BARNES GROUP INC
Form 10-K
February 26, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2006

¨ **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 of incorporation)**	**06-0247840** **(I.R.S. Employer Identification No.)**
123 Main Street, Bristol, Connecticut **(Address of Principal Executive Office)**	**06011-0489** **(Zip Code)**

(860) 583-7070

Registrant s telephone number, including area code

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $0.01 Par Value	**New York Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if the registrant is not required to file report pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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 x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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

The aggregate market value of the voting stock (Common Stock) held by non-affiliates of the registrant as of the close of business on June 30, 2006 was approximately $904,931,137, based on the closing price of the Common Stock on the New York Stock Exchange on that date. The registrant does not have any non-voting common equity.

The registrant had outstanding 52,619,283 shares of common stock as of February 21, 2007.

Documents Incorporated by Reference

Portions of the registrant s definitive proxy statement to be delivered to stockholders in connection with the Annual Meeting of Stockholders to be held May 9, 2007 are incorporated by reference into Part III.

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Barnes Group Inc.

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PART I

Item 1. Business

THE COMPANY[1]

The Company is an international diversified aerospace and industrial products manufacturer and distributor serving a wide range of end markets and customers. Founded in 1857 and headquartered in Bristol, Connecticut, the Company was organized as a Delaware corporation in 1925. The Company has paid cash dividends to stockholders on a continuous basis since 1934. As of December 31, 2006, the Company had 6,666 employees at 71 locations worldwide. The Company consists of three operating segments:

Barnes Distribution, an international, full-service vendor managed inventory (VMI) distributor of maintenance, repair, operating and production supplies (MROP);

Associated Spring, a global provider of precision components for critical applications and one of the world s largest manufacturers of precision mechanical and nitrogen gas products; and

Barnes Aerospace, a specialized manufacturer and repairer of highly engineered components and assemblies for aircraft engines, airframes and land-based industrial gas turbines.

BARNES DISTRIBUTION

Barnes Distribution is an industry leader in the distribution of maintenance, repair, operating and production supplies. Since 1927, it has grown to be one of the largest value-added MROP distributors in North America, providing a wide variety of high-volume replacement parts and other products as well as inventory management and logistic services to a diversified customer base. Barnes Distribution also distributes products in 40 countries supported by distribution or sales centers in the United Kingdom, Canada, France, Spain, Mexico, Singapore, Brazil, China, Germany, Belgium, Italy and Denmark.

Barnes Distribution distributes approximately 150,000 stocked replacement parts and other products and has developed or acquired quality brand names such as Bowman®, Curtis®, Kar® Products, Mechanics Choice®, Autoliaisons, Motalink, and KENT. These parts and products include fasteners, electrical supplies, hydraulic components, chemicals and security products. Die springs and nitrogen gas springs, mechanical struts and standard parts, such as coil and flat springs, are distributed under the brand names of Raymond® and SPEC®. Most of the products sold under the Raymond and SPEC brand names are manufactured by Associated Spring. With the exception of the products from Associated Spring, the products sold by Barnes Distribution are obtained from outside suppliers.

Barnes Distribution faces active competition. The products sold by Barnes Distribution are not unique, and its competitors carry substantially similar products. Barnes Distribution competes based on service alternatives, timeliness and reliability of supply, price, and product breadth and quality. In addition, Barnes Distribution positions itself as a partner in the operations of its customers and helps them increase their profitability by working with them to provide supply management solutions.

Barnes Distribution offers an array of service options, built around a VMI business model, which are designed to improve the productivity of its customers while substantially reducing procurement and transaction costs. Barnes Distribution has a well-diversified customer base ranging from small repair shops to the largest railroads, utilities, food processors, chemical producers, and vehicle fleet operators. Barnes Distribution s products are sold through its technically-trained direct sales force of over 1,700 employees and through its distributors.

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(1) As used in this annual report, Company refers to the registrant and its consolidated subsidiaries except where the context requires otherwise, and Barnes Distribution, Associated Spring, and Barnes Aerospace, refer to the registrant s businesses, but not to separate corporate entities.

ASSOCIATED SPRING

Associated Spring is a global provider of precision components for critical applications; the largest manufacturer and supplier of precision mechanical springs, compressor reed valves, and nitrogen gas products based in North America; and among the world s largest precision mechanical and nitrogen gas products manufacturers. Associated Spring is equipped to produce virtually every type of precision spring, from fine hairsprings for electronics and instruments to large heavy-duty springs for machinery. Associated Spring also manufactures nitrogen gas manifold systems used to precisely control stamping presses; retaining rings that position parts on a shaft or other axis; reed valves that are critical custom-engineered components used in compressors; high-precision punched and fine-blanked components used in transportation and industrial applications; and injection-molded plastic-on-metal and metal-in-plastic components and assemblies used in electronics, medical devices and consumer products.

Associated Spring provides complete engineering solutions from concept to manufacturing. These include product design and development, product and material testing, rapid prototyping and reduction of manufacturing cycle times. Associated Spring s products are sold globally to manufacturers in many industries, chiefly for use as components in their own products. Products are sold primarily through Associated Spring s direct sales force and through the Raymond division of Barnes Distribution.

Nearly all of Associated Spring s products are highly engineered custom solutions that are designed and developed in collaboration with its customers from concept through manufacturing. Associated Spring has a diverse customer base with products purchased primarily by durable goods manufacturers located around the world in industries such as transportation, consumer products, farm equipment, telecommunications, medical devices, home appliances and electronics. In the transportation industry, the customers include both original equipment manufacturers (OEMs) and tier suppliers. Sales by Associated Spring to its three largest customers accounted for approximately 21% of its sales in 2006.

Associated Spring has manufacturing operations in the United States, Brazil, Canada, China, Germany, Mexico, Singapore, Sweden, Switzerland and the United Kingdom, and a minority interest of 15% in its former subsidiary in Argentina.

Associated Spring competes with many large and small companies engaged in the manufacture and sale of custom metal components and assemblies. Associated Spring competes on the basis of quality, service, reliability of supply, technology, innovation, design and cost.

BARNES AEROSPACE

Barnes Aerospace produces precision-machined and fabricated components and assemblies for OEM turbine engine, airframe and industrial gas turbine builders throughout the world, and the military. Barnes Aerospace also provides jet engine component overhaul and repair services for many of the world s major turbine engine manufacturers, commercial airlines and the military. Barnes Aerospace participates in aftermarket Revenue Sharing Programs (RSPs) with General Electric Company (General Electric) under which Barnes Aerospace receives the exclusive right to supply designated aftermarket parts for the life of the related aircraft engine program. Barnes Aerospace products and services are sold primarily through its sales force. Sales by Barnes Aerospace to General Electric accounted for approximately 61% of its sales in 2006.

Barnes Aerospace s machining and fabrication operations, with facilities in Arizona, Connecticut, Michigan, Ohio, Utah and Singapore, produce critical engine and airframe components through technically advanced processes such as creep-feed grinding, multi-axis milling and turning, and electrical discharge machining. Barnes Aerospace also specializes in hot and cold forming of complex parts made from difficult-to-process materials such as titanium, cobalt, inconel, and other aerospace alloys. Additional capabilities include superplastic forming and diffusion bonding, machining of high temperature superalloys and various automated and manual welding processes. Customers include airframe and gas turbine engine manufacturers for commercial and military jets, business jets, and land-based industrial gas turbines. Barnes Aerospace has long-standing customer relationships which enable Barnes Aerospace to participate in the design phase of components and assemblies through which customers are provided with manufacturing research, testing and evaluation.

Barnes Aerospace s OEM business competes with both the leading jet engine OEMs and a large number of machining and fabrication companies. Competition is based mainly on quality, engineering and technical capability, product breadth, service and price.

Barnes Aerospace s aftermarket facilities, located in Connecticut, Ohio and Singapore, specialize in the refurbishment of select jet engine components such as cases, rotating air seals, honeycomb air seals and housings. Processes performed at these facilities include electron beam welding, plasma coating, vacuum brazing and water jet cleaning. Customers include airlines and engine overhaul businesses throughout the world and the military.

Competition for the repair and overhaul of turbine engine components comes from three principal sources: OEMs, major commercial airlines and other independent service companies. Some major commercial airlines own and operate their own service centers and sell repair and overhaul services to other aircraft operators. OEMs also maintain service centers that provide repair and overhaul services for the components that they manufacture. Other independent service organizations also compete for the repair and overhaul business of other users of aircraft components. Turnaround time, technical capability, price, quality and overall customer service are important competitive factors.

FINANCIAL INFORMATION

The backlog of the Company s orders believed to be firm at the end of 2006 was $496 million as compared with $356 million at the end of 2005. Of the 2006 year-end backlog, $403 million was attributable to Barnes Aerospace and the balance was attributable to Associated Spring. Barnes Aerospace s backlog included $167 million which is scheduled to be shipped after 2007. Substantially all of the remainder of the Company s backlog is scheduled to be shipped during 2007. General Electric and its affiliates accounted for 14% of the Company s total sales in 2006.

The Company continues to expand its global manufacturing footprint to service its worldwide customer base. The global economies have a significant impact on the financial results of the business. Outside of North America, Barnes Distribution has a significant amount of business within Europe; Associated Spring has manufacturing operations in Europe, Asia, and South America; and Barnes Aerospace has significant manufacturing locations in the Republic of Singapore. For an analysis of the Company s revenue from sales to external customers, operating profit and assets by business segment as well as revenues from sales to external customers and long-lived assets by geographic area, see Note 17 of the Notes to the Consolidated Financial Statements of this Annual Report on Form 10-K (Annual Report).

ACQUISITIONS

On May 17, 2006, the Company completed its acquisition of Heinz Hänggi GmbH, Stanztechnik (formerly Heinz Hänggi AG, Stanztechnik) (Heinz Hänggi) of Bettlach, Switzerland, a developer and manufacturer of high-precision punched and fine-blanked components, and a producer of orifice plates used in fuel injectors. Heinz Hänggi is being integrated into the Associated Spring segment. On July 31, 2006, the Company acquired the KENT Division of Premier Farnell (KENT), a distributor of adhesives, sealants, specialty cleaning chemicals, abrasives, tools and other consumables to the European transportation aftermarket and industrial maintenance market. KENT is being integrated into the Barnes Distribution segment. On November 27, 2006, the Company acquired the assets of the Nitropush product line of nitrogen gas springs from

Orflam Industries of France (Nitropush). The Nitropush product line is being integrated into the Associated Spring business segment. For more information regarding the acquisitions, see Note 4 of the Notes to the Consolidated Financial Statements of this Annual Report.

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RAW MATERIALS

The principal raw materials used by Associated Spring to manufacture its products are high-grade steel spring wire and flat rolled steel. The principal raw materials used by Barnes Aerospace to manufacture its products are titanium and inconel; however, Barnes Aerospace also requires special materials such as cobalt and other complex aerospace alloys. Many of the products distributed by Barnes Distribution are made of steel, copper or brass. Prices for steel, titanium and inconel, as well as other specialty materials, have periodically increased in the past due to higher demand and, in some cases, reduction of the availability of materials. If this combination of events occurs, the availability of certain raw materials used or distributed by the Company or products sold by the Company may be negatively impacted.

RESEARCH AND DEVELOPMENT

Although most of the products manufactured by the Company are custom parts made to customers specifications, the Company is engaged in continuing efforts aimed at discovering and implementing new knowledge that is useful in developing new products or services and significantly improving existing products or services. In particular, Associated Spring s Product Development Center is focused on design, development, and prototype work and testing of new products and material for the Associated Spring segment. The Company spent approximately $6 million on research and development activities in each of 2006, 2005 and 2004.

PATENTS AND TRADEMARKS

Patents, trademarks, licenses, franchises and concessions are not significant to any of the Company s businesses.

EXECUTIVE OFFICERS OF THE COMPANY

For information regarding the Executive Officers of the Company, see Part III, Item 10 of this Annual Report.

ENVIRONMENTAL

Compliance with federal, state, and local laws, as well as those of other countries, which have been enacted or adopted regulating the discharge of materials into the environment or otherwise relating to the protection of the environment has not had a material effect, and is not expected to have a material effect, upon the capital expenditures, earnings, or competitive position of the Company.

AVAILABLE INFORMATION

The Company s Internet address for its website is www.barnesgroupinc.com. The Company makes its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports available without charge on its website as soon as reasonably practicable after they are filed with, or furnished to, the Securities and Exchange Commission. In addition, the Company has posted on its website, and will make available in print to any stockholder who makes a request, its corporate governance guidelines, its code of business ethics and conduct and the charters of the Audit Committee, Compensation and Management Development Committee and Corporate Governance Committee (the responsibilities of which include serving as the nominating committee) of the Company s Board of Directors.

FORWARD-LOOKING STATEMENTS

This Annual Report may contain forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. 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, which are described in this Annual Report, include, among others, uncertainties 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; changes in raw material prices and availability; our dependence upon revenues and earnings from a small number of significant customers; uninsured claims; and numerous other matters of global, regional or national scale, including those of a political, economic, business, competitive, regulatory and public health nature. The Company assumes no obligation to update our forward-looking statements.

