TIMKEN CO
Form 10-Q
November 07, 2007

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

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

For the quarterly period ended September 30, 2007

OR

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

For the transition period from __________ to __________

Commission file number: 1-1169

THE TIMKEN COMPANY

(Exact name of registrant as specified in its charter)

OHIO	**34-0577130**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1835 Dueber Ave., SW, Canton, OH	**44706-2798**
(Address of principal executive offices)	(Zip Code)

330.438.3000

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant 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 þ Accelerated filer o Non-accelerated filer o

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	Outstanding at September 30, 2007
Common Stock, without par value	95,787,433 shares

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PART I. FINANCIAL INFORMATION
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THE TIMKEN COMPANY AND SUBSIDIARIES
Consolidated Statement of Income
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(Dollars in thousands, except per share data)	2007	2006	2007	2006
Net sales	**$1,261,239**	$1,185,962	**$3,894,983**	$3,742,444
Cost of products sold	**1,009,929**	953,565	**3,097,145**	2,946,385
Gross Profit	**251,310**	232,397	**797,838**	796,059
Selling, administrative and general expenses	**170,841**	160,679	**514,773**	503,940
Impairment and restructuring charges	**11,840**	2,682	**32,870**	11,191
Loss on divestitures	**152**		**468**	9,971
Operating Income	**68,477**	69,036	**249,727**	270,957
Interest expense	**(10,698)**	(11,704)	**(30,422)**	(37,487)
Interest income	**2,381**	854	**5,536**	3,338
Other expense net	**(3,851)**	(1,749)	**(10,829)**	(9,089)
Income from Continuing Operations before Income Taxes	**56,309**	56,437	**214,012**	227,719
Provision for income taxes	**15,066**	17,749	**42,914**	67,049
Income from Continuing Operations	**41,243**	38,688	**171,098**	160,670
Income from discontinued operations, net of income taxes		7,859	**665**	26,508
Net Income	**$ 41,243**	$ 46,547	**$ 171,763**	$ 187,178
Earnings Per Share:				
Basic earnings per share				
Continuing operations	**$ 0.43**	$ 0.41	**$ 1.81**	$ 1.72
Discontinued operations		0.09	**0.01**	0.29
Net income per share	**$ 0.43**	$ 0.50	**$ 1.82**	$ 2.01
Diluted earnings per share				
Continuing operations	**$ 0.43**	$ 0.41	**$ 1.79**	$ 1.70
Discontinued operations		0.08	**0.01**	0.29
Net income per share	**$ 0.43**	$ 0.49	**$ 1.80**	$ 1.99

Dividends per share	**$**	**0.17**	$	0.16	**$**	**0.49**	$	0.46

See accompanying Notes to Consolidated Financial Statements.

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Consolidated Balance Sheet

(Dollars in thousands)	(Unaudited) September 30, 2007	December 31, 2006
ASSETS		
Current Assets		
Cash and cash equivalents	**$ 87,767**	$ 101,072
Accounts receivable, less allowances: 2007 - $39,427; 2006 - $36,673	**734,771**	673,428
Inventories, net	**1,021,961**	952,310
Deferred income taxes	**66,583**	85,576
Deferred charges and prepaid expenses	**14,981**	11,083
Other current assets	**92,305**	76,811
Total Current Assets	**2,018,368**	1,900,280
Property, Plant and Equipment Net	**1,644,965**	1,601,559
Other Assets		
Goodwill	**215,778**	201,899
Other intangible assets	**96,965**	104,070
Deferred income taxes	**159,134**	169,417
Other non-current assets	**61,842**	54,308
Total Other Assets	**533,719**	529,694
Total Assets	**$4,197,052**	$4,031,533
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities		
Short-term debt	**$ 41,711**	$ 40,217
Accounts payable and other liabilities	**502,458**	506,301
Salaries, wages and benefits	**211,598**	225,409
Income taxes payable	**18,445**	52,768
Deferred income taxes	**638**	638
Current portion of long-term debt	**33,180**	10,236
Total Current Liabilities	**808,030**	835,569
Non-Current Liabilities		
Long-term debt	**526,521**	547,390
Accrued pension cost	**328,023**	410,438
Accrued postretirement benefits cost	**681,762**	682,934
Deferred income taxes	**6,659**	6,659
Other non-current liabilities	**91,784**	72,363
Total Non-Current Liabilities	**1,634,749**	1,719,784

Shareholders Equity		
Class I and II Serial Preferred Stock without par value:		
Authorized - 10,000,000 shares each class, none issued		
Common stock without par value:		
Authorized - 200,000,000 shares		
Issued (including shares in treasury) (2007 - 96,109,525 shares; 2006 - 94,244,407 shares)		
Stated capital	**53,064**	53,064
Other paid-in capital	**805,152**	753,095
Earnings invested in the business	**1,347,871**	1,217,167
Accumulated other comprehensive loss	**(441,460)**	(544,562)
Treasury shares at cost (2007 - 322,092 shares; 2006 - 80,005 shares)	**(10,354)**	(2,584)
Total Shareholders Equity	**1,754,273**	1,476,180
Total Liabilities and Shareholders Equity	**$4,197,052**	$4,031,533

See accompanying Notes to Consolidated Financial Statements.

