

PARK OHIO HOLDINGS CORP

Form 10-Q

August 09, 2006

Table of Contents

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

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2006
or
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission file number 0-3134

Park-Ohio Holdings Corp.

(Exact name of registrant as specified in its charter)

Ohio

*(State or other jurisdiction of
incorporation or organization)*

34-1867219

*(I.R.S. Employer
Identification No.)*

23000 Euclid Avenue, Cleveland, Ohio

(Address of principal executive offices)

44117

(Zip Code)

216/692-7200

(Registrant's telephone number, including area code)

Park-Ohio Holdings Corp. is a successor issuer to Park-Ohio Industries, Inc.

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

Number of shares outstanding of registrant's Common Stock, par value \$1.00 per share, as of July 31, 2006:
10,996,246.

The Exhibit Index is located on page 29.

**PARK-OHIO HOLDINGS CORP. AND SUBSIDIARIES
INDEX**

| | Page |
|---|---|
| <u>PART I. FINANCIAL INFORMATION</u> | |
| <u>Item 1.</u> | <u>Financial Statements</u> 3 |
| | <u>Consolidated balance sheets June 30, 2006 and December 31, 2005</u> 3 |
| | <u>Consolidated statements of income Three months and six months ended June 30, 2006 and 2005</u> 4 |
| | <u>Consolidated statement of shareholders equity Six months ended June 30, 2006</u> 5 |
| | <u>Consolidated statements of cash flows Six months ended June 30, 2006 and 2005</u> 6 |
| | <u>Notes to consolidated financial statements June 30, 2006</u> 7 |
| | <u>Report of Independent Registered Public Accounting Firm</u> 16 |
| <u>Item 2.</u> | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> 17 |
| <u>Item 3.</u> | <u>Quantitative and Qualitative Disclosures About Market Risk</u> 23 |
| <u>Item 4.</u> | <u>Controls and Procedures</u> 24 |
| <u>PART II. OTHER INFORMATION</u> | |
| <u>Item 1.</u> | <u>Legal Proceedings</u> 25 |
| <u>Item 1A.</u> | <u>Risk Factors</u> 26 |
| <u>Item 2.</u> | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> 26 |
| <u>Item 4.</u> | <u>Submission of Matters to a Vote of Security Holders</u> 26 |
| <u>Item 6.</u> | <u>Exhibits</u> 27 |
| <u>SIGNATURE</u> | 28 |
| <u>EXHIBIT INDEX</u> | 29 |
| <u>EX-15</u> | |
| <u>EX-31.1</u> | |
| <u>EX-31.2</u> | |
| <u>EX-32</u> | |

Table of Contents**PART I. Financial Information****ITEM 1. Financial Statements****PARK-OHIO HOLDINGS CORP. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS**

| | (Unaudited) June 30, 2006 | December 31, 2005 |
|---|---------------------------------|----------------------|
| (Dollars in thousands) | | |
| ASSETS | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 17,106 | \$ 18,696 |
| Accounts receivable, less allowances for doubtful accounts of \$3,889 at June 30, 2006 and \$5,120 at December 31, 2005 | 187,869 | 153,502 |
| Inventories | 227,536 | 190,553 |
| Deferred tax assets | 8,627 | 8,627 |
| Other current assets | 11,450 | 21,651 |
| Total Current Assets | 452,588 | 393,029 |
| Property, Plant and Equipment | 250,025 | 244,367 |
| Less accumulated depreciation | 140,327 | 130,557 |
| | 109,698 | 113,810 |
| Other Assets | | |
| Goodwill | 85,418 | 82,703 |
| Net assets held for sale | 7,178 | 1,992 |
| Other | 71,042 | 71,320 |
| | \$ 725,924 | \$ 662,854 |
| LIABILITIES AND SHAREHOLDERS EQUITY | | |
| Current Liabilities | | |
| Trade accounts payable | \$ 135,166 | \$ 115,401 |
| Accrued expenses | 67,334 | 65,416 |
| Current portion of long-term liabilities | 5,557 | 4,161 |
| Total Current Liabilities | 208,057 | 184,978 |
| Long-Term Liabilities, less current portion | | |
| 8.375% Senior Subordinated Notes due 2014 | 210,000 | 210,000 |
| Revolving credit | 157,400 | 128,300 |
| Other long-term debt | 6,116 | 6,705 |
| Deferred tax liability | 3,176 | 3,176 |
| Other postretirement benefits and other long-term liabilities | 24,967 | 26,174 |
| | 401,659 | 374,355 |
| Shareholders Equity | | |

Edgar Filing: PARK OHIO HOLDINGS CORP - Form 10-Q

| | | |
|---|------------|------------|
| Capital stock, par value \$1 a share: | | |
| Serial Preferred Stock | -0- | -0- |
| Common Stock | 11,731 | 11,703 |
| Additional paid-in capital | 57,371 | 56,915 |
| Retained earnings | 55,672 | 46,014 |
| Treasury stock, at cost | (9,047) | (9,009) |
| Accumulated other comprehensive income (loss) | 481 | (2,102) |
| | 116,208 | 103,521 |
| | \$ 725,924 | \$ 662,854 |

Note: The balance sheet at December 31, 2005 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

See notes to consolidated financial statements.

Table of Contents

PARK-OHIO HOLDINGS CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|------------|------------------------------|------------|
| | 2006 | 2005 | 2006 | 2005 |
| (Amounts in thousands except per share data) | | | | |
| Net sales | \$ 268,453 | \$ 228,795 | \$ 528,674 | \$ 457,678 |
| Cost of products sold | 230,738 | 193,429 | 454,072 | 387,216 |
| Gross profit | 37,715 | 35,366 | 74,602 | 70,462 |
| Selling, general and administrative expenses | 22,209 | 20,428 | 43,928 | 42,079 |
| Operating income | 15,506 | 14,938 | 30,674 | 28,383 |
| Interest expense | 7,735 | 6,715 | 15,105 | 13,174 |
| Income before income taxes | 7,771 | 8,223 | 15,569 | 15,209 |
| Income taxes | 2,870 | 710 | 5,911 | 1,509 |
| Net income | \$ 4,901 | \$ 7,513 | \$ 9,658 | \$ 13,700 |
| Amounts per common share: | | | | |
| Basic | \$.45 | \$.69 | \$.88 | \$ 1.26 |
| Diluted | \$.43 | \$.66 | \$.84 | \$ 1.21 |
| Common shares used in the computation: | | | | |
| Basic | 10,983 | 10,886 | 10,976 | 10,880 |
| Diluted | 11,446 | 11,348 | 11,440 | 11,363 |

See notes to consolidated financial statements.

Table of Contents

PARK-OHIO HOLDINGS CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY (UNAUDITED)

| | Common Stock | Additional Paid-In Capital | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Income (Loss) | Total |
|---|-----------------|----------------------------------|----------------------|-------------------|---|------------|
| (Dollars in thousands) | | | | | | |
| Balance at January 1, 2006, as adjusted | \$ 11,703 | \$ 56,915 | \$ 46,014 | \$ (9,009) | \$ (2,102) | \$ 103,521 |
| Comprehensive income: | | | | | | |
| Net income | | | 9,658 | | | 9,658 |
| Foreign currency translation adjustment | | | | | 2,583 | 2,583 |
| Comprehensive income | | | | | | 12,241 |
| Amortization of restricted stock | | 230 | | | | 230 |
| Purchase of treasury stock | | | | (38) | | (38) |
| Share-based compensation | | 154 | | | | 154 |
| Exercise of stock options (29,497 shares) | 28 | 72 | | | | 100 |
| Balance at June 30, 2006 | \$ 11,731 | \$ 57,371 | \$ 55,672 | \$ (9,047) | \$ 481 | \$ 116,208 |

See notes to consolidated financial statements.

