

TIMKEN CO  
Form 10-K  
February 28, 2007

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

☐ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**  
**For the fiscal year ended December 31, 2006**

**OR**

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**  
**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number: 1-1169**

**THE TIMKEN COMPANY**

(Exact name of registrant as specified in its charter)

Ohio  
(State or other jurisdiction of  
incorporation or organization)

34-0577130  
(I.R.S. Employer  
Identification No.)

1835 Dueber Avenue, S.W., Canton, Ohio  
(Address of principal executive offices)

44706  
(Zip Code)

(330) 438-3000

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class

Name of each exchange on which registered

Common Stock, without par value

New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes ☐ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the  
Exchange Act. Yes ☐ No ☐

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained  
herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements  
incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated  
filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☐

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

## Edgar Filing: TIMKEN CO - Form 10-K

As June 30, 2006, the aggregate market value of the registrant's common shares held by non-affiliates of the registrant was \$2,836,362,258 based on the closing sale price as reported on the New York Stock Exchange.

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 January 31, 2007
Common Shares, without par value	94,174,971 shares

### **DOCUMENTS INCORPORATED BY REFERENCE**

Document	Parts Into Which Incorporated
Proxy Statement for the Annual Meeting of Shareholders to be held May 1, 2007 (Proxy Statement)	Part III

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THE TIMKEN COMPANY  
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**PART I**

**Item 1. Business**

**General**

As used herein, the term "Timken" or the "company" refers to The Timken Company and its subsidiaries unless the context otherwise requires. Timken, an outgrowth of a business originally founded in 1899, was incorporated under the laws of the state of Ohio in 1904.

Timken is a leading global manufacturer of highly engineered bearings, alloy and specialty steel and related components. The company is the world's largest manufacturer of tapered roller bearings and alloy seamless mechanical steel tubing and the largest North American-based bearings manufacturer. Timken had facilities in 27 countries on six continents and employed approximately 25,000 people as of December 31, 2006.

**Products**

The Timken Company manufactures two basic product lines: anti-friction bearings and steel products. Differentiation in these two product lines comes in two different ways: (1) differentiation by bearing type or steel type, and (2) differentiation in the applications of bearings and steel.

**Tapered Roller Bearings.** In the bearing industry, Timken is best known for the tapered roller bearing, which was originally patented by the company founder, Henry Timken. The tapered roller bearing is Timken's principal product in the anti-friction industry segment. It consists of four components: (1) the cone or inner race, (2) the cup or outer race, (3) the tapered rollers, which roll between the cup and cone, and (4) the cage, which serves as a retainer and maintains proper spacing between the rollers. Timken manufactures or purchases these four components and then sells them in a wide variety of configurations and sizes.

The tapered rollers permit ready absorption of both radial and axial load combinations. For this reason, tapered roller bearings are particularly well-adapted to reducing friction where shafts, gears or wheels are used. The uses for tapered roller bearings are diverse and include applications on passenger cars, light and heavy trucks and trains, as well as a wide variety of industrial applications, ranging from very small gear drives to bearings over two meters in diameter for wind energy machines. A number of applications utilize bearings with sensors to measure parameters such as speed, load, temperature or overall bearing condition.

Matching bearings to the specific requirements of customers' applications requires engineering and often sophisticated analytical techniques. The design of Timken's tapered roller bearing permits distribution of unit pressures over the full length of the roller. This design, combined with high precision tolerances, proprietary internal geometry and premium quality material, provides Timken bearings with high load-carrying capacity, excellent friction-reducing qualities and long life.

**Precision Cylindrical and Ball Bearings.** Timken's aerospace and super precision facilities produce high-performance ball and cylindrical bearings for ultra high-speed and/or high-accuracy applications in the aerospace, medical and dental, computer and other industries. These bearings utilize ball and straight rolling elements and are in the super precision end of the general ball and straight roller bearing product range in the bearing industry. A majority of Timken's aerospace and super precision bearings products are custom-designed bearings and spindle assemblies. They often involve specialized materials and coatings for use in applications that subject the bearings to extreme operating conditions of speed and temperature.

**Spherical and Cylindrical Bearings.** Timken produces spherical and cylindrical roller bearings for large gear drives, rolling mills and other process industry and infrastructure development applications. Timken's cylindrical and spherical roller bearing capability was significantly enhanced with the acquisition of Torrington's broad range of spherical and heavy-duty cylindrical roller bearings for standard industrial and specialized applications. These products are sold worldwide to original equipment manufacturers and industrial distributors serving major industries, including construction and mining, natural resources, defense, pulp and paper production, rolling mills and general industrial goods.

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**Needle Bearings.** With the acquisition of the Engineered Solutions business of Ingersoll-Rand Company Limited (referred to as Torrington ) in February 2003, the company became a leading global manufacturer of highly engineered needle roller bearings. Timken produces a broad range of radial and thrust needle roller bearings, as well as bearing assemblies, which are sold to original equipment manufacturers and industrial distributors worldwide. Major applications include automotive, consumer, construction, agriculture and general industrial.

**Bearing Reconditioning.** A small part of the business involves providing bearing reconditioning services for industrial and railroad customers, both internationally and domestically. These services accounted for less than 5% of the company's net sales for the year ended December 31, 2006.

**Aerospace Aftermarket Products and Services.** Through strategic acquisitions and ongoing product development, Timken continues to expand its portfolio of replacement parts and services for the aerospace aftermarket, where they are used in both civil and military aircraft. In addition to a wide variety of power transmission and drive train components and modules, Timken supplies comprehensive maintenance, repair and overhaul services for gas turbine engines, gearboxes and accessory systems in rotary- and fixed-wing aircraft. Specific parts in addition to bearings include airfoils (such as blades, vanes, rotors and diffusers), nozzles, gears, and oil coolers. Services range from aerospace bearing repair and component reconditioning to the complete overhaul of engines, transmissions and fuel controls.

**Steel.** Steel products include steels of low and intermediate alloy, as well as some carbon grades. These products are available in a wide range of solid and tubular sections with a variety of lengths and finishes. These steel products are used in a wide array of applications, including bearings, automotive transmissions, engine crankshafts, oil drilling components, aerospace parts and other similarly demanding applications.

Timken also produces custom-made steel products, including steel components for automotive and industrial customers. This steel components business has provided the company with the opportunity to further expand its market for tubing and capture higher value-added steel sales. It also enables Timken's traditional tubing customers in the automotive and bearing industries to take advantage of higher-performing components that cost less than current alternative products. Customizing of products is an important portion of the company's steel business.

**Geographical Financial Information**

<b>Geographic Financial Information</b>	<b>United States</b>	<b>Europe</b>	<b>Other Countries</b>	<b>Consolidated</b>
<b>(Dollars in thousands)</b>				
<b>2006</b>				
Net sales	\$3,370,244	\$849,915	\$ 753,206	\$4,973,365
Non-current assets	1,578,856	285,840	266,557	2,131,253
<b>2005</b>				
Net sales	\$3,295,171	\$812,960	\$ 715,036	\$4,823,167
Non-current assets	1,413,575	337,657	177,988	1,929,220
<b>2004</b>				
Net sales	\$2,900,749	\$779,478	\$ 606,970	\$4,287,197
Non-current assets	1,399,155	398,925	221,112	2,019,192

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### **Industry Segments**

The company has three reportable segments: Industrial Group, Automotive Group and Steel Group. Financial information for the segments is discussed in Note 14 to the Consolidated Financial Statements.

#### *Description of types of products and services from which each reportable segment derives its revenues*

The company's reportable segments are business units that target different industry segments or types of product. Each reportable segment is managed separately because of the need to specifically address customer needs in these different industries.

The Automotive Group includes sales of bearings and other products and services (other than steel) to automotive original equipment manufacturers, or OEMs, for passenger cars, trucks and trailers. The Industrial Group includes sales of bearings and other products and services (other than steel) to a diverse customer base, including industrial equipment, off-highway, rail and aerospace and defense customers. The Industrial Group also includes aftermarket distribution operations, including automotive applications, for products other than steel. The company's bearing products are used in a variety of products and applications, including passenger cars, trucks, locomotive and railroad cars, machine tools, rolling mills and farm and construction equipment, aircraft, missile guidance systems, computer peripherals and medical instruments.

The Steel Group includes sales of low and intermediate alloy and carbon grade steel. These are available in a wide range of solid and tubular sections with a variety of lengths and finishes. The company also manufactures custom-made steel products, including precision steel components. Approximately 10% of the company's steel is consumed in its bearing operations. In addition, sales are made to other anti-friction bearing companies and to the automotive and truck, forging, construction, industrial equipment, oil and gas drilling and aircraft industries and to steel service centers. In 2006, the company sold its Latrobe Steel subsidiary. This business was part of the Steel Group for segment reporting purposes. This business has been treated as discontinued operations for all periods presented.

#### *Measurement of segment profit or loss and segment assets*

The company evaluates performance and allocates resources based on return on capital and profitable growth. The primary measurement used by management to measure the financial performance of each segment is adjusted EBIT (earnings before interest and taxes, excluding special items such as impairment and restructuring charges, rationalization and integration costs, one-time gains or losses on sales of assets, allocated receipts received or payments made under the Continued Dumping and Subsidy Offset Act (CDSOA), loss on dissolution of subsidiary, acquisition-related currency exchange gains, and other items similar in nature). The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies. Intersegment sales and transfers are recorded at values based on market prices, which creates intercompany profit on intersegment sales or transfers that is eliminated in consolidation.

