



**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
FORM 10-K**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934**
For the Fiscal Year Ended June 30, 2011
Commission File Number 1-7635

TWIN DISC, INCORPORATED
(Exact Name of Registrant as Specified in its Charter)

Wisconsin
(State or Other Jurisdiction of Incorporation or Organization)

39-0667110
(I.R.S. Employer Identification Number)

1328 Racine Street, Racine, Wisconsin
(Address of Principal Executive Office)

53403
(Zip Code)

Registrant's Telephone Number, including area code:

(262) 638-4000

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

Title of each class
Common stock, no par
Preferred stock purchase rights

Name of each exchange on which registered:
The NASDAQ Stock Market LLC
The NASDAQ Stock Market LLC

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

None
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
YES [] NO []

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
YES [] NO []

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act).
Large Accelerated Filer [] Accelerated Filer [] Non-accelerated Filer [] Smaller reporting company []

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

At December 31, 2010, the last business day of the registrant's second fiscal quarter, the aggregate market value of the common stock held by non-affiliates of the registrant was \$248,814,593. Determination of stock ownership by affiliates was made solely for the purpose of responding to this requirement and registrant is not bound by this determination for any other purpose.

At August 18, 2011, the registrant had 11,419,701 shares of its common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the Proxy Statement for the Annual Meeting of Shareholders to be held October 21, 2011, which will be filed pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this report, are incorporated by reference into Part III.

PART I

Item 1. Business

Twin Disc was incorporated under the laws of the state of Wisconsin in 1918. Twin Disc designs, manufactures and sells marine and heavy duty off-highway power transmission equipment. Products offered include: marine transmissions, surface drives, propellers and boat management systems as well as power-shift transmissions, hydraulic torque converters, power take-offs, industrial clutches and controls systems. The Company sells its products to customers primarily in the pleasure craft, commercial and military marine markets as well as in the energy and natural resources, government and industrial markets. The Company's worldwide sales to both domestic and foreign customers are transacted through a direct sales force and a distributor network. The products described above have accounted for more than 90% of revenues in each of the last three fiscal years.

Most of the Company's products are machined from cast iron, forgings, cast aluminum and bar steel which generally are available from multiple sources and which are believed to be in adequate supply.

The Company has pursued a policy of applying for patents in both the United States and certain foreign countries on inventions made in the course of its development work for which commercial applications are considered probable. The Company regards its patents collectively as important but does not consider its business dependent upon any one of such patents.

The business is not considered to be seasonal except to the extent that employee vacations are taken mainly in the months of July and August, curtailing production during that period.

The Company's products receive direct widespread competition, including from divisions of other larger independent manufacturers. The Company also competes for business with parts manufacturing divisions of some of its major customers. Primary competitive factors for the Company's products are performance, price, service and availability. The Company's top ten customers accounted for approximately 43% of the Company's consolidated net sales during the year ended June 30, 2011. There were no customers that accounted for 10% or more of consolidated net sales in fiscal 2011.

Unfilled open orders for the next six months of \$146,899,000 at June 30, 2011 compares to \$84,419,000 at June 30, 2010. The Company saw an increase in orders by oil and gas customers for its 8500 series transmission as higher oil and gas prices have driven demand for new high-horsepower rigs. Since orders are subject to cancellation and rescheduling by the customer, the six-month order backlog is considered more representative of operating conditions than total backlog. However, as procurement and manufacturing "lead times" change, the backlog will increase or decrease, and thus it does not necessarily provide a valid indicator of the shipping rate. Cancellations are generally the result of rescheduling activity and do not represent a material change in backlog.

Management recognizes that there are attendant risks that foreign governments may place restrictions on dividend payments and other movements of money, but these risks are considered minimal due to the political relations the United States maintains with the countries in which the Company operates or the relatively low investment within individual countries. No material portion of the Company's business is subject to renegotiation of profits or termination of contracts at the election of the Government.

Engineering and development costs include research and development expenses for new product development and major improvements to existing products, and other costs for ongoing efforts to refine existing products. Research and development costs charged to operations totaled \$2,475,000, \$2,347,000 and \$2,636,000 in fiscal 2011, 2010 and 2009, respectively. Total engineering and development costs were \$8,776,000, \$7,885,000 and \$9,142,000 in fiscal 2011, 2010 and 2009, respectively.

The Company's development of its 7500 series transmission is in the final testing phase, and initial shipment of production units has begun. The 7500 series transmission is specifically designed for oil and gas high-pressure pumping applications, and is expected to offer significant advantages in those applications over the Company's current product mix. For example, the 7500 series transmission will be considerably lighter than the Company's 8500 series transmission, and will be able to fit within the frame rails of on-road fracturing rigs so that the rigs won't need special permits to move from one field to another. It is also designed to work in a range of 1500 to 2500 horsepower, which is a larger market than the 2500 to 3000 horsepower application market for the Company's 8500 series transmission.

In fiscal 2011, the Company completed the development and introduced the Express Joystick System (EJS®) to the marine market. The EJS smoothly and simultaneously actuates and controls engines, transmissions and thrusters to allow for effortless movement of the boat in any direction.

Compliance with federal, state and local provisions regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, is not anticipated to have a material effect on capital expenditures, earnings or the competitive position of the Company.

The number of persons employed by the Company at June 30, 2011 was 941.

A summary of financial data by segment and geographic area for the years ended June 30, 2011, 2010 and 2009 appears in Note J to the consolidated financial statements.

The Company's internet website address is www.twindisc.com. The Company makes available free of charge (other than an investor's own internet access charges) through its website the Company's Annual Report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and amendments to those reports, as soon as reasonably practicable after it electronically files such material with, or furnishes such material to, the United States Securities and Exchange Commission. In addition, the Company makes available, through its website, important corporate governance materials. This information is also available from the Company upon request. The Company is not including the information contained on or available through its website as a part of, or incorporating such information by reference into, this Annual Report on Form 10-K.

Item 1A. Risk Factors

The Company's business involves risk. The following information about these risks should be considered carefully together with other information contained in this report. The risks described below are not the only risks the Company faces. Additional risks not currently known, deemed immaterial or that could apply to any issuer may also result in adverse results for the Company's business.

As a global company, we are subject to currency fluctuations and any significant movement between the U.S. Dollar and the Euro, in particular, could have an adverse effect on our profitability. Although the Company's financial results are reported in U.S. Dollars, a significant portion of our sales and operating costs are realized in Euros and other foreign currencies. The Company's profitability is affected by movements of the U.S. Dollar against the Euro and the other currencies in which we generate revenues and incur expenses. Significant long-term fluctuations in relative currency values, in particular a significant change in the relative values of the U.S. Dollar or Euro, could have an adverse effect on our profitability and financial condition.

Certain of the Company's products are directly or indirectly used in oil exploration and oil drilling, and are thus dependent upon the strength of those markets and oil prices. In recent years, the Company has seen a significant growth in the sales of its products that are used in oil and energy related markets. The growth in these markets has been spurred by the rise in oil prices and the global demand for oil. In addition, there has been a substantial increase in capital investment by companies in these markets. In fiscal 2009, a significant decrease in oil prices, the demand for oil and capital investment in the oil and energy markets had an adverse effect on the sales of these products and ultimately on the Company's profitability. While this market has recovered to historically high levels in fiscal 2011, the cyclical nature of the global oil and gas market presents the ongoing possibility of a severe cutback in demand, which would create a significant adverse effect on the sales of these products and ultimately on the Company's profitability.

Many of the Company's product markets are cyclical in nature or are otherwise sensitive to volatile or variable factors. A downturn or weakness in overall economic activity or fluctuations in those other factors can have a material adverse effect on the Company's overall financial performance. Historically, sales of many of the products that the Company manufactures and sells have been subject to cyclical variations caused by changes in general economic conditions and other factors. In particular, the Company sells its products to customers primarily in the pleasure craft, commercial and military marine markets, as well as in the energy and natural resources, government and industrial markets. The demand for the products may be impacted by the strength of the economy generally, governmental spending and appropriations, including security and defense outlays, fuel prices, interest rates, as well as many other factors. Adverse economic and other conditions may cause the Company's customers to forego or otherwise postpone purchases in favor of repairing existing equipment.

In the event of an increase in the global demand for steel, the Company could be adversely affected if it experiences shortages of raw castings and forgings used in the manufacturing of its products. With the continued development of certain developing economies, in particular China and India, the global demand for steel has risen significantly in recent years. The Company

selects its suppliers based on a number of criteria, and we expect that they will be able to support our growing needs. However, there can be no assurance that a significant increase in demand, capacity constraints or other issues experienced by the Company's suppliers will not result in shortages or delays in their supply of raw materials to the Company. If the Company were to experience a significant or prolonged shortage of critical components from any of its suppliers, particularly those who are sole sources, and could not procure the components from other sources, the Company would be unable to meet its production schedules for some of its key products and would miss product delivery dates which would adversely affect our sales, profitability and relationships with our customers.

If the Company were to lose business with any key customers, the Company's business would be adversely affected. Although there were no customers that accounted for 10% or more of consolidated net sales in fiscal 2011, deterioration of a business relationship with one or more of the Company's significant customers would cause its sales and profitability to be adversely affected.

The Company continues to face the prospect of increasing commodity costs, including steel, other raw materials and energy that could have an adverse effect on future profitability. To date, the Company has been successful with offsetting the effects of increased commodity costs through cost reduction programs and pricing actions. However, if material prices were to continue to increase at a rate that could not be recouped through product pricing, it could potentially have an adverse effect on our future profitability.

The termination of relationships with the Company's suppliers, or the inability of such suppliers to perform, could disrupt its business and have an adverse effect on its ability to manufacture and deliver products. The Company relies on raw materials, component parts, and services supplied by outside third parties. If a supplier of significant raw materials, component parts or services were to terminate its relationship with the Company, or otherwise cease supplying raw materials, component parts, or services consistent with past practice, the Company's ability to meet its obligations to its customers may be affected. Such a disruption with respect to numerous products, or with respect to a few significant products, could have an adverse effect on the Company's profitability and financial condition.

A significant design, manufacturing or supplier quality issue could result in recalls or other actions by the Company that could adversely affect profitability. As a manufacturer of highly engineered products, the performance, reliability and productivity of the Company's products is one of its competitive advantages. While the Company prides itself on putting in place procedures to ensure the quality and performance of its products and suppliers, a significant quality or product issue, whether due to design, performance, manufacturing or supplier quality issue, could lead to warranty actions, scrapping of raw materials, finished goods or returned products, the deterioration in a customer relation, or other action that could adversely affect warranty and quality costs, future sales and profitability.

The Company faces risks associated with its international sales and operations that could adversely affect its business, results of operations or financial condition. Sales to customers outside the United States approximated 59% of our consolidated net sales for fiscal 2011. We have international manufacturing operations in Belgium, Italy and Switzerland. In addition, we have international distribution operations in Singapore, China, Australia, Japan, Italy and Canada. Our international sales and operations are subject to a number of risks, including:

- ▷ currency exchange rate fluctuations
- ▷ export and import duties, changes to import and export regulations, and restrictions on the transfer of funds
- ▷ problems with the transportation or delivery of our products
- ▷ issues arising from cultural or language differences and labor unrest
- ▷ longer payment cycles and greater difficulty in collecting accounts receivables
- ▷ compliance with trade and other laws in a variety of jurisdictions
- ▷ changes in tax law

These factors could adversely affect our business, results of operations or financial condition.

A material disruption at the Company's manufacturing facilities in Racine, Wisconsin could adversely affect its ability to generate sales and meet customer demand. The majority of the Company's manufacturing, based on fiscal 2011's sales, came from its two facilities in Racine, Wisconsin. If operations at these facilities were to be disrupted as a result of significant equipment failures, natural disasters, power outages, fires, explosions, adverse weather conditions or other reasons, the Company's business and results of operations could be adversely affected. Interruptions in production would increase costs and reduce sales. Any interruption in production capability could require the Company to make substantial capital expenditures to remedy the situation, which could negatively affect its profitability and financial condition. The Company maintains property damage insurance which it believes to be adequate to provide for reconstruction of its facilities and equipment, as well as business interruption insurance to mitigate losses resulting from any production interruption or shutdown caused by an insured loss. However, any recovery under this insurance policy may not offset the lost sales or increased costs that may be experienced during the disruption of operations. Lost sales may not be recoverable under the policy and long-term business disruptions could result in a loss of customers. If this were to occur, future sales levels and costs of doing business, and therefore profitability, could be adversely affected.

Any failure to meet our debt obligations and satisfy financial covenants could adversely affect our business and financial condition. Beginning in 2008 and continuing into 2010, general worldwide economic conditions experienced a downturn due to the combined effects of the subprime lending crisis, general credit market crisis, collateral effects on the finance and banking industries, slower economic activity, decreased consumer confidence, reduced corporate profits and capital spending, adverse business conditions and liquidity concerns. While some recovery has been seen in 2011, these conditions made it difficult for customers, vendors and the Company to accurately forecast and plan future business activities, and cause U.S. and foreign businesses to slow spending on products, which delay and lengthen sales cycles. These conditions led to declining revenues in several of the Company's divisions in fiscal 2009 and 2010. The Company's amended revolving credit facility and senior notes agreements require it to maintain specified quarterly financial covenants such as a minimum consolidated net worth amount, a minimum EBITDA, as defined, for the most recent four fiscal quarters of \$11,000,000 and a funded debt to EBITDA ratio of 3.0 or less. At June 30, 2011, the Company was in compliance with these financial covenants. Based on its annual financial plan, the Company believes that it will generate sufficient EBITDA levels throughout fiscal 2012 in order to maintain compliance with its financial covenants. However, as with all forward-looking information, there can be no assurance that the Company will achieve the planned results in future periods especially due to the significant uncertainties flowing from the current economic environment. If the Company is not able to achieve these objectives and to meet the required covenants under the agreements, the Company may require forbearance from its existing lenders in the form of waivers and/or amendments of its credit facilities or be required to arrange alternative financing. Failure to obtain relief from covenant violations or to obtain alternative financing, if necessary, would have a material adverse impact on the Company.

The Company may experience negative or unforeseen tax consequences. The Company reviews the probability of the realization of our net deferred tax assets each period based on forecasts of taxable income in both the U.S. and foreign jurisdictions. This review uses historical results, projected future operating results based upon approved business plans, eligible carryforward periods, tax planning opportunities and other relevant considerations. Adverse changes in the profitability and financial outlook in the U.S. or foreign jurisdictions may require the creation of a valuation allowance to reduce our net deferred tax assets. Such changes could result in material non-cash expenses in the period in which the changes are made and could have a material adverse impact on the Company's results of operations and financial condition.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Manufacturing Segment

The Company owns two manufacturing, assembly and office facilities in Racine, Wisconsin, U.S.A., one in Nivelles, Belgium, two in Decima, Italy and one in Novazzano, Switzerland. The aggregate floor space of these six plants approximates 847,000 square feet. One of the Racine facilities includes office space, which includes the Company's corporate headquarters. The Company leases additional manufacturing, assembly and office facilities in Italy (Limite sull'Arno) and India (outsourcing office in Chennai).

Distribution Segment

The Company also has operations in the following locations, all of which are leased and are used for sales offices, warehousing and light assembly or product service:

| | |
|-------------------------------|-------------------------------------|
| Jacksonville, Florida, U.S.A. | Limite sull'Arno, Italy |
| Medley, Florida, U.S.A. | Brisbane, Queensland, Australia |
| Coburg, Oregon, U.S.A. | Perth, Western Australia, Australia |
| Kent, Washington, U.S.A. | Singapore |

Edmonton, Alberta, Canada

Shanghai, China

Burnaby, British Columbia, Canada

Guangzhou, China

The Company believes its properties are well maintained and adequate for its present and anticipated needs.

Item 3. Legal Proceedings

Twin Disc is a defendant in several product liability or related claims of which the ultimate outcome and liability to the Company, if any, are not presently determinable. Management believes that the final disposition of such litigation will not have a material impact on the Company's results of operations, financial position or statement of cash flows.

Item 4. Reserved

Executive Officers of the Registrant

Pursuant to General Instruction G(3) of Form 10-K, the following list is included as an unnumbered Item in Part I of this Report in lieu of being included in the Proxy Statement for the Annual Meeting of Shareholders to be held on October 21, 2011.

| <u>Name</u> | <u>Age</u> | <u>Position</u> |
|-------------------------|------------|---|
| Michael E. Batten | 71 | Chairman and Chief Executive Officer |
| John H. Batten | 46 | President and Chief Operating Officer |
| Christopher J. Eperjesy | 43 | Vice President – Finance, Chief Financial Officer and Treasurer |
| James E. Feiertag | 54 | Executive Vice President |
| Henri-Claude Fabry | 65 | Vice President - International Distribution |
| Dean J. Bratel | 47 | Vice President - Engineering |
| Denise L. Wilcox | 54 | Vice President - Human Resources |
| Jeffrey S. Knutson | 46 | Corporate Controller |
| Thomas E. Valentyn | 52 | General Counsel and Secretary |

Officers are elected annually by the Board of Directors at the Board meeting held in conjunction with each Annual Meeting of the Shareholders. Each officer holds office until a successor is duly elected, or until he/she resigns or is removed from office.

Michael E. Batten, Chairman and Chief Executive Officer. Mr. Batten has been employed with the Company since 1970, and was named Chairman and Chief Executive Officer in 1991.

John H. Batten, President and Chief Operating Officer. Effective July 1, 2008, Mr. Batten was named President and Chief Operating Officer. Prior to this promotion, Mr. Batten served as Executive Vice President since November 2004, Vice President and General Manager – Marine and Propulsion since October 2001 and Commercial Manager – Marine and Propulsion since 1998. Mr. Batten joined Twin Disc in 1996 as an Application Engineer. Mr. Batten is the son of Mr. Michael Batten.

Christopher J. Eperjesy, Vice President – Finance, Chief Financial Officer and Treasurer. Mr. Eperjesy joined the Company in his current role in November 2002. Prior to joining Twin Disc, Mr. Eperjesy was Divisional Vice President – Financial Planning & Analysis for Kmart Corporation since 2001, and Senior Manager – Corporate Finance with DaimlerChrysler AG since 1999.

James E. Feiertag, Executive Vice President. Mr. Feiertag was appointed to his present position in October 2001. Prior to being promoted, he served as Vice President – Manufacturing since joining the Company in November 2000. Prior to joining Twin Disc, Mr. Feiertag was the Vice President of Manufacturing for the Drives and Systems Group of Rockwell Automation since 1999.

Henri Claude Fabry, Vice President – International Distribution. Mr. Fabry was appointed to his current position in January 2009, after serving as Vice President – Global Distribution since 2001. Mr. Fabry joined Twin Disc in 1997 as Director, Marketing and Sales of the Belgian subsidiary.

Dean J. Bratel, Vice President - Engineering. Mr. Bratel was promoted to his current role in November 2004 after serving as Director of Corporate Engineering (since January 2003), Chief Engineer (since October 2001) and Engineering Manager (since December 1999). Mr. Bratel joined Twin Disc in 1987.

Denise L. Wilcox, Vice President - Human Resources. After joining the Company as Manager Compensation & Benefits in September 1998, Ms. Wilcox was promoted to Director Corporate Human Resources in March 2002 and to her current role in November 2004. Prior to joining Twin Disc, Ms. Wilcox held positions with Johnson International and Runzheimer International.

Jeffrey S. Knutson, Corporate Controller. Mr. Knutson was appointed to his current role in October 2005 after joining the Company in February 2005 as Controller of North American Operations. Prior to joining Twin Disc, Mr. Knutson held Operational Controller positions with Tower Automotive (since August 2002) and Rexnord Corporation (since November 1998).

Thomas E. Valentyn, General Counsel and Secretary. Mr. Valentyn joined the Company in his current role in September 2007. Prior to joining Twin Disc, Mr. Valentyn served as Vice President and General Counsel at Norlight Telecommunications, Inc. since July 2000.

