Twin Disc, Inc.
Third Quarter 2008 Financial Results Conference Call
April 22, 2008

Operator: Good afternoon, ladies and gentlemen, and thank you for standing by. Welcome to the Twin Disc 2008 Third Quarter Financial Results conference call. During today's presentation all parties will be in a listen-only mode. Following the presentation the conference will be open for question. If you have a question please press the star followed by the one on your touch tone phone. This conference is being recorded Tuesday, April 22, 2008. I would now like to turn the conference over to Stan Berger of SM Berger. Please go ahead, sir.

Stan Berger: Thank you, Eric. On behalf of the management of Twin Disc we are extremely pleased that you have taken the time to participate in our call, and thank you for joining us to discuss the company's fiscal 2008 third quarter financial results and business outlook. Before I introduce management I would like to remind everyone that certain statements made during the course of this conference call, especially those that state management's intentions, hopes, beliefs, expectation, or predictions for the future are forward-looking statements. It is important to remember that the company's actual results could differ materially from those projected in such forward-looking statements. Additional information concerning factors that could cause actual results to differ materially from those in the forward-looking statements is contained in the company's annual report on Form 10-K, copies of which may be obtained by contacting in to the company or the SEC. By now you should have received a copy of the news release, which was issued this morning before the market opened. If you have not received a copy please call Pauline Collins at 262-638-4000 and she will send a copy to you. Hosting the call today are Michael Batten, Twin Disc Chairman, President, and Chief Executive Officer, and Christopher Eperjesy, the company's Vice President of Finance, Chief Financial Officer, and Treasurer. At this time I will turn the call over to Michael Batten. Mike?

Michael Batten: Thanks, Stan, and good afternoon to everyone. Welcome to our third quarter conference call. As Stan has indicated I will start with a brief statement and then both Chris and I will be available to answer questions.

Reported net sales for the quarter at $85.8 million were about equal to those recorded last year at 86.4 million. Year-to-date net sales totaled 241.3 million, up 6.6% from 226 million in the same period last year. Foreign currency translation impacted sales favorably in the third quarter and nine months by 6.6 million and 14.1 million respectively. Continued strength in our global markets for commercial marine and mega-yachts was offset by softness in oil and gas transmission and industrial markets. Net earnings for the third quarter were 7.9 million or $0.70 per diluted share compared with 7.5 million or $0.64 per diluted share for the same three months a year ago. Two favorable tax adjustments totaling 1.8 million were included in the third quarter. Approximately 1 million represented the impact of a recently enacted reduction in the Italian Corporate tax rate and the remainder reflected a favorable return to provision adjustment related primarily to foreign tax credits. Year-to-date net earnings totaled 17.2 million or $1.51 per diluted share, contrasted with 16.7 million or $1.43 per diluted share for the first nine months of last year.

Gross margins for the third quarter held at 31%, down from 32.6% reported in the same three months a year ago. Year-to-date gross margins were 31.4% down from 32.2% recorded in the same period last year. Third quarter profitability was impacted by lower volume, reduced sales of higher margin products, higher sales of lower margin products, and higher material costs. These were partially offset by higher pricing, expanded outsourcing, and lower pension expense.

The weakening of the US dollar versus the euro continues to put pressure on the sales of our Belgian operations, and their sales into the North American market. However, this situation has enhanced the competitiveness of our domestic operation in their sales of products overseas.

Marketing, engineering, and administrative expenses as a percentage of sales were 17.4% in the third quarter as contrasted to 18.4% a year ago. The reduction was driven primarily by a favorable adjustment for stock-based compensation in the amount of $2.3 million, that was partially offset by higher expenses due to foreign currency translation and the implementation of the company's new global ERP system. Year-to-date ME&A expenses were 19.5% of sales for both nine month fiscal periods.

We continue to invest in our business. In the third quarter we spent 3.8 million on cap ex and year-to-date the total is 10.6 million. We expect to spend another 5 million in the fourth quarter. We are comfortable with our balance sheet and capital structure. As of March 28th total debt was 57.4 million compared to 43.9 million at last fiscal year-end. Our total debt-to-capitalization ratio is at 30.9%.

