

BARNES GROUP INC  
Form 10-Q  
October 28, 2011

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 September 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 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  
Registrant's telephone number, including area code

06010  
(Zip 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 54,737,829 shares of common stock as of October 26, 2011.

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 For the Quarterly Period Ended September 30, 2011

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## 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 September |            | Nine months ended September |            |
|---|------------------------------|------------|-----------------------------|------------|
|   | 30,<br>2011                  | 2010       | 30,<br>2011                 | 2010       |
| Net sales                                   | \$325,394                    | \$289,901  | \$972,098                   | \$849,930  |
| Cost of sales                               | 210,864                      | 184,989    | 621,401                     | 540,833    |
| Selling and administrative expenses         | 81,586                       | 80,079     | 254,782                     | 240,915    |
|   | 292,450                      | 265,068    | 876,183                     | 781,748    |
| Operating income                            | 32,944                       | 24,833     | 95,915                      | 68,182     |
| Interest expense                            | 1,917                        | 5,177      | 7,950                       | 15,273     |
| Other expense (income), net                 | (425                         | ) 773      | 378                         | 2,161      |
| Income before income taxes                  | 31,452                       | 18,883     | 87,587                      | 50,748     |
| Income taxes                                | 8,207                        | 3,779      | 22,938                      | 8,992      |
| Net income                                  | \$23,245                     | \$15,104   | \$64,649                    | \$41,756   |
| Per common share:                           |                              |            |                             |            |
| Net income:                                 |                              |            |                             |            |
| Basic                                       | \$0.42                       | \$0.27     | \$1.17                      | \$0.75     |
| Diluted                                     | 0.41                         | 0.27       | 1.15                        | 0.75       |
| Dividends                                   | 0.08                         | 0.08       | 0.24                        | 0.24       |
| Weighted average common shares outstanding: |                              |            |                             |            |
| Basic                                       | 55,834,038                   | 55,346,517 | 55,325,541                  | 55,428,865 |
| Diluted                                     | 56,380,585                   | 55,839,970 | 56,095,069                  | 56,048,170 |

See accompanying notes.

BARNES GROUP INC.  
CONSOLIDATED BALANCE SHEETS  
(Dollars in thousands)  
(Unaudited)

|  | September 30,<br>2011 | December 31,<br>2010 |
|--|-----------------------|----------------------|
| Assets   |                       |                      |
| Current assets   |                       |                      |
| Cash and cash equivalents  | \$38,843              | \$13,450             |
| Accounts receivable, less allowances (2011 - \$4,862; 2010 - \$5,026)      | 225,676               | 197,715              |
| Inventories  | 227,463               | 216,382              |
| Deferred income taxes  | 31,469                | 10,449               |
| Prepaid expenses and other current assets                                  | 12,179                | 12,212               |
| Total current assets   | 535,630               | 450,208              |
| Deferred income taxes  | 24,147                | 42,722               |
| Property, plant and equipment  | 615,099               | 611,055              |
| Less accumulated depreciation  | (398,836)             | (392,621)            |
|  | 216,263               | 218,434              |
| Goodwill   | 389,972               | 384,241              |
| Other intangible assets, net   | 281,282               | 290,798              |
| Other assets   | 19,323                | 16,854               |
| Total assets   | \$1,466,617           | \$1,403,257          |
| Liabilities and Stockholders' Equity                                       |                       |                      |
| Current liabilities  |                       |                      |
| Notes and overdrafts payable   | \$8,144               | \$4,930              |
| Accounts payable   | 101,322               | 98,191               |
| Accrued liabilities  | 103,566               | 86,602               |
| Long-term debt - current   | 769                   | 93,141               |
| Total current liabilities  | 213,801               | 282,864              |
| Long-term debt   | 338,828               | 259,647              |
| Accrued retirement benefits  | 94,473                | 112,886              |
| Other liabilities  | 35,968                | 35,741               |
| Commitments and contingencies (Note 12)                                    |                       |                      |
| Stockholders' equity   |                       |                      |
| Common stock - par value \$0.01 per share                                  |                       |                      |
| Authorized: 150,000,000 shares   | 585                   | 565                  |
| Issued: at par value (2011 - 58,455,387 shares; 2010 - 56,518,417 shares)  |                       |                      |
| Additional paid-in capital   | 313,113               | 278,287              |
| Treasury stock, at cost (2011 - 3,752,632 shares; 2010 - 2,691,215 shares) | (67,836)              | (44,379)             |
| Retained earnings  | 565,525               | 514,240              |
| Accumulated other non-owner changes to equity                              | (27,840)              | (36,594)             |
| Total stockholders' equity   | 783,547               | 712,119              |

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|  |             |             |
|--|-------------|-------------|
| Total liabilities and stockholders' equity | \$1,466,617 | \$1,403,257 |
|--|-------------|-------------|

See accompanying notes.

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

|  | Nine months ended September 30, |             |
|--|---------------------------------|-------------|
|  | 2011                            | 2010        |
| Operating activities:  |                                 |             |
| Net income   | \$64,649                        | \$41,756    |
| Adjustments to reconcile net income to net cash from operating activities: |                                 |             |
| Depreciation and amortization  | 43,855                          | 38,988      |
| Amortization of convertible debt discount                                  | 1,633                           | 4,251       |
| (Gain) loss on disposition of property, plant and equipment                | (400)                           | ) 253       |
| Stock compensation expense   | 5,866                           | 5,619       |
| Withholding taxes paid on stock issuances                                  | (1,089)                         | ) (287)     |
| Changes in assets and liabilities:   |                                 |             |
| Accounts receivable  | (27,462)                        | ) (27,671)  |
| Inventories  | (11,385)                        | ) (19,492)  |
| Prepaid expenses and other current assets                                  | (1,457)                         | ) (5,420)   |
| Accounts payable   | 4,867                           | 11,359      |
| Accrued liabilities  | 14,119                          | 5,906       |
| Deferred income taxes  | 1,968                           | 4,469       |
| Long-term retirement benefits  | (16,784)                        | ) (12,155)  |
| Other  | 95                              | ) (579)     |
| Net cash provided by operating activities                                  | 78,475                          | 46,997      |
| Investing activities:  |                                 |             |
| Proceeds from disposition of property, plant and equipment                 | 3,352                           | 1,384       |
| Capital expenditures   | (25,169)                        | ) (22,463)  |
| Business acquisitions, net of cash acquired                                | (3,495)                         | ) —         |
| Other  | (3,424)                         | ) (2,393)   |
| Net cash used by investing activities                                      | (28,736)                        | ) (23,472)  |
| Financing activities:  |                                 |             |
| Net change in other borrowings   | 3,023                           | 3,384       |
| Payments on long-term debt   | (354,167)                       | ) (243,658) |
| Proceeds from the issuance of long-term debt                               | 339,290                         | 241,667     |
| Premium paid on convertible debt redemption                                | (9,803)                         | ) —         |
| Proceeds from the issuance of common stock                                 | 26,829                          | 3,871       |
| Common stock repurchases   | (22,369)                        | ) (9,014)   |
| Dividends paid   | (13,197)                        | ) (13,159)  |
| Excess tax benefit on stock awards   | 8,607                           | —           |
| Other  | (2,098)                         | ) (160)     |
| Net cash used by financing activities                                      | (23,885)                        | ) (17,069)  |
| Effect of exchange rate changes on cash flows                              | (461)                           | ) (159)     |
| Increase in cash and cash equivalents                                      | 25,393                          | 6,297       |
| Cash and cash equivalents at beginning of period                           | 13,450                          | 17,427      |
| Cash and cash equivalents at end of period                                 | \$38,843                        | \$23,724    |

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 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, 2010 has been derived from the 2010 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, 2010. 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 nine-month periods ended September 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011. Certain reclassifications have been made to prior year amounts to conform to the current year presentation.

2. Net Income Per Common Share

For the purpose of computing diluted net income per share, the weighted-average number of 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 net income per share, the weighted-average number of shares was increased by 546,547 and 493,453 for the three-month periods ended September 30, 2011 and 2010, respectively, and 769,528 and 619,305 for the nine-month periods ended September 30, 2011 and 2010, respectively, to account for the potential dilutive effect of stock-based incentive plans. There were no adjustments to 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 September 30, 2011 and 2010, the Company excluded 686,016 and 2,340,018 stock options, respectively, from the calculation of weighted average diluted shares outstanding as the stock options would have been anti-dilutive. During the nine-month periods ended September 30, 2011 and 2010, the Company excluded 844,552 and 1,969,091 stock options, respectively, from the calculation of weighted average diluted shares outstanding as the stock options would have been anti-dilutive.

The Company granted 379,900 stock options, 109,989 restricted stock unit awards and 79,500 performance share awards in February 2011 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 new long-term Relative Measure Program, which is designed to assess the long-term Company performance relative to the performance of companies included in the Russell 2000 Index. 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 performance awards was determined using a Monte Carlo simulation as the award contains a market condition.

