NN INC
Form 10-Q
May 10, 2010

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

FORM 10-Q

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

For the quarterly period ended March 31, 2010

OR

o 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 0-23486

NN, Inc.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Delaware | 62-1096725 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification Number) |

2000 Waters Edge Drive
Building C, Suite 12
Johnson City, Tennessee 37604
(Address of principal executive offices, including zip code)
(423) 743-9151
(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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

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

| | |
|---|---|
| Large accelerated filer o | Accelerated filer o |
| Non-accelerated filer x<br>(Do not check if a smaller reporting company) | Smaller reporting company o |

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

As of May 6, 2010, there were 16,516,924 shares of the registrant's common stock, par value $0.01 per share, outstanding.

NN, Inc.
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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

NN, Inc.
Consolidated Statements of Operations and Comprehensive Loss
(Unaudited)

| | Three Months Ended March 31, | |
|---|---|---|
| (In Thousands of Dollars, Except Per Share Data) | 2010 | 2009 |
| Net sales | $ 85,340 | $ 57,921 |
| Cost of products sold (exclusive of depreciation and amortization shown separately below) | 68,916 | 56,054 |
| Selling, general and administrative | 7,890 | 6,895 |
| Depreciation and amortization | 6,120 | 5,318 |
| Loss on disposal of assets | 1 | 14 |
| Restructuring and impairment charges | 569 | 593 |
| Income (loss) from operations | 1,844 | (10,953 ) |
| | | |
| Interest expense | 1,728 | 1,038 |
| Reduction of unamortized debt issue cost | 130 | 604 |
| Other income, net | (1,188 ) | (120 ) |
| Income (loss) before provision (benefit) for income taxes | 1,174 | (12,475 ) |
| Provision (benefit) for income taxes | 949 | (2,950 ) |
| Net income (loss) | 225 | (9,525 ) |
| | | |
| Other comprehensive loss: | | |
| Foreign currency translation loss | (6,436 ) | (5,491 ) |
| Comprehensive loss | $ (6,211 ) | $ (15,016 ) |
| | | |
| Basic income (loss) per common share: | $ 0.01 | $ (0.59 ) |
| Weighted average shares outstanding | 16,309 | 16,268 |
| Diluted income (loss) per common share: | $ 0.01 | $ (0.59 ) |
| Weighted average shares outstanding | 16,405 | 16,268 |

The accompanying notes are an integral part of the financial statements.

NN, Inc.
Condensed Consolidated Balance Sheets
(Unaudited)

| (In Thousands of Dollars) | March 31, 2010 | December 31, 2009 |
|---|---|---|
| Assets | | |
| Current assets: | | |
| Cash | $ 5,779 | $ 8,744 |
| Accounts receivable, net of allowance for doubtful accounts of $510 and $473, respectively | 59,688 | 49,412 |
| Inventories, net | 33,192 | 33,275 |
| Income tax receivable | 2,930 | 3,196 |
| Other current assets | 3,213 | 3,656 |
| Total current assets | 104,802 | 98,283 |
| | | |
| Property, plant and equipment, net | 120,396 | 129,715 |
| Goodwill, net | 8,495 | 9,278 |
| Intangible assets, net | 1,325 | 1,506 |
| Other assets | 3,462 | 3,870 |
| Total assets | $ 238,480 | $ 242,652 |
| | | |
| Liabilities and Stockholders' Equity | | |
| Current liabilities: | | |
| Accounts payable | $ 39,333 | $ 38,048 |
| Accrued salaries, wages and benefits | 12,926 | 14,469 |
| Current maturities of long-term debt | 9,080 | 9,405 |
| Income taxes payable | 833 | -- |
| Other current liabilities | 7,691 | 6,567 |
| Total current liabilities | 69,863 | 68,489 |
| | | |
| Deferred tax liabilities | 2,995 | 3,558 |
| Long-term debt, net of current portion | 78,558 | 77,558 |
| Accrued pension and other | 13,391 | 14,308 |
| Other non-current liabilities | 1,915 | 1,936 |
| Total liabilities | 166,722 | 165,849 |
| | | |
| Total stockholders' equity | 71,758 | 76,803 |
| Total liabilities and stockholders' equity | $ 238,480 | $ 242,652 |

The accompanying notes are an integral part of the financial statements.

