Growth in the Gear Industry

A SUPPLIER'S PERSPECTIVE

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Between the roller coaster ride of the manufacturing economy and the way companies continually change how they conduct business, our industry has seen a lot of change over the past five years.

Barit International Corp. is a company that started small, but continues to grow, even through adverse market conditions.

Barit started out in 1989 selling gear cutting tools. Since then, our company has seen some significant changes, including cutting ties with old vendors and the death of our company's founding president, Alex Polevoy, resulting in an overhaul of our leadership team and sales force. The significance of these events in conjunction with market trends has made for some very interesting observations.

Recently, we conducted a simple analysis, comparing our annual sales and number of orders received with the Dow Jones Index over the past five years. We understand that our analysis is not comprehensive. There are many subjective factors present, and our experience may not reflect what the rest of the industry has experienced. Nevertheless, we believe there is a definite correlation between the Dow Jones Index and the manufacturing sector.

Interestingly, the Dow Jones' worst years were 2001 and 2002, while for Barit the worst years were 2003 and 2004 (see chart 1).

Why did it take two years for Barit to catch up with the Dow Jones? During the time that the rest of the economy was on the rise, consumer confidence was also on the rise. Because of that, manufacturing production increased, demand for new machines increased, the demand for gears increased, and finally, the demand for gear cutting tools increased. As inventories of old tools started to deplete, new tools had to be ordered. As a result, Barit has seen one of the largest growth booms in its history.

Another factor we considered was the total sales volume placed with Barit on an annual basis. From 2002–2004, Barit saw a steady increase of 4% on average. However, in 2005, there was an incredible increase of 43% compared with 2004.

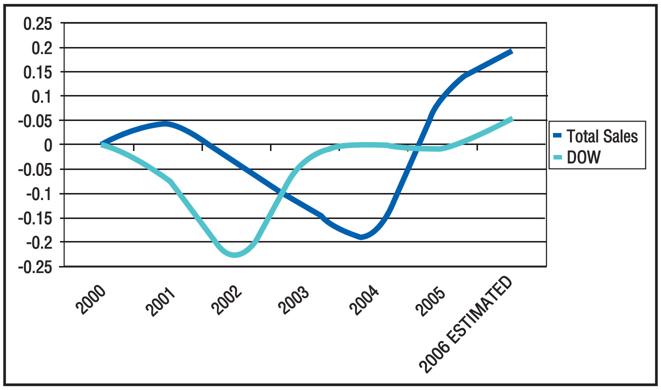

Chart 1 — Barit sales vs. Dow Jones.

Even though total earnings and overall sales increased, the total amount per order went down over that period.

The reason orders got smaller is because we are operating on a smaller margin due to competition. Companies are being careful about their spending and looking for cost-effective methods of manufacturing. For example, instead of buying a hob to cut 200 parts, a manufacturer might buy a milling cutter. This way the manufacturer saves a few dollars and cuts his operating costs to remain competitive.

Also, because of a tough market environment, cutting tool suppliers—including Barit—began to offer more aggressive pricing, even at a time when the price of high-speed steel was rising, and exchange rates and transportation costs were not in our favor. So volume went up, while profit margins went down.

Because we are a small company, we believe we are somewhat more sensitive to fluctuations in the marketplace. Orders—or lack of orders—from a small number of customers might have a big impact on our operation. On the other hand, we believe we're better able to weather the storm than some larger companies because of our lower overhead and ability to react quickly.

What we're seeing so far in 2006 is a slight decrease in the number of orders, but a slight increase in price and quantity per order (see chart 2). We are starting to see orders for greater dollar amounts and from larger customers with greater requirements.

Also, times are changing, and Barit is seeing more requests and orders from all over the world. In 2005, Barit's website received close to 6,500 visitors, with 30% of them coming from abroad.

In the 1990s, there were fewer companies selling gear cutting tools in the U.S. marketplace. Prices and margins were higher. What we see today is a healthy, competitive environment consisting of many companies, selling various product lines,

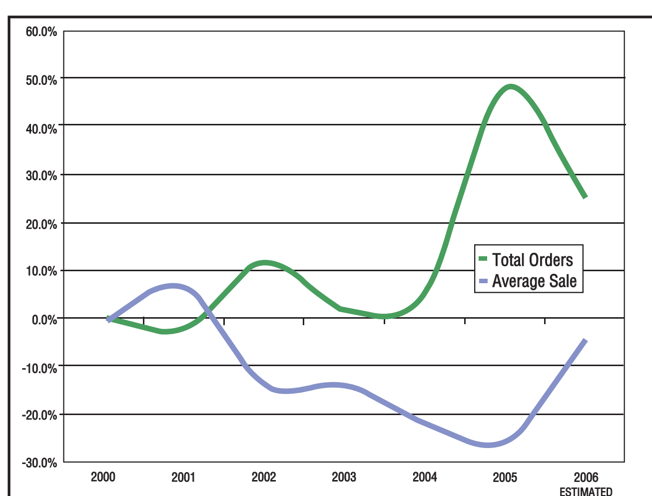

Chart 2 — Total orders and average amount per sale.

all competing for the same business. Consequently, prices are decreasing. So in order to maintain the competitive edge, companies need to differentiate themselves from the competition. That means customers need to know that, in the event of a problem, the vendor will be there to find a solution.

We look forward to meeting the new age of manufacturing head on. Being able to weather the storm made Barit stronger, more efficient and much more competitive, not only in the U.S. arena, but internationally as well. We believe it's important to maintain our core principles, regardless of what's happening in the market. For us, that means:

1.) Believe in the product(s) that we sell, and maintain a proven track record of quality and precision.
2.) Offer personalized customer service and solutions, including expert analysis and engineering services with specifically tailored solutions.
3.) Keep a competitive edge by being aware of new technologies and capabilities.
4.) Maintain a network of vendors, built on trust and reliability.
5.) Always think ahead. Anticipation and flexibility allow you to adapt with changing times.