#### *Factors used by management to identify the enterprise's reportable segments*

The company reports net sales by geographic area in a manner that is more reflective of how the company operates its segments, which is by the destination of net sales. Non-current assets by geographic area are reported by the location of the subsidiary.

Export sales from the U.S. and Canada are less than 10% of revenue. The company's Automotive and Industrial Groups have historically participated in the global bearing industry, while the Steel Group has concentrated primarily on U.S. customers.

Timken's non-U.S. operations are subject to normal international business risks not generally applicable to domestic business. These risks include currency fluctuation, changes in tariff restrictions, difficulties in establishing and maintaining relationships with local distributors and dealers, import and export licensing requirements, difficulties in staffing and managing geographically diverse operations, and restrictive regulations by foreign governments, including price and exchange controls.



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### **Sales and Distribution**

Timken's products in the Automotive Group and Industrial Group are sold principally by their own internal sales organizations. A portion of the Industrial Group's sales are made through authorized distributors.

Traditionally, a main focus of the company's sales strategy has consisted of collaborative projects with customers. For this reason, the company's sales forces are primarily located in close proximity to its customers rather than at production sites. In some instances, the sales forces are located inside customer facilities. The company's sales force is highly trained and knowledgeable regarding all bearings products, and associates assist customers during the development and implementation phases and provide ongoing support.

The company has a joint venture in North America focused on joint logistics and e-business services. This alliance is called CoLinX, LLC and was founded by Timken, SKF, INA and Rockwell Automation. The e-business service was launched in April 2001 and is focused on information and business services for authorized distributors in the Industrial Group. The company also has another e-business joint venture which focuses on information and business services for authorized industrial distributors in Europe, Latin America and Asia. This alliance, which Timken founded with SKF, Sandvik AB, INA and Reliance, is called Endorsia.com International AB.

Timken's steel products are sold principally by its own sales organization. Most orders are customized to satisfy customer-specific applications and are shipped directly to customers from Timken's steel manufacturing plants. Approximately 10% of Timken's Steel Group net sales are intersegment sales. In addition, sales are made to other anti-friction bearing companies and to the automotive and truck, forging, construction, industrial equipment, oil and gas drilling and aircraft industries and to steel service centers.

Timken has entered into individually negotiated contracts with some of its customers in its Automotive Group, Industrial Group and Steel Group. These contracts may extend for one or more years and, if a price is fixed for any period extending beyond current shipments, customarily include a commitment by the customer to purchase a designated percentage of its requirements from Timken. Contracts extending beyond one year that are not subject to price adjustment provisions do not represent a material portion of Timken's sales. Timken does not believe that there is any significant loss of earnings risk associated with any given contract.

### **Competition**

The anti-friction bearing business is highly competitive in every country in which Timken sells products. Timken competes primarily based on price, quality, timeliness of delivery, product design and the ability to provide engineering support and service on a global basis. The company competes with domestic manufacturers and many foreign manufacturers of anti-friction bearings, including SKF, INA, NTN Corporation, Koyo Seiko Co., Ltd. and NSK Ltd.

Competition within the steel industry, both domestically and globally, is intense and is expected to remain so. However, the recent combination of a weakened U.S. dollar, worldwide rationalization of uncompetitive capacity, raw material cost increases and North American and global market strength have allowed steel industry prices to increase and margins to improve. Timken's worldwide competitors for steel bar products include North American producers such as Republic, Mac Steel, Mittal, Steel Dynamics, Nucor and a wide variety of offshore steel producers who export into North America. Competitors for seamless mechanical tubing include Dofasco, Plymouth Tube, Michigan Seamless Tube, V & M Tube, Sanyo Special Steel, Ovako and Tenaris. Competitors in the precision steel components sector include Formtec, Linamar, Jernberg and overseas companies such as Tenaris, Ovako, Stackpole and FormFlo. Maintaining high standards of product quality and reliability while keeping production costs competitive is essential to Timken's ability to compete with domestic and foreign manufacturers in both the anti-friction bearing and steel businesses.

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### **Trade Law Enforcement**

The U.S. government has six antidumping duty orders in effect covering ball bearings from five countries and tapered roller bearings from China. The five countries covered by the ball bearing orders are France, Germany, Italy, Japan and the United Kingdom. The company is a producer of these products in the United States. The U.S. government determined in August 2006 that each of these six antidumping duty orders should remain in effect for an additional five years.

### **Continued Dumping and Subsidy Offset Act (CDSOA)**

The CDSOA provides for distribution of monies collected by U.S. Customs from antidumping cases to qualifying domestic producers where the domestic producers have continued to invest in their technology, equipment and people. The company reported CDSOA receipts, net of expenses, of \$87.9 million, \$77.1 million and \$44.4 million in 2006, 2005 and 2004, respectively.

The amount for 2004 was net of the amount that Timken delivered to the seller of the Torrington business, pursuant to the terms of the agreement under which the company purchased Torrington. In 2004, Timken delivered to the seller of the Torrington business 80% of the CDSOA payments received in 2004 for Torrington's bearing business.

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 would end CDSOA distributions for imports covered by antidumping duty orders entering the U.S. after September 30, 2007. Instead, any such antidumping duties collected would remain with the U.S. Treasury. This legislation is not expected to have a significant effect on potential CDSOA distributions in 2007, but would be expected to reduce likely distributions in years beyond 2007, with distributions eventually ceasing.

In separate cases in July and September 2006, the U.S. Court of International Trade (CIT) ruled that the procedure for determining recipients eligible to receive CDSOA distributions is unconstitutional. The CIT has not ruled on other matters, including any remedy as a result of its ruling. The company expects that these rulings of the CIT will be appealed. The company is unable to determine, at this time, if these rulings will have a material adverse impact on the company's financial results.

In addition to the CIT rulings, there are a number of factors that can affect whether the company receives any CDSOA distributions and the amount of such distributions in any year. These factors include, among other things, potential additional changes in the law, ongoing and potential additional legal challenges to the law and the administrative operation of the law. Accordingly, the company cannot reasonably estimate the amount of CDSOA distributions it will receive in future years, if any. If the company does receive CDSOA distributions in 2007, they likely will be received in the fourth quarter.

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### **Joint Ventures**

The balances related to investments accounted for under the equity method are reported in other non-current assets on the Consolidated Balance Sheet, which were approximately \$12.1 million and \$19.9 million at December 31, 2006 and 2005, respectively.

During 2002, the company's Automotive Group formed a joint venture, Advanced Green Components, LLC (AGC), with Sanyo Special Steel Co., Ltd. (Sanyo) and Showa Seiko Co., Ltd. (Showa). AGC is engaged in the business of converting steel to machined rings for tapered bearings and other related products. The company had been accounting for its investment in AGC under the equity method since AGC's inception. During the third quarter of 2006, AGC refinanced its long-term debt of \$12.2 million. The company guaranteed half of this obligation. The company concluded the refinancing represented a reconsideration event to evaluate whether AGC was a variable interest entity under FASB Interpretation No. 46 (revised December 2003). The company concluded that AGC was a variable interest entity and the company was the primary beneficiary. Therefore, the company consolidated AGC, effective September 30, 2006. As of September 30, 2006, the net assets of AGC were \$9.0 million, primarily consisting of the following: inventory of \$5.7 million; property, plant and equipment of \$27.2 million; goodwill of \$9.6 million; short-term and long-term debt of \$20.3 million; and other non-current liabilities of \$7.4 million. The \$9.6 million of goodwill was subsequently written-off as part of the annual test for impairment in accordance with Statement of Financial Accounting Standards No. 142. All of AGC's assets are collateral for its obligations. Except for AGC's indebtedness for which the company is a guarantor, AGC's creditors have no recourse to the assets of the company.

### **Backlog**

The backlog of orders of Timken's domestic and overseas operations is estimated to have been \$1.96 billion at December 31, 2006 and \$1.98 billion at December 31, 2005. Actual shipments are dependent upon ever-changing production schedules of the customer. Accordingly, Timken does not believe that its backlog data and comparisons thereof, as of different dates, are reliable indicators of future sales or shipments.

### **Raw Materials**

The principal raw materials used by Timken in its North American bearing plants to manufacture bearings are its own steel tubing and bars, purchased strip steel and energy resources. Outside North America, the company purchases raw materials from local sources with whom it has worked closely to ensure steel quality, according to its demanding specifications.

The principal raw materials used by Timken in steel manufacturing are scrap metal, nickel and other alloys. The availability and prices of raw materials and energy resources are subject to curtailment or change due to, among other things, new laws or regulations, changes in demand levels, suppliers' allocations to other purchasers, interruptions in production by suppliers, changes in exchange rates and prevailing price levels. For example, the weighted average price of scrap metal increased 87.1% from 2003 to 2004, decreased 7.7% from 2004 to 2005 and increased 7.9% from 2005 to 2006. Prices for raw materials and energy resources continue to remain high compared to historical levels. The company continues to expect that it will be able to pass a significant portion of these increased costs through to customers in the form of price increases or raw material surcharges.