Item 1A. Risk Factors

Our business, financial condition or results of operations could be materially adversely affected by any of these risks. Please note that additional risks not presently known to us or that we currently deem immaterial may also impact our business and operations.

RISKS RELATED TO OUR BUSINESS

We depend on revenues and earnings from a small number of significant customers. Any loss, cancellation, reduction or delay in purchases by these customers could harm our business. In each of 2006 and 2005, our net sales to General Electric and its subsidiaries accounted for 14% of our total sales for each of those years. Approximately 21% of Associated Spring s sales in 2006 were from Associated Spring s three largest customers, and approximately 61% of Barnes Aerospace s sales in 2006 were from General Electric. Some of our success will depend on our continued ability to develop and manage relationships with significant customers. We cannot assure you that we will be able to retain our largest customers. Some of our customers may in the future shift their purchases from us to our competitors, in-house or to other sources. Our sales agreements provide that until a firm order is placed by a customer for a particular product, the customer may unilaterally reduce or discontinue its projected purchases without penalty. The loss of one or more of our largest customers, any reduction or delay in sales to these customers, our inability to successfully develop relationships with new customers, or future price concessions we make to retain customers could significantly reduce our sales and profitability.

Our ability to execute on capacity expansion and transfer of work initiatives may affect future revenues and profitability. Effective capacity planning and execution and the transfer of work among facilities are key components for meeting customer demand. If we are unable to effectively meet capacity requirements or transfer work among facilities it may adversely impact our net sales, results of operations and cash flows.

The global nature of our business exposes us to foreign currency fluctuations that may affect our future revenues and profitability. We have manufacturing, sales and distribution facilities around the world, and the majority of our foreign operations use the local currency as their functional currency. These include, among others, the Canadian dollar, Euro, British pound, Singapore dollar, Swedish krona, Mexican peso and Brazilian real. Because our financial statements are denominated in U.S. dollars, changes in currency exchange rates between the U.S. dollar and other currencies expose us to translation risk when the local currency financial statements are translated to U.S. dollars, our functional currency. Changes in currency exchange rates may also expose us to transaction risk. We may buy protecting or offsetting positions or hedges in certain currencies to reduce our exposure to currency exchange fluctuations; however, these transactions may not be adequate or effective to protect us from the exposure for which they are purchased. We have not engaged in any speculative hedging activities. Currency fluctuations may impact our revenues and profitability in the future.

Our operations depend on our manufacturing, distribution, sales and service facilities in various parts of the world which are subject to physical, financial, regulatory and other risks that could disrupt our operations. During 2006, approximately 34% of our sales were from facilities outside of the United States. Also, we have twelve manufacturing facilities and twenty distribution centers outside the United States and Canada. The international scope of our business subjects us to risks such as threats of war, terrorism or instability of governments and legal systems in countries in which we or our customers conduct business. In addition, because

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we depend upon our information systems to help process orders, to manage inventory and accounts receivables collections, to purchase, sell and ship products efficiently and on a timely basis, to maintain cost-effective operations, and to help provide superior service to our customers, any disruption in the operation of our information systems, including widespread power outages, could have a material adverse effect on our business, financial condition, results of operations and cash flows. Some of our facilities are located in areas that may be affected by natural disasters, including earthquakes or tsunamis, which could cause significant damage and disruption to the operations of those facilities which could have a material adverse effect on our business, financial condition, results of operations and cash flows. Additionally, some of our manufacturing equipment and tooling is custom made and is not readily replaceable. Loss of such equipment or tooling could have a negative impact on our manufacturing business, financial condition, results of operations and cash flows.

Although we have obtained property damage and business interruption insurance, a major catastrophe such as an earthquake, hurricane, flood or other natural disaster at any of our sites, or significant labor strikes, work stoppages, political unrest, or any of the events described above, some of which may not be covered by our insurance, in any of the areas where we conduct operations could result in a prolonged interruption of our business. Any disruption resulting from these events could cause significant delays in the manufacture or shipment of products or the provision of repair and other services that may result in our loss of sales and customers. Our insurance will not cover all potential risks, and we cannot assure you that we will have adequate insurance to compensate us for all losses that result from any insured risks. Any material loss not covered by insurance could have a material adverse effect on our financial condition, results of operations and cash flows. We cannot assure you that insurance will be available in the future at a cost acceptable to us or at a cost that will not have a material adverse effect on our gross margins, net income and cash flows.

Our significant international operations and assets subject us to additional financial and regulatory risks. We have operations and assets in various parts of the world. In addition, we sell our products and services in foreign countries and seek to increase our level of international business activity. Accordingly, we are subject to various risks, including: U.S.-imposed embargoes of sales to specific countries; foreign import controls (which may be arbitrarily imposed or enforced); import regulations and duties; export regulations (which require us to comply with stringent licensing regimes); anti-dumping regulations; price and currency controls; exchange rate fluctuations; dividend remittance restrictions; expropriation of assets; war, civil uprisings and riots; government instability; the necessity of obtaining governmental approval for new and continuing products and operations; legal systems or decrees, laws, taxes, regulations, interpretations and court decisions that are not always fully developed and that may be retroactively or arbitrarily applied; and difficulties in managing a global enterprise. We have experienced inadvertent violations of some of these regulations, including export regulations and regulations prohibiting air transport of aerosol products, in the past, none of which have had or, we believe, will have a material adverse effect on our business. However, any significant violations of these regulations in the future could result in civil or criminal sanctions, the loss of export or other licenses which could have a material adverse effect on our business. We may also be subject to unanticipated income taxes, excise duties, import taxes, export taxes or other governmental assessments. In addition, our organizational structure may limit our ability to transfer funds between countries, particularly into and out of the United States, without incurring adverse tax consequences. Any of these events could result in a loss of business or other unexpected costs that could reduce sales or profits and have a material adverse effect on our financial condition, results of operations and cash flows.

Changes in the availability or price of materials and energy resources could adversely affect our costs and profitability. We may be adversely affected by the availability or price of raw materials and energy resources, particularly related to certain manufacturing operations that utilize high-grade steel spring wire and titanium. The availability and price of raw materials and energy resources may be subject to curtailment or change due to, among other things, new laws or regulations, global economic or political events including strikes, terrorist attacks and war, suppliers allocations to other purchasers, interruptions in production by suppliers, changes in exchange rates and prevailing price levels. In some instances there are limited sources for raw materials and a limited number of primary suppliers for some of our products for resale. Although we are not dependent upon any single source for any of our principal raw materials or products for resale, and such materials and products have, historically, been readily available, we cannot assure you that such raw materials and products will continue to be readily available. Disruption in the supply of raw materials, products or energy resources or our inability to come to favorable agreements with our suppliers could impair our ability to manufacture, sell and deliver our products and require us to pay higher prices. Any increase in prices for such raw materials, products or energy resources could materially affect our costs and our profitability.

We maintain pension and other postretirement benefit plans in the U.S. and certain international locations. Declines in the stock market, prevailing interest rates and rising medical costs may cause an increase in our pension and other postretirement benefit expenses in the future and result in reductions in our pension fund asset values and increases in our pension and other postretirement benefit obligations. These changes have caused and may continue to cause a significant reduction in our net worth and may require us to make higher cash contributions to our pension and postretirement plans in the future.

We have significant indebtedness that could affect our operations and financial condition. At December 31, 2006, we had consolidated debt and capitalized lease obligations of $427.1 million, representing approximately 45% of our total capital (indebtedness plus stockholders equity) as of that date. We may incur additional indebtedness to finance future acquisitions. Our level of indebtedness and the significant debt servicing costs associated with that indebtedness could have important effects on our operations and financial condition and may adversely affect the value or trading price of our outstanding equity securities and debt securities. For example, our indebtedness could require us to dedicate a substantial portion of our cash flows from operations to payments on our debt, thereby reducing the amount of our cash flows available for working capital, capital expenditures, acquisitions, dividends and other general corporate purposes; limit our flexibility in planning for, or reacting to, changes in the industries in which we compete; place us at a competitive disadvantage compared to our competitors, some of whom have lower debt service obligations and greater financial resources than we do; limit our ability to borrow additional funds; or increase our vulnerability to general adverse economic and industry conditions.

Our failure to meet certain financial covenants required by our debt agreements may materially and adversely affect our assets, financial position and cash flows. Certain of our debt arrangements require us to maintain certain interest coverage and leverage ratios and a minimum net worth and limit our ability to incur debt, make investments or undertake certain other business activities. These requirements could limit our ability to obtain future financing and may prevent us from taking advantage of attractive business opportunities. Our ability to meet the financial covenants or requirements in our debt arrangements may be affected by events beyond our control, and we cannot assure you that we will satisfy such covenants and requirements. A breach of these covenants or our inability to comply with the restrictions could result in an event of default under our debt arrangements, which in turn could result in an event of default under the terms of our other indebtedness. Upon the occurrence of an event of default under our debt arrangements, after the expiration of any grace periods, our lenders could elect to declare all amounts outstanding under our debt arrangements, together with accrued interest, to be immediately due and payable. If this happens, we cannot assure you that our assets would be sufficient to repay in full the payments due under those arrangements or our other indebtedness.

We have significant goodwill and an impairment of our goodwill could cause a decline in our net worth. Our total assets include substantial goodwill. At December 31, 2006, our goodwill totaled $358.6 million. The goodwill results from our acquisitions, representing the excess of the purchase price we paid over the fair value of the tangible and intangible assets we acquired. We assess whether there has been an impairment in the value of our goodwill during each calendar year or sooner if triggering events warrant. If future operating performance at one or more of our businesses does not meet expectations, we may be required to reflect, under current applicable accounting rules, a non-cash charge to operating results for goodwill impairment. The recognition of an impairment of a significant portion of goodwill would negatively affect our results of operations and total capitalization, the effect of which could be material. A reduction in our stockholders equity due to an impairment of goodwill may affect our ability to maintain the required net worth ratios under our debt arrangements.

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We could be adversely affected by changes in interest rates. Our profitability may be adversely affected as a result of increases in interest rates. At December 31, 2006, we and our subsidiaries had approximately $427.1 million aggregate principal amount of consolidated debt and capitalized lease obligations outstanding, of which approximately 50% had interest rates that float with the market, either under the terms of the indebtedness or as a result of interest rate swap agreements that were then in force. A 100 basis point increase in the interest rate on the floating rate debt in effect at December 31, 2006 would have resulted in an approximate $2.2 million annualized increase in interest expense.

We may not realize all of the sales expected from our existing Associated Spring and Barnes Aerospace backlog or anticipated orders. At December 31, 2006, Associated Spring had $93.2 million of order backlog and Barnes Aerospace had $403.0 million of order backlog. There can be no assurances that the revenues projected in our backlog will be realized or, if realized, will result in profits. We consider backlog to be firm customer orders for future delivery. From time to time, OEM customers of Associated Spring and Barnes Aerospace provide projections of components and assemblies that they anticipate purchasing in the future under new and existing programs. Such projections are not included in our backlog unless we have received a firm release from our customers. Our customers may have the right under certain circumstances and with certain penalties or consequences to terminate, reduce or defer firm orders that we have in backlog. If our customers terminate, reduce or defer firm orders, we may be protected from certain costs and losses, but our sales will nevertheless be adversely affected. Although we strive to maintain ongoing relationships with our customers, there is an ongoing risk that orders may be cancelled or rescheduled due to fluctuations in our customers business needs or purchasing budgets.

Also, our realization of sales from new and existing programs is inherently subject to a number of important risks and uncertainties, including whether our customers will execute the launch of product programs on time, or at all, the number of units that our customers will actually produce and the timing of production. In addition, until firm orders are placed, our customers generally have the right to discontinue a program or replace us with another supplier at any time without penalty. Our failure to realize sales from new and existing programs could have a material adverse effect on our net sales, results of operations and cash flows.

We may not recover all of our up-front costs related to new or existing programs. New programs require significant up-front investments and capital expenditures for engineering, design and tooling. As OEMs in the transportation and aerospace industries have looked to suppliers to bear increasing responsibility for the design, engineering and manufacture of systems and components, they have increasingly shifted the financial risk associated with those responsibilities to the suppliers as well. This trend is likely to continue and is most evident in the area of engineering cost reimbursement. Historically, these investments have been fully reimbursed by OEMs, but in the future there may be other mechanisms established by OEMs that could result in less than full reimbursement or no reimbursement. We cannot assure you that we will have adequate funds to make such up-front investments and capital expenditures. In the event that we are unable to make such investments and expenditures, or to recover them through sales or direct reimbursement of our engineering expenses from our customers, our profitability, liquidity and cash flows may be adversely affected. In addition, we incur costs and make capital expenditures for new program awards based upon certain estimates of production volumes. While we attempt to recover such costs and capital expenditures by appropriately pricing our products, the prices of our products are based in part upon planned production volumes. If the actual production is significantly less than planned, we may be unable to recover such costs. In addition, because a significant portion of our overall costs is fixed, declines in our customers production levels can adversely affect the level of our reported results even if our up-front investments and capital expenditures are recovered.

