

BARNES GROUP INC
Form 10-Q
July 27, 2012

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, 2012

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 1-4801

BARNES GROUP INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or
organization)

06-0247840

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

123 Main Street, Bristol, Connecticut
(Address of Principal Executive Offices)
(860) 583-7070

06010
(Zip Code)

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 the 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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes No

The registrant had outstanding 53,972,841 shares of common stock as of July 25, 2012.

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 For the Quarterly Period Ended June 30, 2012

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This Quarterly Report on Form 10-Q contains “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. See “FORWARD-LOOKING STATEMENTS” under Part I - Item 2 “Management's Discussion and Analysis of Financial Condition and Results of Operations” of this Quarterly Report on Form 10-Q.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

BARNES GROUP INC.
CONSOLIDATED STATEMENTS OF INCOME
(Dollars in thousands, except per share data)
(Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Net sales	\$293,422	\$297,837	\$596,518	\$587,427
Cost of sales	193,088	194,564	394,869	385,475
Selling and administrative expenses	66,208	69,499	134,510	137,462
	259,296	264,063	529,379	522,937
Operating income	34,126	33,774	67,139	64,490
Interest expense	2,435	2,350	4,803	6,005
Other expense (income), net	95	321	948	728
Income from continuing operations before income taxes	31,596	31,103	61,388	57,757
Income taxes	6,798	8,377	13,616	14,834
Income from continuing operations	24,798	22,726	47,772	42,923
Income (loss) from discontinued operations, net of income taxes	33	(394)	(734)	(1,519)
Net income	\$24,831	\$22,332	\$47,038	\$41,404
Per common share:				
Basic:				
Income from continuing operations	\$0.46	\$0.41	\$0.87	\$0.78
Loss from discontinued operations, net of income taxes	—	(0.01)	(0.01)	(0.03)
Net income	\$0.46	\$0.40	\$0.86	\$0.75
Diluted:				
Income from continuing operations	\$0.45	\$0.41	\$0.86	\$0.77
Loss from discontinued operations, net of income taxes	—	(0.01)	(0.01)	(0.03)
Net income	\$0.45	\$0.40	\$0.85	\$0.74
Dividends	\$0.10	\$0.08	\$0.20	\$0.16
Weighted average common shares outstanding:				
Basic	54,543,098	55,414,347	54,674,366	55,067,079
Diluted	55,150,806	56,288,447	55,303,192	55,948,098

See accompanying notes.

BARNES GROUP INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Dollars in thousands)
(Unaudited)

	Three months ended		Six months ended	
	June 30,		June 30,	
	2012	2011	2012	2011
Net income	\$24,831	\$22,332	\$47,038	\$41,404
Other comprehensive (loss) income, net of tax				
Unrealized (loss) gain on hedging activities, net of tax (1)	(633	) (238	) (397	) 50
Foreign currency translation adjustments, net of tax (2)	(25,164	) 21,647	(10,455	) 39,793
Defined benefit pension and other postretirement benefits, net of tax (3)	2,706	1,008	3,911	1,330
Total other comprehensive (loss) income, net of tax	(23,091	) 22,417	(6,941	) 41,173
Total comprehensive income	\$1,740	\$44,749	\$40,097	\$82,577

(1) Net of tax of \$(403) and \$(85) for the three months ended June 30, 2012 and 2011, respectively, and \$(319) and \$113 for the six months ended June 30, 2012 and 2011, respectively.

(2) Net of tax of \$(1,209) and \$(53) for the three months ended June 30, 2012 and 2011, respectively, and \$(492) and \$1,440 for the six months ended June 30, 2012 and 2011, respectively.

(3) Net of tax of \$1,144 and \$466 for the three months ended June 30, 2012 and 2011, respectively, and \$2,161 and \$891 for the six months ended June 30, 2012 and 2011, respectively.

See accompanying notes.

BARNES GROUP INC.
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except per share data)
(Unaudited)

	June 30, 2012	December 31, 2011
Assets		
Current assets		
Cash and cash equivalents	\$90,978	\$62,505
Accounts receivable, less allowances (2012 - \$2,909; 2011 - \$2,898)	205,262	200,460
Inventories	216,040	216,520
Deferred income taxes	30,691	28,829
Prepaid expenses and other current assets	23,330	21,680
Total current assets	566,301	529,994
Deferred income taxes	42,673	47,661
Property, plant and equipment	606,361	603,383
Less accumulated depreciation	(399,013)	(392,599)
	207,348	210,784
Goodwill	361,863	366,104
Other intangible assets, net	264,949	272,092
Other assets	14,098	13,730
Total assets	\$1,457,232	\$1,440,365
Liabilities and Stockholders' Equity		
Current liabilities		
Notes and overdrafts payable	\$1,840	\$12,364
Accounts payable	91,157	92,524
Accrued liabilities	74,258	92,250
Long-term debt - current	540	540
Total current liabilities	167,795	197,678
Long-term debt	383,461	333,148
Accrued retirement benefits	130,813	152,696
Other liabilities	34,449	34,443
Commitments and contingencies (Note 12)		
Stockholders' equity		
Common stock - par value \$0.01 per share		
Authorized: 150,000,000 shares	590	586
Issued: at par value (2012 - 58,953,991 shares; 2011 - 58,593,802 shares)		
Additional paid-in capital	325,223	316,251
Treasury stock, at cost (2012 - 4,981,750 shares; 2011 - 4,254,350 shares)	(99,333)	(79,569)
Retained earnings	596,229	560,186
Accumulated other non-owner changes to equity	(81,995)	(75,054)
Total stockholders' equity	740,714	722,400

Total liabilities and stockholders' equity	\$1,457,232	\$1,440,365
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See accompanying notes.

BARNES GROUP INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)
(Unaudited)

	Six months ended June 30,	
	2012	2011
Operating activities:		
Net income	\$47,038	\$41,404
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	25,912	28,822
Amortization of convertible debt discount	1,083	1,117
Gain on disposition of property, plant and equipment	(62)	(607)
Stock compensation expense	4,286	4,294
Withholding taxes paid on stock issuances	(727)	(664)
Loss on the sale of businesses	734	—
Changes in assets and liabilities:		
Accounts receivable	(8,893)	(24,875)
Inventories	(852)	(9,822)
Prepaid expenses and other current assets	(1,290)	22
Accounts payable	(621)	8,051
Accrued liabilities	(15,830)	6,305
Deferred income taxes	789	759
Long-term retirement benefits	(18,770)	(12,871)
Other	837	(1,593)
Net cash provided by operating activities	33,634	40,342
Investing activities:		
Proceeds from disposition of property, plant and equipment	222	2,243
Payments related to the sale of businesses, net	(318)	—
Capital expenditures	(15,658)	(19,342)
Other	(2,476)	(4,236)
Net cash used by investing activities	(18,230)	(21,335)
Financing activities:		
Net change in other borrowings	(10,535)	(1,363)
Payments on long-term debt	(17,770)	(275,074)
Proceeds from the issuance of long-term debt	67,000	249,490
Premium paid on convertible debt redemption	—	(9,803)
Proceeds from the issuance of common stock	4,080	26,086
Common stock repurchases	(19,037)	—
Dividends paid	(10,842)	(8,765)
Excess tax benefit on stock awards	1,331	3,102
Other	(120)	(131)
Net cash provided (used) by financing activities	14,107	(16,458)
Effect of exchange rate changes on cash flows	(1,038)	578
Increase in cash and cash equivalents	28,473	3,127
Cash and cash equivalents at beginning of period	62,505	13,450
Cash and cash equivalents at end of period	\$90,978	\$16,577

See accompanying notes.