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. Of the total \$92,500 principal amount, \$11,865 of these notes were redeemed with accrued interest through the redemption date. The remaining \$80,635 of these notes were surrendered for conversion. 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, resulting in a total cash payment of \$90,438 including a premium on conversion of \$9,803 which reduced the equity component by \$6,085, net of tax of \$3,718. As a result of this transaction, the Company recaptured \$40,217 of previously deducted contingent convertible debt interest which resulted in a \$15,252 reduction in short-term deferred tax liabilities as well as a reduction of tax loss carryforwards reflected in long-term deferred tax assets. The potential shares issuable for the 3.75% Convertible Notes were not included in either basic or diluted average common shares outstanding for the nine-month period ended September 30, 2011

as the notes were settled in cash. For the three- and nine-month periods ended September 30, 2010, there were no potential shares issuable under the notes as the notes would have been anti-dilutive under the net share settlement method.

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 September 30, 2011 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 nine-month periods ended September 30, 2011 and 2010.

### 3. Comprehensive Income

Comprehensive income (loss) includes all changes in equity during a period except those resulting from the investments by, and distributions to, stockholders. For the Company, comprehensive income (loss) for the period includes net income and other non-owner changes to equity, net of taxes.

#### Statements of Comprehensive Income

(Unaudited)

| For the three months ended September 30,  | 2011     | 2010       |   |
|---|----------|------------|---|
| Net income  | \$23,245 | \$15,104   |   |
| Unrealized (loss) gain on hedging activities, net of tax of \$(6) and \$232, respectively             | (19      | ) 422      |   |
| Foreign currency translation adjustments, net of tax of \$(1,464) and \$3,039, respectively           | (34,388  | ) 40,310   |   |
| Defined benefit pension and other postretirement plans, net of tax of \$445 and \$159, respectively   | 1,988    | (66        | ) |
| Comprehensive income (loss)   | \$(9,174 | ) \$55,770 |   |
| For the nine months ended September 30,   | 2011     | 2010       |   |
| Net income  | \$64,649 | \$41,756   |   |
| Unrealized gain on hedging activities, net of tax of \$107 and \$581, respectively                    | 31       | 970        |   |
| Foreign currency translation adjustments, net of tax of \$(24) and \$1,117, respectively              | 5,405    | 11,764     |   |
| Defined benefit pension and other postretirement plans, net of tax of \$1,336 and \$479, respectively | 3,318    | 1,490      |   |
| Comprehensive income  | \$73,403 | \$55,980   |   |

### 4. Inventories

The components of inventories consisted of:

|                           | September 30,<br>2011 | December 31,<br>2010 |
|---------------------------|-----------------------|----------------------|
| Finished goods            | \$132,248             | \$127,254            |
| Work-in-process           | 61,351                | 57,784               |
| Raw material and supplies | 33,864                | 31,344               |
|                           | \$227,463             | \$216,382            |



## 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 September 30, 2011:

|                              | Logistics and<br>Manufacturing<br>Services | Precision<br>Components | Total Company |
|------------------------------|--|-------------------------|---------------|
| January 1, 2011              | \$163,988                                  | \$220,253               | \$384,241     |
| Goodwill acquired            | —  | 167                     | 167           |
| Foreign currency translation | 462  | 5,102                   | 5,564         |
| September 30, 2011           | \$164,450                                  | \$225,522               | \$389,972     |

In the second quarter of 2011, management performed its annual impairment testing. Based on this assessment, there was no goodwill impairment through June 30, 2011.

## Other Intangible Assets:

Other intangible assets consisted of:

|                                    | Range of<br>Life -Years | September 30, 2011 |                             | December 31, 2010 |                             |
|------------------------------------|-------------------------|--------------------|-----------------------------|-------------------|-----------------------------|
|                                    |                         | Gross Amount       | Accumulated<br>Amortization | Gross Amount      | Accumulated<br>Amortization |
| Amortized intangible assets:       |                         |                    |                             |                   |                             |
| Revenue sharing programs<br>(RSPs) | Up to 30                | \$293,700          | \$(43,420)                  | \$293,700         | \$(36,318)                  |
| Customer lists/relationships       | 10                      | 29,759             | (20,346)                    | 28,578            | (17,974)                    |
| Patents, trademarks/trade<br>names | 5-30                    | 22,615             | (13,739)                    | 22,746            | (12,120)                    |
| Other                              | Up to 15                | 11,496             | (4,133)                     | 10,405            | (3,099)                     |
|                                    |                         | 357,570            | (81,638)                    | 355,429           | (69,511)                    |
| Foreign currency translation       |                         | 5,350              | —                           | 4,880             | —                           |
| Other intangible assets            |                         | \$362,920          | \$(81,638)                  | \$360,309         | \$(69,511)                  |

Amortization of intangible assets is expected to increase from approximately \$15,500 in 2011 to \$17,500 in 2015.

In September 2011, the Company acquired a hydro-pneumatic suspensions business from Curtiss-Wright Antriebstechnik GmbH for a cash payment of 3,140 Swiss francs (\$3,495). The business will be integrated into the Precision Components operating segment. Goodwill of \$167 and other intangible assets of \$2,370 were recorded as a result of this acquisition. The impact of this acquisition was not material to the Company's consolidated Balance Sheets or Statements of Income and therefore the unaudited pro forma operating results of the Company have not been presented.

## 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 September 30, 2011, and closely monitors its future compliance based on current and anticipated future economic conditions.

On September 27, 2011, the Company entered into an amended and restated revolving credit agreement (the "Amended Credit Agreement") with Bank of America, N.A. as the administrative agent. The Amended Credit Agreement

increases the borrowing availability of the debt facility from \$400,000 to \$500,000. The Amended Credit Agreement also extends the expiration date of the debt facility by four years from September 2012 to September 2016. At September 30, 2011, borrowings and availability under the Amended Credit Agreement were \$286,100 and \$213,900, respectively. Borrowings under the Amended Credit Agreement bear interest at LIBOR plus a spread ranging from 1.10% to 1.70%, depending on the Company's leverage ratio at the time of the borrowing.

As with the prior revolving credit agreement, the Company's borrowing capacity is limited by various debt covenants within the Amended Credit Agreement. The Amended Credit Agreement requires the Company to maintain a ratio of Consolidated Senior Debt, as defined in the Amended Credit Agreement, to Consolidated EBITDA, as defined in the Amended Credit Agreement, of not more than 3.25 times at the end of each fiscal quarter ending on or before September 30, 2013, after which the ratio will decrease to 3.00 times. In addition, the Amended Credit Agreement requires the Company to maintain a ratio of Consolidated Total Debt, as defined in the Amended Credit Agreement, to Consolidated EBITDA of not more than 4.00 times for each fiscal quarter ending on or before September 30, 2013, and thereafter of not more than 3.75 times at the end of any fiscal quarter, and a ratio of Consolidated EBITDA to Consolidated Cash Interest Expense, as defined in the Amended Credit Agreement, of not less than 4.25 times for each fiscal quarter ending on or before September 30, 2013, and thereafter of not less than 4.50 times at the end of any fiscal quarter. At September 30, 2011, the Company was in compliance with all covenants under the Amended Credit Agreement. The Company paid fees and expenses of \$1,927 in conjunction with the refinancing of the Amended Credit Agreement; such fees will be deferred and amortized into interest expense on the accompanying Consolidated Statements of Income through its maturity.

Effective April 5, 2011, the Company exercised its right to redeem the remaining \$92,500 principal amount of the 3.75% Convertible Notes under their indenture agreement. Of the total \$92,500 principal amount, \$11,865 of these notes were redeemed with accrued interest through the redemption date. The remaining \$80,635 of these notes were surrendered for conversion. 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, resulting in a total cash payment of \$90,438 including a premium on conversion of \$9,803 which reduced the equity component by \$6,085, net of tax of \$3,718. As a result of this transaction, the Company recaptured \$40,217 of previously deducted contingent convertible debt interest which resulted in a \$15,252 reduction in short-term deferred tax liabilities as well as a reduction of tax loss carryforwards reflected in long-term deferred tax assets. The Company used borrowings under its senior credit facility to finance the redemption of the 3.75% Convertible Notes.

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 15<sup>th</sup> 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 third quarter of 2011, the 3.375% Convertible Notes were not eligible for conversion. During the fourth quarter of 2011, the 3.375% Convertible Notes will not be eligible for conversion.

## 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 exposures 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 and were accounted for as cash flow hedges. These agreements matured in the first quarter of 2011.

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, Canadian 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 one year.

Net investment hedges have been used by the Company to mitigate exposure to foreign currency volatility on its future return on capital; however, the Company did not have any net investment hedges outstanding for any periods presented.

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. For a derivative used as a hedge of a net investment in a foreign operation, the changes in the derivative's fair value, to the extent that the derivative is effective as a hedge, are recorded in the foreign currency translation component of accumulated other non-owner changes to equity.