We may not recover all of our up-front costs related to RSPs. Our total commitments in RSP participation fees as of December 31, 2006 equaled $190.2 million, of which $163.1 million had been paid at such time. We participate in aftermarket RSPs under which we receive an exclusive right to supply designated aftermarket parts to a large aerospace manufacturer over the life of an aircraft engine program. As consideration, we pay participation fees, which are recorded as long-lived intangible assets, and are recognized as a reduction to

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sales over the life of the program. The recoverability of the asset is dependent upon future revenues related to the program s aftermarket parts. The potential exists that actual revenues will not meet expectations. A shortfall in future revenues may result in the failure to recover the total amount of the investments, which could adversely affect our financial condition and results of operations and cash flows.

We face risks of cost overruns and losses on fixed-price contracts. We sell certain of our products under firm, fixed-price contracts providing for a fixed price for the products regardless of the production or purchase costs incurred by us. The cost of producing products may be adversely affected by increases in the cost of labor, materials, fuel, outside processing, overhead and other factors, including manufacturing inefficiencies. Increased production costs may result in cost overruns and losses on contracts.

The departure of existing management and key personnel, a shortage of skilled employees or a lack of qualified sales professionals could materially affect our business, operations and prospects. Our executive officers are important to the management and direction of our business. Our future success depends, in large part, on our ability to retain these officers and other capable management personnel. Although we believe we will be able to attract and retain talented personnel and replace key personnel should the need arise, our inability to do so could have a material adverse effect on our business, financial condition, results of operations or cash flows. Because of the complex nature of many of our products and services, we are generally dependent on an educated and highly skilled workforce. In addition, there are significant costs associated with the hiring and training of sales professionals. We could be adversely affected by a shortage of available skilled employees or the loss of a significant number of our sales professionals.

Any product liability claims in excess of insurance may adversely affect our financial condition. Our operations expose us to potential product liability risks that are inherent in the design, manufacture and sale of our products and the products we buy from third parties and sell to our customers. For example, we may be exposed to potential liability for personal injury or death as a result of the failure of a spring or other part in a vehicle or an aircraft component designed, manufactured or sold by us or the failure of an aircraft component that has been serviced by us or the components, including potentially hazardous substances, in a product purchased by us and sold by us to one of our customers. While we believe that our liability insurance is adequate to protect us from these liabilities, our insurance may not cover all liabilities. Additionally, insurance coverage may not be available in the future at a cost acceptable to us. Any material liability not covered by insurance or for which third-party indemnification is not available could have a material adverse effect on our financial condition, results of operations and cash flows.

Our business, financial condition, results of operations and cash flows could be adversely impacted by strikes or work stoppages. Approximately 13% of our U.S. employees are covered by collective bargaining agreements and 45% of our non-U.S. employees are covered by collective bargaining agreements or statutory trade union agreements. We are currently negotiating a collective bargaining agreement with unionized employees at our Burlington, Ontario facility, representing a total of 74 employees. Although we believe that our relations with our employees are good, we cannot assure you that we will be successful in negotiating new collective bargaining agreements, or that such negotiations will not result in significant increases in the cost of labor, including healthcare, pensions or other benefits. Any potential strikes or work stoppages, and the resulting adverse impact on our relationships with customers, could have a material adverse effect on our business, financial condition, results of operations or cash flows. Similarly, a protracted strike or work stoppage at any of our major customers, suppliers or other vendors could materially adversely affect our business.

RISKS RELATED TO ACQUISITIONS

We may not be able to effectively integrate acquired companies into our operations. We have completed 15 acquisitions since 1999. We seek acquisition opportunities that complement and expand our operations and that will help create stockholder value over the long term. We cannot assure you that we will be able to effectively integrate our recent or future acquisitions into our operations. We may not be able to do so

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successfully without substantial costs, delays or other difficulties. We could face significant challenges in consolidating functions and integrating procedures, information technology systems, personnel, product lines and operations in a timely and efficient manner. We may encounter difficulties in training our sales forces to work with new products and customers.

The integration process is complex and time-consuming, may be disruptive to our businesses, and may cause an interruption of, or a loss of momentum in, our businesses as a result of a number of obstacles, such as: the loss of significant customers; the need to retrain skilled engineering, sales and other personnel resulting from the loss of key employees; the failure to maintain the quality of customer service that each business has historically provided; the need to coordinate geographically diverse organizations; retooling and reprogramming of equipment and information technology systems; and the resulting diversion of management s attention from our day-to-day business and the need to hire additional management personnel to address integration obstacles.

If we are not successful in integrating our recent and future acquisitions into our operations, if the integration takes longer than anticipated, if the companies or assets we acquire do not perform as we anticipate, or if the integrated product and service offerings fail to achieve market acceptance, our business, financial position, results of operations and cash flows could be adversely affected.

We may not be able to realize the anticipated cost savings, synergies or revenue enhancements from acquisitions, and we may incur significant costs to achieve these savings. Even if we are able to integrate successfully our operations and the operations of our recent and any future acquisitions, we may not be able to realize the cost savings, synergies or revenue enhancements that we anticipate from these acquisitions, either as to amount or in the time frame that we expect. Our ability to realize anticipated cost savings, synergies and revenue enhancements may be affected by a number of factors, including the following: our ability to effectively eliminate duplicative backoffice overhead and overlapping sales personnel, rationalize manufacturing capacity, synchronize information technology systems, consolidate warehousing and distribution facilities and shift production to more economical facilities; our incurrence of significant cash and non-cash integration and implementation costs or charges in order to achieve those cost savings, which could offset any such savings and other synergies resulting from our recent or future acquisitions; and our ability to avoid labor disruption in connection with integration efforts. In addition, our growth to date has placed, and future acquisitions could continue to place, significant demand on our administrative, operational and financial resources.

Future acquisitions and strategic alliances are a key component of our anticipated growth. We may not be able to identify or complete future acquisitions or strategic alliances. A significant portion of the industries that we serve are mature industries. As a result, our recent growth has resulted in large part from, and our future growth will depend in part on, the successful acquisition and integration of businesses into our existing operations. While we are focused on adding strategic pieces to our operations by acquiring companies, manufacturing and service assets and technologies that complement our existing businesses, we may not be able to identify and successfully negotiate suitable acquisitions, obtain financing for future acquisitions on satisfactory terms, obtain regulatory approval or otherwise complete acquisitions in the future. In addition, opportunities to enter into additional aftermarket RSP or alliances may be limited. Aftermarket RSPs will have an impact on the rate of future growth and profitability as a result of the business mix between aftermarket and OEM, the number of new RSPs entered into, the level of aftermarket volume, increasing management fees, the amortization of the participation fees, and the expirations of the Singapore pioneer tax incentive program on these programs.

RISKS RELATED TO THE INDUSTRIES IN WHICH WE OPERATE

We operate in very competitive markets. We may not be able to compete effectively with our competitors, and competitive pressures could adversely affect our business, financial condition and results of operations. Our three business segments compete with a number of larger and smaller companies in the markets we serve. Some of our competitors have greater financial, production, research and development or other resources than we do. Within Barnes Aerospace, certain of our OEM customers compete with our repair and

overhaul business. Some of our OEM customers in the aerospace industry also compete with us where they have the ability to manufacture the components and assemblies that we supply to them but have chosen, for capacity limitations, cost considerations or other reasons, to outsource the manufacture to us. Our three businesses compete on the basis of price, service, quality, reliability of supply, technology, innovation and, in the case of Associated Spring and Barnes Aerospace, design. We must continue to make investments to maintain and improve our competitive position. We cannot assure you that we will have sufficient resources to continue to make such investments or that we will be successful in maintaining our competitive position. Our competitors may develop products or services, or methods of delivering those products or services, that are superior to our products, services or methods. Our competitors may also adapt more quickly than we to new technologies or evolving customer requirements. Pricing pressures could cause us to adjust the prices of certain of our products to stay competitive. We cannot assure you that we will be able to compete successfully with our existing or future competitors. Also, if consolidation of our existing competitors occurs, we expect the competitive pressures we face to increase. Our failure to compete successfully could adversely affect our business, financial condition, results of operations and cash flows.

Our customers businesses are generally cyclical. Weaknesses in the industries in which our customers operate could impact our revenues and profitability. The industries to which we sell our products are cyclical and tend to decline in response to overall declines in industrial production. Associated Spring is dependent on the transportation industry, and Barnes Aerospace is heavily dependent on the aerospace industry, both of which are cyclical. As a result, our business is also cyclical. In addition, many of our customers have historically experienced periodic downturns, which often have had a negative effect on demand for our products. For example, lower production rates in the transportation markets and reduced overall sales of telecommunications and electronics products adversely affect the volume and price of orders placed for products used to manufacture these products, including our springs. Prior industry downturns have negatively affected our net sales, gross margin, net income and cash flows. For example, there was a downturn in the aerospace industry in the beginning of this decade which resulted in a sharp decrease globally in new commercial aircraft deliveries, order cancellations or deferrals by the major airlines and reduced demand for our aerospace components and overhaul and repair services. While there has been a recovery in commercial air traffic, any future downturn could adversely affect our business, financial condition, results of operations and cash flows.

Original equipment manufacturers in the transportation and aerospace industries have significant pricing leverage over suppliers and may be able to achieve price reductions over time. There is substantial and continuing pressure from OEMs in the transportation, including automotive and aerospace industries to reduce the prices they pay to suppliers. We attempt to manage such downward pricing pressure, while trying to preserve our business relationships with our customers, by seeking to reduce our production costs through various measures, including purchasing raw materials and components at lower prices and implementing cost-effective process improvements. Our suppliers, have periodically resisted and, in the future, may resist pressure to lower their prices and may seek to impose price increases. In the past, our efforts to convince our key transportation OEM customers to share in raw material price increases were met with limited success. If we are unable to offset OEM price reductions through these measures, our gross margins, profitability and cash flows could be adversely affected. In addition, OEMs have substantial leverage in setting purchasing and payment terms, including the terms of accelerated payment programs under which payments are made prior to the account due date in return for an early payment discount. OEMs can unexpectedly change their purchasing policies or payment practices, which could have a negative impact on our short-term working capital.

Demand for our defense-related products depends on government spending. An increasing portion of Barnes Aerospace s sales are derived from the military market. The military market is largely dependent upon government budgets, particularly the U.S. defense budget. The funding of government programs is subject to Congressional appropriation. Although multi-year contracts may be authorized in connection with major procurements, Congress generally appropriates funds on a fiscal year basis even though a program may be expected to continue for several years. Consequently, programs are often only partially funded and additional funds are committed only as Congress makes further appropriations. We cannot assure you that an increase in

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defense spending will be allocated to programs that would benefit our business. Moreover, we cannot assure you that new military aircraft programs in which we participate will enter full-scale production as expected. A decrease in levels of defense spending or the government s termination of, or failure to fully fund, one or more of the contracts for the programs in which we participate could have a material adverse effect on our financial position and results of operations.

A downturn in the transportation industry could adversely affect our business and financial results. We derive a large portion of our sales from the transportation industry. Recently, that industry has suffered from certain financial pressures which have had negative consequences for companies in or with customers in the transportation industry. The transportation industry has generally suffered from unfavorable pricing pressures in North America and Europe. The operation of our business within that industry subjects us to the pressures applicable to all companies operating in it. While the precise effects of such instability on the transportation industry are difficult to determine, they may negatively impact our business, financial condition, results of operations and cash flows.

The consolidation occurring in the industries in which we operate could adversely affect our business and financial results. The industries in which we operate have been experiencing consolidation, particularly in the aerospace industry. There has been consolidation of both suppliers, including us and our competitors, and the customers we serve. Supplier consolidation is in part attributable to OEMs more frequently awarding long-term sole source or preferred supplier contracts to the most capable suppliers in an effort to reduce the total number of suppliers from whom components and systems are purchased. We cannot assure you that our business, financial condition, results of operations or cash flows will not be adversely impacted as a result of consolidation by our competitors or customers.

The aerospace industry is highly regulated. Complications related to aerospace regulations may adversely affect Barnes Aerospace. A substantial portion of our income is derived from our aerospace business. The aerospace industry is highly regulated in the United States by the Federal Aviation Administration, or FAA, and in other countries by similar regulatory agencies. We must be certified by these agencies and, in some cases, by individual OEMs in order to engineer and service systems and components used in specific aircraft models. If material authorizations or approvals were delayed, revoked or suspended, Barnes Aerospace would be adversely affected. New or more stringent governmental regulations may be adopted, or industry oversight heightened, in the future, and we may incur significant expenses to comply with any new regulations or any heightened industry oversight.

