Land and buildings	\$ 689,795	\$ 668,005
Machinery and equipment	3,336,133	3,264,741

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Subtotal	4,025,928	3,932,746
Less allowances for depreciation	(2,292,483)	(2,210,665)
Property, Plant and Equipment Net	\$ 1,733,445	\$ 1,722,081

At September 30, 2008 and December 31, 2007, machinery and equipment included approximately \$129,358 and \$114,500, respectively, of capitalized software. Depreciation expense for the three months ended September 30, 2008 and 2007 was \$57,367 and \$55,336, respectively. Depreciation expense for the nine months ended September 30, 2008 and 2007 was \$167,348 and \$152,115, respectively. Assets held for sale at September 30, 2008 and December 31, 2007 were \$7,020 and \$12,340, respectively. Assets held for sale relate to land and buildings in Torrington, Connecticut and Clinton, South Carolina, and are classified as other current assets on the Consolidated Balance Sheet.

On February 15, 2008, the Company completed the sale of its former seamless steel tube manufacturing facility located in Desford, England for approximately \$28,400. The Company recognized a pretax gain of approximately \$20,400 during the first quarter of 2008 and recorded the gain in other income (expense), net in the Company's Consolidated Statement of Income. This facility was classified as assets held for sale at December 31, 2007.

Table of Contents

Note 5 Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill for the nine months ended September 30, 2008 are as follows:

	Beginning Balance	Acquisitions	Other	Ending Balance
Segment:				
Mobile Industries	\$ 63,251	\$	\$(6,763)	\$ 56,488
Process Industries	55,651		(1,290)	54,361
Aerospace and Defense	152,882		1,103	153,985
Steel		8,640		8,640
Total	\$271,784	\$8,640	\$(6,950)	\$273,474

Acquisitions represent the preliminary opening balance sheet allocation for the acquisition of the assets of Boring Specialties, Inc. completed in February 2008. The purchase price allocation is preliminary for this acquisition because the Company is waiting for final valuation reports, and may be subsequently adjusted. Other primarily includes foreign currency translation adjustments.

The following table displays intangible assets as of September 30, 2008 and December 31, 2007:

	As of September 30, 2008		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Intangible assets subject to amortization:			
Mobile Industries	\$ 51,420	\$25,700	\$ 25,720
Process Industries	56,009	25,934	30,075
Aerospace and Defense	87,119	7,630	79,489
Steel	16,613	924	15,689
	\$211,161	\$60,188	\$150,973
Intangible assets not subject to amortization:			
Goodwill	\$273,474	\$	\$273,474
Other	16,763		16,763
	\$290,237	\$	\$290,237
Total intangible assets	\$501,398	\$60,188	\$441,210

As of December 31, 2007

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
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Intangible assets subject to amortization:

Mobile Industries	\$ 51,122	\$22,277	\$ 28,845
Process Industries	55,826	23,307	32,519
Aerospace and Defense	87,029	3,807	83,222
Steel	944	438	506
	\$194,921	\$49,829	\$145,092

Intangible assets not subject to amortization:

Goodwill	\$271,784	\$	\$271,784
Other	15,360		15,360
	\$287,144	\$	\$287,144
Total intangible assets	\$482,065	\$49,829	\$432,236

Table of Contents**Note 5 Goodwill and Other Intangible Assets (continued)**

Amortization expense for intangible assets was \$3,638 for the three months ended September 30, 2008 and \$10,737 for the nine months ended September 30, 2008. Amortization expense for intangible assets is estimated to be approximately \$14,400 for 2008; \$14,400 in 2009; \$14,200 in 2010; \$13,500 in 2011 and \$12,700 in 2012.

Note 6 Equity Investments

The Company's investments in less than majority-owned companies in which it has the ability to exercise significant influence are accounted for using the equity method except when they qualify as variable interest entities and are consolidated in accordance with FASB Interpretation No. 46 (revised December 2003) (FIN 46(R)), Consolidation of Variable Interest Entities, an interpretation of Accounting Research Bulletin No. 51.

Equity investments are reviewed for impairment when circumstances (such as lower-than-expected financial performance or change in strategic direction) indicate that the carrying value of the investment may not be recoverable. If impairment does exist, the equity investment is written down to its fair value with a corresponding charge to the Consolidated Statement of Income. No impairments were recorded during the first nine months of 2008 and 2007 relating to the Company's equity investments.

Investments accounted for under the equity method were \$14,873 and \$14,426 at September 30, 2008 and December 31, 2007, respectively, and were reported in other non-current assets on the Consolidated Balance Sheet. The Company's Mobile Industries segment has an investment in a joint venture called Advanced Green Components, LLC (AGC). AGC is engaged in the business of converting steel to machined rings for tapered bearings and other related products. During the third quarter of 2006, AGC refinanced its long-term debt of \$12,240. The Company guaranteed half of this obligation. The Company concluded the refinancing represented a reconsideration event to evaluate whether AGC was a variable interest entity under FIN 46(R). The Company concluded that AGC was a variable interest entity and that the Company was the primary beneficiary. Therefore, the Company consolidated AGC effective September 30, 2006. All of AGC's assets are collateral for its obligations. Except for AGC's indebtedness for which the Company is a guarantor, AGC's creditors have no recourse to the general credit of the Company.

