TIMKEN CO
Form 10-Q
July 31, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2013

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 (State or other jurisdiction of incorporation or organization)	34-0577130 (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 ý 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 ý 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	ý	Accelerated filer	o
Non-accelerated filer	o	Smaller reporting company	o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý

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 June 30, 2013
Common Shares, without par value	95,006,238 shares

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS
THE TIMKEN COMPANY AND SUBSIDIARIES
Consolidated Statements of Income
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
(Dollars in millions, except per share data)				
Net sales	$1,126.5	$1,343.2	$2,216.4	$2,764.2
Cost of products sold	824.4	965.9	1,639.8	1,975.3
Gross Profit	302.1	377.3	576.6	788.9
Selling, general and administrative expenses	159.6	163.0	313.2	327.7
Impairment and restructuring charges	6.7	16.7	7.9	16.9
Operating Income	135.8	197.6	255.5	444.3
Interest expense	(6.2)	(8.1)	(12.6)	(16.7)
Interest income	0.5	0.7	1.0	1.4
Continued Dumping & Subsidy Offset Act (CDSOA) receipts, net of expense	—	109.5	(0.4)	109.5
Other (expense), net	(1.2)	(3.8)	(0.8)	(5.1)
Income Before Income Taxes	128.9	295.9	242.7	533.4
Provision for income taxes	46.1	112.5	84.9	194.0
Net Income	82.8	183.4	157.8	339.4
Less: Net (loss) income attributable to noncontrolling interest	—	(0.2)	(0.1)	0.1
Net Income attributable to The Timken Company	$82.8	$183.6	$157.9	$339.3
Net Income per Common Share attributable to The Timken Company Common Shareholders				
Basic earnings per share	$0.86	$1.88	$1.64	$3.47
Diluted earnings per share	$0.86	$1.86	$1.63	$3.44
Dividends per share	$0.23	$0.23	$0.46	$0.46

Consolidated Statements of Comprehensive Income
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
(Dollars in millions)				
Net Income	$82.8	$183.4	$157.8	$339.4
Other comprehensive income, net of tax:				
Foreign currency translation adjustments	(18.4)	(39.4)	(34.5)	(16.0)
Pension and postretirement liability adjustment	27.2	9.7	56.8	22.0
Change in fair value of marketable securities	—	—	—	(0.5)
Change in fair value of derivative financial instruments	0.4	0.4	1.2	1.4
Other comprehensive income (loss)	9.2	(29.3)	23.5	6.9
Comprehensive Income	92.0	154.1	181.3	346.3
Less: comprehensive (loss) income attributable to	(4.3)	(0.2)	(4.4)	—

noncontrolling interest				
Comprehensive Income attributable to The Timken Company	$96.3	$154.3	$185.7	$346.3

See accompanying Notes to the Consolidated Financial Statements.

Consolidated Balance Sheets

	(Unaudited) June 30, 2013	December 31, 2012
(Dollars in millions)		
ASSETS		
Current Assets		
Cash and cash equivalents	$396.8	$586.4
Accounts receivable, less allowances: 2013 – $11.3 million; 2012 – $12.1 million	624.2	546.7
Inventories, net	818.6	862.1
Deferred income taxes	69.1	98.6
Deferred charges and prepaid expenses	31.5	12.6
Other current assets	62.9	67.7
Total Current Assets	2,003.1	2,174.1
Property, Plant and Equipment, net	1,469.1	1,405.3
Other Assets		
Goodwill	362.5	338.9
Other intangible assets	226.7	224.7
Deferred income taxes	6.3	62.5
Other non-current assets	38.6	39.2
Total Other Assets	634.1	665.3
Total Assets	$4,106.3	$4,244.7
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Short-term debt	$7.0	$14.3
Accounts payable, trade	241.9	216.2
Salaries, wages and benefits	164.4	213.9
Income taxes payable	84.2	33.5
Deferred income taxes	7.3	2.9
Other current liabilities	157.9	177.5
Current portion of long-term debt	0.2	9.6
Total Current Liabilities	662.9	667.9
Non-Current Liabilities		
Long-term debt	455.3	455.1
Accrued pension cost	245.9	391.4
Accrued postretirement benefits cost	360.6	371.8
Deferred income taxes	10.6	4.9
Other non-current liabilities	43.2	107.0
Total Non-Current Liabilities	1,115.6	1,330.2
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) (2013 – 98,375,135 shares; 2012 – 98,375,135 shares)		
Stated capital	53.1	53.1
Other paid-in capital	889.6	891.4
Earnings invested in the business	2,524.9	2,411.2
Accumulated other comprehensive loss	(985.4)	(1,013.2)

