

TIMKEN CO  
Form 10-Q  
October 29, 2012

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, 2012

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	34-0577130
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1835 Dueber Ave., SW, Canton, OH	44706-2798
(Address of principal executive offices)	(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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). 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.

Large accelerated filer	✓	Accelerated filer	..
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Non-accelerated filer	..	Smaller reporting company	..
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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes .. No ✓

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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, 2012
Common Shares, without par value	95,847,056 shares

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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## THE TIMKEN COMPANY AND SUBSIDIARIES

## Consolidated Statements of Income

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
(Dollars in millions, except per share data)				
Net sales	\$1,142.5	\$1,321.8	\$3,906.7	\$3,905.5
Cost of products sold	843.6	978.5	2,818.9	2,878.4
Gross Profit	298.9	343.3	1,087.8	1,027.1
Selling, general and administrative expenses	152.7	155.1	480.4	459.1
Impairment and restructuring charges	11.9	1.2	28.8	8.5
Operating Income	134.3	187.0	578.6	559.5
Interest expense	(7.3)	) (9.1	) (24.0	) (28.2
Interest income	0.6	1.5	2.0	4.4
Continued Dumping & Subsidy Offset Act (CDSOA) receipts, net of expense	(0.9)	) —	108.6	—
Other income (expense), net	1.4	2.9	(3.7	) 1.6
Income Before Income Taxes	128.1	182.3	661.5	537.3
Provision for income taxes	47.0	70.1	241.0	189.0
Net Income	81.1	112.2	420.5	348.3
Less: Net income attributable to noncontrolling interest	0.2	1.2	0.3	3.1
Net Income attributable to The Timken Company	\$80.9	\$111.0	\$420.2	\$345.2
Net Income per Common Share attributable to The Timken Company Common Shareholders				
Basic earnings per share	\$0.84	\$1.13	\$4.32	\$3.53
Diluted earnings per share	\$0.83	\$1.12	\$4.28	\$3.48
Dividends per share	\$0.23	\$0.20	\$0.69	\$0.58

See accompanying Notes to the Consolidated Financial Statements.

Consolidated Statements of Comprehensive Income  
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,		
	2012	2011	2012	2011	
(Dollars in millions)					
Net Income	\$81.1	\$112.2	\$420.5	\$348.3	
Other comprehensive income, net of tax:					
Foreign currency translation adjustments	16.5	(77.2	) 0.5	(30.7	)
Unrealized (loss) gain on marketable securities	(0.2	) 0.2	(0.7	) 0.5	
Pension and postretirement liability adjustment	12.2	16.4	34.2	34.9	
Change in fair value of derivative financial instruments	(0.9	) 0.6	0.5	0.7	
Other comprehensive income (loss)	27.6	(60.0	) 34.5	5.4	
Comprehensive Income	108.7	52.2	455.0	353.7	
Less: comprehensive income attributable to noncontrolling interest	0.2	1.2	0.2	3.2	
Comprehensive Income attributable to The Timken Company	\$108.5	\$51.0	\$454.8	\$350.5	

See accompanying Notes to the Consolidated Financial Statements.

## Consolidated Balance Sheets

	(Unaudited) September 30, 2012	December 31, 2011
(Dollars in millions)		
<b>ASSETS</b>		
Current Assets		
Cash and cash equivalents	\$485.5	\$464.8
Restricted cash	—	3.6
Accounts receivable, less allowances: 2012 – \$12.6 million; 2011 – \$19.0 million	629.8	645.5
Inventories, net	928.1	964.4
Deferred income taxes	115.9	113.7
Deferred charges and prepaid expenses	12.9	12.8
Other current assets	61.5	88.1
Total Current Assets	2,233.7	2,292.9
Property, Plant and Equipment-Net	1,344.3	1,308.9
Other Assets		
Goodwill	332.1	332.7
Other intangible assets	221.7	235.7
Deferred income taxes	45.6	117.2
Other non-current assets	41.1	40.0
Total Other Assets	640.5	725.6
Total Assets	\$4,218.5	\$4,327.4
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current Liabilities		
Short-term debt	\$12.9	\$22.0
Accounts payable, trade	270.0	287.3
Salaries, wages and benefits	213.0	259.3
Income taxes payable	112.7	45.5
Deferred income taxes	3.6	3.1
Other current liabilities	171.1	188.4
Current portion of long-term debt	14.6	14.3
Total Current Liabilities	797.9	819.9
Non-Current Liabilities		
Long-term debt	461.4	478.8
Accrued pension cost	158.3	491.0
Accrued postretirement benefits cost	333.9	395.9
Deferred income taxes	6.7	7.5
Other non-current liabilities	114.5	91.8
Total Non-Current Liabilities	1,074.8	1,465.0
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) (2012 – 98,375,135 shares; 2011 – 98,375,135 shares)		
Stated capital	53.1	53.1
Other paid-in capital	887.7	889.2
Earnings invested in the business	2,358.1	2,004.7

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Accumulated other comprehensive loss	(854.9	) (889.5	)
Treasury shares at cost (2012 – 2,528,079 shares; 2011 – 708,327 shares)	(112.6	) (29.2	)
Total Shareholders' Equity	2,331.4	2,028.3	
Noncontrolling Interest	14.4	14.2	
Total Equity	2,345.8	2,042.5	
Total Liabilities and Shareholders' Equity	\$4,218.5	\$4,327.4	
See accompanying Notes to the Consolidated Financial Statements.			