Overall we are pleased with the results of the third quarter. They compare well against the same period last year, which was the best third quarter in the company's history. Demand for our commercial and high-end pleasure craft marine products continues to increase. Sales and orders for marine transmissions from the Pacific basin and the US Gulf Coast and marine propulsion boat management systems for the European mega-yacht market remains strong. Global demand for our marine product line has helped to offset the softness in our industrial and oil and gas transmission products, and augment growing demand in military and airport rescue and firefighting vehicles. Our six month backlog of orders has reached a record high. We are encouraged by recent order activity in both our industrial and oil and gas transmission markets. We expect that our foreign sales will exceed domestic sales this year and have a stabilizing effect on revenues. In addition, we remain focused on lowering our operating cost, continuing to develop and enhance our product portfolio, and modernizing our manufacturing operations as well as expanding our global outsourcing program. The final three months should be another good quarter, and we remain optimistic about the fiscal year 2009.

That concludes the prepared remarks for today, and Eric, Chris and I are ready to take questions.

Operator: Thank you, sir. Ladies and gentlemen, we will now begin the question-and-answer session. As a reminder, if you have a question, please press the star followed by the one on your touch tone phone. If you'd like to withdraw your question, press the star followed by the two. If you are using a speakerphone you will need to lift the handset before making your selection. Our first question comes from Robert Spivey with the Abernathy Group. Please go ahead.

Robert Spivey: Hi, Mike and Chris. How are you guys doing?

Michael Batten: Fine, Rob. And you?

Robert Spivey: Doing all right. Just wanted to get an idea of, well, first what do you guys consider to be your proper capital structure, your target capital structure?

Michael Batten: Well, I think we're pretty much at where we are right now on an operating basis. 30%, 31%, low 30s of total capitalization is a comfortable area for us to be in. Now, that does not mean that we cannot go out and look at acquisitions, which is what we are doing. And as a result of making an acquisition go above the 30, what we are looking at is keeping enough of our powder dry so that we can make those kinds of acquisitions.

Robert Spivey: I don't suppose I can ask you any color on which segment of your division do you want to make an acquisition on?

Michael Batten: Well, we're looking at all of the areas. We're not targeting one particular one or another. We are active in marine as well as land-based opportunities.

Robert Spivey: And just one last question. Can you give some color on what part of your marine businesses were doing -- you felt were the strongest and the weakest in the last quarter and how you project those to go, going forward?

Michael Batten: Sure. The strongest part of our marine business is a combination of our commercial marine sales into the oil and gas markets around the world. That would be driven by demand from the US Gulf Coast as well as the Pacific basin. So our sales in those areas have gone extremely well. And continue to do well and the forecast is for that to remain at high levels that we're seeing. The other part of the marine demand is coming from the European mega-yacht market, particularly in Italy but not necessarily exclusively there. And we see that demand for mega-yachts continues to grow and will remain at high levels for this foreseeable future.

Robert Spivey: So you don't see any weakness there at all?

Michael Batten: Do we see any weakness where?

Robert Spivey: In the mega-yacht market specifically?

Michael Batten: No.

Robert Spivey: Great.

Michael Batten: Not in the European market segment. In the US segment the buyers, the production is going on in Italy and in Europe in the UK. The North American market as you know in the smaller horsepower range has been very soft. And but the mega-yacht market has remained strong.

Robert Spivey: Thanks a lot, guys, and congratulations on the quarter.

Michael Batten: Thank you, Rob.

Operator: And ladies and gentlemen, if there are additional questions, please press the star followed by the one at this time. If you are using a speakerphone we do ask that you lift your handset before pressing the numbers. Your next question comes from Harris Hall with Round Hill Asset Management. Please go ahead.

Harris Hall: Congratulations on the quarter, gentlemen.

Michael Batten: Thank you, Harris.

