TIMKEN CO
Form 10-Q
May 02, 2011

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

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

For the quarterly period ended March 31, 2011

OR

o **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 þ No o

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 þ No o

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 small reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ Accelerated filer o Non-accelerated filer o Smaller reporting company o
(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 o No þ

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 March 31, 2011
Common Stock, without par value	97,906,557 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 March 31,	
	2011	2010
(Dollars in millions, except per share data)		
Net sales	**$ 1,254.1**	$ 913.7
Cost of products sold	**920.8**	691.0
Gross Profit	**333.3**	222.7
Selling, administrative and general expenses	**150.3**	133.0
Impairment and restructuring charges	**1.1**	5.5
Operating Income	**181.9**	84.2
Interest expense	**(9.8)**	(9.6)
Interest income	**1.5**	0.6
Other expense, net	**(2.4)**	(0.6)
Income from Continuing Operations Before Income Taxes	**171.2**	74.6
Provision for income taxes	**57.4**	45.9
Income From Continuing Operations	**113.8**	28.7
Income from discontinued operations, net of income taxes		0.3
Net Income	**113.8**	29.0
Less: Net income attributable to noncontrolling interest	**1.1**	0.4
Net Income Attributable to The Timken Company	**$ 112.7**	$ 28.6
Amounts Attributable to The Timken Company s Common Shareholders:		
Income from continuing operations	**$ 112.7**	$ 28.3
Income from discontinued operations, net of income taxes		0.3
Net Income Attributable to The Timken Company	**$ 112.7**	$ 28.6
Net Income per Common Share Attributable to The Timken Company Common Shareholders		
Earnings per share Continuing Operations	**$ 1.15**	$ 0.29
Earnings per share Discontinued Operations		0.01
Basic earnings per share	**$ 1.15**	$ 0.30

Diluted earnings per share Continuing Operations	**$ 1.13**	$ 0.29
Diluted earnings per share - Discontinued Operations		
Diluted earnings per share	**$ 1.13**	$ 0.29
Dividends per share	**$ 0.18**	$ 0.09

See accompanying Notes to the Consolidated Financial Statements.

Consolidated Balance Sheets

	(Unaudited) March 31, 2011	December 31, 2010
(Dollars in millions)		
ASSETS		
Current Assets		
Cash and cash equivalents	**$ 637.6**	$ 877.1
Restricted cash	**4.8**	
Accounts receivable, less allowances: 2011 - $24.7 million; 2010 - $27.6 million	**672.5**	516.6
Inventories, net	**917.5**	828.5
Deferred income taxes	**100.4**	100.4
Deferred charges and prepaid expenses	**14.3**	11.3
Other current assets	**70.3**	65.3
Total Current Assets	**2,417.4**	2,399.2
Property, Plant and Equipment-Net	**1,250.9**	1,267.7
Other Assets		
Goodwill	**225.9**	224.4
Other intangible assets	**127.1**	129.2
Deferred income taxes	**116.3**	121.5
Other non-current assets	**43.0**	38.4
Total Other Assets	**512.3**	513.5
Total Assets	**$ 4,180.6**	$ 4,180.4
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities		
Short-term debt	**$ 31.2**	$ 22.4
Accounts payable	**320.9**	263.5
Salaries, wages and benefits	**174.9**	233.4
Income taxes payable	**47.2**	14.0
Deferred income taxes	**0.8**	0.7
Other current liabilities	**160.3**	176.3
Current portion of long-term debt	**7.9**	9.6
Total Current Liabilities	**743.2**	719.9
Non-Current Liabilities		
Long-term debt	**483.3**	481.7
Accrued pension cost	**241.0**	394.5
Accrued postretirement benefits cost	**529.4**	531.2
Deferred income taxes	**6.2**	6.0

Other non-current liabilities	**111.2**	105.3
Total Non-Current Liabilities	**1,371.1**	1,518.7
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) (2011 - 98,347,235 shares; 2010 - 98,153,317 shares)		
Stated capital	**53.1**	53.1
Other paid-in capital	**880.8**	881.7
Earnings invested in the business	**1,721.5**	1,626.4
Accumulated other comprehensive loss	**(585.1)**	(624.7)
Treasury shares at cost (2011 - 440,678 shares; 2010 - 350,201 shares)	**(22.2)**	(11.5)
Total Shareholders Equity	**2,048.1**	1,925.0
Noncontrolling Interest	**18.2**	16.8
Total Equity	**2,066.3**	1,941.8
Total Liabilities and Shareholders Equity	**$ 4,180.6**	$ 4,180.4

See accompanying Notes to the Consolidated Financial Statements.