Table of Contents

PARK-OHIO HOLDINGS CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

| | Six Months Ended June 30, | |
|---|--------------------------------------|-----------------|
| | 2006 | 2005 |
| | (Dollars in thousands) | |
| OPERATING ACTIVITIES | | |
| Net income | \$ 9,658 | \$ 13,700 |
| Adjustments to reconcile net income to net cash used by operating activities: | | |
| Depreciation and amortization | 9,869 | 8,918 |
| Share-based compensation expense | 154 | -0- |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (33,655) | (9,181) |
| Inventories and other current assets | (26,159) | (13,075) |
| Accounts payable and accrued expenses | 20,774 | (14,136) |
| Other | (1,458) | (2,946) |
| Net Cash Used by Operating Activities | (20,817) | (16,720) |
| INVESTING ACTIVITIES | | |
| Purchases of property, plant and equipment, net | (7,523) | (7,665) |
| Acquisitions, net of cash acquired | (3,219) | -0- |
| Proceeds from sale of assets held for sale | -0- | 1,100 |
| Net Cash Used by Investing Activities | (10,742) | (6,565) |
| FINANCING ACTIVITIES | | |
| Proceeds from debt, net | 29,907 | 17,476 |
| Purchase of treasury stock | (38) | (67) |
| Exercise of stock options | 100 | 202 |
| Net Cash Provided by Financing Activities | 29,969 | 17,611 |
| Decrease in Cash and Cash Equivalents | (1,590) | (5,674) |
| Cash and Cash Equivalents at Beginning of Period | 18,696 | 7,157 |
| Cash and Cash Equivalents at End of Period | \$ 17,106 | \$ 1,483 |
| Taxes paid | \$ 3,022 | \$ 1,334 |
| Interest paid | 13,897 | 11,328 |

See notes to consolidated financial statements.

Table of Contents

PARK-OHIO HOLDINGS CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
June 30, 2006

(Amounts in Thousands except per share data)

NOTE A Basis of Presentation

The consolidated financial statements include the accounts of Park-Ohio Holdings Corp. and its subsidiaries (the Company). All significant intercompany transactions have been eliminated in consolidation.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three-month and six-month periods ended June 30, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2005. Certain amounts in the prior years' financial statements have been reclassified to conform to the current year presentation.

NOTE B Recent Accounting Pronouncements

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (SFAS No. 123(R)), using the modified prospective method. Under this method, compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS No. 123(R) for all share-based payments granted after the effective date and (b) based on the requirements of SFAS No. 123 for all awards granted to employees prior to the effective date of SFAS No. 123(R) that remain unvested on the effective date.

SFAS No. 123(R) was issued on December 16, 2004 and is a revision of SFAS No. 123, Accounting for Stock-Based Compensation. SFAS No. 123(R) supersedes Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees (APB Opinion No. 25) and amends SFAS No. 95, Statement of Cash Flows. Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. The adoption of fair value recognition provisions for stock options is expected to increase the Company's fiscal 2006 compensation expense by \$500 (before tax).

As permitted by SFAS No. 123, the Company previously accounted for share-based payments to employees using APB Opinion No. 25's intrinsic value method and, as such, generally recognized no compensation cost for employee stock options. SFAS No. 123(R) also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under current accounting guidance. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption. While the Company cannot estimate what those amounts will be in the future (because they depend on, among other things, when employees exercise stock options), the amount of operating cash flows recognized in prior years was zero because the Company did not owe federal income taxes due to the recognition of net operating loss carryforwards for which valuation allowances had been provided.

Additional information regarding our share-based compensation program is provided in Note G.

Table of Contents**PARK-OHIO HOLDINGS CORP. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

In May 2005, the Financial Accounting Standards Board (FASB) issued SFAS No. 154, Accounting Changes and Error Corrections, which replaces APB Opinion No. 20, Accounting Changes, and SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements. The statement changes the requirements for the accounting and reporting of a change in accounting principle and is applicable to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement if that pronouncement does not include specific transition provisions. The statement requires retrospective application to prior periods' financial statements of changes in accounting principle unless it is impractical to determine the period specific effects or the cumulative effect of the change. The correction of an error by the restatement of previously issued financial statements is also addressed by the statement. The Company adopted this statement effective January 1, 2006 as prescribed and its adoption did not have any impact on the Company's results of operations or financial condition.

In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 prescribes a more likely than not threshold for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition of income tax assets and liabilities, classification of current and deferred income tax assets and liabilities, accounting for interest and penalties associated with tax positions, accounting for income taxes in interim periods and income tax disclosures. This interpretation is effective for the Company as of January 1, 2007. We are currently evaluating the impact of FIN 48 on our financial statements.

NOTE C Acquisitions

In January 2006, the Company completed the acquisition of all of the shares of Foundry Service GmbH (Foundry Service) for approximately \$3,219, which resulted in additional goodwill of \$2,313. The acquisition was funded with borrowings from foreign subsidiaries of the Company. The acquisition was not deemed significant as defined in Regulation S-X.

On December 23, 2005, the Company completed the acquisition of the assets of Lectrotherm, Inc. (Lectrotherm) for \$5,125 in cash. The acquisition was funded with borrowings under the Company's revolving credit facility. The purchase price and the results of operations of Lectrotherm prior to its date of acquisition were not deemed significant as defined in Regulation S-X. The preliminary allocation of the purchase price has been performed based on the assignments of fair values to assets acquired and liabilities assumed. The allocation of the purchase price is as follows:

| | |
|--|----------|
| Cash acquisition price, less cash acquired | \$ 4,698 |
| Assets | |
| Accounts receivable | (2,640) |
| Inventories | (954) |
| Prepaid expenses | (97) |
| Equipment | (871) |
| Other assets | (545) |
| Liabilities | |
| Accrued expenses | 409 |
| Goodwill | \$ -0- |

On July 20, 2005, the Company completed the acquisition of the assets of Purchased Parts Group, Inc. (PPG) for \$7,000 in cash, \$1,346 in the form of a short-term note payable and the assumption of approximately \$12,787 of trade liabilities. The acquisition was funded with borrowings under the Company's revolving credit facility. The purchase price and the results of operations of PPG prior to its date of acquisition were not deemed significant as defined in Regulation S-X. The results of operations for PPG have been

Table of Contents**PARK-OHIO HOLDINGS CORP. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

included in the Company's financial statements since July 20, 2005. The final allocation of the purchase price is as follows:

| | |
|------------------------|----------|
| Cash acquisition price | \$ 7,000 |
| Assets | |
| Accounts receivable | (10,835) |
| Inventories | (10,909) |
| Prepaid expenses | (1,201) |
| Equipment | (407) |
| Liabilities | |
| Accounts payable | 12,783 |
| Accrued expenses | 2,270 |
| Note payable | 1,299 |
| Goodwill | \$ -0- |

The Company has a plan for integration activities. In accordance with FASB EITF Issue No. 95-3, Recognition of Liabilities in Connection with a Purchase Business Combination, the Company recorded accruals for severance, exit and relocation costs in the purchase price allocation. A reconciliation of the beginning and ending accrual balance is as follows:

| | Severance and Personnel | Exit and Relocation | Total |
|--------------------------------|------------------------------------|--------------------------------|--------------|
| Balance at June 30, 2005 | \$ -0- | \$ -0- | \$ -0- |
| Add: Accruals | 250 | 1,750 | 2,000 |
| Less: Payments | (551) | (594) | (1,145) |
| Transfers | 400 | (400) | -0- |
| Balance at December 31, 2005 | \$ 99 | \$ 756 | \$ 855 |
| Less: Payments and Adjustments | (43) | (356) | (399) |
| Transfers | (56) | 56 | -0- |
| Balance at June 30, 2006 | \$ -0- | \$ 456 | \$ 456 |

NOTE D Inventories

The components of inventory consist of the following:

| | June 30, 2006 | December 31, 2005 |
|----------------------------|--------------------------|------------------------------|
| Finished goods | \$ 154,981 | \$ 128,465 |
| Work in process | 40,730 | 32,547 |
| Raw materials and supplies | 31,825 | 29,541 |

\$ 227,536 \$ 190,553

NOTE E Shareholders Equity

At June 30, 2006, capital stock consists of (i) Serial Preferred Stock, of which 632,470 shares were authorized and none were issued, and (ii) Common Stock, of which 40,000,000 shares were authorized and 11,731,408 shares were issued, of which 10,996,246 were outstanding and 735,162 were treasury shares.