NN, Inc.
Consolidated Statements of Changes in Stockholders' Equity
(Unaudited)

| (In Thousands of Dollars and Shares) | Common Stock Number Of Shares | Par Value | Additional Paid in Capital | Retained Earnings | Accumulated Other Comprehen-sive Income | Total |
|---|---|---|---|---|---|---|
| Balance, January 1, 2010 | 16,268 | $ 163 | $49,861 | $259 | $26,520 | $76,803 |
| Net Income | -- | -- | -- | 225 | -- | 225 |
| Stock option expense | -- | -- | 65 | -- | -- | 65 |
| Stock compensation expense | 249 | 3 | 1,098 | -- | -- | 1,101 |
| Financial statement translation loss | -- | -- | -- | -- | (6,436 ) | (6,436 ) |
| Balance, March 31, 2010 | 16,517 | $ 166 | $51,024 | $484 | $20,084 | $71,758 |

The accompanying notes are an integral part of the financial statements.

NN, Inc.
Consolidated Statements of Cash Flows
(Unaudited)

| | Three Months Ended March 31, | |
|---|---|---|
| (In Thousands of Dollars) | 2010 | 2009 |
| Operating Activities: | | |
| Net income (loss) | $ 225 | $ (9,525 ) |
| Adjustments to reconcile net income (loss) to net cash used by operating activities: | | |
| Depreciation and amortization | 6,120 | 5,318 |
| Amortization of debt issue costs | 359 | 133 |
| Reduction of unamortized debt issue cost | 130 | 604 |
| Loss on disposal of property, plant and equipment | 1 | 14 |
| Deferred income tax | (20 ) | -- |
| Compensation expense from issuance of stock and incentive stock options | 1,166 | 106 |
| Non-cash interest and other expenses | -- | 38 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (11,941 ) | 6,582 |
| Inventories | (860 ) | 9,354 |
| Accounts payable | 2,933 | (11,351 ) |
| Other assets and liabilities | 1,689 | (2,992 ) |
| Net cash used by operating activities | (198 ) | (1,719 ) |
| | | |
| Investing Activities: | | |
| Acquisition of property, plant and equipment | (1,415 ) | (2,748 ) |
| Proceeds from disposals of property, plant and equipment | -- | 508 |
| Net cash used by investing activities | (1,415 ) | (2,240 ) |
| | | |
| Financing Activities: | | |
| Proceeds from (repayment of) short-term debt | (325 ) | 116 |
| Principal payment on capital lease | (14 ) | (12 ) |
| Proceeds from long term debt | 1,000 | 4,000 |
| Debt issuance cost paid | (391 ) | (2,240 ) |
| Net cash provided by financing activities | 270 | 1,864 |
| | | |
| Effect of exchange rate changes on cash | (1,622 ) | (793 ) |
| | | |
| Net Change in Cash | (2,965 ) | (2,888 ) |
| Cash at Beginning of Period | 8,744 | 11,052 |
| Cash at End of Period | $ 5,779 | $ 8,164 |
| | | |
| Supplemental schedule of non-cash investing and financing activities: | | |
| Reduced note payable to customer with offsetting reduction to accounts receivable ($298 in 2009) | $ -- | $ 260 |

and an increase to interest expense ($38 in 2009)

The accompanying notes are an integral part of the financial statements.

NN, Inc.
Notes To Consolidated Financial Statements
(In Thousands, Except Per Share Data)
(unaudited)

Note 1. Interim Financial Statements

The accompanying consolidated financial statements of NN, Inc. have not been audited, except that the balance sheet at December 31, 2009 is derived from the Company's consolidated audited financial statements. In the opinion of the Company's management, the financial statements reflect all adjustments necessary to fairly state the results of operations for the three month periods ended March 31, 2010 and 2009, the Company's financial position at March 31, 2010 and December 31, 2009, and the cash flows for the three month periods ended March 31, 2010 and 2009. These adjustments are of a normal recurring nature and are, in the opinion of management, necessary for fair statement of the financial position and operating results for the interim periods. As used in this Quarterly Report on Form 10-Q, the terms "NN", "the Company", "we", "our", or "us" mean NN, Inc. and its subsidiaries.

