

REGAL BELOIT CORP  
Form 10-Q  
May 04, 2007

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

FORM 10-Q

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

for the quarterly period ended  
March 31, 2007

or

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

Commission file number  
001-07283

**REGAL-BELOIT CORPORATION**  
(Exact name of registrant as specified in its charter)

Wisconsin  
(State of other jurisdiction of  
incorporation)

39-0875718  
(IRS Employer Identification  
No.)

200 State Street, Beloit, Wisconsin 53511  
(Address of principal executive office)

(608) 364-8800  
Registrant’s telephone number, including area code

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

Indicate by check mark whether the registrant 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. (Check one):

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 ✓

**31,957,525 Shares, Common Stock, \$.01 Par Value (as of April 30, 2007)**

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## REGAL BELOIT CORPORATION

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## CAUTIONARY STATEMENT

**This Quarterly Report contains “forward-looking statements” as defined in the Private Securities Litigation Reform Act of 1995.** Forward-looking statements represent our management’s judgment regarding future events. In many cases, you can identify forward-looking statements by terminology such as “may,” “will,” “plan,” “expect,” “anticipate,” “estimate,” “believe,” or “continue” or the negative of these terms or other similar words. Actual results and events could differ materially and adversely from those contained in the forward-looking statements due to a number of factors, including:

- economic changes in global markets where we do business, such as currency exchange rates, inflation rates, interest rates, recession, foreign government policies and other external factors that we cannot control;
  - unanticipated fluctuations in commodity prices and raw material costs;
  - cyclical downturns affecting the global market for capital goods;
- unexpected issues and costs arising from the integration of acquired companies and businesses;
- marketplace acceptance of new and existing products including the loss of, or a decline in business from, any significant customers;
  - the impact of capital market transactions that we may effect;
  - the availability and effectiveness of our information technology systems;
    - unanticipated costs associated with litigation matters;
    - actions taken by our competitors;
  - difficulties in staffing and managing foreign operations;
- other risks and uncertainties including but not limited to those described in **Item 1A-Risk Factors** of the Company’s Annual Report on Form 10-K filed on February 28, 2007 and from time to time in our reports filed with U.S. Securities and Exchange Commission.

All subsequent written and oral forward-looking statements attributable to us or to persons acting on our behalf are expressly qualified in their entirety by the applicable cautionary statements. The forward-looking statements included in this Form 10-Q are made only as of their respective dates, and we undertake no obligation to update these statements to reflect subsequent events or circumstances. See also **Item 1A - Risk Factors** in the Company's Annual Report on Form 10-K filed on February 28, 2007.

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**PART I - FINANCIAL INFORMATION**  
**REGAL BELOIT CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS**  
(In Thousands of Dollars, Except Per Share Data)

**ITEM I. FINANCIAL STATEMENTS**

|  | (Unaudited)           |               |
|--|-----------------------|---------------|
|  | Three Months Ended    |               |
|  | <b>March 31, 2007</b> | April 1, 2006 |
| Net Sales  | \$ 418,646            | \$ 398,326    |
| Cost of Sales  | 321,419               | 305,046       |
| Gross Profit   | 97,227                | 93,280        |
| Operating Expenses                                       | 49,896                | 49,662        |
| Income From Operations                                   | 47,331                | 43,618        |
| Interest Expense   | 5,066                 | 4,795         |
| Interest Income  | 89                    | 120           |
| Income Before Taxes & Minority Interest                  | 42,354                | 38,943        |
| Provision For Income Taxes                               | 14,690                | 14,342        |
| Income Before Minority Interest                          | 27,664                | 24,601        |
| Minority Interest in Income, Net of Tax                  | 851                   | 813           |
| Net Income   | \$ 26,813             | \$ 23,788     |
| Per Share of Common Stock:                               |                       |               |
| Earnings Per Share - Basic                               | \$ .87                | \$ .77        |
| Earnings Per Share - Assuming Dilution                   | \$ .80                | \$ .72        |
| Cash Dividends Declared                                  | \$ .14                | \$ .13        |
| Average Number of Shares Outstanding - Basic             | 30,814,312            | 30,700,533    |
| Average Number of Shares Outstanding - Assuming Dilution | 33,547,519            | 32,957,209    |

*See accompanying notes to Condensed Consolidated Financial Statements.*



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**REGAL BELOIT CORPORATION**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(In Thousands of Dollars)

|   | (Unaudited)<br>March 31,<br>2007 | (From Audited<br>Statements)<br>December 30, 2006 |
|---|----------------------------------|---|
| <b>ASSETS</b>   |                                  |   |
| Current Assets:   |                                  |   |
| Cash and Cash Equivalents   | \$ 43,086                        | \$ 36,520   |
| Receivables, less Allowances for<br>Doubtful Accounts of<br>\$6,989 in 2007 and \$5,886 in 2006 | 261,322                          | 218,036   |
| Inventories   | 269,488                          | 275,138   |
| Prepaid Expenses and Other Current<br>Assets  | 17,043                           | 22,557  |
| Future Income Tax Benefits  | 24,783                           | 22,877  |
| Total Current Assets  | 615,722                          | 575,128   |
| Property, Plant and Equipment:  |                                  |   |
| Land and Improvements   | 18,232                           | 18,400  |
| Buildings and Improvements  | 105,546                          | 105,425   |
| Machinery and Equipment   | 371,749                          | 360,674   |
| Property, Plant and Equipment, at Cost  | 495,527                          | 484,499   |
| Less - Accumulated Depreciation   | (222,503)                        | (215,619)   |
| Net Property, Plant and Equipment   | 273,024                          | 268,880   |
| Goodwill  | 546,187                          | 546,152   |
| Intangible Assets, net of Amortization  | 41,803                           | 43,257  |
| Other Noncurrent Assets   | 9,107                            | 10,102  |
| Total Assets  | \$ 1,485,843                     | \$ 1,443,519                                      |
| <b>LIABILITIES AND SHAREHOLDERS' INVESTMENT</b>   |                                  |   |
| Current Liabilities:  |                                  |   |
| Accounts Payable  | \$ 120,377                       | \$ 108,050  |
| Commercial Paper Borrowings   | 49,125                           | 49,000  |
| Dividends Payable   | 4,365                            | 4,345   |
| Accrued Compensation and Employee<br>Benefits   | 53,179                           | 51,192  |
| Other Accrued Expenses  | 38,369                           | 45,578  |
| Current Maturities of Debt  | 9,557                            | 376   |
| Total Current Liabilities   | 274,972                          | 258,541   |
| Long-Term Debt  | 323,542                          | 323,946   |
| Deferred Income Taxes   | 66,732                           | 65,937  |
| Other Noncurrent Liabilities  | 10,959                           | 12,302  |
| Minority Interest in Consolidated<br>Subsidiaries   | 10,517                           | 9,634   |
|   | 24,291                           | 23,184  |