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Consolidated Statements of Cash Flows
(Unaudited)

(Dollars in millions)	Three Months Ended March 31, 2011	2010
CASH PROVIDED (USED)		
Operating Activities		
Net income attributable to The Timken Company	**$ 112.7**	$ 28.6
Net income from discontinued operations		(0.3)
Net income attributable to noncontrolling interest	**1.1**	0.4
Adjustments to reconcile income from continuing operations to net cash provided by operating activities:		
Depreciation and amortization	**47.5**	47.7
Impairment charges	**1.8**	
Loss on sale of assets	**0.1**	0.9
Deferred income tax provision	**0.3**	21.7
Stock-based compensation expense	**3.4**	4.5
Pension and other postretirement expense	**22.3**	25.2
Pension contributions and other postretirement benefit payments	**(166.0)**	(118.7)
Changes in operating assets and liabilities:		
Accounts receivable	**(149.6)**	(82.1)
Inventories	**(80.4)**	(22.5)
Trade account payable	**54.8**	66.5
Other accrued expenses	**(81.0)**	(7.8)
Income taxes	**41.0**	22.5
Other net	**(5.6)**	(0.8)
Net Cash Used by Operating Activities Continuing Operations	**(197.6)**	(14.2)
Net Cash Provided by Operating Activities Discontinued Operations		0.3
Net Cash Used by Operating Activities	**(197.6)**	(13.9)
Investing Activities		
Capital expenditures	**(20.1)**	(14.0)
Proceeds from disposals of property, plant and equipment	**0.4**	0.2
Investments in short-term marketable securities	**(13.3)**	
Other	**0.8**	(1.3)
Net Cash Used by Investing Activities	**(32.2)**	(15.1)
Financing Activities		
Cash dividends paid to shareholders	**(17.6)**	(8.7)
Net proceeds from common share activity	**15.2**	8.3
Purchase of treasury shares net	**(25.3)**	(14.0)
Proceeds from issuance of long-term debt	**1.5**	2.1
Payments on long-term debt	**(1.8)**	(2.5)

Short-term debt activity net	**8.6**	4.1
Increase in restricted cash	**(4.8)**	
Other	**0.3**	
Net Cash Used by Financing Activities	**(23.9)**	(10.7)
Effect of exchange rate changes on cash	**14.2**	(6.5)
Decrease In Cash and Cash Equivalents	**(239.5)**	(46.2)
Cash and cash equivalents at beginning of year	**877.1**	755.5
Cash and Cash Equivalents at End of Period	**$ 637.6**	$ 709.3

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, 2010. Certain amounts in the 2010 Consolidated Financial Statements have been reclassified to conform to the 2011 presentation.

Note 2 Inventories

	March 31, 2011	December 31, 2010
Inventories, net:		
Manufacturing supplies	**$ 57.7**	$ 57.9
Work in process and raw materials	**432.7**	371.9
Finished products	**427.1**	398.7
Total Inventories, net	**$ 917.5**	$ 828.5

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 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 March 31, 2011 and December 31, 2010 was $270.6 million and $264.6 million, respectively. The Company recognized an increase in its LIFO reserve of $6.0 million during the first quarter of 2011 compared to an increase in its LIFO reserve of $6.1 million during the first quarter of 2010.

Based on current expectations of inventory levels and costs, the Company expects to recognize approximately $26 million in LIFO expense for the year ended December 31, 2011. The expected increase in the LIFO reserve for 2011 is a result of higher costs, especially scrap steel costs, as well as higher quantities. A 1.0% increase in costs would increase the current LIFO expense estimate for 2011 by $6 million. A 1.0% increase in inventory quantities would increase the current LIFO expense estimate for 2011 by $0.2 million.

Note 3 Property, Plant and Equipment

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

	March 31, 2011	December 31, 2010
Property, Plant and Equipment:		
Land and buildings	**$ 634.2**	$ 623.2
Machinery and equipment	**2,850.3**	2,830.8
Subtotal	**3,484.5**	3,454.0

Less allowances for depreciation	**(2,233.6)**	(2,186.3)
Property, Plant and Equipment net	**$ 1,250.9**	$ 1,267.7

At March 31, 2011 and December 31, 2010, machinery and equipment included approximately $94.6 million and $99.7 million, respectively, of capitalized software. Depreciation expense for the three months ended March 31, 2011 and 2010 was $45.0 million and $45.3 million, respectively. Depreciation expense on capitalized software for the three months ended March 31, 2011 and 2010 was approximately $6.9 million and $5.3 million, respectively.

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Note 4 Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill for the three months ended March 31, 2011 were as follows:

	Beginning Balance	Other	Ending Balance
Segment:			
Process Industries	**$ 50.0**	**$ 1.4**	**$ 51.4**
Aerospace and Defense	**162.3**	**0.2**	**162.5**
Steel	**12.1**	**(0.1)**	**12.0**
Total	**$ 224.4**	**$ 1.5**	**$ 225.9**

Other primarily includes foreign currency translation adjustments.

The following table displays intangible assets as of March 31, 2011 and December 31, 2010:

	As of March 31, 2011			As of December 31, 2010		
	Gross Carrying Amount	**Accumulated Amortization**	**Net Carrying Amount**	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Intangible assets subject to amortization:						
Customer relationships	**$ 82.0**	**$ 19.6**	**$ 62.4**	$ 82.0	$ 18.6	$ 63.4
Engineering drawings	**2.0**	**2.0**		2.0	2.0	
Know-how	**2.1**	**1.1**	**1.0**	2.1	1.0	1.1
Industrial license agreements	**0.4**	**0.1**	**0.3**	0.4	0.1	0.3
Land-use rights	**8.3**	**3.5**	**4.8**	8.2	3.3	4.9
Patents	**4.4**	**3.4**	**1.0**	4.4	3.3	1.1
Technology use	**39.0**	**6.7**	**32.3**	39.0	6.3	32.7
Trademarks	**6.0**	**5.0**	**1.0**	6.0	5.0	1.0
PMA licenses	**8.8**	**2.8**	**6.0**	8.8	2.7	6.1
Non-compete agreements	**2.7**	**2.0**	**0.7**	2.7	1.9	0.8
Unpatented technology	**7.6**	**6.2**	**1.4**	7.6	6.0	1.6
	$ 163.3	**$ 52.4**	**$ 110.9**	$ 163.2	$ 50.2	$ 113.0
Intangible assets not subject to amortization:						
Tradename	**$ 2.0**		**$ 2.0**	$ 2.0		$ 2.0
FAA air agency certificates	**14.2**		**14.2**	14.2		14.2
	$ 16.2		**$ 16.2**	$ 16.2		$ 16.2
Total intangible assets	**$ 179.5**	**$ 52.4**	**$ 127.1**	$ 179.4	$ 50.2	$ 129.2