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BARNES GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All dollar amounts included in the notes are stated in thousands except per share data.)

(Unaudited)

1. Summary of Significant Accounting Policies

The accompanying unaudited consolidated balance sheet and the related unaudited consolidated statements of income, comprehensive income and cash flows have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. The consolidated financial statements do not include all information and notes required by accounting principles generally accepted in the United States of America for complete financial statements. The balance sheet as of December 31, 2011 has been derived from the 2011 financial statements of Barnes Group Inc. (the "Company"). For additional information, please 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, 2011. In the opinion of management, all adjustments, including normal recurring accruals considered necessary for a fair presentation, have been included. Operating results for the three- and six-month periods ended June 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. Certain reclassifications have been made to prior year amounts to conform to the current year presentation.

In the first quarter of 2012, the Company changed its organizational structure to align its strategic business units into three reportable business segments: Aerospace, Industrial and Distribution. See Note 11 for a description of the three reportable segments.

Additionally, in the fourth quarter of 2011, the Company completed the sale of its Barnes Distribution Europe businesses (the "BDE" business). The BDE business was comprised of the Company's European KENT, Toolcom and BD France distribution businesses that were reported within the segment formerly referred to as Logistics and Manufacturing Services.

All previously reported financial information has been adjusted on a retrospective basis to reflect the segment realignment and the discontinued operations for all periods.

2. Discontinued Operations

On December 30, 2011, the Company sold substantially all of the assets of its BDE business to Berner SE (the "Purchaser") in a cash transaction pursuant to the terms of a Share and Asset Purchase Agreement ("SPA") among the Company, the Purchaser, and their respective relevant subsidiaries dated November 17, 2011. The Company received gross proceeds of \$33,358, which represents the initial stated purchase price, and yielded net cash proceeds of \$22,492 after consideration of cash sold, transaction costs paid and closing adjustments. The final amount of proceeds from the sale of the BDE business is subject to post-closing adjustments that are reflected in discontinued operations in 2012. The loss on the transaction for the period ended June 30, 2012 includes certain additional transaction costs and post closing adjustments. As required by the terms of the SPA, the Company was required to place €9,000 (\$11,199 at June 30, 2012) of the proceeds in escrow to be used for any settlement of general representation and warranty claims. The SPA requires the funds to be released from escrow on August 31, 2012 unless there are any then pending claims. Cash related to a pending claim would remain in escrow until a final determination of the claim has been made. The Company has recorded the restricted cash in prepaid expenses and other current assets at June 30, 2012 and December 31, 2011.

The following amounts related to the BDE business were derived from historical financial information. The amounts have been segregated from continuing operations and reported as discontinued operations within the consolidated financial statements:

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	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Net sales	\$—	\$30,113	\$—	\$59,277
Income (loss) before income taxes	—	363	—	(551)
Income tax expense	—	(381)	—	(304)
Loss from operations of discontinued businesses, net of income taxes	—	(18)	—	(855)
Gain (loss) on transaction	14	(606)	(767)	(1,070)
Income tax benefit on loss on sale	19	230	33	406
Gain (loss) on the sale of businesses	33	(376)	(734)	(664)
Income (loss) from discontinued operations, net of income taxes	\$33	\$(394)	\$(734)	\$(1,519)

3. Net Income Per Common Share

For the purpose of computing diluted income from continuing operations and net income per common share, the weighted-average number of common shares outstanding is increased for the potential dilutive effects of stock-based incentive plans and convertible senior subordinated notes. For the purpose of computing diluted income from continuing operations and net income per common share, the weighted-average number of common shares was increased by 607,708 and 874,100 for the three-month periods ended June 30, 2012 and 2011, respectively, and 628,826 and 881,019 for the six-month periods ended June 30, 2012 and 2011, respectively, to account for the potential dilutive effect of stock-based incentive plans. There were no adjustments to income from continuing operations or net income for the purposes of computing income available to common stockholders for those periods.

The calculation of weighted-average diluted shares outstanding excludes all shares that would have been anti-dilutive. During the three-month periods ended June 30, 2012 and 2011, the Company excluded 320,313 and 702,958 stock options, respectively, from the calculation of weighted average diluted shares outstanding as the stock options would have been anti-dilutive. During the six-month periods ended June 30, 2012 and 2011, the Company excluded 313,713 and 923,821 stock options, respectively, from the calculation of weighted average diluted shares outstanding as the stock options would have been anti-dilutive.

The Company granted 101,000 stock options, 161,204 restricted stock unit awards and 103,160 performance share awards in February 2012 as part of its annual grant award. All of the stock options and the restricted stock unit awards vest upon meeting certain service conditions. The restricted stock unit awards are included in basic average common shares outstanding as they contain nonforfeitable rights to dividend payments. The performance share awards are part of a long-term Relative Measure program, which is designed to assess the Company's performance relative to the performance of companies included in the Russell 2000 Index over the three-year term of the program ending December 31, 2014. The performance goals are independent of each other and based on three metrics: the Company's total shareholder return ("TSR"), basic earnings per share growth and operating income before depreciation and amortization growth (weighted equally). The participants can earn from zero to 250% of the target award and the award includes a forfeitable right to dividend equivalents, which are not included in the aggregate target award numbers. The fair value of the TSR portion of the performance share awards was determined using a Monte Carlo valuation method as the award contains a market condition.

The 3.375% convertible senior subordinated notes due in March 2027 (the "3.375% Convertible Notes") are convertible, under certain circumstances, into a combination of cash and common stock of the Company. The conversion price as of June 30, 2012 was approximately \$28.31 per share of common stock. The dilutive effect of the notes is determined based on the average closing price of the Company's stock for the last 30 trading days of the quarter as compared to the conversion price of the notes. Under the net share settlement method, there were no potential shares issuable under

the notes as the notes would have been anti-dilutive for the three- and six-month periods ended June 30, 2012 and 2011.