Consolidated Statements of Cash Flows  
(Unaudited)

	Nine Months Ended September 30,	
	2012	2011
(Dollars in millions)		
<b>CASH PROVIDED (USED)</b>		
Operating Activities		
Net income attributable to The Timken Company	\$420.2	\$345.2
Net income attributable to noncontrolling interest	0.3	3.1
Adjustments to reconcile income before income taxes to net cash provided by operating activities:		
Depreciation and amortization	148.8	142.9
Impairment charges	6.4	3.3
Loss (gain) on sale of assets	3.6	(0.9)
Deferred income tax provision	44.6	48.7
Stock-based compensation expense	13.4	13.1
Pension and other postretirement expense	70.1	55.8
Pension contributions and other postretirement benefit payments	(399.8)	(445.2)
Changes in operating assets and liabilities:		
Accounts receivable	13.8	(187.9)
Inventories	35.2	(122.2)
Accounts payable, trade	(17.0)	39.3
Other accrued expenses	(74.5)	(2.3)
Income taxes	99.3	52.6
Other – net	2.1	(12.9)
Net Cash Provided (Used) by Operating Activities	366.5	(67.4)
Investing Activities		
Capital expenditures	(187.3)	(106.0)
Acquisitions	(0.2)	(198.9)
Proceeds from disposals of property, plant and equipment	1.8	5.7
Divestitures	—	4.8
Investments in short-term marketable securities, net	17.2	(23.9)
Other	3.5	0.8
Net Cash Used by Investing Activities	(165.0)	(317.5)
Financing Activities		
Cash dividends paid to shareholders	(66.8)	(56.6)
Net proceeds from common share activity	20.2	23.4
Purchase of treasury shares	(112.3)	(43.8)
Proceeds from issuance of long-term debt	—	9.3
Payments on long-term debt	(17.2)	(4.0)
Short-term debt activity – net	(9.3)	(7.3)
Decrease (increase) in restricted cash	3.6	(3.6)
Other	—	(3.5)
Net Cash Used by Financing Activities	(181.8)	(86.1)
Effect of exchange rate changes on cash	1.0	(3.2)
Increase (Decrease) In Cash and Cash Equivalents	20.7	(474.2)
Cash and cash equivalents at beginning of year	464.8	877.1
Cash and Cash Equivalents at End of Period	\$485.5	\$402.9

See accompanying Notes to the Consolidated Financial Statements.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

(Dollars in millions, 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 notes required by the accounting principles generally accepted in the United States (U.S. GAAP) 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 notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

Note 2 - Recent Accounting Pronouncements

In July 2012, the Financial Accounting Standards Board (FASB) issued ASU No. 2012-02, Intangibles-Goodwill and Other (Topic 350): "Testing Indefinite-Lived Intangible Assets for Impairment." The new guidance includes periodic testing of indefinite-lived intangibles for impairment. This allows companies to assess qualitative factors to determine if indefinite-lived intangibles might be impaired and whether it is necessary to perform the two-step impairment test. The effective date of the new guidance is for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, and early adoption is permitted. The Company adopted this accounting guidance effective October 1, 2012, and it is not expected to have an impact on the Company's results of operations and financial condition.

Effective January 1, 2012, the Company adopted the two-statement approach for the presentation of other comprehensive income in accordance with Accounting Standards Update (ASU) No. 2011-05, Comprehensive Income (Topic 220): "Presentation of Comprehensive Income." The two-statement approach allows for the components of net income and total net income to be presented in a financial statement, immediately followed by a financial statement presenting the components of other comprehensive income and a total for comprehensive income. The Consolidated Financial Statements include the Consolidated Statements of Comprehensive Income as a result of adopting this new guidance.

In December 2011, the FASB issued ASU No. 2011-12, Comprehensive Income (Topic 220): "Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05." The amendments are being made to allow the FASB time to redeliberate whether to present on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. As the FASB is considering the presentation requirements, entities should continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before ASU No. 2011-05.

The Company adopted ASU No. 2011-04, Fair Value Measurement (Topic 820): "Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs," effective January 1, 2012. The new accounting requirements do not extend the use of fair value accounting; they only provide additional guidance on the application and disclosure of fair value accounting where its use is currently permitted. The new accounting requirements also expand the disclosures about fair value measurement.

Note 3 - Inventories

The components of inventories were as follows:

	September 30, 2012	December 31, 2011
Inventories, net:		
Manufacturing supplies	\$68.4	\$65.6
Raw materials	117.2	129.8
Work in process	315.5	327.4
Finished products	467.1	472.4
Subtotal	968.2	995.2
Allowance for obsolete and surplus inventory	(40.1	) (30.8
Total Inventories, net	\$928.1	\$964.4

Inventories are valued at the lower of cost or market, with approximately 55% valued by the last-in, first-out (LIFO) method and the remaining 45% valued by the first-in, first-out (FIFO) method. The majority of the Company's domestic inventories are valued by the LIFO method and all of the Company's international (outside the United States) inventories are valued by the FIFO method.