Harris Hall: Several questions. One, I noticed inventory was up 18%. What was the constant dollar change and can you give us a little color on what's going on there?

Michael Batten: Sure. Our inventories are up in part from -- I'll let Chris handle the currency effect. But in pure operating terms our inventories were up both in our domestic manufacturing operations and our European manufacturing operation, in part due to here in the US an issue that we had on a particular -- a quality problem, that has been resolved. And we are resuming shipments and expect inventories to decline in the fourth quarter. In the European situation we have -- had a supplier issue which also has been resolved and we expect inventories to begin to decline there as well as shipments resume. So that's from an operating side. Chris will address the currency.

Christopher Eperjesy: Yes, Harris. Roughly a third of what you're seeing as an increase there was purely driven by foreign exchange. And the other two thirds goes to the comments that Mike just made.

Harris Hall: So this is not an unplanned kind of obsolescence issue?

Michael Batten: No, this is clearly not an obsolescence or slow moving issue.

Harris Hall: Okay. The next question. You provide some pretty positive backlog numbers. How much of your business is longer term backlog related versus kind of book to order?

Michael Batten: Well, what you're seeing in the backlog is a backlog that is our orders to be shipped in the next six months. And we do have backlog that goes out beyond that, that is primarily in our transmission product line because just the longer lead times that are necessary with a more sophisticated product. But most of the backlog that we have is in the -- what you see, it is largely being driven at the moment by the marine market, both commercial and mega-yacht. And so the improvement is occurring there.

Harris Hall: So can we read into that backlog, I mean, is it fair to assume positive sales growth for the next two quarters because of that?

Michael Batten: Well, I think that what we're going to see is certainly we're going to at least maintain our levels of activity. What we're seeing is a filling of backlog out into next fiscal year. That is encouraging, and gives us good comfort about how the year 2009 is going to unfold.

Harris Hall: Okay, but the fact that your six month backlog is up over where it was a year ago, does not necessarily translate into you would expect sales to be up over where they were a year ago (inaudible) quarter.

Michael Batten: It's a correct statement that there's not always a direct correlation.

Harris Hall: Okay. And then on the sales, the sales were down 8% constant dollars. How should we look at that? Is the weakness in the industrial and oil and gas business overwhelming the positive, presumably positive sales growth you're getting in the marine business?

Michael Batten: We are seeing that there's a greater decline in the oil and gas and industrial year-to-date. Or say, in the last two quarters. But much of that decline is being absorbed by growth and in the marine sector.

Harris Hall: Would you be willing to quantify it for us even in kind of ranges?

Michael Batten: No, we don't release that information, Harris.

Harris Hall: Okay. Okay, great. That's very helpful. Thank you.

Michael Batten: Okay, fine. Thanks.

Operator: Our next question comes from Tim Griffith with Rockwood Investment Partners. Please go ahead.

Tim Griffith: Hi, good afternoon. How are you all?

Michael Batten: Fine, Tim. How are you doing?

Tim Griffith: Good, thanks. I was curious to know if you can speak to what percentage of your business was related to the mega-yacht segment in the quarter.

Michael Batten: We don't publish that information, Tim, but clearly it's a growing segment of our business with our move over recent years with our Rolla acquisition and our BCS acquisition, Switzerland and Italy, added to our Arneson business that we had, the surface drive business. We've made major moves into this market area and so we see it as a good area for us going out into the future.

Tim Griffith: What's the thinking behind not disclosing the percentage? I'm sure it's for competitive reasons but can you --

Michael Batten: That's clearly it. We're a public company -- we're a public company and our competitors are either large divisions of very large companies or companies that don't disclose their information. So all we're doing is giving away our competitive posture to them where we don't have the quid pro quo.

Tim Griffith: Okay, and you think that could affect your pricing potentially or what would be the downside of them knowing that?

Michael Batten: Well, not only the pricing but the actual values and the size of the market that we're in and also where we're getting margin.