Table of Contents**PARK-OHIO HOLDINGS CORP. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****NOTE F Net Income Per Common Share**

The following table sets forth the computation of basic and diluted earnings per share:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|----------|------------------------------|-----------|
| | 2006 | 2005 | 2006 | 2005 |
| NUMERATOR | | | | |
| Net income | \$ 4,901 | \$ 7,513 | \$ 9,658 | \$ 13,700 |
| DENOMINATOR | | | | |
| Denominator for basic earnings per share weighted average shares | 10,983 | 10,886 | 10,976 | 10,880 |
| Effect of dilutive securities: | | | | |
| Employee stock options | 463 | 462 | 464 | 483 |
| Denominator for diluted earnings per share weighted average shares and assumed conversions | 11,446 | 11,348 | 11,440 | 11,363 |
| Amounts per common share: | | | | |
| Basic | \$.45 | \$.69 | \$.88 | \$ 1.26 |
| Diluted | \$.43 | \$.66 | \$.84 | \$ 1.21 |

Stock options for 104,000 shares were excluded in the three months and six months ended June 30, 2006 because they were anti-dilutive.

NOTE G Stock-Based Compensation

Under the provisions of the Park-Ohio Holdings Corp. 1998 Long-Term Incentive Plan, as amended (1998 Plan), which is administered by the Compensation Committee of the Company s Board of Directors, incentive stock options, non-statutory stock options, stock appreciation rights (SARs), restricted shares, performance shares or stock awards may be awarded to all employees of the Company and its subsidiaries. Stock options will be exercisable in whole or in installments as may be determined provided that no options will be exercisable more than ten years from date of grant. The exercise price will be the fair market value at the date of grant. The aggregate number of shares of the Company s common stock that may be awarded under the 1998 Plan is 2,650,000, all of which may be incentive stock options. No more than 500,000 shares shall be the subject of awards to any individual participant in any one calendar year.

Prior to January 1, 2006, the Company had elected to account for stock-based compensation using the intrinsic value method prescribed in APB Opinion No. 25 and related interpretations using the intrinsic value method. Under APB Opinion No. 25, because the exercise price of the Company s employee stock options equaled the fair market value of the underlying stock on the date of grant, no compensation expense was recognized. Compensation expense resulting from fixed awards of restricted shares was measured at the date of grant and expensed over the vesting period.

An alternative method of accounting for stock-based compensation, allowed before January 1, 2006, was the fair value method defined by SFAS No. 123. Had compensation cost for stock options granted been determined based on the fair value method of SFAS No. 123, the Company s pro forma net income and pro

Table of Contents**PARK-OHIO HOLDINGS CORP. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

forma earnings per share for the three-month and six-month periods ended June 30, 2005 would have been as follows:

| | Three Months Ended June 30, 2005 | Six Months Ended June 30, 2005 |
|--|---|---|
| Net income, as reported | \$ 7,513 | \$ 13,700 |
| Stock-option expense determined under fair value based methods, net of related tax effects | (27) | (35) |
| Pro forma net income | \$ 7,486 | \$ 13,665 |
| Earnings per share: | | |
| Basic as reported | \$ 0.69 | \$ 1.26 |
| Basic pro forma | \$ 0.69 | \$ 1.26 |
| Diluted as reported | \$ 0.66 | \$ 1.21 |
| Diluted pro forma | \$ 0.66 | \$ 1.20 |

The fair value of stock options is estimated as of the grant date using the Black-Scholes option pricing model. No options were granted in the first six months of 2006. There were 65,000 options granted in the first six months of 2005. The following weighted average assumptions were used for options granted in fiscal year 2005:

| Fiscal Year Ended December 31 | 2005 |
|--------------------------------------|-------------|
| Risk free interest rate | 4.15% |
| Expected life of option in years | 6.0 |
| Expected dividend yield | 0% |
| Expected stock volatility | 55% |

The weighted average fair market value of options issued during the fiscal year ended December 31, 2005 was estimated to be \$8.20.

The following table reflects activity in option shares from January 1, 2006 through June 30, 2006:

| | Shares Under Option | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life | Aggregate Intrinsic Value |
|----------------------------------|------------------------------------|--|--|--|
| | | | | (Thousands) |
| Outstanding at December 31, 2005 | 997,751 | \$ 3.55 | 6.4 | \$ 10,523 |
| Granted | 0 | | | |
| Forfeited | 0 | | | |
| Exercised | (333) | 7.77 | 7.8 | 4 |

Edgar Filing: PARK OHIO HOLDINGS CORP - Form 10-Q

| | | | | |
|-------------------------------|----------|------|-----|--------|
| Outstanding at March 31, 2006 | 997,418 | 3.55 | 6.2 | 16,366 |
| Granted | 0 | | | |
| Forfeited | 0 | | | |
| Exercised | (29,164) | 3.82 | 6.1 | 425 |
| Outstanding at June 30, 2006 | 968,254 | 3.54 | 5.9 | 13,291 |
| Exercisable at June 30, 2006 | 882,254 | 2.50 | 5.6 | 13,030 |

Table of Contents**PARK-OHIO HOLDINGS CORP. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

Participants may also be awarded restricted stock under the 1998 Plan. The Company granted 56,300 and 28,000 shares of restricted stock in 2005 and 2004, respectively, with fair values equal to the market price of the stock on the date of grant. The restricted shares were valued at \$682 and \$433 for 2005 and 2004, respectively and will be recognized as compensation expense ratably over the three-year vesting period. Compensation expense associated with the restricted shares of \$120 and \$107 was recognized in the three-month periods ended June 30, 2006 and 2005, respectively. For the six-month periods ended June 30, 2006 and 2005, the compensation cost recognized for restricted shares was \$216 and \$144, respectively. Compensation expense associated with stock options of \$75 and \$-0- was recognized in the three-month period ended June 30, 2006 and 2005, respectively. For the six-month periods ended June 30, 2006 and 2005, the compensation expense associated with stock options was \$154 and \$-0-, respectively.

The following table reflects activity in restricted shares from January 1, 2006 through June 30, 2006:

| | Restricted Shares | Weighted Average Grant-Date Fair Value | Aggregate Intrinsic Value |
|--------------------------------|----------------------|--|------------------------------|
| | | | (Thousands) |
| Outstanding at January 1, 2006 | 51,633 | \$ 14.91 | \$ 728 |
| Granted | 0 | | |
| Forfeited | 0 | | |
| Vested | (1,166) | \$ 22.15 | \$ 23 |
| Outstanding at March 31, 2006 | 50,467 | \$ 14.75 | \$ 1,007 |
| Granted | 0 | | |
| Forfeited | (1,000) | \$ 14.26 | |
| Vested | (4,667) | \$ 9.47 | \$ 92 |
| Outstanding at June 30, 2006 | 44,800 | \$ 15.31 | \$ 774 |

In 2006, before-tax share-based compensation expense is expected to total \$889 and, net of taxes, is expected to approximate \$533 for stock option awards and restricted stock. The total unrecognized share-based compensation expense before tax for awards outstanding as of June 30, 2006 was \$934, which will be recognized over a weighted-average period of two years.

SFAS No. 123(R) requires that cash flows resulting from the tax benefits of deductions in excess of the compensation cost recognized for stock-based awards be classified as financing cash flows. The Company had no gross excess tax benefits in the six months ended June 30, 2006.