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

|  | September 30, 2011   |                          | December 31, 2010    |                          |
|--|----------------------|--------------------------|----------------------|--------------------------|
|  | Asset<br>Derivatives | Liability<br>Derivatives | Asset<br>Derivatives | Liability<br>Derivatives |
| Derivatives designated as hedging instruments:     |                      |                          |                      |                          |
| Interest rate contracts                            | \$—                  | \$—                      | \$—                  | \$(667 )                 |
| Foreign exchange contracts                         | —                    | (200 )                   | 327                  | —                        |
|  | —                    | (200 )                   | 327                  | (667 )                   |
| Derivatives not designated as hedging instruments: |                      |                          |                      |                          |
| Foreign exchange contracts                         | —                    | (2,765 )                 | 1,290                | —                        |
| Total derivatives                                  | \$—                  | \$(2,965 )               | \$1,617              | \$(667 )                 |

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 nine-month periods ended September 30, 2011 and 2010 for derivatives held by the Company and designated as hedging instruments.

|                            | Three months ended September 30, |         | Nine months ended September 30, |       |
|----------------------------|----------------------------------|---------|---------------------------------|-------|
|                            | 2011                             | 2010    | 2011                            | 2010  |
| Cash flow hedges:          |                                  |         |                                 |       |
| Interest rate contracts    | \$—                              | \$319   | \$422                           | \$841 |
| Foreign exchange contracts | (19 )                            | 103 )   | (391 )                          | 129 ) |
|                            | \$(19 )                          | \$422 ) | \$31                            | \$970 |

Amounts included within accumulated other non-owner changes to equity that were reclassified to income during the first nine 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 through the date of maturity. The amounts reclassified for the foreign exchange contracts were not material. Additionally, there were no amounts recognized in income for hedge ineffectiveness during the three- or nine-month periods ended September 30, 2011 or September 30, 2010.

The following table sets forth the gains (losses) recorded in other expense (income), net in the consolidated statements of income for the three- and nine-month periods ended September 30, 2011 and 2010 for non-designated derivatives held by the Company. Such amounts were substantially offset by gains recorded on the underlying hedged asset or liability.

|                            | Three months ended September 30, |         | Nine months ended September 30, |         |
|----------------------------|----------------------------------|---------|---------------------------------|---------|
|                            | 2011                             | 2010    | 2011                            | 2010    |
| Foreign exchange contracts | \$(3,144 )                       | \$4,153 | \$(4,055 )                      | \$3,969 |



## 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) |
| September 30, 2011    |          |  |   |   |
| Asset derivatives     | \$—      | \$—  | \$—   | \$—                                       |
| Liability derivatives | (2,965   | ) —  | (2,965  | ) —                                       |
| Rabbi trust assets    | 1,356    | 1,356  | —   | —   |
|                       | \$(1,609 | ) \$1,356  | \$(2,965                                      | ) \$—                                     |
| December 31, 2010     |          |  |   |   |
| Asset derivatives     | \$1,617  | \$—  | \$1,617                                       | \$—                                       |
| Liability derivatives | (667     | ) —  | (667  | ) —                                       |
| Rabbi trust assets    | 1,350    | 1,350  | —   | —   |
|                       | \$2,300  | \$1,350  | \$950   | \$—                                       |

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.

As disclosed within the Company's Annual Report on Form 10-K for the year ended December 31, 2010, the fair value of the 3.375% Convertible Notes was approximately \$57,244. As of September 30, 2011, the fair value of the 3.375% Convertible Notes was approximately \$55,835. The par value for both periods was \$55,636.



## 9. Pension and Other Postretirement Benefits

Pension and other postretirement benefits expenses consisted of the following:

|                                    | For the three months ended |          | For the nine months ended |           |
|------------------------------------|----------------------------|----------|---------------------------|-----------|
|                                    | September 30,              |          | September 30,             |           |
| Pensions                           | 2011                       | 2010     | 2011                      | 2010      |
| Service cost                       | \$1,477                    | \$1,502  | \$4,421                   | \$4,608   |
| Interest cost                      | 5,626                      | 5,697    | 16,866                    | 17,086    |
| Expected return on plan assets     | (8,030                     | ) (7,703 | ) (24,060                 | ) (23,068 |
| Amortization of prior service cost | 280                        | 239      | 842                       | 697       |
| Recognized losses                  | 1,436                      | 614      | 4,311                     | 1,837     |
| Net periodic benefit cost          | \$789                      | \$349    | \$2,380                   | \$1,160   |

  

|                                    | For the three months ended |        | For the nine months ended |         |
|------------------------------------|----------------------------|--------|---------------------------|---------|
|                                    | September 30,              |        | September 30,             |         |
| Other Postretirement Benefits      | 2011                       | 2010   | 2011                      | 2010    |
| Service cost                       | \$70                       | \$85   | \$213                     | \$272   |
| Interest cost                      | 712                        | 786    | 2,136                     | 2,418   |
| Amortization of prior service cost | (385                       | ) (236 | ) (1,156                  | ) (727  |
| Recognized losses                  | 202                        | 88     | 606                       | 303     |
| Curtailment gain                   | —                          | —      | —                         | (987    |
| Net periodic benefit cost          | \$599                      | \$723  | \$1,799                   | \$1,279 |

The Company recorded a curtailment gain in one of its other postretirement benefit plans during the first quarter of 2010 in connection with the closure of a facility within the Precision Components segment.

## 10. Income Taxes

The Company's effective tax rate for the first nine months of 2011 was 26.2%. In 2010, the Company's effective tax rate was 17.7% in the first nine months of the year and 16.8% for the full year. The increase in the 2011 effective tax rate from the full year 2010 rate is primarily driven by the projected change in the mix of earnings attributable to higher-taxing jurisdictions or jurisdictions where losses cannot be benefited, the impact of an increase in the repatriation of a portion of current year earnings to the U.S. and the second quarter recognition of \$1,793 of discrete tax expense related to tax adjustments for prior years. The third quarter effective tax rate was 26.1%.



## 11. Information on Business Segments

The following table sets forth information about the Company's operations by its two reportable business segments:

|                                      | Three months ended September |            | Nine months ended September |            |
|--------------------------------------|------------------------------|------------|-----------------------------|------------|
|                                      | 30,<br>2011                  | 2010       | 30,<br>2011                 | 2010       |
| Net sales                            |                              |            |                             |            |
| Logistics and Manufacturing Services | \$ 151,600                   | \$ 138,937 | \$ 456,910                  | \$ 412,679 |
| Precision Components                 | 176,598                      | 154,012    | 523,974                     | 446,397    |
| Intersegment sales                   | (2,804                       | ) (3,048   | ) (8,786                    | ) (9,146   |
| Total net sales                      | \$ 325,394                   | \$ 289,901 | \$ 972,098                  | \$ 849,930 |
| Operating profit                     |                              |            |                             |            |
| Logistics and Manufacturing Services | \$ 16,034                    | \$ 10,799  | \$ 45,837                   | \$ 29,296  |
| Precision Components                 | 16,910                       | 14,034     | 50,078                      | 38,886     |
| Total operating profit               | 32,944                       | 24,833     | 95,915                      | 68,182     |
| Interest expense                     | 1,917                        | 5,177      | 7,950                       | 15,273     |
| Other expense (income), net          | (425                         | ) 773      | 378                         | 2,161      |
| Income before income taxes           | \$ 31,452                    | \$ 18,883  | \$ 87,587                   | \$ 50,748  |

## 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 September 30, 2011 and December 31, 2010.

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 division of the 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 \$8,600) 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. Based on the schedule established by the court in September 2011, the Company expects a trial to begin in early 2012. 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.



With respect to the unaudited consolidated financial information of Barnes Group Inc. for the three-month and nine-month periods ended September 30, 2011 and 2010, 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 October 28, 2011 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 September 30, 2011 and the related consolidated statements of income for the three-month and nine-month periods ended September 30, 2011 and September 30, 2010 and the consolidated statements of cash flows for the nine-month periods ended September 30, 2011 and September 30, 2010. 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, 2010, 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 18, 2011, 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, 2010, 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  
October 28, 2011

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

## OVERVIEW

Please refer to the Overview found 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, 2010. The Annual Report on Form 10-K and other documents related to the Company are located on the Company's website: [www.bginc.com](http://www.bginc.com).

## Third Quarter 2011 Highlights

In the third quarter of 2011, sales increased 12.2% from the third quarter of 2010 to \$325.4 million primarily as a result of organic sales growth in both business segments due to improved end-market conditions and approximately \$6.9 million due to foreign exchange translation. In the Logistics and Manufacturing Services segment, the broad end-markets of the distribution businesses, primarily in North America, continued to show improvements. The aerospace aftermarket business continues to reflect strong levels of overhaul and repair activity with significant growth in orders, as opposed to a trend of deferred maintenance that was reflective during the third quarter of 2010. At Precision Components, sales in the third quarter of 2011 were favorably impacted by strong demand in the industrial and transportation end-markets as well as continued growth in the aerospace original equipment manufacturing (OEM) business.