Disruptions in the supply of raw materials or energy resources could temporarily impair the company's ability to manufacture its products for its customers or require the company to pay higher prices in order to obtain these raw materials or energy resources from other sources, which could affect the company's sales and profitability. Any increase in the prices for such raw materials or energy resources could materially affect the company's costs and its earnings.

Timken believes that the availability of raw materials and alloys is adequate for its needs, and, in general, it is not dependent on any single source of supply.

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### **Research**

Timken has developed a significant global footprint of technology centers.

The company operates four corporate innovation and development centers. The largest technical center is located in North Canton, Ohio, near Timken's world headquarters, and it supports innovation and know-how for friction management product lines, such as tapered roller bearings and needle bearings. In 2006, Timken opened a new technical center in Greenville, South Carolina, to support innovation and know-how for power transmission product lines. The company also supports related technical capabilities with facilities in Bangalore, India and Brno, Czech Republic.

In addition, Timken's business groups operate several technology centers for product excellence within the United States in Mesa, Arizona, and Keene and Lebanon, New Hampshire. Within Europe, technology is developed in Ploiesti, Romania; Colmar, France; and Halle-Westfallen, Germany.

The company's technology commitment is to develop new and improved friction management and power transmission product designs, such as tapered roller bearings and needle bearings, with a heavy influence in related steel materials and lean manufacturing processes.

Expenditures for research, development and application amounted to approximately \$67.9 million, \$60.1 million, and \$56.7 million in 2006, 2005 and 2004, respectively. Of these amounts, \$8.0 million, \$7.2 million and \$6.7 million, respectively, were funded by others.

### **Environmental Matters**

The company continues its efforts to protect the environment and comply with environmental protection laws.

Additionally, it has invested in pollution control equipment and updated plant operational practices. The company is committed to implementing a documented environmental management system worldwide and to becoming certified under the ISO 14001 standard where appropriate to meet or exceed customer requirements. By the end of 2006, 30 of the company's plants had obtained ISO 14001 certification.

The company believes it has established adequate reserves to cover its environmental expenses and has a well-established environmental compliance audit program, which includes a proactive approach to bringing its domestic and international units to higher standards of environmental performance. This program measures performance against applicable laws, as well as standards that have been established for all units worldwide. It is difficult to assess the possible effect of compliance with future requirements that differ from existing ones. As previously reported, the company is unsure of the future financial impact to the company that could result from the United States Environmental Protection Agency's (EPA's) final rules to tighten the National Ambient Air Quality Standards for fine particulate and ozone. The company is also unsure of potential future financial impacts to the company that could result from possible future legislation regulating emissions of greenhouse gases.

The company and certain U.S. subsidiaries have been designated as potentially responsible parties by the EPA for site investigation and remediation at certain sites under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), known as the Superfund, or state laws similar to CERCLA. The claims for remediation have been asserted against numerous other entities, which are believed to be financially solvent and are expected to fulfill their proportionate share of the obligation.

Management believes any ultimate liability with respect to pending actions will not materially affect the company's operations, cash flows or consolidated financial position. The company is also conducting voluntary environmental investigations and/or remediations at a number of current or former operating sites. Any liability with respect to such investigations and remediations, in the aggregate, is not expected to be material to the operations or financial position of the company.

New laws and regulations, stricter enforcement of existing laws and regulations, the discovery of previously unknown contamination or the imposition of new clean-up requirements may require the company to incur costs or become the basis for new or increased liabilities that could have a material adverse effect on Timken's business, financial condition or results of operations.

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### Patents, Trademarks and Licenses

Timken owns a number of U.S. and foreign patents, trademarks and licenses relating to certain products. While Timken regards these as important, it does not deem its business as a whole, or any industry segment, to be materially dependent upon any one item or group of items.

### Employment

At December 31, 2006, Timken had 25,418 associates. Approximately 17% of Timken's U.S. associates are covered under collective bargaining agreements.

### Available Information

Timken's annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available, free of charge, on Timken's website at [www.timken.com](http://www.timken.com) as soon as reasonably practical after electronically filing or furnishing such material with the SEC.

### Item 1A: Risk Factors

*The following are certain risk factors that could affect our business, financial condition and result of operations. The risks that are highlighted below are not the only ones that we face. These risk factors should be considered in connection with evaluating forward-looking statements contained in this Annual Report on Form 10-K because these factors could cause our actual results and financial condition to differ materially from those projected in forward-looking statements. If any of the following risks actually occur, our business, financial condition or results of operations could be negatively affected.*

***The bearing industry is highly competitive, and this competition results in significant pricing pressure for our products that could affect our revenues and profitability.***

The global bearing industry is highly competitive. We compete with domestic manufacturers and many foreign manufacturers of anti-friction bearings, including SKF, INA, NTN, Koyo and NSK. The bearing industry is also capital-intensive and profitability is dependent on factors such as labor compensation and productivity and inventory management, which are subject to risks that we may not be able to control. Due to the competitiveness within the bearing industry, we may not be able to increase prices for our products to cover increases in our costs and, in many cases, we may face pressure from our customers to reduce prices, which could adversely affect our revenues and profitability.

***Competition and consolidation in the steel industry, together with potential global overcapacity, could result in significant pricing pressure for our products.***

Competition within the steel industry, both domestically and worldwide, is intense and is expected to remain so. Global production overcapacity has occurred in the past and may reoccur in the future, which, when combined with high levels of steel imports into the United States, may exert downward pressure on domestic steel prices and result in, at times, a dramatic narrowing, or with many companies the elimination, of gross margins. In addition, many of our competitors are continuously exploring and implementing strategies, including acquisitions, which focus on manufacturing higher margin products that compete more directly with our steel products. These factors could lead to significant downward pressure on prices for our steel products, which could have a materially adverse effect on our revenues and profitability.

***We may not be able to realize the anticipated benefits from, or successfully execute, Project O.N.E.***

During 2005, we began implementing Project O.N.E., a multi-year program designed to improve business processes and systems to deliver enhanced customer service and financial performance. During 2007, we expect the first major U.S. implementation of Project O.N.E. We may not be able to realize the anticipated benefits from or successfully execute this program. Our future success will depend, in part, on our ability to improve our business processes and systems. We may not be able to successfully do so without substantial costs, delays or other difficulties. We may face significant challenges in improving our processes and systems in a timely and efficient manner.

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Implementing Project O.N.E. will be complex and time-consuming, may be distracting to management and disruptive to our businesses, and may cause an interruption of, or a loss of momentum in, our businesses as a result of a number of obstacles, such as:

the loss of key associates or customers,

the failure to maintain the quality of customer service that we have historically provided;

the need to coordinate geographically diverse organizations; and

the resulting diversion of management's attention from our day-to-day business and the need to dedicate additional management personnel to address obstacles to the implementation of Project O.N.E.

If we are not successful in executing Project O.N.E., or if it fails to achieve the anticipated results, then our operations, margins, sales and reputation could be adversely affected.

***Any change in the operation of our raw material surcharge mechanisms or the availability or cost of raw materials and energy resources could materially affect our earnings.***

We require substantial amounts of raw materials, including scrap metal and alloys and natural gas to operate our business. Many of our customer contracts contain surcharge pricing provisions. The surcharges are tied to a widely-available market index for that specific raw material. Any change in the relationship between the market indices and our underlying costs could materially affect our earnings.

Moreover, future disruptions in the supply of our raw materials or energy resources could impair our ability to manufacture our products for our customers or require us to pay higher prices in order to obtain these raw materials or energy resources from other sources, and could thereby affect our sales and profitability. Any increase in the prices for such raw materials or energy resources could materially affect our costs and therefore our earnings.

***Warranty, recall or product liability claims could materially adversely affect our earnings.***

In our business, we are exposed to warranty and product liability claims. In addition, we may be required to participate in the recall of a product. A successful warranty or product liability claim against us, or a requirement that we participate in a product recall, could have a materially adverse effect on our earnings.

***The failure to achieve the anticipated results of our Automotive Group initiatives could materially affect our earnings.***

During 2005, we began restructuring our Automotive Group operations to address challenges in the automotive markets. We expect that this restructuring will cost approximately \$80 million to \$90 million (pretax) and we are targeting annual pretax savings of approximately \$40 million by 2008. In response to reduced production demand from North American automotive manufacturers, in September 2006, we announced further planned reductions in our Automotive Group workforce of approximately 700 associates. We expect that this workforce reduction will cost approximately \$25 million (pretax) and we are targeting annual pretax savings of approximately \$35 million by 2008. The failure to achieve the anticipated results of our Automotive Group restructuring and workforce reduction initiatives, including our targeted annual savings, could adversely affect our earnings.

***The failure to achieve the anticipated results of our Canton bearing operation rationalization initiative could materially adversely affect our earnings.***

After reaching a new four-year agreement with the union representing employees in the Canton, Ohio bearing and steel plants in 2005, we refined our plans to rationalize our Canton bearing operations. We expect that this rationalization initiative will cost approximately \$35 million to \$40 million (pretax) over the next three years and we are targeting annual pretax savings of approximately \$25 million. The failure to achieve the anticipated results of this initiative, including our targeted annual savings, could adversely affect our earnings.

