TIMKEN CO
Form 10-Q
April 27, 2016

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, 2016
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	44720-5450
(Address of principal executive offices)	(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, 2016
Common Shares, without par value	79,222,802 shares

PART I. FINANCIAL INFORMATION

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

	Three Months Ended March 31,	
	2016	2015
(Dollars in millions, except per share data)		
Net sales	$684.0	$722.5
Cost of products sold	503.1	520.0
Gross Profit	180.9	202.5
Selling, general and administrative expenses	118.3	128.5
Impairment and restructuring charges	10.5	6.2
Pension settlement charges	1.2	215.2
Operating Income (Loss)	50.9	(147.4)
Interest expense	(8.4)	(8.0)
Interest income	0.3	0.7
Continued Dumping & Subsidy Offset Act income, net of related expenses	47.7	—
Other (expense) income, net	—	(1.4)
Income (Loss) Before Income Taxes	90.5	(156.1)
Provision (benefit) for income taxes	27.6	(21.3)
Net Income (Loss)	62.9	(134.8)
Less: Net (loss) income attributable to noncontrolling interest	(0.1)	0.4
Net Income (Loss) attributable to The Timken Company	$63.0	$(135.2)
Net Income (Loss) per Common Share attributable to The Timken Company's Common Shareholders		
Basic earnings (loss) per share	$0.79	$(1.54)
Diluted earnings (loss) per share	$0.78	$(1.54)
Dividends per share	$0.26	$0.25

See accompanying Notes to the Consolidated Financial Statements.

Consolidated Statements of Comprehensive Income
(Unaudited)

(Dollars in millions)	Three Months Ended March 31, 2016	2015
Net Income (Loss)	$62.9	$(134.8)
Other comprehensive income (loss), net of tax:		
Foreign currency translation adjustments	14.8	(27.8)
Pension and postretirement liability adjustment	3.7	105.1
Change in fair value of derivative financial instruments	(2.3)	—
Other comprehensive income (loss), net of tax	16.2	77.3
Comprehensive Income (Loss), net of tax	79.1	(57.5)
Less: comprehensive income attributable to noncontrolling interest	1.0	0.4
Comprehensive Income (Loss) attributable to The Timken Company	$78.1	$(57.9)

See accompanying Notes to the Consolidated Financial Statements.

Consolidated Balance Sheets

	(Unaudited) March 31, 2016	December 31, 2015
(Dollars in millions)		
ASSETS		
Current Assets		
Cash and cash equivalents	$ 137.3	$ 129.6
Restricted cash	0.2	0.2
Accounts receivable, less allowances (2016 – $16.9 million; 2015 – $16.9 million)	465.0	454.6
Inventories, net	551.3	543.2
Deferred charges and prepaid expenses	25.9	22.7
Other current assets	95.2	56.1
Total Current Assets	1,274.9	1,206.4
Property, Plant and Equipment, net	780.1	777.8
Other Assets		
Goodwill	328.7	327.3
Non-current pension assets	88.1	86.3
Other intangible assets	265.1	271.3
Deferred income taxes	64.9	65.9
Other non-current assets	48.3	49.1
Total Other Assets	795.1	799.9
Total Assets	$ 2,850.1	$ 2,784.1
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Short-term debt	$ 0.2	$ 62.0
Current portion of long-term debt	15.1	15.1
Accounts payable, trade	177.9	159.7
Salaries, wages and benefits	84.6	102.3
Income taxes payable	30.2	13.1
Other current liabilities	134.6	153.1
Total Current Liabilities	442.6	505.3
Non-Current Liabilities		
Long-term debt	673.4	579.4
Accrued pension cost	149.2	146.9
Accrued postretirement benefits cost	133.1	136.1
Deferred income taxes	3.6	3.6
Other non-current liabilities	72.6	68.2
Total Non-Current Liabilities	1,031.9	934.2
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) (2016 – 98,375,135 shares; 2015 – 98,375,135 shares)		
Stated capital	53.1	53.1
Other paid-in capital	901.6	905.1
Earnings invested in the business	1,499.9	1,457.6
Accumulated other comprehensive loss	(271.9)	(287.0)
Treasury shares at cost (2016 – 19,152,333 shares; 2015 – 18,112,047 shares)	(833.0)	(804.3)
Total Shareholders' Equity	1,349.7	1,324.5
Noncontrolling Interest	25.9	20.1
Total Equity	1,375.6	1,344.6
Total Liabilities and Shareholders' Equity	$ 2,850.1	$ 2,784.1

See accompanying Notes to the Consolidated Financial Statements.