Amortization expense for intangible assets was $2.3 million and $2.4 million for the three months ended March 31, 2011 and March 31, 2010, respectively. Amortization expense for intangible assets is estimated to be approximately $9.5 million for 2011; $9.1 million in 2012; $7.6 million in 2013; $7.4 million in 2014; and $7.4 million in 2015.

Note 5 Financing Arrangements

Short-term debt at March 31, 2011 and December 31, 2010 was as follows:

	March 31, 2011	December 31, 2010
Variable-rate lines of credit for certain of the Company s foreign subsidiaries with various banks with interest rates ranging from 2.44% to 6.72% and 1.98% to 5.05% at March 31, 2011 and December 31, 2010, respectively	**$ 31.2**	$ 22.4
Short-term debt	**$ 31.2**	$ 22.4

The lines of credit for certain of the Company s foreign subsidiaries provide for borrowings up to $300.0 million. At March 31, 2011, the Company had borrowings outstanding of $31.2 million and guarantees of $2.7 million, which reduced the availability under these facilities to $266.1 million.

The Company has a $150 million Accounts Receivable Securitization Financing Agreement (Asset Securitization Agreement), which matures on November 10, 2012. 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 to certain borrowing base calculations. Any amounts outstanding under this Asset Securitization Agreement would be reported on the Company s Consolidated Balance Sheets in short-term debt. As of March 31, 2011, there were no outstanding borrowings under the Asset Securitization Agreement. The cost of this credit 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 March 31, 2011 and December 31, 2010 was as follows:

	March 31, 2011	December 31, 2010
Fixed-rate Medium-Term Notes, Series A, due at various dates through May 2028, with interest rates ranging from 6.74% to 7.76%	**$ 175.0**	$ 175.0
Fixed-rate Senior Unsecured Notes, due September 15, 2014, with an interest rate of 6.0%	**249.8**	249.7
Variable-rate State of Ohio Water Development Revenue Refunding Bonds, maturing on November 1, 2025 (0.25% at March 31, 2011)	**12.2**	12.2
Variable-rate State of Ohio Air Quality Development Revenue Refunding Bonds, maturing on November 1, 2025 (0.73% at March 31, 2011)	**9.5**	9.5
Variable-rate State of Ohio Pollution Control Revenue Refunding Bonds, maturing on June 1, 2033 (0.73% at March 31, 2011)	**17.0**	17.0
Variable-rate credit facility with US Bank for Advanced Green Components, LLC, maturing on July 17, 2011 (with interest rates ranging from 1.413% to 2.846% at March 31, 2011)	**6.6**	8.3
Other	**21.1**	19.6
	491.2	491.3
Less current maturities	**7.9**	9.6

Long-term debt	**$**	**483.3**	$	481.7

On July 10, 2009, the Company entered into a $500 million Amended and Restated Credit Agreement (Senior Credit Facility). At March 31, 2011, the Company had no outstanding borrowings under its Senior Credit Facility but had letters of credit outstanding totaling $17.2 million, which reduced the availability under the Senior Credit Facility to $482.8 million. The Senior Credit Facility matures on July 10, 2012. Under the Senior Credit Facility, the Company has three financial covenants: a consolidated leverage ratio, a consolidated interest coverage ratio and a consolidated minimum tangible net worth test. At March 31, 2011, the Company was in full compliance with the covenants under the Senior Credit Facility.

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Note 5 Financing Arrangements (continued)

Advanced Green Components, LLC (AGC) is a joint venture of the Company. As of March 31, 2011, the Company had set aside cash of $4.8 million in a collateral account to secure up to $4.8 million of the indebtedness between AGC and US Bank in the event AGC defaults on its credit facility with US Bank. The $4.8 million collateral account is classified as restricted cash on the Consolidated Balance Sheet as of March 31, 2011.

Certain of the Company s foreign subsidiaries have facilities that also provide for long-term borrowings up to $27.7 million. At March 31, 2011, the Company had borrowings outstanding of $19.9 million, which reduced the availability under these long-term facilities to $7.8 million.

Note 6 Product Warranty

The Company provides limited warranties on certain of its products. The Company accrues liabilities for warranty policies 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 three months ended March 31, 2011 and the twelve months ended December 31, 2010:

	March 31, 2011	December 31, 2010
Beginning balance, January 1	**$ 8.0**	$ 5.4
Expense	**3.4**	6.0
Payments	**(0.3)**	(3.4)
Ending balance	**$ 11.1**	$ 8.0

The product warranty accrual at March 31, 2011 and December 31, 2010 was included in other current liabilities on the Consolidated Balance Sheets.