***We may incur further impairment and restructuring charges that could materially affect our profitability.***

We have taken approximately \$82.6 million in impairment and restructuring charges for our Automotive Group restructuring and workforce reduction and the rationalization of our Canton bearing operations during 2006 and 2005 and expect to take additional charges in connection with these initiatives. Changes in business or economic conditions, or our business strategy may result in additional restructuring programs and may require us to take additional charges

in the future, which could have a materially adverse effect on our earnings.

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### ***Any reduction of CDSOA distributions in the future would reduce our earnings and cash flows.***

The CDSOA provides for distribution of monies collected by U.S. Customs from antidumping cases to qualifying domestic producers where the domestic producers have continued to invest in their technology, equipment and people. The company reported CDSOA receipts, net of expenses, of \$87.9 million, \$77.1 million and \$44.4 million in 2006, 2005 and 2004, respectively. In February 2006, U.S. legislation was enacted that would end CDSOA distributions for 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. This legislation is not expected to have a significant effect on potential CDSOA distributions in 2007, but would be expected to reduce any distributions in years beyond 2007, with distributions eventually ceasing.

In separate cases in July and September 2006, the U.S. Court of International Trade (CIT) ruled that the procedure for determining recipients eligible to receive CDSOA distributions is unconstitutional. The CIT has not finally ruled on other matters, including any remedy as a result of its ruling. The company expects that the ruling of the CIT will be appealed. The company is unable to determine, at this time, if these rulings will have a material adverse impact on the company's financial results.

In addition to the CIT ruling, there are a number of other factors that can affect whether the company receives any CDSOA distributions and the amount of such distributions in any year. These factors include, among other things, potential additional changes in the law, other ongoing and potential additional legal challenges to the law, and the administrative operation of the law. It is possible that CIT rulings might prevent us from receiving any CDSOA distributions in 2007. Any reduction of CDSOA distributions would reduce our earnings and cash flow.

### ***Weakness in any of the industries in which our customers operate, as well as the cyclical nature of our customers businesses generally, could adversely impact our revenues and profitability by reducing demand and margins.***

Our revenues may be negatively affected by changes in customer demand, changes in the product mix and negative pricing pressure in the industries in which we operate. Many of the industries in which our end customers operate are cyclical. Margins in those industries are highly sensitive to demand cycles, and our customers in those industries historically have tended to delay large capital projects, including expensive maintenance and upgrades, during economic downturns. As a result, our business is also cyclical and our revenues and earnings are impacted by overall levels of industrial production.

Certain automotive industry companies have recently experienced significant financial downturns. In 2005, we increased our reserve for accounts receivable relating to our automotive industry customers. If any of our automotive industry customers becomes insolvent or files for bankruptcy, our ability to recover accounts receivable from that customer would be adversely affected and any payment we received in the preference period prior to a bankruptcy filing may be potentially recoverable. In addition, financial instability of certain companies that participate in the automotive industry supply chain could disrupt production in the industry. A disruption of production in the automotive industry could have a materially adverse effect on our financial condition and earnings.

### ***Environmental regulations impose substantial costs and limitations on our operations and environmental compliance may be more costly than we expect.***

We are subject to the risk of substantial environmental liability and limitations on our operations due to environmental laws and regulations. We are subject to various federal, state, local and foreign environmental, health and safety laws and regulations concerning issues such as air emissions, wastewater discharges, solid and hazardous waste handling and disposal and the investigation and remediation of contamination. The risks of substantial costs and liabilities related to compliance with these laws and regulations are an inherent part of our business, and future conditions may develop, arise or be discovered that create substantial environmental compliance or remediation liabilities and costs. Compliance with environmental legislation and regulatory requirements may prove to be more limiting and costly than we anticipate. New laws and regulations, including those which may relate to emissions of greenhouse gases, stricter enforcement of existing laws and regulations, the discovery of previously unknown contamination or the imposition of new clean-up requirements could require us to incur costs or become the basis for new or increased liabilities that could have a material adverse effect on our business, financial condition or results of operations. We may also be subject from time to time to legal proceedings brought by private parties or governmental authorities with respect to environmental matters, including matters involving alleged property damage or personal injury.





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### ***Unexpected equipment failures or other disruptions of our operations may increase our costs and reduce our sales and earnings due to production curtailments or shutdowns.***

Interruptions in production capabilities, especially in our Steel Group, would inevitably increase our production costs and reduce sales and earnings for the affected period. In addition to equipment failures, our facilities are also subject to the risk of catastrophic loss due to unanticipated events such as fires, explosions or violent weather conditions. Our manufacturing processes are dependent upon critical pieces of equipment, such as furnaces, continuous casters and rolling equipment, as well as electrical equipment, such as transformers, and this equipment may, on occasion, be out of service as a result of unanticipated failures. In the future, we may experience material plant shutdowns or periods of reduced production as a result of these types of equipment failures.

### ***The global nature of our business exposes us to foreign currency fluctuations that may affect our asset values, results of operations and competitiveness.***

We are exposed to the risks of currency exchange rate fluctuations because a significant portion of our net sales, costs, assets and liabilities, are denominated in currencies other than the U.S. dollar. These risks include a reduction in our asset values, net sales, operating income and competitiveness.

For those countries outside the United States where we have significant sales, devaluation in the local currency would reduce the value of our local inventory as presented in our Consolidated Financial Statements. In addition, a stronger U.S. dollar would result in reduced revenue, operating profit and shareholders' equity due to the impact of foreign exchange translation on our Consolidated Financial Statements. Fluctuations in foreign currency exchange rates may make our products more expensive for others to purchase or increase our operating costs, affecting our competitiveness and our profitability.

Changes in exchange rates between the U.S. dollar and other currencies and volatile economic, political and market conditions in emerging market countries have in the past adversely affected our financial performance and may in the future adversely affect the value of our assets located outside the United States, our gross profit and our results of operations.

### ***Global political instability and other risks of international operations may adversely affect our operating costs, revenues and the price of our products.***

Our international operations expose us to risks not present in a purely domestic business, including primarily:

- changes in tariff regulations, which may make our products more costly to export or import;

- difficulties establishing and maintaining relationships with local OEMs, distributors and dealers;

- import and export licensing requirements;

- compliance with a variety of foreign laws and regulations, including unexpected changes in taxation and environmental or other regulatory requirements, which could increase our operating and other expenses and limit our operations; and

- difficulty in staffing and managing geographically diverse operations.

These and other risks may also increase the relative price of our products compared to those manufactured in other countries, reducing the demand for our products in the markets in which we operate, which could have a materially adverse effect on our revenues and earnings.

### ***Underfunding of our defined benefit and other postretirement plans has caused and may continue to cause a significant reduction in our shareholders' equity.***

As a result of recent accounting standards, the underfunded status of our pension fund assets and our postretirement health care obligations, we were required to take a total net reduction of \$276 million, net of income taxes, against our shareholders' equity in 2006. We may be required to take further charges related to pension and other postretirement liabilities in the future and these charges may be significant.

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***The underfunded status of our pension fund assets will cause us to prepay the funding of our pension obligations which may divert funds from other uses.***

The increase in our defined benefit pension obligations, as well as our ongoing practice of managing our funding obligations over time, have led us to prepay a portion of our funding obligations under our pension plans. We made cash contributions of \$243 million, \$226 million and \$185 million in 2006, 2005 and 2004, respectively, to our U.S.-based pension plans and currently expect to make cash contributions of \$80 million in 2007 to such plans. However, we cannot predict whether changing economic conditions or other factors will lead us or require us to make contributions in excess of our current expectations, diverting funds we would otherwise apply to other uses.

***Work stoppages or similar difficulties could significantly disrupt our operations, reduce our revenues and materially affect our earnings.***

A work stoppage at one or more of our facilities could have a materially adverse effect on our business, financial condition and results of operations. Also, if one or more of our customers were to experience a work stoppage, that customer would likely halt or limit purchases of our products, which could have a materially adverse effect on our business, financial condition and results of operations.

**Item 1B. Unresolved Staff Comments**

None.

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### **Item 2. Properties**

Timken has Automotive Group, Industrial Group and Steel Group manufacturing facilities at multiple locations in the United States and in a number of countries outside the United States. The aggregate floor area of these facilities worldwide is approximately 16,669,000 square feet, all of which, except for approximately 1,619,000 square feet, is owned in fee. The facilities not owned in fee are leased. The buildings occupied by Timken are principally made of brick, steel, reinforced concrete and concrete block construction. All buildings are in satisfactory operating condition in which to conduct business.

Timken's Automotive and Industrial Groups' manufacturing facilities in the United States are located in Bucyrus, Canton, New Philadelphia, and Niles, Ohio; Altavista, Virginia; Randleman, Iron Station and Rutherfordton, North Carolina; Carlyle, Illinois; South Bend, Indiana; Gaffney, Clinton, Union, Honea Path and Walhalla, South Carolina; Cairo, Norcross, Sylvania, Ball Ground and Dahlonega, Georgia; Pulaski and Mascot, Tennessee; Keene and Lebanon, New Hampshire; Lenexa, Kansas; Ogden, Utah; Mesa, Arizona; and Los Alamitos, California. These facilities, including the research facility in Canton, Ohio, and warehouses at plant locations, have an aggregate floor area of approximately 7,193,000 square feet. The company's Watertown, Connecticut facility was sold on December 18, 2006.