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Consolidated Statement of Cash Flows
(Unaudited)

(Dollars in thousands)	Nine Months Ended September 30, 2007	2006
CASH PROVIDED (USED)		
Operating Activities		
Net income	**$ 171,763**	$ 187,178
Net (income) from discontinued operations	**(665)**	(26,508)
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**160,595**	145,126
Impairment charges	**11,620**	1,792
Loss on disposals of property, plant and equipment	**2,084**	2,109
(Gain) loss on divestiture	**(666)**	9,311
Deferred income taxes	**16,168**	(24,016)
Stock based compensation expense	**12,671**	11,760
Pension and other postretirement expense	**90,792**	116,266
Pension and other postretirement benefit payments	**(138,984)**	(189,306)
Changes in operating assets and liabilities:		
Accounts receivable	**(39,937)**	(15,330)
Inventories	**(34,766)**	(65,572)
Accounts payable and accrued expenses	**(45,167)**	(21,948)
Income taxes payable	**7,083**	24,894
Other net	**(27,077)**	(25,161)
Net Cash Provided by Operating Activities Continuing Operations	**185,514**	130,595
Net Cash Provided by Operating Activities Discontinued Operations	**665**	41,755
Net Cash Provided By Operating Activities	**186,179**	172,350
Investing Activities		
Capital expenditures	**(196,374)**	(175,224)
Proceeds from disposals of property, plant and equipment	**11,809**	6,253
Divestitures	**698**	(2,723)
Acquisitions	**(1,523)**	(4,299)
Other	**1,088**	(85)
Net Cash Used by Investing Activities Continuing Operations	**(184,302)**	(176,078)
Net Cash Used by Investing Activities Discontinued Operations		(4,205)
Net Cash Used by Investing Activities	**(184,302)**	(180,283)
Financing Activities		
Cash dividends paid to shareholders	**(46,682)**	(43,170)
Net proceeds from common share activity	**36,987**	22,066
Accounts receivable securitization financing borrowings		140,000

Accounts receivable securitization financing payments		(50,000)
Proceeds from issuance of long-term debt	**40,054**	191,615
Payments on long-term debt	**(48,423)**	(291,477)
Short-term debt activity net	**(6,490)**	24,984
Net Cash Used by Financing Activities	**(24,554)**	(5,982)
Effect of exchange rate changes on cash	**9,372**	2,567
Decrease In Cash and Cash Equivalents	**(13,305)**	(11,348)
Cash and cash equivalents at beginning of year	**101,072**	65,417
Cash and Cash Equivalents at End of Period	**$ 87,767**	$ 54,069

See accompanying Notes to Consolidated Financial Statements.

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PART I. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(Dollars in thousands, except per share data)

Note 1 Basis of Presentation

The accompanying Consolidated Financial Statements (unaudited) for The Timken Company (the company) have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and footnotes required by the accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) and disclosures considered necessary for a fair presentation have been included. For further information, refer to the Consolidated Financial Statements and footnotes included in the company s Annual Report on Form 10-K for the year ended December 31, 2006. Certain amounts in the 2006 Consolidated Financial Statements have been reclassified to conform to the 2007 presentation.

Note 2 New Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation (FIN) 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109. This interpretation clarifies the accounting for uncertain tax positions recognized in an entity s financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. FIN 48 prescribes requirements and other guidance for financial statement recognition and measurement of positions taken or expected to be taken on tax returns. This interpretation is effective for fiscal years beginning after December 15, 2006. The cumulative effect of adopting FIN 48 is recorded as an adjustment to the opening balance of retained earnings in the period of adoption. The company adopted FIN 48 effective January 1, 2007. In connection with the adoption of FIN 48, the company recorded a $5,623 increase to retained earnings to recognize net tax benefits under the recognition and measurement criteria of FIN 48 that were previously not recognized under the company s former accounting policy.

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements. SFAS No. 157 establishes a framework for measuring fair value that is based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information to develop those assumptions. Additionally, the standard expands the disclosures about fair value measurements to include separately disclosing the fair value measurements of assets or liabilities within each level of the fair value hierarchy. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. The company is currently evaluating the impact of adopting SFAS No. 157 on the company s results of operations and financial condition.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. SFAS No. 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The company is currently evaluating the impact of adopting SFAS No. 159 on the company s results of operations and financial condition.

Note 3 Inventories

	September 30, 2007	December 31, 2006
Inventories:		
Manufacturing supplies	**$ 78,704**	$ 84,398
Work in process and raw materials	**418,703**	390,133
Finished products	**524,554**	477,779
Inventories	**$1,021,961**	$952,310

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Note 3 Inventories (continued)

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

An actual valuation of the inventory under the LIFO method can be made only at the end of each year based on the inventory levels and costs at that time. Accordingly, interim LIFO calculations must be based on management s estimates of expected year-end inventory levels and costs. Because these are subject to many forces beyond management s control, annual results may differ from interim results as they are subject to the final year-end LIFO inventory valuation.

Note 4 Property, Plant and Equipment

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

	September 30, 2007	December 31, 2006
Property, Plant and Equipment:		
Land and buildings	**$ 655,703**	$ 628,542
Machinery and equipment	**3,177,776**	3,036,266
Subtotal	**3,833,479**	3,664,808
Less allowances for depreciation	**(2,188,514)**	(2,063,249)
Property, Plant and Equipment Net	**$ 1,644,965**	$ 1,601,559

At September 30, 2007, property, plant and equipment net included approximately $102,320 in capitalized software. Depreciation expense was $55,301 and $152,037, respectively, for the three and nine months ended September 30, 2007. Assets held for sale at September 30, 2007 were $12,962. Assets held for sale relate to land and buildings in Torrington, Connecticut and Desford, England and are classified as other current assets on the Consolidated Balance Sheet.

Note 5 Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill for the nine months ended September 30, 2007 are as follows:

	Balance December 31, 2006	**Acquisitions**	**Other**	**Balance September 30, 2007**
Goodwill:				
Industrial	**$201,899**	**$1,023**	**$12,856**	**$215,778**

Total	**$201,899**	**$1,023**	**$12,856**	**$215,778**

Acquisitions represent the opening balance sheet adjustment for an acquisition completed in December 2006. Other primarily includes foreign currency translation adjustments.

