TIMKEN CO
Form 10-Q
May 01, 2015

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

FORM 10-Q

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

For the quarterly period ended March 31, 2015

OR

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

For the transition period from to

Commission file number: 1-1169

THE TIMKEN COMPANY
(Exact name of registrant as specified in its charter)

OHIO (State or other jurisdiction of incorporation or organization)	34-0577130 (I.R.S. Employer Identification No.)
4500 Mount Pleasant Street NW North Canton, Ohio (Address of principal executive offices)	44720-5450 (Zip Code)

234.262.3000
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No o

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

Large accelerated filer	ý	Accelerated filer	o
Non-accelerated filer	o	Smaller reporting company	o

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

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

Class	Outstanding at March 31, 2015
Common Shares, without par value	86,393,845 shares

PART I. FINANCIAL INFORMATION

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

	Three Months Ended March 31,	
	2015	2014
(Dollars in millions, except per share data)		
Net sales	$722.5	$736.8
Cost of products sold	520.0	518.7
Gross Profit	202.5	218.1
Selling, general and administrative expenses	128.5	141.8
Impairment and restructuring charges	6.2	3.2
Pension settlement charges	215.2	0.7
Operating (Loss) Income	(147.4)	72.4
Interest expense	(8.0)	(5.5)
Interest income	0.7	1.0
Gain on sale of real estate	—	22.6
Other expense, net	(1.4)	(2.2)
(Loss) Income From Continuing Operations Before Income Taxes	(156.1)	88.3
(Benefit) provision for income taxes	(21.3)	28.0
(Loss) Income From Continuing Operations	(134.8)	60.3
Income from discontinued operations, net of income taxes	—	23.5
Net (Loss) Income	(134.8)	83.8
Less: Net income attributable to noncontrolling interest	0.4	0.3
Net (Loss) Income attributable to The Timken Company	$(135.2)	$83.5
Amounts attributable to The Timken Company's Common Shareholders		
(Loss) income from continuing operations	$(135.2)	$60.0
Income from discontinued operations, net of income taxes	—	23.5
Net (loss) income attributable to The Timken Company	$(135.2)	$83.5
Net (Loss) Income per Common Share attributable to The Timken Company Common Shareholders		
(Loss) earnings per share - Continuing Operations	$(1.54)	$0.64
Earnings per share - Discontinued Operations	—	0.26
Basic (loss) earnings per share	$(1.54)	$0.90
Diluted (loss) earnings per share - Continuing Operations	$(1.54)	$0.64
Diluted earnings per share - Discontinued Operations	—	0.26
Diluted (loss) earnings per share	$(1.54)	$0.90
Dividends per share	$0.25	$0.25

See accompanying Notes to the Consolidated Financial Statements.

Consolidated Statements of Comprehensive Income
(Unaudited)

(Dollars in millions)	Three Months Ended March 31, 2015	2014
Net (Loss) Income	$(134.8)	$83.8
Other comprehensive income (loss), net of tax:		
Foreign currency translation adjustments	(27.8)	(0.6)
Pension and postretirement liability adjustment	105.1	13.2
Other comprehensive income (loss), net of tax	77.3	12.6
Comprehensive (Loss) Income, net of tax	(57.5)	96.4
Less: comprehensive income attributable to noncontrolling interest	0.4	0.8
Comprehensive (Loss) Income attributable to The Timken Company	$(57.9)	$95.6

See accompanying Notes to the Consolidated Financial Statements.

