




Industrial Markets 2007:

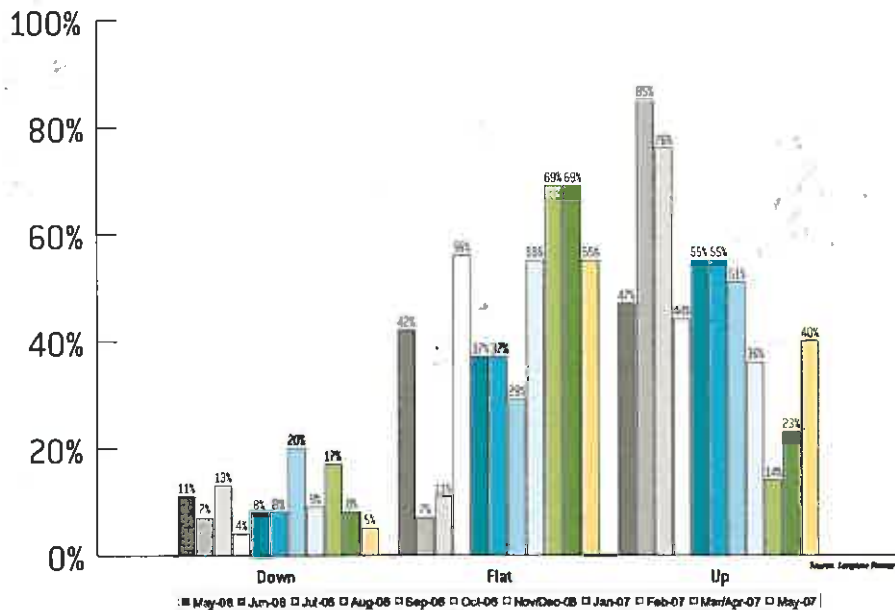


Mid-Cycle Economy Still On Track

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Our underlying economic thesis is that the domestic economy in Mid-Cycle remains on track as we move through the second quarter of 2007. The soft patch in the industrial economy started in second half of 2006 and has taken domestic economic activity from a period of above average growth to a period of below normal growth; the current transitional period during the first half of 2007 can be regarded as the "acid test" for corporations to manage through the current Mid-Cycle pause and transition into a period of average to above average growth during the second half of 2007 and through 2008.

Year-over-Year Change in Demand



index exceeding 50 percent indicating that customers are making progress in reducing the glut of inventories.

Moreover, there is even preliminary evidence of a pending rebound in the capital spending sector which until recently was the biggest surprise and economic risk in 2007. Fourth quarter GDP data reported a 3.2 percent decline in business investment in machinery and a 4.8 percent decline in equipment and software spending, with orders continuing soft in early 2007. However, new orders from U.S. manufacturers (excluding semiconductors) jumped 3.1 percent in March following a revised gain of 1.4 percent in February (though first quarter orders were down 1.1 percent), and equipment and software spending grew almost 2 percent in the first quarter of the year.

What's Ahead for 2007-2008

Overall, recent economic data continues to support our thesis that the current mid cycle pause, and improving industrial activity in the second half of 2007 and beyond, though those markets under pressure including auto, housing, construction equipment and truck will be characterized by a "U" shaped recovery.

The current forecast for the remainder of calendar year 2007 and 2008 is based on the following assumptions:

- Continued strong global demand, weak dollar versus foreign currencies, especially the Euro,

- With gas prices in the range of \$2.50 to \$3.00 plus, auto markets will be difficult all year with sales likely about 16.2 million in 2007 (versus 16.5 million in 2006) and NAFTA production down to 14.9 million at best (versus 15.2 million in 2006); The domestic Big 3 will likely be down 5 to 10 percent; the New Domestics (transplants) will likely see a 5 to 10 percent increase in output.

- A bottoming of housing starts at a lower level of about 1.45 million (Vs. 1.55 million); Non residential construction markets remain strong up about 10 percent this year.

- North American Heavy Truck Market Recovery is more likely later rather than sooner. The current forecast for NAFTA truck shipments in 2007 is 217,000 units based on the stronger first quarter production levels of about 75,000 units

- The U.S. economy grew at above average rates from mid-2004 through mid-2006; the slowdown of domestic economic growth reflects past FED interest rate actions which affect economic activity with a three to four quarter lag.

- A key difference between recessionary period in 2000 and 2001 and today is that the dollar is currently weak rather than strong in 2000-01; and that international markets are robust today compared to weak foreign markets at the turn of the decade. International markets are expected to remain robust for the foreseeable future.