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Note 5 Goodwill and Other Intangible Assets (continued)
The following table displays intangible assets as of September 30, 2007 and December 31, 2006:

	As of September 30, 2007		
	Gross Carrying Amount	**Accumulated Amortization**	**Net Carrying Amount**
Intangible assets subject to amortization:			
Industrial	**$ 54,673**	**$16,443**	**$ 38,230**
Automotive	**72,288**	**29,400**	**42,888**
Steel	**893**	**394**	**499**
	$127,854	**$46,237**	**$ 81,617**
Intangible assets not subject to amortization:			
Goodwill	**$215,778**	**$**	**$215,778**
Other	**15,348**		**15,348**
	$231,126	**$**	**$231,126**
Total intangible assets	**$358,980**	**$46,237**	**$312,743**

	As of December 31, 2006		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Intangible assets subject to amortization:			
Industrial	$ 54,654	$12,754	$ 41,900
Automotive	70,545	24,255	46,290
Steel	864	313	551
	$126,063	$37,322	$ 88,741
Intangible assets not subject to amortization:			
Goodwill	$201,899	$	$201,899
Other	15,329		15,329
	$217,228	$	$217,228
Total intangible assets	$343,291	$37,322	$305,969

Amortization expense for intangible assets was approximately $3,100 and $8,900, respectively, for the three and nine months ended September 30, 2007. Amortization expense for intangible assets is estimated to be approximately $10,900 in 2007; $9,400 in 2008; $9,100 in 2009; $8,900 in 2010 and $8,100 in 2011.

Note 6 Equity Investments

Investments accounted for under the equity method were $13,495 and $12,144 at September 30, 2007 and December 31, 2006, respectively, and were reported in other non-current assets on the Consolidated Balance Sheet. In the third quarter of 2007, the company sold its investment in Timken-NSK Bearings (Suzhou) Co., Ltd., a joint venture based in China, and recognized a pretax gain on divestiture of $666. In the first quarter of 2006, the company sold a portion of CoLinx, LLC due to the addition of another company to the joint venture and recognized a pretax gain on divestiture of $660.

Equity investments are reviewed for impairment when circumstances (such as lower-than-expected financial performance or change in strategic direction) indicate that the carrying value of the investment may not be recoverable. If impairment does exist, the equity investment is written down to its fair value with a corresponding charge to the Consolidated Statement of Income. No impairments were recorded during the first nine months of 2007 and 2006 relating to the company s equity investments.

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Note 6 Equity Investments (continued)

PEL

During 2000, the company s Steel Group invested in a joint venture, PEL, to commercialize a proprietary technology that converts iron units into engineered iron oxides for use in pigments, coatings and abrasives. The company concluded that PEL was a variable interest entity and that the company was the primary beneficiary. In accordance with FIN 46, Consolidation of Variable Interest Entities, an interpretation of Accounting Research Bulletin No. 51, the company consolidated PEL effective March 31, 2004. In the first quarter of 2006, plans were finalized to liquidate the assets of PEL, and the company recorded a related gain of approximately $3,549. In January 2006, the company repaid, in full, the $23,000 balance outstanding of the revenue bonds held by PEL. In June 2006, the company continued to liquidate PEL, with land and buildings exchanged and the buyer s assumption of the fixed-rate mortgage, which resulted in a gain of $2,787.

Advanced Green Components

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 has 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 $12,240. The company guaranteed half of this obligation. The company concluded the refinancing represented a reconsideration event to evaluate whether AGC was a variable interest entity under FIN 46 (revised December 2003). The company concluded that AGC was a variable interest entity and that the company was the primary beneficiary. Therefore, the company consolidated AGC, effective September 30, 2006. All of AGC s assets are collateral for its obligations. Except for AGC s indebtedness for which the company is a guarantor, AGC s creditors have no recourse to the general credit of the company.

Note 7 Financing Arrangements

Short-term debt at September 30, 2007 and December 31, 2006 was as follows:

	September 30, 2007	December 31, 2006
Variable-rate lines of credit for certain of the company s European and Asian subsidiaries with various banks with interest rates ranging from 4.54% to 13.50%	**$ 38,202**	$ 27,000
Fixed-rate short-term loan of an Asian subsidiary with an interest rate of 6.71%	**1,001**	10,005
Other	**2,508**	3,212
Short-term debt	**$ 41,711**	$ 40,217

Borrowings under the Accounts Receivable Securitization financing agreement (Asset Securitization), which provides for borrowings up to $200,000 subject to certain borrowing base limitations, are secured by certain trade receivables. Under the terms of the Asset Securitization, the company sells, on an ongoing basis, certain domestic trade receivables to Timken Receivables Corporation, a wholly owned consolidated subsidiary, which in turn uses the trade receivables to secure the borrowings, which are funded through a vehicle that issues commercial paper in the short-term market. As of September 30, 2007, there were no outstanding borrowings under this facility. A balance outstanding related to the Asset Securitization would be reflected on the company s Consolidated Balance Sheet in short-term debt. The yield on the commercial paper, which is the commercial paper rate plus program fees, is considered a financing cost and is included in interest expense on the Consolidated Statement of Income. As of September 30, 2007, the company had issued letters of credit totaling $18,380, which reduced the availability under the Asset Securitization to $181,620.

The lines of credit for certain of the company s European and Asian subsidiaries provide for borrowings up to $269,313. At September 30, 2007, the company had borrowings outstanding of $38,202, which reduced the availability under these facilities to $231,111.

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Note 7 Financing Arrangements (continued)
Long-term debt at September 30, 2007 and December 31, 2006 was as follows:

	September 30, 2007	December 31, 2006
Fixed-rate Medium-Term Notes, Series A, due at various dates through May 2028, with interest rates ranging from 6.20% to 7.76%	**$191,914**	$191,601
Variable-rate State of Ohio Air Quality and Water Development Revenue Refunding Bonds, maturing on November 1, 2025 (3.70% at September 30, 2007)	**21,700**	21,700
Variable-rate State of Ohio Pollution Control Revenue Refunding Bonds, maturing on June 1, 2033 (3.70% at September 30, 2007)	**17,000**	17,000
Variable-rate State of Ohio Water Development Revenue Refunding Bonds, matured on May 1, 2007		8,000
Variable-rate Unsecured Canadian Note, Maturing on December 22, 2010 (5.67% at September 30, 2007)	**58,266**	49,593
Fixed-rate Unsecured Notes, maturing on February 15, 2010 with an interest rate of 5.75%	**249,027**	247,773
Variable-rate credit facility with US Bank for Advanced Green Components, LLC, maturing on July 18, 2008 (6.12% at September 30, 2007)	**12,240**	12,240
Other	**9,554**	9,719
	559,701	557,626
Less current maturities	**33,180**	10,236
Long-term debt	**$526,521**	$547,390

The company has a $500,000 Amended and Restated Credit Agreement (Senior Credit Facility) that matures on June 30, 2010. At September 30, 2007, the company had no outstanding borrowings under the Senior Credit Facility and had issued letters of credit under this facility totaling $23,809, which reduced the availability under the Senior Credit Facility to $476,191. Under the Senior Credit Facility, the company has two financial covenants: a consolidated leverage ratio and a consolidated interest coverage ratio. At September 30, 2007, the company was in full compliance with the covenants under the Senior Credit Facility and its other debt agreements.

