

REGAL BELOIT CORP  
Form 10-Q  
August 01, 2008

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

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

for the quarterly period ended  
June 28, 2008

or

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

Commission file number  
001-07283

REGAL BELOIT CORPORATION  
(Exact name of registrant as specified in its charter)

Wisconsin  
(State of other jurisdiction of  
incorporation)

39-0875718  
(IRS Employer Identification  
No.)

200 State Street, Beloit, Wisconsin 53511  
(Address of principal executive office)

(608) 364-8800  
Registrant's telephone number, including area code

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

Indicate by check mark whether the registrant 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  Accelerated Filer   
Non-accelerated filer

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

32,213,759 Shares, Common Stock, \$.01 Par Value (as of July 28, 2008)

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## REGAL BELOIT CORPORATION

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## CAUTIONARY STATEMENT

This Quarterly Report contains “forward-looking statements” as defined in the Private Securities Litigation Reform Act of 1995. Forward-looking statements represent our management’s judgment regarding future events. In many cases, you can identify forward-looking statements by terminology such as “may,” “will,” “plan,” “expect,” “anticipate,” “estimate,” “believe,” or “continue” or the negative of these terms or other similar words. Actual results and events could differ materially and adversely from those contained in the forward-looking statements due to a number of factors, including:

- economic changes in global markets where we do business, such as currency exchange rates, inflation rates, interest rates, recession, foreign government policies and other external factors that we cannot control;
  - unanticipated fluctuations in commodity prices and raw material costs;
  - cyclical downturns affecting the global market for capital goods;
- unexpected issues and costs arising from the integration of acquired companies and businesses;
- marketplace acceptance of new and existing products including the loss of, or a decline in business from, any significant customers;
  - the impact of capital market transactions that we may effect;
  - the availability and effectiveness of our information technology systems;
    - unanticipated costs associated with litigation matters;

- actions taken by our competitors;
- difficulties in staffing and managing foreign operations; and
- other risks and uncertainties including but not limited to those described in Item 1A-Risk Factors of the Company's Annual Report on Form 10-K filed on February 27, 2008 and from time to time in our reports filed with U.S. Securities and Exchange Commission.

All subsequent written and oral forward-looking statements attributable to us or to persons acting on our behalf are expressly qualified in their entirety by the applicable cautionary statements. The forward-looking statements included in this Form 10-Q are made only as of their respective dates, and we undertake no obligation to update these statements to reflect subsequent events or circumstances. See also Item 1A - Risk Factors in the Company's Annual Report on Form 10-K filed on February 27, 2008.

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PART I - FINANCIAL INFORMATION  
REGAL BELOIT CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS  
(Unaudited)

(In Thousands of Dollars, Except Shares Outstanding, Dividends Declared and Per Share Data)

## ITEM I. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

|   | Three Months Ended |               | Six Months Ended |               |
|---|--------------------|---------------|------------------|---------------|
|   | June 28, 2008      | June 30, 2007 | June 28, 2008    | June 30, 2007 |
| Net Sales                               | \$ 606,316         | \$ 459,795    | \$ 1,142,659     | \$ 878,441    |
| Cost of Sales                           | 475,139            | 355,919       | 889,383          | 677,338       |
| Gross Profit                            | 131,177            | 103,876       | 253,276          | 201,103       |
| Operating Expenses                      | 63,683             | 43,821        | 128,170          | 93,717        |
| Income From Operations                  | 67,494             | 60,055        | 125,106          | 107,386       |
| Interest Expense                        | 7,127              | 4,425         | 14,346           | 9,491         |
| Interest Income                         | 531                | 241           | 915              | 330           |
| Income Before Taxes & Minority Interest | 60,898             | 55,871        | 111,675          | 98,225        |
| Provision For Income Taxes              | 21,553             | 18,973        | 39,565           | 33,663        |
| Income Before Minority Interest         | 39,345             | 36,898        | 72,110           | 64,562        |
| Minority Interest in Income, Net of Tax | 1,269              | 645           | 1,867            | 1,496         |
| Net Income                              | \$ 38,076          | \$ 36,253     | \$ 70,243        | \$ 63,066     |
| Earnings Per Share of Common Stock:     |                    |               |                  |               |
| Basic                                   | \$ 1.21            | \$ 1.15       | \$ 2.24          | \$ 2.02       |
| Assuming Dilution                       | \$ 1.14            | \$ 1.06       | \$ 2.11          | \$ 1.86       |
| Cash Dividends Declared                 | \$ 0.16            | \$ 0.15       | \$ 0.31          | \$ 0.29       |

Weighted Average Number of Shares Outstanding:

|                   |            |            |            |            |
|-------------------|------------|------------|------------|------------|
| Basic             | 31,305,715 | 31,546,970 | 31,311,296 | 31,180,641 |
| Assuming Dilution | 33,525,725 | 34,177,529 | 33,321,379 | 33,862,524 |

See accompanying Notes to Condensed Consolidated Financial Statements.

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REGAL BELOIT CORPORATION  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(In Thousands of Dollars, Except Share Data)

|  | (Unaudited)<br>June 28, 2008 | (From Audited<br>Statements)<br>December 29, 2007 |
|--|------------------------------|---|
| <b>ASSETS</b>  |                              |   |
| <b>Current Assets:</b>   |                              |   |
| Cash and Cash Equivalents  | \$ 87,710                    | \$ 42,574   |
| Receivables, less Allowances for Doubtful Accounts of<br>\$10,626 in 2008 and \$10,734 in 2007 | 394,308                      | 297,569   |
| Inventories  | 308,462                      | 318,200   |
| Prepaid Expenses and Other Current Assets  | 50,346                       | 35,626  |
| Deferred Income Tax Benefits   | 25,360                       | 34,522  |
| <b>Total Current Assets</b>  | <b>866,186</b>               | <b>728,491</b>                                    |
| <b>Property, Plant and Equipment:</b>  |                              |   |
| Land and Improvements  | 42,349                       | 31,766  |
| Buildings and Improvements   | 128,216                      | 117,707   |
| Machinery and Equipment  | 468,859                      | 435,792   |
| Property, Plant and Equipment, at Cost   | 639,424                      | 585,265   |
| Less - Accumulated Depreciation  | (263,279)                    | (245,922)   |
| <b>Net Property, Plant and Equipment</b>   | <b>376,145</b>               | <b>339,343</b>                                    |
| Goodwill   | 637,451                      | 654,261   |
| Intangible Assets, Net of Amortization   | 124,716                      | 129,473   |
| Other Noncurrent Assets  | 13,819                       | 10,679  |
| <b>Total Assets</b>  | <b>\$ 2,018,317</b>          | <b>\$ 1,862,247</b>                               |
| <b>LIABILITIES AND SHAREHOLDERS' INVESTMENT</b>  |                              |   |
| <b>Current Liabilities:</b>  |                              |   |
| Accounts Payable   | 242,339                      | 183,215   |
| Dividends Payable  | 5,012                        | 4,700   |
| Accrued Compensation and Employee Benefits   | 57,606                       | 55,315  |
| Other Accrued Expenses   | 62,521                       | 63,358  |
| Current Maturities of Debt   | 27,062                       | 5,332   |
| <b>Total Current Liabilities</b>   | <b>394,540</b>               | <b>311,920</b>                                    |
| Long-Term Debt   | 541,131                      | 558,918   |
| Deferred Income Taxes  | 80,643                       | 75,055  |
| Other Noncurrent Liabilities   | 41,474                       | 27,041  |
| Pension and Other Postretirement Benefits  | 22,420                       | 20,742  |
| Minority Interest in Consolidated Subsidiaries   | 13,151                       | 10,542  |
| <b>Shareholders' Investment:</b>   |                              |   |
| Common Stock, \$.01 par value, 100,000,000 shares<br>authorized in 2008 and 2007,              |                              |   |

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|   |    |           |    |           |
|---|----|-----------|----|-----------|
| 32,210,259 shares issued in 2008 and<br>32,105,824 issued in 2007                     |    | 322       |    | 321       |
| Additional Paid-In Capital  |    | 339,299   |    | 335,452   |
| Less - Treasury Stock, at cost, 884,100 shares in 2008,<br>and 774,100 shares in 2007 |    | (19,419)  |    | (15,228)  |
| Retained Earnings   |    | 595,559   |    | 535,304   |
| Accumulated Other Comprehensive Income  |    | 9,197     |    | 2,180     |
| Total Shareholders' Investment  |    | 924,958   |    | 858,029   |
| Total Liabilities and Shareholders' Investment  | \$ | 2,018,317 | \$ | 1,862,247 |

See accompanying Notes to Condensed Consolidated Financial Statements.