Tim Griffith: Okay. Moving to something else, is there any currency exchange effect on your cost of goods sold number? Obviously there is on the top line but...

Michael Batten: Chris will address that.

Christopher Eperjesy: Yes. We have a good guy in translation and then the bad guy is the sales of the Belgian production, which are in euro cost, in US dollars into the US. That increase is not inconsistent with the revenue increase. So in other words, it's a relatively stable margin translation. So I don't have the exact number in my head but it's consistent with the growth in revenue.

Tim Griffith: Okay, and maybe help us with the model there. What was the percentage decline in volume for the quarter?

Christopher Eperjesy: It's the 8% that you talked about without FX.

Tim Griffith: It's the 8%.

Christopher Eperjesy: Sorry -- Harris, Harris mentioned.

Tim Griffith: Got it, okay. And is there anything you can attribute the decline in the oil and gas business to specifically for the quarter?

Christopher Eperjesy: Is there anything you can attribute specifically to the oil and gas decline in the quarter to.

Michael Batten: Well, the -- actually our rate of shipments were comparable -- was comparable or even better than the second quarter. The comparison is really how outstanding the third quarter last year was. So the third quarter last year was a knock-out quarter. If you go back and take a look at it, and basically that's where the negative comparison comes. But our shipments, we're still shipping product into oil and gas, both on a land base side and on a marine transmission side. The marine transmission business is still up but the fracturing rig or pressure pumping market is where the softness occurred. But as I indicated in my remarks, we are seeing order activity and picking up, and we're encouraged by what we see and hear.

Tim Griffith: So is it fair for us to say that pressure pumping for your quarter was down year-over-year for the industry in general between your record quarter, third quarter of '07?

Michael Batten: Yes.

Tim Griffith: Okay, all right. That's all I had. Thank you.

Michael Batten: Thanks, Tim.

Operator: Our next question comes from Gerry Heffernan with Lord Abbett and Company. Please go ahead.

Gerry Heffernan: Good afternoon, everybody.

Michael Batten: Hi, Gerry.

Gerry Heffernan: I just want to concentrate on the pressure pumping business a little bit also. The previous questioner there asking about what has happened. I was most interested in your commentary in the press release of you're encouraged by what appears to be re-emerging activity in the oil and gas markets. Would that be in oil and gas pressure pumping frac business or would that be a accelerating rig for the growing business in oil and gas marine?

Michael Batten: Well, it's actually both. We're seeing the -- to talk specifically to the pressure pumping side of the business, as I just mentioned in the previous question we are seeing orders and inquiries increasing for production in the new fiscal year, our 2009 fiscal year. So we are filling our order boards with our transmission to go forward into next fiscal year. That we see is an encouraging sign. There is some tightness reoccurring in the market, availability and so we're encouraged to see that. Clearly on the marine side there is an awful lot of activity that is going on not only in the US Gulf Coast but in the Pacific basin where we are shipping our marine transmissions to applications that will go into offshore oil, crude boats and supply vessels.

Gerry Heffernan: Okay, and is it primarily for the crew supply vessels? What about I believe it's a -- the propulsion type product there, the products that you have for the propulsion aspect of dynamic positioning drill ships and rigs.

Michael Batten: Yes. The product that we -- the products that we are shipping in the marine market are what we call quick ship enabled. And that enhancement, that quick shift function is what allows for dynamic positioning to occur. In our transmission that gives you the instantaneous shift that is required to maneuver the vessel with the performance that we're talking about. So it's -- all of our transmissions are now enabled with quick shift so virtually anything that goes out in the commercial marine area can be used for dynamic positioning.

Gerry Heffernan: Okay. Thanks. Could you, and I apologize, I missed the -- a good part of your opening comments. Could you just address the topic of share repurchase? Certainly if we look at the basic shares out year-over-year it's down 427, 428,000. I think you completed a 500,000 share buy-back. You did state that you're happy with the capital position of the company as it stands right now with the 30% debt-to-cap. But if you could just approach the topic. Big picture, where you sit as a corporation in regards to share repurchase, the balance sheet, and how you balance cap ex going forward in light of that and a share price, here it's a -- which seems to be relatively attractive or certainly it seems to be more attractive than I think anything you could pay, any valuations you would pay for acquisitions.

