

NN INC
Form 10-Q
August 09, 2011

Table of Contents

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

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

For the quarterly period ended **June 30, 2011**

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 0-23486

NN, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

62-1096725
(I.R.S. Employer
Identification Number)

**2000 Waters Edge Drive
Building C, Suite 12
Johnson City, Tennessee 37604**
(Address of principal executive offices, including zip code)
(423) 743-9151

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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 definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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

As of August 3, 2011, there were 16,948,632 shares of the registrant's common stock, par value \$0.01 per share, outstanding.

NN, Inc.
INDEX

Page No.

Part I. Financial Information

| | | |
|----------------|--|----|
| <u>Item 1.</u> | <u>Financial Statements:</u> | |
| | <u>Condensed Consolidated Statements of Income and Comprehensive Income (Loss) for the three and six months ended June 30, 2011 and 2010 (unaudited)</u> | 2 |
| | <u>Condensed Consolidated Balance Sheets at June 30, 2011 and December 31, 2010 (unaudited)</u> | 3 |
| | <u>Condensed Consolidated Statement of Changes in Stockholders' Equity for the six months ended June 30, 2011 (unaudited)</u> | 4 |
| | <u>Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2011 and 2010 (unaudited)</u> | 5 |
| | <u>Notes to Condensed Consolidated Financial Statements (unaudited)</u> | 6 |
| <u>Item 2.</u> | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 15 |
| <u>Item 3.</u> | <u>Quantitative and Qualitative Disclosures about Market Risk</u> | 23 |
| <u>Item 4.</u> | <u>Controls and Procedures</u> | 23 |

Part II. Other Information

| | | |
|-----------------|--|----|
| <u>Item 1.</u> | <u>Legal Proceedings</u> | 24 |
| <u>Item 1A.</u> | <u>Risk Factors</u> | 24 |
| <u>Item 2.</u> | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 24 |
| <u>Item 3.</u> | <u>Defaults Upon Senior Securities</u> | 24 |
| <u>Item 4.</u> | <u>(Removed and Reserved)</u> | 24 |
| <u>Item 5.</u> | <u>Other Information</u> | 24 |
| <u>Item 6.</u> | <u>Exhibits</u> | 24 |
| | <u>Signatures</u> | 25 |
| | <u>EX-31.1</u> | |
| | <u>EX-31.2</u> | |
| | <u>EX-32.1</u> | |
| | <u>EX-32.2</u> | |
| | <u>EX-101 INSTANCE DOCUMENT</u> | |
| | <u>EX-101 SCHEMA DOCUMENT</u> | |

[EX-101 CALCULATION LINKBASE DOCUMENT](#)

[EX-101 LABELS LINKBASE DOCUMENT](#)

[EX-101 PRESENTATION LINKBASE DOCUMENT](#)

[EX-101 DEFINITION LINKBASE DOCUMENT](#)

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****NN, Inc.****Condensed Consolidated Statements of Income and Comprehensive Income (Loss)
(Unaudited)**

| (In Thousands of Dollars, Except Per Share Data) | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--|-------------|--------------------------------------|-------------|
| | 2011 | 2010 | 2011 | 2010 |
| Net sales | \$ 115,922 | \$ 92,693 | \$ 227,229 | \$ 178,033 |
| Cost of products sold (exclusive of depreciation and amortization shown separately below) | 94,657 | 73,423 | 184,955 | 142,339 |
| Selling, general and administrative | 7,720 | 7,150 | 15,686 | 15,040 |
| Depreciation and amortization | 4,291 | 4,842 | 8,326 | 10,962 |
| Loss on disposal of assets | 3 | 2 | 3 | 3 |
| Restructuring and impairment charges | | 667 | | 1,236 |
| Gain from deconsolidation of bankrupt subsidiary | | | (209) | |
| Income from operations | 9,251 | 6,609 | 18,468 | 8,453 |
| Interest expense | 1,220 | 1,755 | 2,444 | 3,483 |
| Write-off of unamortized debt issuance costs | | | | 130 |
| Other expense (income), net | 155 | (1,789) | 1,191 | (2,977) |
| Income before provision for income taxes | 7,876 | 6,643 | 14,833 | 7,817 |
| Provision for income taxes | 2,049 | 1,520 | 3,499 | 2,469 |
| Net income | 5,827 | 5,123 | 11,334 | 5,348 |
| Other comprehensive income (loss): | | | | |
| Foreign currency translation gain (loss) | 1,964 | (8,485) | 8,494 | (14,921) |
| Comprehensive income (loss) | \$ 7,791 | \$ (3,362) | \$ 19,828 | \$ (9,573) |
| Basic income per common share: | \$ 0.35 | \$ 0.31 | \$ 0.68 | \$ 0.33 |
| Weighted average shares outstanding | 16,864 | 16,522 | 16,733 | 16,388 |
| Diluted income per common share: | \$ 0.34 | \$ 0.31 | \$ 0.67 | \$ 0.32 |
| Weighted average shares outstanding | 17,119 | 16,633 | 16,974 | 16,492 |

The accompanying notes are an integral part of the financial statements.

Table of Contents

NN, Inc.
Condensed Consolidated Balance Sheets
(Unaudited)

| (In Thousands of Dollars) | June 30, 2011 | December 31, 2010 |
|--|--------------------------|------------------------------|
| Assets | | |
| Current assets: | | |
| Cash | \$ 9,923 | \$ 5,556 |
| Accounts receivable, net of allowance for doubtful accounts of \$440 and \$473, respectively | 81,547 | 63,331 |
| Inventories, net | 42,654 | 41,882 |
| Other current assets | 5,525 | 4,901 |
| Total current assets | 139,649 | 115,670 |
| Property, plant and equipment, net | 123,592 | 118,488 |
| Goodwill, net | 9,317 | 8,396 |
| Intangible assets | 900 | 900 |
| Other non-current assets | 5,272 | 5,101 |
| Total assets | \$278,730 | \$248,555 |
| Liabilities and Stockholders Equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 55,458 | \$ 55,549 |
| Accrued salaries, wages and benefits | 12,848 | 13,548 |
| Current maturities of long-term debt | 6,655 | 5,714 |
| Income taxes payable | 1,392 | 2,560 |
| Other current liabilities | 7,002 | 6,216 |
| Total current liabilities | 83,355 | 83,587 |
| Non-current deferred tax liabilities | 4,396 | 3,954 |
| Long-term debt, net of current portion | 80,129 | 67,643 |
| Accrued pension | 8,654 | 13,438 |
| Other non-current liabilities | 1,843 | 1,826 |
| Total liabilities | 178,377 | 170,448 |
| Total stockholders equity | 100,353 | 78,107 |
| Total liabilities and stockholders equity | \$278,730 | \$248,555 |

The accompanying notes are an integral part of the financial statements.