Certain information and footnote disclosures normally included in the consolidated financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted from the interim financial statements presented in this Quarterly Report on Form 10-Q. These unaudited, condensed and consolidated financial statements should be read in conjunction with our audited consolidated financial statements and the notes thereto included in our most recent annual report on Form 10-K for the year ended December 31, 2009 which we filed with the Securities and Exchange Commission on March 31, 2010.

The Company experienced a significant loss of revenue and sustained significant loss of income during the global economic recession that began to impact the Company in the fourth quarter of 2008 through the year ended December 31, 2009. During this time frame, the Company sustained a significant weakening of its financial condition. During the first quarter of 2010, the effects of the global recession on our Company appear to be lessening significantly. The lenders have reestablished covenant levels that provide little flexibility in the case that the Company's projections are not met (although at the date of this report we are in compliance with all such covenants). There is a substantial risk that if projections are not achieved, the lenders may not amend the credit agreements, which would accelerate the due date of the loans, putting the Company in default. Given the recent improvement in the financial performance of the Company, it is less likely we will be in default and it is more probable that new lenders could be found to replace the existing lenders. However, we can provide no assurances that new lenders could be found, and in the event the default is not cured, the Company would be technically insolvent and would need to seek a recapitalization of the Company. If such transaction could not be successfully completed, the Company could possibly have to seek protection under bankruptcy laws in the U.S. and other jurisdictions.

The results for the three month period ended March 31, 2010 are not necessarily indicative of results for the year ending December 31, 2010 or any other future periods.

Note 2. Restructuring Charges and Other

During the first quarter of 2010, we announced the closure of the Tempe (Arizona) Plant. The closure will impact approximately 130 employees. Current economic conditions coupled with the long-term manufacturing strategy for our Whirlaway business necessitated a consolidation of our manufacturing resources in Ohio. We expect to incur cash charges of approximately $2,500 in severance, equipment relocation and other closing costs during 2010 related to this closure. In addition, we expect to incur up to $3,000 in accelerated depreciation during 2010 related to machinery that will cease to be used and be abandoned as part of the closure. During the three month period ended March 31, 2010, we accrued $533 of severance cost related to the closure. The severance costs are being recognized over the period from the announcement date until the employees' termination date. Also, during the first quarter, we incurred

$1,000 of accelerated depreciation related to assets that will cease to be used and be abandoned as of part of the Tempe Plant closure expected to be completed during 2010.

On November 26, 2008, we announced the closure of our Kilkenny (Ireland) Plant. The closure affected 68 employees and was completed in 2009. During the three month periods ended March 31, 2010 and 2009, we recorded restructuring charges of $36 and $463 related to site closure costs and relocation of equipment and inventory from this location to other facilities within the Metal Bearing Components Segment.

NN, Inc.
Notes To Consolidated Financial Statements
(In Thousands, Except Per Share Data)
(unaudited)

During the first quarter of 2009, the Hamilton (Ohio) Plant was closed. This closure affected 11 employees and $130 in severance and other associated closure costs were incurred during the first quarter of 2009. Of this amount, $108 was for employee severance cost which was paid in the second quarter of 2009.

During the third quarter of 2009, we informed our employees of the Veenendaal (The Netherlands) Plant of our intention to begin a reorganization of the plant's labor force which covered the elimination of 53 permanent positions or 17% of the workforce at a cost of $3,849 due to the economic downturn. The majority of the severance cost was paid out during the fourth quarter of 2009 and first quarter of 2010 and we did not incur any restructuring costs for this location during the three month period ended March 31, 2010.

The following table summarizes the 2010 activity related to the four restructuring programs discussed above:

| (In Thousands of Dollars) | Reserve Balance at 1/01/10 | Charges | Paid in 2010 | Currency Impacts | Reserve Balance at 03/31/2010 |
|---|---|---|---|---|---|
| Severance and other employee costs | $ 2,382 | $ 533 | $ (1,701) | $ (102) | $ 1,112 |
| Site closure and other associated cost | $ -- | $ 36 | $ (36) | $ -- | $ -- |
| Total | $ 2,382 | $ 569 | $ (1,737) | $ (102) | $ 1,112 |

The Severance and other employee costs are reported within the Accrued salaries, wages and benefits line of the Condensed Consolidated Balance Sheets.