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REGAL BELOIT CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)  
(In Thousands of Dollars)

|  | Six Months Ended |               |
|--|------------------|---------------|
|  | June 28, 2008    | June 30, 2007 |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>   |                  |               |
| Net income   | \$ 70,243        | \$ 63,066     |
| Adjustments to reconcile net income to net cash provided<br>by operating activities: |                  |               |
| Depreciation and amortization  | 30,211           | 20,367        |
| Minority interest  | 1,867            | 1,496         |
| Excess tax benefit from stock-based compensation                                     | (1,333)          | (6,590)       |
| Loss on sale of assets, net  | 70               | 51            |
| Stock-based compensation expense   | 1,961            | 1,871         |
| Change in assets and liabilities, net  | 13,266           | 19,849        |
| Net cash provided by operating activities  | 116,285          | 100,110       |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>   |                  |               |
| Additions to property, plant and equipment   | (28,134)         | (17,863)      |
| Business acquisitions, net of cash acquired  | (15,805)         | (2,425)       |
| Sale of property, plant and equipment  | 1,149            | -             |
| Net cash used in investing activities  | (42,790)         | (20,288)      |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>   |                  |               |
| Net (repayments) proceeds from short-term borrowing                                  | (92)             | 8,200         |
| Payments of long-term debt   | (233)            | (278)         |
| Net repayments under revolving credit facility                                       | (182,700)        | (31,600)      |
| Net repayments of commercial paper borrowings  | -                | (39,350)      |
| Net proceeds from long-term borrowings   | 165,000          | -             |
| Dividends paid to shareholders   | (9,392)          | (8,709)       |
| Purchases of treasury stock  | (4,191)          | -             |
| Proceeds from the exercise of stock options  | 1,739            | 1,403         |
| Excess tax benefits from stock-based compensation                                    | 1,333            | 6,590         |
| Distributions to minority partners   | -                | (106)         |
| Financing feeds paid   | (418)            | (551)         |
| Net cash used in financing activities  | (28,954)         | (64,401)      |
| <b>EFFECT OF EXCHANGE RATES ON CASH</b>  | <b>595</b>       | <b>1,195</b>  |
| Net increase in cash and cash equivalents  | 45,136           | 16,616        |
| Cash and cash equivalents at beginning of period                                     | 42,574           | 36,520        |
| Cash and cash equivalents at end of period   | \$ 87,710        | \$ 53,136     |

See accompanying Notes to Condensed Consolidated Financial Statements.



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REGAL BELOIT CORPORATION  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 June 28, 2008  
 (Unaudited)

**1. BASIS OF PRESENTATION**

The accompanying (a) condensed consolidated balance sheet as of December 29, 2007, which has been derived from audited financial statements, and (b) unaudited interim condensed consolidated financial statements as of June 28, 2008 have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to those rules and regulations, although the Company believes that the disclosures made are adequate to make the information not misleading.

It is suggested that these condensed consolidated financial statements be read in conjunction with the financial statements and the notes thereto included in the Company's Annual Report on Form 10-K filed on February 27, 2008.

In the opinion of management, all adjustments considered necessary for a fair presentation of financial results have been made. Except as otherwise discussed, such adjustments consist of only those of a normal recurring nature. Operating results for the six months ended June 28, 2008 are not necessarily indicative of the results that may be expected for the entire fiscal year ending December 27, 2008.

**2. INVENTORIES**

Cost for approximately 65% of the Company's inventory is determined using the last-in, first-out (LIFO) inventory valuation method. The approximate percentage distribution between major classes of inventories was as follows:

|  | June 28,<br>2008 | December<br>29, 2007 |
|--|------------------|----------------------|
| Raw Material                             | 21%              | 21%                  |
| Work in Process                          | 16%              | 14%                  |
| Finished Goods<br>and Purchased<br>Parts | 63%              | 65%                  |

**3. ACQUISITIONS****2008 Acquisitions**

On April 25, 2008 the Company acquired Joyce Court Holdings Ltd. and Grand Delight Investments Ltd., sole shareholders of Wuxi Hwada Motor Co. and Wuxi New Hwada Motor Co. (collectively "Hwada") located in Wuxi, China. Hwada is a leading designer and manufacturer of Integral IEC and NEMA electric motors, which are used in various industrial applications such as compressor, pump, paper and steel processing and power plants. Approximately 50% of Hwada's product sales are in the China industrial markets. The business is reported as part of the Company's Electrical Segment. The purchase price was paid in cash (\$27.6 million) plus the assumption of approximately \$7.5 million in net liabilities. The purchase price allocations for Hwada are preliminary, pending the finalization of working capital adjustments and purchase price adjustments. Additionally, under the terms of the transaction, the Company will pay to the seller up to \$8.5 million received in the future upon the sale of certain real property rights owned by Hwada.

## 2007 Acquisitions

On August 31, 2007, the Company completed the acquisition of certain assets comprising the commercial and industrial division of the Fasco Motor business (“Fasco”) from Tecumseh Products, Inc. and certain of its affiliates. On August 31, 2007, the Company also separately acquired the stock of Jakel Incorporated (“Jakel”). Both of the acquired businesses manufacture and market motors and blower systems for a variety of air moving applications including alternative fuel systems, water heaters, heating ventilating and air conditioning (HVAC) systems and other commercial products.

On October 12, 2007, the Company acquired Morrill Motors (“Morrill”). The acquired business is a leading designer and manufacturer of fractional horsepower motors and components for the commercial refrigeration and freezer markets. Included in the motor offering are technology based variable speed products.

On October 29, 2007, the Company acquired Alstom motors and fans business (“Alstom”) in India. The business is located in Kolkata, India and manufactures and markets a full range of low and medium voltage industrial motors and fans for the industrial and process markets in India. Alstom is noted for high quality process duty motors with a full range from 1 to 3500 hp. The purchase price was paid in cash.

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The purchase price allocations for the Fasco, Jakel, Morrill and Alstom acquisitions are preliminary, pending the finalization of working capital adjustments and further analysis of contingencies. The combined purchase price, net of cash acquired, was \$334.8 million. The excess of the purchase price over the estimated fair values of the net assets acquired was assigned to goodwill. Adjustments to the estimated fair values may be recorded during the allocation period, not to exceed one year from the date of acquisition.

## 4. COMPREHENSIVE INCOME

The Company's comprehensive income for the three months and six months ended June 28, 2008 and June 30, 2007, respectively were as follows (in thousands):

|  | Three Months Ending |               | Six Months Ending |               |
|--|---------------------|---------------|-------------------|---------------|
|  | June 28, 2008       | June 30, 2007 | June 28, 2008     | June 30, 2007 |
| Net income as reported   | \$ 38,076           | \$ 36,253     | \$ 70,243         | \$ 63,066     |
| Comprehensive income (loss) from:  |                     |               |                   |               |
| Translation adjustments  | (2,951)             | 6,010         | (1,628)           | 6,812         |
| Changes in fair value of hedging activities, net of tax  | 3,080               | (2,546)       | 13,857            | (3,490)       |
| Hedging activities reclassified into earnings from accumulated other comprehensive income ("AOCI"), net of tax | (4,668)             | 3,159         | (5,108)           | 4,101         |
| Amortization of net prior service costs and actuarial losses   | (199)               | 189           | (104)             | 356           |
| Comprehensive income   | \$ 33,338           | \$ 43,065     | \$ 77,260         | \$ 70,845     |

## 5. WARRANTY COSTS

The Company recognizes the cost associated with its standard warranty on its products at the time of sale. The amount recognized is based on historical experience. The following is a reconciliation of the changes in accrued warranty costs for the three months and six months ended June 28, 2008 and June 30, 2007, respectively (in thousands):

|                         | Three Months Ending |               | Six Months Ending |               |
|-------------------------|---------------------|---------------|-------------------|---------------|
|                         | June 28, 2008       | June 30, 2007 | June 28, 2008     | June 30, 2007 |
| Beginning balance       | \$ 9,951            | \$ 5,445      | \$ 9,872          | \$ 6,300      |
| Deduct: Payments        | (1,662)             | (1,840)       | (3,398)           | (3,454)       |
| Add: Provision          | 1,935               | 2,423         | 3,774             | 3,182         |
| Translation Adjustments | (3)                 | -             | (27)              | -             |
| Ending balance          | \$ 10,221           | \$ 6,028      | \$ 10,221         | \$ 6,028      |