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

AGC is a joint venture of the company formerly accounted for using the equity method. The company is the guarantor of $6,120 of AGC s $12,240 credit facility. Effective September 30, 2006, the company consolidated AGC and its outstanding debt. Refer to Note 6 Equity Investments for additional discussion.

Note 8 Product Warranty

The company provides warranty policies on certain of its products. The company accrues liabilities under warranty policies based upon specific claims and a review of historical warranty claim experience in accordance with SFAS No. 5. Should the company become aware of a specific potential warranty claim, a specific charge is recorded and accounted for accordingly. Adjustments are made quarterly to the reserves as claim data and historical experience change. The following is a rollforward of the warranty reserves for the nine months ended September 30, 2007 and the year ended December 31, 2006:

	September 30, 2007	December 31, 2006
Beginning balance, January 1	**$ 20,023**	$ 910
Expense	**924**	20,024
Payments	**(9,964)**	(911)
Ending balance	**$ 10,983**	$ 20,023

The product warranty charge in 2006 related primarily to a single production line at an individual plant that occurred during a limited period. Part of this claim was paid during the third quarter of 2007. The product warranty accrual at September 30, 2007 and December 31, 2006 was included in accounts payable and other liabilities on the Consolidated Balance Sheet.

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Note 9 Shareholders Equity

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

	Total	Common Stock Stated Capital	Common Stock Other Paid-In Capital	Earnings Invested in the Business	Accumulated Other Comprehensive Income	Treasury Stock
Balance at December 31, 2006	$1,476,180	$53,064	$753,095	$1,217,167	$(544,562)	$ (2,584)
Cumulative effect of adoption of FIN 48	5,623			5,623		
Net Income	171,763			171,763		
Foreign currency translation adjustment	80,780				80,780	
Pension/OPEB liability adjustments during the period	22,667				22,667	
Change in fair value of derivative financial instruments, net of reclassifications	(345)				(345)	
Total comprehensive income	274,865					
Dividends $0.49 per share	(46,682)			(46,682)		
Tax benefit from stock compensation	5,683		5,683			
Issuance (tender) of (242,087) shares from treasury and 1,865,119 shares from authorized	38,604		46,374			(7,770)
Balance at September 30, 2007	**$1,754,273**	**$53,064**	**$805,152**	**$1,347,871**	**$(441,460)**	**$(10,354)**

The total comprehensive income for the three months ended September 30, 2007 and 2006 was $82,946 and $43,581, respectively. Total comprehensive income for the nine months ended September 30, 2006 was $211,998.

Note 10 Earnings Per Share

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

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	**Nine Months Ended September 30, 2007**	Nine Months Ended September 30, 2006
Numerator:				
	$ 41,243	$ 38,688	**$ 171,098**	$ 160,670

Income from continuing operations for basic earnings per share and diluted earnings per share				
Denominator:				
Weighted-average number of shares outstanding basic	**95,029,369**	93,500,491	**94,494,531**	93,239,292
Effect of dilutive securities:				
Stock options and awards based on the treasury stock method	**1,066,491**	876,446	**988,889**	999,121
Weighted-average number of shares outstanding, assuming dilution of stock options and awards	**96,095,860**	94,376,937	**95,483,420**	94,238,413
Basic earnings per share from continuing operations	**$ 0.43**	$ 0.41	**$ 1.81**	$ 1.72
Diluted earnings per share from continuing operations	**$ 0.43**	$ 0.41	**$ 1.79**	$ 1.70

The exercise prices for certain stock options that the company has awarded exceed the average market price of the company s common stock. Such stock options are antidilutive and were not included in the computation of diluted earnings per share. The antidilutive stock options outstanding were zero and 539,550 during the three months ended September 30, 2007 and 2006, respectively. The antidilutive stock options outstanding were 571,046 and 544,583 during the nine months ended September 30, 2007 and 2006, respectively.

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Note 11 Segment Information

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	**2007**	2006
Industrial Group				
Net sales to external customers	**$556,195**	$501,347	**$1,665,729**	$1,533,396
Intersegment sales	**601**	469	**1,453**	1,366
Depreciation and amortization	**27,238**	18,514	**66,059**	55,354
EBIT, as adjusted	**55,365**	48,180	**166,346**	157,557
Automotive Group				
Net sales to external customers	**$361,032**	$363,585	**$1,156,147**	$1,211,283
Depreciation and amortization	**20,459**	19,457	**59,350**	59,434
EBIT (loss), as adjusted	**(20,654)**	(26,276)	**(35,278)**	(31,377)
Steel Group				
Net sales to external customers	**$344,012**	$321,030	**$1,073,107**	$ 997,765
Intersegment sales	**37,100**	34,584	**109,066**	116,555
Depreciation and amortization	**10,423**	9,777	**35,186**	30,338
EBIT, as adjusted	**47,437**	50,436	**170,358**	167,168
Reconciliation to Income from Continuing Operations before Income Taxes				
Total EBIT, as adjusted, for reportable segments	**$ 82,148**	$ 72,340	**$ 301,426**	$ 293,348
Impairment and restructuring	**(11,840)**	(2,682)	**(32,870)**	(11,191)
Manufacturing rationalization expenses	**(6,234)**	(4,463)	**(30,776)**	(14,137)
Loss on divestitures	**(152)**		**(468)**	(9,971)
Other	**983**	76	**3,355**	2,430
Interest expense	**(10,698)**	(11,704)	**(30,422)**	(37,487)
Interest income	**2,381**	854	**5,536**	3,338
Intersegment adjustments	**(279)**	2,016	**(1,769)**	1,389
Income from Continuing Operations before Income Taxes	**$ 56,309**	$ 56,437	**$ 214,012**	$ 227,719