Timken's Automotive and Industrial Groups' manufacturing plants outside the United States are located in Benoni, South Africa; Brescia, Italy; Colmar, Vierzon, Maromme and Moulton, France; Northampton and Wolverhampton, England; Medemblik, The Netherlands; Bilbao, Spain; Halle-Westfalen, Germany; Olomouc, Czech Republic; Ploiesti, Romania; Mexico City, Mexico; Sao Paulo, Brazil; Singapore, Singapore; Jamshedpur, India; Sosnowiec, Poland; St. Thomas and Bedford, Canada; and Yantai and Wuxi, China. The facilities, including warehouses at plant locations, have an aggregate floor area of approximately 5,199,000 square feet. The company's Nova Friburgo, Brazil facility was sold on December 18, 2006.

Timken's Steel Group's manufacturing facilities in the United States are located in Canton and Eaton, Ohio; and Columbus, North Carolina. These facilities have an aggregate floor area of approximately 3,624,000 square feet. The company's Wauseon and Vienna, Ohio; Franklin and Latrobe, Pennsylvania; and White House, Tennessee facilities were sold on December 8, 2006.

Timken's Steel Group's manufacturing facilities outside the United States are located in Leicester and Sheffield, England. These facilities have an aggregate floor area of approximately 653,000 square feet. The company's Fougères and Marnaz, France facilities were sold on June 30, 2006.

In addition to the manufacturing and distribution facilities discussed above, Timken owns warehouses and steel distribution facilities in the United States, United Kingdom, France, Singapore, Mexico, Argentina, Australia, Brazil, Germany and China, and leases several relatively small warehouse facilities in cities throughout the world.

During 2006, the utilization by plant varied significantly due to decreasing demand across all automotive markets, and decreasing demand in industrial sectors served by Automotive Group plants. The overall Automotive Group plant utilization was between approximately 75% and 85%, lower than 2005. In 2006, as a result of the higher industrial global demand, Industrial Group plant utilization was between 85% and 90%, which was the same as 2005. Also, in 2006, Steel Group plants operated at near capacity, which was similar to 2005.

### **Item 3. Legal Proceedings**

The company is involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a materially adverse effect on the company's consolidated financial position or results of operations.

In July 2006, the company entered into a settlement agreement with the State of Ohio concerning both a violation of Ohio air pollution control laws, which was discovered by the company and voluntarily disclosed to the State of Ohio more than ten years ago, as well as a failed grinder bag house stack test, which was corrected within three days. Pursuant to the terms of the settlement agreement, the company has agreed to pay \$200,000. The company will receive a credit of \$22,500 of the total settlement amount due to the company's investments in approved supplemental environmental projects. Pursuant to the terms of the settlement agreement, the company also conducted additional testing of certain equipment.

### **Item 4. Submission of Matters to a Vote of Security Holders**

No matters were submitted to a vote of security holders during the fourth quarter of the fiscal year ended December 31, 2006.

**Table of Contents****Item 4A. Executive Officers of the Registrant**

The executive officers are elected by the Board of Directors normally for a term of one year and until the election of their successors. All executive officers, except for three, have been employed by Timken or by a subsidiary of the company during the past five-year period. The executive officers of the company as of February 28, 2007 are as follows:

Name	Age	Current Position and Previous Positions During Last Five Years	
Ward J. Timken, Jr.	39	2000	Corporate Vice President Office of the Chairman
		2002	Corporate Vice President Office of the Chairman; Director
		2003	Executive Vice President and President Steel Group; Director
		2005	Chairman of the Board
James W. Griffith	53	1999	President and Chief Operating Officer; Director
		2002	President and Chief Executive Officer; Director
Michael C. Arnold	50	2000	President Industrial Group
William R. Burkhart	41	2000	Senior Vice President and General Counsel
Alastair R. Deane	45	2000	Senior Vice President of Engineering, Automotive Driveline Driveshaft business group of GKN Automotive, Incorporated, a global supplier of driveline components and systems.
		2005	Senior Vice President Technology, The Timken Company
Jacqueline A. Dedo	45	2000	Vice President and General Manager Worldwide Market Operations, Motorola, Inc., a global communications company
		2004	President Automotive Group, The Timken Company
Glenn A. Eisenberg	45	1999	President and Chief Operating Officer, United Dominion Industries, an international manufacturing, construction and engineering firm
		2002	Executive Vice President Finance and Administration, The Timken Company
J. Ted Mihaila	52	2001	Controller, Industrial Group
		2006	Senior Vice President and Controller
Salvatore J. Miraglia, Jr.	56	1999	Senior Vice President Technology
		2005	President Steel Group

**Table of Contents****PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

The company's common stock is traded on the New York Stock Exchange under the symbol TKR. The estimated number of record holders of the company's common stock at December 31, 2006 was approximately 6,697. The estimated number of beneficial shareholders at December 31, 2006 was approximately 42,608.

The following table provides information about the high and low sales prices for the company's common stock and dividends paid for each quarter for the last two fiscal years.

	2006			2005		
	Stock prices		Dividends per share	Stock prices		Dividends per share
	High	Low		High	Low	
<b>First quarter</b>	<b>\$36.58</b>	<b>\$26.57</b>	<b>\$0.15</b>	\$29.50	\$22.73	\$0.15
<b>Second quarter</b>	<b>\$36.25</b>	<b>\$27.68</b>	<b>\$0.15</b>	\$27.68	\$22.80	\$0.15
<b>Third quarter</b>	<b>\$34.99</b>	<b>\$29.05</b>	<b>\$0.16</b>	\$30.06	\$22.90	\$0.15
<b>Fourth quarter</b>	<b>\$31.89</b>	<b>\$27.60</b>	<b>\$0.16</b>	\$32.84	\$25.25	\$0.15

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\* Total return assumes reinvestment of dividends.

\*\* Fiscal years ending December 31.

Assumes \$100 invested on January 1, 2002, in Timken Company common stock, S&P 500 Index and Peer Index.

	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
<b>Timken Company</b>	\$ 121.35	\$ 131.59	\$ 174.59	\$ 219.56	\$ 204.14
<b>S&amp;P 500</b>	77.90	100.24	111.15	116.61	135.02
<b>80 % Bearing/20 % Steel ***</b>	99.31	142.89	182.83	274.99	366.39

\*\*\* Effective in 2003, the weighting of the peer index was revised from 70 % Bearing/30 % Steel to more accurately reflect the company's post-Torrington acquisition.

The line graph compares the cumulative total shareholder returns over five years for The Timken Company, the S&P 500 Stock Index, and a peer index that proportionally reflects The Timken Company's two businesses. The S&P Steel Index comprises the steel portion of the peer index. This index was comprised of seven steel companies in 1996 and is now three (Allegheny Technologies, Nucor and US Steel Corp.), as industry consolidation and bankruptcy have reduced the number of companies in the index. The remaining portion of the peer index is a self-constructed bearing index that consists of six companies. These six companies are Kaydon, FAG, JTETK (formerly Koyo Seiko), NSK, NTN and SKF. The last five are non-US bearing companies that are based in Germany (FAG), Japan (JTETK, NSK, NTN), and Sweden (SKF). FAG was eliminated from the bearing index in 2003 when its minority interests were acquired and its shares delisted.



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## Issuer Purchases of Common Stock:

The following table provides information about purchases by the company during the quarter ended December 31, 2006 of its common stock.

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share (2)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (3)	Maximum Number of Shares That May Yet be Purchased Under the Plans or Programs (3)
10/1/06 10/31/06		\$		3,793,700
11/1/06 11/30/06	1,942	30.77		3,793,700
12/1/06 12/31/06	6,850	30.71		3,793,700
Total	8,792	\$ 30.72		3,793,700

(1) Consists solely of company repurchases of shares of its common stock that are owned and tendered by employees to satisfy tax withholding obligations in connection with the vesting of restricted shares and the exercise of stock options.

(2) The average price paid per share is calculated using the daily high and low sales prices of the company's common stock as quoted on the

New York  
Stock Exchange  
at the time the  
employee  
tenders the  
shares.

- (3) Pursuant to the company's 2000 common stock purchase plan, the company may purchase up to four million shares of common stock at an amount not to exceed \$180 million in the aggregate. The company was authorized to purchase shares under its 2000 common stock purchase plan until December 31, 2006. The company did not purchase any shares under its 2000 common stock purchase plan during the periods listed above. On November 3, 2006, the company adopted its 2006 common stock purchase plan, effective as of January 1, 2007. Pursuant to the 2006 common stock purchase plan, the

company may  
purchase up to  
four million  
shares of  
common stock  
at an amount not  
to exceed  
\$180 million, in  
the aggregate,  
until  
December 31,  
2012.