Consolidated Balance Sheets

	(Unaudited) March 31, 2015	December 31, 2014
(Dollars in millions)		
ASSETS		
Current Assets		
Cash and cash equivalents	$154.4	$278.8
Restricted cash	14.8	15.3
Accounts receivable, less allowances (2015 – $13.3 million; 2014 – $13.7 million)	491.5	475.7
Inventories, net	580.3	585.5
Deferred income taxes	49.1	49.9
Deferred charges and prepaid expenses	27.0	25.2
Other current assets	46.7	51.5
Total Current Assets	1,363.8	1,481.9
Property, Plant and Equipment, net	760.2	780.5
Other Assets		
Goodwill	256.6	259.5
Non-current pension assets	109.6	176.2
Other intangible assets	230.1	239.8
Deferred income taxes	35.9	11.2
Other non-current assets	64.2	52.3
Total Other Assets	696.4	739.0
Total Assets	$2,820.4	$3,001.4
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Short-term debt	$3.6	$7.4
Current portion of long-term debt	0.1	0.6
Accounts payable, trade	168.4	143.9
Salaries, wages and benefits	107.0	146.7
Income taxes payable	108.3	80.2
Other current liabilities	132.0	155.0
Total Current Liabilities	519.4	533.8
Non-Current Liabilities		
Long-term debt	519.7	522.1
Accrued pension cost	158.1	165.9
Accrued postretirement benefits cost	137.8	141.8
Other non-current liabilities	69.2	48.7
Total Non-Current Liabilities	884.8	878.5
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) (2015 – 98,375,135 shares; 2014 – 98,375,135 shares)		
Stated capital	53.1	53.1
Other paid-in capital	895.6	899.4
Earnings invested in the business	1,458.3	1,615.4
Accumulated other comprehensive loss	(405.2)	(482.5)
Treasury shares at cost (2015 – 11,981,290 shares; 2014 – 9,783,375 shares)	(598.8)	(509.2)
Total Shareholders’ Equity	1,403.0	1,576.2
Noncontrolling Interest	13.2	12.9
Total Equity	1,416.2	1,589.1
Total Liabilities and Shareholders’ Equity	$2,820.4	$3,001.4

See accompanying Notes to the Consolidated Financial Statements.

Consolidated Statements of Cash Flows
(Unaudited)

	Three Months Ended March 31,	
	2015	2014
(Dollars in millions)		
CASH PROVIDED (USED)		
Operating Activities		
Net (loss) income attributable to The Timken Company	$(135.2)	$83.5
Net income from discontinued operations	—	(23.5)
Net income attributable to noncontrolling interest	0.4	0.3
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	33.5	35.1
Impairment charges	2.7	—
(Gain) loss on sale of assets	0.3	(23.0)
Deferred income tax provision	(84.4)	—
Stock-based compensation expense	4.1	7.6
Excess tax benefits related to stock-based compensation	(1.0)	(2.4)
Pension and other postretirement expense	225.1	9.5
Pension contributions and other postretirement benefit payments	(6.9)	(17.6)
Changes in operating assets and liabilities:		
Accounts receivable	(29.6)	(23.8)
Inventories	(12.8)	(19.9)
Accounts payable, trade	27.9	18.1
Other accrued expenses	(63.5)	(52.0)
Income taxes	54.7	11.1
Other, net	1.7	(4.3)
Net Cash Provided (Used) by Operating Activities - Continuing Operations	17.0	(1.3)
Net Cash Provided by Operating Activities - Discontinued Operations	—	41.5
Net Cash Provided by Operating Activities	17.0	40.2
Investing Activities		
Capital expenditures	(19.7)	(19.1)
Proceeds from disposal of property, plant and equipment	2.8	5.8
Investments in short-term marketable securities, net	2.9	2.7
Other	—	0.3
Net Cash Used by Investing Activities - Continuing Operations	(14.0)	(10.3)
Net Cash Used by Investing Activities - Discontinued Operations	—	(34.7)
Net Cash Used by Investing Activities	(14.0)	(45.0)
Financing Activities		
Cash dividends paid to shareholders	(21.9)	(23.1)
Purchase of treasury shares	(96.8)	(117.7)
Proceeds from exercise of stock options	1.1	3.6
Excess tax benefits related to stock-based compensation	1.0	2.4
Payments on long-term debt	(1.1)	(0.2)
Short-term debt activity, net	(3.6)	4.1
Decrease in restricted cash	0.5	—
Net Cash Used by Financing Activities	(120.8)	(130.9)
Effect of exchange rate changes on cash	(6.6)	(0.6)