Consolidated Statements of Cash Flows
(Unaudited)

	Three Months Ended March 31,	
	2016	2015
(Dollars in millions)		
CASH PROVIDED (USED)		
Operating Activities		
Net income (loss) attributable to The Timken Company	$63.0	$(135.2)
Net (loss) income attributable to noncontrolling interest	(0.1)	0.4
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	32.6	33.5
Impairment charges	2.6	2.7
Loss on sale of assets	0.6	0.3
Continued Dumping and Subsidy Offset Act receivable	(48.1)	—
Deferred income tax provision	0.7	(84.4)
Stock-based compensation expense	4.6	4.1
Excess tax benefits related to stock-based compensation	—	(1.0)
Pension and other postretirement expense	9.3	225.1
Pension contributions and other postretirement benefit payments	(10.2)	(6.9)
Changes in operating assets and liabilities:		
Accounts receivable	(4.9)	(29.6)
Inventories	(0.1)	(12.8)
Accounts payable, trade	16.5	27.9
Other accrued expenses	(28.4)	(63.5)
Income taxes	21.7	54.7
Other, net	(12.7)	1.7
Net Cash Provided by Operating Activities	47.1	17.0
Investing Activities		
Capital expenditures	(24.2)	(19.7)
Proceeds from disposal of property, plant and equipment	—	2.8
Investments in short-term marketable securities, net	(0.5)	2.9
Other	0.1	—
Net Cash Used by Investing Activities	(24.6)	(14.0)
Financing Activities		
Cash dividends paid to shareholders	(20.7)	(21.9)
Purchase of treasury shares	(35.0)	(96.8)
Proceeds from exercise of stock options	0.3	1.1
Excess tax benefits related to stock-based compensation	—	1.0
Proceeds from long-term debt	90.0	—
Accounts receivable facility borrowings	10.0	—
Accounts receivable facility payments	(11.0)	—
Payments on long-term debt	(45.0)	(1.1)
Short-term debt activity, net	(12.8)	(3.6)
Decrease in restricted cash	—	0.5
Other	4.8	—

Net Cash Used by Financing Activities	(19.4)	(120.8)
Effect of exchange rate changes on cash	4.6	(6.6)
Increase (Decrease) In Cash and Cash Equivalents	7.7	(124.4)
Cash and cash equivalents at beginning of year	129.6	278.8
Cash and Cash Equivalents at End of Period	$137.3	$154.4

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, 2015.

Note 2 - Recent Accounting Pronouncements
In March 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-09, "Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting." ASU 2016-09 simplifies various aspects of the accounting for shared-based payments. The simplifications include: (a) recording all tax effects associated with stock-based compensation through the income statement, as opposed to recording certain amounts in other paid-in capital, which eliminates the complications of tracking a "windfall pool," but will increase the volatility of income tax expense; (b) allowing entities to withhold shares to satisfy the employer's statutory tax withholding requirement up to the highest marginal tax rate applicable to employees rather than the employer's minimum statutory rate, without requiring liability classification for the award; (c) modifying the requirement to estimate the number of awards that will ultimately vest by providing an accounting policy election to either estimate the number of forfeitures or recognize forfeitures as they occur; and (d) changing certain presentation requirements in the statement of cash flows, including removing the requirement to present excess tax benefits as an inflow from financing activities and an outflow from operating activities, and requiring the cash paid to taxing authorities arising from withheld shares to be classified as a financing activity.
ASU 2016-09 is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted for any entity in any interim or annual period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity that elects early adoption must adopt all of the amendments in the same period. Amendments related to the timing of when excess tax benefits are recognized, minimum statutory withholding requirements, forfeitures, and intrinsic value should be applied using a modified retrospective transition method by means of a cumulative-effect adjustment to equity as of the beginning of the period in which the guidance is adopted. Amendments related to the presentation of employee taxes paid on the statement of cash flows when an employer withholds shares to meet the minimum statutory withholding requirement should be applied retrospectively. Amendments requiring recognition of excess tax benefits and tax deficiencies in the income statement and the practical expedient for estimating expected term should be applied prospectively. An entity may elect to apply the amendments related to the presentation of excess tax benefits on the statement of cash flows using either a prospective transition method or a retrospective transition method. The Company is currently evaluating the effect that the provisions of ASU 2016-09 will have on the Company's results of operations and financial condition.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)." ASU 2016-02 was issued to increase transparency and comparability among entities by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about lease arrangements. ASU 2016-02 is effective for public companies for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Company is currently evaluating the impact of adopting ASU 2016-02 on the Company's results of operations and financial condition.