Table of Contents**PARK-OHIO HOLDINGS CORP. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****NOTE H Pension Plans and Other Postretirement Benefits**

The components of net periodic benefit cost recognized during the periods indicated were as follows:

| | Pension Benefits | | | | Postretirement Benefits | | | |
|--------------------------------------|-------------------|-----------|-------------------|-----------|-------------------------|--------|-------------------|--------|
| | Three Months | | Six Months | | Three Months | | Six Months | |
| | Ended June 30, | | Ended June 30, | | Ended June 30, | | Ended June 30, | |
| | 2006 | 2005 | 2006 | 2005 | 2006 | 2005 | 2006 | 2005 |
| Service costs | \$ 87 | \$ 97 | \$ 174 | \$ 194 | \$ 50 | \$ 35 | \$ 100 | \$ 70 |
| Interest costs | 726 | 796 | 1,452 | 1,592 | 323 | 348 | 646 | 696 |
| Expected return on plan assets | (2,078) | (2,211) | (4,156) | (4,422) | -0- | -0- | -0- | -0- |
| Transition obligation | (12) | (12) | (24) | (24) | -0- | -0- | -0- | -0- |
| Amortization of prior service cost | 39 | 41 | 78 | 82 | (16) | (17) | (32) | (34) |
| Recognized net actuarial (gain) loss | 81 | (60) | 162 | (120) | 94 | 50 | 188 | 100 |
| Benefit (income) costs | \$(1,157) | \$(1,349) | \$(2,314) | \$(2,698) | \$ 451 | \$ 416 | \$ 902 | \$ 832 |

NOTE I Segments

The Company operates through three segments: Integrated Logistics Solutions (ILS), Aluminum Products and Manufactured Products. ILS is a leading supply chain logistics provider of production components to large, multinational manufacturing companies, other manufacturers and distributors. In connection with the supply of such production components, ILS provides a variety of value-added, cost-effective supply chain management services. Aluminum Products manufactures cast aluminum components for automotive, agricultural equipment, heavy-duty truck and construction equipment. Aluminum Products also provides value-added services such as design and engineering, machining and assembly. Manufactured Products operates a diverse group of niche manufacturing businesses that design and manufacture a broad range of high quality products engineered for specific customer applications.

Results by business segment were as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-----------------------|--------------------------------|------------|------------------------------|------------|
| | 2006 | 2005 | 2006 | 2005 |
| Net sales: | | | | |
| ILS | \$ 150,338 | \$ 129,515 | \$ 300,497 | \$ 256,402 |
| Aluminum products | 44,913 | 43,094 | 87,615 | 85,984 |
| Manufactured products | 73,202 | 56,186 | 140,562 | 115,292 |
| | \$ 268,453 | \$ 228,795 | \$ 528,674 | \$ 457,678 |

Income before income taxes:

| | | | | |
|-----------------------|-----------|----------|-----------|-----------|
| ILS | \$ 10,231 | \$ 8,271 | \$ 20,653 | \$ 16,475 |
| Aluminum products | 2,396 | 3,481 | 4,436 | 5,904 |
| Manufactured products | 6,132 | 5,949 | 11,794 | 11,762 |
| | 18,759 | 17,701 | 36,883 | 34,141 |
| Corporate costs | (3,253) | (2,763) | (6,209) | (5,758) |
| Interest expense | (7,735) | (6,715) | (15,105) | (13,174) |
| | \$ 7,771 | \$ 8,223 | \$ 15,569 | \$ 15,209 |

Table of Contents

PARK-OHIO HOLDINGS CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

| | June 30, 2006 | December 31, 2005 |
|--------------------------------------|--------------------------|------------------------------|
| Identifiable assets were as follows: | | |
| ILS | \$ 358,662 | \$ 323,176 |
| Aluminum products | 113,782 | 101,489 |
| Manufactured products | 207,126 | 169,004 |
| General corporate | 46,354 | 69,185 |
| | \$ 725,924 | \$ 662,854 |

NOTE J Comprehensive Income

Total comprehensive income was as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|------------------------------|--|-----------------|--------------------------------------|------------------|
| | 2006 | 2005 | 2006 | 2005 |
| Net income | \$ 4,901 | \$ 7,513 | \$ 9,658 | \$ 13,700 |
| Foreign currency translation | 2,105 | (1,018) | 2,583 | (689) |
| Total comprehensive income | \$ 7,006 | \$ 6,495 | \$ 12,241 | \$ 13,011 |

The components of accumulated comprehensive income (loss) at June 30, 2006 and December 31, 2005 are as follows:

| | June 30, 2006 | December 31, 2005 |
|---|--------------------------|------------------------------|
| Foreign currency translation adjustment | \$ 5,839 | \$ 3,256 |
| Minimum pension liability | (5,358) | (5,358) |
| | \$ 481 | \$ (2,102) |

NOTE K Restructuring Activities

The Company has responded to the economic downturn by reducing costs in a variety of ways, including restructuring businesses and selling non-core manufacturing assets. These activities generated restructuring and asset impairment charges in 2001, 2002, 2003 and 2005, as the Company's restructuring efforts continued and evolved. For further details on the restructuring activities, see Note O to the audited financial statements contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

The accrued liability balance for severance and exit costs and related cash payments during the first six months of 2006 consisted of:

| | |
|------------------------------|--------|
| Balance at December 31, 2005 | \$ 596 |
| Cash payments | (179) |
| Balance at June 30, 2006 | \$ 417 |

Table of Contents**PARK-OHIO HOLDINGS CORP. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****NOTE L Accrued Warranty Costs**

The Company estimates the amount of warranty claims on sold products that may be incurred based on current and historical data. The actual warranty expense could differ from the estimates made by the Company based on product performance. The following table presents the changes in the Company's product warranty liability:

| | |
|--|----------|
| Balance at January 1, 2006 | \$ 3,566 |
| Claims paid during the year | (1,246) |
| Additional warranties issued during the year | 1,862 |
| Acquired warranty liabilities | 164 |
| Balance at June 30, 2006 | \$ 4,346 |

NOTE M Financing Arrangements

On June 9, 2006, Park-Ohio Industries, Inc., the other loan parties thereto, the lenders party thereto and JPMorgan Chase Bank, N.A. (successor by merger to Bank One, NA), as agent, entered into a Fourth Amendment to the Amended and Restated Credit Agreement dated November 5, 2003, which among other things, increases the availability under the credit facility from \$200,000 to \$220,000 and increases the availability of letters of credit from \$20,000 to \$40,000.

NOTE N Income Taxes

In 2006, the Company began recording a quarterly provision for federal income taxes resulting in a total effective income tax rate of approximately 38%, compared to 10% for the corresponding period in 2005. Only foreign and state income taxes were provided for in 2005 because federal income taxes were offset by net operating loss carryforwards that were not recognized previously. At December 31, 2005, the Company had net operating loss carryforwards of approximately \$41,000, which should preclude the cash payment of federal income taxes in 2006. In the fourth quarter of 2006, if a portion or all of its remaining deferred tax asset will more likely than not be realized, the Company will reverse into income the appropriate portion of its remaining tax valuation allowance of approximately \$5,000.

NOTE O Derivatives and Hedging

The Company recognizes all derivative financial instruments as either assets or liabilities at fair value. The Company has no derivative instruments that are classified as fair value hedges. Changes in the fair value of derivative instruments that are classified as cash flow hedges are recognized in other comprehensive income until such time as the hedged items are recognized in net income.

During the first half of 2006, the Company entered into forward contracts for the purpose of hedging exposure to changes in the value of accounts receivable, primarily euros against the U.S. dollar, for a notional amount of \$1,000, of which \$545 was outstanding at June 30, 2006. These transactions are considered cash flow hedges. The fair market value of these transactions at June 30, 2006 was approximately \$577 and therefore, \$32 has been recognized in other comprehensive income (loss). Because there is no ineffectiveness on the cash flow hedges, all changes in fair value of these derivatives are recorded in equity and not included in the current period's income statement.

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders
Park-Ohio Holdings Corp.