Effective April 5, 2011, the Company, through the trustee of its 3.75% convertible senior subordinated notes due in August 2025 (the "3.75% Convertible Notes"), exercised its right to redeem the remaining \$92,500 principal amount of these notes under their indenture agreement. The Company elected to pay cash to holders of the notes surrendered for conversion, including the value of any residual shares of common stock that were payable to the holders electing to convert their notes into an equivalent share value. Accordingly, the potential shares issuable for the 3.75% Convertible Notes were not included in either basic or diluted weighted average common shares outstanding for the three- and six-month periods ended June 30, 2011.

4. Inventories

The components of inventories consisted of:

	June 30, 2012	December 31, 2011
Finished goods	\$120,944	\$121,984
Work-in-process	61,415	60,557
Raw material and supplies	33,681	33,979
	\$216,040	\$216,520

5. Goodwill and Other Intangible Assets

Goodwill:

The following table sets forth the change in the carrying amount of goodwill for each reportable segment and for the Company as of and for the period ended June 30, 2012:

	Aerospace	Industrial	Distribution	Total Company
January 1, 2012	\$30,786	\$192,544	\$142,774	\$366,104
Foreign currency translation	—	(4,149	) (92	) (4,241
June 30, 2012	\$30,786	\$188,395	\$142,682	\$361,863

Other Intangible Assets:

Other intangible assets consisted of:

		June 30, 2012		December 31, 2011	
	Range of Life -Years	Gross Amount	Accumulated Amortization	Gross Amount	Accumulated Amortization
Amortized intangible assets:					
Revenue sharing programs (RSPs)	Up to 30	\$293,700	\$(50,238	) \$293,700	\$(46,367
Customer lists/relationships	10	23,506	(18,565	) 23,506	(17,292
Patents, trademarks/trade names	5-30	18,622	(12,850	) 18,622	(11,829
Other	Up to 15	11,492	(5,042	) 11,492	(4,454
		347,320	(86,695	) 347,320	(79,942
Foreign currency translation		4,324	—	4,714	—
Other intangible assets		\$351,644	\$(86,695	) \$352,034	\$(79,942

Average amortization of intangible assets for 2012 through 2016 is expected to approximate \$16,000 per year.

6. Debt

The Company's debt agreements contain financial covenants that require the maintenance of interest coverage and leverage ratios. The Company is in compliance with its debt covenants as of June 30, 2012, and closely monitors its future compliance based on current and anticipated future economic conditions.

Long-term debt and notes and overdrafts payable at June 30, 2012 and December 31, 2011 consisted of:

	June 30, 2012		December 31, 2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
3.375% Convertible Notes	\$55,636	\$60,615	\$55,636	\$59,038
Unamortized debt discount – 3.375% Convertible Notes	(4,250)	—	(5,333)	—
Revolving credit agreement	331,400	325,370	281,900	270,288
Borrowings under lines of credit and overdrafts	1,840	1,840	12,364	12,364
Foreign bank borrowings	1,215	1,215	1,485	1,642
	385,841	389,040	346,052	343,332
Less current maturities	(2,380)		(12,904)	
Long-term debt	\$383,461		\$333,148	

The 3.375% Convertible Notes are subject to redemption at their par value at any time, at the option of the Company, on or after March 20, 2014. The note holders may also require the Company to redeem some or all of the notes at their par value on March 15th of 2014, 2017 and 2022. The 3.375% Convertible Notes are also eligible for conversion upon meeting certain conditions as provided in the indenture agreement. The eligibility for conversion is determined quarterly. During the second quarter of 2012, the 3.375% Convertible Notes were not eligible for conversion. During the third quarter of 2012, the 3.375% Convertible Notes will not be eligible for conversion. The notes are valued using quoted market prices that represent Level 2 observable inputs.

The Company maintains an amended and restated revolving credit agreement (the "Credit Agreement") with Bank of America, N.A. as the administrative agent. The \$500,000 Credit Agreement matures in September 2016. Borrowings under the Credit Agreement bear interest at LIBOR plus a spread ranging from 1.10% to 1.70%. The fair value of the borrowings is based on observable Level 2 inputs. The borrowings are valued using discounted cash flows based upon the Company's estimated interest costs for similar types of borrowings.

In addition, the Company has available approximately \$15,000 in uncommitted short-term bank credit lines ("Credit Lines"), of which \$12,000 was borrowed at December 31, 2011 at an interest rate of 2.17%. The Company did not have any borrowings under the Credit Lines at June 30, 2012. The Company had also borrowed \$1,840 and \$364 under overdraft facilities at June 30, 2012 and December 31, 2011, respectively. Repayments under the Credit Lines are due within seven days after being borrowed. Repayments of the overdrafts are generally due within two days after being borrowed. The carrying amounts of the Credit Lines and overdrafts approximate fair value due to the short maturities of these financial instruments.

The Company also has foreign bank borrowings. The fair value of the foreign bank borrowings are based on observable Level 2 inputs. These instruments are valued using discounted cash flows based upon the Company's estimated interest costs for similar types of borrowings.

7. Derivatives

The Company has manufacturing, sales and distribution facilities around the world and thus makes investments and conducts business transactions denominated in various currencies. The Company is also exposed to fluctuations in interest rates and commodity price changes. These financial exposures are monitored and managed by the Company as an integral part of its risk management program.

Financial instruments have been used by the Company to hedge its exposure to fluctuations in interest rates. The Company previously had two, three-year interest rate swap agreements which together converted the interest on the first \$100,000 of the Company's one-month LIBOR-based borrowings from a variable rate plus the borrowing spread to a fixed rate of 2.947% plus the borrowing spread. These agreements matured in the first quarter of 2011. In April

2012, the Company entered into five-year interest rate swap agreements transacted with three banks which together convert the interest on the first \$100,000 of the Company's one-month LIBOR-based borrowings from a variable rate plus the borrowing spread to a fixed rate of 1.03% plus the borrowing spread. These interest rate swap agreements were accounted for as cash flow hedges.

The Company also uses financial instruments to hedge its exposures to fluctuations in foreign currency exchange rates. The Company has various contracts outstanding which primarily hedge recognized assets or liabilities, and anticipated transactions in various currencies including the British pound sterling, U.S. dollar, Euro, Singapore dollar, Swedish krona and Swiss franc. Certain foreign currency derivative instruments are treated as cash flow hedges of forecasted transactions. All foreign exchange contracts are due within two years.

The Company does not use derivatives for speculative or trading purposes or to manage commodity exposures.

Changes in the fair market value of derivatives that qualify as fair value hedges or cash flow hedges are recorded directly to earnings or accumulated other non-owner changes to equity, depending on the designation. Amounts recorded to accumulated other non-owner changes to equity are reclassified to earnings in a manner that matches the earnings impact of the hedged transaction. Any ineffective portion, or amounts related to contracts that are not designated as hedges, are recorded directly to earnings.

The following table sets forth the fair value amounts of derivative instruments held by the Company.