In September 2015, the FASB issued ASU 2015-16, "Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments." ASU 2015-16 eliminates the requirement for an acquirer in a business combination to account for measurement-period adjustments retrospectively. Instead, acquirers must recognize measurement-period adjustments during the period in which they determine the amounts, including the effect on earnings of any amounts they would have recorded in previous periods if the accounting had been completed at the acquisition date. This new accounting guidance does not eliminate the requirement for the measurement period to be completed within one year. This new accounting guidance is effective for annual periods beginning after December 15, 2015. On January 1, 2016, the Company adopted the provisions of ASU 2015-16. The adoption of ASU 2015-16 had no effect on the Company's results of operations or financial condition as there were no measurement-period adjustments during the first three months of 2016.

In May 2015, the FASB issued ASU 2015-07, "Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)." ASU 2015-07 eliminates the requirement to categorize within the fair value hierarchy investments for which fair values are estimated using the net asset value (NAV) practical expedient provided in ASC 820, "Fair Value Measurement." Instead, entities will be required to disclose the fair values of such investments so that financial statement users can reconcile amounts reported in the fair value hierarchy table and the amounts reported on the balance sheet. ASU 2015-07 is effective for fiscal years beginning after December 15, 2015, with retrospective application to all periods presented. On January 1, 2016, the Company adopted the provisions of ASU 2015-07. The adoption of ASU 2015-07 did not have any impact on the Company's results of operations or financial condition as the new guidance addresses disclosure only. See Note 15 - Fair Value for the new disclosures.

In April 2015, the FASB issued ASU 2015-03, "Interest - Imputation of Interest (Subtopic 835-30) - Simplifying the Presentation of Debt Issuance Costs." ASU 2015-03 requires that all costs incurred to issue debt be presented in the balance sheet as a direct deduction in the carrying value of debt. Prior to the issuance of this new accounting guidance, debt issuance costs were required to be presented in the balance sheet as a deferred charge (i.e., an asset), and only a debt discount was recorded as a direct deduction to the carrying value of debt. This new accounting guidance is effective for annual periods beginning after December 15, 2015. ASU 2015-03 requires that the new accounting guidance be applied on a retrospective basis, wherein the balance sheet of each individual period presented should be adjusted to reflect the period-specific effects of applying the new guidance.

On January 1, 2016, the Company adopted the provisions of ASU 2015-03. The following financial statement line items at December 31, 2015 were affected by the adoption of ASU 2015-03.

	As Originally Reported	New Presentation	Effect of Change
Assets:			
Other non-current assets	$ 50.3	$ 49.1	$ 1.2
Liabilities:			
Long-term debt	$ 580.6	$ 579.4	$ 1.2

In May 2014, the FASB issued 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. On July 9, 2015, the FASB decided to delay the effective date of this new accounting guidance by one year, which will 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 and financial condition.

Note 3 - Inventories

The components of inventories were as follows:

	March 31, 2016	December 31, 2015
Manufacturing supplies	$ 29.6	$ 24.7
Raw materials	57.8	58.8
Work in process	182.5	181.9
Finished products	301.6	296.2
Subtotal	571.5	561.6
Allowance for obsolete and surplus inventory	(20.2)	(18.4)
Total Inventories, net	$ 551.3	$ 543.2

Inventories are valued at the lower of cost or market, with approximately 54% valued by the first-in, first-out (FIFO) method and the remaining 46% 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, 2016 and December 31, 2015 were $183.6 million and $188.1 million, respectively. The Company recognized a decrease in its LIFO reserve of $4.5 million during the first three months of 2016, compared to an increase in its LIFO reserve of $1.9