We have reviewed the accompanying consolidated balance sheet of Park-Ohio Holdings Corp. and subsidiaries as of June 30, 2006 and the related consolidated statements of income for the three-month and six-month periods ended June 30, 2006 and 2005, the consolidated statement of shareholders' equity for the six-month period ended June 30, 2006 and the consolidated statements of cash flows for the six-month periods ended June 30, 2006 and 2005. These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based upon our review, we are not aware of any material modifications that should be made to the consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Park-Ohio Holdings Corp. and subsidiaries as of December 31, 2005 and the related consolidated statements of income, shareholders' equity, and cash flows for the year then ended, not presented herein, and in our report dated March 13, 2006, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2005, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP

Cleveland, Ohio
August 8, 2006

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

Our consolidated financial statements include the accounts of Park-Ohio Holdings Corp. and its subsidiaries. All significant intercompany transactions have been eliminated in consolidation. Financial information for the three-month and six-month periods ended June 30, 2006 is not directly comparable to the financial information for the same periods in 2005 primarily due to acquisitions.

Executive Overview

We are an industrial supply chain logistics and diversified manufacturing business, operating in three segments: ILS, Aluminum Products and Manufactured Products. ILS provides customers with integrated supply chain management services for a broad range of high-volume, specialty production components. ILS customers receive various value-added services, such as engineering and design services, part usage and cost analysis, supplier selection, quality assurance, bar coding, product packaging and tracking, just-in-time and point-of use delivery, electronic billing and ongoing technical support. The principal customers of ILS are in the heavy-duty truck, automotive and vehicle parts, electrical distribution and controls, power sports/fitness equipment, HVAC, aerospace and defense, electrical components, appliance and semiconductor equipment industries.

Aluminum Products casts and machines aluminum engine, transmission, brake, suspension and other components such as pump housings, clutch retainers/pistons, control arms, knuckles, master cylinders, pinion housings, brake calipers, oil pans and flywheel spacers for automotive, agricultural equipment, construction equipment, heavy-duty truck and marine equipment OEMs, primarily on a sole-source basis. Aluminum Products also provides value-added services such as design and engineering and assembly.

Manufactured Products operates a diverse group of niche manufacturing businesses that design and manufacture a broad range of highly-engineered products including induction heating and melting systems, pipe threading systems, industrial oven systems, injection molded rubber components, and forged and machined products. Manufactured Products also produces and provides services and spare parts for the equipment it manufactures. The principal customers of Manufactured Products are OEMs, sub-assemblers and end users in the steel, coatings, forging, foundry, heavy-duty truck, construction equipment, bottling, automotive, oil and gas, rail and locomotive manufacturing and aerospace and defense industries. Sales, earnings and other relevant financial data for these three segments are provided in Note I to the consolidated financial statements.

Sales and pre-tax profitability continued to grow substantially in the first six months of 2006. Net sales increased 16%, to \$528.7 million, and pre-tax income grew 2% to \$15.6 million. We recorded income tax expense of \$5.9 million in the first six months of 2006, an effective income tax rate of 38%, compared to \$1.5 million, or an effective income tax rate of 10% in the first six months of 2005. No federal income taxes were expensed in the first half of 2005 due to our deferred tax valuation allowance, of which a portion was reversed at the end of 2005. This resulted in net income of \$9.7 million for the first six months of 2006, compared to \$13.7 million in the same period of 2005.

Sales and profitability grew substantially in 2004 and 2005 as result of new business development, growth in domestic and international manufacturing economies, and acquisitions. Net sales increased 30% and 15% in 2004 and 2005, respectively. We reported net income of \$14.2 million in 2004, which grew 117% in 2005 to \$30.8 million. 2005 net income was affected by a \$7.3 million reversal of our domestic deferred tax asset valuation allowance and \$1.8 million of restructuring charges (\$.8 million reflected in Cost of products sold and \$1.0 million in Restructuring and impairment charges).

During 2004, we reinforced our long-term availability and attractive pricing of funds by refinancing both of our major sources of borrowed funds: senior subordinated notes and our revolving credit facility. In November 2004, we sold \$210.0 million of 8.375% senior subordinated notes due 2014. We used the net proceeds to fund the tender and early redemption of \$199.9 million of our 9.25% senior subordinated notes due 2007. We incurred debt extinguishment costs primarily related to premiums and other transaction costs

Table of Contents

associated with the tender offer and early redemption and wrote off deferred financing costs totaling \$6.0 million associated with the repurchased 9.25% senior subordinated notes.

We recently made two acquisitions to build on the success of our induction heating and melting systems business. In December 2005, we acquired the assets of Lectrotherm, in Canton, Ohio, for \$5.1 million in cash, and in January 2006 we acquired the stock of Foundry Service, in Germany, for \$3.2 million in cash. These acquisitions augment our existing, high-margin aftermarket induction business, and increased our presence, revenues and profits in Germany, an important capital equipment market. We funded these acquisitions with borrowings from our revolving credit facilities and funds from foreign subsidiaries.

We acquired substantially all the assets of PPG, a provider of supply chain management services for a broad range of production components, in July 2005, for \$7.0 million in cash funded with borrowings from our revolving credit facility, \$1.3 million in the form of a short-term note payable and the assumption of approximately \$12.8 million of trade liabilities. This acquisition added significantly to the customer and supplier bases, and expanded the geographic presence of, our ILS segment. ILS has already eliminated substantial overhead cost and begun the process of consolidating redundant service centers.

Accounting Changes

Effective January 1, 2006, we adopted SFAS No. 123(R) using the modified prospective method. Under this method, we recognized \$.2 million of compensation costs (before tax) in the first six months of 2006, related to all share-based awards granted to employees prior to January 1, 2006 that remained unvested on that date. We will continue to recognize such expenses in future periods as long as existing awards continue in existence and continue to be unvested. We expect these existing awards to increase our fiscal 2006 compensation expense by approximately \$.5 million (before tax). As additional share-based payments are awarded in the future, we will also recognize compensation cost for these awards. Additional information regarding our share-based compensation is provided in Notes B and G to the consolidated financial statements.

Results of Operations***Six Months 2006 versus Six Months 2005******Net Sales by Segment:***

| | Six Months Ended June 30, | | Change | Percent Change | Acquired/ (Divested) Sales |
|------------------------|------------------------------|----------|---------|-------------------|----------------------------------|
| | 2006 | 2005 | | | |
| ILS | \$ 300.5 | \$ 256.4 | \$ 44.1 | 17% | \$ 28.0 |
| Aluminum products | 87.6 | 86.0 | 1.6 | 2% | 0.0 |
| Manufactured products | 140.6 | 115.3 | 25.3 | 22% | 11.4 |
| Consolidated net sales | \$ 528.7 | \$ 457.7 | \$ 71.0 | 16% | \$ 39.4 |

Net sales increased by 16% in the first six months of 2006 compared to the same period in 2005. ILS sales increased 17% primarily due to the July 2005 acquisition of PPG, general economic growth, particularly as a result of significant growth in the heavy-duty truck industry, the addition of new customers and increases in product range to existing customers. Aluminum Products sales increased 2% primarily due to passed-through aluminum cost increases. Manufactured Products sales increased 22% primarily in the induction, pipe threading equipment, rubber and forging businesses. Of this increase, \$11.4 million was due to the acquisitions of Lectrotherm and Foundry Service by the induction business in December 2005 and January 2006, respectively.

Table of Contents**Cost of Products Sold & Gross Profit:**

| | Six Months Ended June 30, | | | Percent Change |
|------------------------------------|------------------------------|----------|---------|-------------------|
| | 2006 | 2004 | Change | |
| Consolidated cost of products sold | \$ 454.1 | \$ 387.2 | \$ 66.9 | 17% |
| Consolidated gross profit | \$ 74.6 | \$ 70.5 | \$ 4.1 | 6% |
| Gross margin | 14.1% | 15.4% | | |

Cost of products sold increased 17% in the first six months of 2006 compared to the same period in 2005, while gross margin decreased to 14.1% in the first six months of 2006 from 15.4% in the same period in 2005.

ILS gross margin increased primarily due to increased volumes and greater recovery of steel cost increases. Aluminum Products gross margin decreased primarily due to product mix and pricing changes, plus the cost of preparations for new contracts that will start production in the fourth quarter of 2006. Gross margin in the Manufactured Products segment decreased primarily as a result of operational issues in the Company's rubber products business, and changes in contract mix and timing in the induction and pipe threading equipment businesses. Quarter-to-quarter, gross margins vary widely in Manufactured Products, and these timing issues are not expected to depress full-year 2006 gross margin for the Manufactured Products segment.