	June 30, 2012		December 31, 2011	
	Asset Derivatives	Liability Derivatives	Asset Derivatives	Liability Derivatives
Derivatives designated as hedging instruments:				
Interest rate contracts	\$—	\$(1,126)	\$—	\$—
Foreign exchange contracts	686	—	276	—
Derivatives not designated as hedging instruments:				
Foreign exchange contracts	397	(321)	28	(976)
Total derivatives	\$1,083	\$(1,447)	\$304	\$(976)

Asset derivatives are recorded in prepaid expenses and other current assets in the accompanying consolidated balance sheets. Liability derivatives related to interest rate contracts and foreign exchange contracts are recorded in other liabilities and accrued liabilities, respectively, in the accompanying consolidated balance sheets.

The following table sets forth the gain (loss), net of tax, recorded in accumulated other non-owner changes to equity for the three- and six-month periods ended June 30, 2012 and 2011 for derivatives held by the Company and designated as hedging instruments.

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Cash flow hedges:				
Interest rate contracts	\$(699)	\$—	\$(699)	\$422
Foreign exchange contracts	66	(238)	302	(372)
	\$(633)	\$(238)	\$(397)	\$50

Amounts included within accumulated other non-owner changes to equity that were reclassified to income during the first six months of 2011 related to the interest rate swaps resulted in a fixed rate of interest of 2.947% plus the borrowing spread for the first \$100,000 of one-month LIBOR borrowings. Amounts included within accumulated other non-owner changes to equity that were reclassified to expense during the first six months of 2012 related to the interest rate swaps resulted in a fixed rate of interest of 1.03% plus the borrowing spread for the first \$100,000 of one-month LIBOR borrowings. The amounts reclassified for the foreign exchange contracts were not material in any period presented. Additionally, there were no amounts recognized in income for hedge ineffectiveness during the three- and six-month periods ended June 30, 2012 and 2011.

The following table sets forth the gains (losses) recorded in other expense (income), net in the consolidated statements of income for the three- and six-month periods ended June 30, 2012 and 2011 for non-designated derivatives held by the Company. Such amounts were substantially offset by (losses) gains recorded on the underlying hedged asset or liability.

	Three months ended June 30,	Six months ended June 30,
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	2012	2011	2012	2011	
Foreign exchange contracts	\$(82) \$147	\$975	\$(911)

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8. Fair Value Measurements

The provisions of the accounting standard for fair value define fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This standard classifies the inputs used to measure fair value into the following hierarchy:

Level 1 Unadjusted quoted prices in active markets for identical assets or liabilities

Level 2 Unadjusted quoted prices in active markets for similar assets or liabilities, or unadjusted quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs other than quoted prices that are observable for the asset or liability

Level 3 Unobservable inputs for the asset or liability

The following table provides the financial assets and financial liabilities reported at fair value and measured on a recurring basis:

Description	Total	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
June 30, 2012				
Asset derivatives	\$1,083	\$—	\$1,083	\$—
Liability derivatives	(1,447)	) —	(1,447)) —
Rabbi trust assets	1,889	1,889	—	—
	\$1,525	\$1,889	\$(364)) \$—
December 31, 2011				
Asset derivatives	\$304	\$—	\$304	\$—
Liability derivatives	(976)	) —	(976)) —
Rabbi trust assets	1,494	1,494	—	—
	\$822	\$1,494	\$(672)) \$—

The derivative contracts are valued using observable current market information as of the reporting date such as the prevailing LIBOR-based and U.S. treasury interest rates and foreign currency spot and forward rates. The fair values of rabbi trust assets are based on quoted market prices from various financial exchanges.

9. Pension and Other Postretirement Benefits

Pension and other postretirement benefits expenses consisted of the following:

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Pensions				
Service cost	\$1,645	\$1,375	\$3,258	\$2,944
Interest cost	5,415	5,668	10,737	11,240
Expected return on plan assets	(8,257)	(8,130)	(16,290)	(16,030)
Amortization of prior service cost	209	287	420	562
Recognized losses	3,100	1,543	5,859	2,875
Net periodic benefit cost	\$2,112	\$743	\$3,984	\$1,591
	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Other Postretirement Benefits				
Service cost	\$59	\$48	\$136	\$143
Interest cost	579	685	1,259	1,424
Amortization of prior service credit	(397)	(485)	(793)	(771)
Recognized losses	256	240	542	404
Net periodic benefit cost	\$497	\$488	\$1,144	\$1,200

10. Income Taxes

The Company's effective tax rate from continuing operations for the first half of 2012 was 22.2%. In 2011, the Company's effective tax rate from continuing operations was 25.7% in the first half of the year and 21.7% for the full year. The effective tax rate for the first half of 2011 included the recognition of \$1,793 of discrete tax expense related to tax adjustments for earlier years. The decrease in the 2012 effective tax rate from continuing operations was driven primarily by the absence of this discrete item and the impact of a decrease in the planned repatriation of a portion of current year foreign earnings to the U.S., partially offset by a projected change in the mix of earnings attributable to higher-taxing jurisdictions or jurisdictions where losses cannot be benefited in 2012.

The Company was awarded multi-year Pioneer tax status by the Ministry of Trade and Industry in Singapore for the production of certain engine components by the Aerospace aftermarket business, the earliest of which was granted in August 2005 retroactive to October 2003. In 2010, the Pioneer tax status for certain of the Company's engine components was awarded a two-year extension in exchange for capital investment commitments. The Pioneer tax status is generally awarded for periods of seven to nine years from the effective date and the first two Pioneer certificates are scheduled to expire in the second half of 2012 and the first quarter of 2013, respectively.

11. Information on Business Segments

In the first quarter of 2012, the Company changed its organizational structure to align its strategic business units into three reportable segments: Aerospace, Industrial and Distribution. The Company is organized based upon the nature of its products and services. Segment information is consistent with how management reviews the businesses, makes investing and resource allocation decisions and assesses operating performance. The Company has not aggregated operating segments for purposes of identifying reportable segments.

The Aerospace segment produces precision-machined and fabricated components and assemblies for original equipment manufacturer ("OEM") turbine engine, airframe and industrial gas turbine builders throughout the world, and

for the military. Aerospace also provides jet engine component overhaul and repair services for many of the world's major turbine engine manufacturers, commercial airlines and the military. In addition, Aerospace manufactures and provides aerospace aftermarket spare parts and provides repair services for aerospace engine components. The Industrial segment is a global supplier of high quality manufactured precision components for critical applications serving diverse industrial end markets such as transportation, energy, electronics, medical and consumer products. The Distribution segment is an industry leader in logistics

support through vendor managed inventory and technical sales for maintenance, repair, operating and production supplies, as well as the design, assembly and distribution of engineered supplies for the global industrial base.