Pension and other Postretirement  
Benefits

## Shareholders' Investment:

Common Stock, \$.01 par value,  
50,000,000 shares authorized,

31,949,275 issued in 2007 and

31,812,043 issued in 2006

|  |            |     |
|--|------------|-----|
|  | <b>319</b> | 318 |
|--|------------|-----|

|                            |                |         |
|----------------------------|----------------|---------|
| Additional Paid-In Capital | <b>331,140</b> | 329,142 |
|----------------------------|----------------|---------|

Less-Treasury Stock, at cost, 774,100  
shares in 2007 and 2006

|  |                 |          |
|--|-----------------|----------|
|  | <b>(15,228)</b> | (15,228) |
|--|-----------------|----------|

|                   |                |         |
|-------------------|----------------|---------|
| Retained Earnings | <b>457,860</b> | 435,971 |
|-------------------|----------------|---------|

Accumulated Other Comprehensive

|               |            |       |
|---------------|------------|-------|
| Income (Loss) | <b>739</b> | (228) |
|---------------|------------|-------|

|                                |                |         |
|--------------------------------|----------------|---------|
| Total Shareholders' Investment | <b>774,830</b> | 749,975 |
|--------------------------------|----------------|---------|

Total Liabilities and Shareholders'

|            |                     |              |
|------------|---------------------|--------------|
| Investment | <b>\$ 1,485,843</b> | \$ 1,443,519 |
|------------|---------------------|--------------|

*See accompanying notes to Condensed Consolidated Financial Statements.*

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**REGAL BELOIT CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In Thousands of Dollars)

|   | (Unaudited)        |               |
|---|--------------------|---------------|
|   | Three Months Ended |               |
|   | March 31, 2007     | April 1, 2006 |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>  |                    |               |
| Net income  | \$ 26,813          | \$ 23,788     |
| Adjustments to reconcile net income to net cash provided by operating activities; net of effect of acquisitions |                    |               |
| Depreciation and amortization   | 9,883              | 8,115         |
| Minority interest   | 851                | 813           |
| Excess tax benefit from stock-based compensation  | (3,310)            | (450)         |
| Loss (gain) on sale of assets   | 8                  | (8)           |
| Stock-based compensation expense  | 865                | 867           |
| Change in assets and liabilities, net   | (24,703)           | (35,377)      |
| Net cash provided by (used in) operating activities   | 10,407             | (2,252)       |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>  |                    |               |
| Additions to property, plant and equipment  | (12,163)           | (7,257)       |
| Purchases of short-term investments   | -                  | (4,225)       |
| Business acquisitions, net of cash acquired   | (565)              | (565)         |
| Sale of property, plant and equipment   | -                  | 5,207         |
| Net cash (used) in investing activities   | (12,728)           | (6,840)       |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>  |                    |               |
| Proceeds from short-term borrowing  | 9,200              | -             |
| Payments of long-term debt  | (225)              | (197)         |
| Net (repayments) borrowings under revolving credit facility   | (200)              | 3,500         |
| Proceeds from commercial paper borrowings, net  | 125                | 5,000         |
| Dividends paid to shareholders  | (4,345)            | (3,985)       |
| Proceeds from the exercise of stock options   | 747                | 1,363         |
| Excess tax benefits from stock-based compensation   | 3,310              | 450           |
| Net cash provided by financing activities   | 8,612              | 6,131         |
| <b>EFFECT OF EXCHANGE RATE ON CASH</b>  | <b>275</b>         | <b>(66)</b>   |
| Net increase (decrease) in cash and cash equivalents  | 6,566              | (3,027)       |
| Cash and cash equivalents at beginning of period  | 36,520             | 32,747        |
| Cash and cash equivalents at end of period  | \$ 43,086          | \$ 29,720     |

**SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:**

Cash paid for:

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|              |    |              |    |               |
|--------------|----|--------------|----|---------------|
| Interest     | \$ | <b>5,933</b> | \$ | <b>5,436</b>  |
| Income taxes | \$ | <b>9,343</b> | \$ | <b>19,898</b> |

*See accompanying notes to Condensed Consolidated Financial Statements.*

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**REGAL BELOIT CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**March 31, 2007**  
**(Unaudited)**

**1. BASIS OF PRESENTATION**

The accompanying (a) condensed balance sheet as of December 30, 2006, which has been derived from audited financial statements, and (b) unaudited interim condensed financial statements as of March 31, 2007 have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States has been condensed or omitted pursuant to those rules and regulations, although the Company believes that the disclosures made are adequate to make the information not misleading.

It is suggested that these condensed financial statements be read in conjunction with the financial statements and the notes thereto included in the Company's Annual Report on Form 10-K filed on February 28, 2007.

In the opinion of management, all adjustments considered necessary for a fair presentation of financial results have been made. Except as otherwise discussed, such adjustments consist of only those of a normal recurring nature. Operating results for the three months ended March 31, 2007 are not necessarily indicative of the results that may be expected for the entire fiscal year ending December 29, 2007.

**2. SHORT-TERM INVESTMENTS**

Short-term marketable investments include investments with maturities of greater than three months and less than one year. Such marketable investments were classified as available-for-sale and are reported at fair market value and classified within Prepaid Expenses and Other Current Assets. Mark-to-market gains on such investments are not material.

**3. INVENTORIES**

Cost for approximately 83% of the Company's inventory is determined using the last-in, first-out (LIFO) inventory valuation method. The approximate percentage distribution between major classes of inventories was as follows:

|  | <u>March</u><br><u>31, 2007</u> | <u>December</u><br><u>30, 2006</u> |
|--|---------------------------------|------------------------------------|
| Raw Material                             | 11%                             | 11%                                |
| Work-in Process                          | 20%                             | 21%                                |
| Finished Goods<br>and Purchased<br>Parts | 69%                             | 68%                                |

**4. COMPREHENSIVE INCOME**

The Company's comprehensive income for the first quarter of 2007 and 2006 was as follows:

| (In Thousands of Dollars) |                  |
|---------------------------|------------------|
| First Quarter Ending      |                  |
| <b>March 31, 2007</b>     | April 1,<br>2006 |

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|  |    |               |    |         |
|--|----|---------------|----|---------|
| Net income as reported   | \$ | <b>26,813</b> | \$ | 23,788  |
| Comprehensive income (loss) from:  |    |               |    |         |
| Additional Pension Liability, net of tax   |    | -             |    | (13)    |
| Cumulative translation adjustments   |    | <b>802</b>    |    | 216     |
| Changes in fair value of hedging activities, net of tax  |    | <b>(944)</b>  |    | 1,987   |
| Hedging activities reclassified into earnings from accumulated other comprehensive income ("AOCI"), net of tax |    | <b>942</b>    |    | (3,395) |
| Amortization of net prior service costs and actuarial losses   |    | <b>167</b>    |    | -       |
| Comprehensive income   | \$ | <b>27,780</b> | \$ | 22,583  |

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Index**5. WARRANTY COSTS**

The Company recognizes the cost associated with its standard warranty on its products at the time of sale. The amount recognized is based on historical experience. The following is a reconciliation of the changes in accrued warranty costs for the first quarter of 2007 and 2006 (in thousands):

|                   | <b>March 31,</b> |               |
|-------------------|------------------|---------------|
|                   | 2007             | April 1, 2006 |
| Beginning balance | \$ 6,300         | \$ 5,679      |
| Deduct: Payments  | (1,614)          | (1,359)       |
| Add: Provision    | 759              | 1,332         |
| Ending balance    | 5,445            | \$ 5,652      |