Note 7 Financing Arrangements

Short-term debt at September 30, 2008 and December 31, 2007 was as follows:

	September 30, 2008	December 31, 2007
Variable-rate Accounts Receivable Securitization financing agreement with an interest rate of 3.20%	\$ 95,000	\$
Variable-rate lines of credit for certain of the Company's foreign subsidiaries with various banks with interest rates ranging from 3.14% to 15.50%	106,212	108,370
Short-term debt	\$201,212	\$108,370

The Company has a \$200,000 364-day Accounts Receivable Securitization Financing Agreement (Asset Securitization). On December 28, 2007, the Company renewed its Asset Securitization. Under the terms of the Asset Securitization, the Company sells, on an ongoing basis, certain domestic trade receivables to Timken Receivables Corporation, a wholly-owned consolidated subsidiary that in turn uses the trade receivables to secure borrowings, which are funded through a vehicle that issues commercial paper in the short-term market. As of September 30, 2008, the Company had outstanding borrowings of \$95,000 under the Asset Securitization. The yield on the commercial paper, which is the commercial paper rate plus program fees, is considered a financing cost and is included in interest expense in the Consolidated Statement of Income. The Company expects to refinance this facility by the end of 2008. The lines of credit for certain foreign subsidiaries of the Company provide for borrowings up to \$430,270. At September 30, 2008, the Company had borrowings outstanding of \$106,212, which reduced the availability under these facilities to \$324,058.

Table of Contents

Note 7 Financing Arrangements (continued)

Long-term debt at September 30, 2008 and December 31, 2007 was as follows:

	September 30, 2008	December 31, 2007
Fixed-rate Medium-Term Notes, Series A, due at various dates through May 2028, with interest rates ranging from 6.74% to 7.76%	\$ 175,000	\$ 191,933
Variable-rate Senior Credit Facility		55,000
Variable-rate State of Ohio Air Quality and Water Development Revenue Refunding Bonds, maturing on November 1, 2025 (2.21% at September 30, 2008)	21,700	21,700
Variable-rate State of Ohio Pollution Control Revenue Refunding Bonds, maturing on June 1, 2033 (2.21% at September 30, 2008)	17,000	17,000
Variable-rate Unsecured Canadian Note, maturing on December 22, 2010 (4.35% at September 30, 2008)	54,365	57,916
Fixed-rate Unsecured Notes, maturing on February 15, 2010 with an interest rate of 5.75%	250,539	250,307
Variable-rate credit facility with US Bank for Advanced Green Components, LLC, maturing on July 17, 2009 (3.59% at September 30, 2008)	12,240	12,240
Other	7,153	8,689
	537,997	614,785
Less current maturities	16,101	34,198
Long-term debt	\$ 521,896	\$ 580,587

The Company has a \$500,000 Amended and Restated Credit Agreement (Senior Credit Facility) that matures on June 30, 2010. At September 30, 2008, the Company had no outstanding borrowings and had issued letters of credit under this facility totaling \$41,540, which reduced the availability under the Senior Credit Facility to \$458,460. Under the Senior Credit Facility, the Company has two financial covenants: a consolidated leverage ratio and a consolidated interest coverage ratio. At September 30, 2008, the Company was in full compliance with the covenants under the Senior Credit Facility and its other debt agreements.

In December 2005, the Company entered into a 57,800 Canadian Dollar unsecured loan in Canada. The principal balance of the loan is payable in full on December 22, 2010. The interest rate is variable based on the Canadian LIBOR rate and interest payments are due quarterly.

In January 2008, the Company repaid \$17,000 of medium-term notes upon maturity.

The Company is the guarantor of \$6,120 of AGC's \$12,240 credit facility. Refer to Note 6 Equity Investments for additional discussion. In July 2008, AGC renewed its \$12,240 credit facility with US Bank that was set to expire July 18, 2008 for another 364 days. The Company continues to guarantee half of this obligation.

Note 8 Product Warranty

The Company provides limited warranties on certain of its products. The Company accrues liabilities for warranty based upon specific claims and a review of historical warranty claim experience in accordance with SFAS No. 5, Accounting for Contingencies. Should the Company become aware of a specific potential warranty claim for which liability is probable and reasonably estimable, a specific charge is recorded and accounted for accordingly.

Adjustments are made quarterly to the accruals as claim data and historical experience change. The following is a rollforward of the warranty accruals for the nine months ended September 30, 2008 and the twelve months ended December 31, 2007:

	September 30, 2008	December 31, 2007
Beginning balance, January 1	\$ 12,571	\$ 20,023
Expense	2,089	3,068
Payments	(6,571)	(10,520)
Ending balance	\$ 8,089	\$ 12,571

The product warranty accrual at September 30, 2008 and December 31, 2007 was included in accounts payable and other liabilities on the Consolidated Balance Sheet.