## Note 3. Inventories

Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out method.

Inventories are comprised of the following (in thousands):

| | March 31, 2010 | December 31, 2009 |
|---|---|---|
| Raw materials | $ 9,807 | $ 9,742 |
| Work in process | 7,711 | 7,234 |
| Finished goods | 17,255 | 17,963 |
| Less inventory reserves | (1,581) | (1,664) |
| | $ 33,192 | $ 33,275 |

Inventories on consignment at customer locations as of March 31, 2010 and December 31, 2009 totaled $3,959 and $3,018, respectively.

The inventory valuations above were developed using normalized production capacities for each of our manufacturing locations. Any costs from abnormal excess capacity or under-utilization of fixed production overheads are expensed in the period incurred and are not included as a component of inventory valuation.

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NN, Inc.
Notes To Consolidated Financial Statements
(In Thousands, Except Per Share Data)
(unaudited)

Note 4. Net Income (Loss) Per Share

| (In Thousands of Dollars, Except Per Share Data) | Three months ended March 31, 2010 | Three months ended March 31, 2009 |
|---|---|---|
| Net income (loss) | $ 225 | $ (9,525 ) |
| Weighted average basic shares outstanding | 16,309 | 16,268 |
| Effect of dilutive stock options | 96 | -- |
| Weighted average dilutive shares outstanding | 16,405 | 16,268 |
| Basic net income (loss) per share | $ 0.01 | $ (0.59 ) |
| Diluted net income (loss) per share | $ 0.01 | $ (0.59 ) |

Excluded from the dilutive shares outstanding for the three month period ended March 31, 2010 were 1,132 anti-dilutive options which had exercise prices ranging from $4.42 to $12.62. Excluded from the dilutive shares outstanding for the three month period ended March 31, 2009 were 1,416 anti-dilutive options which had exercise prices ranging from $1.30 to $12.62.

Note 5. Segment Information

The segment information and the accounting policies of each segment are the same as those described in the "Segment Information" note and the "Summary of Significant Accounting Policies and Practices" note, respectively, in our annual report on Form 10-K for the fiscal year ended December 31, 2009. We evaluate segment performance based on segment net income or loss after income taxes. We account for inter-segment sales and transfers at current market prices. We did not have any significant inter-segment transactions during the three month periods ended March 31, 2010 and 2009.

| (In Thousands of Dollars) | Metal Bearing Components Segment | Precision Metal Components Segment | Plastic and Rubber Components Segment | Corporate and Consolidations | Total |
|---|---|---|---|---|---|
| Three Months ended March 31, 2010 | | | | | |
| Revenues from external customers | $ 62,023 | $ 13,594 | $ 9,723 | $ -- | $ 85,340 |
| Segment net income (loss) | $ 5,034 | $ (1,907 ) | $ 700 | $ (3,602 ) | $ 225 |

| | | | | | |
|---|---|---|---|---|---|
| Total assets | $ 184,418 | $ 30,722 | $ 18,930 | $ 4,410 | $ 238,480 |
| | | | | | |
| Three Months ended March 31, 2009 | | | | | |
| Revenues from external customers | $ 39,329 | $ 11,507 | $ 7,085 | $ -- | $ 57,921 |
| | | | | | |
| Segment net loss | $ (6,540 ) | $ (838 ) | $ (617 ) | $ (1,530 ) | $ (9,525 ) |
| | | | | | |
| Total assets | $ 192,480 | $ 34,769 | $ 20,308 | $ 9,949 | $ 257,506 |

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NN, Inc.

Notes To Consolidated Financial Statements
(In Thousands, Except Per Share Data)
(unaudited)

Note 6. Pensions

We have a defined benefit pension plan covering the employees at our Eltmann Plant. The plan is unfunded. There were no prior service costs recognized in the three months ended March 31, 2010 and 2009. We incurred $68 and $64 of interest cost during the three months ended March 31, 2010 and 2009 and expect to contribute approximately $280 to the Eltmann Plant pension plan in 2010. As of March 31, 2010, approximately $68 of contributions had been made.