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Note 12 Impairment and Restructuring Charges
Impairment and restructuring charges by segment are comprised of the following:
For the three months ended September 30, 2007:

	Industrial	**Automotive**	**Steel**	**Total**
Impairment charges	**$6,667**	**$1,600**	**$**	**$ 8,267**
Severance expense and related benefit costs	**396**	**1,190**	**1,310**	**2,896**
Exit costs	**368**	**63**	**246**	**677**
Total	**$7,431**	**$2,853**	**$1,556**	**$11,840**

For the nine months ended September 30, 2007:

	Industrial	**Automotive**	**Steel**	**Total**
Impairment charges	**$10,020**	**$ 1,600**	**$**	**$11,620**
Severance expense and related benefit costs	**241**	**10,845**	**6,926**	**18,012**
Exit costs	**404**	**2,192**	**642**	**3,238**
Total	**$10,665**	**$14,637**	**$7,568**	**$32,870**

For the three months ended September 30, 2006:

	Industrial	Automotive	Steel	Total
Impairment charges	$592	$	$485	$1,077
Severance expense and related benefit costs		1,647		1,647
Exit costs	189	(231)		(42)
Total	$781	$1,416	$485	$2,682

For the nine months ended September 30, 2006:

	Industrial	Automotive	Steel	Total
Impairment charges	$592	$ 689	$485	$ 1,766
Severance expense and related benefit costs		8,248		8,248
Exit costs	363	814		1,177
Total	$955	$9,751	$485	$11,191

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 $25,000 by 2009 through streamlining operations and workforce reductions, with pretax costs of approximately $35,000 to $40,000.

Impairment charges of $1,367 and $4,569, and exit costs of $371 and $404 were recorded in the third quarter and first nine months of 2007, respectively, as a result of the Industrial Group s rationalization plans. During the third quarter and first nine months of 2006, exit costs of $189 and $363, respectively, were recorded as a result of the Industrial Group s rationalization plans. The company also recorded impairment charges of $592 during the third quarter and first nine months of 2006 as a result of these rationalization plans. Including rationalization costs recorded in cost of products sold and selling, administrative and general expenses, the Industrial Group has incurred cumulative pretax costs of approximately $29,444 as of September 30, 2007 for these rationalization plans.

In addition, the company recorded an impairment charge of $5,300 related to one of the Industrial Group s entities during the third quarter of 2007. The company also recorded $396 and $241 of severance and related benefits during the third quarter and first nine months of 2007, respectively, and impairment charges of $151 during the first nine months of 2007 related to other company initiatives.

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Note 12 Impairment and Restructuring Charges (continued)

Automotive

In 2005, the company announced 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 the company s Vierzon, France bearing manufacturing facility in response to changes in customer demand for its products.

In September 2006, the company announced further planned reductions in its Automotive Group workforce. In March 2007, the company announced the closure of its manufacturing facility in Sao Paulo, Brazil. The closure of the manufacturing facility in Sao Paulo, Brazil has been delayed to serve demand, driven primarily by industrial markets, until further notice.

These plans are targeted to collectively deliver annual pretax savings of approximately $75,000 by the fourth quarter of 2008, with expected net workforce reductions of approximately 1,300 to 1,400 positions and pretax costs of approximately $115,000 to $125,000, which include restructuring costs and rationalization costs recorded in cost of products sold and selling, administrative and general expenses. The Automotive Group has incurred cumulative pretax costs of approximately $93,972 as of September 30, 2007 for these plans.

During the third quarter and first nine months of 2007, the company recorded $794 and $10,449, respectively, of severance and related benefit costs and $63 and $2,192, respectively, of exit costs associated with the Automotive Group s restructuring and workforce reduction plans. The exit costs recorded during the first nine months of 2007 were primarily the result of environmental charges related to the closure of a manufacturing facility in Sao Paulo, Brazil. The company also recorded impairment charges of $1,600 during the third quarter and first nine months of 2007 as a result of the Automotive Group s restructuring and workforce reduction plans. The company recorded severance and related benefit costs of $1,647 and exits costs of a negative $231 during the third quarter of 2006. The company recorded impairment charges of $689, severance and related benefit costs of $8,248 and exits costs of $814 during the first nine months of 2006. The charges taken during the respective periods of 2006 related to the closure of a manufacturing facility in Clinton, South Carolina and administrative and engineering facilities in Torrington, Connecticut and Norcross, Georgia, and the rationalization of the company s Vierzon, France bearing manufacturing facility.

The company also recorded $396 of severance and related benefits during the third quarter and first nine months of 2007 related to other company initiatives.

Steel

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

The company also recorded $181 and $241 of severance and related benefits during the third quarter and first nine months of 2007, respectively, related to other company initiatives. During the third quarter of 2006, the company recorded an impairment charge of $485 related to the write-down of property, plant and equipment at one of the Steel Group s facilities.

The rollforward of the consolidated restructuring accrual is as follows:

	September 30, 2007	December 31, 2006
Beginning balance, January 1	**$ 31,985**	$ 18,143
Expense	**21,316**	29,614
Payments	**(28,660)**	(15,772)
Ending balance	**$ 24,641**	$ 31,985

The restructuring accrual at September 30, 2007 and December 31, 2006 was included in accounts payable and other liabilities on the Consolidated Balance Sheet. The majority of the accrual balance at September 30, 2007 is expected to be paid by the middle of 2008.

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Note 13 Retirement and Postretirement Benefit Plans

The following table sets forth the net periodic benefit cost for the company s retirement and postretirement benefit plans. The amounts for the three and nine months ended September 30, 2007 are based on actuarial calculations prepared during 2006. Consistent with prior years, these calculations will be updated later in the year. These updated calculations may result in different net periodic benefit cost for 2007. The net periodic benefit cost recorded for the three and nine months ended September 30, 2007 is the company s best estimate of each period s proportionate share of the amounts to be recorded for the year ended December 31, 2007.