Table of Contents

Note 9 Shareholders Equity

An analysis of the change in capital and earnings invested in the business is as follows:

	Total	Common Stock Stated Capital	Other Paid-In Capital	Earnings Invested in the Business	Accumulated Other Comprehensive Income	Treasury Stock
Balance at December 31, 2007	\$ 1,960,669	\$ 53,064	\$ 809,759	\$ 1,379,876	\$ (271,251)	\$ (10,779)
Net Income	303,821			303,821		
Foreign currency translation adjustment	(65,689)				(65,689)	
Pension and postretirement liability adjustment	30,519				30,519	
Unrealized loss on marketable securities	226				226	
Change in fair value of derivative financial instruments, net of reclassifications	3,125				3,125	
Total comprehensive income	272,002					
Dividends \$0.52 per share	(50,083)			(50,083)		
Tax benefit from stock compensation	4,436		4,436			
(Tender) issuance of (4,761) shares from treasury and 747,887 shares from authorized	19,678		20,400			(722)
Balance at September 30, 2008	\$ 2,206,702	\$ 53,064	\$ 834,595	\$ 1,633,614	\$ (303,070)	\$ (11,501)

The total comprehensive income for the three months ended September 30, 2008 and 2007 was \$41,558 and \$82,946, respectively. Total comprehensive income for the nine months ended September 30, 2007 was \$274,865.

Note 10 Earnings Per Share

The following table sets forth the reconciliation of the numerator and the denominator of basic earnings per share and diluted earnings per share for the three and nine months ended September 30, 2008 and 2007:

Three Months Ended September 30,	Nine Months Ended September 30,
-------------------------------------	------------------------------------

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	2008	2007	2008	2007
Numerator:				
Income from continuing operations for basic earnings per share and diluted earnings per share	\$ 130,413	\$ 41,243	\$ 303,821	\$ 171,098
Denominator:				
Weighted-average number of shares outstanding basic	95,878,978	95,029,369	95,574,420	94,494,531
Effect of dilutive securities:				
Stock options and awards based on the treasury stock method	589,643	1,066,491	740,394	988,889
Weighted-average number of shares outstanding, assuming dilution of stock options and awards	96,468,621	96,095,860	96,314,814	95,483,420
Basic earnings per share from continuing operations	\$ 1.36	\$ 0.43	\$ 3.18	\$ 1.81
Diluted earnings per share from continuing operations	\$ 1.35	\$ 0.43	\$ 3.15	\$ 1.79

The exercise prices for certain stock options that the Company has awarded exceed the average market price of the Company's common stock. Such stock options are antidilutive and were not included in the computation of diluted earnings per share. The antidilutive stock options outstanding were 40,350 and zero during the three months ended September 30, 2008 and 2007, respectively. The antidilutive stock options outstanding were 536,456 and 571,046 during the nine months ended September 30, 2008 and 2007, respectively.

Table of Contents

Note 11 Segment Information

The primary measurement used by management to measure the financial performance of each segment is adjusted EBIT (earnings before interest and taxes, excluding the effect of amounts related to certain items that management considers not representative of ongoing operations such as impairment and restructuring, manufacturing rationalization and integration costs, one-time gains and losses on disposal of non-strategic assets, allocated receipts received or payments made under the U.S. Continued Dumping and Subsidy Offset Act (CDSOA) and gains and losses on the dissolution of subsidiaries).

Effective January 1, 2008, the Company began operating under new reportable segments. The Company's four reportable segments are: Mobile Industries, Process Industries, Aerospace and Defense and Steel. Segment results for 2007 have been reclassified to conform to the 2008 presentation of segments.

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Net sales to external customers:				
Mobile Industries	\$ 538,967	\$ 586,736	\$ 1,802,457	\$ 1,828,688
Process Industries	345,482	260,062	985,198	774,676
Aerospace and Defense	109,987	70,429	317,795	218,513
Steel	488,248	344,012	1,347,453	1,073,106
	\$ 1,482,684	\$ 1,261,239	\$ 4,452,903	\$ 3,894,983
Intersegment sales:				
Process Industries	\$ 972	\$ 600	\$ 2,251	\$ 1,451
Steel	48,291	37,100	133,002	109,067
	\$ 49,263	\$ 37,700	\$ 135,253	\$ 110,518
Segment EBIT, as adjusted:				
Mobile Industries	\$ 4,466	\$ 10,401	\$ 45,560	\$ 55,905
Process Industries	81,678	33,414	205,056	98,837
Aerospace and Defense	12,489	425	31,792	11,117
Steel	133,802	52,278	267,499	183,692
Total EBIT, as adjusted, for reportable segments	\$ 232,435	\$ 96,518	\$ 549,907	\$ 349,551
Unallocated corporate expense	(19,039)	(14,370)	(54,767)	(48,124)
Impairment and restructuring	(3,330)	(11,840)	(8,013)	(32,870)
(Loss) gain on divestitures		(152)	8	(468)
Rationalization and integration charges	35	(6,234)	(4,266)	(30,776)
Gain on sale of non-strategic assets, net of dissolution of subsidiary	(558)	983	19,987	3,355
Interest expense	(11,124)	(10,697)	(33,765)	(30,422)
Interest income	1,494	2,380	4,407	5,536
Intersegment eliminations	(1,016)	(279)	(5,369)	(1,770)

Income from Continuing Operations before Income Taxes	\$ 198,897	\$ 56,309	\$ 468,129	\$ 214,012
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Intersegment sales represent sales between the segments. These sales are eliminated upon consolidation.