The following tables set forth information about the Company's operations by its three reportable segments:

	Three months ended		Six months ended June	
	June 30, 2012	2011	30, 2012	2011
Net sales				
Aerospace	\$93,770	\$94,729	\$191,020	\$185,289
Industrial	110,244	114,004	225,592	225,434
Distribution	91,855	91,731	185,280	181,643
Intersegment sales	(2,447)	(2,627)	(5,374)	(4,939)
Total net sales	\$293,422	\$297,837	\$596,518	\$587,427
Operating profit				
Aerospace	\$14,706	\$14,794	\$28,924	\$28,477
Industrial	11,217	10,977	21,321	21,935
Distribution	8,203	8,003	16,894	14,078
Total operating profit	34,126	33,774	67,139	64,490
Interest expense	2,435	2,350	4,803	6,005
Other expense (income), net	95	321	948	728
Income from continuing operations before income taxes	\$31,596	\$31,103	\$61,388	\$57,757

	June 30, 2012	December 31, 2011
Assets		
Aerospace	\$533,622	\$544,943
Industrial	454,530	453,279
Distribution	282,395	278,139
Other ^(A)	186,685	164,004
Total assets	\$1,457,232	\$1,440,365

(A) "Other" assets include corporate-controlled assets, the majority of which are cash and deferred tax assets.

12. Commitments and Contingencies

Product Warranties

The Company provides product warranties in connection with the sale of certain products. From time to time, the Company is subject to customer claims with respect to product warranties. Product warranty liabilities were not material as of June 30, 2012 and December 31, 2011.

The Company was named in a lawsuit arising out of an alleged breach of contract and implied warranty by a customer of Toolcom Suppliers Limited ("Toolcom"), a business previously included within the former Logistics and Manufacturing Services segment, related to the sale of certain products prior to the Company's 2005 acquisition of Toolcom. In 2006, the plaintiff filed the lawsuit in civil court in Scotland and asserted that certain products sold were not fit for a particular use and claims approximately 5,500 pounds sterling (approximately \$8,500 at June 30, 2012) in damages, plus interest at the statutory rate of 8% per annum and costs. The court found that Toolcom was in breach of contract and implied warranty, and ordered Toolcom to pay a portion of the plaintiff's attorneys' fees. The court has not made determinations as to causation and damages. Although the Company intends to vigorously defend its position

with respect to causation and damages, based on reviews of the currently available information and acknowledging the uncertainties of litigation, management has provided for what it believes to be a reasonable estimate of loss exposure. While it is currently not possible to determine the ultimate outcome of this matter, the Company believes that any ultimate losses would not be expected to have a material adverse effect on the Company's consolidated financial position or cash flows, but could be material to the consolidated results of operations of any

one period.

Income Taxes

In connection with an IRS audit for the tax years 2000 through 2002, the IRS proposed adjustments to these tax years of approximately \$16,500, plus a potential penalty of 20% of the tax assessment plus interest. The adjustment relates to the federal taxation of foreign income of certain foreign subsidiaries. The Company filed an administrative protest of these adjustments. In the third quarter of 2009, the Company was informed that its protest was denied and a tax assessment was received from the Appeals Office of the IRS. In November 2009, the Company filed a petition against the IRS in the U.S. Tax Court contesting the tax assessment received. As expected, a trial was held in the first quarter of 2012. The Court has established a schedule that requires all briefs to be filed in the third quarter of 2012, and a decision is expected late in the fourth quarter of 2012 or in the first half of 2013. Depending on the outcome, an appeal by either party is possible. The Company continues to believe its tax position on the issues raised by the IRS is correct and the Company plans to continue to take appropriate actions to vigorously defend its position. The Company believes it should prevail on this issue. While any additional impact on the Company's liability for income taxes cannot presently be determined, the Company continues to believe it is adequately provided for and the outcome is not expected to have a material effect on the Company's consolidated financial position or cash flows, but could be material to the consolidated results of operations of any one period.

13. Subsequent Events

On July 10, 2012, the Company executed a \$250,000 accordion feature that was available under the Company's existing \$500,000 Credit Agreement, increasing the available amount under the Credit Facility to \$750,000.

On July 16, 2012, the Company entered into a Stock Purchase Agreement (the "Stock Purchase Agreement") to acquire all of the issued and outstanding shares of capital stock of Synventive Acquisition Inc. ("Synventive"). Together with its subsidiaries, Synventive, which is headquartered in Peabody, Massachusetts, is a leading designer and manufacturer of highly engineered and customized hot runner systems and components and provides related services. The purchase price payable by the Company for such shares pursuant to the terms of the Stock Purchase Agreement is \$335,000 in cash, subject to certain adjustments in connection with the closing. The acquisition is subject to closing conditions, including third party agreements, and is currently expected to occur during August 2012. Synventive is expected to operate within the Company's Industrial segment. The Company expects to fund the purchase price for the acquisition from cash on hand and borrowings under the accordion feature.

With respect to the unaudited consolidated financial information of Barnes Group Inc. for the three-month and six-month periods ended June 30, 2012 and 2011, PricewaterhouseCoopers LLP reported that they have applied limited procedures in accordance with professional standards for a review of such information. However, their separate report dated July 27, 2012 appearing herein, states that they did not audit and they do not express an opinion on that unaudited consolidated financial information. Accordingly, the degree of reliance on their report should be restricted in light of the limited nature of the review procedures applied. PricewaterhouseCoopers LLP is not subject to the liability provisions of Section 11 of the Securities Act of 1933, as amended, for their report on the unaudited consolidated financial information because that report is not a "report" or a "part" of the registration statement prepared or certified by PricewaterhouseCoopers LLP within the meaning of Sections 7 and 11 of the Securities Act of 1933, as amended.

Report of Independent Registered Public Accounting Firm
To the Board of Directors and Stockholders of
Barnes Group Inc.

We have reviewed the accompanying consolidated balance sheet of Barnes Group Inc. and its subsidiaries as of June 30, 2012 and the related consolidated statements of income and comprehensive income for the three-month and six-month periods ended June 30, 2012 and June 30, 2011 and the consolidated statements of cash flows for the six-month periods ended June 30, 2012 and June 30, 2011. This interim financial information is 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 (United States), 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 on our review, we are not aware of any material modifications that should be made to the accompanying consolidated interim financial information for it to be in conformity with accounting principles generally accepted in the United States of America.

We previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of December 31, 2011, and the related consolidated statements of income, of changes in stockholders' equity and of cash flows for the year then ended (not presented herein), and in our report dated February 21, 2012, 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, 2011, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

/s/ PricewaterhouseCoopers LLP
PricewaterhouseCoopers LLP
Hartford, Connecticut
July 27, 2012

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

OVERVIEW

Please refer to the Overview in the Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's Annual Report on Form 10-K for the year ended December 31, 2011. The Annual Report on Form 10-K and other documents related to the Company are located on the Company's website: www.bginc.com.