Severance Indemnity

In accordance with Italian law, the Company has an unfunded severance plan covering our Pinerolo Plant employees under which all employees at that location are entitled to receive severance indemnities upon termination of their employment. The table below summarizes the changes to the severance indemnity for the three month periods ended March 31, 2010 and 2009:

| | Three months ended March 31, | |
|---|---|---|
| (In Thousands of Dollars) | 2010 | 2009 |
| Beginning balance | $ 8,015 | $ 8,073 |
| Amounts accrued | 297 | 241 |
| Payments to employees | (95) | (165) |
| Payments to government managed plan | (214) | (179) |
| Currency impacts | (515) | (398) |
| Ending balance | $ 7,488 | $ 7,572 |

Service and Early Retirement Provisions

We have two plans that cover our Veenendaal Plant employees. One provides an award for employees who achieve 25 or 40 years of service and the other is an award for employees upon retirement. These plans are both unfunded and the benefits are based on years of service and rate of compensation at the time the award is paid. The table below summarizes the changes in the two plans combined during the three month periods ended March 31, 2010 and 2009.

| | Three months ended March 31, | |
|---|---|---|
| (In Thousands of Dollars) | 2010 | 2009 |
| Beginning balance | $ 805 | $ 852 |
| Service cost | 19 | 11 |
| Interest cost | 37 | 16 |
| Benefits paid | (40) | (14) |
| Currency impacts | (53) | (41) |
| Ending balance | $ 768 | $ 824 |

Note 7. New Accounting Pronouncements

As of March 31, 2010, there are no new accounting pronouncements that are expected to affect the Company.

NN, Inc.
Notes To Consolidated Financial Statements
(In Thousands, Except Per Share Data)
(unaudited)

Note 8. Long-Term Debt and Short-Term Debt

Long-term debt at March 31, 2010 and December 31, 2009 consisted of the following:

| | March 31, 2010 | December 31, 2009 |
|---|---|---|
| Borrowings under our $85,000 revolving credit facility bearing interest at a floating rate equal to LIBOR (0.29% at March 31, 2010) plus an applicable margin of 4.75%, expiring September 20, 2011. | $ 59,067 | $ 58,392 |
| Borrowings under our $40,000 aggregate principal amount of senior notes bearing interest at a fixed rate of 8.50% maturing on April 26, 2014. Annual principal payments of $5,714 began on April 26, 2008 and extend through the date of maturity. | 28,571 | 28,571 |
| Total debt | 87,638 | 86,963 |
| Less current maturities of long-term debt | 9,080 | 9,405 |
| Long-term debt, excluding current maturities of long-term debt | $ 78,558 | $ 77,558 |

During the first quarter of 2010, we amended both the revolving credit facility and the senior notes. The primary purpose of these amendments was to re-establish covenant levels through the expiration of the revolving credit facility in September 2011 to reflect our current business outlook. The primary financial covenants are the same for both credit agreements through September 2011, the expiration of the revolving credit facility. After September 2011, the covenants for the senior note agreement revert back the covenants in the original agreement. It is likely the covenant levels of the senior note agreement in 2012 through 2014 may no longer be appropriate for our business at that time and these covenant levels may need to be renegotiated in the future.

As a result of the amendments, the revolving credit facility was reduced to $85,000 from $90,000 as of the amendment date, and it will reduce further by $1,000 at the end of each of the three fiscal quarters beginning with the December 31, 2010 quarter end and ending with the June 30, 2011 quarter end, after which the total commitment will be $82,000. Neither the commitment amount nor the payment terms of the senior notes were changed. The amendments provided a restriction on restructuring of foreign subsidiaries and removed certain subsidiaries from participation in the credit agreement. Also as a result of the amendments, the interest rate was amended to LIBOR plus an applicable margin of 4.75% from an applicable margin of 4.00%. The interest rate on the senior notes was not changed and remains at 8.5%. Due to the reduction in the credit availability of the revolving credit facility, $130 in unamortized debt issuance costs from the 2009 revolving credit facility amendment were eliminated during the first quarter of 2010.