Table of Contents

Note 12 Impairment and Restructuring Charges

Impairment and restructuring charges by segment are comprised of the following:

For the three months ended September 30, 2008:

	Mobile Industries	Process Industries	Steel	Total
Impairment charges	\$ 706	\$	\$	\$ 706
Severance expense and related benefit costs	589	(148)		441
Exit costs	1,968	190	25	2,183
Total	\$ 3,263	\$ 42	\$ 25	\$ 3,330

For the nine months ended September 30, 2008:

	Mobile Industries	Process Industries	Steel	Total
Impairment charges	\$ 1,016	\$ 52	\$	\$ 1,068
Severance expense and related benefit costs	3,153	(148)		3,005
Exit costs	1,930	1,621	389	3,940
Total	\$ 6,099	\$1,525	\$ 389	\$ 8,013

For the three months ended September 30, 2007:

	Mobile Industries	Process Industries	Steel	Total
Impairment charges	\$ 6,900	\$1,367	\$	\$ 8,267
Severance expense and related benefit costs	1,190	396	1,310	2,896
Exit costs	63	368	246	677
Total	\$ 8,153	\$2,131	\$1,556	\$11,840

For the nine months ended September 30, 2007:

	Mobile Industries	Process Industries	Steel	Total
Impairment charges	\$ 6,900	\$4,720	\$	\$11,620
Severance expense and related benefit costs	10,845	241	6,926	18,012
Exit costs	2,192	404	642	3,238
Total	\$19,937	\$5,365	\$7,568	\$32,870

Bearings and Power Transmission Reorganization

In August 2007, the Company announced the realignment of its management structure. During the first quarter of 2008, the Company began to operate under two major business groups: the Steel Group and the Bearings and Power Transmission Group. The Bearings and Power Transmission Group includes three reportable segments: Mobile Industries, Process Industries and Aerospace and Defense. The organizational changes have streamlined operations and eliminated redundancies. The Company expects to realize pretax savings of approximately \$10,000 to \$20,000 annually by the end of 2008 as a result of these changes. During the first nine months of 2008, the Company recorded \$1,948 of severance and related benefit costs related to this initiative. The majority of the severance charge related to the Mobile Industries segment. During the third quarter of 2007, the Company recorded \$792 of severance and related benefits costs related to this initiative. Half of the severance charge related to the Mobile Industries segment and the other half of the severance charge related to the Process Industries segment.

Table of Contents

Note 12 Impairment and Restructuring Charges (continued)

Mobile Industries

In 2005, the Company announced plans to restructure the former automotive segment that is now part of its Mobile Industries segment to restructure its business and improve performance. These plans included the closure of a manufacturing facility in Clinton, South Carolina and engineering facilities in Torrington, Connecticut and Norcross, Georgia. In February 2006, the Company announced additional plans to rationalize production capacity at its Vierzon, France bearing manufacturing facility in response to changes in customer demand for its products. During 2006, the Company completed the closure of its engineering facilities in Torrington, Connecticut and Norcross, Georgia. During 2007, the Company completed the closure of its manufacturing facility in Clinton, South Carolina and the rationalization of its Vierzon, France bearing manufacturing facility.

In September 2006, the Company announced further planned reductions in its Mobile Industries segment workforce. In March 2007, the Company announced the planned closure of its manufacturing facility in Sao Paulo, Brazil. However, the closure of the manufacturing facility in Sao Paulo, Brazil has been delayed temporarily to serve higher customer demand.

These plans are targeted to collectively deliver annual pretax savings of approximately \$75,000, with expected net workforce reductions of approximately 1,300 to 1,400 positions and pretax costs of approximately \$115,000 to \$125,000, which include restructuring costs and rationalization costs recorded in cost of products sold and selling, administrative and general expenses. Due to the delay in the timing of the closure of the manufacturing facility in Sao Paulo, Brazil, the Company does not expect to fully realize these savings until the end of 2009. Mobile Industries has incurred cumulative pretax costs of approximately \$100,769 as of September 30, 2008 for these plans.