Operating income in the third quarter of 2011 increased 32.7% to \$32.9 million from the third quarter of 2010 and operating income margin improved to 10.1% in the third quarter of 2011 from 8.6% in the third quarter of 2010. These improvements were primarily the result of the profit flow through of the increased sales volumes and improved productivity resulting in part from the benefits of the lower cost structures due to previous actions. These improvements were partially offset by incremental expenses driven by our higher production level and added costs associated with strategic initiatives.

In August 2011, the Company received a binding offer from privately held Berner SE to acquire its Barnes Distribution Europe ("BDE") businesses, including the businesses that operate as KENT, BD France and Toolcom, for approximately €25.7 million in cash, subject to customary conditions and approvals, as well as closing adjustments. The offer is binding upon Berner SE and irrevocable until January 31, 2012, subject to certain conditions. The Company's BDE businesses are currently reported within the Company's Logistics and Manufacturing Services segment and reported revenues for the year ended December 31, 2010 of approximately \$105 million. The transaction remains subject to approval by the Company's Board of Directors as of September 30, 2011. The Company expects, following the potential approval by the Board of Directors and other required approvals, that the related BDE assets would be classified as "held for sale" and the BDE businesses would be reported as Discontinued Operations on the Consolidated Statements of Income. The Company would expect to record a pretax loss of approximately \$20 million inclusive of non-cash impairments of long-lived assets and subject to changes for various factors such as changes in foreign exchange rates, transaction costs and closing adjustments. Proceeds from the potential transaction are anticipated to provide for global investment in strategic growth initiatives.

## RESULTS OF OPERATIONS

## Net Sales

| (in millions)                        | Three months ended September 30, |         |        |     | Nine months ended September 30, |         |        |      |   |
|--------------------------------------|----------------------------------|---------|--------|-----|---------------------------------|---------|--------|------|---|
|                                      | 2011                             | 2010    | Change |     | 2011                            | 2010    | Change |      |   |
| Logistics and Manufacturing Services | \$151.6                          | \$138.9 | \$12.7 | 9.1 | % \$456.9                       | \$412.7 | \$44.2 | 10.7 | % |

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|                      |         |         |        |      |   |         |         |         |      |   |
|----------------------|---------|---------|--------|------|---|---------|---------|---------|------|---|
| Precision Components | 176.6   | 154.0   | 22.6   | 14.7 | % | 524.0   | 446.4   | 77.6    | 17.4 | % |
| Intersegment sales   | (2.8 )  | (3.0 )  | 0.2    | 8.0  | % | (8.8 )  | (9.1 )  | 0.4     | 3.9  | % |
| Total                | \$325.4 | \$289.9 | \$35.5 | 12.2 | % | \$972.1 | \$849.9 | \$122.2 | 14.4 | % |

The Company reported net sales of \$325.4 million in the third quarter of 2011, an increase of \$35.5 million or 12.2%, from the third quarter of 2010. The sales increase reflected \$28.6 million of organic sales growth which included an increase of \$17.9 million at Precision Components and \$10.5 million at Logistics and Manufacturing Services. The weakening of the U.S. dollar against foreign currencies, primarily in Europe and Brazil, increased net sales by approximately \$6.9 million in the third quarter of 2011 of which \$4.7 million related to Precision Components and \$2.2 million related to Logistics and Manufacturing Services.

The Company reported net sales of \$972.1 million in the first nine months of 2011, an increase of \$122.2 million or 14.4%, from the first nine months of 2010. The sales increase reflected \$97.1 million of organic sales growth which included an

increase of \$61.3 million at Precision Components and \$35.4 million at Logistics and Manufacturing Services. The weakening of the U.S. dollar against foreign currencies, primarily in Europe and Brazil, increased net sales by approximately \$25.1 million in the first nine months of 2011 of which \$16.3 million related to Precision Components and \$8.8 million related to Logistics and Manufacturing Services.

#### Expenses and Operating Income

| (in millions)                       | Three months ended September 30, |         |        |      | Nine months ended September 30, |         |        |      |   |
|-------------------------------------|----------------------------------|---------|--------|------|---------------------------------|---------|--------|------|---|
|                                     | 2011                             | 2010    | Change |      | 2011                            | 2010    | Change |      |   |
| Cost of sales                       | \$210.9                          | \$185.0 | \$25.9 | 14.0 | % \$621.4                       | \$540.8 | \$80.6 | 14.9 | % |
| % sales                             | 64.8                             | % 63.8  | %      |      | 63.9                            | % 63.6  | %      |      |   |
| Gross profit <sup>(1)</sup>         | \$114.5                          | \$104.9 | \$9.6  | 9.2  | % \$350.7                       | \$309.1 | \$41.6 | 13.5 | % |
| % sales                             | 35.2                             | % 36.2  | %      |      | 36.1                            | % 36.4  | %      |      |   |
| Selling and administrative expenses | \$81.6                           | \$80.1  | \$1.5  | 1.9  | % \$254.8                       | \$240.9 | \$13.9 | 5.8  | % |
| % sales                             | 25.1                             | % 27.6  | %      |      | 26.2                            | % 28.3  | %      |      |   |
| Operating income                    | \$32.9                           | \$24.8  | \$8.1  | 32.7 | % \$95.9                        | \$68.2  | \$27.7 | 40.7 | % |
| % sales                             | 10.1                             | % 8.6   | %      |      | 9.9                             | % 8.0   | %      |      |   |

(1) - Sales less cost of sales.

Cost of sales in the third quarter of 2011 increased 14.0% from the 2010 period due primarily to the increase in sales. Each segment reported an improvement in gross profit margin; however, the shift in sales mix to the Precision Components segment, which has a lower gross profit component than the Logistics and Manufacturing Services segment, resulted in a slight decrease in overall gross profit margin from 36.2% in the 2010 period to 35.2% in the 2011 period. Selling and administrative expenses in the third quarter of 2011 increased 1.9% from the third quarter of 2010 due primarily to the increase in sales as well as higher employee related costs and additional costs associated with strategic initiatives. As a percentage of sales, selling and administrative costs decreased from 27.6% in the third quarter of 2010 to 25.1% in the third quarter of 2011. As a result, operating income in the third quarter of 2011 increased 32.7% to \$32.9 million from the third quarter of 2010 and operating income margin improved from 8.6% to 10.1%.

Cost of sales in the first nine months of 2011 increased 14.9% from the 2010 period. The percentage increase in cost of sales was slightly higher than the percentage increase in sales, resulting in a slight decrease in overall gross profit margin from 36.4% in the 2010 period to 36.1% in the 2011 period. Selling and administrative expenses in the first nine months of 2011 increased 5.8% from the first nine months of 2010; however, as a percentage of sales decreased from 28.3% in the first nine months of 2010 to 26.2% in the first nine months of 2011. The increase in selling and administrative expenses was primarily driven by the increase in sales as well as higher employee related costs and additional costs associated with strategic initiatives. As a result, operating income in the first nine months of 2011 increased 40.7% from the first nine months of 2010 and operating income margin improved from 8.0% to 9.9%.

#### Interest expense

Interest expense decreased \$3.3 million in the third quarter of 2011 and \$7.3 million in the first nine months of 2011 compared to the prior year amounts primarily as a result of lower average interest rates and lower debt discount amortization related to the 3.75% Convertible Notes as compared to the 2010 periods. The lower average interest rates reflect the shift to a higher percentage of variable rate debt due to the retirement of the 7.80% Notes and the redemption of the 3.75% Convertible Notes, which were funded with the variable rate credit facility, and the expiration of the interest rate swap agreements.

#### Other expense (income), net

Other expense (income), net in the third quarter of 2011 was \$(0.4) million compared to \$0.8 million in the third quarter of 2010. For the nine-month period ended September 30, 2011, other expense (income), net was \$0.4 million compared to \$2.2 million in the first nine months of 2010. The income recorded during the third quarter of 2011 reflects foreign exchange transaction gains compared with transaction losses in the third quarter of 2010. The lower net expense during the nine month period primarily reflects lower foreign exchange transaction losses during this period.

#### Income Taxes

The Company's effective tax rate for the first nine months of 2011 was 26.2%. In 2010, the Company's effective tax rate was 17.7% in the first nine months of the year and 16.8% for the full year. The increase in the effective tax rate in the first nine

months of the year from the full year 2010 rate is primarily driven by the projected change in the mix of earnings attributable to higher-taxing jurisdictions or jurisdictions where losses cannot be benefited, the impact of an increase in the repatriation of a portion of current year earnings to the U.S. and the second quarter recognition of \$1.8 million of discrete tax expense related to tax adjustments for prior years. The third quarter effective tax rate was 26.1%.

In connection with an IRS audit for the tax years 2000 through 2002, the IRS proposed adjustments to these tax years of approximately \$16.5 million, 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. Based on the schedule established by the court in September 2011, the Company expects a trial to begin in early 2012. 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.