PART II

Item 5. Market for the Registrant's Common Stock and Related Stockholder Matters

The Company's common stock is traded on the NASDAQ Global Select Market under the symbol TWIN. The price information below represents the high and low sales prices from July 1, 2009 through June 30, 2011:

| Quarter | Fiscal Year Ended 6/30/11 | | | Fiscal Year Ended 6/30/10 | | |
|----------------|---------------------------|---------|----------|---------------------------|--------|----------|
| | High | Low | Dividend | High | Low | Dividend |
| First Quarter | \$13.95 | \$10.52 | \$0.07 | \$15.23 | \$6.21 | \$0.07 |
| Second Quarter | 30.25 | 12.68 | 0.07 | 14.77 | 9.12 | 0.07 |
| Third Quarter | 35.10 | 25.24 | 0.08 | 13.17 | 8.77 | 0.07 |
| Fourth Quarter | 39.43 | 29.22 | 0.08 | 14.92 | 11.35 | 0.07 |

For information regarding the Company's equity-based compensation plans, see the discussion under Item 12 of this report. As of August 18, 2011, shareholders of record numbered 699. The closing price of Twin Disc common stock as of August 18, 2011 was \$32.55.

Issuer Purchases of Equity Securities

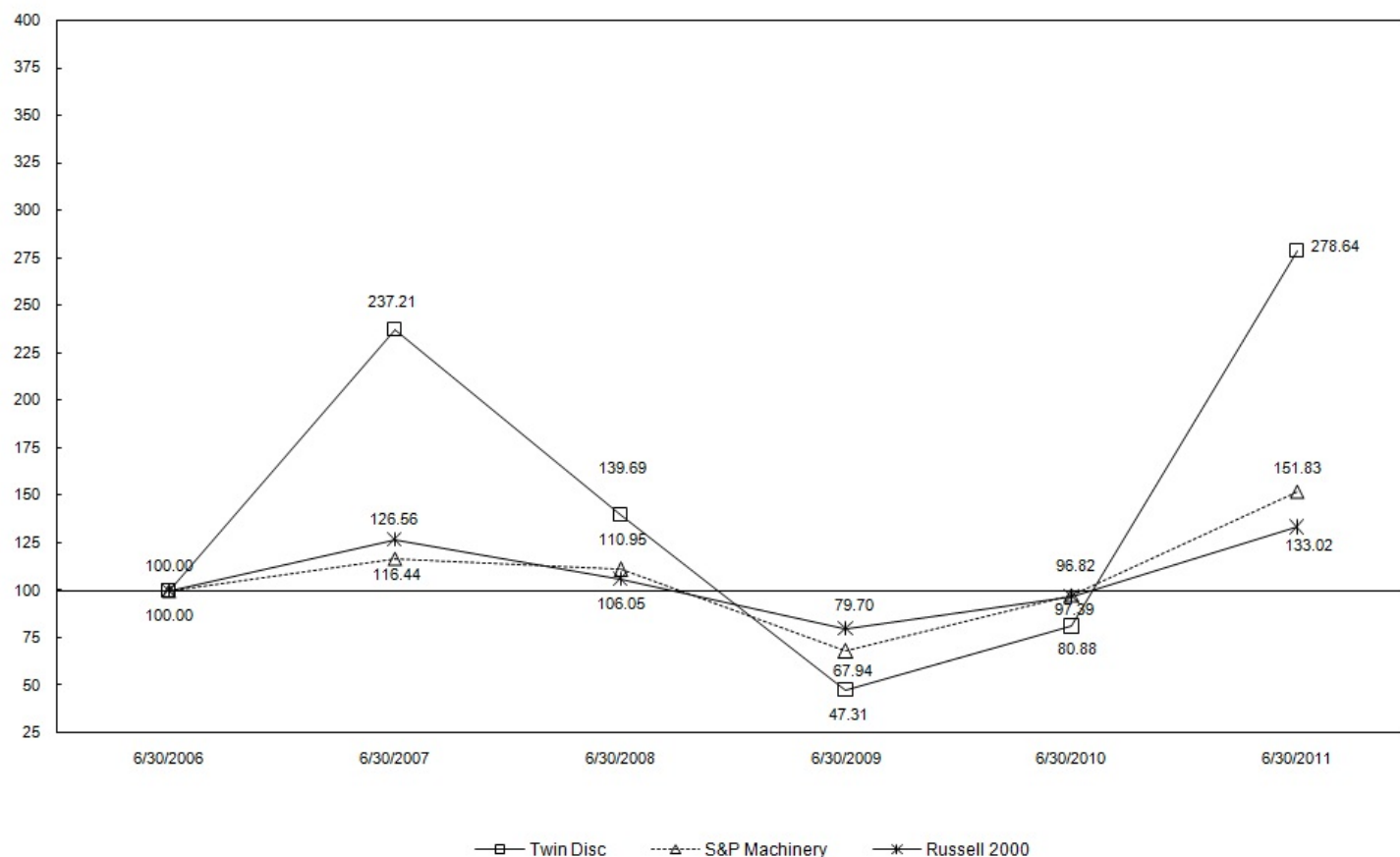
| Period | (a) Total Number of Shares Purchased | (b) Average Price Paid per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | (d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|---------------------------------|--------------------------------------|----------------------------------|--|--|
| March 26, 2011 – April 29, 2011 | 0 | NA | 0 | 250,000 |
| April 30, 2011 – May 27, 2011 | 0 | NA | 0 | 250,000 |
| May 28, 2011 - June 30, 2011 | 0 | NA | 0 | 250,000 |
| Total | 0 | | | |

On February 1, 2008, the Board of Directors authorized the purchase of up to 500,000 shares of Common Stock at market values, of which 250,000 were purchased during the second quarter of fiscal 2009.

Performance Graph

The following table compares total shareholder return over the last 5 fiscal years to the Standard & Poor's 500 Machinery (Industrial) Index and the Russell 2000 index. The S&P 500 Machinery (Industrial) Index consists of a broad range of manufacturers. The Russell 2000 Index consists of a broad range of 2,000 companies. The Company believes, because of the similarity of its business with those companies contained in the S&P 500 Machinery (Industrial) Index, that comparison of shareholder return with this index is appropriate. Total return values for the Corporation's common stock, the S&P 500 Machinery (Industrial) Index and the Russell 2000 Index were calculated based upon an assumption of a \$100 investment on June 30, 2006 and based upon cumulative total return values assuming reinvestment of dividends on a quarterly basis.

Comparison of Five-Year Cumulative Total Return Twin Disc, Inc.; S&P Machinery; and Russell 2000



Item 6. Selected Financial Data

Financial Highlights

(in thousands, except per share amounts)

| | Fiscal Years Ended June 30. | | | | |
|--|-----------------------------|-----------|-----------|-----------|-----------|
| Statement of Operations Data: | 2011 | 2010 | 2009 | 2008 | 2007 |
| Net sales | \$310,393 | \$227,534 | \$295,618 | \$331,694 | \$317,200 |
| Net earnings attributable to Twin Disc | 18,830 | 597 | 11,502 | 24,252 | 21,852 |
| Basic earnings per share attributable to Twin Disc common shareholders | 1.66 | 0.05 | 1.04 | 2.15 | 1.88 |
| Diluted earnings per share attributable to Twin Disc common shareholders | 1.64 | 0.05 | 1.03 | 2.13 | 1.84 |
| Dividends per share | 0.30 | 0.28 | 0.28 | 0.265 | 0.205 |

Balance Sheet Data (at end of period):

| | | | | | |
|----------------------|-----------|-----------|-----------|-----------|-----------|
| Total assets | \$309,120 | \$259,056 | \$290,008 | \$304,628 | \$267,184 |
| Total long-term debt | 25,784 | 27,211 | 46,348 | 48,227 | 42,152 |

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

Note on Forward-Looking Statements

Statements in this report (including but not limited to certain statements in Items 1, 3 and 7) and in other Company communications that are not historical facts are forward-looking statements, which are based on management's current expectations. These statements involve risks and uncertainties that could cause actual results to differ materially from what appears here.

Forward-looking statements include the Company's description of plans and objectives for future operations and assumptions behind those plans. The words "anticipates," "believes," "intends," "estimates," and "expects," or similar anticipatory expressions, usually identify forward-looking statements. In addition, goals established by the Company should not be viewed as guarantees or promises of future performance. There can be no assurance the Company will be successful in achieving its goals.

In addition to the assumptions and information referred to specifically in the forward-looking statements, other factors, including, but not limited to those factors discussed under Item 1A, Risk Factors, could cause actual results to be materially different from what is presented in any forward looking statements.

Results of Operations

(In thousands)

| | <u>2011</u> | <u>%</u> | <u>2010</u> | <u>%</u> | <u>2009</u> | <u>%</u> |
|--|-----------------|----------|----------------|----------|-----------------|----------|
| Net sales | \$310,393 | | \$227,534 | | \$295,618 | |
| Cost of goods sold | <u>202,710</u> | | <u>167,069</u> | | <u>214,175</u> | |
| Gross profit | 107,683 | 34.7 | 60,465 | 26.6 | 81,443 | 27.6 |
| Marketing, engineering and administrative expenses | 72,713 | 23.4 | 56,886 | 25.0 | 60,470 | 20.5 |
| Restructuring of operations | <u>254</u> | 0.1 | <u>494</u> | 0.2 | <u>1,188</u> | 0.4 |
| Earnings from operations | <u>\$34,716</u> | 11.2 | <u>\$3,085</u> | 1.4 | <u>\$19,785</u> | 6.7 |

Fiscal 2011 Compared to Fiscal 2010**Net Sales**

Net sales increased \$82.9 million, or 36.4%, in fiscal 2011. The year-over-year movement in foreign exchange rates resulted in a net favorable translation effect on sales of \$3.2 million in fiscal 2011 compared to fiscal 2010.

In fiscal 2011, sales for our worldwide manufacturing operations, before eliminating intra-segment and inter-segment sales, were higher by \$84.3 million, or 46.0%, than in the prior fiscal year. Year-over-year changes in foreign exchange rates had a net favorable impact on sales of \$0.7 million. In fiscal 2011, our domestic manufacturing operation saw the largest growth, with a 63.8% increase in sales versus fiscal 2010. The primary driver for this increase was the sale of transmissions and related products for the oil and gas markets as well as increased aftermarket shipments. The Company's Italian manufacturing operations, which were adversely impacted by the softness in the European mega yacht and industrial markets in fiscal 2009 and 2010, experienced some growth, with a 28.2% increase in sales compared to the prior fiscal year, after an extended period of decline in the second half of fiscal 2009 and throughout fiscal 2010. The Company's Belgian manufacturing operation saw an 11.8% increase in sales versus the prior year, although it continued to be adversely impacted by the softness in the global mega yacht market. The Company's Swiss manufacturing operation, which supplies customized propellers for the global mega yacht and patrol boat markets, experienced a 10.1% increase in sales compared to the prior fiscal year, primarily due to the impact of the strengthening Swiss Franc compared to the US Dollar.

Our distribution segment, buoyed by continued growth in Asia and the North American oil and gas markets, experienced an increase of \$27.2 million, or 26.9%, in sales in fiscal 2011 compared to fiscal 2010. Compared to fiscal 2010, on average, the Asian currencies strengthened against the U.S. Dollar. The net translation effect of this on foreign distribution operations was to increase revenues for the distribution segment by approximately \$7.8 million versus the prior year, before eliminations. The Company's distribution operations in Singapore continued to experience strong demand for marine transmission products for use in various commercial applications. This operation saw a 7.6% increase in sales versus the same period a year ago, and set a new sales record. The Company's distribution operation in the Northwest of the United States and Southwest of Canada experienced nearly a tripling of its sales due to strength in the Canadian oil and gas market. The Company's distribution operation in Italy, which provides boat accessories and propulsion systems for the pleasure craft market, saw a decrease in sales of 23.6% due to continued weakness in the Italian mega yacht market. The Company's distribution operation in Australia, which provides boat accessories, propulsion and marine transmission systems for the pleasure craft market, saw an increase in sales of 26.1%, due to improving market conditions, including sales of components parts for the Company's new Express Joystick System® that were shipped in fiscal 2011.

Net sales for the Company's largest product market, marine transmission and propulsion systems, were up 9% compared to the prior fiscal year. Sales of the Company's boat management systems manufactured at our Italian operation and servicing the global mega yacht market, were up approximately 12% versus the prior fiscal year. The Company saw modest recovery across most of the marine product markets it serves. In the off-highway transmission market, the year-over-year increase of just over 124% can be attributed primarily to increased sales of the 8500 series transmission system for the oil and gas markets. Sales of transmission systems for the military market were up slightly over the prior fiscal year. Vehicular transmissions for the airport rescue and fire fighting (ARFF) and agricultural tractor markets were down versus fiscal 2010, however, the year-end backlog was up versus the prior fiscal year end. The increase experienced in the Company's industrial products of roughly 10% was due to increased sales into the agriculture, mining and general industrial markets, primarily in the North American and Italian markets, as well as increased activity related to oil field markets.

The elimination for net intra-segment and inter-segment sales increased \$28.6 million, or 50.1%, from \$57.2 million in fiscal 2010 to \$85.8 million in fiscal 2011. Year-over-year changes in foreign exchange rates had a net unfavorable impact of \$5.2 million on net intra-segment and inter-segment sales.

Gross Profit

In fiscal 2011, gross profit increased \$47.2 million, or 78.1%, to \$107.7 million. Gross profit as a percentage of sales increased 810 basis points in fiscal 2011 to 34.7%, compared to 26.6% in fiscal 2010. The table below summarizes the gross profit trend by quarter for fiscal years 2011 and 2010:

| | <u>1st Qtr</u> | <u>2nd Qtr</u> | <u>3rd Qtr</u> | <u>4th Qtr</u> | <u>Year</u> |
|----------------------|---------------------------|---------------------------|---------------------------|---------------------------|-------------|
| <u>Gross Profit:</u> | | | | | |
| (\$ millions) | | | | | |
| 2011 | \$20.0 | \$23.8 | \$27.8 | \$36.1 | \$107.7 |
| 2010 | \$ 9.7 | \$14.8 | \$16.5 | \$19.5 | \$ 60.5 |
| <u>% of Sales:</u> | | | | | |
| 2011 | 32.6% | 31.6% | 36.3% | 37.1% | 34.7% |
| 2010 | 20.7% | 26.8% | 27.1% | 30.2% | 26.6% |

There were a number of factors that impacted the Company's overall gross margin rate in fiscal 2011. Gross margin for the year was favorably impacted by higher volumes, improved product mix, the absence of extended shutdowns in the first half of the fiscal year at the Company's domestic and European manufacturing operations, which occurred in fiscal 2010, and a decrease in expenses related to the Company's defined benefit plans. In addition, warranty expense as a percentage of sales decreased from 1.63%, or \$3.7 million, in fiscal 2010 to 1.27%, or \$3.9 million, in fiscal 2011 (for additional information on the Company's warranty expense, see Note F of the Notes to the Consolidated Financial Statements). The Company estimates the net favorable impact of higher volumes on gross margin in fiscal 2011 was approximately \$36 million. The favorable shift in product mix related to the Company's oil and gas transmission business had an estimated impact of \$7 million. The decrease in warranty expense as a percentage of sales can be attributed to an increase in volume and an overall reduction in specific warranty campaigns that were experienced in fiscal 2010. In addition, the year-over-year movement in foreign exchange rates, primarily driven by movements in the Euro and Asian currencies, resulted in a net favorable translation effect on gross profit of \$1.9 million in fiscal 2011 compared to fiscal 2010. Partially offsetting the above favorable items, the Company reinstated its annual incentive plan in fiscal 2011. Approximately \$1.5 million of the expense associated with the plan was recorded in cost of goods sold in fiscal 2011 compared to \$0 in fiscal 2010.

Marketing, Engineering and Administrative (ME&A) Expenses

Marketing, engineering, and administrative (ME&A) expenses increased \$15.8 million, or 27.8%, in fiscal 2011 versus fiscal 2010. Despite a significant increase in sales, and an increase in compensation related costs, as a percentage of sales, ME&A expenses decreased by 160 basis points to 23.4% in fiscal 2011, compared to 25.0% in fiscal 2010. The table below summarizes significant changes in certain ME&A expenses for the fiscal year:

| | <u>Fiscal Year Ended</u> | | <u>Increase/</u> |
|--|--------------------------|----------------------|-------------------|
| <u>\$ thousands – (Income)/Expense</u> | <u>June 30, 2011</u> | <u>June 30, 2010</u> | <u>(Decrease)</u> |
| Stock-Based Compensation | \$ 6,148 | \$ 507 | \$ 5,641 |
| Incentive/Bonus Expense | 4,964 | - | <u>4,964</u> |
| | | | 10,605 |

| | |
|------------------------------|------------------|
| Foreign Currency Translation | <u>1,015</u> |
| | 11,620 |
| All Other, Net | <u>4,207</u> |
| | <u>\$ 15,827</u> |

The net remaining increase in ME&A expenses for the year of \$4,207,000 was primarily driven by the restoration of salary and wage reductions effected in fiscal 2010, higher benefit costs, increased travel, higher project related expenses and a continued emphasis on the Company's product development program. As announced in June 2009, the Company implemented various measures which included a reduction of annual base salaries of the Company's salaried employees including all executive officers, removal of the fiscal 2010 bonus/incentive plan, changes to several benefit programs, an across-the-board reduction of marketing, advertising, travel and entertainment expenses, and staff reductions and layoffs. The significant increase in stock-based compensation versus the prior year (\$5,641,000) was driven by the accrual for performance-based awards granted in fiscal 2011, a catch-up accrual for performance-based awards granted in fiscal 2010 and the impact of the significant increase in the Company's stock price (+340%) on the cash-based performance stock unit awards. The Company began accruing the performance-based awards granted in fiscal 2009 and 2010 at the maximum payout level in fiscal 2011 due to the strong improvement in operating results. No accrual was recorded for performance awards in fiscal 2010 due to the shortfall against performance targets, resulting in the required "catch-up" accrual for the fiscal 2010 awards. For additional information on the Company's stock-based compensation, see Note K of the Notes to the Consolidated Financial Statements.

Restructuring of Operations

During the fourth quarter of fiscal 2009, the Company recorded a pre-tax restructuring charge of \$948,000 related to a workforce reduction at its Racine, Canadian and Australian operations. The charge consisted of severance costs for 22 salaried employees and voluntary early retirement charges for an additional 16 manufacturing employees. During fiscal 2009, the Company made cash payments of \$180,000, resulting in an accrual balance at June 30, 2009 of \$767,000. The remainder of this balance was paid during fiscal 2010, resulting in no accrual balance at June 30, 2010 or 2011.

During the fourth quarter of fiscal 2007, the Company recorded a pre-tax restructuring charge of \$2,652,000 related to a workforce reduction at its Belgian operation that will allow for improved profitability through targeted outsourcing savings and additional focus on core manufacturing processes. The charge consisted of prepension costs for 32 employees: 29 manufacturing employees and 3 salaried employees. This charge was adjusted in the fourth quarter of fiscal 2008, resulting in a pre-tax benefit of \$373,000, due to final negotiations primarily related to notice period pay. Further adjustments were made in the fourth quarter of fiscal 2009 (resulting in a pre-tax expense of \$240,000 related to legally required inflationary adjustments to benefits) and fiscal 2010 (resulting in a pre-tax expense of \$342,000 primarily related to a Belgian legislation change surrounding the prepension costs and legally required inflationary adjustments). An additional adjustment was made during the fourth quarter of fiscal 2011, resulting in pre-tax expense of \$187,000 related to the annual legally required inflationary adjustments to benefits. During fiscal 2011 and 2010, the Company made cash payments of \$252,000 and \$152,000, respectively. The exchange impact in fiscal 2011 was to increase the accrual by \$413,000. Accrued restructuring costs were \$2,663,000 and \$2,315,000 at June 30, 2011 and 2010, respectively.

The Company recorded a restructuring charge of \$2,076,000 in the fourth quarter of fiscal 2005 as the Company restructured its Belgian operation to improve future profitability. The charge consists of prepension costs for 37 employees: 33 manufacturing employees and 4 salaried employees. An adjustment was made in the fourth quarter of fiscal 2010, resulting in a pre-tax expense of \$138,000 primarily related to a Belgian legislation change surrounding the prepension costs and legally required inflationary adjustments. An additional adjustment was made in the fourth quarter of fiscal 2011, resulting in pre-tax expense of \$58,000 related to the annual legally required inflationary adjustments to benefits. During fiscal 2011 and 2010, the Company made cash payments of \$220,000 and \$192,000, respectively. The exchange impact in fiscal 2011 was to increase the accrual by \$161,000. Accrued restructuring costs were \$944,000 and \$945,000 at June 30, 2011 and 2010, respectively.