In relation to entering into the amended and restated credit agreements mentioned above, we forecasted levels of revenue and cash flow from operations in 2010 versus 2009 based on our recent sales levels, current economic conditions, published economic forecasts and input from our major customers that are lower levels than our normalized historical results prior to the onset of the global recession in the fourth quarter of 2008. These forecasts were used to set new financial and operating covenants in our amended credit facilities through September 2011. However, further deterioration of market conditions and sales levels in excess of our forecasts for revenue and cash flow could result in the Company failing to meet these covenants, which could cause a material adverse impact on our liquidity and financial position. We can provide no assurances we will be in compliance with the existing covenants for the remainder of 2010 through September 2011. The specific covenants to which we are subject, and the actual results achieved for the three month period ended March 31, 2010 are stated below.

NN, Inc.
Notes To Consolidated Financial Statements
(In Thousands, Except Per Share Data)
(unaudited)

(In Thousands of Dollars)

| Financial Covenants | Required Covenant Level | Actual Level Achieved |
|---|---|---|
| Interest coverage ratio | Not to be less than 0.42 to 1.00 for the period ending March 31, 2010 | 0.91 to 1.00 |
| Funded indebtedness to capitalization ratio | Not to exceed 0.60 to 1.00 through June 29, 2010 | 0.56 to 1.00 |
| Minimum EBITDA | Not to be less than $603 for the most recently completed four fiscal quarters ending March 31, 2010 | $5,937 |
| Capital expenditures | Not to exceed $5,015 for the fiscal quarter ending March 31, 2010 | $1,415 |
| Minimum asset coverage ratio | Not to be less than 1.05 to 1.00 | 1.57 to 1.00 |

Note 9. Goodwill

The changes in the carrying amount of goodwill for the three month period ended March 31, 2010 are as follows:

Goodwill

| (In Thousands of Dollars) | Metal Bearing Components Segment |
|---|---|
| Balance as of January 1, 2010 | $ 9,278 |
| Currency impacts | (783 ) |
| Balance as of March 31, 2010 | $ 8,495 |

The goodwill balance is tested for impairment on an annual basis during the fourth quarter and between annual tests if a triggering event occurs. During the three month period ended March 31, 2010, the actual financial results of the remaining reporting unit with a goodwill balance were consistent with the forecasted results used in testing for impairment at December 31, 2009. Thus, as of March 31, 2010, there are no further indications of impairment at this reporting unit.

Note 10. Intangible assets subject to amortization, net of amortization

| (In Thousands of Dollars) | Metal Bearing Components Segment |
|---|---|
| Balance as of January 1, 2010 | $ 606 |
| Amortization | (146 ) |
| Currency impacts | (35 ) |
| Balance as of March 31, 2010 | $ 425 |

Within the Metal Bearing Components Segment, the intangible asset is a contract intangible. This intangible asset was subject to amortization over approximately five years starting in 2006 and amortization expense was to approximate $500 for each of the five years. For the three months ended March 31, 2010, the amortization expense totaled $146, and accumulated amortization totaled $2,317 at March 31, 2010.

The Precision Metal Components Segment has an intangible asset not subject to amortization of $900 related to the value of the trade names of Whirlaway.

NN, Inc.
Notes To Consolidated Financial Statements
(In Thousands, Except Per Share Data)
(unaudited)

Note 11. Stock Compensation

In the three month period ended March 31, 2010 and 2009, approximately $1,166 and $106, respectively, of compensation expense was recognized in selling, general and administrative expense for all share-based awards. On March 17, 2010, we granted 249 shares and 26 share options to non-executive directors, officers and certain other key employees.

We issued the aforementioned 249 shares of our common stock under our 2005 stock incentive plan. The shares were issued on March 17, 2010 and were fully vested at the date of grant. We incurred $1,101 of non-cash compensation expense, which was the entire cost of the grant, at that date. The fair value of the shares issued was determined by using the grant date price of our common stock.

We incurred $65 and $106 in stock option expense in the three month periods ended March 31, 2010 and 2009, respectively. The fair value of the options cannot be determined by market value, as our options are not traded in an open market. Accordingly, a financial pricing model is utilized to determine fair value. The Company utilizes the Black Scholes model which relies on certain assumptions to estimate an option's fair value.