Table of Contents

NN, Inc.
Condensed Consolidated Statement of Changes in Stockholders Equity
(Unaudited)

| (In Thousands of Dollars and Shares) | Common Stock Number Of Shares | Par Value | Additional Paid in Capital | Retained Earnings | Accumulated Other Comprehensive Income | Total |
|--------------------------------------|--|----------------------|---|------------------------------|---|--------------|
| Balance, January 1, 2011 | 16,620 | \$167 | \$51,863 | \$ 6,675 | \$ 19,402 | \$ 78,107 |
| Net income | | | | 11,334 | | 11,334 |
| Shares issued for options | 244 | 2 | 2,300 | | | 2,302 |
| Stock option expense | | | 66 | | | 66 |
| Restricted stock expense | 75 | | 50 | | | 50 |
| Foreign currency translation gain | | | | | 8,494 | 8,494 |
| Balance, June 30, 2011 | 16,939 | \$169 | \$54,279 | \$18,009 | \$ 27,896 | \$100,353 |

The accompanying notes are an integral part of the financial statements.

4

Table of Contents

NN, Inc.
Condensed Consolidated Statements of Cash Flows
(Unaudited)

| (In Thousands of Dollars) | Six Months Ended June 30, | |
|--|--------------------------------------|-------------|
| | 2011 | 2010 |
| Operating Activities: | | |
| Net income | \$ 11,334 | \$ 5,348 |
| Adjustments to reconcile net income to net cash (used) provided by operating activities: | | |
| Depreciation and amortization | 8,326 | 10,962 |
| Amortization of debt issuance costs | 409 | 730 |
| Write-off of unamortized debt issuance cost | | 130 |
| Loss on disposal of assets | 3 | 3 |
| Deferred income tax expense (benefit) | | (57) |
| Non-cash gain from deconsolidation of bankrupt subsidiary | (209) | |
| Share-based compensation expense | 116 | 1,200 |
| Non-cash interest income from long-term note receivable | (126) | |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (19,141) | (20,288) |
| Inventories | (1,668) | (1,743) |
| Accounts payable | (627) | 6,267 |
| Other assets and liabilities | (434) | 2,574 |
| Net cash (used) provided by operating activities | (2,017) | 5,126 |
| Investing Activities: | | |
| Acquisition of property, plant and equipment | (10,173) | (4,354) |
| Cash lost on deconsolidation of Eltmann subsidiary | (979) | |
| Proceeds from disposals of property, plant and equipment | 106 | 2 |
| Net cash used by investing activities | (11,046) | (4,352) |
| Financing Activities: | | |
| Proceeds (repayment) of short-term debt | 941 | (1,228) |
| Principal payment on capital lease | (32) | (28) |
| Proceeds from long term debt | 12,486 | 2,085 |
| Proceeds from issuance of stock | 2,302 | 7 |
| Debt issuance cost paid | (334) | (422) |
| Net cash provided by financing activities | 15,363 | 414 |
| Effect of exchange rate changes on cash flows | 2,067 | (3,889) |

| | | |
|------------------------------------|----------|----------|
| Net Change in Cash | 4,367 | (2,701) |
| Cash at Beginning of Period | 5,556 | 8,744 |
| Cash at End of Period | \$ 9,923 | \$ 6,043 |

Supplemental schedule of non-cash investing and financing activities:

The following amounts were deconsolidated from the Condensed Consolidated Balance Sheet of NN due to the bankruptcy of a subsidiary on January 20, 2011 and are not reflected in the net cash used by operating activities above:

Accounts receivable of \$3,388, Inventory of \$2,407,

Accounts payable of \$1,947 and Other assets and liabilities of \$6,379.

Additionally, property, plant and equipment of \$1,343 was deconsolidated from the Condensed Consolidated Balance Sheet of NN on January 20, 2011 and is not reflected in the net cash used by investing activities above.

The accompanying notes are an integral part of the financial statements.

Table of Contents

NN, Inc.
Notes To Condensed Consolidated Financial Statements
(In Thousands, Except Per Share Data)
(unaudited)

Note 1. Interim Financial Statements

The accompanying condensed consolidated financial statements of NN, Inc. have not been audited, except that the balance sheet at December 31, 2010 was derived from the Company's audited consolidated financial statements. In the opinion of the Company's management, the financial statements reflect all adjustments necessary to fairly state the results of operations for the three and six month periods ended June 30, 2011 and 2010, the Company's financial position at June 30, 2011 and December 31, 2010, and the cash flows for the six month periods ended June 30, 2011 and 2010. These adjustments are of a normal recurring nature and are, in the opinion of management, necessary for fair statement of the financial position and operating results for the interim periods. As used in this Quarterly Report on Form 10-Q, the terms "NN", "the Company", "we", "our", or "us" mean NN, Inc. and its subsidiaries.

Certain information and footnote disclosures normally included in the consolidated financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted from the interim financial statements presented in this Quarterly Report on Form 10-Q. These unaudited, condensed and consolidated financial statements should be read in conjunction with our audited consolidated financial statements and the notes thereto included in our most recent annual report on Form 10-K for the year ended December 31, 2010 which we filed with the Securities and Exchange Commission on March 15, 2011. The results for the three and six month period ended June 30, 2011 are not necessarily indicative of results for the year ending December 31, 2011 or any other future periods.

Due to the impacts of the global economic recession and the resulting reduction in revenue and operating losses, our wholly owned German subsidiary, Kugelfertigung Eltmann GbmH ("Eltmann" or "Eltmann Plant"), sustained a significant weakening of its financial condition and as a result became insolvent at which point it was required to file for bankruptcy under German bankruptcy law. The filing was made in the bankruptcy court in Germany on January 20, 2011. As of this date, NN lost the ability to control or manage Eltmann as a result of the bankruptcy court trustee taking over effective control and day to day management of this subsidiary. As a result of loss of control of this subsidiary, NN deconsolidated the assets and liabilities of Eltmann from our Consolidated Financial Statements effective January 20, 2011.

We were informed that in early April 2011, the bankruptcy trustee sold the majority of the production assets of Eltmann to a non-affiliated manufacturing company. It is our understanding that the remaining assets and liabilities of Eltmann will be liquidated sometime in the future by the bankruptcy court. NN does not expect any further significant impact on our consolidated financial statements as a result of the liquidation of this subsidiary.