In the first quarter of 2012, the Company changed its organizational structure to align its strategic business units into three reportable segments: Aerospace, Industrial and Distribution.

Additionally, in the fourth quarter of 2011, the Company completed the sale of its Barnes Distribution Europe businesses (the "BDE" business). The BDE business was comprised of the Company's European KENT, Toolcom and BD France distribution businesses that were reported within the segment formerly referred to as Logistics and Manufacturing Services.

All previously reported financial information has been adjusted on a retrospective basis to reflect the segment realignment and the discontinued operations for all periods.

Aerospace

Aerospace produces precision-machined and fabricated components and assemblies for original equipment manufacturer ("OEM") turbine engine, airframe and industrial gas turbine builders throughout the world, and the military. Aerospace also provides jet engine component overhaul and repair services for many of the world's major turbine engine manufacturers, commercial airlines and the military. Activities include the manufacture and delivery of aerospace aftermarket spare parts, including the revenue sharing programs ("RSPs") under which the Company receives an exclusive right to supply designated aftermarket parts over the life of the related aircraft engine program, and component repairs.

Aerospace's manufacturing business competes with both the leading jet engine OEMs and a large number of machining and fabrication companies. Competition is based mainly on quality, engineering and technical capability, product breadth, timeliness, service and price. Aerospace's machining and fabrication operations, with facilities in Arizona, Connecticut, Michigan, Ohio, Utah and Singapore, produce critical engine and airframe components through technically advanced processes.

The aerospace aftermarket business competes with aerospace OEMs, service centers of major commercial airlines and other independent service companies for the repair and overhaul of turbine engine components. The manufacturing and supplying of aerospace aftermarket spare parts, including the RSPs, are dependent upon the reliable and timely delivery of high-quality components. Aerospace's aftermarket facilities, located in Connecticut, Ohio and Singapore, specialize in the repair and refurbishment of highly engineered components and assemblies such as cases, rotating air seals, shrouds and honeycomb air seals.

Industrial

Industrial is a global supplier of engineered components for critical applications focused on providing solutions for a diverse industrial and transportation customer base. It is equipped to produce virtually every type of precision spring, from fine hairsprings for electronics and instruments to large heavy-duty springs for machinery. It is also a leading manufacturer and supplier of precision mechanical products, including precision mechanical springs, compressor reed

valves and nitrogen gas products. Industrial also manufactures high-precision punched and fine-blanked components used in transportation and industrial applications, nitrogen gas springs and manifold systems used to precisely control stamping presses, and retention rings that position parts on a shaft or other axis.

Industrial has a diverse customer base with products purchased by durable goods manufacturers located around the world in industries including transportation, consumer products, farm equipment, telecommunications, medical devices, home appliances and electronics. Long-standing customer relationships enable Industrial to participate in the design phase of components and assemblies through which customers receive the benefits of manufacturing research, testing and evaluation. Products are sold primarily through its direct sales force and a global distribution channel.

Industrial competes with a broad base of large and small companies engaged in the manufacture and sale of custom metal components and assemblies and competes on the basis of quality, service, reliability of supply, engineering and technical capability, product breadth, innovation, design, and price.

Industrial has manufacturing, sales, assembly, and distribution operations in the United States, Brazil, Canada, China, Germany, Korea, Mexico, Singapore, Sweden, Switzerland and Thailand.

Distribution

Distribution provides value-added logistics support services including inventory management, technical sales, and supply chain solutions for maintenance, repair, operating, and production supplies and services. The global operations are engaged in the supplying and servicing of maintenance, repair and operating components and also the engineering and technical sales of custom solutions of springs, gas struts and engineered hardware. Activities include logistics support through vendor-managed inventory and technical sales for stocked replacement parts and other products, catalog offerings and custom solutions. Key business drivers include a value proposition centered on customer service, delivery, multiple sales channels, procurement systems, and strong customer relationships.

Distribution has sales, distribution, and assembly operations in the United States, Brazil, Canada, China, France, Mexico, Singapore, Spain and the United Kingdom. Products and services are available in more than 30 countries. The Distribution segment faces active competition throughout the world. The products and services offered are not unique, and its competitors provide substantially similar products and services. Competition comes from local, regional, and national maintenance and repair supply distributors and specialty manufacturers of springs, gas struts and engineered hardware. Service alternatives, timeliness and reliability of supply, price, technical capability, product breadth, quality and overall customer service are important competitive factors.

Second Quarter 2012 Highlights

In the second quarter of 2012, sales decreased by \$4.4 million, or 1.5%, from the second quarter of 2011 to \$293.4 million. Foreign currency translation decreased sales by approximately \$7.4 million as the U.S. dollar strengthened against foreign currencies, primarily in Europe and Brazil. Organic sales increased by \$3.0 million, or 1.0%, in the second quarter of 2012. Sales at the Aerospace segment decreased. A slight increase in the OEM manufacturing business and continued strong levels of aftermarket repair and overhaul sales activity within the Aerospace segment were more than offset by a sales decline in the aftermarket RSP spare parts business. Organic sales increased slightly within the Industrial and Distribution segments.

Operating income in the second quarter of 2012 increased 1.0% to \$34.1 million from the second quarter of 2011 and operating income margin increased from 11.3% to 11.6%. Margins benefited from continued productivity improvements and lower employee related costs, primarily due to incentive compensation, partially offset by higher pension costs, and costs related to acquisition initiatives.

On July 10, 2012, the Company executed a \$250.0 million accordion feature that was available under the Company's existing \$500.0 million Credit Agreement, increasing the available amount under the Credit Facility to \$750.0 million.

On July 16, 2012, the Company entered into a Stock Purchase Agreement (the "Stock Purchase Agreement") to acquire all of the issued and outstanding shares of capital stock of Synventive Acquisition Inc. ("Synventive"). Together with its subsidiaries, Synventive, which is headquartered in Peabody, Massachusetts, is a leading designer and manufacturer of highly engineered and customized hot runner systems and components and provides related services. The purchase price payable by the Company for such shares pursuant to the terms of the Stock Purchase Agreement is \$335.0 million in cash, subject to certain adjustments in connection with the closing. The acquisition is subject to closing conditions, including third party agreements, and is currently expected to occur during August 2012. Synventive is expected to operate within the Company's Industrial segment. The Company expects to fund the purchase price for the acquisition from cash on hand and borrowings under the accordion feature.