Environmental regulations impose costs and regulatory requirements on our operations. Environmental compliance may be more costly than we expect, and we may be subject to material environmental-based claims in the future. Our past and present business operations and past and present ownership and operations of real property and the use, sale, storage and handling of chemicals and hazardous products, subject us to extensive and changing federal, state and local environmental laws and regulations, as well as those of other countries, pertaining to the discharge of materials into the environment, enforcement, disposition of wastes (including hazardous wastes), the use, shipping, labeling, and storage of chemicals and hazardous materials, or otherwise relating to protection of the environment. We have experienced, and expect to continue to experience, costs to comply with environmental laws and regulations. In addition, new laws and regulations, stricter enforcement of existing laws and regulations, the discovery of previously unknown contamination or the imposition of new clean-up requirements could require us to incur costs or become subject to new or increased liabilities that could have a material adverse effect on our business, financial condition, results of operations and cash flows.

We use and generate hazardous substances and wastes in our operations. In addition, many of our current and former properties are or have been used for industrial purposes. Accordingly, we monitor hazardous waste management and applicable environmental permitting and reporting for compliance with applicable laws at our locations in the ordinary course of our business. We may be subject to potential material liabilities relating to any investigation and clean-up of our locations or properties where we delivered hazardous waste for handling or disposal that may be contaminated and to claims alleging personal injury.

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High fuel prices may impact our operating results. Fuel costs constitute a significant portion of operating expenses for companies in the aerospace industry. Widespread disruption to oil production, refinery operations and pipeline capacity in certain areas of the United States can increase the price of jet fuel significantly. Conflicts in the Middle East, an important source of oil for the U.S. and other countries where we do business, cause prices for fuel to be volatile and often significantly higher than historic levels. Because many of our customers and we are in the aerospace industry, increased fuel costs could have a material adverse effect on our financial condition or results of operations. The price of fuel generally impacts the cost of operating our manufacturing and distribution operations. Additionally, higher fuel costs may increase our freight expenses.

Products and services of the mature industries in which we operate may be rendered obsolete by new products, technologies and processes. Our manufacturing operations focus on highly engineered components which require extensive engineering and research and development time. Our competitive advantage may be adversely impacted if we cannot continue to introduce new products ahead of our competition, or if our products are rendered obsolete by other products or by new, different technologies and processes.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

As shown on the following table, at December 31, 2006, the Company had 68 manufacturing, sales, and distribution sites worldwide. Thirteen of the manufacturing sites are leased. The majority of the distribution centers are leased.

Type of Facility	U.S. & Canada	Europe	Mexico & South America	Asia	Total
Barnes Distribution					
Distribution, sales and support centers	15	14	2	3	34
Associated Spring					
Manufacturing	10	4	3	2	19
Sales, distribution & development	4			1	5
Barnes Aerospace					
Manufacturing	6			3	9
Sales		1			1
Total	35	19	5	9	68

The above table does not include the Corporate Office of the Company, which is owned, or the headquarters for each of the businesses, one of which is owned and the other two of which are leased.

Item 3. Legal Proceedings

The Company is subject to litigation from time to time in the ordinary course of business. There are no material pending legal proceedings to which the Company or any of its subsidiaries is a party, or of which any of their property is the subject.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security holders during the fourth quarter of 2006.

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PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

(a) Market Information

The Company s common stock is traded on the New York Stock Exchange under the symbol B . The following table sets forth, for the periods indicated, the low and high sales price per share, as reported by the New York Stock Exchange. The per share amounts reflect the two-for-one stock split in the second quarter of 2006.

	2006		
	Low	**High**	**Dividends**
Quarter ended March 31	**$ 16.13**	**$ 20.27**	**$ 0.11**
Quarter ended June 30	**18.72**	**23.98**	**0.125**
Quarter ended September 30	**15.30**	**20.03**	**0.125**
Quarter ended December 31	**17.14**	**22.04**	**0.125**
	2005		
	Low	**High**	**Dividends**
Quarter ended March 31	$ 11.86	$ 14.48	$ 0.10
Quarter ended June 30	12.65	17.35	0.10
Quarter ended September 30	16.41	18.60	0.11
Quarter ended December 31	15.98	18.28	0.11

Stockholders

As of February 6, 2007, there were 6,932 holders of record of the Company s common stock and approximately 15,208 holders, which includes holders of record, brokers and other institutions.

Dividends

Payment of future dividends will depend upon the Company s financial condition, results of operations and other factors deemed relevant by the Company s Board of Directors, as well as any limitations resulting from financial covenants on net worth under the Company s credit facilities. See the table above for dividend information for 2006 and 2005.

Securities Authorized for Issuance Under Equity Compensation Plans

For information regarding Securities Authorized for Issuance Under Equity Compensation Plans, see Part III, Item 12 of this Annual Report.

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Performance Graph

A stock performance graph based on cumulative total returns (price change plus reinvested dividends) for $100 invested on December 31, 2001 is set forth below.

	2001	2002	2003	2004	2005	2006
BGI	$ 100.0	$ 88.0	$ 144.7	$ 122.4	$ 156.5	$ 210.9
S&P 600	$ 100.0	$ 85.4	$ 118.5	$ 145.3	$ 156.5	$ 180.2
Russell 2000	$ 100.0	$ 79.5	$ 117.1	$ 138.7	$ 145.1	$ 171.9

The performance graph does not include a published industry or line-of-business index or peer group of similar issuers because the Company is in three major distinct lines of business and does not believe a meaningful published index or peer group can be reasonably identified. Accordingly, as permitted by SEC rules, the graph includes the S&P 600 Small Cap Index, which is comprised of issuers with generally similar market capitalizations to that of the Company.

(c) Issuer Purchases of Equity Securities

Period	(a) Total Number of Shares (or Units) Purchased (1)	(b) Average Price Paid Per Share (or Unit) (1)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs (2)
October 1-31, 2006	1,110	$ 19.98	1,110	559,342
November 1-30, 2006				559,342
December 1-31, 2006				559,342
Total	1,110	$ 19.98	1,110	

(1) Share and per share amounts reflect the two-for-one stock split in the second quarter of 2006.
(2) The program was publicly announced on April 12, 2001 authorizing repurchase of up to 1 million shares of its common stock. The two-for-one stock split did not impact these amounts.

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Item 6. Selected Financial Data

	2006 (5)	2005 (3)(4)	2004 (4)	2003 (4)	2002 (4)
Per common share (1)					
Net income					
Basic	**$ 1.46**	$ 1.15	$ 0.65	$ 0.68	$ 0.60
Diluted	**1.39**	1.10	0.63	0.66	0.58
Dividends paid	**0.485**	0.42	0.40	0.40	0.40
Stockholders equity (at year-end)	**9.92**	8.36	7.67	7.33	5.87
Stock price (at year-end)	**21.75**	16.50	13.26	16.16	10.18
For the year *(in thousands)*					
Net sales	**$ 1,259,656**	$ 1,102,174	$ 994,709	$ 890,818	$ 784,036
Operating income	**117,036**	76,385	50,432	46,350	37,147
As a percent of net sales	**9.3%**	6.9%	5.1%	5.2%	4.7%
Net income	**$ 73,845**	$ 54,151	$ 30,026	$ 29,075	$ 22,420
As a percent of net sales	**5.9%**	4.9%	3.0%	3.3%	2.9%
As a percent of average stockholders equity	**15.7%**	14.3%	8.7%	10.2%	10.0%
Depreciation and amortization	**$ 42,226**	$ 34,858	$ 34,177	$ 34,571	$ 33,626
Capital expenditures	**41,712**	26,097	28,509	18,397	19,367
Average common shares outstanding - basic	**50,703**	47,198	46,212	42,951	37,501
Year-end financial position *(in thousands)*					
Working capital	**$ 166,154**	$ 120,808	$ 126,663	$ 132,953	$ 120,085
Goodwill	**358,600**	235,299	221,856	220,118	164,594
Other intangible assets, net	**236,561**	163,849	125,447	61,923	16,702
Property, plant and equipment	**209,645**	157,056	166,284	154,088	159,440
Total assets	**1,336,451**	1,005,860	942,814	844,515	666,799
Long-term debt and notes payable	**427,082**	286,025	268,045	241,017	220,962
Stockholders equity	**519,795**	401,157	356,376	335,434	222,489
Debt as a percent of total capitalization (2)	**45.1%**	41.6%	42.9%	41.8%	49.8%
Year-end statistics					
Employees	**6,666**	6,205	6,047	6,026	5,172

(1) All per share data, other than net income and dividends per common share, are based on actual common shares outstanding at the end of each year. Net income per common share is based on weighted average common shares outstanding during each year. All share and per share amounts reflect the two-for-one stock split in the second quarter of 2006.

(2) Debt includes all interest-bearing debt and total capitalization includes interest-bearing debt and stockholders equity.

(3) The 2005 results include approximately $391, or $0.01 per share, of charges related to the cumulative effect of a change in accounting principle, net of taxes. These charges resulted from the adoption of FIN No. 47, Accounting for Conditional Asset Retirement Obligations.

(4) Effective January 1, 2006, the Company adopted SFAS No. 123R, Share-Based Payment which required the cost of all share-based payments, including stock options, to be measured at fair value on the grant date and recognized in the results of operations. The Company elected to utilize the modified retrospective method of adoption and therefore all periods presented prior to January 1, 2006 were adjusted. See Note 3 of the Notes to the Consolidated Financial Statements of this Annual Report.

(5) Effective December 31, 2006, the Company adopted SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans which required the Company to recognize the overfunded or underfunded status of its defined benefit postretirement plans as an asset or liability in the statement of financial position and to recognize changes in the funded status in comprehensive income in the year in which the changes occur. See Note 10 of the Notes to the Consolidated Financial Statements of this Annual Report.

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Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

OVERVIEW

As discussed in Note 2 of the Notes to the Consolidated Financial Statements of this Annual Report, the Company s Board of Directors declared a two-for-one stock split in the second quarter of 2006. All share and per share amounts have been adjusted to reflect the effect of the stock split. Additionally, as discussed in Note 3 of the Notes to the Consolidated Financial Statements of this Annual Report, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 123R as of January 1, 2006 utilizing the modified retrospective method of adoption which resulted in a change in accounting and the adjustment of previously reported amounts.

2006 Highlights

The Company achieved record sales of $1,259.7 million and 53.2% growth in operating income to $117.0 million in 2006. The record sales year was driven by a combination of organic growth and incremental sales from recent acquisitions. Profitability increased in all three operating segments as a result of profitable sales growth and operational improvements.

The Company completed three acquisitions in 2006; Heinz Hänggi, a developer and manufacturer of high-precision punched and fine-blanked components; KENT, a distributor of adhesives, sealants, specialty cleaning chemicals, abrasives, tools and other consumables to the European transportation aftermarket and industrial maintenance market; and the Nitropush product line of nitrogen gas springs. The Heinz Hänggi and Nitropush acquisitions are being integrated into the Associated Spring segment and the KENT acquisition is being integrated into the Barnes Distribution segment.

During 2006, Barnes Aerospace entered into additional RSP agreements with General Electric, committing approximately $57.1 million in participation fees, and a strategic supply agreement with the Goodrich Aerostructures Group of Rohr, Inc. (Goodrich). These agreements further expanded Barnes Aerospace s long-term position on OEM and aftermarket aircraft engine parts.

The Company entered into an Amended and Restated Credit Agreement in June 2006 which increased its available bank credit from $175.0 million to $400.0 million and permits borrowings in currencies other than the U.S. Dollar.

Management Objectives

Management is focused on three areas of development: employee, process and strategy which in combination will generate long-term value for its stockholders. The Company s strategies for growth include both organic growth from new products, services, markets and customers and growth from acquisitions.

Our Business

Barnes Group consists of three operating segments: Barnes Distribution, an international, full-service VMI distributor of maintenance, repair, operating and production supplies; Associated Spring, a global provider of precision components for critical applications and one of the world s largest manufacturers of precision mechanical and nitrogen gas products; and Barnes Aerospace, a specialized manufacturer and repairer of highly engineered components and assemblies for aircraft engines, airframes and land-based industrial gas turbines.

In each of these businesses, Barnes Group is among the leaders in the market niches it serves, and has highly recognized brands for many of the products it sells or manufactures.

Key Performance Indicators

Management evaluates the performance of its reportable segments based on the operating profit of the respective businesses, which includes net sales, cost of sales, selling and administrative expenses and certain components of other income and other expenses, as well as the allocation of corporate overhead expenses. Management also uses an internal measurement tool called PPAT, or Performance Profit After Tax. PPAT is an economic value added (EVA®) -like metric that calculates operating profit after tax, less a charge for the capital employed by the business. Management utilizes PPAT in economic decision making, such as capital expenditures, investments in growth initiatives, customer pricing decisions, and evaluation of acquisitions. The goal of utilizing PPAT is to create a mindset among all employees to use capital in the most efficient way possible and to link decisions to stockholder value creation.

In addition to PPAT, which is a measurement tool common among each of the operating groups, each business has its own key performance indicators (KPIs), a number of which are focused on customer satisfaction.