Interest Expense

Interest expense decreased by \$0.5 million, or 24.7%, in fiscal 2011. Total interest on the Company's \$40 million revolving credit facility ("revolver") decreased \$0.2 million from \$0.6 million in fiscal 2010 to \$0.4 million in fiscal 2011. This decrease can be attributed to an overall decrease in the average borrowings year-over-year. The average borrowing on the revolver, computed monthly, decreased to \$9.9 million in fiscal 2011, compared to \$14.4 million in fiscal 2010. The interest rate on the revolver remained flat at 4.00%, the rate floor, for the first eleven months of the fiscal year. In the fourth fiscal quarter of fiscal 2011, the Company entered into an amended revolver agreement that eliminated the rate floor. As of June 30, 2011, the rate on the revolver was 2.09%. Interest expense for the Company's \$25 million Senior Notes, which carry a fixed interest rate of 6.05%, decreased by \$0.2 million to \$1.2 million in fiscal 2011.

Income Taxes

The effective tax rate for fiscal 2011 of 40.8 percent is significantly lower than the prior year rate of 57.6 percent. As announced in the third fiscal quarter, the current year rate was unfavorably impacted by the recording of a valuation allowance against the net deferred tax asset at one of the Company's foreign jurisdictions, resulting in additional tax expense of approximately \$1,613,000 related to the reversal of the fiscal 2010 ending deferred tax asset, along with the absence of a tax benefit on the current year losses in this jurisdiction. This unfavorable item was partially offset by a \$794,000 benefit due to a favorable adjustment to the domestic net deferred tax asset resulting from the increase in the domestic estimated tax rate from 34.0 percent to 35.0 percent during fiscal 2011. The current year also includes the favorable impact of the reinstatement of the R&D credit, which was passed into law during the second fiscal quarter. The annualized effective rate before 2011 discrete items is 33.3 percent. The prior year rate was relatively high due to the impact of permanent deferred items, which remained relatively constant but had a greater impact on the rate due to the low base of earnings.

Order Rates

As of June 30, 2011, the Company's backlog of orders scheduled for shipment during the next six months (six-month backlog) was \$146.9 million, or approximately 74% higher than the six-month backlog of \$84.4 million as of June 30, 2010. The improvement in backlog is a result of increased orders by oil and gas customers for the Company's 8500 series transmission as stable oil and gas prices have driven demand for new high-horsepower rigs. With oil and gas prices remaining firm, the Company is optimistic demand for these transmissions will continue. In addition, the Company has begun to accept orders and has shipped initial units of its new 7500 series transmission for the oil and gas market. In the second half of fiscal 2011, the Company also saw modest growth in the six-month backlog for most of its marine and industrial products.

Fiscal 2010 Compared to Fiscal 2009

Net Sales

Net sales decreased \$68.1 million, or 23.0%, in fiscal 2010. The year-over-year movement in foreign exchange rates resulted in a net favorable translation effect on sales of \$3.3 million in fiscal 2010, compared to fiscal 2009.

In fiscal 2010, sales for our worldwide manufacturing operations, before eliminating intra-segment and inter-segment sales, were lower by \$82.5 million, or 31.0%, than in the prior fiscal year. Year-over-year changes in foreign exchange rates had a net favorable impact on sales of \$1.0 million. Sales at the Company's domestic manufacturing location were down \$37.1 million, primarily driven by lower sales of marine transmissions, industrial products and aftermarket parts, partially offset by higher sales of land-based oil and gas transmissions and surface drives for the global patrol boat market. The net remaining decrease came at the Company's European manufacturing operations and was primarily due to the impact of the continued softening experienced in the global mega yacht, European commercial marine and industrial markets.

Net sales for distribution operations were down a more modest \$11.0 million, or 9.8%, in fiscal 2010. Year-over-year changes in foreign exchange rates had a net favorable impact on sales of \$4.9 million. The Company's distribution operation in Singapore, which serves the Asian market, saw a 3.9% year-over-year decrease in sales, off of fiscal 2009's record level. This slight decrease was primarily driven by decreased shipments in the fourth fiscal quarter of commercial marine transmissions for Asian markets. The Company's distribution operations in Europe, Australia and the Southeastern United States experienced sharper declines versus the prior fiscal year due to the continued softening of the global mega yacht and industrial markets. The Company provides marine transmissions, and propulsion and boat management systems to serve the global mega yacht market.

Net sales for the Company's largest product market, marine transmission and propulsion systems, were down 22.7% compared to the prior fiscal year. Increased sales of propulsion and transmission systems for the military patrol boat market were up significantly, but were more than offset by continued weakness in the European mega yacht market as well as some softening off of record levels in the commercial marine market. Sales of the Company's boat management systems manufactured at our Italian operation and servicing the global mega yacht market, were off approximately 40% versus the prior fiscal year. This was primarily driven by continued weakening in sales to builders of mega yachts. In the off-highway transmission market, the year-over-year decrease of just over 10% can be attributed primarily to decreased sales of the Company's vehicular transmissions for the airport, rescue and fire fighting (ARFF) and agricultural tractor markets, only partially offset by increased transmission sales in land-based oil field markets. Sales of transmission systems for the military market were relatively flat year-over-year. The decrease experienced in the Company's industrial products of roughly 29% was due to decreased sales into the agriculture, mining and general industrial markets, primarily in the North American and Italian markets, partially offset by increased activity related to oil field markets.

The elimination for net intra-segment and inter-segment sales decreased \$25.4 million, or 30.7%, from \$82.6 million in fiscal 2009 to \$57.2 million in fiscal 2010. Year-over-year changes in foreign exchange rates had a net unfavorable impact of \$2.6 million on net intra-segment and inter-segment sales.

Gross Profit

In fiscal 2010, gross profit decreased \$21.0 million, or 25.8%, to \$60.5 million. Gross profit as a percentage of sales decreased 100 basis points in fiscal 2010 to 26.6%, compared to 27.6% in fiscal 2009. The table below summarizes the gross profit trend by quarter for fiscal years 2010 and 2009:

| | 1 st Qtr | 2 nd Qtr | 3 rd Qtr | 4 th Qtr | Year |
|----------------------|---------------------|---------------------|---------------------|---------------------|--------|
| Gross Profit: | | | | | |
| (\$ millions) | | | | | |
| 2010 | \$ 9.7 | \$14.8 | \$16.5 | \$19.5 | \$60.5 |
| 2009 | \$20.1 | \$22.9 | \$19.2 | \$19.2 | \$81.4 |
| % of Sales: | | | | | |
| 2010 | 20.7% | 26.8% | 27.1% | 30.2% | 26.6% |
| 2009 | 27.6% | 28.1% | 27.6% | 26.7% | 27.6% |

There were a number of factors that impacted the Company's overall gross margin rate in fiscal 2010. Gross margin for the year was unfavorably impacted by lower volumes, extended shutdowns in the first half of the fiscal year at the Company's domestic and European manufacturing operations, and an increase in expenses related to the Company's defined benefit plans. The Company estimates the net unfavorable impact of lower volumes on gross margin in fiscal 2010 was approximately \$27 million. On June 3, 2009 the Company announced it would freeze future accruals under the domestic defined benefit pension plans effective August 1, 2009. This resulted in a curtailment gain of \$1.7 million recorded in the fourth quarter of fiscal 2009. Of this amount, \$1.2 million was recorded as income in cost of goods sold, with the remainder recorded in ME&A expenses. As a result, there was a net increase in the defined benefit pension expense recorded in cost of goods sold of \$2.8 million, from a net benefit of \$(0.5) million in fiscal 2009 to a net expense of \$2.3 million in fiscal 2010 (see Note M of the Notes to the Consolidated Financial Statements). The net impact of this change was to decrease gross profit as a percentage of sales by nearly 120 basis points. The above were partially offset by a favorable shift in product mix, primarily related to oilfield products in the second half of the fiscal year (estimated impact was \$0.7 million), selective pricing actions, and lower warranty expenses. Total warranty expense decreased over \$2.7 million in the current fiscal year, from \$6.4 million in fiscal 2009 to \$3.7 million in fiscal 2010 (see Note F of the Notes to the Consolidated Financial Statements). The decrease in warranty expense can be attributed to a decrease in volume and an overall reduction in specific warranty campaigns that were experienced in fiscal 2009. The net impact of this change was to increase gross profit as a percentage of sales by nearly 50 basis points. In addition, the year-over-year movement in foreign exchange rates, primarily driven by movements in the Euro and Asian currencies, resulted in a net favorable translation effect on gross profit of \$1.2 million in fiscal 2010, compared to fiscal 2009.

Marketing, Engineering and Administrative (ME&A) Expenses

Marketing, engineering, and administrative (ME&A) expenses decreased \$3.6 million, or 5.9%, in fiscal 2010 versus fiscal 2009. As a percentage of sales, ME&A expenses increased by 450 basis points to 25.0% in fiscal 2010, compared to 20.5% in fiscal 2009. The table below summarizes significant changes in certain ME&A expenses for the fiscal year:

| \$ thousands – (Income)/Expense | Fiscal Year Ended | | Increase/ (Decrease) |
|---------------------------------|-------------------|------------------------------|-------------------------|
| | June 30, 2010 | June 30, 2009 | |
| Pension | \$ 2,044 | \$ 413 | \$ 1,631 |
| Stock Based Compensation | 505 | (581) | 1,086 |
| Severance | - | 1,308 | (1,308) |
| Domestic/Corporate IT Expenses | 4,847 | 5,740 | (893) |
| | | | 516 |
| | | Foreign Currency Translation | 924 |
| | | | 1,440 |
| | | All Other, Net | (5,024) |
| | | | <u>\$ (3,584)</u> |

The net remaining decrease in ME&A expenses for the year of \$5,024,000 primarily relates to the global cost reduction initiatives implemented by the Company at the end of fiscal 2009. As announced in June 2009, the actions included a reduction of annual base salaries of the Company's salaried employees including all executive officers, removal of the fiscal 2010 bonus/incentive plan, changes to several benefit programs, an across-the-board reduction of marketing, advertising, travel and entertainment expenses, and staff reductions and layoffs. In fiscal 2009, the decrease in stock based compensation expense for executive officers was primarily driven by the reversal of accruals for long-term incentive compensation awards for fiscal years 2010 and 2011, due to the low probability of achieving the threshold performance levels (see Note K of the Notes to the Consolidated Financial Statements). The severance change in fiscal 2009 related to actions announced in the second quarter at the Company's Belgian operation. In fiscal 2009, domestic and corporate IT expenses included a higher level of spending related to the implementation of the Company's new global ERP system.

Restructuring of Operations

During the fourth quarter of fiscal 2009, the Company recorded a pre-tax restructuring charge of \$948,000 related to a workforce reduction at its Racine, Canadian and Australian operations. The charge consisted of severance costs for 22 salaried employees and voluntary early retirement charges for an additional 16 manufacturing employees. During fiscal 2009, the Company made cash payments of \$180,000, resulting in an accrual balance at June 30, 2009 of \$767,000. The remainder of this balance was paid during fiscal 2010, resulting in no accrual balance at June 30, 2010.

During the fourth quarter of fiscal 2007, the Company recorded a pre-tax restructuring charge of \$2,652,000 related to a workforce reduction at its Belgian operation to improve profitability through targeted outsourcing savings and additional focus on core manufacturing processes. The charge consisted of prepension costs for 32 employees: 29 manufacturing employees and 3 salaried employees. An adjustment was made in the fourth quarter of fiscal 2009, resulting in a pre-tax expense of \$240,000 related to legally required inflationary adjustments to benefits. An additional adjustment was made in the fourth quarter of fiscal 2010, resulting in a pre-tax expense of \$342,000 primarily related to a Belgian legislation change surrounding the prepension costs and legally required inflationary adjustments. During fiscal 2010 and 2009, the Company made cash payments of \$152,000 and \$120,000, respectively. The exchange impact in fiscal 2010 was to reduce the accrual by \$292,000. Accrued restructuring costs were \$2,315,000 and \$2,417,000 at June 30, 2010 and 2009, respectively.

The Company recorded a restructuring charge of \$2,076,000 in the fourth quarter of fiscal 2005 as the Company restructured its Belgian operation to improve future profitability. The charge consists of prepension costs for 37 employees: 33 manufacturing employees and 4 salaried employees. An adjustment was made in the fourth quarter of fiscal 2010, resulting in a pre-tax expense of \$138,000 primarily related to a Belgian legislation change surrounding the prepension costs and legally required inflationary adjustments. During fiscal 2010 and 2009, the

Company made cash payments of \$192,000 and \$200,000, respectively. The exchange impact in fiscal 2010 was to reduce the accrual by \$122,000. Accrued restructuring costs were \$945,000 and \$1,121,000 at June 30, 2010 and 2009, respectively.

Interest Expense

Interest expense decreased by \$0.2 million, or 8.2%, in fiscal 2010. Total interest on the Company's \$35 million revolving credit facility ("revolver") decreased \$0.2 million from \$0.8 million in fiscal 2009 to \$0.6 million in fiscal 2010. This decrease can be attributed to an overall decrease in the average borrowings year-over-year partially offset by an increase in the interest rate on the revolver year-over-year. The average borrowing on the revolver, computed monthly, decreased to \$14.4 million in fiscal 2010, compared to \$24.0 million in fiscal 2009. Partially offsetting the average decreased borrowing, the interest rate on the revolver increased from a range of 1.69% to 4.00% in fiscal 2009 to 4.00%, the rate floor, for all of fiscal 2010. Interest expense for the Company's \$25 million Senior Notes, which carry a fixed interest rate of 6.05%, remained flat at \$1.5 million. The net remaining interest expense of \$0.2 million was from various borrowings at the Company's foreign subsidiaries.

Income Taxes

For 2010, the effective tax rate was 57.6 percent, compared to 34.7 percent last fiscal year. The increased rate for 2010 was primarily due to the impact of permanent items, which remained relatively constant with the prior year, but had a greater impact on the tax rate due to the low base of earnings. In addition, the prior fiscal year included a 3.0 percentage point benefit (rate reduction) related to an increase in foreign tax credits, which resulted in the relatively low rate for fiscal 2009.

Order Rates

As of June 30, 2010, the Company's backlog of orders scheduled for shipment during the next six months (six-month backlog) was \$84.4 million, or approximately 40% higher than the six-month backlog of \$60.6 million as of June 30, 2009. The improvement in backlog is a result of increased orders by oil and gas customers for the Company's 8500 series transmission as stable oil and gas prices have driven demand for new high-horsepower rigs. With oil and gas prices remaining firm, the Company is optimistic demand for these transmissions will continue. In addition, the Company continues to work on the development of its 7500 series transmission and expects to start production in the second half of fiscal 2011.

Liquidity and Capital Resources

Fiscal Years 2011, 2010 and 2009

The net cash provided by operating activities in fiscal 2011 totaled \$13.9 million, a decrease of \$21.3 million, or 61%, versus fiscal 2010. The net decrease was driven by a net increase in working capital, primarily due to increases in net inventories and trade accounts receivable balances, partially offset by a net increase in trade accounts payable and net earnings of \$18.2 million. The majority of the net increase in inventory came at the Company's North American manufacturing and distribution operations. This increase was driven by strong demand for the Company's 8500 series transmission for the oil and gas market as well as a build-up of inventory in anticipation of the demand for the Company's new 7500 series transmission. Net inventory as a percentage of the six-month backlog decreased from 86.2% as of June 30, 2010 to 67.4% as of June 30, 2011. The increase in trade accounts receivable was a result of higher sales in the second half of fiscal 2011 compared to the same period in fiscal 2010.

The net cash provided by operating activities in fiscal 2010 totaled \$35.1 million, an increase of \$23.5 million, or 203%, versus fiscal 2009. The net increase was driven by a net decrease in working capital, primarily due to decreases in net inventories and trade accounts receivable balances, partially offset by a net decrease in net earnings of \$11.1 million. The net decrease in inventory came primarily at the Company's European manufacturing locations and its distribution operation in Singapore. The decrease in trade accounts receivable was a result of lower sales in the second half of fiscal 2010 compared to the same period in fiscal 2009 as well as a continued effort to collect outstanding receivables balances globally.

The net cash provided by operating activities in fiscal 2009 totaled \$11.6 million, a decrease of \$8.3 million, or 42%, versus fiscal 2008. The net decrease was driven primarily by a net decrease in net earnings of \$12.6 million, partially offset by decreases in working capital, primarily accounts payable and accrued liabilities. The decrease in accounts payable can primarily be attributed to the general volume decline in the fourth fiscal quarter as well as reduced inventories at the Company's manufacturing locations. The decrease in accrued liabilities primarily relates to the reduction in bonus and stock-based compensation accruals versus the end of the prior fiscal year. The net increase in inventory came primarily at the Company's distribution operation in Singapore, which saw double-digit sales growth throughout fiscal 2009 when compared to the same period in fiscal 2008.

The net cash used for investing activities in fiscal 2011 of \$12.0 million consisted primarily of capital expenditures for machinery and equipment at our domestic and Belgian manufacturing operations. In fiscal 2011, the Company spent \$12.0 million for capital expenditures, up from \$4.5 million and \$8.9 million in fiscal years 2010 and 2009, respectively.

The net cash used for investing activities in fiscal 2010 of \$4.6 million consisted primarily of capital expenditures for machinery and equipment at our domestic and Belgian manufacturing operations, and the continuation of the global implementation of a new ERP system started in fiscal 2007. In fiscal 2010, the Company spent \$4.5 million for capital expenditures, down from \$8.9 million and \$15.0 million in fiscal years 2009 and 2008, respectively. The software costs associated with the new ERP have been substantially paid for and were capitalized as appropriate in fiscal years 2007 and 2008.

The net cash used for investing activities in fiscal 2009 of \$7.8 million consisted primarily of capital expenditures for machinery and equipment at our domestic and Belgian manufacturing operations, and the continuation of the global implementation of a new ERP system started in fiscal 2007. In fiscal 2010, the Company expects to complete the majority of the remaining ERP implementation work for its foreign manufacturing and distribution operations. The software costs associated with the new ERP have been substantially paid for and capitalized as appropriate in fiscal years 2007 and 2008.

In fiscal 2011, the net cash used by financing activities of \$4.2 million consisted primarily of payments on long-term debt of \$1.4 million and dividends paid to shareholders of the Company of \$3.4 million.

In fiscal 2010, the net cash used by financing activities of \$23.2 million consisted primarily of payments on long-term debt and dividends paid to shareholders of the Company.

In fiscal 2009, the net cash used by financing activities of \$4.2 million consisted primarily of dividends paid to shareholders of the Company and the purchase of shares of the Company's outstanding common stock under a Board authorized stock repurchase program, offset by net borrowings on the Company's revolving credit facility. In the second fiscal quarter of 2009, the Company repurchased a total of 250,000 shares of its outstanding common stock at an average price of \$7.25 per share, for a total of \$1.8 million. In addition, the Company paid \$3.1 million in dividends to its shareholders, a 3.5% increase over fiscal 2008. These were offset by over \$2.8 million in additional borrowings under the Company's revolving credit facility.