The following table summarizes the effects on the June 30, 2011 Condensed Consolidated Balance Sheet of the deconsolidation of Eltmann effective January 20, 2011:

| | |
|--|------------|
| Cash | \$ (979) |
| Accounts receivable | (3,388) |
| Inventory | (2,407) |
| Other assets | (193) |
| Property, plant and equipment | (1,343) |
| Reduction of total assets | \$ (8,310) |
| Accounts payable | (1,947) |
| Accrued salaries | (1,500) |
| Accrued pension | (5,623) |
| Accumulated other comprehensive income | 551 |

| | |
|---|------------|
| Reduction of total liabilities and stockholders' equity | \$ (8,519) |
|---|------------|

| | |
|--|--------|
| Gain from deconsolidation of bankrupt subsidiary | \$ 209 |
|--|--------|

6

Table of Contents

NN, Inc.
Notes To Condensed Consolidated Financial Statements
(In Thousands, Except Per Share Data)
(unaudited)

Note 2. Restructuring Charges and Other

During the first quarter of 2010, we announced the closure of the Tempe Plant. The closure impacted approximately 130 employees. Economic conditions at that time coupled with the long-term manufacturing strategy for our Whirlaway business necessitated a consolidation of our manufacturing resources into existing facilities in Ohio. During the three and six month periods ended June 30, 2010, we accrued \$604 and \$1,137, respectively, of severance costs related to the closure. The severance costs were recognized pro-rata over the period from the announcement date until the employees' termination date as continued employment was a requirement to receive severance payments. Additionally, during the three and six month periods ended June 30, 2010, we incurred \$63 of site closure and other associated costs. In the first quarter of 2010, we incurred \$1,000 of accelerated depreciation related to certain fixed assets that ceased to be used due to the Tempe Plant closure.

Note 3. Long Term Notes Receivable

Certain property, plant and equipment of the Tempe Plant was sold on August 31, 2010, the day the Tempe Plant ceased operations, to a newly formed company not affiliated with NN. Property, plant and equipment with a net book value of \$2,230 were sold in exchange for a promissory note with a fair value of \$1,562, as of August 31, 2010, (described below as the Tempe Fixed Asset Note).

The Tempe Fixed Asset Note had an original face value of \$2,500, a 60 month term, a 7% interest rate, interest only payments for 24 months, principal and interest payments totaling \$40 per month for the next 36 months followed by a balloon payment of \$1,525. The note is secured by a first lien on approximately \$1,000 of the assets and a second lien on the remaining assets. As of June 30, 2011, the note had an estimated fair value and carrying value of \$1,688 determined using a discounted cash flow method applying market interest rates for similar types of seller financed, partially secured promissory notes (Level 3 under the U.S. GAAP fair value hierarchy). This note is reported within other current assets for the current portion and other non-current assets for the long-term portion within the Condensed Consolidated Balance Sheets.

Note 4. Inventories

Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out method. Inventories are comprised of the following (in thousands):

| | June 30, 2011 | December 31, 2010 |
|-------------------------|--------------------------|----------------------------------|
| Raw materials | \$ 13,422 | \$ 12,882 |
| Work in process | 9,664 | 8,837 |
| Finished goods | 21,061 | 21,467 |
| Less inventory reserves | (1,493) | (1,304) |
| | \$42,654 | \$ 41,882 |

Inventories on consignment at customer locations as of June 30, 2011 and December 31, 2010 totaled \$3,870 and \$3,401, respectively.

During the first quarter of 2011, \$2,407 of inventory at Eltmann was deconsolidated from the financial statements of NN. (See Note 1 of the Notes to Condensed Consolidated Financial Statements).

The inventory valuations above were developed using normalized production capacities for each of our manufacturing locations. Any costs from abnormal excess capacity or under-utilization of fixed production overheads are expensed in the period incurred and are not included as a component of inventory valuation.

Table of Contents

NN, Inc.
Notes To Condensed Consolidated Financial Statements
(In Thousands, Except Per Share Data)
(unaudited)

Note 5. Net Income Per Share

| (In Thousands of Dollars, Except Per Share Data) | Three months ended | | Six months ended | |
|--|---------------------------|-------------|-------------------------|-------------|
| | June 30, | | June 30, | |
| | 2011 | 2010 | 2011 | 2010 |
| Net income | \$ 5,827 | \$ 5,123 | \$11,334 | \$ 5,348 |
| Weighted average basic shares outstanding | 16,864 | 16,522 | 16,733 | 16,388 |
| Effect of dilutive stock options | 255 | 111 | 241 | 104 |
| Weighted average dilutive shares outstanding | 17,119 | 16,633 | 16,974 | 16,492 |
| Basic net income per share | \$ 0.35 | \$ 0.31 | \$ 0.68 | \$ 0.33 |
| Diluted net income per share | \$ 0.34 | \$ 0.31 | \$ 0.67 | \$ 0.32 |

There were 201 anti-dilutive options with an exercise price of \$14.13 excluded from the dilutive shares outstanding for the three and six month periods ended June 30, 2011. Excluded from the dilutive shares outstanding for the three and six month periods ended June 30, 2010 were 1,132 anti-dilutive options which had exercise prices ranging from \$4.42 to \$12.62.

Note 6. Segment Information

The segment information and the accounting policies of each segment are the same as those described in the notes to the consolidated financial statements entitled Segment Information and Summary of Significant Accounting Policies and Practices, respectively, included in our annual report on Form 10-K for the fiscal year ended December 31, 2010. We evaluate segment performance based on segment net income or loss after income taxes. We account for inter-segment sales and transfers at current market prices. We did not have any significant inter-segment transactions during the three and six month periods ended June 30, 2011 and 2010.

| (In Thousands of Dollars) | Metal | Precision | Plastic and | Corporate | Total |
|---|-------------------|-------------------|--------------------|-----------------------|--------------|
| | Bearing | Metal | Rubber | | |
| | Components | Components | Components | and | |
| | Segment | Segment | Segment | Consolidations | |
| Three Months ended June 30, 2011 | | | | | |
| Revenues from external customers | \$ 84,827 | \$19,534 | \$11,561 | \$ | \$115,922 |
| Segment net income (loss) | \$ 8,898 | \$ (1,130) | \$ 918 | \$ (2,859) | \$ 5,827 |

Edgar Filing: NN INC - Form 10-Q

Six Months ended June 30, 2011

| | | | | | |
|----------------------------------|------------|------------|-----------|------------|------------|
| Revenues from external customers | \$ 168,609 | \$ 35,936 | \$ 22,684 | \$ | \$ 227,229 |
| Segment net income (loss) | \$ 18,729 | \$ (3,338) | \$ 1,736 | \$ (5,793) | \$ 11,334 |
| Total assets | \$ 208,313 | \$ 44,703 | \$ 21,559 | \$ 4,155 | \$ 278,730 |