Selling, General & Administrative (SG&A) Expenses:

| | Six Months Ended June 30, | | | Percent Change |
|----------------------------|------------------------------|---------|--------|-------------------|
| | 2006 | 2005 | Change | |
| Consolidated SG&A expenses | \$ 43.9 | \$ 42.1 | \$ 1.8 | 4% |
| SG&A percent | 8.3% | 9.2% | | |

Consolidated SG&A expenses increased 4% in the first six months of 2006 compared to the same period in 2005, representing a .9% reduction in SG&A as a percent of sales. SG&A increased approximately \$2.6 million due to the acquisitions of PPG, Lectrotherm and Foundry Services. SG&A expenses were increased in the first six months 2006 compared to 2005 by a \$.4 million decrease in net pension credits reflecting reduced returns on pension plan assets.

Interest Expense:

| | Six Months Ended June 30, | | | Percent Change |
|--------------------------------|------------------------------|----------|----------------|-------------------|
| | 2006 | 2005 | Change | |
| Interest expense | \$ 15.1 | \$ 13.2 | \$ 1.9 | 14% |
| Average outstanding borrowings | \$ 368.6 | \$ 356.8 | \$ 11.8 | 3% |
| Average borrowing rate | 8.20% | 7.39% | 81basis points | |

Interest expense increased \$1.9 million in the first six months of 2006 compared to the same period of 2005, primarily due to higher average interest rates and average outstanding borrowings during the first six months of 2006.

The increase in average borrowings in the first six months of 2006 resulted primarily from higher working capital requirements and the purchases of PPG, Lectrotherm and Foundry Service in July and December 2005 and January 2006, respectively. The higher average borrowing rate in the first six months of 2006 was due primarily to increased interest rates under our revolving credit facility compared to the same period of 2005, which rates increased primarily as a result of actions by the Federal Reserve.

Income Tax:

The provision for income taxes was \$5.9 million in the six-month period ended June 30, 2006, a 38% effective income tax rate, compared to income taxes of \$1.5 million provided in the corresponding period of 2005, a 10% effective income tax rate. In the first six months of 2005, these taxes consisted primarily of state

Table of Contents

and foreign taxes on profitable operations. Taxes in the first six months of 2006 included state and foreign taxes, but also included federal income taxes. This change resulted from the fourth-quarter 2005 reversal of a portion of our domestic deferred tax valuation allowance.

In the fourth quarter of 2005, the Company reversed \$7.3 million of its \$12.3 million year-end 2005 domestic deferred tax valuation allowance. Based on strong recent and projected earnings, the Company determined that it was more likely than not that this portion of the deferred tax asset would be realized. In 2006, the Company began recording a quarterly provision for federal income taxes. Our significant net operating loss carry-forward should preclude the payment of cash federal income taxes in 2006 and 2007, and possibly beyond. In the fourth quarter of 2006, the Company will reassess the remaining tax valuation allowance. If it is determined that a portion or all of the remaining deferred tax asset will more likely than not be realized, then the appropriate portion of its remaining tax valuation allowance will be reversed into income at that time, which could increase 2006 net income by as much as \$5.0 million.

At December 31, 2005, our subsidiaries had \$41.0 million of net operating loss carryforwards for federal tax purposes.

***Second Quarter 2006 versus Second Quarter 2005
Net Sales by Segment:***

| | Three Months Ended June 30, | | | Percent Change | Acquired/ (Divested) Sales |
|------------------------|--------------------------------|----------|---------|-------------------|----------------------------------|
| | 2006 | 2005 | Change | | |
| ILS | \$ 150.3 | \$ 129.5 | \$ 20.8 | 16% | \$ 14.1 |
| Aluminum products | 44.9 | 43.1 | 1.8 | 4% | 0.0 |
| Manufactured products | 73.2 | 56.2 | 17.0 | 30% | 5.8 |
| Consolidated net sales | \$ 268.4 | \$ 228.8 | \$ 39.6 | 17% | \$ 19.9 |

Net sales increased 17% in the second quarter of 2006 compared to the same quarter in 2005. ILS sales increased 16% primarily due to the July 20, 2005 acquisition of PPG, general economic growth, particularly as a result of significant growth in the heavy-duty truck industry, the addition of new customers and increases in product range to existing customers. Aluminum Products sales increased 4% primarily due to passed-through aluminum cost increases. Manufactured Products sales increased 30% primarily in the induction, pipe threading equipment, rubber and forging businesses. Of this increase, \$5.8 million was due to the acquisitions of Lectrotherm and Foundry Service by the induction business, in December 2005 and January 2006, respectively.

Cost of Products Sold & Gross Profit:

| | Three Months Ended June 30, | | | Percent Change |
|------------------------------------|--------------------------------|----------|---------|-------------------|
| | 2006 | 2005 | Change | |
| Consolidated cost of products sold | \$ 230.7 | \$ 193.4 | \$ 37.3 | 19% |
| Consolidated gross profit | \$ 37.7 | \$ 35.4 | \$ 2.3 | 6% |
| Gross margin | 14.0% | 15.5% | | |

Cost of products sold increased 19% in the second quarter of 2006 compared to the same quarter in 2005, while gross margin decreased to 14.0% in the second quarter of 2006 from 15.5% in the same quarter of 2005.

ILS gross margin increased primarily due to increased volumes and greater recovery of steel cost increases. Aluminum Products gross margin decreased primarily due to product mix and pricing changes, plus the cost of preparations for new contracts that will start production in the fourth quarter of 2006. Gross margin in the Manufactured Products segment decreased primarily as a result of operational issues in the Company's rubber products business, and changes in contract mix and timing in the induction and pipe threading

Table of Contents

equipment businesses. Quarter-to-quarter, gross margins vary widely in Manufactured Products, and these timing issues are not expected to depress full-year 2006 gross margin for the Manufactured Products segment.

SG&A Expenses:

| | Three Months Ended June 30, | | | Percent Change |
|----------------------------|--------------------------------|---------|--------|-------------------|
| | 2006 | 2005 | Change | |
| Consolidated SG&A expenses | \$ 22.2 | \$ 20.4 | \$ 1.8 | 9% |
| SG&A percent | 8.3% | 8.9% | | |

Consolidated SG&A expenses increased 9% in the second quarter of 2006 compared to the same quarter in 2005, representing a .6% reduction in SG&A as a percent of sales. SG&A increased approximately \$1.2 million due to the acquisitions of PPG, Lectrotherm and Foundry Services. SG&A expenses were increased in the second quarter of 2006 compared to 2005 by a \$.2 million decrease in net pension credits reflecting reduced returns on pension plan assets.

Interest Expense:

| | Three Months Ended June 30, | | | Percent Change |
|--------------------------------|--------------------------------|----------|-----------------|-------------------|
| | 2006 | 2005 | Change | |
| Interest expense | \$ 7.7 | \$ 6.7 | \$ 1.0 | 15% |
| Average outstanding borrowings | \$ 379.3 | \$ 361.4 | \$ 17.9 | 5% |
| Average borrowing rate | 8.16% | 7.43% | 73 basis points | |

Interest expense increased \$1.0 million in the second quarter of 2006 compared to the same period of 2005, primarily due to higher average interest rates and average outstanding borrowings during the second quarter of 2006. The increase in average borrowings in the second quarter of 2006 resulted primarily from higher working capital requirements and the purchases of PPG, Lectrotherm and Foundry Service in July and December 2005 and January 2006, respectively. The higher average borrowing rate in the second quarter of 2006 was due primarily to increased interest rates under our revolving credit facility compared to the same quarter of 2005, which rates increased primarily as a result of actions by the Federal Reserve.

Income Tax:

The provision for income taxes was \$2.9 million in the three-month period ended June 30, 2006, a 37% effective income tax rate, compared to income taxes of \$0.7 million provided in the corresponding period of 2005, an effective 9% income tax rate. In the second quarter of 2005, these taxes consisted primarily of state and foreign taxes on profitable operations. Taxes in the second quarter of 2006 included such state and foreign taxes, but also included federal income taxes. This change resulted from the fourth-quarter 2005 reversal of a portion of our domestic deferred tax valuation allowance.