Michael Batten: Well, from, as you say, the big picture point of view, our view is this. That we have been involved in repurchase of our shares. Demonstrated that through last summer and up until the window closed in the third quarter. And so Chris can give you the details, if you wish, of those repurchased though I think they were in the press release. From a strategic point of view, here's the balancing that we're doing. We are actively involved in evaluating and negotiating acquisitions. And quite frankly our preference is to grow the company and move the company in directions that these acquisitions would help us drive to. We think that our shareholder value long term is enhanced by that kind of activity. Let's go back. The things that are doing well for us right now in the mega-yacht market just as an example are a combination of the Rolla acquisition and before that, the Arneson application -- acquisition, and the BCS acquisition. So we wouldn't have the value that that is bringing to the shareholders if we weren't moving ahead on that front. Similarly we would argue that that’s long term the best use of shareholders' money, is to grow the company in areas that will generate earnings in excess of our cost of capital, and quite handsomely. Yes, we can buy back shares of stock, which we are prone to do from time to time as we feel that the stock price is very low and a value enhancer in that regard. But we are not going to be in a position of applying all of our debt capacity to just stock buy-back. Yes, it enhances the value of the shares on a short-term basis but it doesn't necessarily address the long term value enhancement and value creation of the company.

Gerry Heffernan: Thank you very much for covering that.

Michael Batten: Okay.

Operator: Our next question comes from Joe Norton with Singular Research. Please go ahead.

Joe Norton: Thanks, good afternoon.

Michael Batten: Hi, Joe.

Joe Norton: Hi. I'd like to go back to the backlog issue because I'm still not exactly understanding this. Now, it seems in the past that there has been a pretty good correlation between there's always been 6, 8% growth in backlog and that's translated into revenue. And then suddenly this quarter that is not the case, and yet the backlog continues to go up. So is there -- are you seeing order cancellations? Is there some change in the composure of the backlog, that it's stuff that's taking longer to build? I'm just -- I don't understand why the disconnect between sales growth and backlog.

Michael Batten: Right. The backlog as a single number is not necessarily something that can be used to translate to what the volume is going to be. For example, at $125 million of backlog, for six months you can't double that and say we're going to be $250 million. Okay. That's one point. The second point is, is that our backlog is really driven by a multiple of product lines that have different lead times. And so the lead time, let's say of the service part, could be one week or less, and never really make it in and out of the backlog. On the other hand, the other end of the spectrum is transmission that may have a nine month or greater backlog and so it doesn't even show up in the six month backlog until it's been in our total backlog for three months, if you use nine months as an example. So, and then you have products that fall in between that are perhaps a little bit more normal. So our industrial, our after market is the fastest turning, our next is the industrial products that we produce, the next longer lead time would be our marine products, and then the longest lead time is the transmission product line, which is typically nine months or so for order entry. In the case of the build-up over the last couple of years of the pressure pumping business, the backlog grew well ahead because it was all transmission. And so what we're seeing in our backlog, as you say, is a change. The backlog in the pressure pumping or fracturing rig market has -- we have shipped that backlog and so some of it is coming back and going back in to our -- translating into sales. And our marine business is growing which tends to have that shorter backlog. So the --

Joe Norton: So kind of what we're seeing is a shift more to the marine.

Michael Batten: That's right.

Joe Norton: And away from the transmissions and the industrial.

Michael Batten: Right, right. The marine backlog is in effect replacing the transmission backlog.

Joe Norton: Okay, okay. That helped. And then going back to the marine and the mega-yacht, in the past you've talked about very strong demand from emerging markets, and you didn't mention that today. So is that segment flowing in the yacht business?