Table of Contents

NN, Inc.
Notes To Condensed Consolidated Financial Statements
(In Thousands, Except Per Share Data)
(unaudited)

| (In Thousands of Dollars) | Metal Bearing Components Segment | Precision Metal Components Segment | Plastic and Rubber Components Segment | Corporate and Consolidations | Total |
|---|---|---|--|---|--------------|
| Three Months ended June 30, 2010 | | | | | |
| Revenues from external customers | \$ 66,866 | \$ 16,017 | \$ 9,810 | \$ | \$ 92,693 |
| Segment net income (loss) | \$ 8,256 | \$ (592) | \$ 750 | \$ (3,291) | \$ 5,123 |
| Six Months ended June 30, 2010 | | | | | |
| Revenues from external customers | \$ 128,889 | \$ 29,611 | \$ 19,533 | \$ | \$ 178,033 |
| Segment net income (loss) | \$ 13,290 | \$ (2,499) | \$ 1,450 | \$ (6,893) | \$ 5,348 |
| Total assets | \$ 179,365 | \$ 33,441 | \$ 18,772 | \$ 4,036 | \$ 235,614 |

Note 7. Pensions

Effective January 20, 2011, the defined benefit pension plan covering the employees at our Eltmann Plant is under control of the bankruptcy trustee and has been or will be taken over by the German government's pension security fund. The plan is no longer a responsibility of NN, resulting in a reduction of Accrued pension liabilities of \$5,623 on January 20, 2011. We have no remaining pension obligations. (See Note 1 of the Notes to Condensed Consolidated Financial Statements).

Severance Indemnity

In accordance with Italian law, the Company has an unfunded severance plan covering our Pinerolo Plant employees under which all employees at that location are entitled to receive severance indemnities upon termination of their employment. The table below summarizes the changes to the severance indemnity for the three and six month periods ended June 30, 2011 and 2010:

| (In Thousands of Dollars) | Three months ended June 30, | | Six months ended June 30, | |
|-------------------------------------|--|-------------|--------------------------------------|-------------|
| | 2011 | 2010 | 2011 | 2010 |
| Beginning balance | \$7,658 | \$7,488 | \$7,115 | \$8,015 |
| Amounts accrued | 311 | 278 | 651 | 575 |
| Payments to employees | (120) | (235) | (134) | (330) |
| Payments to government managed plan | (168) | (173) | (403) | (387) |
| Currency impacts | 133 | 635 | 585 | 120 |
| Ending balance | \$7,814 | \$7,993 | \$7,814 | \$7,993 |

Table of Contents

NN, Inc.
Notes To Condensed Consolidated Financial Statements
(In Thousands, Except Per Share Data)
(unaudited)

Service and Early Retirement Provisions

We have two plans that cover our Veenendaal Plant employees. One plan provides an award for employees who achieve 25 or 40 years of service and the other plan is an award for employees upon retirement. These plans are both unfunded and the benefits are based on years of service and rate of compensation at the time the award is paid. The table below summarizes the combined changes in the two plans during the three and six month periods ended June 30, 2011 and 2010.

| (In Thousands of Dollars) | Three months ended | | Six months ended | |
|---------------------------|---------------------------|-------------|-------------------------|-------------|
| | June 30, | | June 30, | |
| | 2011 | 2010 | 2011 | 2010 |
| Beginning balance | \$835 | \$768 | \$749 | \$ 805 |
| Service cost | 6 | 14 | 26 | 33 |
| Interest cost | 17 | 3 | 38 | 40 |
| Benefits paid | (33) | 1 | (36) | (39) |
| Currency impacts | 15 | (67) | 63 | (120) |
| Ending balance | \$840 | \$719 | \$840 | \$ 719 |

Note 8. New Accounting Pronouncements

In June 2011, the FASB issued amended accounting guidance related to presentation of comprehensive income. The standards update is intended to help financial statement users better understand the causes of an entity's change in financial position and results of operation. It is effective for reporting periods beginning after December 15, 2011. The amendments eliminate the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. The amendments require that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The guidance also requires that reclassification adjustments for items that are reclassified from other comprehensive income to net income be presented on the face of the financial statement where the components of net income and other comprehensive income are presented. We plan on adopting this guidance for reporting periods beginning after December 15, 2011 and are currently assessing the impact on financial statement presentation of adopting this guidance.

Table of Contents

NN, Inc.
Notes To Condensed Consolidated Financial Statements
(In Thousands, Except Per Share Data)
(unaudited)

Note 9. Long-Term Debt and Short-Term Debt

Long-term debt and short-term debt at June 30, 2011 and December 31, 2010 consisted of the following:

| | June 30, 2011 | December 31, 2010 |
|--|--------------------------|--------------------------------|
| Borrowings under our \$100,000 revolving credit facility bearing interest at a floating rate equal to LIBOR (0.26% at June 30, 2011) plus an applicable margin of 3.25%, expiring December 21, 2014. | \$69,641 | \$50,500 |
| Borrowings under our \$40,000 aggregate principal amount of senior notes bearing interest at a fixed rate of 6.70% maturing on April 26, 2014. Annual principal payments of \$5,714 began on April 26, 2008 and extend through the date of maturity. | 17,143 | 22,857 |
| Total debt | 86,784 | 73,357 |
| Less current maturities of long-term debt | 6,655 | 5,714 |
| Long-term debt, excluding current maturities of long-term debt | \$80,129 | \$67,643 |

On December 21, 2010, we entered into an amended and restated revolving credit facility expiring December 21, 2014 with Key Bank as administrative agent with an initial size of \$75 million. The amended agreement was entered into to adjust our financial and non-financial covenants to more normalized measures and to provide greater ability to fund our capital investment plans. The interest rate was amended to LIBOR plus a margin of 1.5% to 3.5% (depending on the level of the ratio of debt to EBITDA) from LIBOR plus a margin of 4.75%. The facility may be expanded upon our request with approval of the lenders by up to \$60 million, under the same terms and conditions. On March 9, 2011, we exercised an option to increase the size of the facility from \$75 million to \$100 million to allow additional flexibility and to fund potential growth projects.

The loan agreement contains customary restrictions on, among other things, additional indebtedness, liens on our assets, sales or transfers of assets, investments, restricted payments (including payment of dividends and stock repurchases), issuance of equity securities, and merger, acquisition and other fundamental changes in our business including a material adverse change clause, which if triggered would accelerate the maturity of the debt. The facility has a \$10 million swing line feature to meet short term cash flow needs. Any borrowings under this swing line are considered short term. Costs associated with entering into the revolving credit facility were capitalized and will be amortized into interest expense over the life of the facility. As of June 30, 2011, \$1,983 of net capitalized loan origination costs related to the revolving credit facility were recorded on the balance sheet within other non-current assets.