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## 6. BUSINESS SEGMENTS

The Company operates two strategic businesses that are reportable segments, Mechanical and Electrical (in thousands):

|                                 | Mechanical Segment         |                  |                   |                  | Electrical Segment  |                  |                   |                  |
|---------------------------------|----------------------------|------------------|-------------------|------------------|---------------------|------------------|-------------------|------------------|
|                                 | Three Months               |                  | Six Months Ending |                  | Three Months Ending |                  | Six Months Ending |                  |
|                                 | Ending<br>June 28,<br>2008 | June 30,<br>2007 | June 28,<br>2008  | June 30,<br>2007 | June 28,<br>2008    | June 30,<br>2007 | June 28,<br>2008  | June 30,<br>2007 |
| Net Sales                       | \$ 57,420                  | \$ 57,064        | \$ 112,534        | \$ 111,658       | \$ 548,896          | \$ 402,731       | \$ 1,030,125      | \$ 766,783       |
| Income<br>from<br>Operations    | 7,980                      | 9,793            | 16,046            | 16,674           | 59,514              | 50,262           | 109,060           | 90,712           |
| % of Net<br>Sales               | 13.9%                      | 17.2%            | 14.3%             | 14.9%            | 10.8%               | 12.5%            | 10.6%             | 11.8%            |
| Goodwill at<br>end of<br>period | \$ 530                     | \$ 530           | \$ 530            | \$ 530           | \$ 636,921          | \$ 545,721       | \$ 636,921        | \$ 545,721       |

A reclassification of \$2.9 million and \$5.7 million in sales and \$.8 million and \$1.4 million of income from operations was made to results for the three and six months ended June 30, 2007, as previously reported, to reflect the transfer of certain product sales and related operating income from an Electrical Segment unit to a Mechanical Segment unit due to a first quarter 2008 change in management and reporting of such product sales.

## 7. GOODWILL AND OTHER INTANGIBLES

## Goodwill

As described above in Note 3 of Notes to Condensed Consolidated Financial Statements, the Company acquired one business in 2008 and four separate businesses in 2007. The purchase price allocations are preliminary, pending the finalization of working capital, valuations and further analysis of contingencies. The excess of purchase price over estimated fair value was assigned to goodwill. Adjustments to the estimated fair value of the net assets acquired may be recorded during the allocation period, not to exceed one year from the date of acquisition.

A preliminary allocation of \$87.9 million was included in goodwill at June 28, 2008 related to the four 2007 acquisitions. During the six months ended June 28, 2008, the Company completed the fair value analysis of certain property located at the Kolkata, India facility resulting in an increase of the value assigned to property, plant and equipment and a corresponding decrease to goodwill which is included in the table below.

The 2008 acquisition of Hwada resulted in an additional preliminary goodwill allocation of \$3.2 million in the six months ended June 28, 2008.

The Company believes that substantially all of the goodwill is deductible for tax purposes. The following information presents changes to goodwill during the periods indicated (in thousands):

| Electrical | Mechanical | Total |
|------------|------------|-------|
|------------|------------|-------|

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|   | Segment |          | Segment |     |    |          |
|---|---------|----------|---------|-----|----|----------|
| Balance as of December 29, 2007             | \$      | 653,731  | \$      | 530 | \$ | 654,261  |
| Net Acquisitions and Fair Value Adjustments |         | (16,386) |         | -   |    | (16,386) |
| Translation Adjustments                     |         | (424)    |         | -   |    | (424)    |
| Balance as of June 28, 2008                 | \$      | 636,921  | \$      | 530 | \$ | 637,451  |



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## Intangible Assets

Other intangible assets consisted of the following (in thousands):

| Asset Description      | Useful<br>Life (years) | Gross<br>Value    | June 28, 2008               |                   |
|------------------------|------------------------|-------------------|-----------------------------|-------------------|
|                        |                        |                   | Accumulated<br>Amortization | Net Book<br>Value |
| Non-Compete Agreements | 3 - 5                  | \$ 5,759          | \$ 3,173                    | \$ 2,586          |
| Trademarks             | 3 - 20                 | 20,204            | 5,407                       | 14,797            |
| Patents                | 9 - 10.5               | 15,410            | 5,419                       | 9,991             |
| Engineering Drawings   | 10                     | 1,200             | 427                         | 773               |
| Customer Relationships | 10 - 14                | 87,920            | 14,374                      | 73,546            |
| Technology             | 6 - 10                 | 26,022            | 2,999                       | 23,023            |
| <b>Total</b>           |                        | <b>\$ 156,515</b> | <b>\$ 31,799</b>            | <b>\$ 124,716</b> |

| Asset Description      | Useful<br>Life (years) | Gross<br>Value    | December 29, 2007           |                   |
|------------------------|------------------------|-------------------|-----------------------------|-------------------|
|                        |                        |                   | Accumulated<br>Amortization | Net Book<br>Value |
| Non-Compete Agreements | 3 - 5                  | \$ 5,588          | \$ 2,540                    | \$ 3,048          |
| Trademarks             | 3 - 20                 | 18,887            | 4,752                       | 14,135            |
| Patents                | 9 - 10.5               | 15,410            | 4,648                       | 10,762            |
| Engineering Drawings   | 10                     | 1,200             | 367                         | 833               |
| Customer Relationships | 10 - 14                | 84,572            | 10,325                      | 74,247            |
| Technology             | 6 - 10                 | 27,474            | 1,026                       | 26,448            |
| <b>Total</b>           |                        | <b>\$ 153,131</b> | <b>\$ 23,658</b>            | <b>\$ 129,473</b> |

During 2008, the Company adjusted certain other intangible assets gross values to reflect purchase accounting fair value adjustments and currency translation adjustments.

| Estimated Amortization (in millions) |        |        |         |        |  |
|--------------------------------------|--------|--------|---------|--------|--|
| 2008                                 | 2009   | 2010   | 2011    | 2012   |  |
| \$14.7                               | \$15.0 | \$14.3 | \$ 13.6 | \$13.6 |  |

Amortization expense recorded for the six months ended June 28, 2008 and June 30, 2007 was \$7.8 million and \$3.5 million, respectively. The Company performs an annual evaluation of goodwill and other intangible assets in the fourth quarter of each fiscal year for impairment as required by SFAS 142, "Goodwill and Other Intangible Assets".

## 8. DEBT AND BANK CREDIT FACILITIES

The Company's indebtedness as of June 28, 2008 and December 29, 2007 was as follows (in thousands):

|                           | June 28, 2008 |         | December 29, 2007 |         |
|---------------------------|---------------|---------|-------------------|---------|
|                           |               |         |                   |         |
| Senior notes              | \$            | 250,000 | \$                | 250,000 |
| Term loan                 |               | 165,000 |                   | -       |
| Revolving credit facility |               | -       |                   | 182,700 |
|                           |               | 115,000 |                   | 115,000 |

|                                     |    |          |            |
|-------------------------------------|----|----------|------------|
| C o n v e r t i b l e   s e n i o r |    |          |            |
| subordinated debt                   |    |          |            |
| Other                               |    | 38,193   | 16,550     |
|                                     |    | 568,193  | 564,250    |
| Less: Current maturities            |    | (27,062) | (5,332)    |
| Non-current portion                 | \$ | 541,131  | \$ 558,918 |

During 2007, in a private placement exempt from the registration requirements of the Securities Act of 1933, as amended, the Company issued and sold \$250.0 million of senior notes (the "Notes"). The Notes were sold pursuant to a Note

Purchase Agreement (the "Agreement") by and among the Company and the purchasers of the Notes. The Notes were issued and sold in two series: \$150.0 million in Floating Rate Series 2007A Senior Notes, Tranche A, due August 23, 2014, and \$100.0 million in Floating Rate Series 2007A Senior Notes, Tranche B, due August 23, 2017. The Notes bear interest at a margin over the London Inter-Bank Offered Rate ("LIBOR"), which margin varies with the ratio of the Company's consolidated debt to consolidated earnings before interest, taxes, depreciation and amortization ("EBITDA") as defined in the Agreement. These interest rates also vary as LIBOR varies. The Agreement permits the Company to issue and sell additional note series, subject to certain terms and conditions described in the Agreement, up to a total of \$600.0 million in combined Notes.