Michael Batten: It was -- I probably should have said it. Forgive me for that. That's really where the demand is coming from in large measure. That is that the -- there is continuing, high wealth demand from the US and Europe, but it is the fastest growth rate coming from the Russians, the Chinese, and continued support from the Middle East and even Indian -- India.

Joe Norton: Okay. So when you were talking about Italy are you just meaning that's where you're selling it out of?

Michael Batten: That's right. In other words, our customer base is primarily the Italian mega-yacht community but also includes the UK and the US. But Italy has become the largest producer of mega-yachts in the world.

Joe Norton: Okay. So then -- the crashing stock market in the emerging markets is not really affecting, the wealth effect that you guys have seen?

Michael Batten: That's right. You're dealing with people who are exceedingly wealthy and they're not going to be terribly affected by what's happening in terms of normal economy or even wealth. Yes, a market crash, a terrible market crash might give some pause, but we're talking about people if you can afford to buy 50 million or $100 million yacht, you're pretty well insulated.

Joe Norton: Okay, got it. And then the last thing, just on the tax rate. I don't know if you said should we just go back to a normal tax rate in the fourth quarter or what should we be thinking about for tax rate?

Michael Batten: I'll let Chris answer that.

Christopher Eperjesy: Yes. You'll notice last year's fourth quarter also wasn't normal. There was some noise then. The two adjustments that were made in this quarter, the $1 million for the Italian corporate tax rate, and roughly let's call it 800,000, although there's some rounding in there, related to the return to provision adjustment, are just that. I mean they're one-time adjustments. However, and the first one really relates to re -- to setting up a deferred tax asset related to the corporate tax rate change in Italy. That was basically for timing differences, which will happen in the future. So they're both one-time items. However, starting in fiscal '09, which is when the Italian change takes effect, is when you'll start to see it flow through in the normal operating results for our Italian operation. So you will see an effect. And effectively what happened is that change brings it more in line with the US corporate rate. And I think if you go back and look at our income tax footnote you can roughly see what that magnitude of difference is. But roughly it's a 5% reduction in the Italian corporate tax rate. Five percentage points. So actual point reduction.

Joe Norton: So that could take the overall rate down by a couple points possibly.

Christopher Eperjesy: It will take it down by something. I don't know that we know exactly because it's dependent on the mix of where the earnings are coming from.

Joe Norton: Okay, but that's '09. So for the fourth quarter should we go back to kind of the 39.5?

Christopher Eperjesy: It's not going to be an unusual quarter in that you won't -- you shouldn't see any significant, unusual adjustments.

Joe Norton: Okay. Okay, good, very good. Thanks a lot

Michael Batten: Thanks, Joe.

Operator: Our next question comes from Ephraim Fields with Clarus Capital. Please go ahead.

Ephraim Fields: Hi, good afternoon.

Michael Batten: Hi, Ephraim.

Ephraim Fields: Hi. Mike, you tend to be a conservative person by nature so I was pleased to see you commenting about the re-emerging activity in the oil and gas markets. I had two questions. One is, can you tell me what you're looking at that gives you that enthusiasm? And number two, could you speak directionally about the margins that you get in those businesses as opposed to the other businesses that you're also in?

Michael Batten: Sure. With respect to the demand, we are seeing entry of orders. As I said, from customers in the oil and gas market for our fracturing rig transmission. So that is -- that's one basis. We're getting solid orders. Two, we are getting additional inquiries from customers that have been quiet for a period of time and they're talking about additional builds and we haven't heard that in a while, so that adds to our outlook. We aren't counting our eggs, so to speak, but the fact that there is order inquiry usually begins the process of order entry. So that's really what we're seeing. I'm aware of other people reporting perhaps some differing information but at this point based on what we're seeing just ourselves and is the basis of where we're coming from. As to the margin question we do get a better margin from the oil and gas markets as we've indicated in our press release and of course the margin rates of the demand that is replacing it is not as great, that there's still good margins but not necessarily the ones that we have. And I think that that is also covered in the press release. We are seeing reduced volume of higher margin product, vis-à-vis the quarter that would be our fracturing transmission. And we are seeing higher volumes of lower margin products which would be marine. But certain aspects of our marine margins are pretty good so I wouldn't -- I'm not embarrassed by those margins either. It's just that some of them are not as good as we're giving up in the oil and gas vis-à-vis a year ago.