In Barnes Distribution, KPIs include daily sales average, or DSA; average order size; and fill rate, which is the percentage of order lines filled on the first pass from the distribution center assigned to that customer.

At Associated Spring, KPIs include sales and orders per day, which together provide visibility on sales in the next 60 days. Management tracks inventory turns and sales per employee to gauge efficiency, and measures on-time delivery and the number of defective parts per million as means of evaluating quality and customer fulfillment.

At Barnes Aerospace, important KPIs are customer orders and backlog, which are utilized to forecast how sales will develop over the next 12 months. In the OEM operations, management closely tracks quality measurements and on-time delivery to its customers. In the aftermarket operations, management measures quality and turnaround time of overhauled or repaired parts returned to the customers.

Key Industry Data

In each business, management also tracks a variety of economic and industry data as indicators of the health of a particular sector.

At Barnes Distribution, the data includes the Institute for Supply Management s PMI Composite Index (the PMI) and the Federal Reserve s Industrial Production Index (the IPI), which are monthly indicators of the health of U.S. manufacturing activity. Management tracks similar indices in Canada, France and the United Kingdom and also utilizes the Business Conditions Report of the Precision Metalforming Association, which correlates well with demand for Barnes Distribution s Raymond products.

For Associated Spring, key data include the IPI; durable goods orders; tooling build schedules; compressor build forecasts; the production of light vehicles, both in the U.S. and globally; and capital investments in the telecommunications and electronics industries.

At Barnes Aerospace, for its OEM operations, management regularly tracks orders and deliveries for each of the major aircraft manufacturers, as well as engine purchases made for new aircraft. In the aftermarket operations, management monitors the number of aircraft in the active fleet, the number of planes temporarily or permanently taken out of service, aircraft utilization rates for the major airlines, shop visits, and traffic growth. Management also monitors annual appropriations for the U.S. military related to new aircraft purchases and maintenance.

Acquisitions and Strategic Relationships

Acquisitions have been a key growth driver for the Company in each of its three business segments. The Company acquired a number of businesses during the past three years, three of which occurred in 2006 and are described more fully below. The Company continues to evaluate potential acquisitions that will broaden product line offerings and expand geographic reach, and that provide synergistic opportunities. The Company also continues to seek business alliances which foster long-term business relationships, such as the aftermarket RSP agreements and the strategic supply agreement with Goodrich.

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In November 2006, the Company acquired the assets of the Nitropush product line of nitrogen gas springs from Orflam Industries of France for 1.4 million euros (approximately $1.8 million U.S. Dollars). The Nitropush product line is being integrated into the Associated Spring business segment.

The Company acquired KENT, a distributor of adhesives, sealants, specialty cleaning chemicals, abrasives, tools and other consumables to the European transportation aftermarket and industrial maintenance market, in July 2006. KENT is being integrated into the Barnes Distribution segment. The purchase price to the seller of 24.0 million pounds sterling ($44.9 million U.S. Dollars) was paid in cash.

In May 2006, the Company acquired Heinz Hänggi, a developer and manufacturer of high-precision punched and fine-blanked components, and a producer of orifice plates used in fuel injectors throughout the world. Its range of manufacturing solutions allows Heinz Hänggi to serve diversified industries, including high-precision components for transportation suppliers, the power tools sector, the watch industry, consumer electronics, telecommunications, medical devices, and textile machinery sectors. A majority of Heinz Hänggi s sales are in Europe. Heinz Hänggi is being integrated into the Associated Spring segment. The purchase price to the seller of 162.0 million Swiss francs ($132.0 million U.S. Dollars) was paid through a combination of 122.0 million Swiss francs ($101.3 million U.S. Dollars) in cash and 1,628,676 shares (post-stock split) of Barnes Group Inc. common stock ($30.7 million based upon a market value determined at the time of the purchase agreement).

The Company acquired substantially all of the assets of Service Plus Distributors, a distributor of gas springs, dampers and hardware to equipment and vehicle manufacturers, in September 2005. Service Plus Distributors has been integrated into Barnes Distribution s Raymond business and complements Raymond s product offerings. The purchase price to the seller was $13.7 million of which $3.7 million could be earned within three years of the closing date, contingent upon the occurrence of certain events or the achievement of certain performance targets. In 2006, $1.5 million had been earned and paid. The remaining balance as of December 31, 2006 of $2.2 million will be recorded if and when paid.

In August 2005, the Company acquired the stock of Toolcom, a distributor of maintenance, repair and operating (MRO) supplies in the United Kingdom. Toolcom is being integrated into the Barnes Distribution segment, strengthening its presence in Europe through geographic expansion in the United Kingdom and increasing its product offerings. The purchase price to the seller was 7.6 million pounds sterling (approximately $13.6 million U.S. Dollars) of which 2.2 million pounds sterling were payable within two years of the closing date, contingent upon the occurrence of certain events or the achievement of certain performance targets. In 2006, 0.9 million pounds sterling (approximately $1.7 million U.S. Dollars) had been earned and was paid. The remaining balance as of December 31, 2006 of 1.3 million pounds sterling (approximately $2.6 million U.S. Dollars) will be recorded if and when paid.

In September 2004, the Company acquired DE-STA-CO Manufacturing (DE-STA-CO), a world leader in the design and manufacture of specialty spring products reed valves and shock discs. DE-STA-CO, which is now known as Barnes Precision Valve, was formerly an operating division of Dover Resources, Inc., a subsidiary of Dover Corporation. This acquisition expanded the presence of the Associated Spring segment in these markets, internationally and domestically. The purchase price of this acquisition was $18.2 million. In connection with this acquisition, management reorganized Barnes Precision Valve s business facilities and involuntarily terminated employees.

For a further description of acquisitions made over the past three years, refer to Notes 4 and 8 of the Notes to the Consolidated Financial Statements.

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RESULTS OF OPERATIONS

Sales

($ in millions)	2006	2005	$ Change	% Change	2004
Barnes Distribution	**$ 526.9**	$ 453.8	$ 73.1	16.1%	$ 424.8
Associated Spring	**445.9**	422.4	23.5	5.6%	373.5
Barnes Aerospace	**296.9**	235.4	61.5	26.1%	205.9
Intersegment sales	**(10.0)**	(9.4)	(0.6)	7.2%	(9.5)
Total	**$ 1,259.7**	$ 1,102.2	$ 157.5	14.3%	$ 994.7

Barnes Group Inc. reported record net sales of $1,259.7 million in 2006, an increase of $157.5 million, or 14.3%, over 2005 driven by $78.5 million of organic sales growth and $68.7 million from acquisitions. Organic sales growth of $61.5 million and $19.0 million was generated at Barnes Aerospace, including the aftermarket RSPs, and Barnes Distribution, respectively. The acquisitions of Toolcom, Service Plus Distributors and KENT added $49.2 million of incremental sales to Barnes Distribution while the Heinz Hänggi acquisition contributed $19.5 million of incremental sales to Associated Spring. Foreign currency translation favorably impacted sales by $10.3 million as foreign currencies strengthened against the U.S. Dollar, primarily in Canada and Brazil. Geographically, the Company s international sales increased 28.9% year-over-year and domestic sales increased 7.3%. Excluding the positive impact on sales of foreign currency translation, the Company s international sales increased 25.9% in 2006 over 2005.

In 2005, the Company reported net sales of $1,102.2 million, an increase of $107.5 million, or 10.8%, over 2004 net sales of $994.7 million. The sales increase reflected $70.1 million of organic sales growth: $18.8 million at Barnes Distribution, $21.7 million at Associated Spring and $29.5 million at Barnes Aerospace, including the aftermarket RSPs. Barnes Precision Valve, which was acquired in August 2004, contributed $23.3 million of incremental sales to Associated Spring. The acquisitions of Toolcom and Service Plus Distributors, which were acquired in August and September 2005, respectively, contributed $7.3 million of incremental sales to Barnes Distribution. The strengthening of foreign currencies against the U.S. dollar, primarily in Canada, increased net sales approximately $6.8 million during 2005. Geographically, the Company s international sales increased 20.1% year-over-year and domestic sales increased 6.8%. Excluding the positive impact on sales of foreign currency translation, the Company s international sales increased 17.7% in 2005 over 2004.

Expenses and Operating Income

($ in millions)	2006	2005 As adjusted	$ Change	% Change	2004 As adjusted
Cost of sales	**$ 797.5**	$ 705.5	$ 92.0	13.0%	$ 652.9
% sales	**63.3%**	64.0%			65.6%
Gross profit	**$ 462.2**	$ 396.7	$ 65.5	16.5%	$ 341.8
% sales	**36.7%**	36.0%			34.4%
Selling and administrative expenses	**$ 345.1**	$ 320.3	$ 24.8	7.8%	$ 291.4
% sales	**27.4%**	29.1%			29.3%

Operating income	**$ 117.0**	$ 76.4	$ 40.6	53.2%	$ 50.4
% sales	**9.3%**	6.9%			5.1%

Operating income was $117.0 million in 2006, an increase of 53.2% over 2005 and operating income margin improved to 9.3% in 2006 from 6.9% in 2005. All three business segments contributed to the increase in operating income and improvement in operating income margin. Cost of sales increased as a result of higher sales levels, but at a slightly lower rate than sales as a result of gross profit margin improvements at all three

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business segments which were due in part to higher sales prices and volumes as well as operating efficiencies and a shift in the business to the Barnes Distribution segment which has a higher gross profit margin. Selling and administrative expenses declined in 2006 by 1.7 percentage points when measured as a percentage of sales. This reduction was due in part to lower stock-based compensation and severance costs, and lower expenses as a percentage of sales at Associated Spring and Barnes Aerospace, and, to a lesser extent, at Barnes Distribution. Partially offsetting the expense reduction was the impact of the shift of the sales mix to the distribution business which has a higher selling expense component than the manufacturing businesses.

In 2005, operating income improved 51.5% from 2004 to $76.4 million. The 2005 results reflected significant operating profit improvement in each of the three business segments, driven by sales growth and operational improvements. As a result of higher sales volume, cost of sales increased, but at a lower rate than sales due to productivity improvements at all three segments. Late 2004 personnel reductions favorably impacted 2005 operating income by generating approximately $4.8 million in personnel costs savings at Associated Spring and Barnes Distribution. These improvements were offset, in part, by a shift in the overall sales mix to the manufacturing businesses which have lower gross profit margins than the distribution business and higher costs of raw material and purchased parts. Additionally, during 2005, as part of management s ongoing internal control assessment, the Company identified and recorded an adjustment to accounts payable and cost of sales at Barnes Distribution. The Company determined that cost of sales was overstated in prior periods due to inaccuracies in recording inventory receipts. This overstatement was corrected in 2005 as a $1.8 million reduction to cost of sales. Management concluded that such corrections were immaterial, both quantitatively and qualitatively, to the 2005 financial statements and immaterial to the previously reported results of the prior periods to which they relate. Total selling and administrative expenses decreased as a percentage of sales to 29.1% from 29.3% in 2004. This decrease was driven, in part, by the higher proportion of sales in the manufacturing businesses, which have a lower selling expense component than the distribution business. Additionally, included in selling and administrative expenses in 2004 was $3.5 million related to the fourth quarter severance charge discussed above which did not recur in 2005.

Other Income/Expense

Other income, net of other expenses, decreased in 2006 compared to 2005 due in large part to the sale of the Company s investment in NASCO in 2005 which yielded a pre-tax gain of $8.9 million. Interest expense increased in 2006 from 2005 as a result of higher average borrowings used primarily to fund the 2006 acquisitions.

The increase in other income, net of other expenses, in 2005 compared to 2004 was principally a result of the sale of the Company s investment in NASCO in 2005. Additionally, the Company recorded lower foreign exchange losses in 2005 as compared to 2004. This higher income was offset, in part, by lower equity income from NASCO in the period through the sale date. Interest expense increased in 2005 from 2004 as a result of higher interest rates and higher average borrowings. The higher average interest rates resulted from higher rates on the Company s variable rate revolving credit facility. In August, 2005 the Company completed a $100.0 million convertible senior debt offering. The proceeds from this offering were used to reduce borrowings under the revolving credit agreement.

Income Taxes

The Company s effective tax rate was 20.8% in 2006, compared with 20.0% in 2005 and 16.3% in 2004. The 2005 effective tax rate includes certain discrete items including the tax impact of the gain on the sale of the NASCO joint venture, offset, in part, by the tax benefits related to the Company being awarded multi-year Pioneer tax status in the Republic of Singapore. These discrete items in 2005 effectively increased the 2005 effective tax rate from 16.6% to 20.0%. The increase in the 2006 effective tax rate was due in part to a shift in income to jurisdictions with higher tax rates. Among other items impacting the future tax rate is the continuing shift in mix of income to higher taxing jurisdictions.

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The increase in the tax rate in 2005 when compared to 2004 reflects the discrete items discussed above. See Note 11 of the Notes to the Consolidated Financial Statements for a reconciliation of the U.S. federal statutory income tax rate to the consolidated effective income tax rate.