**6. BUSINESS SEGMENTS**

The Company operates two strategic businesses that are reportable segments, Mechanical and Electrical (in thousands):

|                              | (Unaudited)                              |                  |  |                  |
|------------------------------|--|------------------|--|------------------|
|                              | Mechanical Segment<br>Three Months Ended |                  | Electrical Segment<br>Three Months Ended |                  |
|                              | March 31,<br>2007                        | April 1,<br>2006 | March 31,<br>2007                        | April 1,<br>2006 |
| Net Sales                    | \$ 51,846                                | \$ 52,961        | \$ 366,800                               | \$ 345,365       |
| Income from<br>Operations    | 6,326                                    | \$ 3,707         | 41,005                                   | \$ 39,911        |
| % of Net Sales               | 12.2%                                    | 7.0%             | 11.2%                                    | 11.6%            |
| Goodwill at end of<br>period | \$ 530                                   | \$ 530           | \$ 545,657                               | \$ 545,638       |

**7. GOODWILL AND OTHER INTANGIBLES**

Changes in the carrying amount of goodwill for the three months ending March 31, 2007 were as follows (in thousands):

|                                    | Electrical<br>Segment | Mechanical<br>Segment | Total      |
|------------------------------------|-----------------------|-----------------------|------------|
| Balance as of<br>December 30, 2006 | \$ 545,622            | \$ 530                | \$ 546,152 |
| Translation                        | 35                    | -                     | 35         |
| Balance as of<br>March 31, 2007    | \$ 545,657            | \$ 530                | \$ 546,187 |

Other intangible assets consisted of the following (in thousands):

**Summary of Intangible Assets with Definite Lives**

| Asset Description | Useful<br>Life (years) | Gross<br>Value | <b>March 31, 2007</b>       |                   |
|-------------------|------------------------|----------------|-----------------------------|-------------------|
|                   |                        |                | Accumulated<br>Amortization | Net Book<br>Value |

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|                        |          |           |           |           |
|------------------------|----------|-----------|-----------|-----------|
| Non-Compete Agreements | 3 - 5    | \$ 5,408  | \$ 1,683  | \$ 3,725  |
| Trademarks             | 3 - 5    | 6,652     | 3,477     | 3,175     |
| Patents                | 9 - 10.5 | 15,410    | 3,492     | 11,918    |
| Engineering Drawings   | 10       | 1,200     | 277       | 923       |
| Customer Relationships | 10       | 28,600    | 6,538     | 22,062    |
| Total                  |          | \$ 57,270 | \$ 15,467 | \$ 41,803 |

December 30, 2006

| Asset Description      | Useful Life (years) | Gross Value | Accumulated Amortization | Net Book Value |
|------------------------|---------------------|-------------|--------------------------|----------------|
| Non-Compete Agreements | 3 - 5               | \$ 5,470    | \$ 1,425                 | \$ 4,045       |
| Trademarks             | 3 - 5               | 6,490       | 3,311                    | 3,179          |
| Patents                | 9 - 10.5            | 15,410      | 3,107                    | 12,303         |
| Engineering Drawings   | 10                  | 1,200       | 247                      | 953            |
| Customer Relationships | 10                  | 28,600      | 5,823                    | 22,777         |
| Total                  |                     | \$ 57,170   | \$ 13,913                | \$ 43,257      |

Index**Estimated Amortization (in thousands)**

|             |             |             |             |             |
|-------------|-------------|-------------|-------------|-------------|
| <u>2007</u> | <u>2008</u> | <u>2009</u> | <u>2010</u> | <u>2011</u> |
| \$ 7.1      | \$ 6.3      | \$ 5.9      | \$ 5.5      | \$ 4.7      |

Amortization expense recorded for the three months ended March 31, 2007 was \$1.7 million. The Company performs an annual evaluation of goodwill and intangible assets in the fourth quarter of each fiscal year for impairment as required by SFAS 142, "Goodwill and Other Intangible Assets".

**8. DEBT AND BANK CREDIT FACILITIES**

The Company's indebtedness, excluding commercial paper borrowings, as of March 31, 2007, and December 30, 2006 was as follows (in thousands):

|                                      | <b>March 31,<br/>2007</b> | December<br>30, 2006 |
|--------------------------------------|---------------------------|----------------------|
| Revolving credit facility            | \$ 197,000                | \$ 197,200           |
| Convertible senior subordinated debt | 115,000                   | 115,000              |
| Other                                | 21,099                    | 12,122               |
|                                      | <b>333,099</b>            | 324,322              |
| Less: Current maturities             | 9,557                     | 376                  |
| Non-current portion                  | \$ 323,542                | \$ 323,946           |

At March 31, 2007, the Company maintained a \$475.0 million revolving credit facility ("Facility"). Borrowings under the Facility bear interest at 30-day LIBOR plus a borrowing spread of .75%. All Facility borrowings are subject to a pricing grid, which can result in increases or decreases to the borrowing spread on a quarterly basis, depending on the Company's leverage ratios. In addition, a non-use fee is payable quarterly on the average unused credit line under the Facility. At March 31 2007, the non-use fee was 0.15%. The Facility contains customary limits and restrictions concerning investments, sales of assets, liens on assets, interest coverage ratios, maximum leverage, and minimum net worth. As of March 31, 2007, the Company was in compliance with all debt covenants under the Facility.

There was \$49.1 million of commercial paper borrowings outstanding at March 31, 2007, all of which had original maturity terms of 90 days or less, and had a weighted interest rate of 5.45%. Total commercial paper outstanding cannot exceed \$50.0 million under the terms of the Facility. The Facility provides the liquidity backstop for outstanding commercial paper. Accordingly, the combined outstanding balances of the Facility and commercial paper cannot exceed \$475.0 million.

The Company's \$115.0 million, 2.75% convertible senior subordinated debt are convertible as the closing price of the Company's common stock exceeded the contingent conversion share price of \$33.23 for the specified amount of time. As a result, holders of the notes may surrender the notes for conversion at any time until the maturing of the bonds in March 2024. Holders that exercise their right to convert the notes will receive up to the principal amount in cash, with the balance of the conversion obligation, if any, to be satisfied in shares of Company common stock or cash, at the Company's discretion. No notes have been converted into cash or shares of common stock as of March 31, 2007.

During the quarter ended March 31, 2007, a foreign subsidiary of the Company borrowed a total of \$9.2 million denominated in U.S. dollars. The borrowings were made under a \$15.0 million unsecured credit facility which expires in December, 2008. The notes are all short term and bear interest at a margin over LIBOR.