RESULTS OF OPERATIONS

Net Sales

(in millions)	Three months ended June 30,			Six months ended June 30,					
	2012	2011	Change	2012	2011	Change			
Aerospace	\$93.8	\$94.7	\$(1.0)	(1.0)%	\$191.0	\$185.3	\$5.7	3.1	%
Industrial	110.2	114.0	(3.8)	(3.3)%	225.6	225.4	0.2	0.1	%
Distribution	91.9	91.7	0.1	0.1 %	185.3	181.6	3.6	2.0	%
Intersegment sales	(2.5)	(2.6)	0.3	6.9 %	(5.4)	(4.9)	(0.4)	(8.8)	%
Total	\$293.4	\$297.8	\$(4.4)	(1.5)%	\$596.5	\$587.4	\$9.1	1.5	%

The Company reported net sales of \$293.4 million in the second quarter of 2012, a decrease of \$4.4 million or 1.5%, from the second quarter of 2011. The strengthening of the U.S. dollar against foreign currencies, primarily in Europe and Brazil, decreased net sales by approximately \$7.4 million in the second quarter of 2012 of which \$6.5 million related to Industrial and \$0.9 million related to Distribution. The sales decrease was partially offset by \$3.0 million of organic sales growth which included increases of \$2.7 million at Industrial and \$1.0 million at Distribution. Sales decreased by \$1.0 million at Aerospace during the second quarter of 2012.

The Company reported net sales of \$596.5 million in the first half of 2012, an increase of \$9.1 million or 1.5%, from the first half of 2011. The sales increase reflected \$17.5 million of organic sales growth which included increases of \$5.7 million, \$7.5 million and \$4.7 million at Aerospace, Industrial and Distribution, respectively. The strengthening of the U.S. dollar against foreign currencies, primarily in Europe and Brazil, decreased net sales by approximately \$8.4 million in the first half of 2012 of which \$7.3 million related to Industrial and \$1.1 million related to Distribution.

Expenses and Operating Income

(in millions)	Three months ended June 30,			Six months ended June 30,					
	2012	2011	Change	2012	2011	Change			
Cost of sales	\$193.1	\$194.6	\$(1.5)	(0.8)%	\$394.9	\$385.5	\$9.4	2.4	%
% sales	65.8	% 65.3	%		66.2	% 65.6	%		
Gross profit ⁽¹⁾	\$100.3	\$103.3	\$(2.9)	(2.8)%	\$201.6	\$202.0	\$(0.3)	(0.2)	%
% sales	34.2	% 34.7	%		33.8	% 34.4	%		
Selling and administrative expenses	\$66.2	\$69.5	\$(3.3)	(4.7)%	\$134.5	\$137.5	\$(3.0)	(2.1)	%
% sales	22.6	% 23.3	%		22.5	% 23.4	%		
Operating income	\$34.1	\$33.8	\$0.4	1.0 %	\$67.1	\$64.5	\$2.6	4.1	%
% sales	11.6	% 11.3	%		11.3	% 11.0	%		

(1) - Sales less cost of sales.

Cost of sales in the second quarter of 2012 decreased 0.8% from the 2011 period, while gross profit margin decreased from 34.7% in the 2011 period to 34.2% in the 2012 period. Gross margin improved at Industrial and declined at Aerospace and Distribution. Overall, the decline in gross margin was driven primarily by a shift in mix within the Aerospace segment and increased pension costs, partially offset by productivity improvements within the Industrial segment. Selling and administrative expenses in the second quarter of 2012 decreased 4.7% from the second quarter of 2011. This decrease was a result of lower employee related costs, primarily due to incentive compensation, in the second quarter of 2012 as compared to the second quarter of 2011 as a result of the level of achievement of the Company's pre-established annual performance targets, partially offset by an increase in costs related to acquisition initiatives. As a percentage of sales, selling and administrative costs decreased from 23.3% in the second quarter of 2011 to 22.6% in the second quarter of 2012. As a result, operating income in the second quarter of 2012 increased

1.0% to \$34.1 million from the second quarter of 2011 and operating income margin increased from 11.3% to 11.6%.

Cost of sales in the first half of 2012 increased 2.4% from the 2011 period, while gross profit margin decreased from 34.4% in the 2011 period to 33.8% in the 2012 period. The decline was driven primarily by a shift in mix within the Aerospace segment

and increased pension costs. Selling and administrative expenses in the first half of 2012 decreased 2.1% from the first half of 2011 as a result of lower employee related costs, primarily due to incentive compensation, partially offset by an increase in costs related to acquisition initiatives. As a percentage of sales, selling and administrative costs decreased from 23.4% in the first half of 2011 to 22.5% in the first half of 2012. As a result, operating income in the first half of 2012 increased 4.1% from the first half of 2011 and operating income margin improved from 11.0% to 11.3%.

Interest expense

Interest expense increased \$0.1 million in the second quarter of 2012 and decreased \$1.2 million in the first half of 2012 compared to the prior year amounts. The increase in interest expense during the second quarter of 2012 was primarily attributed to the Company's entering into interest rate swap agreements during April 2012, which resulted in a higher portion of the Company's outstanding debt being carried at a higher fixed interest rate. During the first half of 2012, the decrease in interest expense is primarily a result of lower average interest rates, following the redemption of the 3.75% Convertible Notes in April 2011 and earlier interest rate swaps that had matured in March 2011. The redemption of the 3.75% Convertible Notes, which were funded with the variable rate credit facility (the "Credit Facility"), resulted in a higher portion of the Company's outstanding debt being carried at a lower average interest rate.

Other expense (income), net

Other expense (income), net in the second quarter of 2012 was \$0.1 million compared to \$0.3 million in the second quarter of 2011. In the first half of 2012, other expense (income), net was \$0.9 million compared to \$0.7 million in the first half of 2011. The changes in other expense (income), net reflect changes in foreign exchange transaction losses during both periods.

Income Taxes

The Company's effective tax rate from continuing operations for the first half of 2012 was 22.2%. In 2011, the Company's effective tax rate from continuing operations was 25.7% in the first half of the year and 21.7% for the full year. The effective tax rate for the first half of 2011 included the recognition of \$1,793 of discrete tax expense related to tax adjustments for earlier years. The decrease in the 2012 effective tax rate from continuing operations was driven primarily by the absence of this discrete item and the impact of a decrease in the planned repatriation of a portion of current year foreign earnings to the U.S., partially offset by a projected change in the mix of earnings attributable to higher-taxing jurisdictions or jurisdictions where losses cannot be benefited in 2012.

The Company was awarded multi-year Pioneer tax status by the Ministry of Trade and Industry in Singapore for the production of certain engine components by the Aerospace aftermarket business, the earliest of which was granted in August 2005 retroactive to October 2003. In 2010, the Pioneer tax status for certain of the Company's engine components was awarded a two-year extension in exchange for capital investment commitments. The Pioneer tax status is generally awarded for periods of seven to nine years from the effective date and the first two Pioneer certificates are scheduled to expire in the second half of 2012 and the first quarter of 2013, respectively.