During the third quarter and first nine months of 2008, the Company recorded severance and related benefits of \$611 and \$961, respectively, associated with the Mobile Industries restructuring and workforce reduction plans. In addition, the Company recorded an impairment charge of \$706 and exit costs of \$1,044 during the third quarter of 2008 associated with these plans. The exit costs recorded in the third quarter of 2008 were primarily the result of environmental charges related to the planned closure of the manufacturing facility in Sao Paulo, Brazil and the Company's former plant in Clinton, South Carolina. During the third quarter and first nine months of 2007, the Company recorded \$794 and \$10,449, respectively, of severance and related benefit costs and \$63 and \$2,192, respectively, of exit costs associated with the Mobile Industries restructuring and workforce reduction plans. The exit costs recorded in the first nine months of 2007 were primarily the result of environmental charges related to the planned closure of the manufacturing facility in Sao Paulo, Brazil.

In addition to the above charges, the Company recorded \$924 of environmental exit costs during the third quarter of 2008 related to a former plant in Columbus, Ohio. The Company also recorded an impairment charge of \$310 related to one of Mobile Industries' foreign entities during the first nine months of 2008. During the third quarter of 2007, the Company recorded an impairment charge of \$5,300 related to this same foreign entity.

Process Industries

In May 2004, the Company announced plans to rationalize its three bearing plants in Canton, Ohio within the Process Industries segment. On September 15, 2005, the Company reached a new four-year agreement with the United Steelworkers of America, which went into effect on September 26, 2005, when the prior contract expired. This rationalization initiative is expected to deliver annual pretax savings of approximately \$20,000 through streamlining operations and workforce reductions, with pretax costs of approximately \$45,000 to \$50,000, by the end of 2009. The Company recorded exit costs of \$1,621 during the first nine months of 2008 related to the Process Industries rationalization plans. The exit costs recorded during the first nine months of 2008 were primarily the result of environmental charges. During the third quarter and first nine months of 2007, the Company recorded impairment charges of \$1,367 and \$4,569, respectively, as a result of the Process Industries' rationalization plans. In addition, exit costs of \$404 were recorded during the first nine months of 2007 as a result of these rationalization plans. Including rationalization costs recorded in cost of products sold and selling, administrative and general expenses, the Process Industries segment has incurred cumulative pretax costs of approximately \$33,444 as of September 30, 2008 related to these rationalization plans.

Steel

In April 2007, the Company completed the closure of its seamless steel tube manufacturing facility located in Desford, England. The Company recorded \$389 of exit costs during the first nine months of 2008 related to this action. The Company recorded \$1,129 and \$6,685 of severance and related benefit costs, and \$246 and \$642 of exit costs during the third quarter and first nine months of 2007, respectively, related to this action.

Table of Contents

Note 12 Impairment and Restructuring Charges (continued)

The following is a rollforward of the consolidated restructuring accrual for the nine months ended September 30, 2008 and the twelve months ended December 31, 2007:

	September 30, 2008	December 31, 2007
Beginning balance, January 1	\$ 24,455	\$ 31,985
Expense	6,945	28,640
Payments	(13,103)	(36,170)
Ending balance	\$ 18,297	\$ 24,455

The restructuring accrual at September 30, 2008 and December 31, 2007 is included in accounts payable and other liabilities on the Consolidated Balance Sheet. The accrual at September 30, 2008 includes \$9,648 of severance and related benefits, with the remainder of the balance primarily representing environmental exit costs. The majority of the \$9,648 accrual related to severance and related benefits is expected to be paid by the end of 2009 pending the closure of the manufacturing facility in Sao Paulo, Brazil.

Note 13 Retirement and Postretirement Benefit Plans

The following table sets forth the net periodic benefit cost for the Company's retirement and postretirement benefit plans. The amounts for the three and nine months ended September 30, 2008 are based on actuarial calculations prepared during 2007. Consistent with prior years, these calculations will be updated later in the year. These updated calculations may result in different net periodic benefit cost for 2008. The net periodic benefit cost recorded for the three and nine months ended September 30, 2008 is the Company's best estimate of each period's proportionate share of the amounts to be recorded for the year ended December 31, 2008.

	Pension		Postretirement	
	Three Months ended September 30, 2008		Three Months ended September 30, 2007	
Components of net periodic benefit cost				
Service cost	\$ 9,180	\$ 10,402	\$ 781	\$ 1,215
Interest cost	40,316	38,919	9,794	10,341
Expected return on plan assets	(50,254)	(47,512)		
Amortization of prior service cost	3,143	2,837	(544)	(469)
Recognized net actuarial loss	7,246	11,872	900	2,762
Amortization of transition asset	(23)	(46)		
Net periodic benefit cost	\$ 9,608	\$ 16,472	\$10,931	\$13,849

	Pension		Postretirement	
	Nine Months Ended September 30, 2008		Nine Months Ended September 30, 2007	

Components of net periodic benefit cost

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Service cost	\$ 27,633	\$ 31,098	\$ 2,344	\$ 3,646
Interest cost	121,661	116,394	30,511	31,023
Expected return on plan assets	(151,488)	(142,156)		
Amortization of prior service cost	9,443	8,494	(1,633)	(1,408)
Recognized net actuarial loss	21,798	35,545	4,282	8,286
Amortization of transition asset	(72)	(130)		
Net periodic benefit cost	\$ 28,975	\$ 49,245	\$35,504	\$41,547