#### Net Income and Net Income per Share

| (in millions, except per share)             | Three months ended September 30, |        |        |      |   | Nine months ended September 30, |        |        |       |   |
|---|----------------------------------|--------|--------|------|---|---------------------------------|--------|--------|-------|---|
|   | 2011                             | 2010   | Change |      | % | 2011                            | 2010   | Change |       | % |
| Net income                                  | \$23.2                           | \$15.1 | \$8.1  | 53.9 | % | \$64.6                          | \$41.8 | \$22.9 | 54.8  | % |
| Net income per common share:                |                                  |        |        |      |   |                                 |        |        |       |   |
| Basic                                       | \$0.42                           | \$0.27 | \$0.15 | 55.6 | % | \$1.17                          | \$0.75 | \$0.42 | 56.0  | % |
| Diluted                                     | 0.41                             | 0.27   | 0.14   | 51.9 | % | 1.15                            | 0.75   | 0.40   | 53.3  | % |
| Weighted average common shares outstanding: |                                  |        |        |      |   |                                 |        |        |       |   |
| Basic                                       | 55.8                             | 55.3   | 0.5    | 0.9  | % | 55.3                            | 55.4   | (0.1)  | (0.2) | % |
| Diluted                                     | 56.4                             | 55.8   | 0.5    | 1.0  | % | 56.1                            | 56.0   | —      | 0.1   | % |

In the third quarter of 2011, basic and diluted net income per common share increased 55.6% and 51.9%, respectively, from the third quarter of 2010 and for the first nine months of 2011 increased 56.0% and 53.3%, respectively, from the first nine months of 2010. The increases were directly attributable to the increases in net income. Basic weighted average shares outstanding during the first nine months of 2011 decreased primarily as a result of 1,483,527 and 1,009,156 shares repurchased during 2010 and 2011, respectively, as part of the publicly announced repurchase program. The decrease was offset in part by additional shares issued for employee stock plans. Diluted weighted average shares outstanding during the first nine months of 2011 increased slightly, as a result of the higher dilutive effect in 2011 of potentially issuable shares under the employee stock plans which was driven by an increase in the Company's stock price, and was partially offset by the decrease in basic weighted average shares outstanding.

#### Financial Performance by Business Segment

##### Logistics and Manufacturing Services

| (in millions)    | Three months ended September 30, |         |        |      |   | Nine months ended September 30, |         |        |      |   |
|------------------|----------------------------------|---------|--------|------|---|---------------------------------|---------|--------|------|---|
|                  | 2011                             | 2010    | Change |      | % | 2011                            | 2010    | Change |      | % |
| Sales            | \$151.6                          | \$138.9 | \$12.7 | 9.1  | % | \$456.9                         | \$412.7 | \$44.2 | 10.7 | % |
| Operating profit | 16.0                             | 10.8    | 5.2    | 48.5 | % | 45.8                            | 29.3    | 16.5   | 56.5 | % |
| Operating margin | 10.6                             | % 7.8   | %      |      |   | 10.0                            | % 7.1   | %      |      |   |

The Logistics and Manufacturing Services segment reported sales of \$151.6 million in the third quarter of 2011, a 9.1% increase from the third quarter of 2010. Organic sales improved by \$10.5 million, while the positive impact of foreign currency translation increased sales by approximately \$2.2 million as the U.S. dollar weakened against foreign currencies primarily in Europe and Canada. In the first nine months of 2011, this segment reported sales of \$456.9 million, a 10.7% increase from the

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first nine months of 2010 primarily as a result of organic sales increases of \$35.4 million. The positive impact of foreign currency translation also increased sales by approximately \$8.8 million during the first nine months of 2011, primarily a result of the U.S. dollar weakening against foreign currencies in Europe and Canada. The most significant improvements occurred in the aerospace aftermarket business and in the North American distribution businesses due to end-market improvements.

Operating profit at Logistics and Manufacturing Services in the third quarter of 2011 increased 48.5% from the third quarter of 2010 to \$16.0 million and operating profit in the first nine months of 2011 increased 56.5% to \$45.8 million. The increases in these periods were driven primarily by the profit impact of higher sales volumes, lower cost structures from earlier actions and productivity improvements most significantly in the North American distribution businesses. Operating profit within the aerospace aftermarket business was impacted most significantly by higher sales volumes. Operating profit increases for the segment were partially offset by higher costs related to strategic initiatives, incentive compensation and management fees related to the aftermarket RSP spare parts business.

Outlook: Organic sales levels in the distribution businesses of the Logistics and Manufacturing Services segment are largely dependent upon the economy in the regions served, the retention of its customers and continuation of existing sales volumes to such customers, and the effectiveness and size of its sales force. Both near-term and long-term economic conditions remain uncertain as customers within our distribution businesses continue to manage costs and inventory levels. Management believes future sales growth may result from improvements in economic and end-market conditions, pricing initiatives, and investments in market penetration activities and sales force productivity initiatives. Near-term sales levels in the aerospace aftermarket business are expected to continue reflecting recent trends towards improving maintenance, repair and overhaul activity, but may be negatively impacted by engine cannibalization of older engines which impacts the demand within the aftermarket RSP spare parts business. 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 overhaul and repair business, expected future improvement in demand in the aftermarket spare parts businesses, expanded capabilities and current capacity levels.

Management is focused on growing operating profit at Logistics and Manufacturing Services primarily through organic sales growth, productivity initiatives 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 continues to actively manage commodity price increases through pricing actions and other productivity initiatives. In addition, the highly profitable aftermarket RSPs will 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.

#### Precision Components

| (in millions)    | Three months ended September 30, |         |        |        | Nine months ended September 30, |         |        |        |
|------------------|----------------------------------|---------|--------|--------|---------------------------------|---------|--------|--------|
|                  | 2011                             | 2010    | Change |        | 2011                            | 2010    | Change |        |
| Sales            | \$176.6                          | \$154.0 | \$22.6 | 14.7 % | \$524.0                         | \$446.4 | \$77.6 | 17.4 % |
| Operating profit | 16.9                             | 14.0    | 2.9    | 20.5 % | 50.1                            | 38.9    | 11.2   | 28.8 % |
| Operating margin | 9.6                              | % 9.1   | %      |        | 9.6                             | % 8.7   | %      |        |

Sales at Precision Components were \$176.6 million in the third quarter of 2011, a 14.7% increase from the third quarter of 2010, and \$524.0 million in the first nine months of 2011, a 17.4% increase from the first nine months of 2010. These increases were due primarily to organic sales increases of \$17.9 million in the third quarter of 2011 and \$61.3 million in the first nine months of 2011. The organic sales growth was primarily driven by increases in the industrial manufacturing businesses based in North America and Europe reflecting improvements in the transportation

industry, including automotive. Sales in the aerospace OEM business also improved as compared to 2010. The positive impact of foreign currency translation increased sales by approximately \$4.7 million in the third quarter of 2011 and \$16.3 million in the first nine months of 2011 as the U.S. dollar weakened against foreign currencies primarily in Europe and Brazil.

Operating profit in the third quarter of 2011 at Precision Components was \$16.9 million, an increase of 20.5% from the third quarter of 2010, and in the first nine months of 2011 was \$50.1 million, an increase of 28.8% from the first nine months of 2010. Operating profit improvements in the third quarter and first nine months of 2011 were due primarily to the profit impact of higher sales levels in 2011 combined with productivity improvements and lean initiatives. Operating profit increases for the segment were partially offset by higher costs associated with strategic and productivity initiatives, investments in new product introductions and outsourcing certain manufacturing processes.

Outlook: In the industrial manufacturing businesses, management is focused on generating organic sales growth by leveraging the benefits of the diversified products and industrial end-markets in which its businesses have a global presence as well as gaining market share and introducing new products. Sales growth in the global markets served by these businesses is expected to remain uncertain due to economic conditions. Order activity in certain end-markets, including transportation, may provide extended sales growth. Strategic investments are expected to provide incremental benefits in the long term. 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 \$354.8 million at September 30, 2011, of which approximately 67% is expected to be shipped in the next 12 months. The aerospace OEM business may be impacted by adjustments of customer inventory levels, commodity 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.

Operating profit is largely dependent on the sales volumes and mix within all businesses of the segment. Management continues to focus on improving profitability through organic sales growth, pricing initiatives, lean productivity and process improvements and investments to reduce outsourcing costs related to certain manufacturing processes. Management continues to actively manage commodity price increases through pricing and productivity initiatives. Costs associated with increases in new product introductions may negatively impact operating profit.

#### LIQUIDITY AND CAPITAL RESOURCES

Management assesses the Company's liquidity in terms of its overall ability to generate cash to fund its operating and investing activities. Of particular importance in the management of liquidity are cash flows generated from operating activities, capital expenditure levels, dividends, capital stock transactions, effective utilization of surplus cash positions overseas and adequate lines of credit.

The Company's ability to generate cash from operations in excess of its internal operating needs is one of its financial strengths. Management continues to focus on cash flow and working capital management, and anticipates that operating activities in 2011 will generate adequate cash. The Company closely monitors its cash generation, usage and preservation including the management of working capital to generate cash.