**9. PENSION PLANS**

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As of December 30, 2006, the Company adopted SFAS No. 158, “*Employer’s Accounting for Defined Benefit Pension and Other Postretirement Plans.*” The Company’s net periodic pension cost is comprised of the following components:

|                                    | (In Thousands)            |                  |
|------------------------------------|---------------------------|------------------|
|                                    | First Quarter Ending      |                  |
|                                    | <b>March 31,<br/>2007</b> | April 1,<br>2006 |
| Service cost                       | \$ 1,207                  | \$ 940           |
| Interest cost                      | 1,267                     | 1,140            |
| Expected return on plan assets     | (1,283)                   | (1,225)          |
| Amortization of prior service cost | 32                        | 123              |
| Amortization of net actuarial loss | 239                       | 2,302            |
| Net periodic benefit expense       | \$ 1,462                  | \$ 3,279         |

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The estimated net actuarial loss and prior service cost for defined benefit pension plans that will be amortized from accumulated other comprehensive income into net periodic benefit cost during the 2007 fiscal year are \$1.0 million and \$0.1 million, respectively.

In both the first quarter of 2007 and 2006, the Company contributed \$0.1 million to defined benefit pension plans. The Company expects to contribute an additional \$1.1 million, for total contributions of \$1.2 million in 2007. The Company contributed a total of \$3.0 million in 2006. The assumptions used in the valuation of the Company's pension plans and in the target investment allocation have remained the same as those disclosed in the Company's Annual Report on Form 10-K filed on February 28, 2007.

**10. SHAREHOLDERS' INVESTMENT**

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards SFAS 123(R), *Share-Based Payment*, using the modified prospective application transition method.

During the three months ended March 31, 2007 and April 1, 2006, the Company recognized approximately \$0.9 million in share-based compensation expense. The total income tax benefit recognized relating to share-based compensation for the three months ended March 31, 2007 and April 1, 2006 was approximately \$3.3 and \$0.4 million, respectively. The Company recognizes compensation expense on grants of share-based compensation awards on a straight-line basis over the vesting period of each award recipient. As of March 31, 2007, total unrecognized compensation cost related to share-based compensation awards was approximately \$9.1 million, net of estimated forfeitures, which the Company expects to recognize over a weighted average period of approximately 2.7 years.

Under the Company's 1998 and 2003 stock plans, the Company was authorized as of March 31, 2007 to deliver up to 2.5 million shares of common stock upon exercise of non-qualified stock options or incentive stock options, or upon grant or in payment of stock appreciation rights, performance shares, performance units and restricted stock. Approximately 0.4 million shares were available for future grant or payment under the various plans at March 31, 2007.

**Share-based Incentive Awards**

The Company uses several forms of share-based incentive awards, including non-qualified stock options, incentive stock options and stock appreciation rights (SAR's). All grants are made at prices equal to the fair market value of the stock on the grant dates, and expire ten years from the grant date.

The per share weighted average fair value of stock options granted during the three months ended March 31, 2007 and April 1, 2006 was \$18.11 and \$12.60, respectively. The Company estimated the fair value of each stock option on the date of grant using the Black-Scholes pricing model and the following assumptions:

|                                       | Three Months<br>Ended |                  |
|---------------------------------------|-----------------------|------------------|
|                                       | March<br>31,<br>2007  | April 1,<br>2006 |
| Average<br>risk-free<br>interest rate | 4.6%                  | 4.5%             |
| Expected<br>dividend                  | 1.2%                  | 1.4%             |

|              |       |       |
|--------------|-------|-------|
| yield        |       |       |
| Expected     | 32.0% | 27.0% |
| volatility   |       |       |
| Average      |       |       |
| expected     |       |       |
| term (years) |       |       |
| Options      | NA    | 8.0   |
| SAR's        | 7.0   | 5.0   |

The average risk-free interest rate is based on U.S. Treasury security rates in effect as of the grant date. The expected dividend yield is based on the projected annual dividend as a percentage of the estimated market value of the Company's common stock as of the grant date. The Company determined expected volatility using a weighted average of daily historical volatility of the Company's stock price over the expected term of the award. The Company determined the expected term of the stock options using historical data adjusted for the estimated exercise dates of unexercised options.

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A summary of stock option activity (options and SAR's) during the three months ended March 31, 2007 is as follows:

|                                    | Shares    | Wtd. Avg.<br>Exercise<br>Price | Wtd. Avg.<br>Remaining<br>Contractual<br>Term (years) | Aggregate<br>Intrinsic<br>Value<br>(in millions) |
|------------------------------------|-----------|--------------------------------|---|--|
| Number of shares under option:     |           |                                |   |  |
| Outstanding at beginning of period | 1,602,725 | \$ 26.64                       |   |  |
| Granted                            | 140,000   | 48.05                          |   |  |
| Exercised                          | (31,050)  | 24.07                          |   |  |
| Forfeited                          | (2,250)   | 33.35                          |   |  |
| Outstanding at end of period       | 1,709,425 | 28.44                          | 5.0   | \$ 32.1  |
| Exercisable at end of period       | 1,085,466 | \$ 24.16                       | 3.8   | \$ 24.1  |

The table below presents share-based compensation activity for the quarters ended March 31, 2007 and April 1, 2006:

|   | (In Thousands)       |                  |
|---|----------------------|------------------|
|   | First Quarter Ending |                  |
|   | March 31,<br>2007    | April 1,<br>2006 |
| Total intrinsic value of stock options exercised      | \$ 730               | \$ 1,225         |
| Cash received from stock option exercises             | 747                  | 1,363            |
| Income tax benefit from the exercise of stock options | 3,310                | 450              |
| Total fair value of stock options vested              | 8,955                | 8,768            |

**Restricted Stock**

The Company also granted restricted stock awards to certain employees during the three months ended March 31, 2007. The Company recorded pretax compensation expense associated with the stock grants amounting to \$0.3 million and \$0.2 million for the three months ending March 31, 2007 and April 1, 2006, respectively. Restrictions generally lapse two to three years after the date of grant. The Company values restricted stock awards at the closing market value of its common stock on the date of grant.

A summary of restricted stock activity for the three months ended March 31, 2007 is as follows:

|   | Shares   | Wtd. Avg.<br>Fair<br>Value | Aggregate<br>Intrinsic<br>Value<br>(in<br>millions) |
|---|----------|----------------------------|---|
| Restricted stock balance at December 30, 2006 | 93,675   | \$ 32.31                   |   |
| Granted                                       | 22,000   | 48.05                      |   |
| Restrictions lapsed                           | (23,000) | 27.63                      |   |
|   | 92,675   | \$ 37.20                   | \$ 3.4  |

Restricted stock balance at March 31,  
2007

## **11. INCOME TAXES**

The Company adopted Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48) as of the beginning of fiscal 2007, December 31, 2006. FIN 48 clarifies the accounting for uncertainty in income taxes by defining criteria that a tax position on an individual matter basis must meet before that position is recognized in the financial statements. Additionally, FIN 48 provides guidance on measurement, derecognition, classification, interest and penalties, interim period accounting, disclosures and transition. As a result of adopting FIN 48, the Company determined that approximately \$560 (including approximately \$392 in estimated interest payments) of tax benefits previously recognized were considered uncertain tax positions; as such these deductions may not be sustained upon examination by taxing authorities. This adjustment was reflected as a reduction of retained earnings. In addition, consistent with the provisions of FIN 48, the Company reclassified \$6.9 million of income tax liabilities from current to non-current liabilities because payment of cash is not anticipated within one year of the balance sheet date. As a result of the adoption of FIN 48, certain tax liabilities as of December 30, 2006 were reclassified in the condensed consolidated balance sheet. Income tax liabilities of \$6.3 million were reclassified from current liabilities to non-current liabilities. In addition, \$5.9 million of prepaid taxes were reclassified from current liabilities to current assets in the December 30, 2006 comparative condensed consolidated balance sheet.