	Pension Three Months ended September 30,		Postretirement Three Months ended September 30,	
	2007	2006	**2007**	2006
Components of net periodic benefit cost				
Service cost	**$ 10,402**	$ 11,388	**$ 1,215**	$ 1,327
Interest cost	**38,919**	39,562	**10,341**	11,066
Expected return on plan assets	**(47,512)**	(43,546)		
Amortization of prior service cost	**2,837**	3,122	**(469)**	(486)
Recognized net actuarial loss	**11,872**	14,540	**2,762**	3,060
Amortization of transition asset	**(46)**	(43)		
Net periodic benefit cost	**$ 16,472**	$ 25,023	**$13,849**	$14,967

	Pension Nine Months Ended September 30,		Postretirement Nine Months Ended September 30,	
	2007	2006	**2007**	2006
Components of net periodic benefit cost				
Service cost	**$ 31,098**	$ 34,081	**$ 3,646**	$ 3,982
Interest cost	**116,394**	118,311	**31,023**	33,197
Expected return on plan assets	**(142,156)**	(130,279)		
Amortization of prior service cost	**8,494**	9,364	**(1,408)**	(1,456)
Recognized net actuarial loss	**35,545**	43,511	**8,286**	9,179
Amortization of transition asset	**(130)**	(129)		
Net periodic benefit cost	**$ 49,245**	$ 74,859	**$41,547**	$44,902

Effective November 30, 2006, the company sold its Latrobe Steel subsidiary. As part of the sale, Latrobe Steel retained responsibility for the pension and postretirement benefit obligations with respect to current and retired employees covered by collective bargaining arrangements. The net periodic benefit cost for the third quarter and first nine months of 2006 includes $1,165 and $3,495, respectively, for defined benefit pension and postretirement plans retained by Latrobe Steel classified as discontinued operations.

Note 14 Income Taxes

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	**2007**	2006

Provision for income taxes	**$15,066**	$17,749	**$42,914**	$67,049
Effective tax rate	**26.8%**	31.4%	**20.1%**	29.4%

The company s provision for income taxes in interim periods is computed by applying an estimated annual effective tax rate against income from continuing operations before income taxes for the period. In addition, non-recurring or discrete items, including interest on prior year tax liabilities, are recorded during the period in which they occur.

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Note 14 Income Taxes (continued)
The effective tax rate for the third quarter of 2007 was lower than the U.S. Federal statutory tax rate primarily due to (1) earnings of certain foreign subsidiaries being taxed at a rate less than 35%, (2) the U.S. manufacturing deduction, (3) a tax benefit on the divesture of a foreign joint venture in the third quarter of 2007, and (4) other tax benefit items, including an adjustment to the company s deferred tax assets to reflect a state tax law change and the U.S. research tax credit. These benefits were partially offset by (1) the inability to record a tax benefit for losses at certain foreign subsidiaries, (2) U.S. state and local income taxes, (3) taxes incurred on foreign remittances and (4) other tax expense items.

For the third quarter of 2006, the effective tax rate was lower than the U.S. federal statutory tax rate primarily due to (1) earnings of certain foreign subsidiaries being taxed at a rate less than 35%, (2) tax benefits on U.S. exports, and (3) other tax benefit items. These benefits were partially offset by (1) U.S. state and local income taxes, (2) taxes incurred on foreign remittances, (3) the inability to record a tax benefit for losses at certain foreign subsidiaries and (4) other tax expense items.

The decrease in the effective tax rate in the third quarter of 2007 compared to the third quarter of 2006 was primarily caused by a tax benefit realized upon divestiture of a foreign joint venture in the third quarter of 2007, a favorable deferred tax adjustment to reflect a U.S. state tax law change in the third quarter of 2007, and increased U.S. research tax credits in 2007. These benefits were partially offset by increased losses in 2007 at certain foreign subsidiaries where no tax benefit could be claimed.

The effective tax rate for the first nine months of 2007 was lower than the U.S. Federal statutory tax rate primarily due to (1) the net tax benefit of adjustments to the company s accruals for uncertain tax positions, including a favorable adjustment of $32,100 recorded in the first quarter of 2007 to recognize the benefit of a prior year tax position as a result of a change in tax law, (2) earnings of certain foreign subsidiaries being taxed at a rate less than 35%, (3) the U.S. manufacturing deduction, and (4) other tax benefit items. These additional tax benefits were partially offset by (1) the inability to record a tax benefit for losses at certain foreign subsidiaries, (2) U.S. state and local income taxes, (3) taxes incurred on foreign remittances and (4) other tax expense items.

For the first nine months of 2006, the effective tax rate was lower than the U.S. federal statutory tax rate primarily due to (1) earnings of certain foreign subsidiaries being taxed at a rate less than 35%, (2) tax benefits on U.S. exports, and (3) other tax benefit items. These benefits were partially offset by (1) U.S. state and local income taxes, (2) taxes on foreign remittances, (3) the inability to record a tax benefit for losses at certain foreign subsidiaries and (4) other tax expense items.

The decrease in the effective tax rate for the first nine months of 2007 compared to the first nine months of 2006 was primarily caused by a $32,100 tax benefit recorded in the first quarter of 2007 to recognize the benefit of a prior year tax position as a result of a change in tax law, as well as the third quarter items described above. These benefits were partially offset by increased losses in 2007 at certain foreign subsidiaries where no tax benefit could be claimed.

In July 2007, the Governor of Michigan signed into law the Michigan Business Tax Act (Public Act 36 of 2007), creating the Michigan Business Tax (MBT). The MBT will be effective January 1, 2008 and replaces the Michigan Single Business Tax, which was recorded as a component of pre-tax income. The MBT will be recorded as a component of income tax expense. The company adjusted its deferred taxes in the third quarter of 2007 to reflect the new income tax. The company anticipates that the new MBT will increase the company s state effective tax rate and overall expense for 2008 and subsequent tax years, but the amount is not expected to be material.