Decrease In Cash and Cash Equivalents	(124.4)	(136.3)
Cash and cash equivalents at beginning of year	278.8	384.6
Cash and Cash Equivalents at End of Period	$154.4	$248.3

See accompanying Notes to the Consolidated Financial Statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(Dollars in millions, except per share data)

Note 1 - Basis of Presentation
The accompanying Consolidated Financial Statements (unaudited) for The Timken Company (the Company) have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and notes required by the accounting principles generally accepted in the United States (U.S. GAAP) for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) and disclosures considered necessary for a fair presentation have been included. For further information, refer to the Consolidated Financial Statements and notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014.

Note 2 - Recent Accounting Pronouncements
In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, "Revenue from Contracts with Customers (Topic 606)." ASU 2014-09 introduces a new five-step revenue recognition model in which an entity should recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 also requires disclosures sufficient to enable users to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers, including qualitative and quantitative disclosures about contracts with customers, significant judgments and changes in judgments and assets recognized from the costs to obtain or fulfill a contract. This new accounting guidance is effective for annual periods beginning after December 15, 2016, including interim periods within that reporting period. However, on April 1, 2015, the FASB proposed a one-year deferral of this new accounting guidance, which would result in it being effective for annual periods beginning after December 15, 2017. The Company is currently evaluating the impact of adopting ASU 2014-09 on the Company's results of operations or financial condition.

In April 2014, the FASB issued ASU 2014-08, "Presentation of Financial Statements (Topic 205) and Property, Plant and Equipment (Topic 360)." ASU 2014-08 amends the requirements for reporting discontinued operations and requires additional disclosures about discontinued operations. Under the new guidance, only disposals representing a strategic shift in operations or that have a major effect on the Company's operations and financial results should be presented as discontinued operations. ASU 2014-08 also requires expanded disclosures about discontinued operations that will provide financial statement users with more information about the assets, liabilities, income, and expenses of discontinued operations. This new accounting guidance is effective for annual periods beginning after December 15, 2014. The adoption of this accounting guidance did not have any impact on the Company's results of operations or financial condition.

Note 3 - Discontinued Operations

On June 30, 2014, the Company completed the tax-free spinoff of its steel business (the Spinoff) into a separate independent publicly traded company, TimkenSteel Corporation (TimkenSteel). The Company's board of directors declared a distribution of all outstanding common shares of TimkenSteel through a dividend. At the close of business on June 30, 2014, the Company's shareholders received one common share of TimkenSteel for every two common shares of the Company they held as of the close of business on June 23, 2014.

In connection with the Spinoff, the Company and TimkenSteel entered into certain transitional relationships, including a commercial supply agreement for TimkenSteel to supply the Company with certain steel products and other relationships described in the section of the Company's Annual Report on Form 10-K for the year ended December 31, 2014 titled "Risks Relating to the Spinoff of TimkenSteel."

The operating results, net of tax, included one-time transaction costs of $11.5 million for the first quarter of 2014 in connection with the separation of the two companies. These costs primarily consisted of consulting and professional fees associated with preparing for and executing the Spinoff.

The following table presents the results of operations for TimkenSteel that have been reclassified to discontinued operations.

	Three Months Ended March 31, 2014
Net sales	$367.7
Cost of goods sold	294.8
Gross profit	72.9
Selling, administrative and general expenses	20.2
Separation Costs	11.5
Other income, net	1.6
Income before income taxes	42.8
Income tax expense	(19.3)
Income from discontinued operations	$23.5

Note 4 - Inventories

The components of inventories were as follows:

	March 31, 2015	December 31, 2014
Manufacturing supplies	$25.4	$25.0
Raw materials	56.5	51.3
Work in process	214.9	219.3
Finished products	299.6	302.7
Subtotal	596.4	598.3
Allowance for obsolete and surplus inventory	(16.1)	(12.8)
Total Inventories, net	$580.3	$585.5

Inventories are valued at the lower of cost or market, with approximately 50% valued by the first-in, first-out (FIFO) method and the remaining 50% valued by the last-in, first-out (LIFO) method. The majority of the Company's domestic inventories are valued by the LIFO method and all of the Company's international (outside the United States) inventories are valued by the FIFO method.