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Note 7 Equity

		The Timken Company shareholder s					
	Total	Stated Capital	Other Paid-In Capital	Earnings Invested in the Business	Accumulated Other Comprehensive (Loss)	Treasury Stock	Noncontrolling Interest
Balance at December 31, 2010	$ 1,941.8	$ 53.1	$ 881.7	$ 1,626.4	$ (624.7)	$ (11.5)	$ 16.8
Net income	113.8			112.7			1.1
Foreign currency translation adjustment	33.0				33.0		
Pension and postretirement liability adjustment (net of the income tax benefit of $5.3 million)	6.7				6.7		
Unrealized gain on marketable securities	0.1				0.1		
Change in fair value of derivative financial instruments, net of reclassifications	(0.2)				(0.2)		
Total comprehensive income	153.4						
Capital investment Timken Anshan	0.3						0.3
Dividends $0.18 per share	(17.6)			(17.6)			
Tax benefit from stock compensation	5.3		5.3				
Stock-based compensation expense	3.4		3.4				
Tender of 90,477 shares to treasury	(21.0)		(10.3)			(10.7)	
Issuance of 193,918 shares from authorized	0.7		0.7				
Balance at March 31, 2011	**$ 2,066.3**	**$ 53.1**	**$ 880.8**	**$ 1,721.5**	**$ (585.1)**	**$ (22.2)**	**$ 18.2**

The total comprehensive income for the three months ended March 31, 2010 was $46.8 million.

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Note 8 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 ended March 31, 2011 and 2010:

	Three Months Ended March 31,	
	2011	2010
Numerator:		
Income from continuing operations attributable to The Timken Company	**$ 112.7**	$ 28.3
Less: undistributed earnings allocated to nonvested stock	**0.5**	0.1
Income from continuing operations available to common shareholders for basic earnings per share and diluted earnings per share	**$ 112.2**	$ 28.2
Denominator:		
Weighted average number of shares outstanding basic	**97,444,389**	96,360,137
Effect of dilutive securities:		
Stock options and awards based on the treasury stock method	**1,451,437**	501,264
Weighted average number of shares outstanding, assuming dilution of stock options and awards	**98,895,826**	96,861,401
Basic earnings per share from continuing operations	**$ 1.15**	$ 0.29
Diluted earnings per share from continuing operations	**$ 1.13**	$ 0.29

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 353,000 and 2,367,304 during the first quarter of 2011 and 2010, respectively.

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Note 9 Segment Information
The primary measurement used by management to measure the financial performance of each segment is EBIT (earnings before interest and taxes).

	Three Months Ended March 31,	
	2011	2010
Net sales to external customers:		
Mobile Industries	**$ 442.9**	$ 367.5
Process Industries	**284.1**	205.9
Aerospace and Defense	**79.1**	92.1
Steel	**448.0**	248.2
	$ 1,254.1	$ 913.7
Intersegment sales:		
Mobile Industries	**$ 0.1**	$
Process Industries	**0.9**	0.7
Steel	**33.5**	22.1
	$ 34.5	$ 22.8
Segment EBIT:		
Mobile Industries	**$ 68.0**	$ 39.6
Process Industries	**66.7**	24.1
Aerospace and Defense	**2.2**	11.9
Steel	**60.0**	19.9
Total EBIT for reportable segments	**$ 196.9**	$ 95.5
Unallocated corporate expenses	**(18.0)**	(14.4)
Interest expense	**(9.8)**	(9.6)
Interest income	**1.5**	0.6
Intersegment adjustments	**0.6**	2.5
Income from continuing operations before income taxes	**$171.2**	$ 74.6

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Note 10 Impairment and Restructuring Charges

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

For the three months ended March 31, 2011:

	Mobile Industries	Process Industries	Aerospace & Defense	Corporate	Total
Severance expense and related benefit costs	**$ 1.1**	**$**	**$**	**$**	**$ 1.1**
Total	**$ 1.1**	**$**	**$**	**$**	**$ 1.1**

For the three months ended March 31, 2010:

	Mobile Industries	Process Industries	Aerospace & Defense	Corporate	Total
Severance expense and related benefit costs	$ 2.2	$ 1.6	$ 0.6	$ 0.6	$ 5.0
Exit costs	0.4		0.1		0.5
Total	$ 2.6	$ 1.6	$ 0.7	$ 0.6	$ 5.5

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.

Workforce Reductions

In 2009, the Company began the realignment of its organization to improve efficiency and reduce costs as a result of the economic downturn that began during the latter part of 2008. This initiative was completed in 2010. During the first quarter of 2010, the Company recorded $4.7 million of severance and related benefit costs related to this initiative, which included both selling and administrative cost reductions, as well as manufacturing workforce reductions. Of the $4.7 million charge recorded during the first quarter of 2010, $1.9 million related to the Mobile Industries segment, $1.6 million related to the Process Industries segment, $0.6 million related to the Aerospace and Defense segment and $0.6 million related to Corporate positions.

Mobile Industries

In March 2007, the Company announced the closure of its manufacturing facility in Sao Paulo, Brazil. The Company has substantially completed the closure of this facility. Pretax costs associated with the closure are expected to be approximately $40 million, which includes restructuring costs and rationalization costs recorded in cost of products sold and selling, administrative and general expenses. During the first quarter of 2011 and 2010, the Company recorded $1.1 million and $0.3 million, respectively, of severance and related benefit costs associated with the closure of this facility.