**Table of Contents****Item 6. Selected Financial Data****Summary of Operations and Other Comparative Data**

	2006	2005	2004	2003	2002
(Dollars in thousands, except per share data)					
<b>Statements of Income</b>					
Net Sales					
Industrial	\$ 2,072,495	\$ 1,925,211	\$ 1,709,770	\$ 1,498,832	\$ 971,534
Automotive	1,573,034	1,661,048	1,582,226	1,396,104	752,763
Steel	1,327,836	1,236,908	995,201	731,554	659,780
Total net sales	4,973,365	4,823,167	4,287,197	3,626,490	2,384,077
Gross profit	1,005,844	999,957	824,376	632,082	462,749
Selling, administrative and general expenses	677,342	646,904	575,910	511,053	345,240
Impairment and restructuring charges	44,881	26,093	13,538	19,154	31,852
Loss on divestitures	64,271				
Operating income	219,350	326,960	234,928	101,875	85,657
Other income (expense) net	79,666	67,726	12,100	9,903	36,326
Earnings before interest and taxes (EBIT) <sup>(1)</sup>	299,016	394,686	247,028	111,778	121,983
Interest expense	49,387	51,585	50,834	48,401	31,540
Income from continuing operations	176,439	233,656	134,046	38,940	55,385
Income from discontinued operations, net of income taxes	46,088	26,625	1,610	(2,459)	(16,636)
Net income	\$ 222,527	\$ 260,281	\$ 135,656	\$ 36,481	\$ 38,749
<b>Balance Sheets</b>					
Inventories net	\$ 952,310	\$ 900,294	\$ 799,717	\$ 634,906	\$ 425,003
Property, plant and equipment net	1,601,559	1,474,074	1,508,598	1,531,423	1,142,056
Total assets	4,031,533	3,993,734	3,942,909	3,689,789	2,748,356
Total debt:					
Commercial paper					8,999
Short-term debt	40,217	63,437	157,417	114,469	78,354
Current portion of long-term debt	10,236	95,842	1,273	6,725	23,781
Long-term debt	547,390	561,747	620,634	613,446	350,085
Total debt:	597,843	721,026	779,324	734,640	461,219
Net debt:					
Total debt	597,843	721,026	779,324	734,640	461,219

Less: cash and cash equivalents	<b>(101,072)</b>	(65,417)	(50,967)	(28,626)	(82,050)
Net debt: <sup>(2)</sup>	<b>496,771</b>	655,609	728,357	706,014	379,169
Total liabilities	<b>2,555,353</b>	2,496,667	2,673,061	2,600,162	2,139,270
Shareholders' equity	<b>\$ 1,476,180</b>	\$ 1,497,067	\$ 1,269,848	\$ 1,089,627	\$ 609,086
Capital:					
Net debt	<b>496,771</b>	655,609	728,357	706,014	379,169
Shareholders' equity	<b>1,476,180</b>	1,497,067	1,269,848	1,089,627	609,086
Net debt + shareholders' equity (capital)	<b>1,972,951</b>	2,152,676	1,998,205	1,795,641	988,255

**Other Comparative Data**

Income from continuing operations/Net sales	<b>3.5%</b>	4.8%	3.1%	1.1%	2.3%
EBIT /Net sales	<b>6.0%</b>	8.2%	5.8%	3.1%	5.1%
Return on equity <sup>(3)</sup>	<b>12.0%</b>	15.6%	10.6%	3.6%	9.1%
Net sales per associate <sup>(4)</sup>	<b>\$ 191.5</b>	\$ 186.7	\$ 170.0	\$ 170.6	\$ 135.8
Capital expenditures	<b>\$ 296,093</b>	\$ 217,411	\$ 143,781	\$ 125,596	\$ 87,869
Depreciation and amortization	<b>\$ 196,592</b>	\$ 209,656	\$ 201,173	\$ 200,548	\$ 137,451
Capital expenditures /Net sales	<b>6.0%</b>	4.5%	3.4%	3.5%	3.7%
Dividends per share	<b>\$ 0.62</b>	\$ 0.60	\$ 0.52	\$ 0.52	\$ 0.52
Earnings per share <sup>(5)</sup>	<b>\$ 2.38</b>	\$ 2.84	\$ 1.51	\$ 0.44	\$ 0.63
Earnings per share assuming dilution <sup>(5)</sup>	<b>\$ 2.36</b>	\$ 2.81	\$ 1.49	\$ 0.44	\$ 0.62
Net debt to capital <sup>(2)</sup>	<b>25.2%</b>	30.5%	36.5%	39.3%	38.4%
Number of associates at year-end <sup>(6)</sup>	<b>25,418</b>	26,528	25,128	25,299	17,226
Number of shareholders <sup>(7)</sup>	<b>42,608</b>	54,514	42,484	42,184	44,057

(1) EBIT is defined as operating income plus other income (expense) net.

(2) The company presents net debt because it believes net debt is more representative of the company's indicative financial position due to temporary changes in cash and cash equivalents.

- (3) Return on equity is defined as income from continuing operations divided by ending shareholders equity.
- (4) Based on average number of associates employed during the year.
- (5) Based on average number of shares outstanding during the year and includes discontinued operations for all periods presented.
- (6) Adjusted to exclude Latrobe Steel for all periods.
- (7) Includes an estimated count of shareholders having common stock held for their accounts by banks, brokers and trustees for benefit plans.

**Table of Contents****Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations****Overview*****Introduction***

The Timken Company is a leading global manufacturer of highly engineered anti-friction bearings and alloy steels and a provider of related products and services. Timken operates under three segments: Industrial Group, Automotive Group and Steel Group.

The Industrial and Automotive Groups design, manufacture and distribute a range of bearings and related products and services. Industrial Group customers include both original equipment manufacturers and distributors for agriculture, construction, mining, energy, mill, machine tool, aerospace and rail applications. Automotive Group customers include original equipment manufacturers and suppliers for passenger cars, light trucks, and medium- to heavy-duty trucks. Steel Group products include steels of low and intermediate alloy and carbon grades, in both solid and tubular sections, as well as custom-made steel products for both industrial and automotive applications, including bearings.

***Financial Overview******2006 compared to 2005******Overview:***

	<b>2006</b>	<b>2005</b>	<b>\$Change</b>	<b>% Change</b>
(Dollars in millions, except earnings per share)				
Net sales	\$ <b>4,973.4</b>	\$ 4,823.2	\$ 150.2	3.1%
Income from continuing operations	<b>176.4</b>	233.7	(57.3)	(24.5)%
Income from discontinued operations	<b>46.1</b>	26.6	19.5	73.3%
Net income	<b>222.5</b>	260.3	(37.8)	(14.5)%
Diluted earnings per share:				
Continuing operations	\$ <b>1.87</b>	\$ 2.52	\$ (0.65)	(25.8)%
Discontinued operations	<b>0.49</b>	0.29	0.20	69.0%
Net income per share	\$ <b>2.36</b>	\$ 2.81	\$ (0.45)	(16.0)%
Average number of shares diluted	<b>94,294,716</b>	92,537,529		1.9%

The Timken Company reported net sales for 2006 of approximately \$5.0 billion, compared to \$4.8 billion in 2005, an increase of 3.1%. Sales were higher across the Industrial and Steel Groups, offset by lower sales in the Automotive Group. In December 2006, the company completed the divestiture of its Latrobe Steel subsidiary. Discontinued operations represent the operating results and related gain on sale, net of tax, of this business. For 2006, earnings per diluted share were \$2.36, compared to \$2.81 per diluted share for 2005. Income from continuing operations per diluted share was \$1.87, compared to \$2.52 per diluted share for 2005.

The ongoing strength of global industrial markets drove the increase in Industrial and Steel Group sales, while the declines in North American automotive demand during the second half of 2006 constrained results. The company's growth initiatives, loss on divestitures and restructuring the company's operations, also constrained overall results. The company continued its focus on increasing production capacity in targeted areas, including major capacity expansions for industrial products at several manufacturing locations around the world. The company expects the strength in industrial markets will continue in 2007 and drive year-over-year sales increases in both the Industrial and Steel Groups.

While global industrial markets are expected to remain strong, the improvements in the company's operating performance will be partially constrained by investments, including Project O.N.E. and Asian growth initiatives. Project O.N.E. is a program designed to improve the company's business processes and systems. In 2006, the company successfully completed a pilot program of Project O.N.E. in Canada. The objective of Asian growth initiatives is to

increase market share, influence major design centers and expand the company's network of sources of globally competitive friction management products.

The company's strategy for the Industrial Group is to pursue growth in selected industrial markets and achieve a leadership position in targeted Asian markets. In 2006, the company invested in three new plants in Asia to build the infrastructure to support its Asian growth initiative. The company also expanded its capacity in aerospace products by investing in a new aerospace aftermarket facility in Mesa, Arizona and through the acquisition of the assets of Turbo Engines, Inc. in December 2006. The new facility in Mesa, which will include manufacturing and engineering functions, more than doubles the capacity of the company's previous aerospace aftermarket operations in Gilbert, Arizona. In addition, the company is increasing large-bore bearing capacity in Romania, China and the United States to serve heavy industrial markets. The company is also expanding its line of industrial seals to include large-bore seals to provide a more complete line of friction management products to distribution channels.