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

The LIFO reserves at March 31, 2015 and December 31, 2014 were $201.6 million and $199.7 million, respectively. The Company recognized an increase in its LIFO reserve of $1.9 million during the first three months of 2015, compared to an increase in its LIFO reserve of $1.3 million during the first three months of 2014.

Note 5 - Property, Plant and Equipment
The components of property, plant and equipment were as follows:

	March 31, 2015	December 31, 2014
Land and buildings	$425.3	$428.8
Machinery and equipment	1,712.7	1,735.3
Subtotal	2,138.0	2,164.1
Accumulated depreciation	(1,377.8)	(1,383.6)
Property, Plant and Equipment, net	$760.2	$780.5

Depreciation expense for the three months ended March 31, 2015 and 2014 was $24.0 million and $30.7 million, respectively.

During the fourth quarter of 2014, the Company transferred approximately $45 million of capitalized software from property, plant and equipment to intangible assets. The Company did not reclassify the 2013 amounts to conform to the 2014 presentation because management of the Company determined the amount was immaterial to the 2013 Consolidated Balance Sheet. Depreciation expense on capitalized software for the three months ended March 31, 2014 was approximately $3.8 million.

Capitalized interest during the three months ended March 31, 2015 and 2014 was zero and $0.8 million, respectively.

In November 2013, the Company finalized the sale of its former manufacturing site in Sao Paulo, Brazil (Sao Paulo). The Company expects to receive approximately $31 million over a twenty-four month period, of which $23.6 million was received as of March 31, 2015. The total cost of this transaction, including the net book value of the real estate and broker's commissions, was approximately $3 million. The Company began recognizing the gain on the sale of this site using the installment method. In the first quarter of 2014, the Company changed to the full accrual method of recognizing the gain after it had received 25% of the total sales value. As a result, the Company recognized the remaining gain of $22.6 million ($19.5 million after tax) related to this transaction during the first quarter of 2014.

Note 6 - Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill for the three months ended March 31, 2015 were as follows:

	Mobile Industries	Process Industries	Total
Beginning balance	$89.6	$169.9	$259.5
Other	(0.7)	(2.2)	(2.9)
Ending balance	$88.9	$167.7	$256.6

“Other” primarily includes foreign currency translation adjustments.

The following table displays intangible assets as of March 31, 2015 and December 31, 2014:

	As of March 31, 2015			As of December 31, 2014		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Intangible assets subject to amortization:						
Customer relationships	$160.7	$62.3	$98.4	$160.1	$59.0	$101.1
Know-how	32.2	5.5	26.7	33.4	5.1	28.3
Industrial license agreements	0.1	0.1	—	0.1	0.1	—
Land-use rights	8.7	4.8	3.9	8.7	4.7	4.0
Patents	2.1	2.0	0.1	2.3	2.0	0.3
Technology	36.7	12.3	24.4	37.0	11.9	25.1
Tradenames	4.8	2.9	1.9	5.4	3.0	2.4
PMA licenses	5.3	4.5	0.8	5.3	4.5	0.8
Non-compete agreements	3.3	3.0	0.3	3.5	3.2	0.3
Software	234.7	185.6	49.1	235.0	182.0	53.0
	$488.6	$283.0	$205.6	$490.8	$275.5	$215.3
Intangible assets not subject to amortization:						
Tradenames	$15.8	$—	$15.8	$15.8	$—	$15.8
FAA air agency certificates	8.7	—	8.7	8.7	—	8.7
	$24.5	$—	$24.5	$24.5	$—	$24.5
Total intangible assets	$513.1	$283.0	$230.1	$515.3	$275.5	$239.8

Amortization expense for intangible assets was $9.5 million and $4.4 million for the three months ended March 31, 2015 and 2014, respectively. Amortization expense for intangible assets is estimated to be $33.2 million in 2015; $28.8 million in 2016; $25.0 million in 2017; $18.9 million in 2018; and $16.8 million in 2019.