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On June 16, 2008, the Company entered into a Term Loan Agreement (“Term Loan”) with certain financial institutions, whereby the Company borrowed an aggregate principal amount of \$165.0 million. The Term Loan matures in June 2013, and borrowings generally bear interest at a variable rate equal to (i) a margin over LIBOR, which margin varies depending on whether certain criteria are satisfied, or (ii) the alternate base rate as defined in the agreement. At June 28, 2008, the interest rate of 3.8% was based on a margin over LIBOR. The proceeds from the Term Loan were used to payoff the balance on the Company’s revolving credit facility.

The Company’s \$500.0 million revolving credit facility (“Facility”) permits the Company to borrow at interest rates based upon a margin above LIBOR, which margin varies with the ratio of total funded debt to EBITDA. These interest rates also vary as LIBOR varies. The Company pays a commitment fee on the unused amount of the Facility, which also varies with the ratio of total debt to EBITDA as defined in the Facility.

The Notes, the Term Loan and the Facility require the Company to meet specified financial ratios and to satisfy certain financial condition tests. The Company was in compliance with all debt covenants as of June 28, 2008.

The Company’s \$115.0 million, 2.75% convertible senior subordinated debt is convertible as the closing price of the Company’s common stock exceeded the contingent conversion share price for the specified amount of time. As a result, holders of the notes may surrender the notes for conversion at any time until the maturing of the bonds in March 2024. Holders that exercise their right to convert the notes will receive up to the principal amount of the notes in cash, with the balance of the conversion obligation, if any, to be satisfied in shares of Company common stock or cash, at the Company’s discretion. No notes have been converted into cash or shares of common stock as of June 28, 2008.

As part of the 2008 acquisition of Hwada (see Note 3 of Notes to Condensed Consolidated Financial Statements), the Company assumed \$21.6 million of short term notes payable to banks. At June 28, 2008, the balance of these notes payable was approximately \$21.8 million. The weighted average interest rate was 7.3% at June 28, 2008.

As of June 28, 2008, a foreign subsidiary of the Company had outstanding borrowings of \$5.0 million denominated in U.S. dollars. The borrowings were made under a \$15.0 million unsecured credit facility which expires in December 2008. The borrowings are short-term and bear interest at a margin over LIBOR.

## 9. PENSION PLANS

The Company’s net periodic pension cost is comprised of the following components (in thousands):

|                                    | Three Months Ending |               | Six Months Ending |               |
|------------------------------------|---------------------|---------------|-------------------|---------------|
|                                    | June 28, 2008       | June 30, 2007 | June 28, 2008     | June 30, 2007 |
| Service cost                       | \$ 1,003            | \$ 1,215      | \$ 2,006          | \$ 2,422      |
| Interest cost                      | 1,478               | 1,267         | 2,956             | 2,534         |
| Expected return on plan assets     | (1,393)             | (1,282)       | (2,786)           | (2,565)       |
| Amortization of prior service cost | 53                  | 31            | 106               | 63            |
| Amortization of net actuarial loss | 126                 | 238           | 252               | 477           |
| Net periodic benefit expense       | \$ 1,267            | \$ 1,469      | \$ 2,534          | \$ 2,931      |

The estimated net actuarial loss and prior service cost for defined benefit pension plans that will be amortized from accumulated other comprehensive income into net periodic benefit cost during the 2008 fiscal year is \$0.5 million and \$0.2 million, respectively.

In the second quarter of 2008 and 2007, the Company contributed \$0.3 million and \$0.1 million, respectively, to defined benefit pension plans. Contributions to defined benefit plans for the six months ended June 28, 2008 and June 30, 2007 were \$0.6 million and \$0.2 million, respectively. The Company expects to contribute an additional \$0.5 million, for total contributions of \$1.1 million in 2008. The Company contributed a total of \$3.3 million in 2007. The assumptions used in the valuation of the Company's pension plans and in the target investment allocation have remained the same as those disclosed in the Company's Annual Report on Form 10-K filed on February 27, 2008.

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## 10. SHAREHOLDERS' INVESTMENT

The Company recognized approximately \$1.1 million and \$1.0 million in share-based compensation expense for the three month period ending June 28, 2008 and June 30, 2007, respectively. Share-based compensation expense for the six months ended June 28, 2008 and June 30, 2007 was \$2.0 million and \$1.9 million, respectively. The total income tax benefit recognized relating to share-based compensation for the six months ended June 28, 2008 and June 30, 2007 was approximately \$1.3 million and \$6.6 million, respectively. The Company recognizes compensation expense on grants of share-based compensation awards on a straight-line basis over the vesting period of each award recipient. As of June 28, 2008, total unrecognized compensation cost related to share-based compensation awards was approximately \$13.3 million, net of estimated forfeitures, which the Company expects to recognize over a weighted average period of approximately 2.9 years.

The Company was authorized as of June 28, 2008 to deliver up to 5.0 million shares of common stock upon exercise of non-qualified stock options or incentive stock options, or upon grant or in payment of stock appreciation rights, and restricted stock. Approximately 2.4 million shares were available for future grant or payment under the various plans at June 28, 2008.

During the six months ended June 28, 2008, the Company repurchased 110,000 shares at a total cost of \$4.2 million. There were no shares repurchased in the comparable period of 2007.

## Share-based Incentive Awards

The Company uses several forms of share-based incentive awards, including non-qualified stock options, incentive stock options and stock appreciation rights (SAR's). All grants are made at prices equal to the fair market value of the stock on the grant dates, and expire ten years from the grant date.

The majority of the Company's annual option and SAR incentive awards are made in the fiscal second quarter. The per share weighted average fair value of share-based incentive awards granted in the May, 2008 annual grant was \$14.68. The fair value of the awards is estimated on the date of the grant using the Black-Scholes pricing model and the following assumptions: risk-free interest rate of 3.7%, expected dividend yield of 1.4%, expected volatility of 32.0% and an estimated life of 7 years.

A summary of share-based awards (options and SAR's) as of June 28, 2008 follows below. Forfeitures of share-based awards were immaterial.

|                   | Shares    | Wtd. Avg.<br>Exercise<br>Price | Wtd. Avg.<br>Remaining<br>Contractual<br>Term (years) | Aggregate<br>Intrinsic<br>Value<br>(in millions) |
|-------------------|-----------|--------------------------------|---|--|
| Number of shares: |           |                                |   |  |
| Outstanding       | 1,712,075 | \$ 32.35                       | 6.7   | \$ 18.5  |
| Exercisable       | 789,008   | \$ 27.00                       | 5.3   | \$ 12.3  |

## Restricted Stock

The Company also granted a total of 31,050 restricted stock awards to certain employees during the six months ended June 28, 2008. The Company values restricted stock awards at the closing market value of its common stock on the date of grant and restrictions generally lapse three years after the date of grant.



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## 11. INCOME TAXES

The Company adopted Financial Accounting Standards Board Interpretation No. 48, Accounting for Uncertainty in Income Taxes (“FIN 48”) as of the beginning of fiscal 2007. FIN 48 clarifies the accounting for uncertainty in income taxes by defining criteria that a tax position on an individual matter basis must meet before that position is recognized in the financial statements. Additionally, FIN 48 provides guidance on measurement, derecognition, classification, interest and penalties, interim period accounting, disclosures and transition. As a result of adopting FIN 48, the Company determined that approximately \$0.6 million (including approximately \$0.4 million in estimated interest payments) of tax benefits previously recognized were considered uncertain tax positions; as such these deductions may not be sustained upon examination by taxing authorities. This adjustment was reflected as a reduction of retained earnings.

As of June 28, 2008 and December 29, 2007, the Company had approximately \$6.8 million of unrecognized tax benefits, \$3.2 million of which would affect its effective tax rate if recognized. The Company recognizes interest and penalties related to uncertain tax positions in income tax expense.