The following is a rollforward of the consolidated restructuring accrual for the three months ended March 31, 2011 and the twelve months ended December 31, 2010:

	March 31, 2011	December 31, 2010

Beginning balance, January 1	**$**	**22.1**	$	34.0
Expense		**1.1**		17.0
Payments		**(2.2)**		(28.9)
Ending balance	**$**	**21.0**	$	22.1

Note 10 Impairment and Restructuring Charges (continued)

The restructuring accrual at March 31, 2011 and December 31, 2010 was included in other current liabilities on the Consolidated Balance Sheets. The accrual at March 31, 2011 included $7.5 million of severance and related benefits, which are expected to be paid by the end of 2011. The accrual for severance and related benefits at March 31, 2011 primarily related to the closure of the distribution center in Bucyrus, Ohio, which is expected to be completed during the second quarter of 2011, and the closure of the manufacturing facility in Sao Paulo, Brazil. The remainder of the restructuring accrual at March 31, 2011 primarily represented environmental exit costs, which is principally related to Sao Paulo, Brazil. 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. Actual remediation costs may be more or less than estimated.

Note 11 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 ended March 31, 2011 are based on actuarial calculations prepared during 2010. 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 2011. The net periodic benefit cost recorded for the three months ended March 31, 2011 is the Company s best estimate of the period s proportionate share of the amounts to be recorded for the year ending December 31, 2011.

	Pension Three Months Ended March 31,		**Postretirement Three Months Ended March 31,**	
	2011	2010	**2011**	2010
Components of net periodic benefit cost				
Service cost	**$ 8.3**	$ 9.5	**$ 0.5**	$ 0.7
Interest cost	**39.8**	39.7	**8.7**	9.1
Expected return on plan assets	**(50.1)**	(49.3)	**(0.7)**	
Amortization of prior service cost (credit)	**2.4**	2.3	**(0.4)**	(0.3)
Amortization of net actuarial loss	**12.8**	12.2	**1.0**	1.3
Net periodic benefit cost	**$ 13.2**	$ 14.4	**$ 9.1**	$ 10.8

Note 12 Income Taxes

	Three Months Ended March 31,	
	2011	2010
Provision for income taxes	**$ 57.4**	$ 45.9
Effective tax rate	**33.5%**	61.5%

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.

The effective tax rate in the first quarter of 2011 was lower than the U.S. federal statutory tax rate primarily due to the earnings in certain foreign jurisdictions where the effective tax rate is less than 35%, the U.S. research tax credit and the U.S. manufacturing deduction, partially offset by losses at certain foreign subsidiaries where no tax benefit could be recorded, U.S. state and local taxes and other U.S. tax items.

The effective tax rate in the first quarter of 2010 was higher than the U.S. federal statutory tax rate primarily due to a $21.6 million charge to income tax expense to record the deferred tax impact of the U.S. Patient Protection and Affordable Care Act (as amended) enacted in March 2010, losses at certain foreign subsidiaries where no tax benefit could be recorded and U.S. state and local taxes. These increases were partially offset by the earnings in certain foreign jurisdictions where the effective tax rate is less than 35%.

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Note 13 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 Financial Accounting Standards Board (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 March 31, 2011:

	Fair Value at March 31, 2011			
	Total	**Level 1**	**Level 2**	**Level 3**
Assets:				
Cash and cash equivalents	$ 637.6	$ 637.6	$	$
Short-term investments	28.6	28.6		
Foreign currency hedges	4.1		4.1	
Total Assets	$ 670.3	$ 666.2	$ 4.1	$
Liabilities:				
Foreign currency hedges	$ 7.6	$	$ 7.6	$
Total Liabilities	$ 7.6	$	$ 7.6	$

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.

The following table presents those assets measured at fair value on a nonrecurring basis for the three months ended March 31, 2011 using Level 3 inputs:

	Carrying Value	Fair Value Adjustment	Fair Value
Assets held for sale:			
Equity Investments	$ 5.9	$ (1.8)	$ 4.1
Total assets held for sale	$ 5.9	$ (1.8)	$ 4.1

The Company s equity investment, International Component Supply LTDA, was reviewed for impairment during the first quarter of 2011. This equity investment was written down to its fair value of $4.1 million, resulting in an

impairment charge of $1.8 million recognized in other expense, net during the first quarter of 2011. The fair value of this investment was based on the estimated sales proceeds to be received from a third party if the Company were to sell its interest in the joint venture.

Financial Instruments

The carrying value of cash and cash equivalents, accounts receivable, commercial paper, short-term borrowings and accounts payable are a reasonable estimate of their fair value due to the short-term nature of these instruments. The fair value of the Company s long-term fixed-rate debt, based on quoted market prices, was $487.7 million and $468.7 million at March 31, 2011 and December 31, 2010, respectively. The carrying value of this debt was $438.4 million and $430.4 million at March 31, 2011 and December 31, 2010, respectively.

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

Overview

Introduction

The Timken Company engineers, manufactures, sells and services highly engineered anti-friction bearings and assemblies, high-quality alloy steels and aerospace power transmission systems, as well as provides a broad spectrum of related products and services. The Company operates under four operating segments: (1) Mobile Industries; (2) Process Industries; (3) Aerospace and Defense; and (4) Steel. The following is a description of the Company s segments:

Mobile Industries provides bearings, power transmission components and related products and services to original equipment manufacturers and suppliers of agricultural, construction and mining equipment, passenger cars, light trucks, medium and heavy-duty trucks, rail cars and locomotives, as well as to automotive and heavy truck aftermarket distributors.