On December 21, 2010, our senior note agreement with Prudential Capital was also amended. The amended agreement was entered into to adjust our financial and non-financial covenants to more normalized measures and to provide greater ability to fund our capital investment plans. There were no changes to the terms or availability of

credit but the interest rate was reduced from 8.50% to 6.70%. The agreement contains customary restrictions on, among other things, additional indebtedness, liens on our assets, sales or transfers of assets, investments, restricted payments (including payment of dividends and stock repurchases), issuance of equity securities, and mergers, acquisitions and other fundamental changes in our business including a material adverse change clause, which if triggered would accelerate the maturity of the debt. Interest is paid semi-annually and the note matures on April 26, 2014. Annual principal payments of approximately \$5,714 began on April 26, 2008 and extend through the date of maturity. We incurred costs as a result of issuing these notes which have been recorded as a component of

Table of Contents

NN, Inc.
Notes To Condensed Consolidated Financial Statements
(In Thousands, Except Per Share Data)
(unaudited)

other non-current assets and are being amortized over the term of the notes. The unamortized balance at June 30, 2011 was \$350.

The specific covenants to which we are subject and the actual results achieved for the six month period ended June 30, 2011 are stated below.

| Financial Covenants | Required Covenant Level | Actual Level Achieved |
|----------------------------|--|------------------------------|
| Interest coverage ratio | Not to be less than 3.00 to 1.00 as of the last day of any fiscal quarter | 4.90 to 1.00 |
| Fixed charge coverage | Not to be less 1.10 to 1.00 as of the last day of any fiscal quarter | 1.13 to 1.00 |
| Leverage ratio | Not to exceed 2.75 to 1.00 for the most recently completed four fiscal quarters | 2.13 to 1.00 |
| Capital expenditures | Not to exceed 150% of Consolidated Depreciation charges for the immediate previous fiscal year | 36% |

While the actual fixed charge coverage ratio approximates the required ratio at June 30, 2011, we do not project any failures of our financial covenants within the next 12 months due to projected earnings before interest, taxes, depreciation, and amortization. The main drivers of the fixed charge coverage ratio are rolling four quarters earnings before interest, taxes, depreciation, and amortization and rolling four quarters capital expenditures. The reasons the actual ratio approximated the required ratio at June 30, 2011, were lower Q3 2010 earnings before interest, taxes, depreciation, and amortization and a higher level of capital expenditure in the second quarter of 2011 versus the first quarter of 2011. The lower Q3 2010 earnings before interest, taxes, depreciation, and amortization was due to lower income from operations related to normal seasonality and from almost \$2.2 million of cash and non-cash restructuring charges incurred in that quarter. If necessary to maintain financial covenant compliance, we can control subsequent quarterly capital expenditure levels.

Note 10. Goodwill, net

The changes in the carrying amount of goodwill for the six month period ended June 30, 2011 are as follows:

Goodwill, net

| (In Thousands of Dollars) | Metal Bearing Components Segment |
|-------------------------------|---|
| Balance as of January 1, 2011 | \$ 8,396 |
| Currency translation impacts | 921 |
| Balance as of June 30, 2011 | \$ 9,317 |

The goodwill balance is tested for impairment on an annual basis during the fourth quarter and between annual tests if a triggering event occurs. During the three and six month periods ended June 30, 2011, the financial results of the reporting unit with a goodwill balance exceeded the forecasted results used in testing for impairment at December 31, 2010. As of June 30, 2011, there are no further indications of impairment at this reporting unit.

Note 11. Intangible Assets

The Precision Metal Components Segment has an intangible asset not subject to amortization of \$900 related to the value of the trade names of Whirlaway. There are no indicators of impairment for this indefinite lived intangible asset

as of June 30, 2011.

Table of Contents

NN, Inc.
Notes To Condensed Consolidated Financial Statements
(In Thousands, Except Per Share Data)
(unaudited)

Note 12. Shared-Based Compensation

In the three and six month periods ended June 30, 2011 and 2010, approximately \$116 and \$116 in 2011 and \$34 and \$1,200 in 2010, respectively, of compensation expense was recognized in selling, general and administrative expense for all share-based awards. There were 75 share awards and 201 option awards granted to non-executive directors, officers and certain other key employees during the three and six month periods ended June 30, 2011.

During the three month period ended March 31, 2010, we granted 249 shares and 26 share options to non-executive directors, officers and certain other key employees. The 249 shares of our common stock were issued on March 17, 2010 and were fully vested at the date of grant. We incurred \$1,101 of non-cash compensation expense, which was the entire fair value of the grant, at that date. The fair value of the shares issued was determined by using the grant date closing price of our common stock.

We incurred \$66 and \$99 of stock option expense in the six month periods ended June 30, 2011 and 2010, respectively. The fair value of the options cannot be determined by market value, as our options are not traded in an open market. Accordingly, a financial pricing model is utilized to determine fair value. The Company utilizes the Black Scholes model which relies on certain assumptions to estimate an option's fair value.

The following table provides a reconciliation of option activity for the six month period ended June 30, 2011:

| Options | Shares (000) | Weighted- Average Exercise Price | Weighted- Average Remaining Contractual Term | Aggregate Intrinsic Value (\$000) |
|--------------------------------|-------------------------|---|---|--|
| Outstanding at January 1, 2011 | 1,205 | \$ 9.23 | | |
| Granted | 201 | \$14.13 | | |
| Exercised | (244) | \$ 9.45 | | |
| Forfeited or expired | (3) | \$ 1.30 | | |
| Outstanding at June 30, 2011 | 1,159 | \$10.05 | 6.1 | \$ 5,687 ⁽¹⁾ |
| Exercisable at June 30, 2011 | 897 | \$ 9.62 | 7.4 | \$ 4,765 ⁽¹⁾ |

⁽¹⁾ The intrinsic value is the amount by which the market price of our stock was greater than the exercise price of any individual option grant at June 30, 2011.

Note 13. Provision for Income Taxes

As of June 30, 2011, we continued to place a valuation allowance on all of the deferred tax assets of our U.S. locations, based on the negative financial performance of our U.S. operations during the global economic recession of 2008 and 2009. If U.S. operations return to a level of profitability sufficient to utilize a portion of these deferred tax assets, these assets will be used to offset future U.S. based taxable income. If we determine the probability of realizing all the tax benefits is more likely than not, the entire valuation allowance will be released and deferred tax benefits will be recognized.