Ephraim Fields: Okay.

Michael Batten: But I do think that our -- the fact that we are maintaining a gross margin in excess of 31% is saying that the ongoing margin rate is still in pretty good shape.

Ephraim Fields: All right. And my final question is I know you've spent a lot of time and money on the ERP system. Could you just give us some color to the benefits that you hope to derive once it's all fully functioning?

Michael Batten: Sure. A lot of it depends -- is based on where we were and you and the others may not know, but we had as many as eight different platforms around the world and through a multiple of manufacturing operations, acquisitions, and distribution subsidiaries. And of course as we came to Sarbanes-Oxley that was pretty costly to have to generate individual Sarbanes-Oxley controls at each one of these. So we obviously made the decision to go to a global program, ERP program, to A, eliminate those ongoing costs of maintaining Sarbanes-Oxley. But in addition there's going to be a benefit from the ability of our centralized and corporate financial control operation to be able to analyze information more quickly off of the standard chart of accounts and database, to be able to go in and query, get information. It will also reduce to a certain extent, not completely, the headcount that is required in each of these operations around the world. So we think that we're going to see value occur as we go into the system and really that's why we're paying the freight (sp?) now to get to that point of having one common system, fewer people in the organization, and ability to get information more quickly and on a standardized basis.

Ephraim Fields: Great, thank you very much.

Michael Batten: Okay, Ephraim.

Operator: Once again, ladies and gentlemen, if there are any additional questions, please press the star followed by the one. If you are using a speaker phone we do ask that you lift your handset before pressing the numbers. Your next question is a follow-up from Harris Hall. Please go ahead.

Harris Hall: Thanks. Just a couple more things. The operating cost, obviously you said it was reduced by stock option compensation of about 2.3 million. Backing that out it's a little over 17 million in the quarter and just looking at Q4, is that a good run rate to use going forward or was there something special in last year's Q4, or it was up over 19 million. Kind of how should we think about operating cost going forward?

Michael Batten: I'm going to let Chris answer that since you're getting into some of the numbers.

Christopher Eperjesy: I think you're asking about the ME&A in the third quarter adjusted for the stock-based comp compared to the fourth quarter. It's not quite that simple to say yes or no because there's a number of factors including foreign exchange which may or may not play an impact. Then also you have again the issue of what happens in the quarter on stock-based comp. I guess I would say there's nothing significant that we're aware of today that is unusual from the existing operation of the company. So in terms of our fixed cost structure. There may be something related to, again, stock-based comp or some other anticipated item but as of right now there's no major changes that have been made or are expected to be made in the fourth quarter beyond the ERP implementation.

Harris Hall: But was there anything special or one-time that happened about Q4 '07 that got you up over 19 million last year?

Christopher Eperjesy: There was, there was, and I don't have the number in front of me. I apologize. But there was the -- there was a stock-based compensation adjustment in the fourth quarter of last year in the other direction. And actually I do have it here. In the fourth quarter of last year, which I think we disclosed in last year's press release, there was a roughly I believe a $1 million adjustment. So up in stock-based compensation expense that would have flowed through ME&A in the fourth quarter of last year.

Harris Hall: Okay. So it wasn't just that you had pretty solid sales last year in the fourth quarter. It wasn't the commissions, it was really a one-time thing and we should kind of look at that $19 million number as an outlier. Is that fair?

Christopher Eperjesy: I say yes, but then we've had a number of outliers as a result of some of these movements. So if you adjust for those stock-based compensation then that would be a correct statement.