Table of Contents

Note 14 Income Taxes

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2008	2007	2008	2007
Provision for income taxes	\$68,484	\$15,066	\$164,308	\$42,914
Effective tax rate	34.4%	26.8%	35.1%	20.1%

The Company's provision for income taxes in interim periods is computed by applying its estimated annual effective tax rate against income from continuing operations before income taxes for the period. In addition, non-recurring or discrete items, including interest on prior year tax liabilities, are recorded during the period in which they occur. The effective tax rate for the third quarter of 2008 was lower than the U.S. federal statutory tax rate primarily due to the earnings of certain foreign subsidiaries being taxed at a rate less than 35% and the benefit of the U.S. manufacturing deduction. These decreases were partially offset by the inability to record a tax benefit for losses at certain foreign subsidiaries, U.S. state and local income taxes, a discrete tax adjustment reflecting the filing of the Company's 2007 U.S. federal income tax return in the third quarter of 2008 and the net impact of other items. The effective tax rate for the first nine months of 2008 was slightly higher than the U.S. federal statutory tax rate primarily due to the inability to record a tax benefit for losses at certain foreign subsidiaries, U.S. state and local income taxes, discrete tax adjustments recorded during the first nine months of 2008 to increase the Company's accrual for uncertain tax positions and the net impact of other items. These increases were partially offset by the earnings of certain foreign subsidiaries being taxed at a rate less than 35% and the benefit of the U.S. manufacturing deduction. As of September 30, 2008, the Company has approximately \$58,600 of total gross unrecognized tax benefits. During the first nine months of 2008, the Company's total gross unrecognized tax benefits decreased by \$54,500. This decrease was primarily due to the settlement and resulting cash payment related to tax years 2002 through 2005, which were under examination by the Internal Revenue Service (IRS). The tax positions under examination included the timing of income recognition for certain amounts received by the Company and treated as capital contributions pursuant to Internal Revenue Code Section 118 and other items. The following chart reconciles the Company's total gross unrecognized tax benefits for the nine months ended September 30, 2008.

Balance at January 1, 2008	\$ 113,100
Tax positions related to the current year:	
Additions	3,000
Tax positions related to prior years:	
Additions	600
Reductions	(4,800)
Settlements with tax authorities	(53,300)
Lapses in statutes of limitation	
Balance at September 30, 2008	\$ 58,600

Included in the \$58,600 total gross unrecognized tax benefits amount is approximately \$23,100 (including the federal tax benefit on state tax positions), which represents the amount of unrecognized tax benefits that would favorably impact the Company's effective tax rate in any future periods if such benefits were recognized. As of September 30, 2008, the Company anticipates a decrease in its unrecognized tax positions of approximately \$10,000 to \$12,000

during the next 12 months. The anticipated decrease is primarily due to the expiration of the statute of limitations for various uncertain tax positions. As of September 30, 2008, the Company has accrued approximately \$4,600 of interest and penalties related to uncertain tax positions.

As of September 30, 2008, the Company is subject to examination by the IRS for tax years 2004 to the present. The Company is also subject to tax examination in various U.S. state and local tax jurisdictions for tax years 2002 to the present, as well as various foreign tax jurisdictions, including France, Germany, India, Czech Republic, China and Canada, for tax years 1999 to the present.

The current portion of the Company's accrual for uncertain tax positions is presented on the Consolidated Balance Sheet within income taxes payable, a current liability, and the non-current portion is recorded as a component of other non-current liabilities.

Table of Contents**Note 15 Acquisitions**

On February 21, 2008, the Company purchased the assets of Boring Specialties, Inc. (BSI), a leading provider of a wide range of precision deep-hole oil and gas drilling and extraction products and services, for \$56,834, including acquisition costs. The acquisition will extend the Company's presence in the energy market by adding BSI's value-added products to the Company's current range of alloy steel products for oil and gas customers. The acquisition agreement allows for an earnout payment of up to \$15,000 to be paid if certain milestones are met over the following five years. BSI is based in Houston, Texas, employs 190 people and had 2006 sales of approximately \$48,000. The Company has preliminarily allocated the purchase price to assets of \$57,560, including \$9,557 of accounts receivable, \$9,531 of inventories, \$12,251 of property, plant and equipment and \$17,460 of amortizable intangible assets, and liabilities of \$727. The excess of the purchase price over the fair value of the net assets acquired was recorded as goodwill in the amount of \$8,640. The results of the operations of BSI are included in the Company's Consolidated Statement of Income for the period subsequent to the effective date of the acquisition. Pro forma results of the operations are not presented because the effect of the acquisition was not significant.