An actual valuation of the inventory under the 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 calculations are subject to many factors 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, 2012 and December 31, 2011 was \$300.6 million and \$287.7 million, respectively. The Company recognized an increase in its LIFO reserve of \$3.7 million and \$12.9 million during the third quarter and first nine months of 2012, respectively, compared to an increase in its LIFO reserve of \$8.1 million and \$23.8 million during the third quarter and first nine months of 2011, respectively.

Based on current expectations of inventory levels and costs, the Company expects to recognize approximately \$17.9 million in LIFO expense for the year ended December 31, 2012. The expected increase in the LIFO reserve for 2012 reflects anticipated higher costs, especially scrap steel costs. A 1.0% increase in costs would increase the current LIFO expense estimate for 2012 by \$6.4 million. A 1.0% increase in inventory quantities would have no effect on the current LIFO expense estimate for 2012.

#### Note 4 - Property, Plant and Equipment

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

	September 30, 2012	December 31, 2011
Property, Plant and Equipment:		
Land and buildings	\$655.2	\$637.3
Machinery and equipment	3,072.9	2,952.1
Subtotal	3,728.1	3,589.4
Less allowances for depreciation	(2,383.8)	(2,280.5)
Property, Plant and Equipment – net	\$1,344.3	\$1,308.9

Depreciation expense for the nine months ended September 30, 2012 and 2011 was \$134.5 million and \$133.7 million, respectively. At September 30, 2012 and December 31, 2011, machinery and equipment included approximately \$84.7 million and \$90.5 million, respectively, of capitalized software. Depreciation expense on capitalized software for the nine months ended September 30, 2012 and 2011 was approximately \$17.6 million and \$17.2 million, respectively.

#### Note 5 - Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill for the nine months ended September 30, 2012 were as follows:

	Mobile Industries	Process Industries	Aerospace and Defense	Steel	Total
Beginning balance	\$16.9	\$141.1	\$162.1	\$12.6	\$332.7
Acquisitions	—	0.2	—	—	0.2
Other	—	(0.7)	—	(0.1)	(0.8)
Ending balance	\$16.9	\$140.6	\$162.1	\$12.5	\$332.1

During the first nine months of 2012, the Company allocated goodwill acquired as part of the acquisition of Drives, LLC (Drives) between the Mobile Industries and Process Industries segments based on the relative fair value of each reporting unit. The Company also obtained additional information on the fair value of intangible assets acquired in 2011 and, therefore, adjusted the value of goodwill and other intangible assets during the first nine months of 2012 (See Note 14 – Acquisitions for additional information on the purchase price allocation). The purchase price allocation adjustments were made retroactive to December 31, 2011. Other primarily includes foreign currency translation adjustments.

The following table displays intangible assets as of September 30, 2012 and December 31, 2011:

	As of September 30, 2012			As of December 31, 2011		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Intangible assets subject to amortization:						
Customer relationships	\$157.1	\$35.4	\$121.7	\$157.1	\$26.3	\$130.8
Know-how	22.6	2.5	20.1	22.6	1.5	21.1
Industrial license agreements	0.2	0.1	0.1	0.1	0.1	—
Land-use rights	8.6	4.0	4.6	8.6	3.8	4.8
Patents	2.5	1.8	0.7	2.5	1.7	0.8
Technology use	47.0	10.6	36.4	46.9	8.7	38.2
Trademarks	2.9	2.8	0.1	2.8	2.3	0.5
PMA licenses	8.8	3.5	5.3	8.8	3.1	5.7
Non-compete agreements	3.9	3.2	0.7	3.9	2.5	1.4
Unpatented technology	7.2	6.7	0.5	7.2	6.3	0.9
	\$260.8	\$70.6	\$190.2	\$260.5	\$56.3	\$204.2
Intangible assets not subject to amortization:						
Tradenname	\$17.3	\$—	\$17.3	\$17.3	\$—	\$17.3
FAA air agency certificates	14.2	—	14.2	14.2	—	14.2
	\$31.5	\$—	\$31.5	\$31.5	\$—	\$31.5
Total intangible assets	\$292.3	\$70.6	\$221.7	\$292.0	\$56.3	\$235.7

Amortization expense for intangible assets was \$14.3 million and \$9.2 million for the nine months ended September 30, 2012 and September 30, 2011, respectively. Amortization expense for intangible assets is estimated to be approximately \$18.7 million for 2012; \$17.4 million in 2013; \$16.9 million in 2014; \$16.8 million in 2015; and \$16.5 million in 2016.

#### Note 6 - Financing Arrangements

Short-term debt at September 30, 2012 and December 31, 2011 was as follows:

	September 30, 2012	December 31, 2011
Variable-rate lines of credit for certain of the Company's foreign subsidiaries with various banks with interest rates ranging from 2.53% to 6.16% and 2.24% to 11.0% at September 30, 2012 and December 31, 2011, respectively	\$12.9	\$22.0
Short-term debt	\$12.9	\$22.0

The lines of credit for certain of the Company's foreign subsidiaries provide for short-term borrowings up to \$221.3 million. At September 30, 2012, the Company's foreign subsidiaries had borrowings outstanding of \$12.9 million and guarantees of \$3.8 million, which reduced the availability under these facilities to \$204.6 million.