For the six month periods ended June 30, 2011 and 2010, the difference between the U.S. federal statutory tax rate of 34% and our effective tax rates of 24% and 32%, respectively, was primarily due to non-U.S. based earnings taxed at lower rates. The statutory and effective income tax rates in many of the foreign countries in which we operate are

lower than the U.S. federal statutory rate. Additionally, during the first quarter of 2011, the effective tax rate was reduced by recognizing deferred tax benefits totaling \$631 related to the Eltmann deconsolidation. These benefits related to losses for write-offs of receivables owed by Eltmann to certain NN subsidiaries that will be deductible once Eltmann is finally liquidated in 2012 or 2013. The table below summarizes the impacts on the effective tax rate for the six month periods ended June 30, 2011 and 2010.

Table of Contents

NN, Inc.
Notes To Condensed Consolidated Financial Statements
(In Thousands, Except Per Share Data)
(unaudited)

| | Six Months ended June 30, 2011 | Six Months ended June 30, 2010 |
|---|---|---|
| (In Thousands of Dollars) | | |
| Income tax provision at the federal statutory rate of 34% | \$ 5,043 | \$ 2,658 |
| (Decrease) increase in U.S. valuation allowance | (181) | 1,012 |
| Non-U.S. earnings taxed at lower rates | (1,522) | (1,125) |
| U.S. State income taxes | 123 | |
| Other differences | 36 | (76) |
| Provision for income taxes | \$ 3,499 | \$ 2,469 |

During the three and six month periods ended June 30, 2011, we have begun to recognize tax expense at our Kunshan (China) Plant and our Kysucke (Slovakia) Plant as we have fully utilized the previous net operating losses at these foreign jurisdictions.

We do not foresee any significant changes to our unrecognized tax benefits within the next twelve months.

Note 14. Commitments and Contingencies

As described more fully in our Form 10-K for 2010, we continue to monitor the remediation efforts at a former waste recycling vendor used by our former Walterboro, South Carolina facility. The costs associated with the remediation, which has been tentatively approved by the EPA, are estimated to be approximately \$10,000. Our allocated share is approximately \$143 which has been fully accrued as of June 30, 2011. While there can be no assurances, we believe that the \$143 is the maximum amount for which we will be liable under the tentatively accepted remediation plan. All other legal matters are of an ordinary and routine nature and are incidental to our operations. Management believes that such proceedings should not, individually or in the aggregate, have a material adverse effect on our business or financial condition or on the results of operations.

Note 15. Property Plant and Equipment

During the first quarter of 2011, \$1,343 of property, plant and equipment at Eltmann was deconsolidated from the financial statements of NN. (See Note 1 of the Notes to the Condensed Consolidated Financial Statements).

During the first quarter of 2010, we incurred \$1,000 of accelerated depreciation to adjust certain assets that ceased to be used as of part of the Tempe Plant closure to the new estimated salvage values. (See Note 2 of the Notes to Consolidated Financial Statements).

Note 16. Fair Value of Financial Instruments

The fair values of the Company's fixed rate long-term borrowings are calculated by using a discounted cash flow analysis factoring in current market borrowing rates for similar types of borrowing arrangements under our credit profile. The current market borrowing rates are Level 2 inputs under the U.S. GAAP fair value hierarchy. The carrying amounts and fair values of the Company's long-term debt are in the table below:

| | June 30, 2011 | | December 31, 2010 | |
|------------------------------|----------------------------|-----------------------|----------------------------|-----------------------|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| (In Thousands of Dollars) | | | | |
| Variable rate long-term debt | \$69,641 | \$69,641 | \$50,500 | \$50,500 |
| Fixed rate long-term debt | \$17,143 | \$16,860 | \$22,857 | \$22,195 |

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

Our risk factors are disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010 under Item 1.A. Risk Factors. There have been no material changes to these risk factors since December 31, 2010.

Results of Operations**Three Months Ended June 30, 2011 Compared to the Three Months Ended June 30, 2010.****OVERALL RESULTS**

| <i>(In Thousands of Dollars)</i> | NN, Inc. | | | |
|---|------------------|-----------------|-----------------|---------|
| | 2011 | 2010 | | Change |
| Net sales | \$115,922 | \$92,693 | \$23,229 | |
| <i>Foreign exchange effects</i> | | | | 6,280 |
| <i>Volume</i> | | | | 11,129 |
| <i>Price</i> | | | | 1,944 |
| <i>Mix</i> | | | | 288 |
| <i>Material inflation pass-through</i> | | | | 3,588 |
| Cost of products sold (exclusive of depreciation and amortization shown separately below) | 94,657 | 73,423 | 21,234 | |
| <i>Foreign exchange effects</i> | | | | 5,890 |
| <i>Volume</i> | | | | 7,608 |
| <i>Cost reduction</i> | | | | (1,936) |
| <i>Mix</i> | | | | 450 |
| <i>Inflation</i> | | | | 4,747 |
| <i>New sales program start-up costs and other specific costs increases</i> | | | | 4,475 |
| Selling, general and administrative | 7,720 | 7,150 | 570 | |
| <i>Foreign exchange effects</i> | | | | 333 |
| <i>Increase in spending</i> | | | | 237 |
| Depreciation and amortization | 4,291 | 4,842 | (551) | |
| <i>Foreign exchange effects</i> | | | | 248 |
| <i>Elimination of depreciation expense on fully depreciated assets</i> | | | | (799) |
| Restructuring and impairment charges | | 667 | (667) | |
| Interest expense | 1,220 | 1,755 | (535) | |
| Loss on disposal of assets | 3 | 2 | 1 | |
| Other expense (income), net | 155 | (1,789) | 1,944 | |
| Income before provision for income taxes | 7,876 | 6,643 | 1,233 | |
| Provision for income taxes | 2,049 | 1,520 | 529 | |
| Net income | \$ 5,827 | \$ 5,123 | \$ 704 | |

Net Sales. Net sales increased during the second quarter of 2011 from the second quarter of 2010 due to sales growth in the customer end markets we serve. Both automotive and industrial end markets have experienced year over year

sales growth due to the overall macroeconomic growth and higher consumer demand. Additionally, sales were higher due to the appreciation in value of Euro denominated sales. However, the growth in sales volume during the second quarter of 2011 was relatively flat compared with the first quarter of 2011. The increase in sales due to price was the result of targeted price increases to our customers across all businesses and product lines. The increase in sales from material inflation pass-through was due to increasing sales prices to our customers to recover

Table of Contents

actual material inflation incurred during the second quarter of 2011.