Table of Contents**Liquidity and Sources of Capital**

Our liquidity needs are primarily for working capital and capital expenditures. Our primary sources of liquidity have been funds provided by operations and funds available from existing bank credit arrangements and the sale of our senior subordinated notes. On July 30, 2003, we entered into a revolving credit facility with a group of banks that provided for availability of up to \$165.0 million, subject to an asset-based formula. In September 2004, December 2004 and June 2006, we amended our revolving credit facility to increase the availability to \$185.0 million, \$200.0 million, and \$220.0 million, respectively, subject to the same asset-based formula. The December 2004 amendment also extended the maturity from July 30, 2007 to December 31, 2010, while in May 2006 the revolving credit facility was amended to reduce the pricing applicable to LIBOR-based interest rates by 50 basis points effective as of April 1, 2006. The revolving credit facility is secured by substantially all our assets in the United States, Canada and the United Kingdom. Borrowings from this revolving credit facility will be used for general corporate purposes.

Amounts borrowed under the revolving credit facility may be borrowed at the Company's election at either (i) LIBOR plus .75% to 1.75% or (ii) the bank's prime lending rate. The LIBOR-based interest rate is dependent on the Company's debt service coverage ratio, as defined in the revolving credit facility. Under the revolving credit facility, a detailed borrowing base formula provides borrowing availability to the Company based on percentages of eligible accounts receivable, inventory and fixed assets. As of June 30, 2006, the Company had \$157.4 million outstanding under the revolving credit facility and approximately \$51.7 million of unused borrowing availability.

Current financial resources (working capital and available bank borrowing arrangements) and anticipated funds from operations are expected to be adequate to meet current cash requirements. The future availability of bank borrowings under the revolving credit facility is based on the Company's ability to meet a debt service coverage ratio covenant, which could be materially impacted by negative economic trends. Failure to meet the debt service coverage ratio could materially impact the availability and interest rate of future borrowings.

At June 30, 2006, the Company was in compliance with the debt service coverage ratio covenant and other covenants contained in the revolving credit facility.

The ratio of current assets to current liabilities was 2.18 at June 30, 2005 versus 2.12 at December 31, 2005. Working capital increased by \$36.4 million to \$244.5 million at June 30, 2006 from \$208.1 million at December 31, 2005. Major components of working capital, including accounts receivable, inventories, trade accounts payable and accrued expenses, increased substantially during the first six months of 2006 due primarily to significant revenue growth and the acquisition of Foundry Services.

During the first six months of 2006, the Company used \$20.8 million from operating activities compared to using \$16.7 million in the same period of 2005. The increase in operating cash usage of \$4.1 million was primarily the result of a greater increase in accounts receivable, inventories and other current assets in the first six months of 2006 compared to the same period of 2005 (\$59.8 million compared to \$22.3 million, respectively). Accounts receivable, inventories and other current assets increased primarily as a result of sales volume increases. These increases in current assets more than offset the operating cash generated by an increase of \$20.8 million in accounts payable in the first six months of 2006 compared to a reduction of \$14.1 million in the first half of 2005, and a reduction in net income of \$4.0 million, primarily due to the provision of federal income tax expense in the first six months of 2006. In the first six months of 2006, the Company also used cash of \$7.5 million for capital expenditures and \$3.2 million to acquire Foundry Service. These activities, plus an increase cash interest and taxes payments of \$16.9 million and a net increase in borrowing of \$29.9 million, resulted in a decrease in cash of \$1.6 million in the first six months of 2006.

The Company does not have off-balance-sheet arrangements, financing or other relationships with unconsolidated entities or other persons.

Table of Contents

Seasonality; Variability of Operating Results

Our results of operations are typically stronger in the first six months than the last six months of each calendar year due to scheduled plant maintenance in the third quarter to coincide with customer plant shutdowns and due to holidays in the fourth quarter.

The timing of orders placed by our customers has varied with, among other factors, orders for customers' finished goods, customer production schedules, competitive conditions and general economic conditions. The variability of the level and timing of orders has, from time to time, resulted in significant periodic and quarterly fluctuations in the operations of our business units. Such variability is particularly evident at the capital equipment businesses that are included in the Manufactured Products segment, which typically ship a few large systems per year.

Forward-Looking Statements

This quarterly report on Form 10-Q contains certain statements that are forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. The words believes, anticipates, plans, expects, intends, estimates and similar expressions are intended to identify forward-looking statements. These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance and achievements, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. These uncertainties and other factors include such things as: general business conditions and competitive factors, including pricing pressures and product innovation; demand for our products and services; raw material availability and pricing; changes in our relationships with customers and suppliers; the financial condition of our customers, including the impact of any bankruptcies; our ability to successfully integrate recent and future acquisitions into existing operations; changes in general domestic economic conditions such as inflation rates, interest rates, tax rates and adverse impacts to us, our suppliers and customers from acts of terrorism or hostilities; our ability to meet various covenants, including financial covenants, contained in our revolving credit agreement and the indenture governing our senior subordinated notes; increasingly stringent domestic and foreign governmental regulations, including those affecting the environment; inherent uncertainties involved in assessing our potential liability for environmental remediation-related activities; the outcome of pending and future litigation and other claims; dependence on the automotive and heavy-duty truck industries, which are highly cyclical; dependence on key management; and dependence on information systems. Any forward-looking statement speaks only as of the date on which such statement is made, and we undertake no obligation to update any forward-looking statement, whether as a result of new information, future events or otherwise, except as required by law. In light of these and other uncertainties, the inclusion of a forward-looking statement herein should not be regarded as a representation by us that our plans and objectives will be achieved.

Review By Registered Public Accounting Firm

The consolidated financial statements at June 30, 2006 and for the three-month and six-month periods ended June 30, 2006 and 2005 have been reviewed, prior to filing, by Ernst & Young LLP, our registered public accounting firm, and their report is included herein.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to market risk including changes in interest rates. We are subject to interest rate risk on borrowings under our floating rate revolving credit agreement, which consisted of borrowings of \$157.4 million at June 30, 2006. A 100 basis point increase in the interest rate would have resulted in an increase in interest expense of approximately \$.8 million during the six-month period ended June 30, 2006.

Our foreign subsidiaries generally conduct business in local currencies. During the first six months of 2006, we recorded a favorable foreign currency translation adjustment of \$2.6 million related to net assets located outside the United States. This foreign currency translation adjustment resulted primarily from the weakening of the U.S. dollar in relation to the euro and Canadian dollar. Our foreign operations are also

Table of Contents

subject to other customary risks of operating in a global environment, such as unstable political situations, the effect of local laws and taxes, tariff increases and regulations and requirements for export licenses, the potential imposition of trade or foreign exchange restrictions and transportation delays.

The Company enters into forward contracts on foreign currencies, primarily the euro and the British Pound Sterling, purely for the purpose of hedging exposure to changes in the value of accounts receivable in those currencies against the U.S. dollar. The Company currently uses no other derivative instruments. At June 30, 2006, \$.5 million of such currency hedge contracts were outstanding.

Item 4. Controls and Procedures

Under the supervision of and with the participation of our management, including our chief executive officer and chief financial officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15(d)-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this quarterly report.

Based on that evaluation, our chief executive officer and chief financial officer have concluded that, as of the end of the period covered by this quarterly report, our disclosure controls and procedures were effective.

There have been no changes in our internal control over financial reporting that occurred during the second quarter of 2006 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

**PART II
OTHER INFORMATION**

Item 1. Legal Proceedings

We are subject to various pending and threatened lawsuits in which claims for monetary damages are asserted in the ordinary course of business. While any litigation involves an element of uncertainty, in the opinion of management, liabilities, if any, arising from currently pending or threatened litigation is not expected to have a material adverse effect on our financial condition, liquidity or results of operations.