Future Liquidity and Capital Resources

In December 2002, the Company entered into a \$20,000,000 revolving loan agreement with M&I Marshall & Ilsley Bank ("M&I"), which had an original expiration date of October 31, 2005. Through a series of amendments, the last of which was agreed to during the fourth quarter of fiscal 2011, the total commitment was increased to \$40,000,000 and the term was extended to May 31, 2015. This agreement contains certain covenants, including restrictions on investments, acquisitions and indebtedness. Financial covenants include a minimum consolidated net worth amount, a minimum EBITDA for the most recent four fiscal quarters of \$11,000,000 at June 30, 2011, and a maximum total funded debt to EBITDA ratio of 3.0 at June 30, 2011. As of June 30, 2011, the Company was in compliance with these covenants with a four quarter EBITDA total of \$43,517,000 and a funded debt to EBITDA ratio of 0.68. The minimum net worth covenant fluctuates based upon actual earnings and is subject to adjustment for certain pension accounting adjustments to equity. As of June 30, 2011, the minimum equity requirement was \$108,427,000 compared to an actual result of \$171,085,000 after all required adjustments. The outstanding balance under the revolving loan agreement of \$11,300,000 and \$9,000,000 at June 30, 2011 and June 30, 2010, respectively, is classified as long-term debt. In accordance with the loan agreement as amended, the Company can borrow at LIBOR plus an additional "Add-On," between 1.5% and 2.5%, depending on the Company's Total Funded Debt to EBITDA ratio. The rate was 2.09% and 4.0% at June 30, 2011 and 2010, respectively.

On April 10, 2006, the Company entered into a Note Agreement (the "Note Agreement") with The Prudential Insurance Company of America and certain other entities (collectively, "Purchasers"). Pursuant to the Note Agreement, Purchasers acquired, in the aggregate, \$25,000,000 in 6.05% Senior Notes due April 10, 2016 (the "Notes"). The Notes mature and become due and payable in full on April 10, 2016 (the "Payment Date"). Prior to the Payment Date, the Company is obligated to make quarterly payments of interest during the term of the Notes, plus prepayments of principal of \$3,571,429 on April 10 of each year from 2010 to 2015, inclusive. The outstanding balance was \$17,857,143 and \$21,428,571 at June 30, 2011 and 2010, respectively. Of the outstanding balance, \$3,571,429 was classified as a current maturity of long-term debt at June 30, 2011 and 2010, respectively. The remaining \$14,287,714 and \$17,857,142 is classified as long-term debt as of June 30, 2011 and 2010, respectively. The Company also has the option of making additional prepayments subject to certain limitations, including the payment of a Yield-Maintenance Amount as defined in the Note Agreement. In addition, the Company will be required to make an offer to purchase the Notes upon a Change of Control, and any such offer must include the payment of a Yield-Maintenance Amount. The Note Agreement includes certain financial covenants which are identical to those associated with the revolving loan agreement discussed above. The Note Agreement also includes certain restrictive covenants that limit, among other things, the incurrence of additional indebtedness and the disposition of assets outside the ordinary course of business. The Note Agreement provides that it shall automatically include any covenants or events of default not previously included in the Note Agreement to the extent such covenants or events of default are granted to any other lender of an amount in excess of \$1,000,000. Following an Event of Default, each Purchaser may accelerate all amounts outstanding under the Notes held by such party.

Four quarter EBITDA and total funded debt are non-GAAP measures, and are included herein for the purpose of disclosing the status of the Company's compliance with the four quarter EBITDA covenant and the total funded debt to four quarter EBITDA ratio covenant described above. In accordance with the Company's revolving loan agreement with M&I and the Note Agreement:

- "Four quarter EBITDA" is defined as "the sum of (i) Net Income plus, to the extent deducted in the calculation of Net Income, (ii) interest expense, (iii) depreciation and amortization expense, and (iv) income tax expense;" and
- "Total funded debt" is defined as "(i) all Indebtedness for borrowed money (including without limitation, Indebtedness evidenced by promissory notes, bonds, debentures and similar interest-bearing instruments), plus (ii) all purchase money Indebtedness, plus (iii) the principal portion of capital lease obligations, plus (iv) the maximum amount which is available to be drawn under letters of credit then outstanding, all as determined for the Company and its consolidated Subsidiaries as of the date of determination, without duplication, and in accordance with generally accepted accounting principles applied on a consistent basis."
- "Total funded debt to four quarter EBITDA" is defined as the ratio of total funded debt to four quarter EBITDA calculated in accordance with the above definitions.

The Company's total funded debt as of June 30, 2011 and June 30, 2010 was equal to the total debt reported on the Company's June 30, 2011 and June 30, 2010 Consolidated Balance Sheet, and therefore no reconciliation is included herein. The following table sets forth the reconciliation of the Company's reported Net Earnings to the calculation of four quarter EBITDA for the four quarters ended June 30, 2011:

Four Quarter EBITDA Reconciliation

| | |
|--|---------------------|
| Net Earnings Attributable to Twin Disc | \$18,830,000 |
| Depreciation & Amortization | 9,904,000 |
| Interest Expense | 1,719,000 |
| Income Taxes | <u>13,064,000</u> |
| Four Quarter EBITDA | <u>\$43,517,000</u> |

Total Funded Debt to Four Quarter EBITDA

| | |
|--|-------------------|
| Total Funded Debt | \$29,699,000 |
| Divided by: Four Quarter EBITDA | <u>43,517,000</u> |
| Total Funded Debt to Four Quarter EBITDA | <u>0.68</u> |

As of June 30, 2011, the Company was in compliance with all of the covenants described above. As of June 30, 2011, the Company's backlog of orders scheduled for shipment during the next six months (six-month backlog) was \$146.9 million, or approximately 74% higher than the six-month backlog of \$84.4 million as of June 30, 2010. In light of the increasing order backlog and overall improving business trends in some of the Company's key product markets, in particular the global land-based oil & gas transmission market, the Company does not expect to violate any of its financial covenants in fiscal 2012. The current margin surrounding ongoing compliance with the above covenants, in particular, minimum EBITDA for the most recent four fiscal quarters and total funded debt to EBITDA, are expected to continue to improve in fiscal 2012. Please see the factors discussed under Item 1A, Risk Factors, of this Form 10-K for further discussion of this topic.

The Company's balance sheet remains very strong, there are no off-balance-sheet arrangements other than the operating leases listed below, and we continue to have sufficient liquidity for near-term needs. The Company had \$28.7 million of available borrowings on our \$40 million revolving loan agreement as of June 30, 2011, and continues to generate enough cash from operations to meet our operating and investing needs. For the years ended June 30, 2011 and June 30, 2010, respectively, the Company generated net cash from operating activities of \$13.9 million and \$35.1 million, respectively. As of June 30, 2011, the Company also had cash of \$20.2 million, primarily at its overseas operations. These funds, with some restrictions, are available for repatriation as deemed necessary by the Company. In fiscal 2012, the Company expects to contribute \$3,728,000 to its defined benefit plans, the minimum contributions required. However, if the Company elects to make voluntary contributions in fiscal 2012, it intends to do so using cash from operations and, if necessary, from available borrowings under existing credit facilities.

Net working capital increased \$27.1 million, or 32.2%, in fiscal 2011, and the current ratio remained flat at 2.3 at June 30, 2011 and June 30, 2010, respectively. The increase in net working capital was primarily driven by an increase in accounts receivable and inventories as a result of a significant increase in sales and orders in fiscal 2011, partially offset by an increase in trade accounts payable.

Twin Disc expects capital expenditures to be between \$15 and \$20 million in fiscal 2012. These anticipated expenditures reflect the Company's plans to continue investing in modern equipment and facilities, its global sourcing program and new products as well as expanding capacity at facilities around the world.

Management believes that available cash, the credit facility, cash generated from future operations, existing lines of credit and potential access to debt markets will be adequate to fund Twin Disc's capital requirements for the foreseeable future.

Off Balance Sheet Arrangements and Contractual Obligations

The Company had no off-balance sheet arrangements, other than operating leases, as of June 30, 2011 and 2010.

The Company has obligations under non-cancelable operating lease contracts and loan and senior note agreements for certain future payments. A summary of those commitments follows (in thousands):

| | Total | Less than 1 Year | 1-3 Years | 3-5 Years | After 5 Years |
|--------------------------|----------|------------------|-----------|-----------|---------------|
| Contractual Obligations | | | | | |
| Revolving loan borrowing | \$11,300 | \$ - | \$ - | \$11,300 | \$ - |
| Long-term debt | \$18,399 | \$ 3,915 | \$ 7,310 | \$ 7,143 | \$ 31 |
| Operating leases | \$ 5,954 | \$ 2,920 | \$ 2,666 | \$ 368 | \$ - |

The table above does not include tax liabilities for unrecognized tax benefits totaling \$853,000, excluding related interest and penalties, as the timing of their resolution cannot be estimated. See Note N of the Consolidated Financial Statements for disclosures surrounding uncertain income tax positions.

The Company maintains defined benefit pension plans for some of its operations in the United States and Europe. The Company has established the Pension Committee to manage the operations and administration of the defined benefit plans. The Company estimates that fiscal 2012 contributions to all defined benefit plans will total \$3,728,000.

Other Matters

Critical Accounting Policies

The preparation of this Annual Report requires management's judgment to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenues and expenses during the reporting period. There can be no assurance that actual results will not differ from those estimates.

The Company's significant accounting policies are described in Note A to the consolidated financial statements. Not all of these significant accounting policies require management to make difficult, subjective, or complex judgments or estimates. However, the policies management considers most critical to understanding and evaluating our reported financial results are the following:

Accounts Receivable

Twin Disc performs ongoing credit evaluations of our customers and adjusts credit limits based on payment history and the customer's credit-worthiness as determined by review of current credit information. We continuously monitor collections and payments from our customers and maintain a provision for estimated credit losses based upon our historical experience and any specific customer-collection issues. In addition, senior management reviews the accounts receivable aging on a monthly basis to determine if any receivable balances may be uncollectible. Although our accounts receivable are dispersed among a large customer base, a significant change in the liquidity or financial position of any one of our largest customers could have a material adverse impact on the collectibility of our accounts receivable and future operating results.

Inventory

Inventories are valued at the lower of cost or market. Cost has been determined by the last-in, first-out (LIFO) method for the majority of the inventories located in the United States, and by the first-in, first-out (FIFO) method for all other inventories. Management specifically identifies obsolete products and analyzes historical usage, forecasted production based on future orders, demand forecasts, and economic trends when evaluating the adequacy of the reserve for excess and obsolete inventory. The adjustments to the reserve are estimates that could vary significantly, either favorably or unfavorably, from the actual requirements if future economic conditions, customer demand or competitive conditions differ from expectations.

Goodwill

In conformity with U.S. GAAP, goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that an impairment might exist. The Company performs impairment reviews for its reporting units using a fair-value method based on management's judgments and assumptions or third party valuations. The Company is subject to financial statement risk to the extent the carrying amount of a reporting unit exceeds its fair value. The impairment testing performed by the Company at June 30, 2011 indicated that the estimated fair value of each reporting unit exceeded its corresponding carrying value, including goodwill and as such, no impairment existed at that time. While the Company believes its judgments and assumptions were reasonable, different assumptions, economic factors and/or market indicators could change the estimated fair values of the Company's reporting units and, therefore, impairment charges could be required in the future.

Warranty

Twin Disc engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of its suppliers. However, its warranty obligation is affected by product failure rates, the extent of the market affected by the failure and the expense involved in satisfactorily addressing the situation. The warranty reserve is established based on our best estimate of the amounts necessary to settle future and existing claims on products sold as of the balance sheet date. When evaluating the adequacy of the reserve for warranty costs, management takes into consideration the term of the warranty coverage, historical claim rates and costs of repair, knowledge of the type and volume of new products and economic trends. While we believe the warranty reserve is adequate and that the judgment applied is appropriate, such amounts estimated to be due and payable in the future could differ materially from what actually transpires.

Pension and Other Postretirement Benefit Plans

The Company provides a wide range of benefits to employees and retired employees, including pensions and postretirement health care coverage. Plan assets and obligations are recorded annually based on the Company's measurement date utilizing various actuarial assumptions such as discount rates, expected return on plan assets, compensation increases, retirement and mortality tables, and health care cost trend rates as of that date. The approach used to determine the annual assumptions are as follows:

- *Discount rate* – based on the Hewitt Top Quartile Yield Curve at June 30, 2011 as applied to the expected payouts from the pension plans. This yield curve is made up of Corporate Bonds rated AA or better.
- *Expected Return on Plan Assets* – based on the expected long-term average rate of return on assets in the pension funds, which is reflective of the current and projected asset mix of the funds and considers historical returns earned on the funds.
- *Compensation Increase* – reflect the long-term actual experience, the near-term outlook and assumed inflation.
- *Retirement and Mortality Rates* – based upon the Generational Mortality Table for fiscal 2009, 2010 and 2011.
- *Health Care Cost Trend Rates* – developed based upon historical cost data, near-term outlook and an assessment of likely long-term trends.

Measurements of net periodic benefit cost are based on the assumptions used for the previous year-end measurements of assets and obligations. The Company reviews its actuarial assumptions on an annual basis and makes modifications to the assumptions when appropriate. As required by U.S. GAAP, the effects of the modifications are recorded currently or amortized over future periods. Based on information provided by its independent actuaries and other relevant sources, the Company believes that the assumptions used are reasonable; however, changes in these assumptions could impact the Company's financial position, results of operations or cash flows.

Income Taxes

The Company accounts for income taxes in accordance with ASC Topic 740, "Income Taxes." Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The Company's policy is to remit earnings from foreign subsidiaries only to the extent any resultant foreign taxes are creditable in the United States. Accordingly, the Company does not currently provide for additional United States and foreign income taxes which would become payable upon repatriation of undistributed earnings of certain foreign subsidiaries. The Company maintains valuation allowances when it is more likely than not that all or a portion of a deferred tax asset will not be realized. In determining whether a valuation allowance is required, the Company takes into account such factors as prior earnings history, expected future earnings, carry-back and carry-forward periods, and tax strategies that could potentially enhance the likelihood of realization of a deferred tax asset. During fiscal 2011, the Company concluded that it was more likely than not that certain net deferred tax assets in foreign jurisdictions would not be realized, resulting in the recording of a valuation allowance totaling \$2,751,000.

Recently Issued Accounting Standards

In June 2011, the Financial Accounting Standards Board ("FASB") issued a standards update that will allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This standards update eliminates the option of presenting the components of other comprehensive income as part of the statement of changes in stockholders' equity. This update is effective for

fiscal years, and interim periods within those years, beginning after December 15, 2011 (the Company's fiscal 2013). This standards update is not expected to have a material impact on the Company's financial statements.

In May 2011, the FASB issued a standards update which represents the converged guidance of the FASB and the International Accounting Standards Board ("IASB") on fair value measurement. This collective effort has resulted in common requirements for measuring fair value and for disclosing information about fair value measurements, including a consistent meaning of the term "fair value." This update is to be applied prospectively effective for interim and annual periods beginning after December 15, 2011 (the Company's third fiscal quarter of 2012). This standards update is not expected to have a material impact on the Company's financial statements.

In April 2010, the FASB issued a standards update providing guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition. Consideration that is contingent on achievement of a milestone in its entirety may be recognized as revenue in the period in which the milestone is achieved only if the milestone is judged to meet certain criteria to be considered substantive. This update was effective for milestones achieved in fiscal years, and interim periods within those years, beginning on or after June 15, 2010 (July 1, 2010 for the Company) and did not have a material impact on the Company's financial statements.

Item 7(a). Quantitative and Qualitative Disclosure About Market Risk

The Company is exposed to market risks from changes in interest rates, commodities and foreign currency exchange rates. To reduce such risks, the Company selectively uses financial instruments and other proactive management techniques. All hedging transactions are authorized and executed pursuant to clearly defined policies and procedures, which prohibit the use of financial instruments for trading or speculative purposes. Discussion of the Company's accounting policies and further disclosure relating to financial instruments is included in Note A to the consolidated financial statements.

Interest rate risk - The Company's earnings exposure related to adverse movements of interest rates is primarily derived from outstanding floating rate debt instruments that are indexed to the LIBOR interest rate. The Company currently has a \$40 million revolving loan agreement, which is due to expire on May 31, 2015. In accordance with the loan agreement as amended, the Company borrows at LIBOR plus an additional "Add-On," between 1.5% and 2.5%, depending on the Company's Total Funded Debt to EBITDA ratio. Due to the relative stability of interest rates, the Company did not utilize any financial instruments at June 30, 2011 to manage interest rate risk exposure. A 10 percent increase or decrease in the applicable interest rate would result in a change in pretax interest expense of approximately \$24,000.

Commodity price risk - The Company is exposed to fluctuation in market prices for such commodities as steel and aluminum. The Company does not utilize commodity price hedges to manage commodity price risk exposure. Direct material cost as a percent of total cost of goods sold was 53.4% for fiscal 2011.

Currency risk - The Company has exposure to foreign currency exchange fluctuations. Approximately twenty two percent of the Company's revenues in the year ended June 30, 2011 were denominated in currencies other than the U.S. Dollar. Of that total, approximately seventy two percent was denominated in Euros with the balance comprised of Japanese Yen, Swiss Franc and the Australian and Singapore Dollars. The Company does not hedge the translation exposure represented by the net assets of its foreign subsidiaries. Foreign currency translation adjustments are recorded as a component of shareholders' equity. Forward foreign exchange contracts are used to hedge the currency fluctuations on significant transactions denominated in foreign currencies.

Derivative financial instruments - The Company has written policies and procedures that place all financial instruments under the direction of the Company corporate treasury department and restrict derivative transactions to those intended for hedging purposes. The use of financial instruments for trading purposes is prohibited. The Company uses financial instruments to manage the market risk from changes in foreign exchange rates.

Periodically, the Company enters into forward exchange contracts to reduce the earnings and cash flow impact of non-functional currency denominated receivables and payables. These contracts are highly effective in hedging the cash flows attributable to changes in currency exchange rates. Gains and losses resulting from these contracts offset the foreign exchange gains or losses on the underlying assets and liabilities being hedged. The maturities of the forward exchange contracts generally coincide with the settlement dates of the related transactions. Gains and losses on these contracts are recorded in Other Income (Expense), net in the Consolidated Statement of Operations and Comprehensive (Loss) Income as the changes in the fair value of the contracts are recognized and generally offset the gains and losses on the hedged items in the same period. The primary currency to which the Company was exposed in fiscal 2011 and 2010 was the Euro. At June 30, 2011 and 2010, the Company had no outstanding forward exchange contracts.

Item 8. Financial Statements and Supplementary Data

See Consolidated Financial Statements and Financial Statement Schedule.

Sales and Earnings by Quarter - Unaudited (in thousands, except per share amounts)

| 2011 | <u>1st Qtr.</u> | <u>2nd Qtr.</u> | <u>3rd Qtr.</u> | <u>4th Qtr.</u> | <u>Year</u> |
|---|-----------------|-----------------|-----------------|-----------------|-------------|
| Net sales | \$61,395 | \$75,160 | \$76,471 | \$97,367 | \$310,393 |
| Gross profit | 20,023 | 23,757 | 27,782 | 36,121 | 107,683 |
| Net earnings attributable to Twin Disc | 2,656 | 4,034 | 4,548 | 7,592 | 18,830 |
| Basic earnings per share attributable to Twin Disc common shareholders | 0.24 | 0.36 | 0.40 | 0.67 | 1.66 |
| Diluted earnings per share attributable to Twin Disc common shareholders | 0.24 | 0.35 | 0.40 | 0.66 | 1.64 |
| Dividends per share | 0.07 | 0.07 | 0.08 | 0.08 | 0.30 |
| 2010 | <u>1st Qtr.</u> | <u>2nd Qtr.</u> | <u>3rd Qtr.</u> | <u>4th Qtr.</u> | <u>Year</u> |
| Net sales | \$47,057 | \$55,186 | \$60,977 | \$64,314 | \$227,534 |
| Gross profit | 9,747 | 14,786 | 16,505 | 19,427 | 60,465 |
| Net (loss) earnings attributable to Twin Disc | (2,404) | (490) | 1,451 | 2,040 | 597 |
| Basic (loss) earnings per share attributable to Twin Disc common shareholders | (0.22) | (0.04) | 0.13 | 0.18 | 0.05 |
| Diluted (loss) earnings per share attributable to Twin Disc common shareholders | (0.22) | (0.04) | 0.13 | 0.18 | 0.05 |
| Dividends per share | 0.07 | 0.07 | 0.07 | 0.07 | 0.28 |

Item 9. Change in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9(a). Controls and Procedures

Conclusion Regarding Disclosure Controls and Procedures

As required by Rules 13a-15 and 15d-15 of the Securities Exchange Act of 1934, as of the end of the period covered by this report and under the supervision and with the participation of management, including the Chief Executive Officer and the Chief Financial Officer, the Company has evaluated the effectiveness of the design and operation of its disclosure controls and

procedures. Based on such evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that such disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms, and to provide reasonable assurance that information required to be disclosed by the Company in the reports it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, as appropriate, to allow timely decisions regarding disclosure.