In the normal course of business, the Company and its subsidiaries are examined by various tax authorities, including the Internal Revenue Service (IRS). The IRS completed its review of the Company for the tax years 2000 through 2002. The IRS has proposed changes to these tax years which could result in a tax cost of approximately $16.5 million, plus a potential penalty of 20% of the tax assessment plus interest. The Company is currently protesting the proposed IRS tax assessment. The Company and its advisors believe the Company s tax position on the issues raised by the IRS is correct and, therefore, the Company will vigorously defend its position. The Company and its advisors believe the Company will prevail on this issue. Any additional impact on the Company s liability for income taxes cannot presently be determined, but the Company believes the outcome will not have a material impact on its results of operations, financial position or cash flows.

Income and Income Per Share

($ in millions, except per share)	**2006**	**2005**	**$ Change**	**% Change**	**2004**
		As adjusted			**As adjusted**
Income before change in accounting principle	**$ 73.8**	$ 54.5	$ 19.3	35.4%	$ 30.0
Income per share before change in accounting principle:					
Basic	**$ 1.46**	$ 1.16	$ 0.30	25.9%	$ 0.65
Diluted	**1.39**	1.11	0.28	25.2%	0.63
Average common shares outstanding:					
Basic	**50.7**	47.2	3.5	7.4%	46.2
Diluted	**52.9**	49.0	3.9	8.0%	47.9

Basic and diluted net income per share increased over 25% in 2006 as compared to 2005. The increase in basic and diluted average shares outstanding adversely impacted the increase in earnings per share when compared to the increase in net income. Basic and diluted average shares outstanding increased 7.4% and 8.0%, respectively, primarily as a result of 1,628,676 (post-stock split) shares issued for the Heinz Hänggi acquisition and shares issued for employee stock plans.

The 2005 results included $1.5 million ($0.03 per diluted share) of Singapore Pioneer Status tax benefit related to income reported in periods prior to January 1, 2005, the $1.1 million ($0.02 per diluted share) after-tax favorable adjustment to cost of sales at Barnes Distribution, and the after-tax impact of the gain on the sale of NASCO of $4.0 million ($0.08 per diluted share).

As of December 31, 2005, the Company adopted the provisions of FASB Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations. The cumulative effect of applying this Interpretation was treated as a change in accounting principle. This cumulative change in accounting principle decreased 2005 net income by $0.4 million, net of tax, or $0.01 per share.

Financial Performance by Business Segment

Barnes Distribution

($ in millions)	2006	2005	$ Change	% Change	2004
		As adjusted			As adjusted
Sales	**$ 526.9**	$ 453.8	$ 73.1	16.1%	$ 424.8
Operating profit	**31.5**	22.6	8.9	39.7%	10.8
Operating margin	**6.0%**	5.0%			2.5%

Barnes Distribution reported record sales of $526.9 million in 2006, a 16.1% increase over 2005 reflecting sales growth from acquisitions of 10.8%, organic sales growth of 4.2% and the favorable impact of foreign

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currency translation on sales of 1.1%. Incremental sales of $49.2 million in 2006 were provided by the recent acquisitions of Toolcom, Service Plus Distributors and KENT. Organic sales growth of $19.0 million was driven by further market penetration in North America, primarily in Corporate accounts and Tier II relationships, and improvements in key performance indicators such as the average order size. In addition, Barnes Distribution s Raymond and French operations reported higher year-over-year sales increases. Foreign currency translation favorably impacted sales by approximately $4.9 million as foreign currencies strengthened against the U.S. Dollar, primarily in Canada.

Barnes Distribution s operating profit in 2006 increased 39.7% over 2005. Operating profits were positively impacted by contributions from recent acquisitions and higher sales, particularly in the U.S. Additionally, 2006 profits were favorably impacted by a $1.5 million gain on the sale of a facility in Canada, lower incentive compensation and lower stock compensation. Partially offsetting these factors was the cost of a reduction in force in France in late 2006 of $1.7 million, higher sales force compensation costs, a shift in the business mix to lower margin customers and additional supplier costs which were not fully offset by higher selling prices. Pension costs were $1.7 million higher in 2006, due in part to a $0.7 million curtailment gain in 2005 which did not recur in 2006 and higher pension costs in Europe. As previously discussed, in 2005 Barnes Distribution recorded the out-of-period $1.8 million reduction to cost of sales which positively impacted 2005 operating profit.

Outlook: Barnes Distribution continues to focus on organic sales growth driven by its team selling model which emphasizes expansion in both its core account sales and its strategic growth initiatives. Barnes Distribution management is driving for continued organic sales growth in 2007. Additionally, the 2006 acquisition of KENT will further enhance Barnes Distribution s European presence and contribute to sales growth in 2007. Management will continue to evaluate the expansion of operations and aggressively pursue product cost recovery. Operating profit is expected to be positively impacted by the KENT acquisition and investments in operational efficiencies. The KENT integration, which resulted in a $1.7 million charge related to a reduction in personnel in France, is expected to be completed during 2007.

Barnes Distribution achieved sales of $453.8 million in 2005, a 6.8% increase over 2004. Organic sales grew $18.8 million, or 4.4%, in part due to the positive results of Barnes Distribution s strategic initiatives in the U.S., particularly its Corporate and Tier II account initiatives. Sales from Barnes Distribution s Raymond business improved 10.0% over 2004. Toolcom and Service Plus Distributors, which were acquired by Barnes Distribution in 2005, provided incremental sales of $7.3 million while foreign exchange rates had a favorable impact of $2.9 million on 2005 sales. Key performance indicators in the U.S., such as the daily sales average and average order size, improved as compared to 2004. Additionally, Barnes Distribution s operations in Canada and Europe reported higher year-over-year sales.

Barnes Distribution s operating profit more than doubled from 2004 to 2005 due, in large part, to higher sales and improved gross margins driven by cost savings and operational improvements. Higher selling prices in 2005 offset increased vendor costs, primarily for steel-based product and freight costs. The personnel reductions in late 2004 generated $1.9 million in savings during 2005. Operating profit in 2004 also included approximately $4.2 million of integration costs related to the Kar acquisition and costs incurred to address customer service levels which did not recur in 2005. As previously discussed, Barnes Distribution recorded a $1.8 million reduction to cost of sales in 2005 which positively impacted operating profit. These items were offset, in part, by higher sales personnel costs and higher incentive compensation expense. Operating profit in 2004 included a $1.3 million severance charge and approximately $1.0 million in inventory and facility charges which did not recur in 2005.

Associated Spring

($ in millions)	**2006**	**2005**	**$ Change**	**% Change**	**2004**
		As adjusted			**As adjusted**
Sales	**$ 445.9**	$ 422.4	$ 23.5	5.6%	$ 373.5
Operating profit	**42.9**	28.6	14.3	50.2%	20.8
Operating margin	**9.6%**	6.8%			5.6%

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Associated Spring reported record sales of $445.9 million in 2006, a 5.6% increase over 2005. The 2006 sales included incremental sales from the Heinz Hänggi acquisition of $19.5 million. Sales from traditional spring operations improved over 2005, primarily the result of increased sales in Asia and pricing initiatives in North America. This organic sales growth was more than offset by decreased sales from the specialty operations, excluding Heinz Hänggi, largely reflecting lower sales of nitrogen gas springs. Translation of foreign currency sales favorably impacted sales by approximately $5.4 million in 2006.

Associated Spring s operating profit was $42.9 million in 2006, a 50.2% increase from 2005. The higher operating profit includes the profit contribution from the recent acquisition of Heinz Hänggi as well as higher profits at traditional operations, the favorable impact of raw material cost deflation, lower stock compensation as compared to 2005, and lower costs driven by cost reduction initiatives. The higher profits at the traditional operations were driven by the recovery of a portion of prior years raw material cost inflation in the form of price increases in 2006. This was offset, in part, by $1.4 million of reorganization costs at Barnes Precision Valve related to a plant closure and costs for the transfer of certain production to lower-cost facilities and lower operating profit from the lower sales at the specialty operations. Associated Spring recorded higher pension and other postretirement benefit costs of $2.4 million in 2006 due in part to the ratification of union pension agreements in 2006. The incremental costs related to the new pension agreements were largely offset by cost savings.

Outlook: Management is focused on profitable growth in its specialty and traditional operations. Associated Spring continues to strengthen its specialty operations through investments in capacity, geographic expansion and acquisitions, such as the 2006 acquisition of Heinz Hänggi, which expanded its product scope and geographic presence, and the acquisition of the Nitropush product line of nitrogen gas springs. Management expects continued modest sales growth in its traditional business into 2007 and continues to pursue new markets, however, decreases are expected from the heavy duty truck market in early 2007. Management is focused on profitable sales growth through increased market penetration and improving the operational performance of its businesses through the transfer of certain production to lower-cost facilities and other productivity initiatives.

Associated Spring reported sales of $422.4 million in 2005, a 13.1% increase over 2004, driven by sales growth in its specialty operations, particularly with respect to nitrogen gas products, retaining rings and reed valves. Organic sales growth was $21.7 million in 2005. Barnes Precision Valve, which was acquired during the third quarter of 2004, contributed approximately $23.3 million of incremental sales. Additionally, sales were positively impacted by approximately $3.9 million related to the impact of foreign exchange translation, primarily in Brazil and Canada. Sales from the traditional spring operations were essentially flat year over year.

Associated Spring s operating profit increased 37.6% to $28.6 million in 2005. The increase was driven in large part by the profit contribution on higher sales volume from the specialty operations, and the incremental sales from the Barnes Precision Valve acquisition. Partially offsetting the profit improvement in the specialty operations was a decline in profit at the traditional spring operations. During 2005, Associated Spring incurred higher raw material costs which were largely offset with customer price increases. The late 2004 personnel reductions positively impacted 2005 operating profit by reducing 2005 operating costs by approximately $2.9 million. These improvements were offset, in part, by higher than anticipated domestic operating costs and continued costs related to the start-up of the Monterrey, Mexico facility. Also, the Company incurred approximately $1.2 million in costs in 2005 related to the successful negotiation of certain union pension and health care agreements. Operating profit in 2004 included $2.2 million of severance costs which did not recur in 2005.

Barnes Aerospace

($ in millions)	**2006**	**2005**	**$ Change**	**% Change**	**2004**
		As adjusted			**As adjusted**
Sales	**$ 296.9**	$ 235.4	$ 61.5	26.1%	$ 205.9

Operating profit	**42.7**	25.5	17.2	67.3%	19.9
Operating margin	**14.4%**	10.8%			9.7%

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Barnes Aerospace s sales in 2006 were a record $296.9 million, a 26.1% increase over 2005. The sales increase reflects growth in aftermarket sales of 51.2% driven by higher overhaul and repair sales in the U.S. and aftermarket RSP sales. Sales to OEMs grew by 15.6% on the strength of its increasing backlog particularly from the commercial OEM business. Barnes Aerospace generated orders of $429.4 million in 2006 which included $246.0 million of commercial OEM orders driven in large part by increased orders received on strategic engine programs, including orders resulting from a new supply agreement with Goodrich. Military orders were $76.4 million, a 14.4% increase over 2005. The order backlog at Barnes Aerospace at the end of 2006 was $403.0 million, up 49.6% from $269.3 million at December 31, 2005. Approximately 58% of the backlog at December 31, 2006 is expected to be shipped in 2007.

Barnes Aerospace s 2006 operating profit was $42.7 million, a 67.3% increase from 2005. Operating profit was positively impacted by profit contribution from the high-margin aftermarket RSPs as well as the impact of higher sales volume in the overhaul and repair and the OEM businesses. The continued focus on productivity and lean initiatives positively benefited operating profits in 2006.

Outlook: Sales in the commercial OEM business are expected to grow based on the strong commercial engine order backlog and Barnes Aerospace s participation in strategic engine programs. In addition, management expects aftermarket sales growth based on the strength of the aftermarket MRO and spare parts business. Management is focused on meeting increased demand by transferring production to Singapore, through operational improvements and adding capacity domestically and internationally. Operating profits are expected to continue to be positively impacted by the high-margin aftermarket RSPs and solid contributions from the sales volume in the overhaul and repair and OEM businesses. Barnes Aerospace continues to focus on operational and productivity efficiencies to improve long-term results. Lead times on raw materials, particularly titanium, have continued to increase and management is taking actions to minimize potential exposure to material shortages and price increases by building inventory buffers of key components to the extent practical, and purchasing raw materials in advance of anticipated price increases or recovering the price increases from its customers through higher selling prices whenever possible.

Barnes Aerospace achieved sales of $235.4 million in 2005. The sales increase included a 38.3% increase in aftermarket sales, driven by increased sales from the aftermarket RSPs and increased overhaul and repair sales in Asia. Additionally, OEM sales increased 8.6% during 2005. Total orders for 2005 were $311.3 million, compared with $253.6 million in 2004 and $161.9 million in 2003. Included in the 2005 orders were $87.9 million in orders for the GE90 commercial engine program and $66.8 million of direct and indirect military orders. The 2005 increase in orders also included the impact of extended customer lead times driven by raw material availability. Order backlog increased 39.0% to $269.3 million at December 31, 2005, from $193.8 million at December 31, 2004.