The Company has a \$150 million Accounts Receivable Securitization Financing Agreement (Asset Securitization Agreement), which matures on November 10, 2012. The Company is currently reviewing its options to establish a new agreement prior to the current maturity date. Under the terms of the Asset Securitization Agreement, 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. Borrowings under the agreement are limited by certain borrowing base calculations. Any amounts outstanding under this Asset Securitization Agreement would be reported in short-term debt on the Company's Consolidated Balance Sheet. As of September 30, 2012, there were no outstanding borrowings under the Asset Securitization Agreement. The cost of this facility, which is the commercial paper rate plus program fees, is considered a financing cost and is included in interest expense in the Consolidated Statements of Income.

Long-term debt at September 30, 2012 and December 31, 2011 was as follows:

	September 30, 2012	December 31, 2011
Fixed-rate Medium-Term Notes, Series A, mature at various dates through May 2028, with interest rates ranging from 6.74% to 7.76%	\$175.0	\$175.0
Fixed-rate Senior Unsecured Notes, maturing on September 15, 2014, with an interest rate of 6.0%	249.9	249.8
Variable-rate State of Ohio Water Development Revenue Refunding Bonds, maturing on November 1, 2025 (0.16% at September 30, 2012)	12.2	12.2
Variable-rate State of Ohio Air Quality Development Revenue Refunding Bonds, maturing on November 1, 2025 (0.34% at September 30, 2012)	9.5	9.5
Variable-rate State of Ohio Pollution Control Revenue Refunding Bonds, maturing on June 1, 2033 (0.34% at September 30, 2012)	8.5	17.0
Variable-rate credit facility with US Bank for Advanced Green Components, LLC, maturing on May 23, 2013 (1.35% at September 30, 2012)	0.2	5.1
Other	20.7	24.5
	\$476.0	\$493.1
Less current maturities	14.6	14.3
Long-term debt	\$461.4	\$478.8

The Company has a \$500 million Amended and Restated Credit Agreement (Senior Credit Facility) which matures on May 11, 2016. At September 30, 2012, the Company had no outstanding borrowings under the Senior Credit Facility but had letters of credit outstanding totaling \$8.6 million, which reduced the availability under the Senior Credit Facility to \$491.4 million. Under the Senior Credit Facility, the Company has two financial covenants: a consolidated leverage ratio and a consolidated interest coverage ratio. At September 30, 2012, the Company was in full compliance with the covenants under the Senior Credit Facility.

In 2011, the Company was notified that its variable-rate State of Ohio Pollution Control Revenue Refunding Bonds, maturing on June 1, 2033, had lost their tax-exempt status and would now be taxable to its bondholders. As part of the negotiation with the Internal Revenue Service (IRS), the Company redeemed half of the balance during the third quarter of 2012. The Company now expects to pay off the remaining balance of \$8.5 million on December 31, 2022.

Certain of the Company's foreign subsidiaries have facilities that also provide for long-term borrowings up to \$19.1 million. At September 30, 2012, the Company had outstanding borrowings of \$19.1 million, leaving no availability under these long-term facilities.



## Note 7 - Product Warranty

The Company generally provides limited warranties on its products. The Company accrues liabilities for warranty costs based upon specific claims and a review of historical warranty claim experience in accordance with accounting rules relating to contingent liabilities. The Company records and accounts for its warranty reserve based on specific claim incidents. 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, 2012 and the twelve months ended December 31, 2011:

	September 30, 2012	December 31, 2011
Beginning balance, January 1	\$11.7	\$8.0
(Income) expense	(1.6)	) 9.0
Payments	(4.6)	) (5.3)
Ending balance	\$5.5	\$11.7

The product warranty accrual at September 30, 2012 and December 31, 2011, respectively, was included in other current liabilities on the Consolidated Balance Sheets.

## Note 8 - Equity

	The Timken Company Shareholders						
	Total	Stated Capital	Other Paid-In Capital	Earnings Invested in the Business	Accumulated Other Comprehensive (Loss)	Treasury Stock	Non- controlling Interest
Balance at December 31, 2011	\$2,042.5	\$53.1	\$889.2	\$2,004.7	\$(889.5)	) \$(29.2)	) \$14.2
Net income	420.5			420.2			0.3
Foreign currency translation adjustment	0.5				0.5		
Pension and postretirement liability adjustment (net of the income tax benefit of \$24.5 million)	34.2				34.2		
Unrealized loss on marketable securities	(0.7)	)			(0.6)	)	(0.1)
Change in fair value of derivative financial instruments, net of reclassifications	0.5				0.5		
Dividends – \$0.69 per share	(66.8)	)		(66.8)	)		
Excess tax benefit from stock compensation	9.6		9.6				
Stock-based compensation expense	13.4		13.4				
Stock purchased at cost	(112.3)	)				(112.3)	)
Stock option exercise activity	12.5		(20.6)	)		33.1	
Restricted shares (issued) surrendered	—		(3.9)	)		3.9	

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Shares surrendered for taxes	(8.1	)					(8.1	)
Balance at September 30, 2012	\$2,345.8	\$53.1	\$887.7	\$2,358.1	\$(854.9	)	\$(112.6)	\$14.4