Effective January 1, 2007, the company adopted FIN 48, including the provisions of FASB Staff Position No. FIN 48-1, Definition of Settlement in FASB Interpretation No. 48. In connection therewith, the company recorded a $5,623 increase to retained earnings to recognize net tax benefits under the recognition and measurement criteria of FIN 48 that were previously not recognized under the company s former accounting policy. The company records interest and penalties related to uncertain tax positions as a component of income tax expense. As of January 1, 2007, the company had approximately $7,800 of accrued interest and penalties related to uncertain tax positions. As of January 1, 2007, the company had approximately $137,300 of total gross unrecognized tax benefits.

During the first quarter of 2007, the company s unrecognized tax benefits decreased by $29,800 (excluding interest), as the company recognized a tax benefit related to a prior year tax position due to a change in tax law in the quarter. The tax position relates to one of the company s foreign affiliates and was not anticipated as of the beginning of the year.

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Note 14 Income Taxes (continued)

As of September 30, 2007, the company had approximately $111,200 of total gross unrecognized tax benefits. Included in this amount is approximately $34,700 (including the federal benefit on state tax positions), which represents the amount of unrecognized tax benefits that would favorably impact the company s effective income tax rate in any future periods if such benefits were recognized. As of September 30, 2007, the company anticipates a decrease in its unrecognized tax positions of approximately $70,000 to $75,000 during the next 12 months. The anticipated decrease is primarily due to settlements and resulting cash payments related to tax years 2002 through 2005, which are currently under examination by the IRS. The tax positions under examination include the timing of income recognition for certain amounts received by the company and treated as capital contributions pursuant to Internal Revenue Code Section 118 and other miscellaneous items. As of September 30, 2007, the company had accrued approximately $6,400 of interest and penalties related to uncertain tax positions.

Note 15 Divestitures

In December 2006, the company completed the divestiture of its subsidiary, Latrobe Steel. Latrobe Steel is a leading global producer and distributor of high-quality, vacuum melted specialty steels and alloys. This business was part of the Steel Group for segment reporting purposes. The following results of operations for this business have been classified as discontinued operations for all periods presented.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	**2007**	2006
Net sales	**$**	$86,960	**$**	$265,583
Earnings before income taxes		12,574		42,413
Income tax on operations		(4,715)		(15,905)
Gain on divestiture			**1,098**	
Income tax on disposal			**(433)**	
Income from discontinued operations, net of income taxes	**$**	$ 7,859	**$ 665**	$ 26,508

The gain on divestiture recorded in the first nine months of 2007 primarily represents a purchase price adjustment. As of December 31, 2006, there were no assets or liabilities remaining from the divestiture of Latrobe Steel.

In June 2006, the company completed the divestiture of its Timken Precision Components Europe business. This business was part of the Steel Group. The company recognized a pretax loss on divestiture of $9,971 and the loss was reflected in Loss on divestitures in the Consolidated Statement of Income.

Note 16 Subsequent Events

On October 23, 2007, the company announced the acquisition of the assets of The Purdy Corporation, a leading precision manufacturer and systems integrator for military and commercial aviation customers, for $200,000. The Purdy Corporation s expertise includes design, manufacturing, testing, overhaul and repair of transmissions, gears, rotor-head systems and other high-complexity components for helicopter and fixed-wing aircraft platforms. The Purdy Corporation is based in Manchester, Connecticut, employs more than 200 people and had 2006 sales of approximately $87,000.

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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

Overview:

(Dollars in millions, except earnings per share)	**3Q 2007**	3Q 2006	$ Change	% Change
Net sales	**$ 1,261.2**	$ 1,186.0	$ 75.2	6.3%
Income from continuing operations	**41.2**	38.7	2.5	6.5%
Income from discontinued operations		7.8	(7.8)	(100.0)%
Net income	**$ 41.2**	$ 46.5	(5.3)	(11.4)%
Diluted earnings per share:				
Continuing operations	**$ 0.43**	$ 0.41	$ 0.02	4.9%
Discontinued operations		0.08	(0.08)	(100.0)%
Net income per share	**$ 0.43**	$ 0.49	$(0.06)	(12.2)%
Average number of shares diluted	**96,095,860**	94,376,937		1.8%

(Dollars in millions, except earnings per share)	**YTD 2007**	YTD 2006	$ Change	% Change
Net sales	**$ 3,895.0**	$ 3,742.4	$152.6	4.1%
Income from continuing operations	**171.1**	160.7	10.4	6.5%
Income from discontinued operations	**0.7**	26.5	(25.8)	(97.4)%
Net income	**$ 171.8**	$ 187.2	(15.4)	(8.2)%
Diluted earnings per share:				
Continuing operations	**$ 1.79**	$ 1.70	$ 0.09	5.3%
Discontinued operations	**0.01**	0.29	(0.28)	(96.6)%
Net income per share	**$ 1.80**	$ 1.99	$ (0.19)	(9.5)%
Average number of shares diluted	**95,483,420**	94,238,413		1.3%

Net sales for the third quarter of 2007 were approximately $1.26 billion, compared to $1.19 billion in the third quarter of 2006, an increase of 6.3%. Net sales for the first nine months of 2007 were approximately $3.90 billion, compared to $3.74 billion for the first nine months of 2006, an increase of 4.1%. Higher sales were driven by continued strong industrial markets across the Industrial and Steel Groups, offset by lower sales in the Automotive Group due to the divestiture of its steering operations in 2006. In December 2006, the company completed the divestiture of its Latrobe Steel subsidiary. Discontinued operations for the third quarter and first nine months of 2006 represent the operating results, net of tax, of Latrobe Steel. For the third quarter of 2007, earnings per diluted share were $0.43, compared to $0.49 per diluted share for third quarter of 2006. Income from continuing operations per diluted share was $0.43 for the third quarter of 2007, compared to $0.41 per diluted share for the third quarter of 2006. For the first nine months of 2007, earnings per diluted share were $1.80, compared to $1.99

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

per diluted share for the first nine months of 2006. Income from continuing operations per diluted share was $1.79 for the first nine months of 2007, compared to $1.70 per diluted share for the same period a year ago.