Note 7 - Financing Arrangements

Short-term debt at March 31, 2015 and December 31, 2014 was as follows:

	March 31, 2015	December 31, 2014
Borrowings under variable-rate lines of credit for certain of the Company’s foreign subsidiaries with various banks with interest rates ranging from 5.13% to 5.89% at March 31, 2015 and interest rates ranging from 0.51% to 5.13% at December 31, 2014.	$3.6	$7.4
Short-term debt	$3.6	$7.4

The lines of credit for certain of the Company’s foreign subsidiaries provide for short-term borrowings up to $220.3 million. Most of these lines of credit are uncommitted. At March 31, 2015, the Company’s foreign subsidiaries had borrowings outstanding of $3.6 million and guarantees of $5.5 million, which reduced the availability under these facilities to $211.2 million.

On April 30, 2014, the Company reduced its aggregate borrowing available under its Amended and Restated Asset Securitization Agreement (Asset Securitization Agreement) from $200 million to $100 million. This agreement matures on November 30, 2015. Under the terms of the Asset Securitization Agreement, the Company sells, on an ongoing basis, certain domestic trade receivables to Timken Receivables Corporation, a wholly-owned consolidated subsidiary, that in turn uses the trade receivables to secure borrowings, which are funded through a vehicle that issues commercial paper in the short-term market. Borrowings under the Asset Securitization Agreement are limited by certain borrowing base calculations. Any amounts outstanding under the Asset Securitization Agreement would be reported in short-term debt in the Company’s Consolidated Balance Sheet. As of March 31, 2015, the Company had no outstanding borrowings under the Asset Securitization Agreement. However, certain borrowing base limitations reduced the availability of the Asset Securitization Agreement to $88.9 million at March 31, 2015. The cost of this facility, which is the commercial paper rate plus program fees, is considered a financing cost and is included in interest expense in the Consolidated Statements of Income.

Long-term debt at March 31, 2015 and December 31, 2014 was as follows:

	March 31, 2015	December 31, 2014
Fixed-rate Medium-Term Notes, Series A, mature at various dates through May 2028, with interest rates ranging from 6.74% to 7.76%	$175.0	$175.0
Fixed-rate Senior Unsecured Notes, maturing on September 1, 2024, with an interest rate of 3.875%	344.6	346.4
Other	0.2	1.3
	$519.8	$522.7
Less current maturities	0.1	0.6
Long-term debt	$519.7	$522.1

The Company has a $500 million Amended and Restated Credit Agreement (Senior Credit Facility), which matures on May 11, 2016. At March 31, 2015, the Company had no outstanding borrowings under the Senior Credit Facility. Under the Senior Credit Facility, the Company has two financial covenants: a consolidated leverage ratio and a consolidated interest coverage ratio. At March 31, 2015, the Company was in full compliance with both of these covenants under the Senior Credit Facility.

On August 20, 2014, the Company issued $350 million of fixed-rated 3.875% senior unsecured notes that mature on September 1, 2024 (2024 Notes). The Company used the net proceeds from the issuance of the 2024 Notes to repay the Company's fixed-rate 6.00% senior unsecured notes that matured on September 15, 2014 and for general corporate purposes.

Note 8 - Equity

The changes in the equity components for the three months ended March 31, 2015 were as follows:

		The Timken Company Shareholders					
	Total	Stated Capital	Other Paid-In Capital	Earnings Invested in the Business	Accumulated Other Comprehensive (Loss)	Treasury Stock	Non-controlling Interest
Balance at December 31, 2014	$1,589.1	$53.1	$899.4	$1,615.4	$(482.5)	$(509.2)	$12.9