## Note 9 - 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 months and nine months ended September 30, 2012 and 2011:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Numerator:				
Net income attributable to The Timken Company	\$80.9	\$111.0	\$420.2	\$345.2
Less: undistributed earnings allocated to nonvested stock	0.2	0.4	1.3	1.3
Net income available to common shareholders for basic earnings per share and diluted earnings per share	\$80.7	\$110.6	\$418.9	\$343.9
Denominator:				
Weighted average number of shares outstanding – basic	96,356,772	97,489,819	96,981,922	97,509,361
Effect of dilutive securities:				
Stock options and awards - based on the treasury stock method	766,401	996,021	933,878	1,234,225
Weighted average number of shares outstanding, assuming dilution of stock options and awards	97,123,173	98,485,840	97,915,800	98,743,586
Basic earnings per share	\$0.84	\$1.13	\$4.32	\$3.53
Diluted earnings per share	\$0.83	\$1.12	\$4.28	\$3.48

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 during the three months ended September 30, 2012 and 2011 were 1,299,460 and 697,500, respectively. The antidilutive stock options outstanding during the nine months ended September 30, 2012 and 2011 were 739,577 and 350,167, respectively.



## Note 10 - Segment Information

The primary measurement used by management to measure the financial performance of each segment is EBIT (earnings before interest and taxes). As of January 1, 2012, the Company modified the way in which certain selling, general and administrative (SG&A) expenses are allocated among segments to better reflect the use of shared resources by the business. Prior year amounts have been revised to be consistent with the new allocations.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net sales to external customers:				
Mobile Industries	\$396.7	\$441.3	\$1,314.0	\$1,349.3
Process Industries	309.8	328.1	1,000.5	919.7
Aerospace and Defense	84.0	81.8	262.5	244.4
Steel	352.0	470.6	1,329.7	1,392.1
	\$1,142.5	\$1,321.8	\$3,906.7	\$3,905.5
Intersegment sales:				
Mobile Industries	\$0.2	\$0.3	\$0.4	\$0.5
Process Industries	1.3	0.8	3.9	2.5
Steel	25.0	30.9	82.6	96.0
	\$26.5	\$32.0	\$86.9	\$99.0
Segment EBIT:				
Mobile Industries	\$37.9	\$69.5	\$173.4	\$213.0
Process Industries	60.1	75.6	213.7	209.6
Aerospace and Defense	7.7	(1.7)	26.3	2.4
Steel	49.7	66.2	226.6	196.8
Total EBIT for reportable segments	\$155.4	\$209.6	\$640.0	\$621.8
Unallocated corporate expenses	(20.1)	(18.8)	(63.8)	(59.9)
CDSOA receipts, net of expense	(0.9)	—	108.6	—
Interest expense	(7.3)	(9.1)	(24.0)	(28.2)
Interest income	0.6	1.5	2.0	4.4
Intersegment adjustments	0.4	(0.9)	(1.3)	(0.8)
Income before income taxes	\$128.1	\$182.3	\$661.5	\$537.3

## Note 11 - Impairment and Restructuring Charges

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

For the three months ended September 30, 2012:

	Mobile Industries	Process Industries	Aerospace & Defense	Total
Impairment charges	\$6.4	\$—	\$—	\$6.4
Severance and related benefit costs	0.3	1.0	—	1.3
Exit costs	4.2	—	—	4.2
Total	\$10.9	\$1.0	\$—	\$11.9

For the three months ended September 30, 2011:

	Mobile Industries	Process Industries	Aerospace & Defense	Total
Impairment charges	\$—	\$0.1	\$—	\$0.1
Severance and related benefit costs	0.1	—	—	0.1
Exit costs	0.9	0.1	—	1.0
Total	\$1.0	\$0.2	\$—	\$1.2

For the nine months ended September 30, 2012:

	Mobile Industries	Process Industries	Aerospace & Defense	Total
Impairment charges	\$6.4	\$—	\$—	\$6.4
Severance and related benefit costs	16.6	1.3	—	17.9
Exit costs	4.5	—	—	4.5
Total	\$27.5	\$1.3	\$—	\$28.8

For the nine months ended September 30, 2011:

	Mobile Industries	Process Industries	Aerospace & Defense	Total
Impairment charges	\$0.1	\$0.3	\$0.1	\$0.5
Severance expense and related benefit costs	0.2	—	—	0.2
Exit costs	7.5	0.3	—	7.8
Total	\$7.8	\$0.6	\$0.1	\$8.5

The following discussion explains the major impairment and restructuring charges recorded for the periods presented; however, it is not intended to reflect a comprehensive discussion of all amounts in the tables above.

#### Mobile Industries

In May 2012, the Company announced the closure of its manufacturing facility in St. Thomas, Ontario, Canada (St. Thomas), expected to be completed in approximately one year, and its intent to consolidate bearing production at this plant with its existing U.S. operations to better align the Company's manufacturing footprint and customer base. The Company will also move customer service for the Canadian market to its offices in Toronto. Production is expected to be transferred to the Company's operations in Ohio, North Carolina and South Carolina by mid-2013. The closure of the St. Thomas manufacturing facility will displace approximately 190 employees. The Company expects to incur pretax costs of approximately \$55 million to \$65 million in connection with this closure, of which approximately \$20

million to \$25 million is expected to be pretax cash costs.