On September 27, 2011, the Company entered into an amended and restated revolving credit agreement (the "Amended Credit Agreement") with Bank of America, N.A. as the administrative agent. The Amended Credit Agreement increases the borrowing availability of the debt facility from \$400 million to \$500 million. The Amended Credit Agreement also extends the expiration date of the debt facility by four years from September 2012 to September 2016. At September 30, 2011, borrowings and availability under the Amended Credit Agreement were \$286.1 million and \$213.9 million, respectively. Borrowings under the Amended Credit Agreement bear interest at LIBOR plus a spread ranging from 1.10% to 1.70%, depending on the Company's leverage ratio at the time of the borrowing.

As with the prior revolving credit agreement, the Company's borrowing capacity is limited by various debt covenants within the Amended Credit Agreement. The Amended Credit Agreement requires the Company to maintain a ratio of Consolidated Senior Debt, as defined in the Amended Credit Agreement, to Consolidated EBITDA, as defined in the Amended Credit Agreement, of not more than 3.25 times at the end of each fiscal quarter ending on or before September 30, 2013, after which the ratio will decrease to 3.00 times. In addition, the Amended Credit Agreement requires the Company to maintain a ratio of Consolidated Total Debt, as defined in the Amended Credit Agreement, to Consolidated EBITDA of not more than 4.00 times for each fiscal quarter ending on or before September 30, 2013, and thereafter of not more than 3.75 times at the end of any fiscal quarter, and a ratio of Consolidated EBITDA to Consolidated Cash Interest Expense, as defined in the Amended Credit Agreement, of not less than 4.25 times for each fiscal quarter ending on or before September 30, 2013, and thereafter of not less than 4.50 times at the end of any

fiscal quarter. At September 30, 2011, the Company was in compliance with all covenants under the Amended Credit Agreement. The Company paid fees and expenses of \$1.9 million in conjunction with the refinancing of the Amended Credit Agreement; the fees will be deferred and amortized into interest expense on the accompanying Consolidated Statements of Income through its maturity.

Effective April 5, 2011, the Company exercised its right to redeem the remaining \$92.5 million principal amount of the 3.75% Convertible Notes under their indenture agreement. Of the total \$92.5 million principal amount, \$11.9 million of these notes were redeemed with accrued interest through the redemption date. The remaining \$80.6 million of these notes were surrendered for conversion. The Company elected to pay cash to holders of the 3.75% Convertible 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, resulting in a total cash payment of \$90.4 million including a premium on conversion of \$9.8 million which reduced the equity component by \$6.1 million, net of tax of \$3.7 million. As a result of this transaction,

the Company recaptured \$40.2 million of previously deducted contingent convertible debt interest which resulted in a \$15.3 million reduction in short-term deferred tax liabilities as well as a reduction of tax loss carryforwards reflected in long-term deferred tax assets. The Company used borrowings under its senior credit facility to finance the redemption of the 3.75% Convertible Notes.

The Company's 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 3.375% Convertible Notes on March 15<sup>th</sup> of 2014, 2017 and 2022.

Operating cash flow may be supplemented with external borrowings to meet near-term business expansion needs and the Company's current financial commitments. As described above, the Company has renegotiated an amended credit facility during the third quarter of 2011. The Company has assessed its credit facilities and currently expects that its bank syndicate, comprised on 15 banks, will continue to support the \$500.0 million credit facility which matures in September 2016. At September 30, 2011, the Company has \$213.9 million unused and available for borrowings under its \$500.0 million credit facility, subject to covenants in the Company's debt agreements. The Company believes its credit facilities and access to capital markets, coupled with cash generated from operations, are adequate for its anticipated future requirements.

The Company closely monitors compliance with its various debt covenants. As a result of the redemption of the remaining \$92.5 million principal amount of the 3.75% Convertible Notes in the second quarter of 2011, the Company's most restrictive financial covenant is now the Senior Debt Ratio which requires the Company to maintain a ratio of Consolidated Senior Debt, as defined, to Consolidated EBITDA, as defined, of not more than 3.25 times at September 30, 2011. The actual ratio at September 30, 2011 was 1.74 times. The Company's debt agreements also contain other financial covenants that require the maintenance of a certain other debt ratio (Consolidated Total Debt, as defined, to Consolidated EBITDA of not more than 4.00 times) and a certain interest coverage ratio (Consolidated EBITDA to Consolidated Cash Interest Expense, as defined, of at least 4.25 times) at September 30, 2011. The Company is in compliance with its debt covenants as of September 30, 2011.

Any future acquisitions are expected to be financed through internal cash, borrowings and equity, or a combination thereof. Additionally, we may from time to time seek to retire or repurchase our outstanding debt through cash purchases and / or exchanges for equity securities, in open market purchases, privately negotiated transactions or otherwise. Such repurchases or exchanges, if any, will depend on prevailing market conditions, our liquidity requirements, contractual restrictions and other factors.

#### Cash Flow

| (in millions)        | Nine months ended |         |        |
|----------------------|-------------------|---------|--------|
|                      | September 30,     |         |        |
|                      | 2011              | 2010    | Change |
| Operating activities | \$78.5            | \$47.0  | \$31.5 |
| Investing activities | (28.7 )           | (23.5 ) | (5.3 ) |
| Financing activities | (23.9 )           | (17.1 ) | (6.8 ) |
| Exchange rate effect | (0.5 )            | (0.2 )  | (0.3 ) |
| Increase in cash     | \$25.4            | \$6.3   | \$19.1 |

Operating activities provided \$78.5 million in cash in the first nine months of 2011 compared to \$47.0 million in the first nine months of 2010. In the first nine months of 2011, operating cash flows were impacted by improved operating performance. Cash used for working capital in 2011 and 2010, primarily accounts receivable and inventory, reflects higher sales levels. A continued focus on inventory management resulted in less of an inventory increase than in the corresponding 2010 period. Higher discretionary contributions to the Company's pension plans provided increased

cash outflows during the 2011 period. The cash generated from operations in the 2011 and 2010 periods was primarily used for capital expenditures, the repurchase of stock, dividends and debt reduction.

Investing activities in the 2011 period primarily consisted of capital expenditures of \$25.2 million compared to \$22.5 million in the 2010 period. The increase from the 2010 period relates primarily to an investment made in previously leased equipment. The Company expects capital spending in 2011 to approximate \$40 to \$45 million. Investing activities for the 2011 period also includes an acquisition of the hydro-pneumatic suspensions business from Curtiss-Wright Antriebstechnik GmbH for 3.1 million Swiss francs (\$3.5 million).

Cash used for financing activities in the first nine months of 2011 included a net decrease in borrowings of \$11.9 million compared to a net increase in borrowings of \$1.4 million in the comparable 2010 period. The 2011 period reflects the redemption of the remaining \$92.5 million principal amount of the 3.75% Convertible Notes including a \$9.8 million premium paid on conversion for those notes surrendered for conversion. The redemption, including the premium, was funded by borrowings under the revolving credit facility. Total cash used to pay dividends was \$13.2 million in both the 2011 and 2010 periods. Proceeds from the issuance of common stock increased \$23.0 million in the 2011 period from the 2010 period primarily as a result of higher stock option exercises in the 2011 period. Cash outflow associated with the the Company's stock repurchase program increased by \$13.4 million over the 2010 period. In addition, cash used by financing activities in the 2011 period was partially offset by an \$8.6 million excess tax benefit recorded for current year tax deductions related to employee stock plan activity in the current year and prior years.

During the nine months ended September 30, 2011, the Company repurchased 1.0 million shares of the Company's stock at a cost of \$22.4 million under the terms of its publicly announced repurchase program. The repurchase program, announced on May 8, 2008 (the "2008 Program"), authorized the repurchase of up to 5.0 million shares of the Company's common stock. Through September 30, 2011, the Company has repurchased the maximum number of shares authorized under the 2008 Program. During the nine months ended September 30, 2010, the Company repurchased 0.5 million shares of the Company's stock at a cost of \$9.0 million under the 2008 Program. On October 20, 2011, the Company publicly announced a repurchase program authorizing the repurchase of up to 5.0 million additional shares of the Company's common stock (the "2011 Program").

At September 30, 2011, the Company held \$38.8 million in cash and cash equivalents, the majority of which are held outside of the U.S. In the near term, the Company expects its cash and cash equivalents held outside of the U.S. will continue to increase. The balances remain outside of the U.S. and are available primarily to fund international investments. The Company repatriated a portion of current year earnings to the U.S. in 2011.

The Company maintains borrowing facilities with banks to supplement internal cash generation. At September 30, 2011, \$286.1 million was borrowed at an average interest rate of 1.46% under the Company's \$500.0 million borrowing facility which matures in September 2016. As of September 30, 2011, the Company had borrowed \$4.0 million under its short-term bank credit lines. At September 30, 2011, the Company's total borrowings are comprised of approximately 17% fixed rate debt and approximately 83% variable rate debt compared to approximately 42% fixed rate debt and approximately 58% variable rate debt as of December 31, 2010. Beginning in the second quarter of 2011, the Company's percentage of variable rate debt increased as a result of the expiration of the interest rate swap agreements in March 2011 and the redemption of the 3.75% Convertible Notes with borrowings under the variable rate credit facility.