The company s results for the third quarter and first nine months of 2007 reflect the ongoing strength of industrial markets and the performance of the Steel Group, partially offset by higher raw material costs, higher manufacturing costs and restructuring activities. 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 that the continued strength in industrial markets throughout 2007 should drive year-over-year volume increases. While global industrial markets are expected to remain strong, the improvements in the company s operating performance will be partially constrained by restructuring initiatives, as well as strategic investments, including Asian growth and Project O.N.E. initiatives. The objective of the Asian growth initiatives is to increase market share, influence major design centers and expand the company s network of sources of globally competitive friction management products.

Project O.N.E. is a five-year program, which began in 2005, designed to improve the company s business processes and systems. The company expects to invest approximately $170 million, which includes internal and external costs, to implement Project O.N.E. As of September 30, 2007, the company has incurred approximately $140 million, of which approximately $81 million has been capitalized to the Consolidated Balance Sheet. The company completed the installation of Project O.N.E. for a major portion of its domestic operations during the second quarter of 2007.

The company s results for the first nine months of 2007 also reflect a favorable discrete tax adjustment of $32.1 million to recognize the benefits of a prior year tax position due to a change in tax law.

The company s strategy for the Industrial Group is to pursue growth in selected industrial markets and achieve a leadership position in targeted Asian sectors. The company is increasing large-bore bearing capacity in Romania, China, India and the United States to serve heavy industrial markets. The Industrial Group expects to benefit from this increase in large-bore bearing capacity during the remainder of 2007, as well as in 2008. In addition, the company is investing in a new aerospace precision products manufacturing facility in China, which is expected to make its first shipment in early 2008. In October 2007, the company completed the acquisition of The Purdy Corporation, located in Manchester, Connecticut, for $200 million. This acquisition further expands the growing range of power-transmission products and capabilities that the company provides to the aerospace market.

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 announced 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. 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. In March 2007, the company announced the closure of its manufacturing facility in Sao Paulo, Brazil. The closure of the manufacturing facility in Sao Paulo, Brazil has been delayed to serve demand, driven primarily by industrial markets, until further notice.

These plans are targeted to collectively deliver annual pretax savings of approximately $75 million by the fourth quarter of 2008, with expected net workforce reductions of approximately 1,300 to 1,400 positions and pretax costs of approximately $115 million to $125 million, which include restructuring costs and rationalization costs recorded in cost of products sold and selling, administrative and general expenses.

In December 2006, the company completed the divestiture of its steering operations located in Watertown, Connecticut and Nova Friburgo, Brazil. The steering operations 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 January 2007, the company announced plans to invest approximately $60 million to enable the company to competitively produce steel bars down to 1-inch

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

diameter for use in power transmission and friction management applications for a variety of customers, including the rapidly growing automotive transplants. During the first quarter of 2007, the company added a new induction heat-treat line in Canton, Ohio, which increased capacity and the ability to provide differentiated product to more customers in its global energy markets. In April 2007, the company completed the closure of its seamless steel tube manufacturing operations located in Desford, England.

The Statement of Income

Sales by Segment:

(Dollars in millions, and exclude intersegment sales)	**3Q 2007**	3Q 2006	$ Change	% Change
Industrial Group	**$ 556.2**	$ 501.4	$54.8	10.9%
Automotive Group	**361.0**	363.6	(2.6)	(0.7)%
Steel Group	**344.0**	321.0	23.0	7.2%
Total Company	**$1,261.2**	$1,186.0	$75.2	6.3%

(Dollars in millions, and exclude intersegment sales)	**YTD 2007**	YTD 2006	$ Change	% Change
Industrial Group	**$1,665.7**	$1,533.4	$132.3	8.6%
Automotive Group	**1,156.2**	1,211.3	(55.1)	(4.5)%
Steel Group	**1,073.1**	997.7	75.4	7.6%
Total Company	**$3,895.0**	$3,742.4	$152.6	4.1%

The Industrial Group s net sales in the third quarter of 2007 increased from the third quarter of 2006 as a result of favorable pricing, higher volume across most end markets, particularly in the off-highway, aerospace, heavy industry and rail market sectors, as well as the favorable impact of foreign currency translation on sales. The Automotive Group s net sales in the third quarter of 2007 decreased slightly from the third quarter of 2006 primarily due to the divestiture of its steering operations located in Watertown, Connecticut and Nova Friburgo, Brazil and lower demand from North American heavy truck customers, partially offset by higher demand from North American light truck customers, higher demand in Europe and the favorable impact of foreign currency translation. The Steel Group s net sales in the third quarter of 2007 increased from the same period a year ago primarily due to strong demand across all market sectors, particularly in the energy and automotive sectors, as well as increased surcharges to recover high raw material costs, partially offset by the decline in sales resulting from the closure of its manufacturing operations in Desford, England in April 2007.

The Industrial Group s net sales in the first nine months of 2007 increased from the first nine months of 2006 as a result of favorable pricing, higher volume across most end markets, particularly in the heavy industry, automotive aftermarket and aerospace sectors, and the favorable impact of foreign currency translation on sales. The Automotive Group s net sales in the first nine months of 2007 decreased from the first nine months of 2006 primarily due to the divestiture of its steering operations and lower demand from North American heavy truck customers, partially offset by the favorable impact of foreign currency translation on sales. The Steel Group s net sales in the first nine months of 2007 increased from the same period a year ago primarily due to strong demand by customers in the energy and automotive market sectors, as well as increased pricing and surcharges to recover high raw material costs, partially offset by lower sales resulting from the sale of its Timken Precision Steel Components Europe business and the closure of its manufacturing operations in Desford, England.

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

Gross Profit:

(Dollars in millions)	**3Q 2007**	3Q 2006	$ Change	Change
Gross profit	**$251.3**	$232.4	$18.9	8.1%