The Company has incurred pretax costs of approximately \$26.1 million as of September 30, 2012, including rationalization costs recorded in cost of products sold. During the third quarter of 2012, the Company recorded \$6.4 million of impairment charges. During the first nine months of 2012, the Company recorded \$16.8 million of severance and related benefits, including a curtailment of pension benefits of \$10.7 million, and impairment charges of \$6.4 million. The majority of the \$16.8 million charge was incurred by the Mobile Industries segment.

In March 2007, the Company announced the closure of its manufacturing facility in Sao Paulo, Brazil (Sao Paulo). The Company completed the closure of this manufacturing facility on March 31, 2010. Pretax costs associated with the closure could be as high as approximately \$60 million, which includes restructuring costs and rationalization costs recorded in cost of products sold and selling, general and administrative expenses. Mobile Industries has incurred cumulative pretax costs of approximately \$56.8 million as of September 30, 2012 related to this closure. During the third quarter and first nine months of 2012, the Company recorded \$4.2 million and \$7.1 million of exit costs associated with the closure of this facility primarily related to environmental remediation costs. During the third quarter and first nine months of 2011, the Company recorded \$0.9 million and \$6.9 million, respectively, of exit costs associated with this closure. The exit costs recorded in the third quarter and first nine months of 2011 were primarily related to environmental remediation costs and workers' compensation claims for former employees. The Company accrues environmental remediation costs and workers' compensation claims when they are probable and estimable.

In addition to the above charges, the Company recorded a favorable adjustment of \$2.7 million during the first nine months of 2012 for environmental exit costs at the site of its former plant in Columbus, Ohio. The favorable adjustment was a result of the sale of the real estate at the site of this former plant during the first quarter of 2012. The buyer assumed responsibility for the environmental remediation as a result of the sale. The buyer was able to obtain funding from the State of Ohio to remediate the site.

The following is a rollforward of the consolidated restructuring accrual for the nine months ended September 30, 2012 and the twelve months ended December 31, 2011:

	September 30, 2012	December 31, 2011
Beginning balance, January 1	\$21.8	\$22.1
Expense	11.7	13.9
Payments	(15.1)	(14.2)
Ending balance	\$18.4	\$21.8

The restructuring accrual at September 30, 2012 and December 31, 2011 was included in other current liabilities on the Consolidated Balance Sheets. The restructuring accrual at September 30, 2012 excluded costs related to the curtailment of pension benefit plans of \$10.7 million. The restructuring accrual at September 30, 2012 included \$6.8 million of environmental remediation costs, of which \$5.8 million relates to Sao Paulo. The Company adjusts environmental remediation accruals based on the best available estimate of costs to be incurred, the timing and extent of remedial actions required by governmental authorities and the amount of the Company's liability in proportion to other responsible parties. The Company's estimated total liability for this site ranges from a minimum of \$5.8 million to a maximum of \$9.7 million. It is possible that the estimates may change in the near term.



## Note 12 - Retirement and Postretirement Benefit Plans

The following table sets forth the net periodic benefit cost for the Company's defined benefit pension and postretirement benefit plans. The amounts for the three months and nine months ended September 30, 2012 are based on updated actuarial calculations prepared during the second quarter of 2012. The net periodic benefit cost recorded for the three months and nine months ended September 30, 2012 is the Company's best estimate of each period's proportionate share of the amounts to be recorded for the year ending December 31, 2012.

	Pension Three Months Ended September 30, 2012		Postretirement Three Months Ended September 30, 2012	
	2012	2011	2012	2011
Components of net periodic benefit cost:				
Service cost	\$8.7	\$8.0	\$0.6	\$0.7
Interest cost	37.7	39.6	7.0	8.1
Expected return on plan assets	(55.3)	(53.7)	(2.7)	(1.2)
Amortization of prior service cost	2.3	2.4	—	—
Amortization of net actuarial loss	20.8	14.0	0.6	0.7
Net periodic benefit cost	\$14.2	\$10.3	\$5.5	\$8.3
	Pension Nine Months Ended September 30, 2012		Postretirement Nine Months Ended September 30, 2012	
	2012	2011	2012	2011
Components of net periodic benefit cost:				
Service cost	\$25.9	\$24.2	\$1.9	\$1.9
Interest cost	113.3	119.0	20.9	24.3
Expected return on plan assets	(165.8)	(161.3)	(8.0)	(3.4)
Amortization of prior service cost (credit)	7.0	7.1	(0.2)	(0.2)
Amortization of net actuarial loss	62.5	42.0	1.9	2.2
Curtailment loss	10.7	—	—	—
Net periodic benefit cost	\$53.6	\$31.0	\$16.5	\$24.8

## Note 13 - Income Taxes

The Company's provision for income taxes in interim periods is computed by applying the appropriate annual effective tax rates to income or loss 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(s) in which they occur.

	Three Months Ended September 30, 2012		Nine Months Ended September 30, 2012	
	2012	2011	2012	2011
Provision for income taxes	\$47.0	\$70.1	\$241.0	\$189.0
Effective tax rate	36.7	% 38.5	% 36.4	% 35.2

The effective tax rate in the third quarter of 2012 was higher than the U.S. federal statutory rate of 35% primarily due to losses at certain foreign subsidiaries where no tax benefit could be recorded, including restructuring charges related to the closure of the manufacturing facility in St. Thomas, U.S. state and local taxes, and U.S. taxation of foreign income. These factors were partially offset by the U.S. manufacturing deduction and certain discrete U.S. tax benefits.