Management's Report on Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The Company's internal control over financial reporting includes those policies and procedures that:

- (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the Company,
- (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company, and
- (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of the effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures included in such controls may deteriorate.

The Company conducted an evaluation of the effectiveness of our internal control over financial reporting based upon the framework in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based upon such evaluation, our management concluded that our internal control over financial reporting was effective as of June 30, 2011.

PricewaterhouseCoopers LLP, an independent registered public accounting firm, has audited the Company's consolidated financial statements and the effectiveness of internal control over financial reporting as of June 30, 2011, as stated in their report which is included herein.

Changes in Internal Control Over Financial Reporting

During the fourth quarter of fiscal 2011, there have not been any changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9(b). Other Information

Not applicable.

PART III

Item 10. Directors and Executive Officers of the Registrant

For information with respect to the executive officers of the Registrant, see "Executive Officers of the Registrant" at the end of Part I of this report.

For information with respect to the Directors of the Registrant, see "Election of Directors" in the Proxy Statement for the Annual Meeting of Shareholders to be held October 21, 2011, which is incorporated into this report by reference.

For information with respect to compliance with Section 16(a) of the Securities Exchange Act of 1934, see "Section 16(a) Beneficial Ownership Reporting Compliance" in the Proxy Statement for the Annual Meeting of Shareholders to be held October 21, 2011, which is incorporated into this report by reference.

For information with respect to the Company's Code of Ethics, see "Guidelines for Business Conduct and Ethics" in the Proxy Statement for the Annual Meeting of Shareholders to be held October 21, 2011, which is incorporated into this report by reference. The Company's Code of Ethics, entitled, "Guidelines for Business Conduct and Ethics," is included on the Company's website, www.twindisc.com.

For information with respect to procedures by which shareholders may recommend nominees to the Company's Board of Directors, see "Selection of Nominees for the Board" in the Proxy Statement for the Annual Meeting of Shareholders to be held October 21, 2011, which is incorporated into this report by reference. There were no changes to these procedures since the Company's last disclosure relating to these procedures.

For information with respect to the Audit Committee Financial Expert, see "Director Committee Functions: Audit Committee" in the Proxy Statement for the Annual Meeting of Shareholders to be held October 21, 2011, which is incorporated into this report by reference.

For information with respect to the Audit Committee Disclosure, see "Director Committee Functions: Audit Committee" in the Proxy Statement for the Annual Meeting of Shareholders to be held October 21, 2011, which is incorporated into this report by reference.

For information with respect to the Audit Committee Membership, see "Director Committee Functions: Committee Membership" in the Proxy Statement for the Annual Meeting of Shareholders to be held October 21, 2011, which is incorporated into this report by reference.

Item 11. Executive Compensation

The information set forth under the captions "Executive Compensation," "Director Compensation," "Compensation Committee Interlocks and Insider Participation," and "Compensation Committee Report," in the Proxy Statement for the Annual Meeting of Shareholders to be held on October 21, 2011, is incorporated into this report by reference. Discussion in the Proxy Statement under the captions "Compensation Committee Report" is incorporated by reference but shall not be deemed "soliciting material" or to be "filed" as part of this report.

Item 12. Security Ownership of Certain Beneficial Owners and Management

Security ownership of certain beneficial owners and management is set forth in the Proxy Statement for the Annual Meeting of Shareholders to be held on October 21, 2011 under the captions "Principal Shareholders" and "Directors and Executive Officers" and incorporated into this report by reference.

For information regarding securities authorized for issuance under equity compensation plans of the Company, see "Equity Compensation Plan Information" in the Proxy Statement for the Annual Meeting of Shareholders to be held on October 21, 2011, which incorporated into this report by reference.

There are no arrangements known to the Registrant, the operation of which may at a subsequent date result in a change in control of the Registrant.

Item 13. Certain Relationships and Related Transactions, Director Independence

For information with respect to transactions with related persons and policies for the review, approval or ratification of such transactions, see "Corporate Governance – Review, Approval or Ratification of Transactions with Related Persons" in the Proxy Statement for the Annual Meeting of Shareholders to be held October 21, 2011, which is incorporated into this report by reference.

For information with respect to director independence, see “Corporate Governance – Board Independence” in the Proxy Statement for the Annual Meeting of Shareholders to be held October 21, 2011, which is incorporated into this report by reference.

Item 14. Principal Accounting Fees and Services

The Company incorporates by reference the information contained in the Proxy Statement for the Annual Meeting of Shareholders to be held October 21, 2011 under the heading “Fees to Independent Registered Public Accounting Firm.”

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a)(1) Consolidated Financial Statements

See “Index to Consolidated Financial Statements and Financial Statement Schedule”, the Report of Independent Registered Public Accounting Firm and the Consolidated Financial Statements, all of which are incorporated by reference.

(a)(2) Consolidated Financial Statement Schedule

See “Index to Consolidated Financial Statements and Financial Statement Schedule”, and the Consolidated Financial Statement Schedule, all of which are incorporated by reference.

(a)(3) Exhibits. See Exhibit Index included as the last page of this form, which is incorporated by reference.

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND
FINANCIAL STATEMENT SCHEDULE**

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Schedules, other than those listed, are omitted for the reason that they are inapplicable, are not required, or the information required is shown in the financial statements or the related notes.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Twin Disc, Incorporated:

In our opinion, the consolidated financial statements listed in the index appearing under Item 15(a)(1) present fairly, in all material respects, the financial position of Twin Disc, Incorporated and its subsidiaries at June 30, 2011 and June 30, 2010, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2011 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under Item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of June 30, 2011, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control Over Financial Reporting appearing under item 9(a). Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP

Milwaukee, Wisconsin
September 13, 2011

TWIN DISC, INCORPORATED AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS June 30, 2011 and 2010 (In thousands, except share amounts)

| | <u>2011</u> | <u>2010</u> |
|---|-------------------|-------------------|
| ASSETS | | |
| Current assets: | | |
| Cash | \$ 20,167 | \$ 19,022 |
| Trade accounts receivable, net | 61,007 | 43,014 |
| Inventories, net | 99,139 | 72,799 |
| Deferred income taxes | 5,765 | 5,224 |
| Other | <u>9,090</u> | <u>7,391</u> |
| Total current assets | 195,168 | 147,450 |
| Property, plant and equipment, net | 65,791 | 58,243 |
| Goodwill, net | 17,871 | 16,440 |
| Deferred income taxes | 16,480 | 24,029 |
| Intangible assets, net | 6,439 | 6,268 |
| Other assets | <u>7,371</u> | <u>6,626</u> |
| | \$ 309,120 | \$ 259,056 |
| LIABILITIES and EQUITY | | |
| Current liabilities: | | |
| Short-term borrowings and current maturities of long-term debt | \$ 3,915 | \$ 3,920 |
| Accounts payable | 38,372 | 23,842 |
| Accrued liabilities | <u>41,673</u> | <u>35,545</u> |
| Total current liabilities | 83,960 | 63,307 |
| Long-term debt | 25,784 | 27,211 |
| Accrued retirement benefits | 50,063 | 72,833 |
| Deferred income taxes | 4,170 | 3,914 |
| Other long-term liabilities | <u>7,089</u> | <u>2,472</u> |
| | 171,066 | 169,737 |
| Twin Disc shareholders' equity: | | |
| Preferred shares authorized: 200,000; issued: none; no par value | - | - |
| Common shares authorized: 30,000,000; issued: 13,099,468; no par value | 10,863 | 10,667 |
| Retained earnings | 162,857 | 147,438 |
| Accumulated other comprehensive loss | <u>(11,383)</u> | <u>(42,048)</u> |

| | | |
|---|-------------------|-------------------|
| | 162,337 | 116,057 |
| Less treasury stock, at cost (1,739,574 and 1,901,242 shares, respectively) | <u>25,252</u> | <u>27,597</u> |
| Total Twin Disc shareholders' equity | 137,085 | 88,460 |
| Noncontrolling interest | <u>969</u> | <u>859</u> |
| Total equity | <u>138,054</u> | <u>89,319</u> |
| | \$ <u>309,120</u> | \$ <u>259,056</u> |

The notes to consolidated financial statements are an integral part of these statements.

TWIN DISC, INCORPORATED and SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS and COMPREHENSIVE INCOME (LOSS)

For the years ended June 30, 2011, 2010 and 2009
(In thousands, except per share data)

| | <u>2011</u> | <u>2010</u> | <u>2009</u> |
|--|------------------|--------------------|--------------------|
| Net sales | \$ 310,393 | \$ 227,534 | \$ 295,618 |
| Cost of goods sold | <u>202,710</u> | <u>167,069</u> | <u>214,175</u> |
| Gross profit | 107,683 | 60,465 | 81,443 |
| Marketing, engineering and administrative expenses | 72,713 | 56,886 | 60,470 |
| Restructuring of operations | <u>254</u> | <u>494</u> | <u>1,188</u> |
| Earnings from operations | 34,716 | 3,085 | 19,785 |
| Other income (expense): | | | |
| Interest income | 98 | 84 | 207 |
| Interest expense | (1,719) | (2,282) | (2,487) |
| Other, net | <u>(1,066)</u> | <u>835</u> | <u>540</u> |
| | <u>(2,687)</u> | <u>(1,363)</u> | <u>(1,740)</u> |
| Earnings before income taxes and noncontrolling interest | 32,029 | 1,722 | 18,045 |
| Income taxes | <u>13,064</u> | <u>992</u> | <u>6,257</u> |
| Net earnings | 18,965 | 730 | 11,788 |
| Less: Net earnings attributable to noncontrolling interest | <u>(135)</u> | <u>(133)</u> | <u>(286)</u> |
| Net earnings attributable to Twin Disc | \$ <u>18,830</u> | \$ <u>597</u> | \$ <u>11,502</u> |
| Earnings per share data: | | | |
| Basic earnings per share attributable to Twin Disc common shareholders | \$ 1.66 | \$ 0.05 | \$ 1.04 |
| Diluted earnings per share attributable to Twin Disc common shareholders | 1.64 | 0.05 | 1.03 |
| Weighted average shares outstanding data: | | | |
| Basic shares outstanding | 11,319 | 11,063 | 11,097 |
| Dilutive stock awards | <u>144</u> | <u>96</u> | <u>97</u> |
| Diluted shares outstanding | <u>11,463</u> | <u>11,159</u> | <u>11,194</u> |
| Comprehensive income (loss): | | | |
| Net earnings | \$ 18,965 | \$ 730 | \$ 11,788 |
| Foreign currency translation adjustment | 19,272 | (9,650) | (10,458) |
| Benefit plan adjustments, net | <u>11,506</u> | <u>(6,414)</u> | <u>(17,908)</u> |
| Comprehensive income (loss) | 49,743 | (15,334) | (16,578) |
| Comprehensive earnings attributable to noncontrolling interest | <u>(135)</u> | <u>(133)</u> | <u>(286)</u> |
| Comprehensive income (loss) attributable to Twin Disc | \$ <u>49,608</u> | \$ <u>(15,467)</u> | \$ <u>(16,864)</u> |

The notes to consolidated financial statements are an integral part of these statements.

TWIN DISC, INCORPORATED and SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended June 30, 2011, 2010 and 2009
(In thousands)

| | <u>2011</u> | <u>2010</u> | <u>2009</u> |
|---|-------------|-------------|-------------|
| Cash flows from operating activities: | | | |
| Net earnings | \$ 18,965 | \$ 730 | \$ 11,788 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | | |
| Depreciation and amortization | 9,904 | 9,817 | 9,774 |
| Loss on sale of plant assets | 120 | 261 | 17 |
| Restructuring of operations | 254 | 494 | 1,188 |
| Stock compensation expense (benefit) | 6,148 | 507 | (2,481) |
| Provision (benefit) for deferred income taxes | 1,354 | (1,474) | 730 |
| Changes in operating assets and liabilities: | | | |
| Trade accounts receivable, net | (13,605) | 8,181 | 9,568 |
| Inventories, net | (17,258) | 16,338 | (1,282) |
| Other assets | (1,736) | 1,177 | 1,200 |
| Accounts payable | 11,839 | (191) | (10,890) |

| | | | |
|--|-----------|-----------|-----------|
| Accrued liabilities | 6,459 | (3,779) | (6,314) |
| Accrued/prepaid retirement benefits | (8,584) | 3,055 | (1,692) |
| Net cash provided by operating activities | 13,860 | 35,116 | 11,606 |
| Cash flows from investing activities: | | | |
| Proceeds from sale of plant assets | 296 | 148 | 20 |
| Capital expenditures | (12,028) | (4,456) | (8,895) |
| Other, net | (293) | (293) | 1,111 |
| Net cash used by investing activities | (12,025) | (4,601) | (7,764) |
| Cash flows from financing activities: | | | |
| Proceeds from notes payable | 84 | 86 | - |
| Payments of notes payable | (83) | (690) | (1,653) |
| (Payment of) proceeds from long-term debt | (1,405) | (18,950) | 2,787 |
| Proceeds from exercise of stock options | 322 | 108 | 110 |
| Acquisition of treasury stock | - | - | (1,813) |
| Dividends paid to shareholders | (3,411) | (3,133) | (3,105) |
| Dividends paid to noncontrolling interest | (138) | (160) | (143) |
| Other | 453 | (449) | (428) |
| Net cash used by financing activities | (4,178) | (23,188) | (4,245) |
| Effect of exchange rate changes on cash | 3,488 | (1,571) | (778) |
| Net change in cash | 1,145 | 5,756 | (1,181) |
| Cash: | | | |
| Beginning of year | 19,022 | 13,266 | 14,447 |
| End of year | \$ 20,167 | \$ 19,022 | \$ 13,266 |
| Supplemental cash flow information: | | | |
| Cash paid during the year for: | | | |
| Interest | \$ 1,520 | \$ 2,092 | \$ 2,699 |
| Income taxes | 10,453 | 2,832 | 7,009 |

The notes to consolidated financial statements are an integral part of these statements.

TWIN DISC, INCORPORATED and SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
For the years ended June 30, 2011, 2010 and 2009
(In thousands)

| | Twin Disc, Inc. Shareholders' Equity | | | | | Non- Controlling Interest | Total Equity |
|---|--------------------------------------|----------------------|--|-------------------|-------|---------------------------------|-----------------|
| | Common Stock | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Treasury Stock | | | |
| Balance at June 30, 2008 | \$14,693 | \$142,361 | \$2,446 | (\$29,854) | \$679 | \$130,325 | |
| Net earnings | | 11,502 | | | 286 | 11,788 | |
| Translation adjustments | | | (10,473) | | 15 | (10,458) | |
| Benefit plan adjustments, net of tax | | | (17,908) | | | (17,908) | |
| Adjustment for the change in measurement date due to the adoption of SFAS No. 158 | | (784) | | | | (784) | |
| Cash dividends | | (3,105) | | | (143) | (3,248) | |
| Compensation expense and windfall tax benefits | 840 | | | | | 840 | |
| Shares (acquired) issued, net | (2,328) | | | (402) | | (2,730) | |
| Balance at June 30, 2009 | 13,205 | 149,974 | (25,935) | (30,256) | 837 | 107,825 | |
| Net earnings | | 597 | | | 133 | 730 | |
| Translation adjustments | | | (9,699) | | 49 | (9,650) | |
| Benefit plan adjustments, net of tax | | | (6,414) | | | (6,414) | |
| Cash dividends | | (3,133) | | | (160) | (3,293) | |
| Compensation expense and windfall tax benefits | 329 | | | | | 329 | |
| Shares (acquired) issued, net | (2,867) | | | 2,659 | | (208) | |
| Balance at June 30, 2010 | 10,667 | 147,438 | (42,048) | (27,597) | 859 | 89,319 | |
| Net earnings | | 18,830 | | | 135 | 18,965 | |
| Translation adjustments | | | 19,159 | | 113 | 19,272 | |
| Benefit plan adjustments, net of tax | | | 11,506 | | | 11,506 | |
| Cash dividends | | (3,411) | | | (138) | (3,549) | |
| Compensation expense and windfall tax benefits | 2,219 | | | | | 2,219 | |
| Shares (acquired) issued, net | (2,023) | | | 2,345 | | 322 | |
| Balance at June 30, 2011 | \$10,863 | \$162,857 | (\$11,383) | (\$25,252) | \$969 | \$138,054 | |

The notes to consolidated financial statements are an integral part of these statements.

TWIN DISC, INCORPORATED AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A. SIGNIFICANT ACCOUNTING POLICIES

The following is a summary of the significant accounting policies followed in the preparation of these financial statements:

Consolidation Principles--The consolidated financial statements include the accounts of Twin Disc, Incorporated and its wholly and partially owned domestic and foreign subsidiaries. Certain foreign subsidiaries are included based on fiscal years ending May 31, to facilitate prompt reporting of consolidated accounts. The Company also has a noncontrolling interest in a Japanese joint venture, which is consolidated based upon a fiscal year ending March 31. All significant intercompany transactions have been eliminated.

Translation of Foreign Currencies--The financial statements of the Company's non-U.S. subsidiaries are translated using the current exchange rate for assets and liabilities and the weighted-average exchange rate for the year for revenues and expenses. The resulting translation adjustments are recorded as a component of accumulated other comprehensive income (loss), which is included in equity. Gains and losses from foreign currency transactions are included in earnings. Included in other income (expense) are foreign currency transaction losses (gains) of \$1,141,000, (\$571,000) and (\$328,000) in fiscal 2011, 2010 and 2009, respectively.

Receivables--Trade accounts receivable are stated net of an allowance for doubtful accounts of \$2,093,000 and \$1,792,000 at June 30, 2011 and 2010, respectively. The Company records an allowance for doubtful accounts provision for certain customers where a risk of default has been specifically identified as well as provisions determined on a general basis when it is believed that some default is probable and estimable but not yet clearly associated with a specific customer. The assessment of likelihood of customer default is based on a variety of factors, including the length of time the receivables are past due, the historical collection experience and existing economic conditions. The current conditions in the global credit markets may reduce a customer's ability to access sufficient liquidity and capital to fund their operations and render the Company's estimation of customer defaults inherently uncertain. While the Company believes current allowances for doubtful accounts are adequate, it is possible that the adverse impact of the global credit crisis may cause higher levels of customer defaults and bad debt expense in future periods.

Fair Value of Financial Instruments--The carrying amount reported in the consolidated balance sheets for cash, trade accounts receivable, accounts payable and short term borrowings approximate fair value because of the immediate short-term maturity of these financial instruments. The fair value of the Company's 6.05% Senior Notes due April 10, 2016 was approximately \$19,589,000 and \$22,977,000 at June 30, 2011 and 2010, respectively. The fair value of long-term debt is estimated by discounting the future cash flows at rates offered to the Company for similar debt instruments of comparable maturities. This rate was represented by the US Treasury Three-Year Yield Curve Rate (0.81% and 1.00% for fiscal 2011 and 2010, respectively), plus the current add-on related to the Company's revolving loan agreement (2.00% and 3.00% for fiscal 2011 and 2010, respectively) resulting in a total rate of 2.81% and 4.00% for fiscal 2011 and 2010, respectively. See Note G, "Debt" for the related book value of this debt instrument. The Company's revolving loan agreement approximates fair value at June 30, 2011.

Derivative Financial Instruments--The Company has written policies and procedures that place all financial instruments under the direction of the Company's corporate treasury and restricts all derivative transactions to those intended for hedging purposes. The use of financial instruments for trading purposes is prohibited. The Company uses financial instruments to manage the market risk from changes in foreign exchange rates.