#### Debt Covenants

Borrowing capacity is limited by various debt covenants in the Company's debt agreements. As of September 30, 2011 the most restrictive borrowing capacity covenant in any agreement requires the Company to maintain a maximum ratio of Consolidated Senior Debt, as defined, to Consolidated EBITDA, as defined, of not more than 3.25 times for the four fiscal quarters then ending. The Company's debt agreements also contain other financial covenants that require the maintenance of a certain other debt ratio, Consolidated Total Debt, as defined, to Consolidated EBITDA of not more than 4.00 times and a certain interest coverage ratio, Consolidated EBITDA to Consolidated Cash Interest Expense, as defined, of at least 4.25 times, at September 30, 2011. Following is a reconciliation of Consolidated EBITDA to the Company's net income (in millions):





|  | Four fiscal quarters ended<br>September 30, 2011 |
|--|--|
| Net income   | \$76.2   |
| Add back:  |  |
| Interest expense   | 12.7   |
| Income taxes   | 24.7   |
| Depreciation and amortization  | 57.6   |
| Other adjustments  | 0.1  |
| Consolidated EBITDA, as defined  | \$171.3  |
| <br>   |  |
| Consolidated Senior Debt, as defined, as of September 30, 2011           | \$298.0  |
| Ratio of Consolidated Senior Debt to Consolidated EBITDA                 | 1.74   |
| Maximum  | 3.25   |
| Consolidated Total Debt, as defined, as of September 30, 2011            | \$353.6  |
| Ratio of Consolidated Total Debt to Consolidated EBITDA                  | 2.06   |
| Maximum  | 4.00   |
| Consolidated Cash Interest Expense, as defined, as of September 30, 2011 | \$9.6  |
| Ratio of Consolidated EBITDA to Consolidated Cash Interest Expense       | 17.88  |
| Minimum  | 4.25   |

Other adjustments primarily represent net gains on the sale of assets and due diligence and transaction expenses as permitted under the Amended Credit Agreement. Consolidated Total Debt excludes the debt discount related to the convertible notes. The Company's financial covenants are measured as of the end of each fiscal quarter. At September 30, 2011, additional borrowings of \$331.7 million of Total Debt and \$258.8 million of Senior Debt would have been allowed under the covenants. The Company's unused credit facilities at September 30, 2011 were \$213.9 million.

## OTHER MATTERS

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant accounting policies are disclosed in Note 1 of the Notes to the Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2010. The most significant areas involving management judgments and estimates are described in Management's Discussion and Analysis of Financial Conditions and Results of Operations in the Company's Annual Report on Form 10-K for the year ended December 31, 2010. There have been no material changes to such judgments and estimates. Actual results could differ from those estimates.

### Critical Accounting Policies

**Business Acquisitions and Goodwill:** Assets and liabilities acquired in a business combination are recorded at their estimated fair values at the acquisition date. At September 30, 2011, the Company had \$390.0 million of goodwill, representing the cost of acquisitions in excess of fair values assigned to the underlying net assets of acquired companies. Goodwill and intangible assets deemed to have indefinite lives are not amortized but are subject to impairment testing annually or earlier if an event or change in circumstances indicates that the fair value of a reporting unit may have been reduced below its carrying value. Management completes their annual impairment assessment during the second quarter of each year.

The assessment of goodwill involves the estimation of the fair value of reporting units. The Company has determined that its reporting units are businesses with discrete financial information reviewed by segment management one level below the operating segment level and which are aggregated when those components have similar economic characteristics. Management estimates the fair value of each reporting unit primarily using the income approach, which reflects management's cash flow projections, and also evaluates the fair value using a market approach. These methodologies used in the current year are consistent with those used in the prior year. Management believes the cash flow projections utilized and/or market multiples are reasonable and consistent with the expectations of market participants. Inherent in management's development of cash flow projections are assumptions and estimates, including those related to future earnings and growth and the weighted average cost

of capital. Many of the factors used in assessing fair value are outside the control of management, and these assumptions and estimates can change in future periods as a result of both Company-specific and overall economic conditions. Future cash flows can be affected by changes in the global economy and local economies, industries and markets in which the Company sells products or services, and the execution of management's plans. There can be no assurance that future events will not result in impairment of goodwill or other intangible assets.

In August 2011, the Company received a binding offer from privately held Berner SE to acquire its Barnes Distribution Europe ("BDE") businesses, including the businesses that operate as KENT, BD France and Toolcom, for approximately €25.7 million in cash, subject to customary conditions and approvals, as well as closing adjustments. The offer is binding upon Berner SE and irrevocable until January 31, 2012, subject to certain conditions. The Company's BDE businesses are currently reported within the Company's Logistics and Manufacturing Services segment and had revenues for the twelve month period ended December 31, 2010 of approximately \$105 million. The transaction remains subject to approval by the Company's Board of Directors as of September 30, 2011; therefore the net assets associated with the BDE businesses have not been classified as "held for sale" on the Consolidated Balance Sheets. The Company expects, following the potential approval by the Board of Directors and other required approvals, that such assets would be classified as "held for sale" and the BDE businesses would be reported as Discontinued Operations on the Consolidated Statements of Income. The Company would also allocate goodwill to the BDE businesses based on the relative fair values of those businesses to be sold and to be retained, and evaluate goodwill for impairment based on this allocation. If the businesses had qualified for "held for sale" as of September 30, 2011, the Company would have allocated approximately \$18 million of goodwill to the BDE businesses. The Company would expect to record a pretax loss of approximately \$20 million inclusive of non-cash impairments of long-lived assets and subject to changes for various factors such as changes in foreign exchange rates, transaction costs and closing adjustments.

**Income Taxes:** The Company has recognized significant deferred tax assets, net of valuation reserves, principally in the United States. The realization of these benefits is dependent in part on the amount and timing of future taxable income in the jurisdictions where deferred tax assets reside. For those jurisdictions where the expiration date of tax loss carry forwards or the projected operating results indicate that realization is not likely, a valuation allowance is provided. Management believes that sufficient taxable income will be earned in the future to realize deferred income tax assets, net of valuation allowances recorded.

The United States deferred tax assets include significant tax operating loss carryforwards. If it became more likely than not that the deferred tax assets would expire unused, the Company would record a valuation allowance to reflect this fact. The Company experienced challenging economic conditions in the United States in 2009 and 2010. While the Company is not in a cumulative loss position over the last three years (defined as pre-tax book income plus permanent tax items) and does not currently project to be in a cumulative loss position through 2011, the valuation of deferred tax assets requires significant judgment and management's assessment that these deferred tax assets will be realized represents its estimate of future results. Changes in management's assessment could materially increase the Company's tax expense and could have a material adverse effect on the Company's financial condition and results of operations. Management will continue to assess the need for a valuation allowance in the future.

#### Recent Accounting Changes

In May 2011, the Financial Accounting Standards Board (FASB) amended its guidance related to fair value measurement and disclosure. The amended guidance generally clarifies existing measurement and disclosure requirements and results in greater consistency between U.S. GAAP and IFRS. The provisions of the amended guidance will be effective for the Company beginning in the first quarter of 2012. The Company does not expect the adoption of the provisions of the amended guidance to have a material impact on its disclosures.

In June 2011, the FASB amended its guidance related to the presentation of other comprehensive income. The amended guidance requires the presentation of other comprehensive income and its components either (1) together

with the components of net income in one continuous statement of comprehensive income or (2) as a separate statement immediately following the statement of income with equal prominence. The provisions of the amended guidance will be effective for the Company beginning in the first quarter of 2012 and will be applied retrospectively. In September 2011, the FASB amended its guidance related to the periodic testing of goodwill for impairment. This guidance will allow companies to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If the entity determines that this threshold is not met, then performing the two-step impairment test may not be necessary. The provisions of the amended guidance will be effective for the Company beginning in the first quarter of 2012. The Company is currently evaluating this guidance, but does not expect its adoption will have a material effect on its consolidated financial statements. In September 2011, the FASB amended its guidance related to the disclosure of multi-employer pension plans. The guidance

requires incremental disclosures that will provide additional information related to an employer's financial obligations within multi-employer pension plans. The provisions of the amended guidance will be effective for the Company in the year ending December 31, 2011 and will be applied retrospectively. The Company is currently evaluating the impact that this guidance will have on its disclosures.

## EBITDA

EBITDA for the first nine months of 2011 were \$139.4 million compared to \$105.1 million in the first nine months of 2010. EBITDA is a measurement not in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The Company defines EBITDA as net income plus interest expense, income taxes and depreciation and amortization which the Company incurs in the normal course of business. The Company does not intend EBITDA to represent cash flows from operations as defined by GAAP, and the reader should not consider it as an alternative to net income, net cash provided by operating activities or any other items calculated in accordance with GAAP, or as an indicator of the Company's operating performance. The Company's definition of EBITDA may not be comparable with EBITDA as defined by other companies. Accordingly, the measurement has limitations depending on its use. The Company believes EBITDA is commonly used by financial analysts and others in the industries in which the Company operates and, thus, provides useful information to investors.