The decrease in the effective tax rate in the third quarter of 2012 compared to the third quarter of 2011 was primarily due to higher tax benefits from the U.S. manufacturing deduction and certain discrete U.S. tax benefits. These factors were partially offset by higher losses at certain foreign subsidiaries where no tax benefit could be recorded, including restructuring charges related to the closure of the manufacturing facility in St. Thomas, lower earnings in certain foreign jurisdictions where the effective tax rate was lower than 35%.

The effective tax rate for the first nine months of 2012 was higher than the U.S. federal statutory rate of 35% primarily due to U.S. state and local taxes, U.S. taxation of foreign income and losses at certain foreign subsidiaries where no tax benefit could be recorded, including restructuring charges related to the closure of the manufacturing facility in St. Thomas. These factors were partially offset by earnings in certain foreign jurisdictions where the effective tax rate was lower than 35%, the U.S. manufacturing deduction and certain discrete U.S. tax benefits.

The increase in the effective tax rate in the first nine months of 2012 compared to the first nine months of 2011 was primarily due to higher losses at certain foreign subsidiaries where no tax benefit could be recorded, including restructuring charges related to the closure of the manufacturing facility in St. Thomas, lower earnings in certain foreign jurisdictions where the effective tax rate was lower than 35% and higher U.S. state and local taxes. These factors were partially offset by higher tax benefits from the U.S. manufacturing deduction and certain discrete U.S. tax benefits.

As of September 30, 2012, the Company had approximately \$111.2 million of total gross unrecognized tax benefits. Included in this amount was approximately \$45.5 million, which represents the amount of unrecognized tax benefits that would favorably impact the Company's effective income tax rate in any future periods if such benefits were recognized. As of September 30, 2012, the Company anticipates a decrease in its unrecognized tax positions of approximately \$43.0 million to \$44.0 million during the next 12 months. The anticipated decrease is primarily due to settlements with tax authorities. As of September 30, 2012, the Company has accrued approximately \$10.7 million of interest and penalties related to uncertain tax positions. The Company records interest and penalties related to uncertain tax positions as a component of income tax expense.

As of December 31, 2011, the Company had \$87.2 million of total gross unrecognized tax benefits. Included in this amount was approximately \$45.3 million, which represents the amount of unrecognized tax benefits that would favorably impact the Company's effective income tax rate in any future periods if such benefits were recognized. As of December 31, 2011, the Company has accrued approximately \$9.0 million of interest and penalties related to uncertain tax positions. The Company records interest and penalties related to uncertain tax positions as a component of income tax expense.

The following table reconciles the Company's total gross unrecognized tax benefits:

	September 30, 2012	December 31, 2011
Beginning balance, January 1	\$87.2	\$77.8
Tax positions related to the current year:		
Additions	21.1	1.3
Tax positions related to prior years:		
Additions	4.3	13.7
Reductions	(0.9)	(5.6)
Lapses in statutes of limitation	(0.5)	—
Ending balance	\$111.2	\$87.2

During the first nine months of 2012, gross unrecognized tax benefits increased primarily due to net additions related to current year tax matters including the timing of income recognition for certain amounts received by the Company

and treated as capital contributions pursuant to Section 118 of the Internal Revenue Code and other miscellaneous items. These increases were partially offset by reductions related to prior year tax matters including taxes related to the Company's international operations, and lapses of the statutes of limitation associated with various tax matters. During 2011, gross unrecognized tax benefits increased primarily due to net additions related to various prior year and current year tax matters, including U.S. state and local taxes, and taxes related to the Company's international operations. These increases were partially offset by reductions related to prior year and current year tax matters, including U.S. state and local taxes and taxes related to the Company's international operations, and lapses of the statutes of limitation associated with various tax matters.

As of September 30, 2012, the Company is subject to examination by the IRS for tax years 2006 to the present. The Company is also subject to tax examination in various U.S. state and local tax jurisdictions for tax years 2007 to the present, as well as various foreign tax jurisdictions, including Brazil, Germany, India and Canada for tax years 2004 to the present.

The current portion of the Company's unrecognized tax benefits was presented on the Consolidated Balance Sheets within income taxes payable, and the non-current portion was presented as a component of other non-current liabilities.

During the third quarter of 2012, the Company recorded an adjustment to decrease non-current deferred tax assets and income taxes payable to record the impact of certain pension accruals, which should have been included in the computation of the U.S. federal and state income tax liabilities for the tax year ending December 31, 2011.

Non-current deferred taxes assets and income taxes payable were reclassified as of December 31, 2011 to reflect the adjustment.