Barnes Aerospace s operating profit was $25.5 million in 2005, a 27.8% increase over 2004. Operating profit improvement was driven by the increased sales volume from the high margin aftermarket RSPs and the increase in overhaul and repair sales. In addition, the OEM business s operating profit improved during a year in which new product introduction was at historically high levels. Both the OEM and aftermarket operating profits benefited from continued focus on Six Sigma and lean initiatives.

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

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anticipates that operating activities in 2007 will generate significant cash. This operating cash flow may be supplemented with external borrowings to meet near-term organic business expansion and the Company s current financial commitments. Any future acquisitions are expected to be financed through internal cash, borrowings and equity, or a combination thereof.

The Company regularly reviews its capital commitments and needs and the availability of financing through institutional sources and the capital markets. The Company expects to pursue opportunities to raise capital from time to time as it determines to be advisable based upon its capital needs, financing capabilities and market conditions.

Cash Flow

($ in millions)	2006	2005	$ Change	% Change	2004
		As adjusted			As adjusted
Operating activities	**$ 114.3**	$ 69.7	$ 44.6	64.1%	$ 52.7
Investing activities	**(247.3)**	(85.5)	(161.8)	NM	(75.6)
Financing activities	**140.9**	7.9	133.0	NM	7.7
Exchange rate effect	**(0.7)**	(0.3)	(0.4)	NM	1.7
Increase (decrease) in cash	**$ 7.2**	$ (8.2)	$ 15.4	NM	$ (13.5)

NM Not meaningful

Operating activities are the principal source of cash flow for the Company, generating $114.3 million in cash during 2006 compared to $69.7 million in 2005. The increase in operating cash flow in 2006 is due primarily to higher operating performance. In 2006, additional working capital was needed to fund organic sales growth, but at levels of investment that were reduced from 2005 working capital additions.

Cash used by investing activities in 2006 includes $96.3 million and $45.9 million, respectively, for the Heinz Hänggi and KENT acquisitions, net of cash acquired. Investing activities also included the acquisitions of Toolcom and Service Plus Distributors in 2005 and DE-STA-CO in 2004. Capital expenditures in 2006 were $41.7 million compared to $26.1 million in the 2005 period. The higher expenditure level in 2006 reflects investments made to increase capacity primarily at Barnes Aerospace. The Company expects capital spending in 2007 to be in the range of $40-50 million. Included in investing activities in 2005 was $18.6 million related to the proceeds from the sale of NASCO. Participation fee payments related to the aftermarket RSPs were $56.8 million in both 2006 and 2005. These payments were funded mainly with cash held outside the U.S. As of December 31, 2006, the Company had a $27.2 million liability for participation fees under the RSPs which is included in accounts payable. See Note 7 of the Notes to the Consolidated Financial Statements for further discussion of the aftermarket RSPs.

Cash from financing activities in 2006 included a net increase in borrowings of $139.5 million. The proceeds from borrowings along with cash generated from operating activities were used primarily to fund acquisitions, repay borrowings from The Development Bank of Singapore, and to fund working capital requirements, capital expenditures and dividends. In 2005, the net increase in borrowings included the issuance of $100.0 million of convertible subordinated debt, the proceeds of which were used to pay down borrowings under the revolving credit facility. Proceeds from the issuance of common stock increased $21.1 million to $28.2 million as a result of stock option exercises. Cash dividends were increased to $0.485 per share compared to $0.42 in 2005. Total cash used to pay dividends increased in 2006 by $4.9 million to $24.8 million.

At December 31, 2006, the Company held $35.4 million in cash and cash equivalents, nearly all of which are held outside the U.S. Since the repatriation of this cash to the U.S. would have adverse tax consequences, the balances remain outside the U.S. to fund future international growth investments, including capital expenditures, acquisitions and aftermarket RSP participation fees. In 2007, management anticipates that the RSP payments and borrowing repayments will be funded with cash generated outside the U.S.

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The Company maintains borrowing facilities with banks to supplement internal cash generation. During 2006, the Company entered into an amended and restated revolving credit agreement which increased the available bank credit to $400.0 million. At December 31, 2006, $203.5 million was borrowed at an interest rate of 6.12% under this borrowing facility which matures in January 2011. Additionally, the Company had $5.6 million in borrowings under short-term bank credit lines at an interest rate of 7.34% at December 31, 2006. At December 31, 2006, approximately one half of the Company s borrowings are comprised of fixed rate debt.

Borrowing capacity is limited by various debt covenants in the Company s debt agreements. The most restrictive borrowing capacity covenant required the Company to maintain a ratio of Senior Debt to EBITDA, as defined in the revolving credit agreement, of not more than 3.25 times at December 31, 2006. The ratio requirement will decrease to 3.00 times for any fiscal quarter ending after September 30, 2007. The actual ratio at December 31, 2006 was 1.90 times and would have allowed additional borrowings of $232.4 million.

The Company believes its credit facilities, coupled with cash generated from operations, are adequate for its anticipated future requirements.

The funded status of the Company s pension plans is dependent upon many factors, including returns on invested assets, the level of market interest rates and benefit obligations. In 2006, the fair value of pension plan assets increased, which had a positive impact on the funded status of the plans. Additionally, the projected benefit obligation decreased due to an update of certain actuarial assumptions including the assumptions related to the discount rate, salary scale, turnover rates and retirement rates. In 2006, the Company recorded a $9.8 million non-cash after-tax credit to accumulated other non-owner changes to equity for the current year minimum pension liability adjustment as previously required by SFAS No. 87, Employers Accounting for Pensions. The Company also recorded a $26.3 million non-cash after-tax charge to other non-owner changes to equity to record the impact of the adoption of SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans , related to its pension and postretirement benefit plans. From a cash perspective, approximately $6.7 million in cash contributions were made by the Company to its various pension plans in 2006 including the required minimum contributions to its qualified U.S. pension plans. The Company expects to contribute approximately $4.6 million to its various plans in 2007.

Contractual Obligations and Commitments

At December 31, 2006, the Company had the following contractual obligations and commitments:

($ in millions)	**Total**	**Less Than 1 Year**	**1-3 Years**	**3-5 Years**	**More than 5 Years**
Long-term debt obligations	$ 426.9	$ 50.6	$ 57.6	$ 318.7	$
Estimated interest payments under long-term obligations (1)	92.6	27.6	44.5	20.5	
Capital lease obligations	0.2	0.1	0.1		
Operating lease obligations	54.0	14.1	18.2	9.9	11.8
Purchase obligations (2)	204.5	167.3	36.5	0.2	0.5
Expected pension contributions (3)	4.6	4.6			
Expected benefit payments other postretirement benefit plans (4)	62.1	7.3	13.3	12.3	29.2
Total	$ 844.9	$ 271.6	$ 170.2	$ 361.6	$ 41.5

(1) Interest payments under long-term debt obligations have been estimated based on the borrowings outstanding and market interest rates as of December 31, 2006.

(2) The amounts do not include purchase obligations already reflected as current liabilities on the consolidated balance sheet. The purchase obligation amount includes all outstanding purchase orders as of the balance sheet date as well as the minimum contractual obligation or termination penalty under other contracts.

(3) The amount included in Less than 1 Year reflects anticipated contributions to the Company s various pension plans. Anticipated contributions beyond one year are not determinable.

(4) The amounts reflect anticipated future benefit payments under the Company s various other postretirement benefit plans based on current actuarial assumptions. Expected benefit payments do not extend beyond 2016. See Note 10 of the Notes to the Consolidated Financial Statements.

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OTHER MATTERS

Inflation

Inflation generally affects the Company through its costs of labor, equipment and raw materials. Increases in the costs of these items have historically been offset by price increases, operating improvements, and other cost saving initiatives. The Company has periodically experienced inflation in raw material prices.

Critical Accounting Policies

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. The most significant areas involving management judgments and estimates are described below. Actual results could differ from such estimates.

Inventory Valuation: Inventories are valued at the lower of cost, determined on a first-in, first-out (FIFO) basis, or market. Provisions are made to reduce excess or obsolete inventories to their estimated net realizable value. Loss provisions, if any, on contracts are established when estimable. Loss provisions are based on the projected excess of manufacturing costs over the net revenues of the products or group of related products under contract. The process for evaluating the value of excess and obsolete inventory often requires the Company to make subjective judgments and estimates concerning future sales levels, quantities and prices at which such inventory will be sold in the normal course of business. Accelerating the disposal process or incorrect estimates of future sales potential may necessitate future adjustments to these provisions.

Business Acquisitions: Assets and liabilities acquired in a business combination are recorded at their estimated fair values at the acquisition date. At December 31, 2006, the Company had $358.6 million of goodwill, representing the cost of acquisitions in excess of fair values assigned to the underlying net assets of acquired companies. In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, goodwill and intangible assets deemed to have indefinite lives are not amortized but are subject to impairment testing annually or earlier testing if an event or change in circumstances indicates that the fair value of a reporting unit has been reduced below its carrying value. The assessment of goodwill involves the estimation of the fair value of reporting units, as defined by SFAS No. 142. Management completed this annual assessment during the second quarter of 2006 based on the best information available as of the date of the assessment, which incorporated management assumptions about expected future cash flows. Based on this assessment, there was no goodwill impairment in 2006. 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, particularly with respect to integrating acquired companies. There can be no assurance that future events will not result in impairment of goodwill or other intangible assets.

Revenue Sharing Programs: The Company participates in aftermarket RSPs under which the Company receives an exclusive right to supply designated aftermarket parts over the life of the related aircraft engine program. As consideration, the Company pays participation fees, which are recorded as long-lived intangible assets, and are recognized as a reduction to sales over the life of the program. The recoverability of the intangible asset is subject to significant estimates about future revenues related to the program s aftermarket parts. Management updates revenue projections periodically, which includes comparing actual experience against projected revenue and obtaining industry projections. The potential exists that actual revenues will not meet expectations due to a change in market conditions. A shortfall in future revenues may indicate an impairment of the intangible asset. The Company evaluates the remaining useful life of this asset to determine whether events and circumstances warrant a revision to the remaining period of amortization. The intangible asset is reviewed for impairment whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. The Company has not identified any impairment of these intangible assets. See Note 7 of the Notes to the Consolidated Financial Statements.

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Reorganization of Businesses: For non-acquisition related reorganizations, the Company records the cost of reorganization initiatives at the time the liability is incurred. For reorganization initiatives in connection with acquisitions, the Company records liabilities at the time that management has approved and committed to a reorganization plan. Such a plan identifies all significant actions to be taken and specifies an expected completion date that is within a reasonable period of time. The liability includes those costs that can be reasonably estimated. These estimates are subject to adjustments based upon actual costs incurred.

Pension and Other Postretirement Benefits: Accounting policies and significant assumptions related to pension and other postretirement benefits are disclosed in Note 10 of the Notes to the Consolidated Financial Statements.

The following table provides a breakout of the current targeted mix of investments, by asset classification, along with the historical rates of return for each asset class and the long-term projected rates of return for the U.S. plans.

	Target Asset Mix %	Annual Return % Historical[1]	Annual Return % Long-Term Projection
Asset class			
Large cap growth	17	10.5	9.5
Large cap value	17	14.0	13.0
Mid cap equity	12	14.3	13.3
Small cap growth	7	7.7	6.7
Small cap value	7	14.9	13.9
Non-U.S. equity	10	14.5	13.5
Real estate-related	5	14.5	13.5
Fixed income	20	6.2	3.2
Cash	5	6.2	3.2
Weighted average		12.3	10.8

(1) Historical returns based on the life of the respective index, approximately 25 years.

The historical rates of return were calculated based upon compounded average rates of return of published indices. The 25% aggregate target for fixed income and cash investments is lower than the fixed income and cash component of a typical pension trust. The fixed income investments include a higher-than-average component of yield-aggressive investments, including high-yield corporate bonds. Based on the overall historical and projected rates of return, management is using the long-term rate of return on its U.S. pension assets of 9.0%. The long-term rates of return for non-U.S. plans were selected based on actual historical rates of return of published indices that were used to measure the plans target asset allocations. Historical rates were then discounted to consider fluctuations in the historical rates as well as potential changes in the investment environment.

The discount rate used for the Company s U.S. pension plans is selected based on highly rated long-term corporate bond indices and yield curves that match the duration of the plans benefit obligations. The selected rate reflects the rate at which the pension benefits could be effectively settled. At December 31, 2006, the Company selected a discount rate of 5.90% for its U.S. pension plans. The discount rates for non-U.S. plans were selected based on indices of high-quality bonds using criteria applicable to the respective countries.