Process Industries provides bearings, power transmission components and related products and services to original equipment manufacturers and suppliers of power transmission, energy and heavy industries machinery and equipment. This includes rolling mills, cement and aggregate processing equipment, paper mills, sawmills, printing presses, cranes, hoists, drawbridges, wind energy turbines, gear drives, drilling equipment, coal conveyors, coal crushers and food processing equipment. The segment also serves the aftermarket through its global network of authorized industrial distributors.

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

Steel produces more than 450 grades of carbon and alloy steel, which are sold in both solid and tubular sections in a variety of chemistries, lengths and finishes. The segment s metallurgical expertise and operational capabilities result in solutions for the automotive, industrial and energy sectors. Timken® specialty steels feature prominently in a wide variety of end products including oil country drill pipe, bits and collars; gears, hubs, axles, crankshafts and connecting rods; bearing races and rolling elements, and bushings, fuel injectors and wind energy shafts.

The Company s strategy balances corporate aspirations for sustained growth and a determination to optimize the Company s existing portfolio of business, with the objective of generating strong profits and cash flows. Specifically, the growth element of the strategy addresses differentiation and expansion.

For differentiation, the Company undertakes investments in new technologies to enhance existing products and services or to create new products that capture value for its customers. The Company recently broadened its product offering by introducing new housed bearings, adding to its spherical and cylindrical bearing line, developing new products and services for the wind energy market sector and introducing several new grades of steel.

Regarding expansion, the Company s strategy is to grow in attractive sectors, with particular emphasis on those industrial markets that test the limits of the Company s products and create significant aftermarket, thereby providing a lifetime of opportunity in both product sales and services. The Company s strategy also encompasses expanding its portfolio in new geographic spaces, with an emphasis in Asia. The Company s acquisition strategy is directed at complementing its existing portfolio and expanding the Company s market position.

Simultaneously, the Company works to optimize its existing business with specific initiatives aimed at transformation and execution. This includes transforming the overall portfolio of businesses and products to create further value and profitability, which can include addressing or repositioning underperforming product lines and segments, revising

market sector or geographic strategies and divesting non-strategic assets. The Company drives execution by embracing a continuous improvement culture that is charged with lowering costs, increasing efficiency, encouraging organizational agility and building greater brand equity.

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Management s Discussion and Analysis of Financial Condition and Results of Operations (continued)

The following items highlight the more recent significant strategic accomplishments:

In April 2011, the Company announced it will increase its annual steelmaking capacity by 120,000 tons across its steel manufacturing facilities in Canton, Ohio. The Company is achieving this boost through a series of improvements at its Harrison Steel Plant. Additional investments and crew additions will enable a further increase in output and will allow the Company to optimize production loads between its Harrison and Faircrest plants. The changes will effectively create new capacity at both of these steel facilities to support growing demand for finished bar products and billets for tubing product which serve customers in the global industrial; oil and gas; and mobile markets.

During the first quarter of 2011, the Company began expanding three of its Process Industries plants in Asia. The three plants are located in Chennai, India and Wuxi and Xiangtan, China. The Company expects to investment approximately $50 million for these expansions.

In February 2011, the Company announced a $35 million investment to install a high-volume, in-line forge press at its Faircrest rolling mill facility in Canton, Ohio. Slated to begin operation in early 2013, the addition of the in-line forge press is expected to generate value by increasing capacity, lowering costs through improved yield, expanding product capabilities to meet ultrasonic specifications that are more demanding and reducing cycle times for larger products.

Financial Overview:

Overview:

	1Q 2011	1Q 2010	$ Change	% Change
Net sales	**$ 1,254.1**	$ 913.7	$ 340.4	37.3%
Income from continuing operations	**113.8**	28.7	85.1	296.5%
Income from discontinued operations		0.3	(0.3)	(100.0)%
Income attributable to noncontrolling interest	**1.1**	0.4	0.7	175.0%
Net income attributable to The Timken Company	**112.7**	28.6	84.1	294.1%
Diluted earnings per share	**$ 1.13**	$ 0.29	$ 0.84	289.7%
Average number of shares diluted	**98,895,826**	96,861,401		2.1%

The Timken Company reported net sales for the first quarter of 2011 of $1.3 billion, compared to $913.7 million in the first quarter of 2010, an increase of 37.3%. Higher sales were driven by strong demand from all business segments except the Aerospace and Defense segment, as well as higher surcharges and pricing. For the first quarter of 2011, net income per diluted share was $1.13 compared to $0.29 per diluted share for the first quarter of 2010.

The Company s first quarter results reflect the continued improvement in the end market sectors served by the Mobile Industries and Steel segments, as well as the industrial distribution channel within the Process Industries segment. In addition, the first quarter results reflect higher surcharges and improved manufacturing performance, partially offset by lower demand from aerospace markets, higher raw material costs and higher expense related to incentive compensation plans. Results for the first quarter of 2010 reflect a one-time charge of $21.6 million to record the deferred tax impact of U.S. health care legislation enacted in March 2010.