On November 3, 2008, the Company announced the acquisition of the assets of EXTEX Ltd., a leading designer and marketer of high-quality replacement engine parts for the aerospace aftermarket. The acquisition will add most of EXTEX's nearly 600 Federal Aviation Administration (FAA) parts manufacturer approval (PMA) components to the Company's existing portfolio of more than 1,400 PMAs. This expanded PMA base further positions the Company to offer comprehensive fleet-support programs, including asset management that maximizes uptime for aircraft operators. EXTEX is based in Gilbert, Arizona and had 2007 sales of approximately \$15,400.

Note 16 Fair Value

SFAS No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). SFAS No. 157 classifies the inputs used to measure fair value into the following hierarchy:

Level 1 Unadjusted quoted prices in active markets for identical assets or liabilities.
1

Level 2 Unadjusted quoted prices in active markets for similar assets or liabilities, or unadjusted quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs other than quoted prices that are observable for the asset or liability.

Level 3 Unobservable inputs for the asset or liability.
3

The following table presents the fair value hierarchy for those assets measured at fair value on a recurring basis as of September 30, 2008 (there were no liabilities measured at fair value at September 30, 2008):

	Fair Value at September 30, 2008			Level 3
	Total	Level 1	Level 2	
Assets:				
Available-for-sale securities	\$27,167	\$27,167	\$	\$
Derivatives	4,482		4,482	
Interest rate swaps	539		539	
Total Assets	\$32,188	\$27,167	\$5,021	\$

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

Overview

Introduction

The Timken Company is a leading global manufacturer of highly engineered anti-friction bearings and assemblies, high-quality alloy steels, aerospace power transmission systems as well as a provider of related products and services. During the fourth quarter of 2007, the Company implemented changes in its management structure. Beginning with the first quarter of 2008, the Company began operating under two business groups: the Steel Group and the Bearings and Power Transmission Group. The Bearings and Power Transmission Group is composed of three operating segments: (1) Mobile Industries, (2) Process Industries and (3) Aerospace and Defense. These three operating segments and the Steel Group comprise the Company's four reportable segments.

The Mobile Industries segment provides bearings, power transmission components and related products and services. Customers of the Mobile Industries segment include original equipment manufacturers and suppliers for passenger cars, light trucks, medium- to heavy-duty trucks, rail cars, locomotives and agricultural, construction and mining equipment, in addition to aftermarket distributors of automotive products. The Company's strategy for the Mobile Industries segment is to improve its financial performance or exit those businesses where adequate returns can not be achieved.

The Process Industries segment provides bearings, power transmission components and related products and services. Customers of the Process Industries segment include original equipment manufacturers of power transmission, energy and heavy industries machinery and equipment, including rolling mills, cement and aggregate processing equipment, paper mills, sawmills, printing presses, cranes, hoists, drawbridges, wind energy turbines, gear drives, drilling equipment, coal conveyors and crushers and food processing equipment. Customers of the Process Industries segment also include aftermarket distributors of products other than those for steel and automotive applications. The Company's strategy for the Process Industries segment is to pursue growth in selected industrial markets and achieve a leadership position in targeted Asian sectors. The Company has been increasing large-bore bearing capacity in Romania, China, India and the United States to serve heavy industrial market sectors. The Process Industries segment began to benefit from this increase in large-bore bearing capacity during the latter part of 2007. In December 2007, the Company announced the establishment of a joint venture in China to manufacture ultra-large-bore bearings for the growing Chinese wind energy market. In April 2008, the Process Industries segment began shipping product from its new industrial bearing plant in Chennai, India.

The Aerospace and Defense segment manufactures bearings, helicopter transmission systems, rotor head assemblies, turbine engine components, gears and other precision flight-critical components for commercial and military aviation applications. The Aerospace and Defense segment also provides aftermarket services, including repair and overhaul of engines, transmissions and fuel controls, as well as aerospace bearing repair and component reconditioning.

Customers of the Aerospace and Defense segment also include original equipment manufacturers of health and positioning control equipment. The Company's strategy for the Aerospace and Defense segment is to: (1) grow value by adding power transmission parts, assemblies and services, utilizing a platform approach; (2) develop new aftermarket channels; and (3) add core bearing capacity through manufacturing initiatives in North America and China. In October 2007, the Company completed the acquisition of the assets of The Purdy Corporation (Purdy), located in Manchester, Connecticut. This acquisition further expands the growing range of power-transmission products and capabilities that the Company provides to aerospace customers. In addition, the Company opened a new aerospace precision products manufacturing facility in China in April 2008.

The Steel segment manufactures more than 450 grades of carbon and alloy steel, which are produced in both solid and tubular sections with a variety of lengths and finishes. The Steel segment also manufactures custom-made steel products for both industrial and automotive applications. The Company's strategy for the Steel segment is to focus on opportunities where the Company can offer differentiated capabilities while driving profitable growth. In January 2007, the Company announced plans to invest approximately \$60 million to enable the Company to competitively produce steel bars down to 1-inch diameter for use in power transmission and friction management applications for a variety of customers, including the rapidly growing automotive transplants. This expansion is expected to become operational during the fourth quarter of 2008. During the first quarter of 2007, the Company

added a new induction heat-treat line in Canton, Ohio, which increased capacity and enabled the Company to provide differentiated product to more customers in its global energy markets. In February 2008, the Company completed the acquisition of the assets of Boring Specialties, Inc., a provider of a wide range of precision deep-hole oil and gas drilling and extraction products and services.