A one-quarter percentage point change in the assumed long-term rate of return on the Company s U.S. pension plans would impact the Company s pretax income by approximately $0.8 million annually. A one-quarter percentage point decrease in the discount rate would decrease the Company s pretax income by approximately $0.1 million annually. The Company reviews these and other assumptions at least annually.

During 2006, the fair value of the Company s pension plan assets increased by $30.9 million compared to a decrease in projected benefit obligations of $13.6 million. The decrease in the benefit obligation was driven by an update to certain actuarial assumptions including the assumptions related to the discount rate, salary scale, turnover rates and retirement rates. The Company s pension expense for 2006 was $4.6 million. Pension expense for 2007 is expected to decrease by approximately $2.4 million from 2006 expense, due in part to higher discount rates, higher returns on plan assets and plan changes.

Income Taxes: As of December 31, 2006, the Company had recognized $48.5 million of deferred tax assets, net of valuation reserves. The realization of these benefits is dependent in part on future taxable income. For those jurisdictions where the expiration date of tax loss carryforwards or the projected operating results indicate that realization is not likely, a valuation allowance is provided. Management believes that sufficient income will be earned in the future to realize deferred income tax assets, net of valuation allowances recorded. The recognized net deferred tax asset is based on the Company s estimates of future taxable income. The realization of these deferred tax assets can be impacted by changes to tax codes, statutory tax rates and future taxable income levels. Additionally, the Company is exposed to certain tax contingencies in the ordinary course of business. The Company records a liability when an exposure item becomes probable and can be reasonably estimated.

Stock-Based Compensation: The Company accounts for its stock-based employee compensation plans at fair value on the grant date and recognizes the related cost in its statement of operations in accordance with SFAS No. 123R, Share-Based Payment, which the Company adopted effective January 1, 2006 utilizing the modified retrospective method. The Company previously accounted for its stock-based employee compensation plans under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and its related interpretations. The fair values of stock options are estimated using the Black-Scholes option-pricing model based on certain assumptions. The fair values of other stock awards are estimated based on the fair market value of the Company s stock price on the grant date. See Note 3 of the Notes to the Consolidated Financial Statements.

Recent Accounting Changes

In June 2006, the FASB issued Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes (an interpretation of FASB Statement No. 109), which is effective for fiscal years beginning after December 15, 2006. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Company will adopt FIN 48 as of January 1, 2007. The cumulative effect upon adoption will be reported as an adjustment to opening retained earnings. The Company has estimated that the cumulative effect of adopting FIN 48 will not have a material impact on the financial statements of the Company.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. This Statement defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and expands disclosures about fair value measurements. This Statement will be effective for the Company in 2008. The Company is currently evaluating the impact this Statement will have on the Company s financial position, results of operations and cash flows.

In September 2006, the SEC issued Staff Accounting Bulletin (SAB) No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements. SAB No. 108 was issued in order to eliminate the diversity of practice surrounding how public companies quantify financial statements misstatements. The Company has applied the provisions of this SAB as of December 31, 2006. Application of this Bulletin did not have any impact on the Company s financial position, results of operations or cash flows.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. This Statement permits the measurement of certain financial instruments at fair value. This Statement will be effective for the Company in 2008. The Company is currently evaluating the impact this Statement will have on the Company s financial position, results of operations and cash flows.

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EBITDA

Earnings before interest expense, income taxes, depreciation and amortization (EBITDA) for 2006 were $159.1 million compared to $120.0 million in 2005. EBITDA is a measurement not in accordance with generally accepted accounting principles (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. 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. Accordingly, the calculation has limitations depending on its use.

Following is a reconciliation of EBITDA to the Company s net income (in millions). The 2005 EBITDA results include the $8.9 million gain on the sale of NASCO, the $1.5 million tax benefit realized from prior periods related to being awarded Pioneer Status in Singapore and the $1.8 million favorable adjustment to cost of sales at Barnes Distribution:

	2006	**2005**
		As adjusted
Net income	**$ 73.8**	$ 54.2
Add back:		
Interest expense	**23.7**	17.6
Income taxes	**19.4**	13.4
Depreciation and amortization	**42.2**	34.8
EBITDA	**$ 159.1**	$ 120.0

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Item 7A. 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 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 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.

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. At December 31, 2006, the result of a hypothetical 100 basis point increase in the average cost of the Company s variable-rate debt would have reduced annual pretax profit by $2.2 million.

At December 31, 2006, the fair value of the Company s fixed-rate debt was $239.7 million, compared with its carrying amount of $211.0 million. The Company estimates that a 100 basis point decrease in market interest rates at December 31, 2006 would have increased the fair value of the Company s fixed-rate debt to $242.1 million.

The Company has manufacturing, sales and distribution facilities around the world and thus makes investments and conducts business transactions denominated in various currencies. The currencies of the locations where the Company s business operations are conducted include the U.S. dollar, Brazilian real, British pound sterling, Canadian dollar, Chinese yuan, Euro, Mexican peso, Singapore dollar, Swedish krona, Swiss franc and Thai baht. The Company is exposed primarily to financial instruments denominated in currencies other than the functional currency at its international locations. A 10% adverse change in all currencies at December 31, 2006 would have resulted in a $0.6 million loss in the fair value of those financial instruments.

Foreign currency commitments and transaction exposures are managed at the operating units as an integral part of their businesses in accordance with a corporate policy that addresses acceptable levels of foreign currency exposures. The Company does not hedge its foreign currency net investment exposure. To reduce foreign currency exposure, management maintains the majority of foreign cash and short-term investments in local currency and uses forward currency contracts for non-functional currency denominated assets in an effort to reduce the effect of the volatility of changes in foreign exchange rates on the income statement. In historically weaker currency countries, such as Brazil and Mexico, management assesses the strength of these currencies relative to the U.S. dollar and may elect during periods of local currency weakness to invest excess cash in U.S. dollar-denominated instruments.

The Company s exposure to commodity price changes relates to certain manufacturing operations that utilize high-grade steel spring wire, titanium and other specialty metals. The Company attempts to manage its exposure to increases in those prices through its procurement and sales practices.

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Item 8. Financial Statements and Supplementary Data

BARNES GROUP INC.

CONSOLIDATED STATEMENTS OF INCOME

(Dollars in thousands, except per share data)

	Years Ended December 31,		
	2006	2005	2004
		As adjusted	As adjusted
Net sales	**$ 1,259,656**	$ 1,102,174	$ 994,709
Cost of sales	**797,472**	705,488	652,904
Selling and administrative expenses	**345,148**	320,301	291,373
	1,142,620	1,025,789	944,277
Operating income	**117,036**	76,385	50,432
Other income	**1,181**	10,449	2,145
Interest expense	**23,691**	17,551	15,390
Other expenses	**1,284**	1,132	1,310
Income before income taxes and cumulative effect of a change in accounting principle	**93,242**	68,151	35,877
Income taxes	**19,397**	13,609	5,851
Income before cumulative effect of a change in accounting principle	**73,845**	54,542	30,026
Cumulative effect of a change in accounting principle, net of income taxes of $190		(391)	
Net income	**$ 73,845**	$ 54,151	$ 30,026
Per common share [1]:			
Basic:			
Income before cumulative effect of change in accounting principle	**$ 1.46**	$ 1.16	$ 0.65
Cumulative effect of change in accounting principle, net of tax		(0.01)	
Net income	**$ 1.46**	$ 1.15	$ 0.65
Diluted:			
Income before cumulative effect of change in accounting principle	**$ 1.39**	$ 1.11	$ 0.63
Cumulative effect of change in accounting principle, net of tax		(0.01)	
Net income	**$ 1.39**	$ 1.10	$ 0.63

Dividends	**0.485**	0.42	0.40
Average common shares outstanding [1]:			
Basic	**50,702,992**	47,197,650	46,211,706
Diluted	**52,943,494**	49,018,382	47,935,268

(1) As adjusted for the two-for-one stock split in the second quarter of 2006. See Note 2.

See accompanying notes.

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BARNES GROUP INC.

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)

	December 31,	
	2006	2005
		As adjusted
Assets		
Current assets		
Cash and cash equivalents	**$ 35,360**	$ 28,112
Accounts receivable, less allowances (2006 $3,589; 2005 $3,063)	**190,775**	155,595
Inventories	**198,960**	159,238
Deferred income taxes	**24,923**	24,563
Prepaid expenses	**11,196**	11,157
Total current assets	**461,214**	378,665
Deferred income taxes	**23,544**	22,478
Property, plant and equipment, net	**209,645**	157,056
Goodwill	**358,600**	235,299
Other intangible assets, net	**236,561**	163,849
Other assets	**46,887**	48,513
Total assets	**$ 1,336,451**	$ 1,005,860
Liabilities and Stockholders Equity		
Current liabilities		
Notes payable	**$ 5,600**	$ 4,000
Accounts payable	**141,345**	120,158
Accrued liabilities	**102,951**	93,615
Long-term debt current	**45,164**	40,084
Total current liabilities	**295,060**	257,857
Long-term debt	**376,318**	241,941
Accrued retirement benefits	**114,757**	88,036
Other liabilities	**30,521**	16,869
Commitments and Contingencies (Notes 10 and 18)		
Stockholders equity		
Common stock par value $0.01 per share		
Authorized: (2006 150,000,000 shares; 2005 60,000,000 shares)		
Issued (2006 52,639,594; 2005 48,839,388)	**526**	488
Additional paid-in capital	**194,210**	136,962
Treasury stock, at cost (2006 230,741 shares; 2005 831,820 shares)	**(4,608)**	(14,590)
Retained earnings	**352,823**	304,274
Accumulated other non-owner changes to equity	**(23,156)**	(25,977)

Total stockholders equity	**519,795**	401,157
Total liabilities and stockholders equity	**$ 1,336,451**	$ 1,005,860

See accompanying notes.

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BARNES GROUP INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

	Years Ended December 31,		
	2006	**2005**	**2004**
		As adjusted	**As adjusted**
Operating activities:			
Net income	**$ 73,845**	$ 54,151	$ 30,026
Adjustments to reconcile net income to net cash from operating activities:			
Cumulative effect of change in accounting principle		391	
Depreciation and amortization	**42,226**	34,858	34,177
Gain on disposition of property, plant and equipment	**(986)**	(287)	(96)
Non-cash stock compensation expense	**7,929**	16,914	10,935
Gain on the sale of NASCO		(8,892)	
Changes in assets and liabilities, net of the effects of acquisitions:			
Accounts receivable	**(7,942)**	(15,749)	(11,566)
Inventories	**(24,658)**	(22,978)	(8,559)
Prepaid expenses	**1,127**	997	(1,385)
Accounts payable	**14,407**	5,209	2,043
Accrued liabilities	**(1,275)**	6,382	5,717
Deferred income taxes	**2,763**	2,300	(3,080)
Long-term retirement benefits	**4,263**	(1,342)	(2,935)
Other	**2,622**	(2,302)	(2,560)
Net cash provided by operating activities	**114,321**	69,652	52,717
Investing activities:			
Proceeds from disposition of property, plant and equipment	**4,975**	1,867	4,970
Proceeds from the sale of NASCO		18,600	
Capital expenditures	**(41,712)**	(26,097)	(28,509)
Business acquisitions, net of cash acquired	**(147,896)**	(20,591)	(17,720)
Revenue sharing program payments	**(56,800)**	(56,750)	(32,000)
Other	**(5,912)**	(2,486)	(2,305)
Net cash used by investing activities	**(247,345)**	(85,457)	(75,564)
Financing activities:			
Net change in other borrowings	**3,815**	4,138	(11,976)
Payments on long-term debt	**(156,181)**	(146,366)	(20,804)
Proceeds from the issuance of long-term debt	**291,852**	164,029	58,000
Proceeds from the issuance of common stock	**28,193**	7,101	4,534
Common stock repurchases	**(712)**	(149)	(3,498)
Dividends paid	**(24,803)**	(19,879)	(18,509)
Other	**(1,252)**	(926)	(40)
Net cash provided by financing activities	**140,912**	7,948	7,707
Effect of exchange rate changes on cash flows	**(640)**	(366)	1,687

Increase (decrease) in cash and cash equivalents	**7,248**	(8,223)	(13,453)
Cash and cash equivalents at beginning of year	**28,112**	36,335	49,788
Cash and cash equivalents at end of year	**$ 35,360**	$ 28,112	$ 36,335

Supplemental Disclosure of Cash Flow Information:

Non-cash financing and investing activities in 2006, 2005 and 2004 include the acquisition of $27.2 million, $27.8 million and $47.0 million, respectively, of intangible assets and the recognition of the corresponding liabilities in connection with the aftermarket RSPs. In 2006, non-cash investing and financing activities include the issuance of $30.7 million of common stock in connection with the acquisition of Heinz Hänggi.

See accompanying notes.

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BARNES GROUP INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

(Dollars in thousands)

	Common Stock	Additional Paid-In Capital	Treasury Stock	Retained Earnings	Accumulated Other Non-Owner Changes to Equity	Total Stockholders Equity
	As adjusted	As adjusted		As adjusted		