Harris Hall: Okay. And then I know you were talking about volumes being down 8% in the quarter, but that sales line, but that was actually just constant dollars. Can you give us any more color on pricing and units? I know you mentioned that some of your higher material prices were being offset by higher prices, the final customer demand? Does that imply that units were down more than 8% and pricing was up? Or how should we look at ASB trends and unit trends?

Michael Batten: The pricing that we've put into effect was -- it was staggered through the year. Some of it occurring at the beginning of the fiscal year and some of it occurring at quarters and at mid-year depending upon -- just based on different product. So we are in the process of raising prices again and we expect to fully offset any inflationary activity that we are experiencing.

Harris Hall: Okay, so on balance would you say that average selling prices are higher than they were a year ago?

Michael Batten: Our average prices were higher than they were a year ago? That's correct.

Harris Hall: Okay. And then the last thing, you talked about Q3 being a tough comp from last year. Obviously Q4 was even $4 million higher. Is there some seasonal factors going on or should we look at the comp with Q4's $91 million in sales last year as a tough comp as well?

Christopher Eperjesy: He's talking about sales.

Michael Batten: Sales.

Harris Hall: Right.

Michael Batten: The -- last -- the third quarter last year was a remarkable quarter. And obviously we had just about everything going right in terms of shipping high margin product out the door and we had very few, if any, what Chris calls noise in the quarter. As we look at the fourth quarter coming up I'm not quite sure, and we don't forecast what our specific numbers are going to be going out in the quarter or even beyond. But we ought to be in the ballpark with the fourth quarter next year. I mean, this fourth quarter versus a year ago.

Harris Hall: Right. I guess my question was, the impressive fourth quarter you had last year, was that a function of seasonal issues where normally you have a big fourth quarter? Or was it again a tough comp where you had a real record fourth quarter last year that you'd expect that to be a tough comp this fourth quarter?

Michael Batten: Well, I think that last year was a very good year in the company's history. And we started out this year with a very good first quarter and saw some softness occur in oil and gas in the second quarter which followed into the third quarter and is likely to continue into the fourth quarter at this year's rate of shipments rather than last year's rate of shipments. However, offsetting that has been the emergence of our commercial marine and mega-yacht activity, also bolstered by military and our airport, rescue, and firefighting activity that has picked up most of the slack to allow us to continue reporting numbers that are very respectable against last year. So that process is continuing into the fourth quarter. So what you're going to see in the fourth quarter is very much a continuation of the trends that have been in place over the last couple of quarters anyway. And we're developing a fourth quarter that is going to be different than last year but is going to be a good quarter.

Harris Hall: Okay. I guess what I'm getting at is it looks historically like your fourth quarter has been your strongest quarter. Is there some seasonal issues there that lead to that or is that just a coincidence (inaudible).

Michael Batten: I see. I'm sorry. I guess I'm a little dense today. But the fourth quarter tends to have more shipping days in it than the other quarters in the year. First quarter starts out with a lot of vacation schedules, both our own and customers, and the second and third quarters tend to be more of a middle-of-the-road, and the fourth quarter tends to be a better year, better quarter in the year because it has a more shipping days typically and I guess there's the tendency on the part of customers to anticipate that there's going to be summer shutdowns or not the effect of summer vacation schedules so they get their orders and want their shipments in hand by the end of June so that they aren't waiting in July or August.

Harris Hall: Great, that's very helpful. I'll let someone else on. Thanks.

Michael Batten: Yes, okay. Fine, Harris.

Operator: And at this time, gentlemen, I am showing no further questions in the queue. I'd like to turn the call back over to you for any concluding remarks you may have.

Michael Batten: Well, thank you, Eric, and thank you, everyone, for attending the call today. We're, as I said earlier, we're pleased with the results of the third quarter. We are optimistic about the balance of the year and see demand continuing into 2009. So we value your interest and the questions that you generate and hope we've responded to them adequately. Again, thanks a lot and we'll see you next quarter.

Operator: Ladies and gentlemen, this does conclude the Twin Disc 2008 Third Quarter Financial Results conference call. You may now disconnect and have a pleasant day.