Treasury shares at cost (2013 – 3,368,897 shares; 2012 – 2,476,921 shares)	(170.6)	(110.3)
Total Shareholders’ Equity	2,311.6	2,232.2
Noncontrolling Interest	16.2	14.4
Total Equity	2,327.8	2,246.6
Total Liabilities and Shareholders’ Equity	$4,106.3	$4,244.7

See accompanying Notes to the Consolidated Financial Statements.

Consolidated Statements of Cash Flows
(Unaudited)

	Six Months Ended June 30, 2013	2012
(Dollars in millions)		
CASH PROVIDED (USED)		
Operating Activities		
Net income attributable to The Timken Company	$157.9	$339.3
Net (loss) income attributable to noncontrolling interest	(0.1)	0.1
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	97.1	99.8
Loss on sale of assets	2.4	2.9
Deferred income tax provision	51.3	4.2
Stock-based compensation expense	8.4	9.3
Pension and other postretirement expense	43.8	50.4
Pension contributions and other postretirement benefit payments	(127.8)	(225.9)
Changes in operating assets and liabilities:		
Accounts receivable	(73.9)	(74.5)
Inventories	45.9	15.1
Accounts payable, trade	25.2	(2.1)
Other accrued expenses	(78.7)	(77.2)
Income taxes	1.4	102.9
Other, net	(13.4)	(7.9)
Net Cash Provided by Operating Activities	139.5	236.4
Investing Activities		
Capital expenditures	(145.2)	(115.3)
Acquisitions, net of cash received	(67.3)	(0.2)
Proceeds from disposals of property, plant and equipment	1.1	1.4
Investments in short-term marketable securities, net	7.0	18.2
Other	0.8	2.6
Net Cash Used by Investing Activities	(203.6)	(93.3)
Financing Activities		
Cash dividends paid to shareholders	(44.2)	(44.9)
Net proceeds from common share activity	18.6	19.8
Purchase of treasury shares	(81.8)	(51.7)
Payments on long-term debt	(9.8)	(6.9)
Short-term debt activity, net	(6.8)	(13.7)
Decrease in restricted cash	—	3.6
Proceeds from sale of shares in subsidiary	8.9	—
Net Cash Used by Financing Activities	(115.1)	(93.8)
Effect of exchange rate changes on cash	(10.4)	(4.2)
(Decrease) increase In Cash and Cash Equivalents	(189.6)	45.1
Cash and cash equivalents at beginning of year	586.4	464.8
Cash and Cash Equivalents at End of Period	$396.8	$509.9

See accompanying Notes to the Consolidated Financial Statements.

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, 2012.

Note 2 - Recent Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2013-02, Comprehensive Income (Topic 220): "Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income," effective for annual and interim reporting periods beginning after December 15, 2012. The new accounting rules require all U.S. public companies to report the effect of items reclassified out of accumulated other comprehensive income on the respective line items of net income, net of tax, either on the face of the financial statements where net income is presented or in a tabular format in the notes to the financial statements. Effective January 1, 2013, the Company adopted ASU No. 2013-02. The new accounting rules expand the disclosure of other comprehensive income and had no impact on the Company's results of operations and financial condition. See Note 9 - Accumulated Other Comprehensive Loss for additional information on the new disclosure.