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The company's strategy for the Automotive Group is to make structural changes to its business to improve its financial performance. In 2005, the company disclosed plans for its Automotive Group to restructure its business. These plans included the closure of its automotive engineering center in Torrington, Connecticut and its manufacturing engineering center in Norcross, Georgia. These facilities were consolidated into a new technology facility in Greenville, South Carolina. Additionally, the company announced the closure of its manufacturing facility in Clinton, South Carolina. In February 2006, the company announced plans to downsize its manufacturing facility in Vierzon, France.

In September 2006, the company announced further planned reductions in its Automotive Group workforce of approximately 700 associates. These plans are targeted to deliver annual pretax savings of approximately \$35 million by 2008, with pretax costs of approximately \$25 million.

In December 2006, the company completed the divestiture of its Steering business located in Watertown, Connecticut and Nova Friburgo, Brazil, resulting in a loss on divestiture of \$54.3 million. The Steering business employed approximately 900 associates.

The company's strategy for the Steel Group is to focus on opportunities where the company can offer differentiated capabilities while driving profitable growth. In 2006, the company announced plans to invest in a new induction heat-treat line in Canton, Ohio, which will increase capacity and the ability to provide differentiated product to more customers in its global energy markets. In January 2007, the company announced plans to invest approximately \$60 million to enable the company to competitively produce steel bars down to 1-inch diameter for use in power transmission and friction management applications for a variety of customers, including the rapidly growing automotive transplants. In 2006, the company also completed the divestiture of its Latrobe Steel subsidiary and its Timken Precision Steel Components Europe business. In addition, the company announced plans to exit its seamless steel tube manufacturing operations located in Desford, England.

The Statement of Income

*Sales by Segment:*

	2006	2005	\$Change	% Change
(Dollars in millions, and exclude intersegment sales)				
Industrial Group	\$ 2,072.5	\$ 1,925.2	\$ 147.3	7.7%
Automotive Group	1,573.0	1,661.1	(88.1)	(5.3)%
Steel Group	1,327.9	1,236.9	91.0	7.4%
Total Company	\$ 4,973.4	\$ 4,823.2	\$ 150.2	3.1%

The Industrial Group's net sales in 2006 increased from 2005 primarily due to higher demand across most end markets, with the highest growth in aerospace, heavy industry and industrial distribution. The Automotive Group's net sales in 2006 decreased from 2005 primarily due to significantly lower volume, driven by reductions in vehicle production by North American original equipment manufacturers, partially offset by improved pricing. The Steel Group's net sales in 2006 increased from 2005 primarily due to increased pricing and surcharges to recover high raw material and energy costs, as well as strong demand in industrial and energy market sectors, partially offset by lower sales to automotive customers.

*Gross Profit:*

	2006	2005	\$Change	Change
(Dollars in millions)				

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Gross profit	<b>\$ 1,005.8</b>	\$ 1,000.0	\$ 5.8	0.6%
Gross profit % to net sales	<b>20.2%</b>	20.7%		(50)bps
Rationalization expenses included in cost of products sold	<b>\$ 18.5</b>	\$ 14.5	\$ 4.0	27.6%

Gross profit margin decreased in 2006 compared to 2005, primarily due to the impact of lower volume in the Automotive Group, driven by reductions in vehicle production by North American original equipment manufacturers, leading to underutilization of manufacturing capacity, as well as an increase in product warranty reserves. The impact of lower volumes and the increase in product warranty reserves in the Automotive Group more than offset favorable sales volume from the Industrial and Steel businesses, price increases, and increased productivity in the company's other businesses.

In 2006, rationalization expenses included in cost of products sold related to the company's Canton, Ohio Industrial Group bearing facilities, certain Automotive Group domestic manufacturing facilities, certain facilities in Torrington, Connecticut and the closure of the company's seamless steel tube manufacturing operations located in Desford, England. In 2005, rationalization expenses included in cost of products sold related to the rationalization of the company's Canton, Ohio bearing facilities and costs for certain facilities in Torrington, Connecticut.

**Table of Contents***Selling, Administrative and General Expenses:*

	2006	2005	\$Change	Change
(Dollars in millions)				
Selling, administrative and general expenses	<b>\$677.3</b>	\$646.9	\$30.4	4.7%
Selling, administrative and general expenses % to net sales	<b>13.6%</b>	13.4%		20bps
Rationalization expenses included in selling, administrative and general expenses	<b>\$ 5.9</b>	\$ 2.8	\$ 3.1	110.7%

The increase in selling, administrative and general expenses in 2006 compared to 2005 was primarily due to higher costs associated with investments in the Asian growth initiative and Project O.N.E. and higher rationalization expenses, partially offset by lower bad debt expense.

In 2006, the rationalization expenses included in selling, administrative and general expenses primarily related to Automotive Group manufacturing and engineering facilities. In 2005, the rationalization expenses included in selling, administrative and general expenses primarily related to the company's Canton, Ohio bearing facilities and costs associated with the Torrington acquisition.

*Impairment and Restructuring Charges:*

	2006	2005	\$Change
(Dollars in millions)			
Impairment charges	<b>\$15.3</b>	\$ 0.8	\$14.5
Severance and related benefit costs	<b>25.8</b>	20.3	5.5
Exit costs	<b>3.8</b>	5.0	(1.2)
Total	<b>\$44.9</b>	\$26.1	\$18.8

**Industrial**

In May 2004, the company announced plans to rationalize the company's three bearing plants in Canton, Ohio within the Industrial Group. On September 15, 2005, the company reached a new four-year agreement with the United Steelworkers of America, which went into effect on September 26, 2005, when the prior contract expired. This rationalization initiative is expected to deliver annual pretax savings of approximately \$25 million through streamlining operations and workforce reductions, with pretax costs of approximately \$35 to \$40 million over the next three years.

In 2006, the company recorded \$1.0 million of impairment charges and \$0.6 million of exit costs associated with the Industrial Group's rationalization plans. In 2005, the company recorded \$0.8 million of impairment charges and environmental exit costs of \$2.2 million associated with the Industrial Group's rationalization plans.

In November 2006, the company announced plans to vacate its Torrington, Connecticut office complex. In 2006, the company recorded \$1.5 million of severance and related benefit costs and \$0.1 million of impairment charges associated with the Industrial Group vacating the Torrington complex.

In addition, the company recorded \$1.4 million of environmental exit costs in 2006 related to a former plant in Columbus, Ohio and \$0.1 million of severance and related benefit costs related to other company initiatives.

**Automotive**

In 2005, the company disclosed detailed plans for its Automotive Group to restructure its business and improve performance. These plans included the closure of a manufacturing facility in Clinton, South Carolina and engineering

facilities in Torrington, Connecticut and Norcross, Georgia. In February 2006, the company announced additional plans to rationalize production capacity at its Vierzon, France bearing manufacturing facility in response to changes in customer demand for its products. These restructuring efforts, along with other future actions, are targeted to deliver annual pretax savings of approximately \$40 million by 2008, with expected net workforce reductions of approximately 400 to 500 positions and pretax costs of approximately \$80 million to \$90 million.

In September 2006, the company announced further planned reductions in its workforce of approximately 700 associates. These additional plans are targeted to deliver annual pretax savings of approximately \$35 million by 2008, with expected pretax costs of approximately \$25 million.

In 2006, the company recorded \$16.5 million of severance and related benefit costs, \$1.5 million of exit costs and \$1.6 million of impairment charges associated with the Automotive Group's restructuring plans. In 2005, the company recorded approximately \$20.3 million of severance and related benefit costs and \$2.8 million of exit costs as a result of environmental charges related to the closure of a manufacturing facility in Clinton, South Carolina, and administrative facilities in Torrington, Connecticut and Norcross, Georgia.

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In 2006, the company recorded an additional \$0.7 million of severance and related benefit costs and \$0.3 million of impairment charges for the Automotive Group related to the announced plans to vacate its Torrington campus office complex and \$0.1 million of severance and related benefit costs related to other company initiatives.

In addition, the company recorded impairment charges of \$11.9 million in 2006 representing the write-off of goodwill associated with the Automotive Group in accordance with Statement of Financial Accounting Standards No. 142 (SFAS No. 142), Goodwill and Other Intangible Assets. Refer to Note 8 Goodwill and Other Intangible Assets in the Notes to Consolidated Financial Statements for additional discussion.

**Steel**

In October 2006, the company announced its intention to exit during 2007 its European seamless steel tube manufacturing operations located in Desford, England. The company recorded approximately \$6.9 million of severance and related benefit costs in 2006 related to this action. In addition, the company recorded an impairment charge and removal costs of \$0.6 million related to the write-down of property, plant and equipment at one of the Steel Group's facilities.

***Rollforward of Restructuring Accruals:***

	2006	2005
(Dollars in millions)		
Beginning balance, January 1	\$ 18.1	\$ 4.1
Expense	29.6	17.5
Payments	(15.7)	(3.5)
Ending balance, December 31	\$ 32.0	\$ 18.1

The restructuring accrual for 2006 and 2005 was included in accounts payable and other liabilities in the Consolidated Balance Sheet. The restructuring accrual at December 31, 2005 excludes costs related to curtailment of pension and postretirement benefit plans.