The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. Federal tax returns from 2004 through 2006 and various state tax returns from 2002 through 2006 remain subject to income tax examinations by tax authorities. The Company estimates that the unrecognized tax benefits will not change significantly within the next year.

## 12. EARNINGS PER SHARE (EPS)

The numerator for the calculation of basic and diluted earnings per share is net income. The denominator is computed as follows (in thousands):

|  | Three Months Ending |               | Six Months Ending |               |
|--|---------------------|---------------|-------------------|---------------|
|  | June 28, 2008       | June 30, 2007 | June 28, 2008     | June 30, 2007 |
| Denominator for basic EPS - weighted average | 31,306              | 31,547        | 31,311            | 31,181        |
| Effect of dilutive securities                | 2,220               | 2,631         | 2,010             | 2,682         |
| Denominator for diluted EPS                  | 33,526              | 34,178        | 33,321            | 33,863        |

The “Effect of dilutive securities” represents the dilution impact of equity awards and the convertible senior subordinated debt (see Note 8). The dilutive effect of the convertible senior subordinated debt was approximately 1.8 million shares and 1.6 million shares for the three and six months ended June 28, 2008, respectively, and 2.0 million shares for both the three and six months ended June 30, 2007.

Options for common shares where the exercise price was above the market price at June 28, 2008, totaling approximately 368,000 shares, have been excluded from the calculation of the effect of dilutive securities as the effect of such options is anti-dilutive. There were approximately 133,000 anti-dilutive option shares outstanding at June 30, 2007.

## 13. CONTINGENCIES

On April 26, 2007, the Company received notice that the U.S. Environmental Protection Agency (“U.S. EPA”) has filed an action against the Company in the United States District Court for the Northern District of Illinois seeking reimbursement of the U.S. EPA’s unreimbursed past and future remediation costs incurred in cleaning up an environmental site located near a former manufacturing facility of the Company in Illinois. In 1999, the Company

and other parties identified as potentially responsible parties (“PRPs”) reached an agreement with the U.S. EPA to partially fund the costs of certain response actions taken with respect to this site. In 2004, the Company received communications from the U.S. EPA indicating that the Company was identified as one of three PRPs regarding additional remedial actions to be taken by the U.S. EPA at this site. In response, the Company provided to the U.S. EPA its environmental expert’s assessment of the site in 2004. The Company believes that it is not a PRP with respect to the site in question and intends to defend vigorously the associated claim. As of June 28, 2008 amounts that have been recorded in the Company’s financial statements related to this contingency are not material.

The Company is, from time to time, party to other lawsuits arising from its normal business operations. It is believed that the outcome of these lawsuits will have no material effect on the Company’s financial position or its results of operations.



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14. DERIVATIVE INSTRUMENTS

The Company periodically enters into commodity futures and options hedging transactions to reduce the impact of changing prices for certain commodities such as copper and aluminum based upon certain firm commitments to purchase such commodities. These transactions are designated as cash flow hedges and the contract terms of commodity hedge instruments generally mirror those of the hedged item, providing a high degree of risk reduction and correlation. Derivative commodity assets of \$13.3 million are recorded in other current assets at June 28, 2008. Derivative commodity liabilities of \$6.1 million are recorded in other current liabilities at December 29, 2007. The unrealized gain (loss) on the effective portion of the contracts of \$8.3 million net of tax and (\$3.8) million net of tax, as of June 28, 2008 and December 29, 2007, respectively, was recorded in Accumulated Other Comprehensive Income (“AOCI”).

The Company uses a cash flow hedging strategy to protect against an increase in the cost of forecasted foreign currency denominated transactions. As of June 28, 2008, derivative currency assets of \$3.0 million and \$2.8 million are recorded in other current assets and other non-current assets, respectively. As of December 29, 2007, derivative currency assets of \$3.4 million and \$0.1 million are recorded in other current assets and other non-current liabilities, respectively. The value of the effective portion of the contracts of \$3.7 million net of tax and \$2.1 million net of tax, as of June 28, 2008 and December 29, 2007, was recorded in AOCI.

The Company has LIBOR-based floating rate borrowings, which expose the Company to variability in interest payments due to changes in interest rates. The Company has entered into pay fixed/receive LIBOR-based floating interest rate swaps to manage fluctuations in cash flows resulting from interest rate risk. These interest rate swaps have been designated as cash flow hedges against forecasted LIBOR-based interest payments. As of June 28, 2008, an interest rate swap liability of \$15.3 million was included in other non-current liabilities. The unrealized loss on the effective portion of the contracts of (\$9.5) million net of tax as of June 28, 2008 was recorded in AOCI. As of December 29, 2007, an interest rate swap liability of \$14.4 million was included in other non-current liabilities. The unrealized loss on the effective portion of the contracts of (\$8.9) million net of tax as of December 29, 2007 was recorded in AOCI.

The net AOCI balance of \$2.5 million gain at June 28, 2008 is comprised of \$10.2 million of net current deferred gains expected to be realized in the next year, and \$7.7 million of net non-current deferred losses. The impact of hedge ineffectiveness was immaterial for all periods presented.

15. FAIR VALUE

The implementation of SFAS No. 157 “Fair Value Measurements” for financial assets and financial liabilities, on December 30, 2007, the first day of the 2008 fiscal year, did not have a material impact on our consolidated financial position and results of operations. The Company is currently assessing the impact of SFAS No. 157 for nonfinancial assets and nonfinancial liabilities on its consolidated financial position and results of operations.

SFAS No. 157, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). SFAS No. 157 classifies the inputs and used to measure fair value into the following hierarchy:

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

Level 2 Unadjusted quoted prices in active markets for similar assets or liabilities, or

Unadjusted quoted prices for identical or similar assets  
or liabilities in markets that are not active, or

Inputs other than quoted prices that are observable for  
the asset or liability

Level 3 Unobservable inputs for the asset or liability

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The Company uses the best available information in measuring fair value. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company has determined that our financial assets and liabilities are level 2 in the fair value hierarchy. The following table sets for the Company's financial assets and liabilities that were accounted for at fair value on a recurring basis as of June 28, 2008 (in millions):

|                                |    |      |
|--------------------------------|----|------|
| Assets:                        |    |      |
| Prepaid Expenses and Other     |    |      |
| Current Assets                 |    |      |
| Derivative currency contracts  | \$ | 3.0  |
| Derivative commodity contracts |    | 13.3 |
| Other Noncurrent Assets        |    |      |
| Derivative currency contracts  |    | 2.8  |
| Liabilities:                   |    |      |
| Other Noncurrent Liabilities   |    |      |
| Interest rate swap             | \$ | 15.3 |

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Unless the context requires otherwise, references in this Item 2 to “we”, “us”, “our” or the “Company” refer collectively to Regal Beloit Corporation and its subsidiaries.

### OVERVIEW

Net sales increased 31.9% to \$606.3 million from \$459.8 million in the comparable period of 2007. Sales for the three months ended June 28, 2008 included \$108.5 million of sales related to the four 2007 acquired businesses described in Note 3 of Notes to the Condensed Consolidated Financial Statements. An additional \$23.3 million of the 2008 sales are attributable to the Hwada acquisition completed on April 25, 2008.

Net income increased 5.0% to \$38.1 million for the three months ended June 28, 2008 as compared to \$36.3 million in the comparable period last year. Diluted earnings per share increased 7.5% to \$1.14 for the three months ended June 28, 2008 as compared to \$1.06 for the comparable period of 2007.

### RESULTS OF OPERATIONS

#### Three Months Ended June 28, 2008 versus Three Months Ended June 30, 2007

Sales for the three months ended June 28, 2008 were \$606.3 million, a 31.9% increase over the \$459.8 million reported for the three months ended for June 30, 2007. Second quarter 2008 sales included \$108.5 million of sales related to the four 2007 acquired businesses described in Note 3 of Notes to the Condensed Consolidated Financial Statements. An additional \$23.3 million of the second quarter 2008 sales are attributable to the Hwada acquisition completed on April 25, 2008.

In the Electrical segment, sales increased 36.3%, including the impact of the acquisitions noted above. Exclusive of the acquired businesses, global generator sales increased 40.2% and commercial and industrial motors sales in North America increased 4.6%, offsetting a 3.6% decline in residential HVAC motor sales. Sales in the Mechanical segment increased 0.6% from the prior year period. From a geographic perspective, Asia-based sales increased 59.3%

as compared to the comparable period of 2007. In total, sales to regions outside of the United States were 27.0% of total sales for the three months ended June 28, 2008 in comparison to 22.8% for the comparable period of 2007.