Cost of Products Sold (exclusive of depreciation). The majority of the increase was due to the sales volume increases discussed above and from the appreciation of Euro denominated costs. Cost of products sold increased \$2.0 million due to production inefficiencies and additional incurred costs from starting up production on new multi-year sales programs at our Wellington Plants of the Precision Metal Components Segment (discussed below). Additionally, cost of products sold increased due to specific costs added during the second quarter of 2011 for compensation related costs (\$0.7 million), and from higher levels of spending on scheduled repairs and maintenance and for manufacturing supplies (\$1.4 million). During the first quarter of 2010, spending was greatly depressed in these areas due to the global recession. Finally, there were one time benefits during the second quarter of 2010 related to credits from a material supplier (\$0.4 million) in Europe that did not repeat in the second quarter of 2011.

During the second quarter of 2011, our cost of products sold as a percentage of sales was approximately 81.7%, which is slightly higher than our historical range. The higher cost of products sold was due to operational inefficiencies related to the new sales program start-ups and additional specific costs mentioned above.

Selling, General and Administrative. The increase in spending in selling, general and administrative expenses was due to higher incentive compensation at most locations and from the addition of certain key positions at our Precision Metal Segment to support growth in this business.

Depreciation and Amortization. The reduction was due to certain assets, which are still in use, at our Pinerolo Plant becoming fully depreciated from the second quarter of 2010 onward and from the elimination of the Tempe Plant depreciation due to ceasing operations in August 2010.

Interest Expense. Interest expense was lower primarily due to decreases in the interest rate spread charged on our LIBOR credit facility and our senior notes, partially offset by higher overall debt levels during 2011. These savings were achieved under the new credit agreement entered into in December 2010.

Restructuring and impairment charges. During the three month period ended June 30, 2010, we incurred \$0.7 million in restructuring charges related to the closure of our Tempe Plant. (See Note 2 of the Notes to Condensed Consolidated Financial Statements).

Other expense (income), net. Included in other expense (income), net, during the three months ended June 30, 2011, was \$0.3 million related to foreign exchange losses on inter-company loans. During the three months ended June 30, 2010, inter-company loans generated foreign exchange gains of \$1.7 million. The gains and losses are a function of the appreciation or depreciation of the Euro versus the U.S. Dollar.

Provision for income taxes. For the three months ended June 30, 2011 and 2010, the difference between the effective tax rates of 26% and 23%, respectively, was mainly due to accruing tax expense in China and Slovakia for the first time during 2011 as the previous net operating losses for these locations have been fully utilized. (See Note 13 of the Notes to Condensed Consolidated Financial Statements).

Table of Contents**RESULTS BY SEGMENT****METAL BEARING COMPONENTS SEGMENT**

| <i>(In Thousands of Dollars)</i> | 2011 | 2010 | Three months ended June 30, | Change |
|--|-----------------|-----------------|--|---------------|
| Net sales | \$84,827 | \$66,866 | \$17,961 | |
| <i>Foreign exchange effects</i> | | | | 6,280 |
| <i>Volume</i> | | | | 7,416 |
| <i>Price</i> | | | | 1,029 |
| <i>Mix</i> | | | | 288 |
| <i>Material inflation pass-through</i> | | | | 2,948 |
| Segment net income | \$ 8,898 | \$ 8,256 | \$ 642 | |

The majority of our sales volume increase has been in our core Metal Bearings Component Segment. During the second quarter the majority of our growth was at our U.S. based businesses which serve both domestic and international automotive and industrial markets. During the second quarter, sales volumes were flat at this segment compared to the levels experienced during the first quarter of 2011.

The segment net income was impacted primarily by the increase in sales volume and the related production efficiencies and leveraging of fixed production costs. Additionally, the segment net income was higher due to the sales price increases. Finally, the segment results were favorably impacted by the implementation of planned cost reduction projects. The 2010 segment net income included \$1.4 million in after-tax foreign exchange gains on certain inter-company loans as discussed above.

PRECISION METAL COMPONENTS SEGMENT

| <i>(In Thousands of Dollars)</i> | 2011 | 2010 | Three months ended June 30, | Change |
|--|-------------------|-----------------|--|---------------|
| Net sales | \$19,534 | \$16,017 | \$3,517 | |
| <i>Volume</i> | | | | 2,516 |
| <i>Price</i> | | | | 717 |
| <i>Material inflation pass-through</i> | | | | 284 |
| Segment net loss | \$ (1,130) | \$ (592) | \$ (538) | |

The majority of the increase in sales at this segment was due to the addition of four new multi-year sales programs. Partially offsetting the volume increases from the new sales programs was volume lost due to ceasing operations at the Tempe Plant during the third quarter of 2010. Additionally sales were higher due to targeted price increases rolled out during early 2011.

The segment net loss in the second quarter of 2011 was affected by \$2.0 million in operational inefficiencies and additional incurred costs related to ramping up production for four new large multi-year sales programs. We have begun to see reductions in start-up costs on the first major sales program from the levels experienced during the fourth quarter of 2010 and the first quarter of 2011. However, we have begun to incur substantial start-up costs on the other major multi-year sales programs as production of these products began during the first quarter of 2011. The start-up costs for these programs more than offset the benefits from the additional sales volume during the second quarter of 2011.

Table of Contents**PLASTIC AND RUBBER COMPONENTS SEGMENT**

| <i>(In Thousands of Dollars)</i> | 2011 | Three months ended June 30, 2010 | Change |
|--|-----------------|---|----------------|
| Net sales | \$11,561 | \$9,810 | \$1,751 |
| <i>Volume</i> | | | <i>1,197</i> |
| <i>Price</i> | | | <i>198</i> |
| <i>Material inflation pass-through</i> | | | <i>356</i> |
| Segment net income | \$ 918 | \$ 750 | \$ 168 |

The volume increase for this segment was related to increased U.S. automotive end market demand as the economy and consumer demand have returned to more normalized levels.

The increase in segment net income for the first quarter of 2011 resulted from the 18% increase in sales and the related operational efficiencies from higher levels of production partially offset by operational inefficiencies due to starting-up a new sales program.