***Loss on Divestitures***

	2006	2005	\$Change
(Dollars in millions)			
(Loss) on Divestitures	\$(64.3)	\$	\$(64.3)

In June 2006, the company completed the divestiture of its Timken Precision Steel Components Europe business and recorded a loss on disposal of \$10.0 million. In December 2006, the company completed the divestiture of the Automotive Group's steering business located in Watertown, Connecticut and Nova Friburgo, Brazil and recorded a loss on disposal of \$54.3 million.

***Interest Expense and Income:***

	2006	2005	\$Change	% Change
(Dollars in millions)				
Interest expense	\$49.4	\$51.6	\$(2.2)	(4.3)%
Interest income	\$ 4.6	\$ 3.4	\$ 1.2	35.3%

Interest expense for 2006 decreased slightly compared to 2005 due to lower average debt outstanding in 2006 compared to 2005, partially offset by higher interest rates. Interest income increased for 2006 compared to 2005 due to higher invested cash balances and higher interest rates.

**Table of Contents***Other Income and Expense:*

	2006	2005	\$Change	% Change
(Dollars in millions)				
CDSOA receipts, net of expenses	\$ 87.9	\$ 77.1	\$ 10.8	14.0%
Other expense net:				
Gain on sale of non-strategic assets	\$ 7.1	\$ 8.9	\$ (1.8)	(20.2)%
Gain (loss) on dissolution of subsidiaries	0.9	(0.6)	1.5	NM
Other	(16.2)	(17.7)	1.5	8.5%
Other expense net	\$ (8.2)	\$ (9.4)	\$ 1.2	12.8%

The U.S. Continued Dumping and Subsidy Offset Act (CDSOA) receipts are reported net of applicable expenses. CDSOA provides for distribution of monies collected by 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 2006, the company received CDSOA receipts, net of expenses, of \$87.9 million. In 2005, the company received CDSOA receipts, net of expenses, of \$77.1 million. In September 2002, the World Trade Organization (WTO) ruled that such payments are inconsistent with international trade rules. In February 2006, U.S. legislation was signed into law that would end CDSOA distributions for imports covered by antidumping duty orders entering the U.S. after September 30, 2007. Instead, any such antidumping duties collected would remain with the U.S. Treasury. This legislation by itself is not expected to have a significant effect on potential CDSOA distributions in 2007, but would be expected to reduce any distributions in years beyond 2007, with distributions eventually ceasing altogether. There are a number of factors that can affect whether the company receives any CDSOA distributions and the amount of such distributions in any year. These factors include, among other things, potential additional changes in the law, ongoing and potential additional legal challenges to the law, the administrative operation of the law and the status of the underlying antidumping orders. Accordingly, the company cannot reasonably estimate the amount of CDSOA distributions it will receive in future years, if any. If the company does receive CDSOA distributions in 2007, they will most likely be received in the fourth quarter.

In 2006, the gain on sale of non-strategic assets primarily related to the sale of assets of PEL Technologies (PEL). In 2000, the company's Steel Group invested in PEL, a joint venture to commercialize a proprietary technology that converted iron units into engineered iron oxide for use in pigments, coatings and abrasives. The company consolidated PEL effective March 31, 2004 in accordance with Financial Accounting Standards Board (FASB) Interpretation No. 46 (FIN 46). In 2006, the company liquidated the joint venture. Refer to Note 12 Equity Investments in the Notes to Consolidated Financial Statements for additional discussion.

In 2005, the gain on sale of non-strategic assets of \$8.9 million related to the sale of certain non-strategic assets, including NRB Bearings, a joint venture based in India, and the Industrial Group's Linear Motion Systems business, based in Europe.

For 2006, other expense primarily included losses from equity investments, donations, minority interests, and losses on the disposal of assets. For 2005, other expense primarily included losses on the disposal of assets, losses from equity investments, donations, minority interests and foreign currency exchange losses.

**Table of Contents***Income Tax Expense:*

	<b>2006</b>	2005	\$Change	% Change
(Dollars in millions)				
Income tax expense	<b>\$77.8</b>	\$112.9	\$(35.1)	(31.1)%
Effective tax rate	<b>30.6%</b>	32.6%		(200)bps

The effective tax rate for 2006 was less than the U.S. federal statutory tax rate due to the favorable impact of taxes on foreign income, including earnings of certain foreign subsidiaries being taxed at a rate less than 35%, the extraterritorial income exclusion on U.S. exports, and tax holidays in China and the Czech Republic. In addition, the effective tax rate was favorably impacted by certain U.S. tax benefits, including a net reduction in our tax reserves related primarily to the settlement of certain prior year tax matters with the Internal Revenue Service during the year, accrual of the tax-free Medicare prescription drug subsidy, deductible dividends paid to the company's Employee Stock Ownership Plan (ESOP), and the U.S. domestic manufacturing deduction provided by the American Jobs Creation Act of 2004 (the AJCA). These benefits were offset partially by the inability to record tax benefits for losses at certain foreign subsidiaries, taxes on foreign remittances, the impairment of non-deductible goodwill recorded in the fourth quarter of 2006, U.S. state and local income taxes, and the aggregate impact of other U.S. tax items. The effective tax rate for 2005 was less than the U.S. statutory tax rate due to tax benefits on foreign income, including the extraterritorial income exclusion on U.S. exports, tax holidays in China and the Czech Republic, and earnings of certain foreign subsidiaries being taxed at a rate less than 35%, as well as the aggregate tax benefit of other U.S. tax items. These benefits were offset partially by taxes incurred on foreign remittances, including a remittance during the fourth quarter of 2005 pursuant to the AJCA, U.S. state and local income taxes and the inability to record a tax benefit for losses at certain foreign subsidiaries.

In October 2004, the AJCA was signed into law. The AJCA contains a provision that eliminates the benefits of the extraterritorial income exclusion for U.S. exports after 2006. The company recognized tax benefits of \$5.3 million related to the extraterritorial income exclusion in 2006. Additionally, the AJCA contains a provision that enables companies to deduct a percentage (3% in 2005 and 2006; 6% in 2007 through 2009; and 9% in 2010 and later years) of taxable income derived from qualified domestic manufacturing operations. The company recognized tax benefits of approximately \$1.6 million related to the manufacturing deduction in 2006.

In December 2006, the Tax Relief and Health Care Act of 2006 (the TRHCA) was signed into law. The TRHCA extends the U.S. federal income tax credit for qualified research and development activities (the R&D credit), which had expired on December 31, 2005, through December 31, 2007. The TRHCA also provides an alternative simplified method for calculating the R&D credit for 2007. The company expects the alternative simplified method to result in an increased R&D credit for 2007, versus prior years.

*Discontinued Operations*

	<b>2006</b>	2005	\$Change	% Change
(Dollars in millions)				
Operating results, net of tax	<b>\$33.2</b>	\$26.6	\$ 6.6	24.8%
Gain on disposal, net of tax	<b>12.9</b>		12.9	NM
Total	<b>\$46.1</b>	\$26.6	\$19.5	73.3%

In December 2006, the company completed the divestiture of its Latrobe Steel subsidiary. Latrobe Steel is a global producer and distributor of high-quality, vacuum melted specialty steels and alloys. Discontinued operations represent



the operating results and related gain on sale, net of tax, of this business. Refer to Note 2 Acquisitions and Divestitures in the Notes to Consolidated Financial Statements for additional discussion.

**Table of Contents***Business Segments:*

The primary measurement used by management to measure the financial performance of each segment is adjusted EBIT (earnings before interest and taxes, excluding the effect of amounts related to certain items that management considers not representative of ongoing operations such as impairment and restructuring, rationalization and integration charges, one-time gains or losses on sales of non-strategic assets, allocated receipts received or payments made under the CDSOA and loss on the dissolution of subsidiary). Refer to Note 14 Segment Information in the Notes to Consolidated Financial Statements for the reconciliation of adjusted EBIT by Group to consolidated income before income taxes.

*Industrial Group:*

	2006	2005	\$Change	Change
(Dollars in millions)				
Net sales, including intersegment sales	<b>\$2,074.5</b>	\$1,927.1	\$147.4	7.6%
Adjusted EBIT	<b>\$ 201.3</b>	\$ 199.9	\$ 1.4	0.7%
Adjusted EBIT margin	<b>9.7%</b>	10.4%		(70)bps

Sales by the Industrial Group include global sales of bearings and other products and services (other than steel) to a diverse customer base, including: industrial equipment; construction and agriculture; rail; and aerospace and defense customers. The Industrial Group also includes aftermarket distribution operations, including automotive applications, for products other than steel.

The Industrial Group's net sales for 2006 compared to 2005 increased primarily due to higher demand across most end markets, particularly aerospace, heavy industry and industrial distribution markets. While sales increased in 2006, adjusted EBIT margin was lower compared to 2005 primarily due to higher manufacturing costs associated with ramping up new facilities to meet customer demand and investments in the Asian growth initiative and Project O.N.E., mostly offset by higher volume and increased pricing. The company expects the Industrial Group to benefit from continued strength in most industrial segments in 2007. The Industrial Group is also expected to benefit from additional supply capacity in constrained products throughout 2007.

*Automotive Group:*

	2006	2005	\$Change	Change
(Dollars in millions)				
Net sales, including intersegment sales	<b>\$1,573.0</b>	\$1,661.1	\$(88.1)	(5.3)%
Adjusted EBIT (loss)	<b>\$ (73.7)</b>			