Outlook

The Company s outlook for 2011 reflects continued improvement in the global economy following the recovery in 2010. The Company expects higher sales of approximately 20% to 25%, primarily driven by stronger sales in all segments. The Company expects to leverage sales growth to drive improved operating performance. However, the strengthening margins will be partially offset by slightly higher selling, general and administrative expenses to support

the higher sales.
From a liquidity standpoint, the Company expects to generate cash from operations of approximately $390 million in 2011, which is an increase of approximately 25% over 2010, driven primarily by higher operating margins. Pension contributions are expected to be approximately $170 million in 2011, compared to $230 million in 2010. The Company expects to increase capital expenditures to $220 million in 2011, compared to $115 million in 2010. Dividends are also expected to increase to approximately $70 million in 2011, compared to $51 million in 2010, reflecting the full-year impact of the current quarterly dividend rate of $0.18 per share.

Management s Discussion and Analysis of Financial Condition and Results of Operations (continued)

The Statement of Income

Sales by Segment:

	1Q 2011	1Q 2010	$ Change	% Change
Mobile Industries	**$ 442.9**	$ 367.5	$ 75.4	20.5%
Process Industries	**284.1**	205.9	78.2	38.0%
Aerospace and Defense	**79.1**	92.1	(13.0)	(14.1)%
Steel	**448.0**	248.2	199.8	80.5%
Total Company	**$ 1,254.1**	$ 913.7	$ 340.4	37.3%

Net sales for the first quarter of 2011 increased $340.4 million, or 37.3%, compared to the first quarter of 2010, primarily due to higher volume of approximately $210 million across all business segments except the Aerospace and Defense segment, higher surcharges of approximately $75 million and higher pricing and favorable sales mix of approximately $55 million.

Gross Profit:

	1Q 2011	1Q 2010	$ Change	Change
Gross profit	**$ 333.3**	$ 222.7	$ 110.6	49.7%
Gross profit % to net sales	**26.6%**	24.4%		220 bps

Gross profit margin increased in the first quarter of 2011 compared to the first quarter of 2010 primarily due to the impact of higher sales volume of approximately $85 million, the timing of surcharges of approximately $75 million and higher pricing and favorable sales mix of approximately $50 million, partially offset by higher raw material and logistics costs of approximately $100 million.

Selling, General and Administrative Expenses:

	1Q 2011	1Q 2010	$ Change	Change
Selling, general and administrative expenses	**$ 150.3**	$ 133.0	$ 17.3	13.0%
Selling, general and administrative expenses % to net sales	**12.0%**	14.6%		(260) bps

The increase in selling, general and administrative expenses of $17.3 million in first quarter of 2011, compared to the first quarter of 2010, was primarily due to higher expenses related to incentive compensation plans of approximately $6 million, with the remainder of the increase relating to higher employee and professional costs.

Impairment and Restructuring Charges:

	1Q 2011	1Q 2010	$ Change
Severance and related benefit costs	**$ 1.1**	$ 5.0	$ (3.9)
Exit costs		0.5	(0.5)
Total	**$ 1.1**	$ 5.5	$ (4.4)

The decrease in impairment and restructuring charges of $4.4 million in the first quarter of 2011, compared to the first quarter of 2010, was primarily due to the completion of most of the Company s major restructuring programs. In the first quarter of 2010, the Company recorded $5.0 million of severance and related benefits costs primarily due to restructuring programs that began in 2009 to realign its organization to improve efficiency and reduce costs as a result of the economic downturn. These programs included both selling and administrative cost reductions, as well as manufacturing workforce reductions.

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Management s Discussion and Analysis of Financial Condition and Results of Operations (continued)

Interest Expense and Income:

	1Q 2011	1Q 2010	$ Change	% Change
Interest expense	**$ 9.8**	$ 9.6	$ 0.2	2.1%
Interest income	**$ (1.5)**	$ (0.6)	$ (0.9)	(150.0)%

Interest expense for the first quarter of 2011 increased slightly compared to the first quarter of 2010, primarily due to higher debt levels at non-U.S. affiliates. Interest income for the first quarter of 2011 increased compared to the same period in the prior year, primarily due to higher invested cash balances.

Other Expense:

	1Q 2011	1Q 2010	$ Change	% Change
Other expense, net	**$ 2.4**	$ 0.6	$ 1.8	300.0%

Other expense, net for the first quarter of 2011 increased compared to the same period in the prior year primarily due to an impairment loss on an equity investment of $1.8 million. The Company recorded the impairment loss as a result of the carrying value of this investment exceeding its expected future cash flows.

Income Tax Expense:

	1Q 2011	1Q 2010	$ Change	Change
Income Tax Expense:	**$ 57.4**	$ 45.9	$ 11.5	25.1%
Effective tax rate	**33.5%**	61.5%		(2,800)bps

The decrease in the effective tax rate in the first quarter of 2011, compared to the first quarter of 2010, was primarily due to a $21.6 million charge to income tax expense to record the deferred tax impact of the U.S. Patient Protection and Affordable Care Act (as amended) enacted in the first quarter of 2010.