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As of the adoption date at the beginning of the quarter and at March 31, 2007, the Company had approximately \$6.9 million of unrecognized tax benefits, \$3.3 million of which would affect its effective tax rate if recognized. The Company recognizes interest and penalties related to uncertain tax positions in income tax expense.

The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. Federal tax returns from 2003 through 2006 and various state tax returns from 2001 through 2006 remain subject to income tax examinations by tax authorities. The Company estimates that the unrecognized tax benefits will not change significantly within the next year.

**12. EARNINGS PER SHARE (EPS)**

The numerator for the calculation of basic and diluted earnings per share is net income. The denominator is computed as follows (in thousands):

|   | First Quarter Ending |                  |
|---|----------------------|------------------|
|   | March 31,<br>2007    | April 1,<br>2006 |
| Denominator for basic EPS - weighted average shares | 30,814               | 30,701           |
| Effect of dilutive securities                       | 2,734                | 2,256            |
| Denominator for diluted EPS                         | 33,548               | 32,957           |

Options for common shares where the exercise price was above the market price at March 31, 2007, totaling 106,000 shares, have been excluded from the calculation of the effect of dilutive securities as the effect of such options is anti-dilutive. There were no such anti-dilutive option shares outstanding at April 1, 2006.

**13. CONTINGENCIES**

An action was filed on June 4, 2004, and amended in September 2004, against one of the Company's subsidiaries, Marathon Electric Manufacturing Corporation ("Marathon"), by Enron Wind Energy Systems, LLC, Enron Wind Contractors, LLC and Zond Minnesota Construction Company, LLC (collectively, "Enron Wind"). The action was filed in the United States Bankruptcy Court for the Southern District of New York where each of the Enron Wind entities has consolidated its Chapter 11 bankruptcy petition as part of the Enron Corporation bankruptcy proceedings. In the action against Marathon, Enron Wind has asserted various claims relating to the alleged failures and/or degradations of performance of about 564 generators sold by Marathon to Enron Wind from 1997 to 1999. In January 2001, Enron Wind and Marathon entered into a "Generator Warranty and Settlement Agreement and Release of All Claims" ("Warranty Agreement"). This Warranty Agreement resolved various issues related to past performance of the generators, provided a limited warranty related to the generators going forward, and contained a release by all parties of any claims related to the generators other than those arising out of the obligations contained in the Warranty Agreement.

Enron Wind is seeking to recover the purchase price of the generators and transportation costs totaling about \$21 million. In addition, although the Warranty Agreement contains a waiver of consequential, incidental, and punitive damages, Enron Wind claims that this limitation is unenforceable and seeks recovery of consequential, incidental and punitive damages incurred by it and by its customers, totaling an additional \$100 million. Enron Wind has asserted claims of breach of contract, breach of the implied covenant of good faith and fair dealing, promissory fraud, and intentional interference with contractual relations. Marathon has filed a motion with the court seeking to have many of Enron Wind's claims dismissed. Enron Wind recently has filed a motion with the court seeking a declaration that Marathon had an obligation under the Warranty Agreement to repair or replace the generators in the first instance

regardless of whether an actual breach of warranty had occurred. The court has held hearings on both motions, but has not yet ruled.

The Company believes that this action is without merit and that it has meritorious defenses to the action. The Company intends to defend vigorously all of the asserted claims. The litigation is in an early discovery phase and it is difficult for the Company to predict the impact the litigation may ultimately have on the Company's results of operations or financial condition, including the expenses the Company may incur to defend against the action. As of March 31, 2007, amounts that have been recorded in the Company's financial statements related to this contingency are immaterial.

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On April 26, 2007, the Company received notice that the U.S. Environmental Protection Agency (“U.S. EPA”) has filed an action against the Company in the United States District Court for the Northern District of Illinois seeking reimbursement of the U.S. EPA’s unreimbursed past and future remediation costs incurred in cleaning up an environmental site located near a former manufacturing facility of the Company in Illinois. In 1999, the Company and other parties identified as potentially responsible parties (“PRPs”) reached an agreement with the U.S. EPA to partially fund the costs of certain response actions taken with respect to this site. In 2004, the Company received communications from the U.S. EPA indicating that the Company was identified as one of three PRPs regarding additional remedial actions to be taken by the U.S. EPA at this site. In response, the Company provided to the U.S. EPA its environmental expert’s assessment of the site in 2004. The Company believes that it is not a PRP with respect to the site in question and intends to defend vigorously the associated claim. As of March 31, 2007 amounts that have been recorded in the Company’s financial statements related to this contingency are immaterial.

The Company is, from time to time, party to other lawsuits arising from its normal business operations. It is believed that the outcome of these lawsuits will have no material effect on the Company’s financial position or its results of operations.

**14. DERIVATIVE INSTRUMENTS**

The Company periodically enters into commodity futures and options hedging transactions to reduce the impact of changing prices for certain commodities such as copper and aluminum based upon certain firm commitments to purchase such commodities. These transactions are designated as cash flow hedges and the contract terms of commodity hedge instruments generally mirror those of the hedged item, providing a high degree of risk reduction and correlation. Derivative commodity assets of \$3.1 million and \$1.7 million are recorded in current assets as of March 31, 2007 and December 30, 2006, respectively. The value of the effective portion of the contracts of \$1.8 million net of tax and \$1.0 million net of tax, as of March 31, 2007 and December 30, 2006, was recorded in accumulated other comprehensive income (“AOCI”).

The Company uses a cash hedging strategy to protect against an increase in the cost of forecasted foreign currency denominated transactions. As of March 31, 2007, derivative currency assets of \$1.4 million and \$0.6 million are recorded in other current assets and other non-current assets, respectively. At December 30, 2006, derivative currency assets of \$2.2 million and \$1.0 million were recorded in other current assets and other non-current assets, respectively. The value of the effective portion of the contracts of \$1.2 million net of tax and \$2.0 million net of tax, as of March 31, 2007 and December 30, 2006, respectively, was recorded in AOCI.

Of the net unrealized gain of \$3.0 million in AOCI at March 31, 2007, \$2.7 million is expected to be realized in the next year. The impact of hedge ineffectiveness was immaterial for all periods.

**15. SUBSEQUENT EVENTS**

On April 20, 2007, the Company’s shareholders approved an amendment to the Company’s Articles of Incorporation that increased the number of shares of common stock that the Company is authorized to issue from 50 million shares to 100 million shares. The Company also authorized the issuance of up to 2.5 million shares to be used under the Regal Beloit Corporation 2007 Equity Incentive Plan approved by the Company’s shareholders on April 20, 2007. Each authorized share is accompanied by one Common Stock Purchase Right as described in our Annual Report on Form 10-K filed on February 28, 2007.