Following is a reconciliation of EBITDA to the Company's net income (in millions):

|                               | Nine months ended<br>September 30, |         |
|-------------------------------|------------------------------------|---------|
|                               | 2011                               | 2010    |
| Net income                    | \$64.6                             | \$41.8  |
| Add back:                     |                                    |         |
| Interest expense              | 8.0                                | 15.3    |
| Income taxes                  | 22.9                               | 9.0     |
| Depreciation and amortization | 43.9                               | 39.0    |
| EBITDA                        | \$139.4                            | \$105.1 |

## Forward-looking Statements

Certain of the statements in this quarterly report may contain forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. Forward-looking statements are made based upon management's good faith expectations and beliefs concerning future developments and their potential effect upon the Company and can be identified by the use of words such as "anticipated," "believe," "expect," "plans," "strategy," "estimate," "project," and other words of similar meaning in connection with a discussion of future operating or financial performance. These forward-looking statements are subject to risks and uncertainties that may cause actual results to differ materially from those expressed in the forward-looking statements. The risks and uncertainties, described in our periodic filings with the Securities and Exchange Commission, include, among others, uncertainties including whether the transaction proposed by Berner SE will be consummated and others arising from the behavior of financial markets; future financial performance of the industries or customers that we serve; changes in market demand for our products and services; integration of acquired businesses; restructuring costs or savings; the impact of the proposed acquisition of the BDE businesses by Berner SE and any other future strategic actions, including acquisitions, joint ventures, divestitures, restructurings, or strategic business realignments, and our ability to achieve the financial and operational targets set in connection with any such actions; introduction or development of new products or transfer of work; changes in raw material or product prices and availability; foreign currency exposure; our dependence upon revenues and earnings from a small number of significant customers; a major loss of customers; the outcome of pending and future claims or litigation or governmental, regulatory proceedings, investigations, inquiries, and audits; uninsured claims and litigation; outcome of contingencies; future repurchases of common stock; future levels of indebtedness;

and numerous other matters of global, regional or national scale, including those of a political, economic, business, competitive, environmental, regulatory and public health nature. The Company assumes no obligation to update our forward-looking statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk is the potential economic loss that may result from adverse changes in the fair value of financial instruments. The

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Company's financial results could be impacted by changes in interest rates and foreign currency exchange rates, and commodity price changes. The Company uses financial instruments from time to time to hedge its exposure to fluctuations in interest rates and foreign currency exchange rates. The Company does not use derivatives for speculative or trading purposes.

There has been no significant change in the Company's exposure to market risk during the first nine months of 2011 other than the following:

The Company's long-term debt portfolio consists of fixed-rate and variable-rate instruments and is managed to reduce the overall cost of borrowing while also minimizing the effect of changes in interest rates on near-term earnings. The Company's primary interest rate risk is derived from its outstanding variable-rate debt obligations. In 2008, the Company entered into two, three-year interest rate swap agreements which together converted the interest on the first \$100.0 million of the Company's London Interbank Offered Rate ("LIBOR")-based borrowings from a variable rate plus the borrowing spread to a fixed rate of 2.947% plus the borrowing spread for the purpose of mitigating its exposure to variable interest rates. These swap agreements matured at the end of March, 2011.

Effective April 5, 2011, the Company exercised its right to redeem the remaining \$92.5 million principal amount of the 3.75% Convertible Notes under the terms of the indenture. The Company financed the cost of redeeming and converting the 3.75% Convertible Notes using its variable rate revolving credit facility, which increased borrowings under this facility by approximately \$102.3 million including the premium on conversion. Borrowings under the revolving credit facility bear interest at LIBOR plus a spread ranging from 1.10% to 1.70%, depending on the Company's Debt Ratio at the time of the borrowing. The average interest rate on these borrowings was 1.46% at September 30, 2011. As a result, the Company's percent of variable rate debt increased from approximately 58% at December 31, 2010 to approximately 83% at September 30, 2011.

For additional discussion of the Company's exposure to market risk, refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

#### Item 4. Controls and Procedures

Management, including the Company's President and Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the period covered by this report. Based upon, and as of the date of, that evaluation, the President and Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures were effective, in all material respects, to ensure that information required to be disclosed in the reports the Company files and submits under the Securities Exchange Act of 1934, as amended, is (i) recorded, processed, summarized and reported as and when required and (ii) is accumulated and communicated to the Company's management, including our President and Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

#### Changes in Internal Control Over Financial Reporting

There has been no change in our internal control over financial reporting during the Company's third fiscal quarter of 2011 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.





## PART II. OTHER INFORMATION

## Item 1. Legal Proceedings

The Company was named in a lawsuit arising out of an alleged breach of contract and implied warranty by a customer of Toolcom, a division of the 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 5.5 million pounds sterling (approximately \$8.6 million) 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.

In addition, we are subject to litigation from time to time in the ordinary course of business and various other suits, proceedings and claims are pending against us and our subsidiaries. While it is not possible to determine the ultimate disposition of each of these proceedings and whether they will be resolved consistent with our beliefs, we expect that the outcome of such proceedings, individually or in the aggregate, will not have a material adverse effect on our financial condition or results of operations.

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

## (c) Issuer Purchases of Equity Securities

| Period               | (a)<br>Total Number of<br>Shares (or Units)<br>Purchased | (b)<br>Average Price Paid<br>Per Share (or Unit) | (c)<br>Total Number of<br>Shares (or Units)<br>Purchased as Part of<br>Publicly Announced<br>Plans or Programs | (d)<br>Maximum Number<br>(or Approximate<br>Dollar Value) of<br>Shares (or Units) that<br>May Yet Be<br>Purchased Under the<br>Plans or Programs <sup>(2)</sup> |
|----------------------|--|--|--|---|
| July 1-31, 2011      | —  | \$—  | —  | 1,009,156   |
| August 1-31, 2011    | 320,139  | \$21.55  | 300,000  | 709,156   |
| September 1-30, 2011 | 709,156  | \$22.41  | 709,156  | —   |
| Total                | 1,029,295  | <sup>(1)</sup> \$22.15                           | 1,009,156  |   |

Other than 1,009,156 shares purchased in the third quarter of 2011 which were purchased as part of the Company's publicly announced plans, all acquisitions of equity securities during the third quarter of 2011 were the result of the (1) operation of the terms of the Company's stockholder-approved equity compensation plans and the terms of the equity rights granted pursuant to those plans to pay for the related income tax upon issuance of shares. The purchase price of a share of stock used for tax withholding is the market price on the date of issuance.

(2)

The 2008 Program authorized the repurchase of up to 5.0 million shares of the Company's common stock. Through September 30, 2011, the Company has repurchased the maximum number of shares authorized under the 2008 Program. On October 20, 2011, the Company publicly announced the 2011 Program, authorizing the repurchase of up to 5.0 million additional shares of the Company's common stock.

Item 6. Exhibits

(a) Exhibits

|                 |  |
|-----------------|--|
| Exhibit 4.1     | Fifth Amended and Restated Revolving Credit Facility Agreement dated September 27, 2011.                               |
| Exhibit 10.1    | Deed Poll constituting Offer of Berner SE dated August 20, 2011.   |
| Exhibit 10.2    | Letter Agreement between the Company and Berner SE dated August 20, 2011.  |
| Exhibit 15      | Letter regarding unaudited interim financial information.  |
| Exhibit 31.1    | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.   |
| Exhibit 31.2    | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.   |
| Exhibit 32      | Certification Pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| Exhibit 101.INS | XBRL Instance Document.  |
| Exhibit 101.SCH | XBRL Taxonomy Extension Schema Document.   |
| Exhibit 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document.   |
| Exhibit 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document.  |
| Exhibit 101.LAB | XBRL Taxonomy Extension Label Linkbase Document.   |
| Exhibit 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document.  |

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Barnes Group Inc.  
(Registrant)

Date: October 28, 2011

/s/ CHRISTOPHER J. STEPHENS, JR.  
Christopher J. Stephens, Jr.  
Senior Vice President, Finance  
Chief Financial Officer  
(Principal Financial Officer)

Date: October 28, 2011

/s/ MARIAN ACKER  
Marian Acker  
Vice President, Controller  
(Principal Accounting Officer)

EXHIBIT INDEX

Barnes Group Inc.

Quarterly Report on Form 10-Q

For Quarter ended September 30, 2011

| Exhibit No.     | Description  | Reference                   |
|-----------------|--|-----------------------------|
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| 10.1            | Deed Poll constituting Offer of Berner SE dated August 20, 2011.   | Filed with this report.     |
| 10.2            | Letter Agreement between the Company and Berner SE dated August 20, 2011.  | Filed with this report.     |
| 15              | Letter regarding unaudited interim financial information.  | Filed with this report.     |
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