At June 30, 2006, we were a co-defendant in approximately 380 cases asserting claims on behalf of approximately 10,000 plaintiffs alleging personal injury as a result of exposure to asbestos. These asbestos cases generally relate to production and sale of asbestos-containing products and allege various theories of liability, including negligence, gross negligence and strict liability and seek compensatory and, in some cases, punitive damages.

In every asbestos case in which we are named as a party, the complaints are filed against multiple named defendants. In substantially all of the asbestos cases, the plaintiffs either claim damages in excess of a specified amount, typically a minimum amount sufficient to establish jurisdiction of the court in which the case was filed (jurisdictional minimums generally range from \$25,000 to \$75,000), or do not specify the monetary damages sought. To the extent that any specific amount of damages is sought, the amount applies to claims against all named defendants.

There are only four asbestos cases, involving 21 plaintiffs, that plead specified damages. In each of the four cases, the plaintiff is seeking compensatory and punitive damages based on a variety of potentially alternative causes of action. In three cases, the plaintiff has alleged compensatory damages in the amount of \$3.0 million for four separate causes of action and \$1.0 million for another cause of action and punitive damages in the amount of \$10.0 million. In the other case, the plaintiff has alleged compensatory damages in the amount of \$20.0 million for three separate causes of action and \$5.0 million for another cause of action and punitive damages in the amount of \$20.0 million.

Historically, we have been dismissed from asbestos cases on the basis that the plaintiff incorrectly sued one of our subsidiaries or because the plaintiff failed to identify any asbestos-containing product manufactured or sold by us or our subsidiaries. We intend to vigorously defend these asbestos cases, and believe we will continue to be successful in being dismissed from such cases. However, it is not possible to predict the ultimate outcome of asbestos-related lawsuits, claims and proceedings due to the unpredictable nature of personal injury litigation. Despite this uncertainty, and although our results of operations and cash flows for a particular period could be adversely affected by asbestos-related lawsuits, claims and proceedings, management believes that the ultimate resolution of these matters will not have a material adverse effect on our financial condition, liquidity or results of operations. Among the factors management considered in reaching this conclusion were: (a) our historical success in being dismissed from these types of lawsuits on the bases mentioned above; (b) many cases have been improperly filed against one of our subsidiaries; (c) in many cases, the plaintiffs have been unable to establish any causal relationship to us or our products or premises; (d) in many cases, the plaintiffs have been unable to demonstrate that they have suffered any identifiable injury or compensable loss at all, that any injuries that they have incurred did in fact result from alleged exposure to asbestos; and (e) the complaints assert claims against multiple defendants and, in most cases, the damages alleged are not attributed to individual defendants. Additionally, we do not believe that the amounts claimed in any of the asbestos cases are meaningful indicators of our potential exposure because the amounts claimed typically bear no relation to the extent of the plaintiff's injury, if any.

Our cost of defending these lawsuits has not been material to date and, based upon available information, our management does not expect its future costs for asbestos-related lawsuits to have a material adverse effect on our results of operations, liquidity or financial position.

Table of Contents**Item 1A. Risk Factors**

There have been no material changes in the risk factors previously disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

| Period | (a) Total Number of Shares (or Units) Purchased(1) | (b) Average Price Paid per Share (or Unit) | (c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs | (d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May yet be Purchased Under the Plans or Programs |
|--------------------------------------|---|---|--|--|
| April 1, 2006 through April 30, 2006 | 1,571 | \$ 19.81 | 0 | 0 |
| May 1, 2006 through May 31, 2006 | | | 0 | 0 |
| June 1, 2006 through June 30, 2006 | | \$ | 0 | 0 |
| Total | 1,571 | \$ 19.81 | 0 | 0 |

(1) Represents shares surrendered or deemed surrendered to us to satisfy tax withholding obligations in connection with the vesting of restricted shares under employee stock-based compensation plans.

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

The Company held its annual meeting of shareholders on May 25, 2006, at which the following matters were submitted to a vote of the shareholders with the results indicated:

a) the election of the persons named below as Directors for a term expiring in 2009 were as follows:

| | For | Withheld |
|---------------------|------------|-----------------|
| Matthew V. Crawford | 10,436,059 | 107,877 |
| Kevin R. Greene | 10,506,108 | 37,828 |
| Ronna Romney | 10,515,318 | 28,618 |

b) the approval of an amendment to the Park-Ohio Holdings Corp. Amended and Restated 1998 Long-Term Incentive Plan were as follows:

| For | Against | Abstentions |
|------------|----------------|--------------------|
|------------|----------------|--------------------|

| | | |
|-----------|-----------|-----------|
| 7,543,938 | 1,719,321 | 1,280,677 |
|-----------|-----------|-----------|

c) the approval to adopt the Park-Ohio Holdings Corp. Annual Cash Bonus Plan were as follows:

| For | Against | Abstentions |
|------------|----------------|--------------------|
| 10,381,707 | 147,094 | 15,135 |

Table of Contents

Item 6. Exhibits

The following exhibits are included herein:

- 4 Fourth Amendment, dated June 9, 2006, to the Amended and Restated Credit Agreement, dated November 5, 2003, among Park-Ohio Industries, Inc., the other loan parties thereto, the lenders party thereto and JPMorgan Chase Bank, N.A. (successor by merger to Bank One, NA), as agent (filed as Exhibit 4.1 to the Form 8-K of Park-Ohio Holdings Corp. filed on June 14, 2006, SEC File No. 000-03134 and incorporated by reference and made a part hereof)
- 10.1 Park-Ohio Holdings Corp. Amended and Restated 1998 Long-Term Incentive Plan (filed as Exhibit 10.1 to the Form 8-K of Park-Ohio Holdings Corp. filed on June 1, 2006, SEC File No. 000-03134 and incorporated by reference and made a part hereof)
- 10.2 Park-Ohio Holdings Corp. Annual Cash Bonus Plan (filed as Exhibit 10.2 to the Form 8-K of Park-Ohio Holdings Corp. filed on June 1, 2006, SEC File No. 000-03134 and incorporated by reference and made a part hereof)
- 15 Letter re: unaudited financial information
- 31.1 Principal Executive Officer's Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Principal Financial Officer's Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32 Certification requirement under Section 906 of the Sarbanes-Oxley Act of 2002

Table of Contents

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.

Date: August 8, 2006

PARK-OHIO HOLDINGS CORP.

(Registrant)

By /s/ Richard P. Elliott

Name: Richard P. Elliott

Title: Vice President and Chief Financial Officer

(Principal Financial and Accounting Officer)

28

Table of Contents

**EXHIBIT INDEX
QUARTERLY REPORT ON FORM 10-Q
PARK-OHIO HOLDINGS CORP. AND SUBSIDIARIES
FOR THE QUARTER ENDED JUNE 30, 2006**

Exhibit

| | |
|------|---|
| 4 | Fourth Amendment, dated June 9, 2006, to the Amended and Restated Credit Agreement, dated November 5, 2003, among Park-Ohio Industries, Inc., the other loan parties thereto, the lenders party thereto and JP Morgan Chase Bank, N.A. (successor by merger to Bank One, NA), as agent (filed as Exhibit 4.1 to the Form 8-K of Park-Ohio Holdings Corp. filed on June 14, 2006, SEC File No. 000-03134 and incorporated by reference and made a part hereof) |
| 10.1 | Park-Ohio Holdings Corp. Amended and Restated 1998 Long-Term Incentive Plan (filed as Exhibit 10.1 to the Form 8-K of Park-Ohio Holdings Corp. filed on June 1, 2006, SEC File No. 000-03134 and incorporated by reference and made a part hereof) |
| 10.2 | Park-Ohio Holdings Corp. Annual Cash Bonus Plan (filed as Exhibit 10.2 to the Form 8-K of Park-Ohio Holdings Corp. filed on June 1, 2006, SEC File No. 000-03134 and incorporated by reference and made a part hereof) |
| 15 | Letter re: unaudited financial information |
| 31.1 | Principal Executive Officer's Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Principal Financial Officer's Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32 | Certification requirement under Section 906 of the Sarbanes-Oxley Act of 2002 |