On April 30, 2007, the Company amended its revolving credit facility. The committed amount of the revolving credit facility increased from \$475.0 million to \$500.0 million. The conditional commitment, subject to certain approvals and covenants, increased from \$75.0 million to \$200.0 million under the new facility. The facility still bears interest

based on a margin over LIBOR and contains revised covenants.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Unless the context requires otherwise, references in this Item 2 to “we”, “us”, “our” or the “Company” refer collectively to Regal Beloit Corporation and its subsidiaries.

**OVERVIEW**

End markets for the Company’s products continued to show strength during the first quarter of 2007. Net sales increased 5.1% to \$418.6 million from \$398.3 million in the first quarter of 2006.

Net income increased 12.7% to \$26.8 million in the first quarter of 2007 as compared to \$23.8 million in the comparable period last year. Diluted earnings per share increased 11.1% to \$0.80 as compared to \$0.72 for the first quarter of 2006.

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**RESULTS OF OPERATIONS**

Sales for the quarter were \$418.6 million, a 5.1% increase over the \$398.3 million reported for the first quarter of 2006. First quarter 2007 sales included \$17.9 million of sales related to the Sinya motor business that was purchased in May 2006. First quarter 2006 sales included \$4.7 million of sales related to the Company's cutting tools business. Substantially all of the assets of the Company's cutting tools business were sold in May 2006.

In the Electrical segment, sales increased 6.2%. The soft housing market and a comparison to a strong 2006 that was favorably impacted by the SEER 13 legislation impacted sales in the HVAC business, which decreased 14.2%. The sales for the remainder of the motor businesses increased 20.5%, including \$17.9 million of sales attributable to the Sinya motor business acquired in the second quarter of 2006. Sales for the power generation businesses increased 24.3%. Sales in the Mechanical segment were down 2.1%, however, the sale of substantially all of the assets of the Company's cutting tools business in May 2006 reduced segment sales by approximately \$4.7 million for the quarter.

Gross margins for the quarter were 23.2%, compared to 23.4% in the first quarter of 2006. Material costs, specifically copper and aluminum, continued to increase and have a significant impact on our gross margins during the quarter, partially offset by new products, productivity, pricing actions and positive product mix across our entire business resulting in the 0.2% decrease.

Operating expenses were \$49.9 million (11.9% of sales) in the first quarter of 2007 versus \$49.7 million (12.5% of sales) in first quarter of 2006. Included in operating expenses for the first quarter of 2006 was \$2.0 million of expense related to the Regal Beloit Supplemental Executive Retirement Plan resulting from a change in assumptions associated with retirement benefits for certain key executives. Income from operations was \$47.3 million versus \$43.6 million in the first quarter of 2006, an increase of 8.5%. As a percent of sales, income from operations was 11.3% in the first quarter of 2007 versus 11.0% for the first quarter of 2006. This increase reflected contributions from new products, pricing actions, productivity, and the leveraging of fixed costs.

Net interest expense was \$5.0 million versus \$4.7 million in the first quarter of 2006. The increase was due to higher interest rates we paid on debt outstanding, which was partially offset by lower average borrowings.

The tax rate for the quarter was 34.7% versus 36.8% in the prior year period. The tax rate for the first quarter of 2007 was impacted by the distribution of income, which was weighted more to lower tax rate countries than during the comparable period of 2006.

Net income for the first quarter of 2007 was \$26.8 million, an increase of 12.7% versus the \$23.8 million reported in same period of 2006. Fully diluted earnings per share was \$0.80 as compared to \$0.72 per share reported in the first quarter of 2006. The average number of diluted shares was 33,547,519 during the first quarter of 2007 as compared to 32,957,209 during the comparable period last year. The increase reflects the dilutive impact of the Company's convertible senior subordinated debt which was greater in the first quarter of 2007 resulting from the increase in the price of our stock during the comparable period of 2007 and 2006.

**LIQUIDITY AND CAPITAL RESOURCES**

Our working capital was \$340.8 million at March 31, 2007, a 7.6% increase from \$316.6 million at year-end 2006. The \$24.2 million increase was due primarily to a \$43.3 million accounts receivable increase resulting primarily from increased sales in the first quarter of 2007, partially offset by a \$12.3 million increase in accounts payable and a \$5.7 million decrease in inventories. The ratio of our current assets to our current liabilities ("current ratio") of 2.2:1 at March 31, 2007 was unchanged from year-end 2006.

Net cash provided by operating activities was \$10.4 million in the first quarter of 2007 as compared to \$2.3 million cash used in the first quarter of 2006. During the first quarter of 2007, decreases in our inventories provided \$13.0 million more as compared to the prior year's quarter. Net cash used in investing activities was \$12.7 million in the first quarter of 2007, above the \$6.8 million used in last year's first quarter, due primarily to the \$5.2 million sale of our Grafton, Wisconsin facility in 2006. Additions to property, plant and equipment of \$12.2 million in the first quarter of 2007 were \$4.9 million above the \$7.3 million in the comparable period of 2006. Our cash flow provided by financing activities was \$8.6 million during the first quarter of 2007 versus \$6.1 million in the first quarter of 2006.

Our outstanding long-term debt decreased from \$323.9 million at December 30, 2006 to \$323.5 million at March 31, 2007. Of our total long-term debt, \$197.0 million was outstanding under our \$475.0 million unsecured revolving credit facility that expires on May 5, 2009 (the "Facility"). The Facility permits the Company to borrow at interest rates based upon a margin above the London Inter-Bank Offered Rate ("LIBOR"), which margin varies with the ratio of total funded debt to earnings before interest, taxes, depreciation and amortization ("EBITDA"). These interest rates also vary as LIBOR varies. We pay a commitment fee on the unused amount of the Facility, which also varies with the ratio of our total debt to our EBITDA. At March 31, 2007, the Company's margin above LIBOR was .75% and our commitment fee rate was .15%. The Facility requires us to meet specified financial ratios and to satisfy certain financial condition tests. We were in compliance with all of these tests as of March 31, 2007. The Facility was amended subsequent to the end of the quarter. See Note 15 to the condensed consolidated financial statements.

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In addition to the Facility, at March 31, 2007, we also had \$115.0 million of convertible senior subordinated debt outstanding at a fixed interest rate of 2.75%, \$49.1 million of short-term commercial paper borrowings and \$21.1 million of other debt. At March 31, 2007, our borrowing availability under the Facility was \$223.2 million based on the Facility's credit limit.

During the quarter ended March 31, 2007, a foreign subsidiary of the Company borrowed a total of \$9.2 million denominated in U.S. dollars. The borrowings were made under a \$15.0 million unsecured credit facility which expires in December 2008. The notes are all short term and bear interest at a margin over LIBOR.

**CRITICAL ACCOUNTING POLICIES**

*Revenue Recognition*

We recognized revenue when all of the following have occurred: an agreement of sale exists; pricing is determinable; collection is reasonably assured; and product has been delivered and acceptance has occurred according to contract terms.