#### Note 14 - Acquisitions

On October 3, 2011, the Company completed the acquisition of Drives for approximately \$93 million in cash. On July 1, 2011, the Company completed the acquisition of substantially all of the assets of Philadelphia Gear Corp. (Philadelphia Gear) for approximately \$199 million in cash. The Company made an initial allocation of the purchase price at the date of acquisition based upon its understanding of the fair value of the acquired assets and assumed liabilities at that time. In the months after closing, the Company obtained additional information and was able to refine the estimates of fair value and more accurately allocate the purchase price. During the first nine months of 2012, the Company finalized the purchase price allocation for the Philadelphia Gear acquisition and the Drives acquisition and all appropriate adjustments were made. The purchase price allocation was made retroactive to December 31, 2011 on the Consolidated Balance Sheets.

The following table presents the initial purchase price allocation for acquisitions in 2011 and adjustments to the purchase price allocation during the first nine months of 2012:

	Initial Purchase Price Allocation	Adjustments	Adjusted Purchase Price Allocation
Assets:			
Accounts receivable, net	\$25.6	\$—	\$25.6
Inventories, net	23.6	—	23.6
Deferred charges and prepaid expenses	0.9	—	0.9
Other current assets	0.1	0.5	0.6
Property, plant and equipment – net	32.1	—	32.1
Goodwill	83.3	25.7	109.0
Other intangible assets	146.9	(25.9)	121.0
Other non-current assets	0.6	(0.1)	0.5
Total assets acquired	\$313.1	\$0.2	\$313.3
Liabilities:			
Accounts payable, trade	\$10.7	\$—	\$10.7
Salaries, wages and benefits	5.1	—	5.1
Other current liabilities	5.2	—	5.2
Total liabilities assumed	\$21.0	\$—	\$21.0
Net assets acquired	\$292.1	\$0.2	\$292.3



The following table summarizes the initial purchase price allocation for acquisitions in 2011 and the adjusted purchase price allocation as of September 30, 2012:

	Initial Purchase Price Allocation	Weighted - Average Life	Adjusted Purchase Price Allocation	Weighted - Average Life
Trade name (not subject to amortization)	\$4.1	Indefinite	\$15.3	Indefinite
Developed Technology	5.4	7 years	8.0	15 years
Trade name	12.0	15 years	0.3	2 years
Know-how	15.0	20 years	20.6	20 years
All customer relationships	108.4	17 years	75.7	10 years
Non-compete agreements	2.0	5 years	1.1	3 years
Total intangible assets allocated	\$146.9		\$121.0	

#### Note 15 - Fair Value

Fair value is defined 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). The FASB provides accounting rules that classify the inputs used to measure fair value into the following hierarchy:

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

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.

The following table presents the fair value hierarchy for those financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2012:

	Fair Value at September 30, 2012			
	Total	Level 1	Level 2	Level 3
Assets:				
Cash and cash equivalents	\$485.5	\$485.5	\$—	\$—
Short-term investments	28.6	28.6	—	—
Foreign currency hedges	1.6	—	1.6	—
Total Assets	\$515.7	\$514.1	\$1.6	\$—
Liabilities:				
Foreign currency hedges	\$3.0	\$—	\$3.0	
Total Liabilities	\$3.0	\$—	\$3.0	\$—

Cash and cash equivalents are highly liquid investments with maturities of three months or less when purchased and are valued at redemption value. Short-term investments are investments with maturities between four months and one year and are valued at amortized cost. The Company uses publicly available foreign currency forward and spot rates to measure the fair value of its foreign currency forward contracts.

The Company does not believe it has significant concentrations of risk associated with the counterparts to its financial instruments.

During the third quarter of 2012, machinery and equipment associated with the manufacturing facility in St. Thomas, with a carrying value of \$10.2 million was written down to its fair value of \$3.8 million, resulting in an impairment loss of \$6.4 million. The fair value for these assets was based on the price that would be received in a current transaction to sell the assets on a standalone basis, considering the age and physical attributes of the equipment, compared to cost of similar used equipment. The fair value of machinery and equipment was measured using Level 3 inputs.



The Company's financial instruments consist primarily of cash and cash equivalents, short-term investments, accounts receivable, net, accounts payable, trade, short-term borrowings and long-term debt. Due to their short-term nature, the carrying value of cash and cash equivalents, short-term investments, accounts receivable, net, accounts payable, trade and short-term borrowings are a reasonable estimate of their fair value. The fair value of the Company's long-term fixed-rate debt, based on quoted market prices, was \$488.3 million and \$480.7 million at September 30, 2012 and December 31, 2011, respectively. The carrying value of this debt was \$426.7 million and \$428.9 million at September 30, 2012 and December 31, 2011, respectively. The fair value of long-term fixed debt was measured using Level 2 inputs.

#### Note 16 - Continued Dumping and Subsidy Offset Act (CDSOA)

CDSOA provides for distribution of monies collected by U.S. Customs and Border Protection (U.S. Customs) from antidumping cases to qualifying domestic producers where the domestic producers have continued to invest in their technology, equipment and people.

In September 2002, the World Trade Organization (WTO) ruled that CDSOA payments are not consistent with international trade rules. In February 2006, U.S. legislation was enacted that ended CDSOA distributions for dumped imports covered by antidumping duty orders entering the United States after September 30, 2007. Instead, any such antidumping duties collected would remain with the U.S. Treasury. Several countries have objected that this U.S. legislation is not consistent with WTO rulings, and were granted retaliation rights by the WTO, typically in the form of increased tariffs on some imported goods from the United States. The European Union and Japan hav