- The current inventory adjustment that is underway is a critical event in the domestic economy resuming growth in the second half of this year. While some headway has been made, manufacturers inventories must be brought into line over the next several months. In 2000-01 it took two and a half years for inventories to be brought into line, but the excess conditions today are nowhere near as severe.

There are some early signs of the domestic economy stabilizing and poised for renewed growth. These include the improvement in the recent Institute of Supply Management data in April, higher Census orders for manufacturing and a one month increase in freight orders after almost 15 months of decline.

The recent ISM report on business conditions shows that the manufacturing sector accelerated in April in comparison to losing momentum in the second half of 2006 and starting 2007 in a less than robust fashion. The purchasing managers' index (PMI—over 50 percent means growth) averaged 50.9 percent for the previous six months and 50.8 percent for the first quarter of 2007 before the acceleration to 54.7 percent in April with strength across the entire manufacturing complex. The key manufacturing inventory index of 46.3 percent was the ninth consecutive month of contraction. More importantly, the customer inventory index of 47 percent in April was the second month of decline following five months in a row of the

helped by the shipment of 2007 trucks with 2006 engines and strong export and Mexico demand. The remaining quarters are likely to be no better than 45,000 units produced in the second and third quarters perhaps rising to 52,000 in the fourth quarter. However, truck demand is ultimately related to freight activity and the decline in freight moved in 2006 (2.8 percent) and YTD in 2007 suggests that excess trucks in the market may total about 115,000 units based on seven percent of a nominal 1.6 million unit fleet. This is reflected in the operating rate in the truck sector being seven percent below normal or about 82 percent compared to a sweet spot of 89 percent.

- Solid jobs climate, with unemployment in area of about 4.5 percent; Disposable income at about three percent.

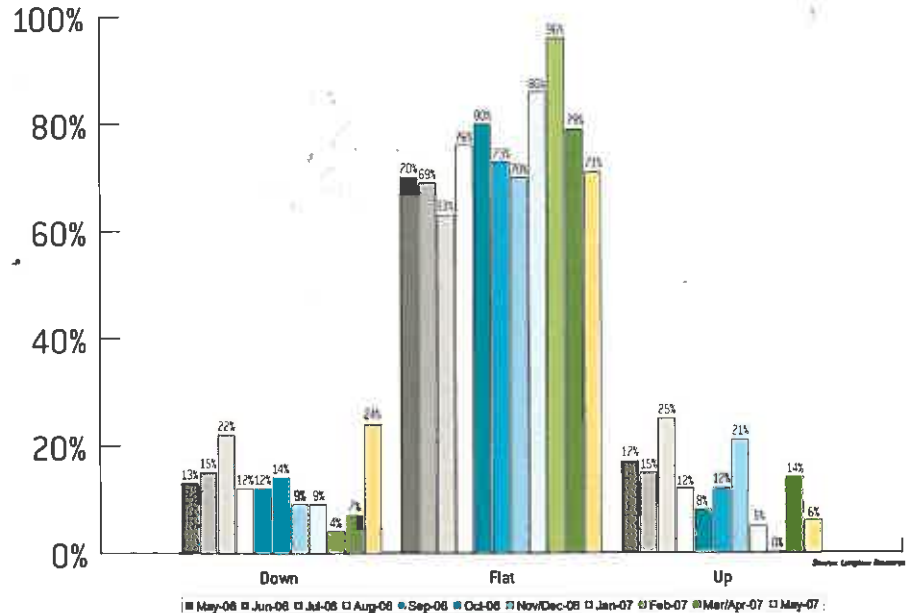
- A FED rate cut in the second half of 2007.

Our most recent surveys of bearing distributors support our current outlook. Overall demand was up at 40 percent of May respondents, (above the 23 percent in March/April) and 55 percent reported flat demand with the improvement likely due to seasonality and ongoing stable demand in the medium and heavy duty machinery and equipment from a number of end markets including farm equipment.

Distributors have also experienced a substantial increase in prices from the manufacturers. Eighty-eight percent of the May respondents indicated increased prices compared to only 39 percent and 40 percent in March/April and February, respectively. In fact, a majority of the respondents, 63 percent, indicated price increases of 5-10 percent compared to only seven percent and three percent of the respondents in April and February, respectively. Imported bearings were also up significantly this month at 53 percent (vs. 14 percent last month) due to improved availability, and cost versus domestic competition. Inventory levels have come down slightly, inline with recent ISM and government data.

Overall, the bearings market remains strong, with future outlook still overwhelmingly positive going forward in second half of 2007 and beyond. □

Sequential Change in Inventory Level



Sales Outlook