Note 3 - Acquisitions

On March 11, 2013, the Company completed the acquisition of Interlube Systems Ltd. (Interlube), which makes and markets automated lubrication delivery systems and related components to end market sectors including commercial vehicles, construction, mining, and heavy and general industries, for approximately $14.8 million, including cash acquired of approximately $0.3 million, that is subject to a post-closing indebtedness adjustment. Based in Plymouth, United Kingdom, Interlube employs about 90 employees and had 2012 sales of approximately $13 million. The results of Interlube are reported in the Mobile Industries segment.

On April 11, 2013, the Company completed the acquisition of the assets of Smith Services, Inc. (Smith Services), an electric motor repair specialist, for approximately $13.3 million. Based in Princeton, West Virginia and employing approximately 140 people, Smith Services had 2012 sales of approximately $17 million. The results for Smith Services are reported in the Process Industries segment.

On May 13, 2013, the Company completed the acquisition of Hamilton Gear Ltd., d/b/a Standard Machine (Standard Machine), which provides new gearboxes, gearbox service and repair, open gearing, large gear fabrication, machining and field technical services to end users in Canada and the western United States, for approximately $39.7 million in cash, including cash acquired of approximately $0.1 million that is subject to a post-closing indebtedness adjustment. Based in Saskatoon, Saskatchewan, Canada, Standard Machine employs 125 people and serves a wide variety of industrial sectors including mining, oil and gas, and pulp and paper. In 2012, Standard Machine reported sales of approximately $31 million. The results for Standard Machine are reported in the Process Industries segment.

.

Pro forma results of operations have not been presented because the effects of the acquisitions were not significant to the Company's income before income taxes or total assets in 2013. The following table presents the preliminary purchase price allocations, net of cash acquired, for acquisitions in 2013:

	Initial Purchase Price Allocation
Assets:	
Accounts receivable, net	$10.7
Inventories, net	12.7
Deferred charges and prepaid expenses	0.3
Other current assets	0.2
Property, plant and equipment, net	19.1
Goodwill	23.1
Other intangible assets	11.7
Total assets acquired	$77.8
Liabilities:	
Accounts payable, trade	$4.1
Salaries, wages and benefits	1.3
Other current liabilities	1.0
Other non-current liabilities	4.1
Total liabilities assumed	$10.5
Net assets acquired	$67.3

The following table summarizes the preliminary purchase price allocation for identifiable intangible assets acquired in 2013:

	Initial Purchase Price Allocation	
		Weighted - Average Life
Trade name	$0.9	8 years
Know-how	6.7	15 years
All customer relationships	3.8	10 years
Non-compete agreements	0.3	4 years
Total intangible assets allocated	$11.7	

Note 4 - Inventories

The components of inventories were as follows:

	June 30, 2013	December 31, 2012
Manufacturing supplies	$56.6	$64.3
Raw materials	79.4	110.7
Work in process	284.2	278.1
Finished products	423.4	430.4
Subtotal	843.6	883.5
Allowance for obsolete and surplus inventory	(25.0)	(21.4)
Total Inventories, net	$818.6	$862.1

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 June 30, 2013 and December 31, 2012 was $281.2 million and $280.6 million, respectively. The Company recognized an increase in its LIFO reserve of $4.5 million and $0.6 million during the second quarter and first six months of 2013, respectively, compared to an increase in its LIFO reserve of $0.1 million and $9.2 million during the second quarter and first six months of 2012, respectively.

Based on current expectations of inventory levels and costs, the Company expects to recognize a decrease of approximately $0.7 million in its LIFO reserve for the year ended December 31, 2013. The expected decrease in the LIFO reserve for 2013 reflects lower anticipated costs, especially scrap steel costs. A 1.0% increase in costs would increase the current LIFO expense estimate for 2013 by $5.8 million. A 1.0% increase in inventory quantities would have no effect on the current LIFO expense estimate for 2013.

Note 5 - Property, Plant and Equipment

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

	June 30, 2013	December 31, 2012
Land and buildings	$663.1	$653.8
Machinery and equipment	3,249.1	3,138.3
Subtotal	3,912.2	3,792.1
Accumulated depreciation	(2,443.1)	(2,386.8)
Property, Plant and Equipment, net	$	