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Management s Discussion and Analysis of Financial Condition and Results of Operations (continued)

Business Segments:

Effective January 1, 2011, the primary measurement used by management to measure the financial performance of each segment was EBIT (earnings before interest and taxes). Prior to January 1, 2011, the primary measurement used by management to measure the financial performance of each segment was adjusted EBIT (earnings before interest and taxes, excluding the effect of impairment and restructuring, manufacturing rationalization and integration charges, one-time gains or losses on disposal of non-strategic assets, allocated receipts received or payments made under the U.S. Continued Dumping Subsidy Offset Act (CDSOA) and gains and losses on the dissolution of subsidiaries). The change in 2011 was primarily due to the completion of most of the Company s previously-announced restructuring initiatives. Segment results for 2010 have been reclassified to conform to the 2011 presentation of segments. Refer to Note 13 Segment Information in the Notes to the Consolidated Financial Statements for the reconciliation of EBIT by segment to consolidated income before income taxes.

The presentations of segment results below include a reconciliation of the changes in net sales for each segment reported in accordance with U.S. GAAP to net sales adjusted to remove the effects of acquisitions made in 2010 and currency exchange rates. The effects of acquisitions and currency exchange rates are removed to allow investors and the Company to meaningfully evaluate the percentage change in net sales on a comparable basis from period to period. During the third quarter of 2010, the Company completed the acquisition of QM Bearings and Power Transmission, Inc. (QM Bearings). QM Bearings is part of the Process Industries segment. During the fourth quarter of 2010, the Company completed the acquisition of City Scrap and Salvage Co. (City Scrap). City Scrap is part of the Steel segment. The year 2010 represents the base year for which the effects of currency are measured; as such, currency is assumed to be zero for 2010.

Mobile Industries Segment:

	1Q 2011	1Q 2010	$ Change	Change
Net sales, including intersegment sales	**$ 443.0**	$ 367.5	$ 75.5	20.5%
EBIT	**$ 68.0**	$ 39.6	$ 28.4	71.7%
EBIT margin	**15.3%**	10.8%		450 bps

	1Q 2011	1Q 2010	$ Change	% Change
Net sales, including intersegment sales	**$ 443.0**	$ 367.5	$ 75.5	20.5%
Currency	**5.7**		5.7	NM
Net sales, excluding the impact of currency	**$ 437.3**	$ 367.5	$ 69.8	19.0%

The Mobile Industries segment s net sales, excluding the effects of currency-rate changes, increased 19.0% for the first quarter of 2011, compared to the first quarter of 2010, primarily due to higher volume of approximately $60 million, as well as higher pricing and a favorable sales mix of approximately $10 million. The sales increases were seen across most market sectors, led by a 52% increase in off-highway, a 44% increase in rail and a 23% increase in heavy truck. EBIT was higher in the first quarter of 2011 compared to the first quarter of 2010, primarily due to higher volume of approximately $20 million and better manufacturing utilization of approximately $20 million, partially offset by higher logistics costs of approximately $10 million.

The Mobile Industries segment s sales are expected to increase by 10 to 15 percent in 2011, compared to 2010, primarily due to higher demand across most of the Mobile Industries market sectors, led by increases in off-highway, rail and heavy truck, partially offset by lower light vehicle demand. EBIT for the Mobile Industries segment is

expected to increase primarily due to slightly higher volume, as well as better manufacturing utilization.

Management s Discussion and Analysis of Financial Condition and Results of Operations (continued)

Process Industries Segment:

	1Q 2011	1Q 2010	$ Change	Change
Net sales, including intersegment sales	**$ 285.0**	$ 206.6	$ 78.4	37.9%
EBIT	**$ 66.7**	$ 24.1	$ 42.6	176.8%
EBIT margin	**23.4%**	11.7%		1,170 bps

	1Q 2011	1Q 2010	$ Change	% Change
Net sales, including intersegment sales	**$ 285.0**	$ 206.6	$ 78.4	37.9%
Acquisitions	**5.5**		5.5	NM
Currency	**3.7**		3.7	NM
Net sales, excluding the impact of acquisitions and currency	**$ 275.8**	$ 206.6	$ 69.2	33.5%

The Process Industries segment s net sales, excluding the effects of acquisitions and currency-rate changes, increased 33.5% in the first quarter of 2011 compared to the same period in the prior year, primarily due to higher volume of approximately $60 million, as well as higher pricing and a favorable sales mix of approximately $10 million. The higher sales were primarily due to an approximately 50% increase to industrial distributors. EBIT was higher in the first quarter of 2011, compared to the first quarter of 2010, primarily due to the impact of higher volumes of approximately $30 million, as well as higher pricing and a favorable sales mix of approximately $10 million.

The Company expects the Process Industries segment s sales to increase by 20% to 25% in 2011 compared to 2010. The increase in sales reflects strengthening global industrial distribution, growth in Asia and sales from new product lines. EBIT for 2011 is expected to be higher than 2010, as a result of increased volume.

Aerospace and Defense Segment:

	1Q 2011	1Q 2010	$ Change	Change
Net sales, including intersegment sales	**$ 79.1**	$ 92.1	$ (13.0)	(14.1)%
EBIT	**$ 2.2**	$ 11.9	$ (9.7)	(81.5)%
EBIT margin	**2.8%**	12.9%		(1,010)bps

	1Q 2011	1Q 2010	$ Change	% Change
Net sales, including intersegment sales	**$ 79.1**	$ 92.1	$ (13.0)	(14.1)%
Currency	**0.4**		0.4	NM
Net sales, excluding the impact of currency	**$ 78.7**	SIGMA-TAU INTERNATIONAL		

S.A.

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Dated: October 2, 2009 SIGMA-TAU AMERICA S.A.

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