The gross profit margin for the three months ended June 28, 2008 was 21.6% as compared to the 22.6% reported for the comparable period of 2007. Lower gross profit margins of 17.7% from the acquired businesses, and material costs had a significant impact on the three months ended June 28, 2008, partially offset by the contribution from new products, productivity efforts, pricing actions, and product mix. The raw material costs increases resulted primarily from increases in the cost of copper and steel.

Operating expenses were \$63.7 million (10.5% of sales) in the three months ended June 28, 2008 versus \$43.8 million (9.5% of sales) in 2007. Income from operations was \$67.5 million versus \$60.1 million in the comparable period of 2007. As a percent of sales, income from operations was 11.1% for the three months ended June 28, 2008 versus 13.1% in the comparable period of 2007. This decrease reflected lower operating profit margins from the acquired businesses, and increased raw material costs partially offset by contributions from new products, pricing actions, and productivity.

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Net interest expense was \$6.6 million versus \$4.2 million in the comparable period of 2007. The increase reflected higher levels of average debt outstanding driven by the acquisitions completed in the second half of 2007.

The tax rate for the three months ended June 28, 2008 was 35.4% versus 34.0% in the prior year period. The increase in the effective tax rate results from the global distribution of income, increases in certain statutory tax rates in Mexico and China, and the impact of the expiration of the United States Research and Engineering tax credit which has not been extended to 2008.

Net income for the three months ended June 28, 2008 was \$38.1 million, an increase of 5.0% versus the \$36.3 million reported in comparable period of 2007. Fully diluted earnings per share was \$1.14 as compared to \$1.06 per share reported in the second quarter of 2007. The average number of diluted shares was 33,525,725 during the three months ended June 28, 2008 as compared to 34,177,529 during the comparable period last year.

Six Months Ended June 28, 2008 versus Six Months Ended June 30, 2007

Sales for the six months ended June 28, 2008 were \$1,142.7 million, which is a 30.1% increase over the \$878.4 million reported for the comparable period of 2007. Sales for the six months ended June 28, 2008 included \$220.4 million of sales related to the four 2007 acquired businesses described in Note 3 of Notes to the Consolidated Financial Statements. An additional \$23.3 million of sales in the six months ended June 28, 2008 relate to the Hwada business acquired on April 25, 2008.

In the Electrical segment, sales increased 34.3%, including the impact of the acquisitions noted above. Exclusive of the acquired businesses, global generator sales increased 28.9% and commercial and industrial motors sales in North America increased 3.1%, offsetting a 3.4% decline in residential HVAC motor sales. Sales in the Mechanical segment increased 0.8% from the prior year period. From a geographic perspective, Asia-based sales increased 80.5% as compared to the comparable period of 2007. In total, sales to regions outside of the United States were 26.4% of total sales in comparison to 21.1% for the comparable period of 2007.

Gross margin for the six months ended June 30, 2008 was 22.2% which is 0.7 percentage points lower than the comparable period of 2007. Lower operating margins from the acquired businesses, and material costs had a significant impact on the first six months of 2008, partially offset by the contribution from new products, productivity efforts, pricing actions and positive product mix across our entire business. The raw material cost increases resulted primarily from increases in the costs of copper and steel.

Operating expenses for the six months ended June 28, 2008 were \$128.2 million (11.2% of sales) versus \$93.7 million (10.7% of sales) in the comparable period of 2007. Income from operations was \$125.1 million versus \$107.4 million in the comparable period of 2007, an increase of 16.5%. As a percent of sales, income from operations was 10.9% versus 12.2% in the comparable period of 2007.

Net interest expense was \$13.4 million versus \$9.2 million in the comparable period of 2007. This increase was driven by the higher levels of debt outstanding, driven by the acquisitions completed during the second half of 2007.

The tax rate for the six months ended June 28, 2008 was 35.4% versus 34.3% in the prior year comparable period. The increase in the effective rate results primarily from the global distribution of income, increases in certain statutory tax rates in Mexico and China, and the impact of the expiration of the United States Research and Engineering tax credit which has not been extended to 2008.

LIQUIDITY AND CAPITAL RESOURCES

Our working capital was \$471.6 million at June 28, 2008, a 13.3% increase from \$416.6 million at year-end 2007. The \$55.0 million increase was primarily driven by a \$96.7 million increase in net receivables partially offset by a \$59.1 million increase in accounts payable and \$9.7 million decrease in inventory. The ratio of our current assets to our current liabilities (“current ratio”) was 2.2:1 at June 28, 2008 and 2.3:1 at December 29, 2007.

Net cash provided by operating activities was \$116.3 million for the six months ended June 28, 2008 as compared to \$100.1 million in the comparable period of 2007. The improvement is a result of the increase in net income and increases depreciation and amortization. Net cash used in investing activities was \$42.8 million in the first six months of 2008 as compared to the \$20.3 million used in the comparable period of the prior year. Additions to property, plant and equipment were \$28.1 million in the first six months of 2008, which was \$10.3 million more than the comparable period of 2007. The change in capital spending results from increased investments in productivity and new product development projects. Our cash used in financing activities was \$29.0 million for the first six months of 2008 versus \$64.4 million used in the comparable period of 2007. During the six months ended June 28, 2008, the Company repurchased 110,000 shares at a total cost of \$4.2 million. There were no shares repurchased in the equivalent period of 2007.

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Our outstanding long-term debt decreased from \$558.9 million at December 29, 2007 to \$541.1 million at June 28, 2008. There were no borrowings outstanding under our \$500.0 million unsecured revolving credit facility that expires on April 30, 2012 (the "Facility"). The Facility permits the Company to borrow at interest rates based upon a margin above the London Inter-Bank Offered Rate ("LIBOR"), which margin varies with the ratio of total funded debt to earnings before interest, taxes, depreciation and amortization ("EBITDA") as defined in the Facility. These interest rates also vary as LIBOR varies. We pay a commitment fee on the unused amount of the Facility, which also varies with the ratio of our total debt to our EBITDA.

On June 16, 2008, the Company entered into a Term Loan Agreement ("Term Loan") with certain financial institutions, whereby the Company borrowed an aggregate principal amount of \$165.0 million. The Term Loan matures in June 2013, and borrowings under the Term Loan generally bear interest at a variable rate equal to (i) a margin over the LIBOR, which margin varies depending on whether certain criteria are satisfied, or (ii) the alternate base rate as defined in the agreement. At June 28, 2008, the interest rate was based on a margin over LIBOR.

At June 28, 2008, there was \$250.0 million of senior notes (the "Notes") outstanding. The Notes were issued and sold in two series: \$150.0 million in Floating Rate Series 2007A Senior Notes, Tranche A, due August 23, 2014, and \$100.0 million in Floating Rate Series 2007A Senior Notes, Tranche B, due August 23, 2017. The Notes bear interest at a margin over LIBOR, which margin varies with the ratio of the Company's consolidated debt to consolidated EBITDA as defined in the Agreement. These interest rates also vary as LIBOR varies. The note Purchase Agreement (the "Agreement") permits the Company to issue and sell additional note series, subject to certain terms and conditions described in the Agreement, up to a total of \$600.0 million in combined Notes.

The Notes, the Term Loan and the Facility require us to meet specified financial ratios and to satisfy certain financial condition tests. We were in compliance with all debt covenants as of June 28, 2008.

In addition to the Facility, the Term Loan and the Notes, at June 28, 2008, we also had \$115.0 million of convertible senior subordinated debt outstanding at a fixed interest rate of 2.75%, and \$38.2 million of other debt.

As part of the 2008 acquisition of Hwada (see Note 3 of Notes to Condensed Consolidated Financial Statements), the Company assumed \$21.6 of short term notes payable to banks. At June 28, 2008, the balance of these notes payable was approximately \$21.8 million. The weighted average interest rate was 7.3% at June 28, 2008.

As of June 28, 2008, a foreign subsidiary of the Company had outstanding borrowings of \$5.0 million denominated in U.S. dollars. The borrowings were made under a \$15.0 million unsecured credit facility which expires in December 2008. The borrowings are short-term and bear interest at a margin over LIBOR.