The following table provides a reconciliation of option activity for the three month period ended March 31, 2010:

| Options | Shares (000) | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term | Aggregate Intrinsic Value ($000) |
|---|---|---|---|---|
| Outstanding at January 1, 2010 | 1,391 | $ 9.23 | | |
| Granted | 26 | $ 4.42 | | |
| Forfeited or expired | (53) | $ 11.56 | | |
| Outstanding at March 31, 2010 | 1,364 | $ 9.05 | 5.6 | $ (4,838) (1) |
| Exercisable at March 31, 2010 | 1,147 | $ 9.82 | 5.0 | $ (4,953) (1) |

(1) The negative intrinsic value is the amount by which the exercise price of each individual option grant was greater than the market price of the stock at March 31, 2010.

Note 12. Provision for Income Taxes

During the three month period ended March 31, 2010, we continued to place a valuation allowance on all of the deferred tax assets of our U.S. locations, based on the recent negative financial performance of our U.S. operations during the global economic recession of 2008 and 2009. The determination to place a valuation allowance on the tax benefits incurred by our U.S. based operations was made based upon the fact that second quarter and cumulative 2009 results of these entities were much more unfavorable than originally forecasted. If U.S. operations return to a level of profitability sufficient to utilize these deferred tax assets, they will be used to offset future U.S. based taxable income. If we determine that this is more likely than not, a deferred tax benefit will be recognized.

For the three month period ended March 31, 2010, the difference between the U.S. federal statutory tax rate of 34% and our effective tax rate of 82%, was mainly due to the valuation allowance placed on deferred taxes at our U.S. locations as discussed above. In addition, we did not recognize tax benefits at four international locations in which we operate. Prior to 2009, valuation allowances were placed on the net deferred tax assets at these foreign locations. Finally, the effective rate was impacted by non-U.S. based earnings taxed at lower rates. The statutory and effective income tax rates in many of the foreign countries in which we operate are lower than the U.S. federal rate. The table below summarizes the impacts on the effective tax rate for the three months period ended March 31, 2010 and 2009.

NN, Inc.
Notes To Consolidated Financial Statements
(In Thousands, Except Per Share Data)
(unaudited)

| (In Thousands of Dollars) | Three Months ended March 31, 2010 | Three Months ended March 31, 2009 |
|---|---|---|
| Income tax provision (benefit) at the federal statutory rate of 34% | $ 399 | $ (4,241) |
| Applied U.S. valuation allowance | 910 | -- |
| Non-U.S. earnings taxed at lower rates | (387) | 1,336 |
| Other differences | 27 | (45) |
| Provision (benefit) for income taxes | $ 949 | $ (2,950) |

We do not foresee any significant changes to our unrecognized tax benefits within the next twelve months.

Note 13. Commitments and Contingencies

During 2006, we received correspondence from the Environmental Protection Agency ("EPA") requesting information regarding a former waste recycling vendor ("AER") used by our former Walterboro, South Carolina facility. AER, located in Augusta, Georgia, ceased operations in 2000 and EPA began investigating its facility. As a result of AER's operations, soil and groundwater became contaminated. Besides us, EPA initially contacted fifty-four other companies ("Potentially Responsible Parties" or PRPs") who also sent waste to AER. Most of these PRPs, including us, have entered into a consent order with EPA to investigate and remediate the site proactively. To date, the PRP Group has submitted a Remedial Investigation, which has been accepted by EPA. In addition, a Feasibility Study has been substantially approved by EPA. Once approved, costs associated with the chosen remediation can be assessed and the PRPs can discuss allocation of the overall cost. As of the date hereof, we do not know the amount of our allocated share.

All other legal matters are of an ordinary and routine nature and are incidental to our operations. Management believes that such proceedings should not, individually or in the aggregate, have a material adverse effect on our business or financial condition or on the results of operations.