We use contracts and customer purchase orders to determine the existence of an agreement of sale. We use shipping documents and customer acceptance, when applicable, to verify delivery. We assess whether the sale price is subject to refund or adjustment, and we assess collectibility based on the creditworthiness of the customer as well as the customer's payment history.

*Returns, Rebates and Incentives*

Our primary incentive program provides distributors with cash rebates or account credits based on agreed amounts that vary depending on the end user or original equipment manufacturing (OEM) customer to whom our distributor ultimately sells the product. We also offer various other incentive programs that provide distributors and direct sale customers with cash rebates, account credits or additional products and services based on meeting specified program criteria. Certain distributors are offered a right to return product, subject to contractual limitations.

We record accruals for customer returns, rebates and incentives at the time of revenue recognition based primarily on historical experience. Adjustments to the accrual may be required if actual returns, rebates and incentives differ from historical experience or if there are changes to other assumptions used to estimate the accrual.

*Impairment of Long-Lived Assets or Goodwill and Other Intangibles*

We evaluate the recoverability of the carrying amount of long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be fully recoverable through future cash flows. We evaluate the recoverability of goodwill and other intangible assets with indefinite useful lives annually or more frequently if events or circumstances indicate that an asset might be impaired. We use judgment when applying the impairment rules to determine when an impairment is necessary. Factors that could trigger an impairment review include significant underperformance relative to historical or forecasted operating results, a significant decrease in the market value of an asset or significant negative industry or economic trends. We perform our annual impairment test in accordance with SFAS 142, "Goodwill and Other Intangible Assets."

*Retirement Plans*

Approximately half of our domestic employees are covered by defined benefit pension plans with the remaining employees covered by defined contribution plans. Most of our foreign employees are covered by government sponsored plans in the countries in which they are employed. Our obligations under our domestic defined benefit plans are determined with the assistance of actuarial firms. The actuaries make certain assumptions regarding such factors as withdrawal rates and mortality rates. The actuaries also provide us with information and recommendations from which management makes further assumptions on such factors as the long-term expected rate of return on plan

assets, the discount rate on benefit obligations, and where applicable, the rate of annual compensation increases. Based upon the assumptions made, the investments made by the plans, overall conditions and movement in financial markets, particularly the stock market and how actual withdrawal rates, life-spans of benefit recipients, and other factors differ from assumptions, annual expenses and recorded assets or liabilities of these defined benefit plans may change significantly from year to year. Based on our annual review of actuarial assumptions as well as historical rates of return on plan assets and existing long-term bond rates, we set the long-term rate of return on plan assets at 8.5% and an average discount rate at 5.9% for our defined benefit plans as of December 30, 2006.

*Income Taxes*

We operate in numerous taxing jurisdictions and are subject to regular examinations by various U.S. Federal, state, and foreign jurisdictions for various tax periods. Our income tax positions are based on research and interpretations of the income tax laws and rulings in each of the jurisdictions in which we do business. Due to the subjectivity of interpretations of laws and rulings in each jurisdiction, the differences and interplay in tax laws between those jurisdictions as well as the inherent uncertainty in estimating the final resolution of complex tax audit matters, our estimates of income tax liabilities may differ from actual payments or assessments.

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*Use of Estimates and Assumptions*

The preparation of our condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States requires the use of estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the related disclosure of contingent assets and liabilities. Management bases its estimates on historical experience and on other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

*New Accounting Pronouncements*

In February 2007, Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standard (SFAS) No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, Including an Amendment of FASB Statement No. 115* (“SFAS 159”). SFAS 159 permits entities to choose to measure many financial instruments and certain other items generally on an instrument-by-instrument basis at fair value that are not currently required to be measured at fair value. SFAS 159 is intended to provide entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS 159 is effective for the Company on January 1, 2008, although early adoption is permitted. If the Company elects to adopt SFAS 159 early, it would need to concurrently early adopt the provisions of Statement of Financial Accounting Standard No. 157, *Fair Value Measurements* (“SFAS 157”), which is described below. The Corporation is evaluating the provisions of SFAS 159.

In September 2006, the FASB issued SFAS 158, *Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans* (“SFAS 158”). SFAS 158 requires that public companies prospectively recognize through Accumulated Other Comprehensive Income the over funded or under funded status of their defined benefit plans as an asset or liability beginning in their 2006 year-end balance sheet. The Company adopted SFAS 158 as of December 30, 2006.

In September 2006, the FASB issued SFAS 157, *Fair Value Measurements* (“SFAS 157”). SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 will be effective beginning in fiscal 2008. We are evaluating the new standard to determine the effect on our financial statements and related disclosures.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (“FIN 48”). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company has adopted FIN 48 in the first quarter of 2007. See Note 11 to the condensed consolidated financial statements.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are exposed to market risk relating to the Company’s operations due to changes in interest rates, foreign currency exchange rates and commodity prices of purchased raw materials. We manage the exposure to these risks through a combination of normal operating and financing activities and derivative financial instruments such as commodity cash flow hedges and foreign currency forward exchange contracts.

The Company is exposed to interest rate risk on certain of its short-term and long-term debt obligations used to finance our operations and acquisitions. At March 31, 2007, we had \$123.9 million of fixed rate debt and \$258.3

million of variable rate debt, the latter subject to interest rate risk. The variable rate debt is primarily under the Facility with an interest rate based on a margin above LIBOR. As a result, interest rate changes impact future earnings and cash flow assuming other factors are constant. A hypothetical 10% change in our weighted average borrowing rate on outstanding variable rate debt at March 31, 2007, would result in a change in after-tax annualized earnings of approximately \$0.9 million.

The Company periodically enters into commodity futures and options hedging transactions to reduce the impact of changing copper, aluminum and natural gas commodity prices. Contract terms of commodity hedge instruments generally mirror those of the hedged item, providing a high degree of risk reduction and correlation.

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We are also exposed to foreign currency risks that arise from normal business operations. These risks include the translation of local currency balances of foreign subsidiaries, intercompany loans with foreign subsidiaries and transactions denominated in foreign currencies. Our objective is to minimize our exposure to these risks through a combination of normal operating activities and the utilization of foreign currency contracts to manage our exposure on the transactions denominated in currencies other than the applicable functional currency. Contracts are executed with creditworthy banks and are denominated in currencies of major industrial countries. It is our policy not to enter into derivative financial instruments for speculative purposes. We do not hedge our exposure to the translation of reported results of foreign subsidiaries from local currency to United States dollars.

All hedges are recorded on the balance sheet at fair value and are accounted for as cash flow hedges, with changes in fair value recorded in accumulated other comprehensive income ("AOCI") in each accounting period. An ineffective portion of the hedge's change in fair value, if any, is recorded in earnings in the period of change. The impact due to ineffectiveness was immaterial for all periods included in this report.

Derivative commodity assets of \$3.1 million and \$1.7 million are recorded in current assets as of March 31, 2007, and December 30, 2006, respectively. The value of the effective portion of the contracts of \$1.8 million net of tax and \$1.0 million net of tax, as of March 31, 2007 and December 30, 2006, was recorded in accumulated other comprehensive income.