Table of Contents**Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)***Financial Overview**Overview:*

	3Q 2008	3Q 2007	\$ Change	% Change
(Dollars in millions, except earnings per share)				
Net sales	\$ 1,482.7	\$ 1,261.2	\$221.5	17.6%
Income from continuing operations	130.4	41.2	89.2	216.5%
Net income	\$ 130.4	\$ 41.2	\$ 89.2	216.5%
Diluted earnings per share:				
Continuing operations	\$ 1.35	\$ 0.43	\$ 0.92	214.0%
Net income per share	\$ 1.35	\$ 0.43	\$ 0.92	214.0%
Average number of shares diluted	96,468,621	96,095,860		0.4%

	YTD 2008	YTD 2007	\$ Change	% Change
(Dollars in millions, except earnings per share)				
Net sales	\$ 4,452.9	\$ 3,895.0	\$557.9	14.3%
Income from continuing operations	303.8	171.1	132.7	77.6%
Income from discontinued operations		0.7	(0.7)	(100.0)%
Net income	\$ 303.8	\$ 171.8	\$132.0	76.8%
Diluted earnings per share:				
Continuing operations	\$ 3.15	\$ 1.79	\$ 1.36	76.0%
Discontinued operations		0.01	(0.01)	(100.0)%
Net income per share	\$ 3.15	\$ 1.80	\$ 1.35	75.0%
Average number of shares diluted	96,314,814	95,483,420		0.9%

Net sales for the third quarter of 2008 were \$1.48 billion, compared to \$1.26 billion in the third quarter of 2007, an increase of 17.6%. Net sales for the first nine months of 2008 were \$4.45 billion, compared to \$3.90 billion for the first nine months of 2007, an increase of 14.3%. The increase in sales was primarily driven by higher surcharges to recover historically high raw material costs and higher pricing, as well as higher volume across most market sectors, acquisitions and foreign currency translation, partially offset by weaker automotive demand. For the third quarter of 2008, earnings per diluted share were \$1.35, compared to \$0.43 per diluted share for third quarter of 2007. For the first nine months of 2008, earnings per diluted share were \$3.15, compared to \$1.80 per diluted share for the first nine months of 2007. Income from continuing operations per diluted share was \$3.15, compared to \$1.79 per diluted share for the same period a year ago.

The Company's results for the third quarter and first nine months of 2008 reflect the strength of industrial markets and increased raw material surcharges, pricing and mix, partially offset by higher material, manufacturing and logistics costs. The Company's third quarter also benefited from LIFO income as a result of expectations that historically high steel scrap costs during 2008 will significantly decline in the fourth quarter of 2008. Additionally, the Company's results for the third quarter and first nine months reflect lower expenses associated with restructuring activities. Results for the first nine months of 2008 also reflect income from the sale of the Company's former seamless steel tube manufacturing facility located in Desford, England. The Company recognized a pretax gain of \$20.4 million on the sale of this facility. The Company continued its focus on ramping up new production capacity in targeted areas, including major capacity expansions for industrial products at several manufacturing locations around the world.

The Company expects the relative strength of key global market sectors, such as heavy industries, aerospace and energy, and favorable pricing will be offset by lower demand in the light-vehicle market sector for the remainder of 2008. While these key market sectors are expected to remain relatively strong, the improvements in the Company's operating performance will be partially constrained by weaker automotive demand in the Company's Mobile Industries and Steel segments, increases in raw material costs, the timing of its surcharge mechanism, as well as strategic investments including Asian growth and Project O.N.E. initiatives. The objective of the Asian growth initiatives is to increase market share, influence major design centers and expand the Company's network of sources of globally competitive friction management products.

Project O.N.E. is a multi-year program, which began in 2005, designed to improve the Company's business processes and systems. The Company expects to invest approximately \$210 million to \$220 million, which includes internal and external costs, to implement Project O.N.E. As of September 30, 2008, the Company has incurred costs of approximately \$190.5 million, of which approximately \$110.3 million have been capitalized to the Consolidated Balance Sheet. During the second quarter of 2007, the Company completed the installation of Project O.N.E. for a major portion of its domestic operations. On April 1, 2008, the Company completed the next installation of Project O.N.E. for the majority of the Company's remaining domestic operations and a major portion of its European operations.

Table of Contents**Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

The Company's results for the first nine months of 2007 reflect a lower tax rate primarily due to favorable adjustments to the Company's accruals for uncertain tax positions.

The Statement of Income

Sales by Segment:

	3Q 2008	3Q 2007	\$ Change	% Change
(Dollars in millions, and exclude intersegment sales)				
Mobile Industries	\$539.0	\$586.7	\$(47.7)	(8.1)%
Process Industries	345.5	260.1		