Periodically, the Company enters into forward exchange contracts to reduce the earnings and cash flow impact of non-functional currency denominated receivables and payables. These contracts are highly effective in hedging the cash flows attributable to changes in currency exchange rates. Gains and losses resulting from these contracts offset the foreign exchange gains or losses on the underlying assets and liabilities being hedged. The maturities of the forward exchange contracts generally coincide with the settlement dates of the related transactions. Gains and losses on these contracts are recorded in other income (expense) as the changes in the fair value of the contracts are recognized and generally offset the gains and losses on the hedged items in the same period. The primary currency to which the Company was exposed in fiscal 2011 and 2010 was the Euro. At June 30, 2011 and 2010, the Company had no outstanding forward exchange contracts.

Inventories--Inventories are valued at the lower of cost or market. Cost has been determined by the last-in, first-out (LIFO) method for the majority of inventories located in the United States, and by the first-in, first-out (FIFO) method for all other inventories. Management specifically identifies obsolete products and analyzes historical usage, forecasted production based on future orders, demand forecasts, and economic trends when evaluating the adequacy of the reserve for excess and obsolete inventory.

Property, Plant and Equipment and Depreciation--Assets are stated at cost. Expenditures for maintenance, repairs and minor renewals are charged against earnings as incurred. Expenditures for major renewals and betterments are capitalized and depreciated. Depreciation is provided on the straight-line method over the estimated useful lives of the assets for financial reporting and on accelerated methods for income tax purposes. The lives assigned to buildings and related improvements range from 10 to 40 years, and the lives assigned to machinery and equipment range from 5 to 15 years. Upon disposal of property, plant and equipment, the cost of the asset and the related accumulated depreciation are removed from the accounts and the resulting gain or loss is reflected in earnings. Fully depreciated assets are not removed from the accounts until physically disposed.

Impairment of Long-lived Assets--The Company reviews long-lived assets for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable. For property, plant and equipment and other long-lived assets, excluding indefinite-lived intangible assets, the Company performs undiscounted operating cash flow analyses to determine if an impairment exists. If an impairment is determined to exist, any related impairment loss is calculated based on fair value.

Revenue Recognition--Revenue is recognized by the Company when all of the following criteria are met: persuasive evidence of an arrangement exists; delivery has occurred and ownership has transferred to the customer; the price to the customer is fixed or determinable; and collectability is reasonably assured. Revenue is recognized at the time product is shipped to the customer, except for certain domestic shipments to overseas customers where revenue is recognized upon receipt by the customer. A significant portion of our consolidated net sales is transacted through a third party distribution network. Sales to third party distributors are subject to the revenue recognition criteria described above. Goods sold to third party distributors are subject to an annual return policy, for which a provision is made at the time of shipment based upon historical experience.

Goodwill and Other Intangibles-- Goodwill and other indefinite-lived intangible assets, primarily tradenames, are tested for impairment at least annually on the last day of the Company's fiscal year and more frequently if an event occurs which indicates the asset may be impaired in accordance with the ASC Topic 360-10, "Intangibles - Goodwill and Other." If applicable, goodwill and other indefinite-lived intangible assets not subject to amortization have been assigned to reporting units for purposes of impairment testing based upon the relative fair value of the asset to each reporting unit.

A significant amount of judgment is involved in determining if an indicator of impairment has occurred. Such indicators may include, among others: a significant decline in expected future cash flows; a sustained, significant decline in the Company's stock price and market capitalization; a significant adverse change in legal factors or in the business climate; unanticipated competition; the testing for recoverability of a significant asset group within a reporting unit; and slower growth rates. Any adverse change in these factors could have a significant impact on the recoverability of these assets and could have a material impact on the Company's consolidated financial statements.

Impairment of goodwill is measured according to a two step approach. In the first step, the fair value of a reporting unit, as defined, is compared to the carrying value of the reporting unit, including goodwill. The fair value is primarily determined using discounted cash flow analyses; however, other methods may be used to substantiate the discounted cash flow analyses, including third party valuations when necessary. For purposes of the June 30, 2011 impairment analysis, the Company has utilized discounted cash flow analyses. If the carrying amount exceeds the fair value, the second step of the goodwill impairment test is performed to measure the amount of the impairment loss, if any. In the second step, the implied value of the goodwill is estimated as the fair value of the reporting unit less the fair value of all other tangible and identifiable intangible assets of the reporting unit. If the carrying amount of the goodwill exceeds the implied fair value of the goodwill, an impairment loss is recognized in an amount equal to that excess, not to exceed the carrying amount of the goodwill.

Based upon the goodwill impairment review completed at the end of fiscal 2011, which incorporates management's best estimates of economic and market conditions over the projected period and a weighted-average cost of capital that reflects current market conditions, the fair value of goodwill in each reporting unit exceeded the carrying value and therefore goodwill was not impaired.

The fair value of the Company's other intangible assets with indefinite lives, primarily tradenames, is estimated using the relief-from-royalty method, which requires assumptions related to projected revenues; assumed royalty rates that could be payable if the Company did not own the asset; and a discount rate. The Company completed the impairment testing of indefinite-lived intangibles as of June 30, 2011 and concluded there were no impairments.

Changes in circumstances, existing at the measurement date or at other times in the future, or in the numerous estimates associated with management's judgments, assumptions and estimates made in assessing the fair value of goodwill and other intangibles, could result in an impairment charge in the future. The Company will continue to monitor all significant estimates and impairment indicators, and will perform interim impairment reviews as necessary.

Warranty--The Company warrants all assembled products and parts (except component products or parts on which written warranties are issued by the respective manufacturers thereof and are furnished to the original customer, as to which the Company makes no warranty and assumes no liability) against defective materials or workmanship. Such warranty generally extends from periods ranging from 12 months to 24 months.

The Company engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of its suppliers. However, its warranty obligation is affected by product failure rates, the extent of the market affected by the failure and the expense involved in satisfactorily addressing the situation. The warranty reserve is established based on the Company's best estimate of the amounts necessary to settle future and existing claims on products sold as of the balance sheet date. When evaluating the adequacy of the reserve for warranty costs, management takes into consideration the term of the warranty coverage, historical claim rates and costs of repair, knowledge of the type and volume of new products and economic trends. While the Company believes the warranty reserve is adequate and that the judgment applied is appropriate, such amounts estimated to be due and payable in the future could differ materially from what actually transpires. See Note F for activity in the warranty reserve for fiscal 2011 and 2010.

Deferred Taxes--The Company recognizes deferred tax liabilities and assets for the expected future income tax consequences of events that have been recognized in the Company's financial statements. Under this method, deferred tax liabilities and assets are determined based on the temporary differences between the financial statement carrying amounts and the tax bases of assets and liabilities using enacted tax rates in effect in the years in which temporary differences are expected to reverse. Valuation allowances are provided for deferred tax assets where it is considered more likely than not that the Company will not realize the benefit of such assets.

Stock-Based Compensation--At June 30, 2011, the Company has several stock-based compensation plans, which are described more fully in Note K, "Stock-Based Compensation." The Company accounts for these plans under the recognition and measurement provisions of ASC Topic 718-10, "Compensation-Stock Compensation."

Management Estimates--The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual amounts could differ from those estimates.

Shipping and Handling Fees and Costs--The Company records revenue from shipping and handling costs in net sales. The cost associated with shipping and handling of products is reflected in cost of goods sold.

Recently Issued Accounting Standards

In June 2011, the Financial Accounting Standards Board ("FASB") issued a standards update that will allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This standards update eliminates the option of presenting the components of other comprehensive income as part of the statement of changes in stockholders' equity. This update is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 (the Company's fiscal 2013). This standards update is not expected to have a material impact on the Company's financial statements.

In May 2011, the FASB issued a standards update which represents the converged guidance of the FASB and the International Accounting Standards Board ("IASB") on fair value measurement. This collective effort has resulted in common requirements for measuring fair value and for disclosing information about fair value measurements, including a consistent meaning of the term "fair value." This update is to be applied prospectively effective for interim and annual periods beginning after December 15, 2011 (the Company's third fiscal quarter of 2012). This standards update is not expected to have a material impact on the Company's financial statements.

In April 2010, the FASB issued a standards update providing guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition. Consideration that is contingent on achievement of a milestone in its entirety may be recognized as revenue in the period in which the milestone is achieved only if the milestone is judged to meet certain criteria to be considered substantive. This update was effective for milestones achieved in fiscal years, and interim periods within those years, beginning on or after June 15, 2010 (July 1, 2010 for the Company) and did not have a material impact on the Company's financial statements.

B. INVENTORIES

The major classes of inventories at June 30 were as follows (in thousands):

| | <u>2011</u> | <u>2010</u> |
|-----------------|-----------------|-----------------|
| Finished parts | \$56,074 | \$47,051 |
| Work-in-process | 18,561 | 8,998 |
| Raw materials | <u>24,504</u> | <u>16,750</u> |
| | <u>\$99,139</u> | <u>\$72,799</u> |

Inventories stated on a LIFO basis represent approximately 32% and 22% of total inventories at June 30, 2011 and 2010, respectively. The approximate current cost of the LIFO inventories exceeded the LIFO cost by \$23,020,000 and \$24,617,000 at June 30, 2011 and 2010, respectively.

C. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment at June 30 were as follows (in thousands):

| | <u>2011</u> | <u>2010</u> |
|--------------------------------|------------------|------------------|
| Land | \$ 4,445 | \$ 3,557 |
| Buildings | 42,279 | 38,512 |
| Machinery and equipment | <u>139,526</u> | <u>123,629</u> |
| | 186,250 | 165,698 |
| Less: accumulated depreciation | <u>120,459</u> | <u>107,455</u> |
| | <u>\$ 65,791</u> | <u>\$ 58,243</u> |

Depreciation expense for the years ended June 30, 2011, 2010 and 2009 was \$9,110,000, \$9,021,000 and \$8,766,000, respectively.

D. GOODWILL AND OTHER INTANGIBLES

The changes in the carrying amount of goodwill, substantially all of which is allocated to the manufacturing segment, for the years ended June 30, 2011 and 2010 were as follows (in thousands):

| | |
|--------------------------|-----------------|
| Balance at June 30, 2009 | \$17,509 |
| Translation adjustment | <u>_(1,069)</u> |
| Balance at June 30, 2010 | 16,440 |
| Translation adjustment | <u>1,431</u> |

Balance at June 30, 2011 \$17,871

At June 30, the following acquired intangible assets have defined useful lives and are subject to amortization (in thousands):

| | <u>2011</u> | <u>2010</u> |
|--------------------------|-----------------|-----------------|
| Licensing agreements | \$ 3,015 | \$ 3,015 |
| Non-compete agreements | 2,050 | 2,050 |
| Other | <u>5,991</u> | <u>5,991</u> |
| | 11,056 | 11,056 |
| Accumulated amortization | (7,774) | (6,980) |
| Translation adjustment | <u>817</u> | <u>211</u> |
| Total | <u>\$ 4,099</u> | <u>\$ 4,287</u> |

The weighted average remaining useful life of the intangible assets included in the table above is approximately 6 years.

Intangible amortization expense for the years ended June 30, 2011, 2010 and 2009 was \$794,000, \$796,000 and \$1,008,000, respectively. Estimated intangible amortization expense for each of the next five fiscal years is as follows (in thousands):

| <u>Fiscal Year</u> | |
|--------------------|----------------|
| 2012 | \$ 845 |
| 2013 | 786 |
| 2014 | 786 |
| 2015 | 455 |
| 2016 | 302 |
| Thereafter | <u>925</u> |
| | <u>\$4,099</u> |

The gross carrying amount of the Company's intangible assets that have indefinite lives and are not subject to amortization as of June 30, 2011 and 2010 are \$2,340,000 and \$1,981,000, respectively. These assets are comprised of acquired tradenames.

E. ACCRUED LIABILITIES

Accrued liabilities at June 30 were as follows (in thousands):

| | <u>2011</u> | <u>2010</u> |
|------------------------------------|-----------------|-----------------|
| Salaries and wages | \$13,976 | \$ 6,067 |
| Retirement benefits | 4,483 | 6,090 |
| Warranty | 4,503 | 4,829 |
| Customer advances/deferred revenue | 7,566 | 8,240 |
| Accrued income tax | 4,350 | 1,691 |
| Other | <u>6,795</u> | <u>8,628</u> |
| | <u>\$41,673</u> | <u>\$35,545</u> |

F. WARRANTY

The Company engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of its suppliers. However, its warranty obligation is affected by product failure rates, the number of units affected by the failure and the expense involved in satisfactorily addressing the situation. The warranty reserve is established based on our best estimate of the amounts necessary to settle future and existing claims on products sold as of the balance sheet date. When evaluating the adequacy of the reserve for warranty costs, management takes into consideration the term of the warranty coverage, historical claim rates and costs of repair, knowledge of the type and volume of new products and economic trends. While we believe the warranty reserve is adequate and that the judgment applied is appropriate, such amounts estimated to be due and payable in the future could differ materially from what actually transpires. The following is a listing of the activity in the warranty reserve during the years ended June 30 (in thousands):

| | <u>2011</u> | <u>2010</u> |
|----------------------------------|----------------|----------------|
| Reserve balance, July 1 | \$6,061 | \$8,028 |
| Current period expense | 3,927 | 3,703 |
| Payments or credits to customers | (4,440) | (5,266) |
| Translation | <u>474</u> | <u>(404)</u> |
| Reserve balance, June 30 | <u>\$6,022</u> | <u>\$6,061</u> |

The current portion of the warranty accrual (\$4,503,000) is reflected in accrued liabilities, while the long-term portion (\$1,519,000) is included in other long-term liabilities on the Consolidated Balance Sheets.

G. DEBT

Notes Payable:

Notes payable consists of amounts borrowed under unsecured line of credit agreements. These lines of credit may be withdrawn at the option of the banks. The following is aggregate borrowing information at June 30 (in thousands):

| | <u>2011</u> | <u>2010</u> |
|--------------------------|--------------|--------------|
| Available credit lines | \$2,733 | \$7,716 |
| Unused credit lines | <u>2,733</u> | <u>7,716</u> |
| Outstanding credit lines | - | - |
| Notes payable-other | <u>-</u> | <u>-</u> |
| Total notes payable | <u>\$ 0</u> | <u>\$ 0</u> |

Weighted-average interest

Long-term Debt:

Long-term debt consisted of the following at June 30 (in thousands):

| | <u>2011</u> | <u>2010</u> |
|--------------------------------|-----------------|-----------------|
| Revolving loan agreement | \$11,300 | \$ 9,000 |
| 10-year unsecured senior notes | 17,857 | 21,429 |
| Secured long-term debt | 84 | 23 |
| Capital lease obligations | 19 | 61 |
| Other long-term debt | <u>439</u> | <u>618</u> |
| Subtotal | 29,699 | 31,131 |
| Less: current maturities | <u>(3,915)</u> | <u>(3,920)</u> |
| Total long-term debt | <u>\$25,784</u> | <u>\$27,211</u> |

The Company has a revolving loan agreement with M&I Marshall & Ilsley Bank ("M&I"). During the fourth quarter of fiscal 2011, the total commitment was increased to \$40,000,000 from \$35,000,000 and the term was extended to May 31, 2015. The outstanding balance of \$11,300,000 and \$9,000,000 at June 30, 2011 and 2010, respectively, is classified as long-term debt. In accordance with the loan agreement, as amended, the Company can borrow at LIBOR plus an additional "Add-On," between 1.5% and 2.5%, depending on the Company's total funded debt to EBITDA ratio. The rate was 2.09% and 4.0% at June 30, 2011 and 2010, respectively. This agreement contains certain covenants, including restrictions on investments, acquisitions and indebtedness. Financial covenants include a minimum consolidated net worth amount, as defined, a minimum EBITDA for the most recent four fiscal quarters, and a maximum total funded debt to EBITDA ratio. As of June 30, 2011, the Company was in compliance with these covenants. Based on its annual financial plan, the Company believes it is well positioned to generate sufficient EBITDA levels throughout fiscal 2012 in order to maintain compliance with the above covenants. However, as with all forward-looking information, there can be no assurance that the Company will achieve the planned results in future periods due to the uncertainties in certain of its markets.

On April 10, 2006, the Company entered into a Note Agreement (the "Note Agreement") with The Prudential Insurance Company of America and certain other entities (collectively, "Purchasers"). Pursuant to the Note Agreement, Purchasers acquired, in the aggregate, \$25,000,000 in 6.05% Senior Notes due April 10, 2016 (the "Notes"). The Notes mature and become due and payable in full on April 10, 2016 (the "Payment Date"). Prior to the Payment Date, the Company is obligated to make quarterly payments of interest during the term of the Notes, plus prepayments of principal of \$3,571,429 on April 10 of each year from 2010 to 2015, inclusive. The Company also has the option of making additional prepayments subject to certain limitations, including the payment of a Yield-Maintenance Amount as defined in the Note Agreement. In addition, the Company will be required to make an offer to purchase the Notes upon a Change of Control, and any such offer must include the payment of a Yield-Maintenance Amount. The Note Agreement includes certain financial covenants which are identical to those associated with the revolving loan agreement discussed above. The Note Agreement also includes certain restrictive covenants that limit, among other things, the incurrence of additional indebtedness and the disposition of assets outside the ordinary course of business. The Note Agreement provides that it shall automatically include any covenants or events of default not previously included in the Note Agreement to the extent such covenants or events of default are granted to any other lender of an amount in excess of \$1,000,000. Following an Event of Default, each Purchaser may accelerate all amounts outstanding under the Notes held by such party. As of June 30, 2011, the Company was in compliance with these covenants.

The aggregate scheduled maturities of outstanding long-term debt obligations in subsequent years are as follows (in thousands):

| <u>Fiscal Year</u> | |
|--------------------|-----------------|
| 2012 | \$ 3,915 |
| 2013 | 3,687 |
| 2014 | 3,623 |
| 2015 | 14,871 |
| 2016 | 3,572 |
| Thereafter | <u>31</u> |
| | <u>\$29,699</u> |

H. LEASE COMMITMENTS

Approximate future minimum rental commitments under noncancellable operating leases are as follows (in thousands):

| <u>Fiscal Year</u> | |
|--------------------|-----------------|
| 2012 | \$ 2,920 |
| 2013 | 1,972 |
| 2014 | 694 |
| 2015 | 362 |
| 2016 | 6 |
| Thereafter | <u>0</u> |
| | <u>\$ 5,954</u> |

Total rental expense for operating leases approximated \$4,103,000, \$3,989,000 and \$4,136,000 in fiscal 2011, 2010 and 2009, respectively.

I. SHAREHOLDERS' EQUITY

At June 30, 2011 and 2010, treasury stock consisted of 1,739,574 and 1,901,242 shares of common stock, respectively. The Company issued 161,668 shares of treasury stock in fiscal 2011, to fulfill its obligations under the stock option plans and restricted stock grants. The difference between the cost of treasury shares and the option price is recorded in common stock.

On February 1, 2008, the Board of Directors authorized the purchase of 500,000 shares of Common Stock at market values. In fiscal 2009, the Company purchased 250,000 shares of its outstanding common stock at an average price of \$7.25 per share for a total cost of \$1,812,500.

Cash dividends per share were \$0.30, \$0.28 and \$0.28 in fiscal 2011, 2010 and 2009, respectively.

Effective June 30, 2008, the Company's Board of Directors established a Shareholder Rights Plan and distributed to shareholders one preferred stock purchase right (a "Right") for each outstanding share of common stock. Under certain circumstances, a Right can be exercised to purchase one four-hundredth of a share of Series A Junior Preferred Stock at an exercise price of \$125, subject to certain anti-dilution adjustments. The Rights will become exercisable on the earlier of: (i) ten business days following a public announcement that a person or group of affiliated or associated persons (an "Acquiring Person") has acquired, or obtained the right to acquire from shareholders, beneficial ownership of 15% or more of the outstanding Company's common stock (or 30% or more in the case of any person or group which currently owns 15% or more of the shares or who shall become the beneficial owner of 15% or more of the shares as a result of any transfer by reason of the death of or by gift from any other person who is an affiliate or an associate of such existing holder or by succeeding such a person as trustee of a trust existing on the Record Date ("Existing Holder")) or (ii) ten business days following the commencement of a tender offer or exchange offer that would result in a person or group beneficially owning 15% or more of such outstanding Common Stock (or 30% or more for an Existing Holder), as such periods may be extended pursuant to the Rights Agreement. In the event that any person or group becomes an Acquiring Person, each holder of a Right shall thereafter have the right to receive, upon exercise, in lieu of Preferred Stock, common stock of the Company having a value equal to two times the exercise price of the Right. However, Rights are not exercisable as described in this paragraph until such time as the Rights are no longer redeemable by the Company as set forth below. Notwithstanding any of the foregoing, if any person becomes an Acquiring Person all Rights that are, or (under certain circumstances specified in the Rights Agreement) were, beneficially owned by an Acquiring Person will become null and void.