The Company uses a cash hedging strategy to protect against an increase in the cost of forecasted foreign currency denominated transactions. As of March 31, 2007, derivative currency assets of \$1.4 million and \$0.6 million are recorded in other current assets and other non-current assets, respectively. At December 30, 2006, derivative currency assets of \$2.2 million and \$1.0 million were recorded in other current assets and other non-current assets, respectively. The value of the effective portion of the contracts of \$1.2 million net of tax and \$2.0 million net of tax, as of March 31, 2007, and December 30, 2006 respectively, was recorded in AOCI.

Of the net unrealized gain of \$3.0 million in AOCI at March 31, 2007, \$2.7 million is expected to be realized in the next year. The impact of hedge ineffectiveness was immaterial for all periods included in this report.

**ITEM 4. CONTROLS AND PROCEDURES**

**Disclosure Controls and Procedures.** The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures were effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act.

**Internal Control Over Financial Reporting.** There were no changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**PART II - OTHER INFORMATION**

Items 2 and 3 are inapplicable and have been omitted.

**ITEM 1. LEGAL PROCEEDINGS**

An action was filed on June 4, 2004, and amended in September 2004, against one of the Company's subsidiaries, Marathon Electric Manufacturing Corporation ("Marathon"), by Enron Wind Energy Systems, LLC, Enron Wind Contractors, LLC and Zond Minnesota Construction Company, LLC (collectively, "Enron Wind"). The action was filed in the United States Bankruptcy Court for the Southern District of New York where each of the Enron Wind entities has consolidated its Chapter 11 bankruptcy petition as part of the Enron Corporation bankruptcy proceedings. In the action against Marathon, Enron Wind has asserted various claims relating to the alleged failures and/or degradations of performance of about 564 generators sold by Marathon to Enron Wind from 1997 to 1999. In January 2001, Enron Wind and Marathon entered into a "Generator Warranty and Settlement Agreement and Release of All Claims" ("Warranty Agreement"). This Warranty Agreement resolved various issues related to past performance of the generators, provided a limited warranty related to the generators going forward, and contained a release by all parties of any claims related to the generators other than those arising out of the obligations contained in the Warranty Agreement.

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Enron Wind is seeking to recover the purchase price of the generators and transportation costs totaling about \$21 million. In addition, although the Warranty Agreement contains a waiver of consequential, incidental, and punitive damages, Enron Wind claims that this limitation is unenforceable and seeks recovery of consequential, incidental and punitive damages incurred by it and by its customers, totaling an additional \$100 million. Enron Wind has asserted claims of breach of contract, breach of the implied covenant of good faith and fair dealing, promissory fraud, and intentional interference with contractual relations. Marathon has filed a motion with the court seeking to have many of Enron Wind's claims dismissed. Enron Wind recently has filed a motion with the court seeking a declaration that Marathon had an obligation under the Warranty Agreement to repair or replace the generators in the first instance regardless of whether an actual breach of warranty had occurred. The court has held hearings on both motions, but has not yet ruled.

The Company believes that this action is without merit and that it has meritorious defenses to the action. The Company intends to defend vigorously all of the asserted claims. The litigation is in an early discovery phase and it is difficult for the Company to predict the impact the litigation may ultimately have on the Company's results of operations or financial condition, including the expenses the Company may incur to defend against the action. As of March 31, 2007, amounts that have been recorded in the Company's financial statements related to this contingency are immaterial.

On April 26, 2007, the Company received notice that the U.S. Environmental Protection Agency ("U.S. EPA") has filed an action against the Company in the United States District Court for the Northern District of Illinois seeking reimbursement of the U.S. EPA's unreimbursed past and future remediation costs incurred in cleaning up an environmental site located near a former manufacturing facility of the Company in Illinois. In 1999, the Company and other parties identified as potentially responsible parties ("PRPs") reached an agreement with the U.S. EPA to partially fund the costs of certain response actions taken with respect to this site. In 2004, the Company received communications from the U.S. EPA indicating that the Company was identified as one of three PRPs regarding additional remedial actions to be taken by the U.S. EPA at this site. In response, the Company provided to the U.S. EPA its environmental expert's assessment of the site in 2004. The Company believes that it is not a PRP with respect to the site in question and intends to defend vigorously the associated claim. As of March 31, 2007 amounts that have been recorded in the Company's financial statements related to this contingency are immaterial.

The Company is, from time to time, party to other lawsuits arising from its normal business operations. It is believed that the outcome of these other lawsuits will have no material effect on the Company's financial position or its results of operations.

**ITEM 1A. RISK FACTORS**

The business and financial results of the Company are subject to numerous risks and uncertainties. The risks and uncertainties have not changed materially from those reported in the 2006 Annual Report on Form 10-K.

Index**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

The following table contains detail related to the repurchase of common stock based on the date of trade during the quarter ended March 31, 2007.

| <b>2007<br/>Fiscal Month</b>             | <b>Total Number<br/>of Shares<br/>Purchased</b> | <b>Average<br/>Price Paid<br/>per Share</b> | <b>Total Number of<br/>Shares Purchased<br/>as<br/>Part of Publicly<br/>Announced Plans<br/>or<br/>Programs</b> | <b>Maximum Number<br/>of Shares that May<br/>Be Purchased<br/>Under the Plan or<br/>Programs</b> |
|--|---|---|---|--|
| December 31, 2006 to<br>February 3, 2007 | 48,896  | \$ 51.25                                    | -   | 1,225,900  |
| February 4 to March 3,<br>2007           | -   | \$ -  | -   | 1,225,900  |
| March 4 to March 31,<br>2007             | -   | \$ -  | -   | 1,225,900  |
| Total                                    | 48,896  |   | -   |  |

Under the Company's equity incentive plans, participants may pay the exercise price or satisfy all or a portion of the federal, state and local withholding tax obligations arising in connection with plan awards by electing to (a) have the Company withhold shares of common stock otherwise issuable under the award, (b) tender back shares received in connection with such award or (c) deliver other previously owned shares of common stock, in each case having a value equal to the exercise price or the amount to be withheld. During the first quarter of 2007, the Company acquired 48,896 shares of common stock that were presented to the Company by employees to pay the exercise price or to satisfy withholding taxes in connection with the exercise and/or vesting of stock awards. These shares were then cancelled by the Company.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

There were no matters submitted to a vote of security holders during the quarter ended March 31, 2007.

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**ITEM 6. EXHIBITS**

| Exhibit Number | Exhibit Description  |
|----------------|--|
| 4.1            | Second Amended and Restated Credit Agreement, dated as of April 30, 2007, among Regal Beloit Corporation, the financial institutions party thereto and Bank of America, N.A., as administrative agent. [Incorporated by reference to Exhibit 4.1 to Regal Beloit Corporation's Current Report on Form 8-K dated April 30, 2007 (File No. 001-07283)] |
| 31.1           | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 31.2           | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 32.1           | Certifications of the Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350   |

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**REGAL BELOIT CORPORATION**  
(Registrant)

Date: May 4, 2007

By: /s/ David A. Barta

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David A. Barta  
Vice President and Chief Financial Officer  
(Principal Accounting and Financial Officer)

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