Table of Contents**Results of Operations****Six Months Ended June 30, 2011 Compared to the Six Months Ended June 30, 2010.****OVERALL RESULTS**

| <i>(In Thousands of Dollars)</i> | 2011 | Consolidated NN, Inc. | | Change |
|--|-------------------|------------------------------|------------------|---------------|
| | | 2010 | | |
| Net sales | \$ 227,229 | \$ 178,033 | \$ 49,196 | |
| <i>Foreign exchange effects</i> | | | | 6,442 |
| <i>Volume</i> | | | | 31,904 |
| <i>Price</i> | | | | 3,648 |
| <i>Mix</i> | | | | 674 |
| <i>Material inflation pass-through</i> | | | | 6,528 |
| Cost of products sold (exclusive of depreciation and amortization shown separately below) | 184,955 | 142,339 | 42,616 | |
| <i>Foreign exchange effects</i> | | | | 5,798 |
| <i>Volume</i> | | | | 22,565 |
| <i>Cost reduction</i> | | | | (3,641) |
| <i>Mix</i> | | | | 674 |
| <i>Inflation</i> | | | | 8,454 |
| <i>New sales program start-up costs and other specific costs increases</i> | | | | 8,766 |
| Selling, general, and administrative | 15,686 | 15,040 | 646 | |
| <i>Foreign exchange effects</i> | | | | 283 |
| <i>Increase in spending</i> | | | | 363 |
| Depreciation and amortization | 8,326 | 10,962 | (2,636) | |
| <i>Foreign exchange effects</i> | | | | 203 |
| <i>Accelerated depreciation due to plant closure during 2010 that did not repeat in 2011</i> | | | | (1,000) |
| <i>Elimination of depreciation expense on fully depreciated assets</i> | | | | (1,839) |
| Restructuring and impairment charges | | 1,236 | (1,236) | |
| Gain from deconsolidation of bankrupt subsidiary | (209) | | (209) | |
| Interest expense, net | 2,444 | 3,483 | (1,039) | |
| (Gain) loss on disposal of assets | 3 | 3 | | |
| Write-off of unamortized debt issuance cost | | 130 | (130) | |
| Other expense (income), net | 1,191 | (2,977) | 4,168 | |
| Income before provision for income taxes | 14,833 | 7,817 | 7,016 | |
| Provision for income taxes | 3,499 | 2,469 | 1,030 | |
| Net income | \$ 11,334 | \$ 5,348 | \$ 5,986 | |

Net Sales. Net sales increased during the first half of 2011 from the first half of 2010 due to sales growth in the customer end markets we serve. Both automotive and industrial end markets have experienced strong year over year sales growth due to the overall macro-economic growth and higher consumer demand. The increase in sales due to price was the result of targeted price increases to our customers across all businesses and product lines. The increase in sales from material inflation pass-through was due to increasing sales prices to our customers to recover actual material inflation incurred during the first half of 2011.

Cost of Products Sold (exclusive of depreciation). The majority of the increase was due to the same sales volume increases discussed above. Cost of products sold increased \$4.5 million due to production inefficiencies and additional incurred costs from starting up production on new multi-year sales programs at our Wellington Plants of the Precision Metal Components Segment (discussed below). Additionally, cost of products sold increased due to specific costs added during the first half of 2011 for incentive compensation and compensation related costs (\$1.4 million), and from higher levels of spending on scheduled repairs and maintenance and for manufacturing supplies

Table of Contents

(\$2.0 million). During the first half of 2010, spending was greatly depressed in these areas due to the global recession. Finally, there were various one time benefits during the first half of 2010 related to labor concessions and credits from a material supplier (totaling \$1.0 million) in Europe that did not repeat in the first half of 2011.

During the first half of 2011, our cost of products sold as a percentage of sales was approximately 81.4%, which is slightly higher than our historical range. The higher cost of products sold was due to operational inefficiencies related to the new sales program start-ups and additional specific costs mentioned above.

Selling, General and Administrative. The increase in spending in selling, general and administrative expenses was due to the addition of incentive compensation that was not in place during 2010 and from the addition of certain key positions at our Precision Metal Components Segment to support growth in this business.

Depreciation and Amortization. A large portion of the decrease in depreciation and amortization expense was due to the accelerated depreciation of \$1.0 million on certain fixed assets at our Tempe Plant during the first quarter of 2010, which did not repeat during 2011, and the elimination of the Tempe Plant depreciation from the 2011 expense due to ceasing operations in August 2010. The remainder of the reduction was due to certain assets, which are still in use, at our Pinerolo Plant becoming fully depreciated from the second quarter of 2010 onward.

Interest Expense. Interest expense was lower primarily due to decreases in the interest rate spread charged on our LIBOR credit facility and our senior notes partially offset by higher overall debt levels during 2011. These savings were achieved under the new credit agreement entered into in December 2010.

Restructuring and impairment charges. During the six month period ended June 30, 2010, we incurred \$1.2 million in restructuring charges related to the closure of our Tempe Plant. (See Note 2 of the Notes to Condensed Consolidated Financial Statements).

Other expense (income), net. Included in other expense (income), net, during the six months ended June 30, 2011, was \$1.1 million related to foreign exchange losses on inter-company loans. During the six months ended June 30, 2010, inter-company loans generated foreign exchange gains of \$2.8 million. The gains and losses are a function of the appreciation or depreciation of the Euro versus the U.S. Dollar.

Provision for income taxes. For the six months ended June 30, 2011 and 2010, the difference between the effective tax rates of 24% and 32%, respectively, was mainly due to the 2011 tax rate being reduced from a greater portion of non-U.S. earnings being taxed at lower rates and from recognizing tax benefits related to the Eltmann deconsolidation. (See Note 13 of the Notes to Condensed Consolidated Financial Statements).

RESULTS BY SEGMENT**METAL BEARING COMPONENTS SEGMENT**

| <i>(In Thousands of Dollars)</i> | 2011 | Six months ended June 30, 2010 | Change |
|--|-------------------|---|------------------|
| Net sales | \$ 168,609 | \$ 128,889 | \$ 39,720 |
| <i>Foreign exchange effects</i> | | | 6,442 |
| <i>Volume</i> | | | 24,759 |
| <i>Price</i> | | | 2,284 |
| <i>Mix</i> | | | 674 |
| <i>Material inflation pass-through</i> | | | 5,561 |
| Segment net income | \$ 18,729 | \$ 13,290 | \$ 5,439 |

The majority of our sales volume increase has been in our core Metal Bearings Component Segment. This growth

Table of Contents

has been across all geographic regions and all end markets served, principally automotive and industrial. However, sales volume did not grow incrementally from the first quarter of 2011 primarily due to lower sales to a specific customer in Western Europe.

The segment net income was impacted primarily by the large increase in sales volume and the related production efficiencies and leveraging of fixed production costs. The impact of fixed costs and related leveraging of production capacity is significant in this segment because a large portion of our installed capacity is in Western Europe, where labor cost is semi-variable. Additionally, the segment results were favorably impacted by the implementation of planned cost reduction projects. The 2010 segment net income included \$2.2 million in after-tax foreign exchange gains on certain inter-company loans as discussed above.

PRECISION METAL COMPONENTS SEGMENT

| <i>(In Thousands of Dollars)</i> | 2011 | Six months ended June 30, 2010 | Change |
|----------------------------------|-----------------|---|----------------|
| Net sales | \$35,936 | \$29,611 | \$6,325 |