The Rights will expire at the close of business on June 30, 2018, unless earlier redeemed or exchanged by the Company. At any time before a person becomes an Acquiring Person, the Company may redeem the Rights in whole, but not in part, at a price of \$.01 per Right, appropriately adjusted to reflect any stock split, stock dividend or similar transaction occurring after the

date hereof. Immediately upon the action of the Board of Directors ordering redemption of the Rights, the Rights will terminate and the only right of the holders of Rights will be to receive the \$.01 redemption price.

The Company is authorized to issue 200,000 shares of preferred stock, none of which have been issued. The Company has designated 150,000 shares of the preferred stock for the purpose of the Shareholder Rights Plan.

The components of accumulated other comprehensive loss included in equity as of June 30, 2011 and 2010 are as follows (in thousands):

| | <u>2011</u> | <u>2010</u> |
|---|--------------------------|--------------------------|
| Translation adjustments | \$ 28,097 | \$ 8,938 |
| Benefit plan adjustments, net of income taxes of \$22,635 and \$28,672, respectively | <u>_(39,480)</u> | <u>_(50,986)</u> |
| Accumulated other comprehensive loss | <u><u>\$(11,383)</u></u> | <u><u>\$(42,048)</u></u> |

J. BUSINESS SEGMENTS AND FOREIGN OPERATIONS

The Company and its subsidiaries are engaged in the manufacture and sale of marine and heavy duty off-highway power transmission equipment. Principal products include marine transmissions, surface drives, propellers and boat management systems, as well as power-shift transmissions, hydraulic torque converters, power take-offs, industrial clutches and controls systems. The Company sells to both domestic and foreign customers in a variety of market areas, principally pleasure craft, commercial and military marine markets, as well as in the energy and natural resources, government and industrial markets.

The Company has two reportable segments: manufacturing and distribution. These segments are managed separately because each provides different services and requires different technology and marketing strategies. The accounting practices of the segments are the same as those described in the summary of significant accounting policies. Transfers among segments are at established inter-company selling prices. Management evaluates the performance of its segments based on net earnings.

Information about the Company's segments is summarized as follows (in thousands):

| | <u>Manufacturing</u> | <u>Distribution</u> | <u>Total</u> |
|---------------------------------|----------------------|---------------------|--------------|
| 2011 | | | |
| Net sales | \$267,630 | \$128,559 | \$396,189 |
| Intra-segment sales | 12,712 | 13,289 | 26,001 |
| Inter-segment sales | 56,159 | 3,636 | 59,795 |
| Interest income | 856 | 34 | 890 |
| Interest expense | 4,168 | 66 | 4,234 |
| Income taxes | 18,565 | 3,233 | 21,798 |
| Depreciation and amortization | 7,605 | 834 | 8,439 |
| Net earnings | 25,983 | 6,759 | 32,742 |
| Assets | 271,454 | 54,028 | 325,482 |
| Expenditures for segment assets | 11,293 | 334 | 11,627 |
| 2010 | | | |
| Net sales | \$183,369 | \$101,337 | \$284,706 |
| Intra-segment sales | 10,752 | 12,990 | 23,742 |
| Inter-segment sales | 29,715 | 3,715 | 33,430 |
| Interest income | 979 | 21 | 1,000 |
| Interest expense | 4,795 | 75 | 4,870 |
| Income taxes | 1,475 | 2,412 | 3,887 |
| Depreciation and amortization | 7,537 | 873 | 8,410 |
| Net earnings | 400 | 5,079 | 5,479 |
| Assets | 217,656 | 53,514 | 271,170 |
| Expenditures for segment assets | 3,714 | 234 | 3,948 |
| 2009 | | | |
| Net sales | \$265,852 | \$112,323 | \$378,175 |
| Intra-segment sales | 27,001 | 15,906 | 42,907 |
| Inter-segment sales | 34,003 | 5,647 | 39,650 |
| Interest income | 1,113 | 94 | 1,207 |
| Interest expense | 5,669 | 90 | 5,759 |
| Income taxes | 5,920 | 3,595 | 9,515 |
| Depreciation and amortization | 7,531 | 899 | 8,430 |
| Net earnings | 16,602 | 6,438 | 23,040 |
| Assets | 236,923 | 61,052 | 297,975 |
| Expenditures for segment assets | 8,267 | 606 | 8,873 |

The following is a reconciliation of reportable segment net sales, net earnings and assets to the Company's consolidated totals (in thousands):

| | <u>2011</u> | <u>2010</u> | <u>2009</u> |
|---|-------------------------|-------------------------|-------------------------|
| Net sales: | | | |
| Total net sales from reportable segments | \$396,189 | \$284,706 | \$378,175 |
| Elimination of inter-company sales | <u>_(85,796)</u> | <u>_(57,172)</u> | <u>(82,557)</u> |
| Total consolidated net sales | <u><u>\$310,393</u></u> | <u><u>\$227,534</u></u> | <u><u>\$295,618</u></u> |
| Net earnings attributable to Twin Disc: | | | |
| Total net earnings from reportable segments | \$ 32,742 | \$ 5,479 | \$ 23,040 |
| Other corporate expenses | <u>_(13,912)</u> | <u>(4,882)</u> | <u>_(11,538)</u> |
| Total consolidated net earnings attributable to Twin Disc | <u><u>\$ 18,830</u></u> | <u><u>\$ 597</u></u> | <u><u>\$ 11,502</u></u> |
| Assets | | | |
| Total assets for reportable segments | \$325,482 | \$271,170 | |
| Corporate assets | <u>_(16,362)</u> | <u>_(12,114)</u> | |
| Total consolidated assets | <u><u>\$309,120</u></u> | <u><u>\$259,056</u></u> | |

Other significant items (in thousands):

| | Segment <u>Totals</u> | <u>Adjustments</u> | Consolidated <u>Totals</u> |
|---------------------------------|--------------------------|--------------------|-------------------------------|
| 2011 | | | |
| Interest income | \$ 890 | \$ (792) | \$ 98 |
| Interest expense | 4,234 | (2,515) | 1,719 |
| Income taxes | 21,798 | (8,734) | 13,064 |
| Depreciation and amortization | 8,439 | 1,465 | 9,904 |
| Expenditures for segment assets | 11,627 | 401 | 12,028 |
| 2010 | | | |
| Interest income | \$ 1,000 | \$ (916) | \$ 84 |
| Interest expense | 4,870 | (2,588) | 2,282 |
| Income taxes | 3,887 | (2,895) | 992 |
| Depreciation and amortization | 8,410 | 1,407 | 9,817 |
| Expenditures for segment assets | 3,948 | 508 | 4,456 |
| 2009 | | | |
| Interest income | \$ 1,207 | \$ (1,000) | \$ 207 |
| Interest expense | 5,759 | (3,272) | 2,487 |
| Income taxes | 9,515 | (3,258) | 6,257 |
| Depreciation and amortization | 8,430 | 1,344 | 9,774 |
| Expenditures for segment assets | 8,873 | 22 | 8,895 |

All adjustments represent inter-company eliminations and corporate amounts.

Geographic information about the Company is summarized as follows (in thousands):

| | <u>2011</u> | <u>2010</u> | <u>2009</u> |
|------------------|------------------|------------------|------------------|
| Net sales | | | |
| United States | \$127,469 | \$ 79,301 | \$114,540 |
| Canada | 44,659 | 13,600 | 17,921 |
| Italy | 32,063 | 30,244 | 47,676 |
| Other countries | <u>106,202</u> | <u>104,389</u> | <u>115,481</u> |
| Total | <u>\$310,393</u> | <u>\$227,534</u> | <u>\$295,618</u> |

Net sales by geographic region are based on product shipment destination.

| | <u>2011</u> | <u>2010</u> |
|--------------------------|------------------|------------------|
| Long-lived assets | | |
| United States | \$ 48,077 | \$ 42,810 |
| Belgium | 8,761 | 7,785 |
| Switzerland | 9,574 | 7,449 |
| Italy | 6,137 | 6,257 |
| Other countries | <u>613</u> | <u>568</u> |
| Total | <u>\$ 73,162</u> | <u>\$ 64,869</u> |

There were no customers that accounted for 10% or more of consolidated net sales in fiscal 2011 or fiscal 2010. One customer, Sewart Supply, Inc. (a distributor of Twin Disc), accounted for approximately 10% of consolidated net sales in fiscal 2009.

K. STOCK-BASED COMPENSATION

During fiscal 2011, the Company adopted the Twin Disc, Incorporated 2010 Stock Incentive Plan for Non-Employee Directors (the "Directors' Plan"), a plan to grant non-employee directors equity based awards up to 250,000 shares of common stock, and the Twin Disc, Incorporated 2010 Long-Term Incentive Compensation Plan (the "Incentive Plan"), a plan under which officers and key employees may be granted equity based awards up to 650,000 shares of common stock. The Directors' Plan may grant options to purchase shares of common stock, at the discretion of the board, to non-employee directors who are elected or reelected to the board, or who continue to serve on the board. Such options carry an exercise price equal to the fair market value of the Company's common stock as of the date of grant, vest immediately, and expire ten years after the date of grant. Options granted under the Incentive Plan are determined to be non-qualified or incentive stock options as of the date of grant, and may carry a vesting schedule. For options under the Incentive Plan that are intended to qualify as incentive stock options, if the optionee owns more than 10% of the total combined voting power of the Company's stock, the price will not be less than 110% of the grant date fair market value and the options expire five years after the date of grant. There were no incentive options granted to a greater than 10% shareholder during the years presented. There were no options outstanding under the Directors' Plan and the Incentive Plan as of June 30, 2011.

The Company has 26,400 non-qualified stock options outstanding as of June 30, 2011 under the Twin Disc, Incorporated 2004 Stock Incentive Plan for Non-Employee Directors. There were no options outstanding under the Twin Disc, Incorporated 2004 Stock Incentive Plan. Both of these 2004 plans were terminated during 2010, except options then outstanding will remain so until exercised or until they expire.

The Company has 8,200 incentive stock options and 69,000 non-qualified stock options outstanding at June 30, 2011 under the Twin Disc, Incorporated 1998 Incentive Compensation plan and the 1998 Stock Option Plan for Non-employee Directors. The 1998 plans were terminated during 2004, except that options then outstanding will remain so until exercised or until they expire.

Shares available for future options as of June 30 were as follows:

| | <u>2011</u> | <u>2010</u> |
|--|-------------|-------------|
| 2010 Long-Term Incentive Compensation Plan | 650,000 | - |
| 2010 Stock Incentive Plan for Non-employee Directors | 233,512 | - |
| 2004 Stock Incentive Plan | - | 242,232 |
| 2004 Stock Incentive Plan for Non-employee Directors | - | 57,600 |

Stock option transactions under the plans during 2011 were as follows:

| <u>2011</u> | Weighted Average Price | Weighted Average Remaining Contractual Life (years) | Aggregate Intrinsic Value |
|--|------------------------------|---|---------------------------------|
| Non-qualified stock options: | | | |
| Options outstanding at beginning of year | 141,000 | \$ 6.99 | |
| Granted | - | - | |

| | | | | |
|--|-----------------|----------------|-------------|--------------------|
| Canceled/expired | (3,200) | 5.57 | | |
| Exercised | <u>(42,400)</u> | <u>7.59</u> | | |
| Options outstanding at June 30 | <u>95,400</u> | <u>\$ 6.76</u> | <u>3.17</u> | <u>\$3,054,599</u> |
| Options exercisable at June 30 | <u>95,400</u> | <u>\$ 6.76</u> | <u>3.17</u> | <u>\$3,054,599</u> |
| Options price range (\$3.25 - \$4.98) | | | | |
| Number of shares | 69,000 | | | |
| Weighted average price | \$ 3.61 | | | |
| Weighted average remaining life | 1.83 years | | | |
| Options price range (\$5.73 - \$7.19) | | | | |
| Number of shares | 3,600 | | | |
| Weighted average price | \$ 6.23 | | | |
| Weighted average remaining life | 4.00 years | | | |
| Options price range (\$10.01 - \$27.55) | | | | |
| Number of shares | 22,800 | | | |
| Weighted average price | \$ 16.37 | | | |
| Weighted average remaining life | 7.11 years | | | |

| | <u>2011</u> | Weighted Average Price | Weighted Average Remaining Contractual Life (years) | Aggregate Intrinsic Value |
|---|--------------|------------------------------|---|---------------------------------|
| Incentive stock options: | | | | |
| Options outstanding at beginning of year | 15,800 | \$ 4.06 | | |
| Granted | - | - | | |
| Canceled/expired | (7,600) | 4.38 | | |
| Exercised | <u>-</u> | <u>-</u> | | |
| Options outstanding at June 30 | <u>8,200</u> | <u>\$ 3.76</u> | <u>1.00</u> | <u>\$287,144</u> |
| Options exercisable at June 30 | <u>8,200</u> | <u>\$ 3.76</u> | <u>1.00</u> | <u>\$287,144</u> |
| Options price range (\$3.76 - \$4.98) | | | | |
| Number of shares | 8,200 | | | |
| Weighted average price | \$ 3.76 | | | |
| Weighted average remaining life | 1.00 years | | | |

The Company accounts for stock-based compensation in accordance with ASC Topic 718-10, "Compensation – Stock Compensation." In addition, the Company computes its windfall tax pool using the shortcut method. ASC Topic 718-10 requires the Company to expense the cost of employee services received in exchange for an award of equity instruments using the fair-value-based method. All options were 100% vested at the adoption of this statement.

During fiscal 2011, 2010 and 2009, 0, 7,200 and 7,200 non-qualified stock options were granted, respectively. As a result, compensation cost of \$0, \$44,000 and \$31,000 has been recognized in the Consolidated Statements of Operations and Comprehensive Income (Loss) for fiscal 2011, 2010 and 2009, respectively.

The total intrinsic value of options exercised during the years ended June 30, 2011, 2010 and 2009 was approximately \$630,000, \$89,000 and \$155,000, respectively.

In fiscal 2011, 2010 and 2009, the Company granted a target number of 98,358, 91,807 and 88,500 performance stock unit awards, respectively, to various employees of the Company, including executive officers. The performance stock unit awards granted in fiscal 2011 will vest if the Company achieves a specified target objective relating to consolidated economic profit (as defined in the Performance Stock Unit Award Grant Agreement) in the cumulative three fiscal year period ending June 30, 2013. The performance stock unit awards granted in fiscal 2011 are subject to adjustment if the Company's economic profit for the period falls below or exceeds the specified target objective, and the maximum number of performance stock units that can be awarded if the target objective is exceeded is 118,030. Based upon actual results to date and the probability of achieving the maximum performance levels, the Company is accruing the performance stock unit awards granted in fiscal 2011 at the maximum level. The performance stock unit awards granted in fiscal 2010 will vest if the Company achieves a specified target objective relating to consolidated economic profit (as defined in the Performance Stock Unit Award Grant Agreement) in the cumulative three fiscal year period ending June 30, 2012. The performance stock unit awards granted in fiscal 2010 are subject to adjustment if the Company's economic profit for the period falls below or exceeds the specified target objective, and the maximum number of performance stock units that can be awarded if the target objective is exceeded is 110,168. Based upon actual results to date and the probability of achieving the maximum performance levels, the Company is accruing the performance stock unit awards granted in fiscal 2010 at the maximum level. The performance stock unit awards granted in fiscal 2009 will vest if the Company achieves a specified target objective relating to consolidated economic profit (as defined in the Performance Stock Unit Award Grant Agreement) in the cumulative three fiscal year period ending June 30, 2011. The performance stock unit awards granted in fiscal 2009 are subject to adjustment if the Company's economic profit for the period falls below or exceeds the specified target objective, and the maximum number of performance stock units that can be awarded if the target objective is exceeded is 106,200. Based upon actual results to date, the Company did not accrue for the performance stock unit awards granted in fiscal 2009. There were 316,698, 233,065 and 141,258 unvested performance stock unit awards outstanding at June 30, 2011, 2010 and 2009, respectively. The weighted average grant date fair value of the unvested awards at June 30, 2011 was \$11.02. The performance stock unit awards are remeasured at fair-value based upon the Company's stock price at the end of each reporting period. The fair-value of the stock unit awards are expensed over the performance period for the shares that are expected to ultimately vest. The compensation expense (income) for the year ended June 30, 2011, 2010 and 2009 related to the performance stock unit awards, approximated \$4,246,000, \$0 and \$(852,000), respectively. At June 30, 2011, the Company had \$4,603,000 of unrecognized compensation expense related to the unvested shares that are ultimately expected to vest based upon the probability of achieving threshold performance levels. The total fair value of performance stock unit awards vested in fiscal 2011, 2010 and 2009 was \$0, \$0 and \$496,000, respectively. The performance stock unit awards are cash based, and are thus recorded as a liability on the Company's Consolidated Balance Sheets. As of June 30, 2011, these awards are included in "Other long-term liabilities" due to the performance periods all exceeding one year.

In fiscal 2011, 2010 and 2009, the Company granted a target number of 72,546, 74,173 and 66,500 performance stock awards, respectively, to various employees of the Company, including executive officers. The performance stock awards granted in fiscal 2011 will vest if the Company achieves a specified target objective relating to consolidated economic profit (as defined in the Performance Stock Award Grant Agreement) in the cumulative three fiscal year period ending June 30, 2013. The performance stock awards granted in fiscal 2011 are subject to adjustment if the Company's economic profit for the period falls below or exceeds the specified target objective, and the maximum number of performance shares that can be awarded if the target objective is exceeded is 87,055. Based upon actual results to date and the probability of achieving the maximum performance levels, the Company is accruing the performance stock awards granted in fiscal 2011 at the maximum level. The performance stock awards granted in fiscal 2010 will vest if the Company achieves a specified target objective relating to consolidated economic profit (as defined in the Performance Stock Award Grant Agreement) in the cumulative three fiscal year period ending June 30, 2012. The performance stock awards granted in fiscal 2010 are subject to adjustment if the Company's economic profit for the period falls below or exceeds the specified target objective, and the maximum number of performance shares that can be awarded if the target objective is exceeded is 89,008. Based upon actual results to date and the probability of achieving the maximum performance levels, the Company is accruing the performance stock awards granted in fiscal 2010 at the maximum level. The performance stock awards granted in fiscal 2009 will vest if the Company achieves a specified target objective relating to consolidated economic profit (as defined in the Performance Stock Award Grant Agreement) in the cumulative three fiscal year period ending June 30, 2011. The performance stock awards granted in fiscal 2009 are subject to adjustment if the Company's economic profit for the period falls below or exceeds the specified target objective, and the maximum number of performance shares that can be awarded if the target objective is exceeded is 79,800. Based upon actual results to date, the Company did not accrue for the performance stock awards granted in fiscal 2009. There were 242,563, 177,983 and 103,810 unvested performance stock awards outstanding at June 30, 2011, 2010 and 2009, respectively. The fair value of the stock awards (on the date of grant) is expensed over the performance period for the shares that are expected to ultimately vest. The compensation expense for the year ended June 30, 2011, 2010 and 2009, related to performance stock awards, approximated \$876,000, \$0 and \$31,000, respectively. The weighted average grant date fair value of the unvested awards at June 30, 2011 was \$10.74. At June 30, 2011, the Company had \$1,048,000 of unrecognized compensation expense related to the unvested shares that are ultimately expected to vest based upon the probability of achieving threshold performance levels. The total fair value of performance stock awards vested in fiscal 2011, 2010 and 2009 was \$0, \$0 and \$496,000, respectively.