## CRITICAL ACCOUNTING POLICIES

### Revenue Recognition

We recognized revenue when all of the following have occurred: an agreement of sale exists; pricing is determinable; collection is reasonably assured; and product has been delivered and acceptance has occurred according to contract terms.

We use contracts and customer purchase orders to determine the existence of an agreement of sale. We use shipping documents and customer acceptance, when applicable, to verify delivery. We assess whether the sale price is subject to refund or adjustment, and we assess collectibility based on the creditworthiness of the customer as well as the customer's payment history.

### Returns, Rebates and Incentives

Our primary incentive program provides distributors with cash rebates or account credits based on agreed amounts that vary depending on the end user or original equipment manufacturing (OEM) customer to whom our distributor ultimately sells the product. We also offer various other incentive programs that provide distributors and direct sale customers with cash rebates, account credits or additional products and services based on meeting specified program criteria. Certain distributors are offered a right to return product, subject to contractual limitations.

We record accruals for customer returns, rebates and incentives at the time of revenue recognition based primarily on historical experience. Adjustments to the accrual may be required if actual returns, rebates and incentives differ from historical experience or if there are changes to other assumptions used to estimate the accrual.



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### Impairment of Long-Lived Assets or Goodwill and Other Intangibles

We evaluate the recoverability of the carrying amount of long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be fully recoverable through future cash flows. We evaluate the recoverability of goodwill and other intangible assets with indefinite useful lives annually or more frequently if events or circumstances indicate that an asset might be impaired. We use judgment when applying the impairment rules to determine when an impairment is necessary. Factors that could trigger an impairment review include significant underperformance relative to historical or forecasted operating results, a significant decrease in the market value of an asset or significant negative industry or economic trends. We perform our annual impairment test in accordance with SFAS 142, "Goodwill and Other Intangible Assets."

### Retirement Plans

Approximately half of our domestic employees are covered by defined benefit pension plans with the remaining employees covered by defined contribution plans. Most of our foreign employees are covered by government sponsored plans in the countries in which they are employed. Our obligations under our domestic defined benefit plans are determined with the assistance of actuarial firms. The actuaries provide us with information and recommendations regarding such factors as withdrawal rates and mortality rates. The actuaries also provide us with information and recommendations from which management makes further assumptions on such factors as the long-term expected rate of return on plan assets, the discount rate on benefit obligations, and where applicable, the rate of annual compensation increases. Based upon the assumptions made, the investments made by the plans, overall conditions and movement in financial markets, particularly the stock market and how actual withdrawal rates, life-spans of benefit recipients, and other factors differ from assumptions, annual expenses and recorded assets or liabilities of these defined benefit plans may change significantly from year to year. Based on our annual review of actuarial assumptions as well as historical rates of return on plan assets and existing long-term bond rates, we set the long-term rate of return on plan assets at 8.25% and an average discount rate at approximately 6.5% for our defined benefit plans as of December 29, 2007.

### Income Taxes

We operate in numerous taxing jurisdictions and are subject to regular examinations by various U.S. Federal, state, and foreign jurisdictions for various tax periods. Our income tax positions are based on research and interpretations of the income tax laws and rulings in each of the jurisdictions in which we do business. Due to the subjectivity of interpretations of laws and rulings in each jurisdiction, the differences and interplay in tax laws between those jurisdictions as well as the inherent uncertainty in estimating the final resolution of complex tax audit matters, our estimates of income tax liabilities may differ from actual payments or assessments.

### Use of Estimates and Assumptions

The preparation of our condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States requires the use of estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the related disclosure of contingent assets and liabilities. Management bases its estimates on historical experience and on other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

### New Accounting Pronouncements

In May 2008, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position APB 14-1, "Accounting for Convertible Debt Instruments that May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement)" ("APB 14-1"), which requires that convertible debt securities, that upon conversion may be settled by the issuer fully or partially in cash, be split into a debt and equity component. APB 14-1 is effective for fiscal years (and interim periods) beginning after December 15, 2008 and must be applied retroactively to all past periods presented. The

Company will adopt APB 14-1 upon its effective date, which will have a material impact on the reported values of debt, equity and earnings per share.

In April 2008, the FASB issued FASB Staff Position (FSP) 142-3, "Determination of the Useful Life of Intangible Assets" ("FSP 142-3"). FSP 142-3 intends to improve the consistency between the useful life of a recognized intangible asset under SFAS 142, "Goodwill and Other Intangible Assets" and the period of expected cash flows used to measure the fair value of the asset under SFAS 141 (Revised 2007), "Business Combinations", which is applicable to us beginning in 2010. We are evaluating FSP 142-3 to determine the effect on our financial statements and related disclosures.

In March 2008, the FASB issued SFAS 161, "Disclosures about Derivative Instruments and Hedging Activities" ("SFAS 161"), which requires expanded disclosures about derivative instruments and hedging activities. SFAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008, with earlier adoption permitted. We are evaluating the new standard to determine its effect on our financial statements and related disclosures.

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In December 2007, the FASB issued SFAS 141 (Revised 2007), “Business Combinations” (“SFAS 141R”), effective prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. SFAS 141R establishes principles and requirements on how an acquirer recognizes and measures in its financial statements identifiable assets acquired, liabilities assumed, noncontrolling interest in the acquiree, goodwill or gain from a bargain purchase and accounting for transaction costs. Additionally, SFAS 141R determines what information must be disclosed to enable users of the financial statements to evaluate the nature and financial effects of the business combination. The Company will adopt SFAS 141R upon its effective date as appropriate for any future business combinations.

In December 2007, the FASB also issued SFAS 160, “Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51” (“SFAS 160”). SFAS 160 will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests (NCI) and classified as a component of equity. This new consolidation method will significantly change the accounting for transactions with minority interest holders. SFAS 160 is effective for fiscal years beginning after December 15, 2008. We have not yet determined the impact, if any, of SFAS 160 on our consolidated financial statements.

In February 2007, the FASB issued SFAS 159, “The Fair Value Option for Financial Assets and Financial Liabilities”, including an Amendment of FASB Statement No. 115 (“SFAS 159”). SFAS 159 permits entities to choose to measure many financial instruments and certain other items generally on an instrument-by-instrument basis at fair value that are not currently required to be measured at fair value. SFAS 159 is intended to provide entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The implementation of this standard did not have an impact on our consolidated financial position and results of operations.

In September 2006, the FASB issued SFAS 157, “Fair Value Measurements” (“SFAS 157”). SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. In February, 2008 the FASB issued FSP FAS 157-2, which delays the effective date of Statement 157 for all nonrecurring fair value measurements of nonfinancial assets and nonfinancial liabilities until fiscal years beginning after November 15, 2008. The Company is eligible for the delay as it has not previously adopted SFAS 157. The Company has chosen to partially adopt SFAS 157 (see Note 15 to Condensed Consolidated Financial Statements).

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk relating to the Company’s operations due to changes in interest rates, foreign currency exchange rates and commodity prices of purchased raw materials. We manage the exposure to these risks through a combination of normal operating and financing activities and derivative financial instruments such as interest rate swaps, commodity cash flow hedges and foreign currency forward exchange contracts.

The Company is exposed to interest rate risk on certain of its short-term and long-term debt obligations used to finance our operations and acquisitions. At June 28, 2008, net of interest rate swaps, we had \$395.4 million of fixed rate debt and \$172.8 million of variable rate debt, the latter subject to interest rate risk. As a result, interest rate changes impact future earnings and cash flows assuming other factors are constant. The Company utilizes interest rate swaps to manage fluctuations in cash flows resulting from exposure to interest rate risk on forecasted variable rate interest payments.

Details regarding the instruments, as of June 28, 2008, are as follows:

| Notional | Rate |
|----------|------|
|----------|------|

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| Instrument | Amount          | Maturity        | Paid | Rate<br>Received | Fair<br>Value<br>Gain<br>(Loss) |
|------------|-----------------|-----------------|------|------------------|---------------------------------|
| Swap       | \$150.0 million | August 23, 2014 | 5.3% | LIBOR (3 month)  | (\$8.3) million                 |
| Swap       | \$100.0 million | August 23, 2017 | 5.4% | LIBOR (3 month)  | (\$7.0) million                 |

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A hypothetical 10% change in our weighted average borrowing rate on outstanding variable rate debt at June 28, 2008, would result in a change in after-tax annualized earnings of approximately \$---0.4 million.