Today we are seeing a lot of positive signs in the market and hope that the trends are not a fluke. With the Dow reaching a peak now, we will probably see another year or two years of stable business before we see further growth. In any case, we are living in very opportune times, and we hope that all the companies in the gear industry can embrace this exciting period with optimism, adventurous spirit and ambition. ■

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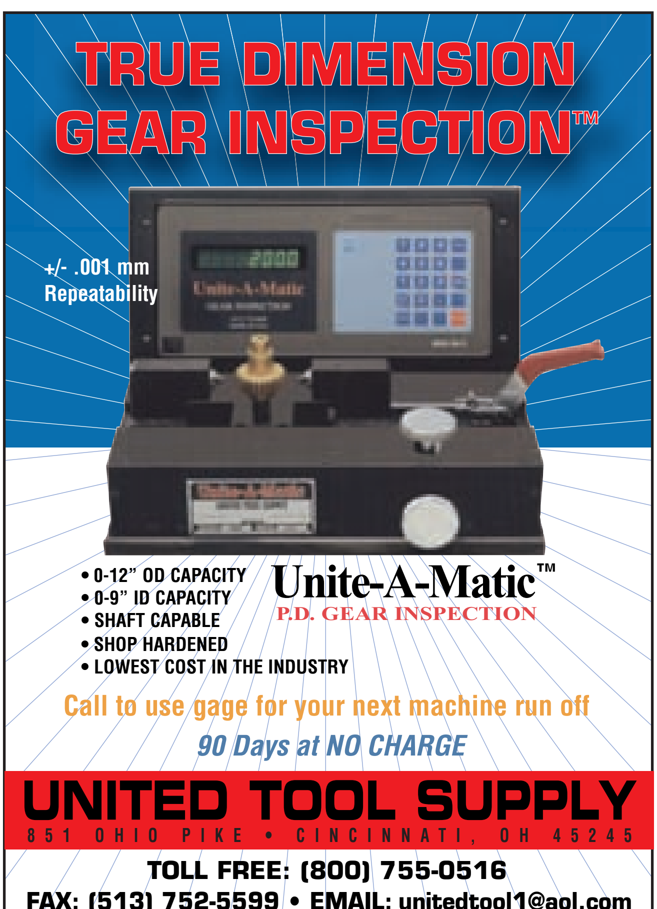

Nachi

OPENS TOOL FACILITY

Nachi-Fujikoshi of Japan announced the opening in May of a new cutting tool regrinding and coating facilities in Charlotte, NC.

"As a recent trend, manufacturers have been actively regrinding/recoating worn cutting tools whose accuracy has dropped, in order to reuse existing tools," Nachi said in its press release. "In the precision tooling industry, the regrinding/recoating market has even grown to a size comparable to the volumes of newly designed/manufactured tools."

Nachi Precision North Carolina Inc. will focus on regrinding and recoating precision tools mainly for automobile parts manufacturers and their suppliers in the Southeast.

"In addition to manufacturing/selling newly designed tools and providing various engineering know-how, Nachi-Fujikoshi has also been supplying regringing/recoating services at the request of certain large customers," the release says. Nachi will use its new facility "as a hub, along with other existing U.S. facilities, to launch full-scale engineering services to build the foundation for a new business."

Birkshire Hathaway

BUYS ISCAR

Berkshire Hathaway Inc. and Iscar Ltd. announced in May that Berkshire has agreed to acquire 80% of the Iscar Metalworking Companies (IMC) in a transaction that values IMC at $5 billion.

The Iscar Metalworking Companies is a privately held group, with operations worldwide, and a number of metal cutting tools business, including the Iscar, TaeguTec, Ingersoll and other IMC group companies. Upon completion of the transaction, Berkshire will own 80% of the business and the Wertheimer family, IMC's current shareholders, will own the remaining 20%. The transaction remains subject to customary closing conditions, including regulatory approvals, although the U.S. Federal Trade Commission has already cleared the transaction.

After becoming a part of the Berkshire family of businesses, IMC will continue to be managed by its current executives, including Chairman Eitan Wertheimer and President and Chief Executive Officer Jacob Harpaz, according to Berkshire's press release. IMC will remain headquartered in Tefen, Israel.

"We are delighted to partner with the Wertheimer family and IMC's current management," said Warren Buffett, Berkshire Hathaway chairman and chief executive officer. "As a truly international business, IMC is a top performer in its industry, with exposure to European, Asian and Latin American markets, as well as significant opportunities for growth as it continues to penetrate the North American market. My partner, Charlie Munger, and I have been impressed by IMC's simple and profitable business model. With this acquisition, we have the benefit of investing in a stable business with very significant growth prospects."

As a member of the Berkshire family, we'll have the benefit of a strong platform that's committed to continuing our historical success," Wertheimer said.

Regal-Beloit

SELLS CUTTING TOOLS UNIT

Regal-Beloit Corp. announced in May the completion of the sale of substantially all of the assets of its Regal Cutting Tools division to Korean cutting tools manufacturer YG-1.

"This is a very positive move for the Regal Cutting Tools business as it will be aligned with a world leading manufacturer and marketer of high speed and carbide rotary cutting tools," said Henry W. Knueppel, chairman and CEO of Regal-Beloit, in the company's press release.

"As we moved aggressively into motion control systems, electric motors and power generation over the past several years, the cutting tools business was no longer a strategic focus for us. We are pleased that a global, cutting tool-focused company has purchased the business and that we were able to agree to a structure that should benefit the employees, the community and the respective businesses."