In connection with an IRS audit for the tax years 2000 through 2002, the IRS proposed adjustments to these tax years of approximately \$16,500, plus a potential penalty of 20% of the tax assessment plus interest. The adjustment relates to the federal taxation of foreign income of certain foreign subsidiaries. The Company filed an administrative protest of these adjustments. In the third quarter of 2009, the Company was informed that its protest was denied and a tax assessment was received from the Appeals Office of the IRS. In November 2009, the Company filed a petition against the IRS in the U.S. Tax Court contesting the tax assessment received. As expected, a trial was held in the first quarter of 2012. The Court has established a schedule that requires all briefs to be filed in the third quarter of 2012, and a decision is expected late in the fourth quarter of 2012 or in the first half of 2013. Depending on the outcome, an appeal by either party is possible. The Company continues to believe its tax position on the issues raised by the IRS is correct and the Company plans to continue to take appropriate actions to vigorously defend its position. The Company

believes it should prevail on this issue. While any additional impact on the Company's liability for income taxes cannot presently be determined, the Company continues to believe it is adequately provided for and the outcome is not expected to have a material effect on the Company's consolidated financial position or cash flows, but could be material to the consolidated results of operations of any one period.

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Income and Income per Share

(in millions, except per share)	Three months ended June 30,					Six months ended June 30,				
	2012	2011	Change			2012	2011	Change		
Income from continuing operations	\$24.8	\$22.7	\$2.1	9.1	%	\$47.8	\$42.9	\$4.8	11.3	%
Loss from discontinued operations, net of income taxes	—	(0.4)	0.4	NM		(0.7)	(1.5)	\$0.8	51.7	%
Net income	\$24.8	\$22.3	\$2.5	11.2	%	\$47.0	\$41.4	\$5.6	13.6	%
Per common share:										
Basic:										
Income from continuing operations	\$0.46	\$0.41	\$0.05	12.2	%	\$0.87	\$0.78	\$0.09	11.5	%
Loss from discontinued operations, net of income taxes	—	(0.01)	0.01	NM		(0.01)	(0.03)	0.02	66.7	%
Net income	\$0.46	\$0.40	\$0.06	15.0	%	\$0.86	\$0.75	\$0.11	14.7	%
Diluted:										
Income from continuing operations	\$0.45	\$0.41	\$0.04	9.8	%	\$0.86	\$0.77	\$0.09	11.7	%
Loss from discontinued operations, net of income taxes	—	(0.01)	0.01	NM		(0.01)	(0.03)	0.02	66.7	%
Net income	\$0.45	\$0.40	\$0.05	12.5	%	\$0.85	\$0.74	\$0.11	14.9	%
Weighted average common shares outstanding:										
Basic	54.5	55.4	(0.9)	(1.6)	%	54.7	55.1	(0.4)	(0.7)	%
Diluted	55.2	56.3	(1.1)	(2.0)	%	55.3	55.9	(0.6)	(1.2)	%

NM - Not meaningful

In the second quarter of 2012, basic and diluted income from continuing operations per common share increased 12.2% and 9.8%, respectively, from the second quarter of 2011 and for the first half of 2012 increased 11.5% and 11.7%, respectively, from the first half of 2011. The increases were directly attributable to the increases in income from continuing operations for the periods. Basic weighted average common shares outstanding decreased due to the repurchase of 1,509,156 shares and 700,000 shares during 2011 and 2012, respectively. The decrease was partially offset by shares issued for employee stock plan activity. Diluted weighted average common shares outstanding decreased primarily as a result of the decrease in basic weighted average common shares outstanding.

Financial Performance by Business Segment

Aerospace

(in millions)	Three months ended June 30,					Six months ended June 30,				
	2012	2011	Change			2012	2011	Change		
Sales	\$93.8	\$94.7	\$(1.0)	(1.0)	%	\$191.0	\$185.3	\$5.7	3.1	%
Operating profit	14.7	14.8	(0.1)	(0.6)	%	28.9	28.5	0.4	1.6	%
Operating margin	15.7	% 15.6	%			15.1	% 15.4	%		

The Aerospace segment reported sales of \$93.8 million in the second quarter of 2012, a 1.0% decrease from the second quarter of 2011. The aftermarket repair and overhaul business continued to reflect strong levels of sales

activity during the second quarter of 2012, however this growth was more than offset by a decline in sales within the aftermarket RSP spare parts business. Sales within the OEM manufacturing business increased slightly during the second quarter of 2012. In the first half of 2012, this segment reported sales of \$191.0, a 3.1% increase from the first half of 2011 primarily as a result of growth in the aftermarket repair and overhaul business. Sales growth within the OEM manufacturing business during the first quarter of 2012 also contributed to increased sales in the first half of 2012.

Operating profit at Aerospace in the second quarter of 2012 decreased 0.6% from the second quarter of 2011 to \$14.7 million. The decrease was driven primarily by the profit impact of lower sales volumes and a shift in mix. Operating margin improved from 15.6% in the second quarter of 2011 to 15.7% in the second quarter of 2012. Operating profit in the first half of 2012

increased 1.6% from the first half of 2011 to \$28.9 million. The increase relates primarily to the profit impact of higher sales volumes during the first quarter of 2012.

Outlook: Sales in the aerospace OEM business are impacted by the general state of the aerospace market driven by the worldwide economy and are driven by its order backlog through its participation in certain strategic commercial and military engine and airframe programs. Backlog in this business was \$526.1 million at June 30, 2012, of which approximately 54% is expected to be shipped in the next 12 months. The aerospace OEM business may be impacted by adjustments of customer inventory levels, commodity availability and pricing, changes in the content levels on certain platforms including insourcing, changes in production schedules of specific engine and airframe programs, as well as the pursuit of new programs. Near-term sales levels in the aerospace aftermarket repair and overhaul business are expected to continue reflecting recent trends towards improving maintenance, repair and overhaul activity, but may be negatively impacted by short-term fluctuations in demand. Management continues to believe its aerospace aftermarket business is favorably positioned based on strong customer relationships including long-term maintenance and repair contracts in the repair and overhaul business, expanded capabilities and current capacity levels.

Management is focused on growing operating profit at Aerospace primarily through organic sales growth, productivity initiatives, new product introductions and continued cost management. Operating profit is expected to continue to be affected by the profit impact of the changes in sales volume and sales mix, particularly as it relates to the highly profitable aftermarket RSP spare parts business, and investments made in each of its businesses. Management actively manages commodity price increases through pricing actions and other productivity initiatives. In addition, the highly profitable aftermarket RSPs are expected to continue to be impacted by the management fees payable to the customer which generally increase in the fourth or later years of each program. These and other similar fees are deducted from sales and temper sales growth of the aftermarket RSPs and operating margin. Costs associated with increases in new product introductions may also negatively impact operating profit.

Industrial

(in millions)	Three months ended June 30,			Six months ended June 30,					
	2012	2011	Change	2012	2011	Change			
Sales	\$110.2	\$114.0	\$(3.8)	(3.3)%	\$225.6	\$225.4	\$0.2	0.1	%
Operating profit	11.2	11.0	0.2	2.2 %	21.3	21.9	(0.6		