The Company periodically enters into commodity futures and options hedging transactions to reduce the impact of changing prices for certain commodities, such as copper and aluminum. Contract terms of commodity hedge instruments generally mirror those of the hedged item, providing a high degree of risk reduction and correlation.

We are also exposed to foreign currency risks that arise from normal business operations. These risks include the translation of local currency balances of foreign subsidiaries, intercompany loans with foreign subsidiaries and transactions denominated in foreign currencies. Our objective is to minimize our exposure to these risks through a combination of normal operating activities and the utilization of foreign currency contracts to manage our exposure on the transactions denominated in currencies other than the applicable functional currency. Contracts are executed with creditworthy banks and are denominated in currencies of major industrial countries. It is our policy not to enter into derivative financial instruments for speculative purposes. We do not hedge our exposure to the translation of reported results of foreign subsidiaries from local currency to United States dollars.

All hedges are recorded on the balance sheet at fair value and are accounted for as cash flow hedges, with changes in fair value recorded in accumulated other comprehensive income ("AOCI") in each accounting period. An ineffective portion of the hedge's change in fair value, if any, is recorded in earnings in the period of change. The impact due to ineffectiveness was immaterial for all periods included in this report.

The Company periodically enters into commodity futures and options hedging transactions to reduce the impact of changing prices for certain commodities such as copper and aluminum based upon certain firm commitments to purchase such commodities. These transactions are designated as cash flow hedges and the contract terms of commodity hedge instruments generally mirror those of the hedged item, providing a high degree of risk reduction and correlation. Derivative commodity assets of \$13.3 million are recorded in other current assets at June 28, 2008. Derivative commodity liabilities of \$6.1 million are recorded in other current liabilities at December 29, 2007. The unrealized gain (loss) on the effective portion of the contracts of \$8.3 million net of tax and (\$3.8) million net of tax, as of June 28, 2008 and December 29, 2007, was recorded in AOCI.

The Company uses a cash hedging strategy to protect against an increase in the cost of forecasted foreign currency denominated transactions. As of June 28, 2008, derivative currency assets of \$3.0 million and \$2.8 million are recorded in other current assets and other non-current assets, respectively. As of December 29, 2007, derivative currency assets of \$3.4 million and \$0.1 million (notional value of \$213.3 million) are recorded in other current assets and other non-current liabilities, respectively. The value of the effective portion of the contracts of \$3.7 million net of tax and \$2.1 million net of tax, as of June 28, 2008 and December 29, 2007, was recorded in AOCI.

The Company has LIBOR-based floating rate borrowings, which expose the Company to variability in interest payments due to changes in interest rates. The Company has entered into pay fixed/receive LIBOR-based floating interest rate swaps to manage fluctuations in cash flows resulting from interest rate risk. These interest rate swaps have been designated as cash flow hedges against forecasted LIBOR-based interest payments. As of June 28, 2008 and December 29, 2007, an interest rate swap liability of \$15.3 million and \$14.4 million was included in other non-current liabilities, respectively. The unrealized loss on the effective portion of the contracts of (\$9.5) million net of tax as of June 28, 2008 was recorded in AOCI.

The net AOCI balance of \$2.5 million gain at June 28, 2008 is comprised of \$10.2 million of net current deferred gains expected to be realized in the next year, and \$7.7 million of net non-current deferred losses. The impact of hedge ineffectiveness was immaterial for all periods presented.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures. The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures were effective to ensure that (a) information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and (b) information required to be disclosed by us in the reports we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Internal Control Over Financial Reporting. There were no changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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## PART II - OTHER INFORMATION

Items 3 and 5 are inapplicable and have been omitted.

## ITEM 1. LEGAL PROCEEDINGS

On April 26, 2007, the Company received notice that the U.S. Environmental Protection Agency (“U.S. EPA”) has filed an action against the Company in the United States District Court for the Northern District of Illinois seeking reimbursement of the U.S. EPA’s unreimbursed past and future remediation costs incurred in cleaning up an environmental site located near a former manufacturing facility of the Company in Illinois. In 1999, the Company and other parties identified as potentially responsible parties (“PRPs”) reached an agreement with the U.S. EPA to partially fund the costs of certain response actions taken with respect to this site. In 2004, the Company received communications from the U.S. EPA indicating that the Company was identified as one of three PRPs regarding additional remedial actions to be taken by the U.S. EPA at this site. In response, the Company provided to the U.S. EPA its environmental expert’s assessment of the site in 2004. The Company believes that it is not a PRP with respect to the site in question and intends to defend vigorously the associated claim. As of June 28, 2008 amounts that have been recorded in the Company’s financial statements related to this contingency are not material.

The Company is, from time to time, party to other lawsuits arising from its normal business operations. It is believed that the outcome of these other lawsuits will have no material effect on the Company’s financial position or its results of operations.

## ITEM 1A. RISK FACTORS

The business and financial results of the Company are subject to numerous risks and uncertainties. The risks and uncertainties have not changed materially from those reported in the 2007 Annual Report on Form 10-K.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table contains detail related to the repurchase of common stock based on the date of trade during the three months ended June 28, 2008.

| 2008<br>Fiscal<br>Month                | Total<br>Number<br>of Shares<br>Purchased | Average<br>Price Paid<br>per Share | Total Number of<br>Shares Purchased<br>as<br>Part of Publicly<br>Announced Plans<br>or<br>Programs | Maximum Number<br>of Shares that May<br>Be Purchased<br>Under the Plan or<br>Programs |
|--|---|------------------------------------|--|---|
| March 30,<br>2008 to<br>May 3,<br>2008 | -   | \$ -                               | -  | 2,115,900   |
| May 4,<br>2008 to<br>May 31,<br>2008   | 53,277                                    | \$ 43.64                           | -  | 2,115,900   |

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|  |        |   |   |           |
|--|--------|---|---|-----------|
| June 1,<br>2008 to<br>June 28,<br>2008 | - \$   | - | - | 2,115,900 |
| Total                                  | 53,277 |   | - |           |



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Under the Company's equity incentive plans, participants may pay the exercise price or satisfy all or a portion of the federal, state and local withholding tax obligations arising in connection with plan awards by electing to (a) have the Company withhold shares of common stock otherwise issuable under the award, (b) tender back shares received in connection with such award or (c) deliver other previously owned shares of common stock, in each case having a value equal to the exercise price or the amount to be withheld. During the three months ended June 28, 2008, there were 53,277 shares acquired in connection with equity incentive plans.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

(a) The Company held its Annual Meeting of Shareholders on April 28, 2008.

The Directors elected at the meeting and those continuing after the Annual Meeting:

|                     |                      |                    |
|---------------------|----------------------|--------------------|
| Class A Directors   | Class B Directors    | Class C Directors  |
| Dean A. Foate       | Christopher L. Doerr | Thomas J. Fischer  |
| G. Frederick Kasten | Mark J. Gliebe       | Rakesh Sachdev     |
| Henry W. Knueppel   | Curtis W. Stoelting  | Carol N. Skornicka |

(b) (1) The Shareholders voted for the election of the following Class C Directors to serve until the 2011 Annual Meeting of Shareholders:

|                    | Votes For  | Votes Against | Abstentions |
|--------------------|------------|---------------|-------------|
| Thomas J. Fischer  | 27,479,396 | 757,401       | 2,437       |
| Rakesh Sachdev     | 28,019,991 | 210,374       | 8,870       |
| Carol N. Skornicka | 27,981,188 | 251,489       | 6,558       |

(2) The proposal to ratify the appointment of Deloitte & Touche LLP as the company's independent registered public accounting firm for 2008 was approved by a vote of 27,932,226 Votes For, 300,045 Votes Against and 6,963 abstentions

ITEM 6. EXHIBITS

| Exhibit Number | Exhibit Description   |
|----------------|---|
| 31.1           | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.           |
| 31.2           | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.           |
| 32.1           | Certifications of the Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350. |

SIGNATURE

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

REGAL BELOIT CORPORATION

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(Registrant)

Date: August 1, 2008

By: /s/ David A. Barta  
David A. Barta  
Vice President and Chief Financial  
Officer  
(Principal Accounting and Financial  
Officer)

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