Due to the impacts of the global economic recession and the resulting reduction in revenue and operating losses, our Eltmann, Germany Plant could reach a point of technical insolvency or illiquidity within the next 12 to 24 months. If this occurs, local laws could require the subsidiary to file for bankruptcy unless we provide additional support in the form of financial guarantees or additional funding of operations. During the first quarter of 2010, we took certain actions in this regard including subordination of certain intercompany obligations and committing to additional equity contributions under certain circumstances. If in the future the Eltmann Plant should be required to file for bankruptcy, we could potentially lose the value of the assets of Eltmann of approximately $8,016 at March 31, 2010 but could also be released from certain liabilities totaling $8,333 at March 31, 2010. We believe that in the event of bankruptcy, there could be a temporary disruption of normal product flow to customers, but that it is unlikely that such an event would have a long-term significant impact given the current level of excess capacity within our European plants.

Note 14. Property Plant and Equipment

During the first quarter of 2010, we incurred $1,000 of accelerated depreciation related to assets that will cease to be used and be abandoned as of part of the Tempe Plant closure expected to be completed during 2010.

During the first quarter of 2009, the land and building of the former Hamilton, Ohio Plant of the Precision Metal Components Segment was sold for proceeds of $508, which resulted in no gain or loss from sale.

NN, Inc.
Notes To Consolidated Financial Statements
(In Thousands, Except Per Share Data)
(unaudited)

Note 15. Fair Value of Financial Instruments

The fair value of the Company's fixed rate long-term borrowings is calculated by use of a discounted cash flow analysis factoring in current market borrowing rates for similar types of borrowing arrangements under our credit profile. The current market borrowing rates are Level 2 inputs under the U.S. GAAP fair value hierarchy. The carrying amounts and fair values of the Company's long-term debt are in the table below:

| | March 31, 2010 | | December 31, 2009 | |
|---|---|---|---|---|
| (In Thousands of Dollars) | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Variable rate short-term debt | $ 59,067 | $ 59,067 | $ 58,392 | $ 58,392 |
| Fixed rate short-term debt | $ 28,571 | $ 27,999 | $ 28,571 | $ 27,787 |

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

Risk Factors

Our risk factors are disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2009 under Item 1.A. "Risk Factors." There have been no material changes to these risk factors since December 31, 2009.

Economic Impacts on the three month period ended March 31, 2010

During the three month period ended March 31, 2010, sales showed significant improvement from the dramatic reductions witnessed in the first quarter of 2009 due to the worldwide recession. Sales increased 43% for the three month period ended March 31, 2010 from the three month period ended March 31, 2009, excluding the effects of exchange rates. For the three month period ended March 31, 2010, sales were up approximately 13% compared to the sales in the fourth quarter of 2009, excluding the effects of exchange rates.

We believe the increase in sales that occurred during the first quarter of 2010 versus the first quarter of 2009, was due both to customers adopting more normalized ordering patterns and increased demand in the end markets we serve. It is unclear what portion of the increase was due to customer ordering patterns versus market demand. We believe during 2009, demand for our products had decreased more than actual demand in the end markets we serve. We referred to this as the "de-stocking effect" and believed it was due to reduction in overall inventory levels throughout the supply chain. We are uncertain to what extent the change of overall stock levels within the supply chains we serve had on the first quarter of 2010. Furthermore, we are unsure to what extent our customers' demand in the remaining quarters of 2010 will be affected by the management of inventory levels within the supply chain.

The 43% increase in sales volume was the main driver of the improvement in net income during the three month period ended March 31, 2010. Despite the increase in sales volume during the first quarter of 2010, we continued to aggressively manage employment levels, production levels, and discretionary spending.

Results of Operations

Three Months Ended March 31, 2010 Compared to the Three Months Ended March 31, 2009.

OVERALL RESULTS

| | NN, Inc. | | | |
|---|---|---|---|---|
| (In Thousands of Dollars) | 2010 | 2009 | Change | |
| Net sales | $ 85,340 | $ 57,921 | $ 27,419 | |
| Foreign exchange effects | | | | 2,403 |
| Volume | | | | 29,144 |
| Price | | | | (265 ) |
| Mix | | | | (2,758 ) |
| Material inflation pass-through | | | | (1,105 ) |
| | | | | |
| Cost of products sold (exclusive of depreciation and amortization shown separately below) | 68,916 | 56,054 | 12,862 | |
| Foreign exchange effects | | | | 2,059 |
| Volume | | | | 15,666 |
| Cost reduction | | | | (2,066 ) |