In addition to the performance shares mentioned above, the Company has unvested restricted stock outstanding that will vest if certain service conditions are fulfilled. The fair value of the restricted stock grants is recorded as compensation over the vesting period, which is generally 1 to 4 years. During fiscal 2011, 2010 and 2009, the Company granted 119,268, 109,123 and 17,700 service based restricted shares, respectively, to employees and non-employee directors in each year. There were 237,691, 126,423 and 23,700 unvested shares outstanding at June 30, 2011, 2010 and 2009, respectively. Compensation expense of \$1,026,000, \$463,000 and \$208,000 was recognized during the year ended June 30, 2011, 2010 and 2009, respectively, related to these service-based awards. The total fair value of restricted stock grants vested in fiscal 2011, 2010 and 2009 was \$133,000, \$138,000 and \$138,000, respectively. As of June 30, 2011, the Company had \$1,361,000 of unrecognized compensation expense related to restricted stock which will be recognized over the next three years.

L. ENGINEERING AND DEVELOPMENT COSTS

Engineering and development costs include research and development expenses for new products, development and major improvements to existing products, and other costs for ongoing efforts to refine existing products. Research and development costs charged to operations totaled \$2,475,000, \$2,347,000 and \$2,636,000 in fiscal 2011, 2010 and 2009, respectively. Total engineering and development costs were \$8,776,000, \$7,885,000 and \$9,142,000 in fiscal 2011, 2010 and 2009, respectively.

M. PENSION AND OTHER POSTRETIREMENT BENEFIT PLANS

The Company has non-contributory, qualified defined benefit pension plans covering substantially all domestic employees hired prior to October 1, 2003, and certain foreign employees. Domestic plan benefits are based on years of service, and, for salaried employees, on average compensation for benefits earned prior to January 1, 1997, and on a cash balance plan for benefits earned after January 1, 1997. The Company's funding policy for the plans covering domestic employees is to contribute an actuarially determined amount which falls between the minimum and maximum amount that can be deducted for federal income tax purposes.

On June 3, 2009 the Company announced it would freeze future accruals under the domestic defined benefit pension plans effective August 1, 2009. This resulted in a curtailment gain of \$1,700,000 recorded in the fourth quarter of fiscal 2009.

In addition, the Company has unfunded, non-qualified retirement plans for certain management employees and Directors. In the case of management employees, benefits are based either on final average compensation or on an annual credit to a bookkeeping account, intended to restore the benefits that would have been earned under the qualified plans, but for the earnings limitations under the Internal Revenue Code. In the case of Directors, benefits are based on years of service on the Board. All benefits vest upon retirement from the Company.

In addition to providing pension benefits, the Company provides other postretirement benefits, including healthcare and life insurance benefits for certain domestic retirees. All employees retiring after December 31, 1992, and electing to continue healthcare coverage through the Company's group plan, are required to pay 100% of the premium cost.

The measurement date for the Company's pension and postretirement benefit plans in fiscal 2011 and 2010 was June 30. The Company was required to adopt the year end measurement date for its pension and postretirement benefit plans in fiscal 2009 using the prospective method. Prior to fiscal 2009, the measurement date was March 31. The adoption of the change in measurement date requirement in fiscal 2009 resulted in a \$784,000 charge to retained earnings, net of tax.

Obligations and Funded Status

The following table sets forth the Company's defined benefit pension plans' and other postretirement benefit plans' funded status and the amounts recognized in the Company's balance sheets and statement of operations as of June 30 (in thousands):

| | <u>2011</u> | <u>2010</u> | <u>2011</u> | <u>2010</u> |
|--|-------------------|-------------------------|-------------------|--------------------------------------|
| | | Pension Benefits | | Other Postretirement Benefits |
| Change in benefit obligation: | | | | |
| Benefit obligation, beginning of year | \$125,857 | \$115,572 | \$ 22,834 | \$ 21,985 |
| Service cost | 198 | 292 | 32 | 28 |
| Interest cost | 6,324 | 7,282 | 1,096 | 1,347 |
| Actuarial loss (gain) | 4,523 | 11,740 | (1,038) | 1,937 |
| Benefits paid | <u>(10,388)</u> | <u>(9,029)</u> | <u>(2,353)</u> | <u>(2,463)</u> |
| Benefit obligation, end of year | <u>\$126,514</u> | <u>\$ 125,857</u> | <u>\$ 20,571</u> | <u>\$ 22,834</u> |
| Change in plan assets: | | | | |
| Fair value of assets, beginning of year | \$ 76,391 | \$ 77,517 | \$ - | \$ - |
| Actual return on plan assets | 21,810 | 7,075 | - | - |
| Employer contribution | 9,717 | 828 | 2,353 | 2,463 |
| Benefits paid | <u>(10,388)</u> | <u>(9,029)</u> | <u>(2,353)</u> | <u>(2,463)</u> |
| Fair value of assets, end of year | <u>\$ 97,530</u> | <u>\$ 76,391</u> | <u>\$ -</u> | <u>\$ -</u> |
| Funded status | <u>\$(28,984)</u> | <u>\$(49,466)</u> | <u>\$(20,571)</u> | <u>\$(22,834)</u> |
| Amounts recognized in the balance sheet consist of: | | | | |
| Noncurrent assets | \$ 587 | \$ 319 | \$ - | \$ - |
| Current liabilities | (130) | (137) | (3,008) | (2,605) |
| Noncurrent liabilities | <u>(29,441)</u> | <u>(49,648)</u> | <u>(17,563)</u> | <u>(20,229)</u> |
| Net amount recognized | <u>\$(28,984)</u> | <u>\$(49,466)</u> | <u>\$(20,571)</u> | <u>\$(22,834)</u> |
| Amounts recognized in accumulated other comprehensive loss consist of (net of tax): | | | | |
| Net transition obligation | \$ - | \$ - | \$ - | \$ - |
| Prior service cost | - | - | (321) | (760) |
| Actuarial net loss | <u>34,768</u> | <u>45,250</u> | <u>5,033</u> | <u>6,496</u> |
| Net amount recognized | <u>\$ 34,768</u> | <u>\$ 45,250</u> | <u>\$ 4,712</u> | <u>\$ 5,736</u> |

The amounts in accumulated other comprehensive loss that are expected to be recognized as components of net periodic benefit cost during the next fiscal year for the qualified domestic defined benefit plans are as follows (in thousands):

| | Pension Benefits | Other Postretirement Benefits |
|-----------------------------|-------------------------|--------------------------------------|
| Actuarial net loss | \$2,319 | \$ 930 |
| Prior service cost | - | (509) |
| Net amount to be recognized | <u>\$2,319</u> | <u>\$ 421</u> |

The accumulated benefit obligation for all defined benefit pension plans was \$126,514,000 and \$125,857,000 at June 30, 2011 and 2010, respectively.

Information for pension plans with an accumulated benefit obligation in excess of plan assets (in thousands):

| | <u>2011</u> | <u>2010</u> |
|--|-------------|-------------|
| Projected and accumulated benefit obligation | \$124,328 | \$123,072 |
| Fair value of plan assets | 94,757 | 73,287 |

Components of Net Periodic Benefit Cost (in thousands):

| | <u>2011</u> | <u>2010</u> | <u>2009</u> |
|---------------------------------------|-----------------|-----------------|---------------|
| Service cost | \$ 198 | \$ 292 | \$ 1,266 |
| Interest cost | 6,324 | 7,282 | 7,082 |
| Expected return on plan assets | (6,096) | (6,052) | (8,947) |
| Curtailed benefit | - | - | (1,700) |
| Settlement loss | 23 | 99 | - |
| Amortization of prior service cost | - | - | (718) |
| Amortization of transition obligation | - | 60 | 69 |
| Amortization of actuarial net loss | <u>3,118</u> | <u>2,637</u> | <u>3,205</u> |
| Net periodic benefit cost | <u>\$ 3,567</u> | <u>\$ 4,318</u> | <u>\$ 257</u> |

In the fourth quarter of fiscal 2009, the Company discovered that the net periodic pension benefit cost related to its foreign pension plan had been overstated in prior years and during the first three quarters of fiscal 2009. To correct for this error, the Company recorded \$626,000 of net periodic pension benefit income in the fourth quarter of fiscal 2009. Of this amount, \$345,000 related to previous fiscal years. The Company believes that the error was not material to any previously issued financial statements.

| | <u>2011</u> | <u>2010</u> | <u>2009</u> |
|------------------------------------|----------------|-----------------|-----------------|
| Service cost | \$ 32 | \$ 28 | \$ 38 |
| Interest cost | 1,096 | 1,347 | 1,297 |
| Amortization of prior service cost | (678) | (678) | (679) |
| Amortization of actuarial net loss | <u>1,124</u> | <u>859</u> | <u>1,228</u> |
| Net periodic benefit cost | <u>\$1,574</u> | <u>\$ 1,556</u> | <u>\$ 1,884</u> |

Other Changes in Plan Assets and Benefit Obligations Recognized in Other Comprehensive Income for Fiscal 2011 (Pre-tax, thousands):

| | <u>Pension</u> | <u>Other Postretirement Benefits</u> |
|---------------------------------------|----------------|--------------------------------------|
| Net (loss) gain | (\$13,738) | \$ 1,038 |
| Amortization of prior service benefit | - | (678) |

| | | |
|--|-------------------|-----------------|
| Amortization of net (loss) gain | <u>(3,110)</u> | <u>1,124</u> |
| Total recognized in other comprehensive income | <u>(\$16,848)</u> | <u>\$ 1,484</u> |
| Net periodic benefit cost | <u>3,567</u> | <u>1,574</u> |
| Total recognized in net periodic benefit cost and other comprehensive income | <u>(\$13,281)</u> | <u>\$ 3,058</u> |

Additional Information

Assumptions (as of June 30, 2011 and 2010)

| | <u>Pension Benefits</u> | | <u>Other Postretirement Benefits</u> | | | |
|--|-------------------------|-------------|--------------------------------------|-------------|-------------|-------------|
| Weighted average assumptions used to determine benefit obligations at June 30 | | | | | | |
| | <u>2011</u> | <u>2010</u> | <u>2011</u> | <u>2010</u> | | |
| Discount rate | 5.16% | 5.09% | 5.16% | 5.09% | | |
| Expected return on plan assets | 8.50% | 8.50% | | | | |
| Weighted average assumptions used to determine net periodic benefit cost for years ended June 30 | | | | | | |
| | <u>2011</u> | <u>2010</u> | <u>2009</u> | <u>2011</u> | <u>2010</u> | <u>2009</u> |
| Discount rate | 5.09% | 6.60% | 6.00% | 5.09% | 6.60% | 6.00% |
| Expected return on plan assets | 8.50% | 8.50% | 8.50% | | | |
| Rate of compensation increase | NA | 5.00% | 5.00% | | | |

The assumed weighted-average healthcare cost trend rate was 8.0% in 2011, grading down to 5% in 2017. A 1% increase in the assumed health care cost trend would increase the accumulated postretirement benefit obligation by approximately \$490,000 and the service and interest cost by approximately \$28,000. A 1% decrease in the assumed health care cost trend would decrease the accumulated postretirement benefit obligation by approximately \$439,000 and the service and interest cost by approximately \$25,000.

Plan Assets

The Company's Pension Committee ("Committee") oversees investment matters related to the Company's funded benefit plans. The Committee works with external actuaries and investment consultants on an ongoing basis to establish and monitor investment strategies and target asset allocations. The overall objective of the Committee's investment strategy is to earn a rate of return over time to satisfy the benefit obligations of the pension plans and to maintain sufficient liquidity to pay benefits and address other cash requirements of the pension plans. The Committee has established an Investment Policy Statement which provides written documentation of the Company's expectations regarding its investment programs for the pension plans, establishes objectives and guidelines for the investment of the plan assets consistent with the Company's financial and benefit-related goals, and outlines criteria and procedures for the ongoing evaluation of the investment program. The Company employs a total return on investment approach whereby a mix of investments among several asset classes are used to maximize long-term return of plan assets while avoiding excessive risk. Investment risk is measured and monitored on an ongoing basis through quarterly investment portfolio reviews, and annual liability measurements.

The Company's pension plan weighted-average asset allocations at June 30, 2011 and 2010 by asset category are as follows:

| <u>Asset Category</u> | <u>Target Allocation</u> | <u>2011</u> | <u>2010</u> |
|-----------------------|--------------------------|-------------|-------------|
| Equity securities | 65% | 66% | 69% |
| Debt securities | 25% | 25% | 21% |
| Real estate | 10% | 9% | 10% |
| | <u>100%</u> | <u>100%</u> | <u>100%</u> |

Due to market conditions and other factors, actual asset allocation may vary from the target allocation outlined above. The pension plans held 98,211 shares of Company stock with a fair market value of \$3,793,891 (4.1 percent of total plan assets) at June 30, 2011 and 168,211 shares with a fair market value of \$1,910,877 (2.6 percent of total plan assets) at June 30, 2010.

The plans have a long-term return assumption of 8.50%. This rate was derived based upon historical experience and forward-looking return expectations for major asset class categories.

Fair value is defined as the price that would be received on the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The inputs used to measure fair value are classified into the following hierarchy:

| | |
|-----------|---|
| Level I | Unadjusted quoted prices in active markets for identical instruments |
| Level II | Unadjusted quoted prices in active markets for similar instruments, or Unadjusted quoted prices for identical or similar instruments in markets that are not active, or Other inputs that are observable in the market or can be corroborated by observable market data |
| Level III | Use of one or more significant unobservable inputs |

The following table presents plan assets using the fair value hierarchy as of June 30, 2011 (in thousands):

| | <u>Total</u> | <u>Level I</u> | <u>Level II</u> | <u>Level III</u> |
|---------------------------|-----------------|-----------------|-----------------|------------------|
| Cash and cash equivalents | \$ 893 | \$ 893 | \$ - | \$ - |
| Equity securities: | | | | |
| U.S. (a) | 31,761 | 31,761 | - | - |
| International (b) | 16,211 | 10,732 | 5,479 | - |
| Fixed income (c) | 21,816 | 8,993 | 12,823 | - |
| Group insurance contracts | 5,810 | - | - | 5,810 |
| Real estate | 8,671 | - | 3,411 | 5,260 |
| Other (d) | <u>12,368</u> | <u>-</u> | <u>-</u> | <u>12,368</u> |
| Total | <u>\$97,530</u> | <u>\$52,379</u> | <u>\$21,713</u> | <u>\$23,438</u> |

(a) U.S. equity securities include companies that are well diversified by industry sector and equity style (i.e., growth and value strategies). Investments are primarily in large capitalization stocks and, to a lesser extent, mid- and small-cap stocks.

(b) International equities are invested in companies that are traded on exchanges outside the U.S. and are well diversified by industry sector, country, capitalization and equity style (i.e., growth and value strategies). The vast majority of the investments are made in companies in developed markets with a smaller percentage in emerging markets.

(c) Fixed income consists of corporate bonds with investment grade BBB or better from diversified industries, as well as government debt securities.

(d) Other consists of hedged equity.

The following table presents a reconciliation of the fair value measurements using significant unobservable inputs (Level III) as of June 30, 2011 (in thousands):

| | Annuity Contracts | Real Estate | Other |
|---|----------------------|-----------------|------------------|
| Balance – June 30, 2010 | \$ 3,104 | \$ 7,213 | \$ 7,572 |
| Actual return on plan assets: | | | |
| Relating to assets still held at reporting date | 695 | 832 | 796 |
| Relating to assets sold during the period | - | - | - |
| Purchases, sales and settlements, net | 2,011 | - | 4,000 |
| Transfers in and/or out of Level III | <u>-</u> | <u>(2,785)</u> | <u>-</u> |
| Balance – June 30, 2011 | <u>\$ 5,810</u> | <u>\$ 5,260</u> | <u>\$ 12,368</u> |

Cash Flows

Contributions

The Company expects to contribute \$3,728,000 to its defined benefit pension plans in fiscal 2012.

Estimated Future Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid (in thousands):

| | Pension Benefits | Gross Benefits | Other Postretirement Benefits Part D Reimbursement | Net Benefit Payments |
|------------------|---------------------|-------------------|--|-------------------------|
| 2012 | \$ 9,707 | \$3,008 | \$ - | \$3,008 |
| 2013 | 9,787 | 2,873 | - | 2,873 |
| 2014 | 9,564 | 2,298 | - | 2,298 |
| 2015 | 9,614 | 2,180 | - | 2,180 |
| 2016 | 9,619 | 2,053 | - | 2,053 |
| Years 2017- 2021 | 45,537 | 8,255 | - | 8,255 |

The Company sponsors defined contribution plans covering substantially all domestic employees and certain foreign employees. These plans provide for employer contributions based primarily on employee participation. The total expense under the plans was \$2,469,000, \$2,111,000 and \$1,829,000 in fiscal 2011, 2010 and 2009, respectively.

N. INCOME TAXES

United States and foreign earnings before income taxes and noncontrolling interest were as follows (in thousands):

| | 2011 | 2010 | 2009 |
|---------------|-----------------|-----------------|-----------------|
| United States | \$27,914 | \$ 4,127 | \$ 8,747 |
| Foreign | <u>4,115</u> | <u>(2,405)</u> | <u>9,298</u> |
| | <u>\$32,029</u> | <u>\$ 1,722</u> | <u>\$18,045</u> |

The provision (benefit) for income taxes is comprised of the following (in thousands):

| | 2011 | 2010 | 2009 |
|---------------------------|-----------------|----------------|-----------------|
| Currently payable: | | | |
| Federal | \$ 8,704 | \$ 490 | \$ 120 |
| State | 373 | 302 | (6) |
| Foreign | <u>2,633</u> | <u>1,674</u> | <u>5,413</u> |
| | <u>11,710</u> | <u>2,466</u> | <u>5,527</u> |
| Deferred: | | | |
| Federal | (315) | 532 | 1,725 |
| State | (97) | (58) | 1 |
| Foreign | <u>1,766</u> | <u>(1,948)</u> | <u>(996)</u> |
| | <u>1,354</u> | <u>(1,474)</u> | <u>6,257</u> |
| Total provision (benefit) | <u>\$13,064</u> | <u>\$ 992</u> | <u>\$ 6,257</u> |

The components of the net deferred tax asset as of June 30 are summarized in the table below (in thousands).

| | 2011 | 2010 |
|---|---------------|---------------|
| <i>Deferred tax assets:</i> | | |
| Retirement plans and employee benefits | \$24,387 | \$27,228 |
| Foreign tax credit carryforwards | - | 828 |
| AMT credit carryforwards | - | 363 |
| Federal tax credits | - | 484 |
| State net operating loss and other state credit carryforwards | 240 | 500 |
| Inventory | 3,772 | 2,645 |
| Reserves | 1,810 | 1,558 |
| Research & development capitalization | 186 | 345 |
| Foreign NOL carryforwards | 3,379 | 2,058 |
| Accruals | 306 | 820 |
| Other assets | <u>124</u> | <u>-</u> |
| | <u>34,204</u> | <u>36,829</u> |
| <i>Deferred tax liabilities:</i> | | |
| Property, plant and equipment | 6,704 | 5,519 |
| Intangibles | 6,313 | 5,403 |
| Other liabilities | <u>361</u> | <u>308</u> |

| | | |
|-------------------------------|-----------------|-----------------|
| | <u>13,378</u> | <u>11,230</u> |
| Valuation allowance | <u>(2,751)</u> | <u>(260)</u> |
| Total net deferred tax assets | <u>\$18,075</u> | <u>\$25,339</u> |

The Company maintains valuation allowances when it is more likely than not that all or a portion of a deferred tax asset will not be realized. Changes in valuation allowances from period to period are included in the tax provision in the period of change. In determining whether a valuation allowance is required, the Company takes into account such factors as prior earnings history, expected future earnings, carry-back and carry-forward periods, and tax strategies that could potentially enhance the likelihood of realization of a deferred tax asset. During fiscal 2011, the Company incurred operating losses in certain foreign jurisdictions where the loss carryforward period is unlimited. The Company has evaluated the realizability of the net deferred tax assets related to these jurisdictions and concluded that it is more likely than not that all or a portion of the net deferred tax assets will not be realized, therefore, has established a full valuation allowance of \$2,751,000 against the balance. A valuation allowance of \$260,000 recorded at June 30, 2010 related to state tax credits has been reversed during the fiscal year ended June 30, 2011, as management believes that it is more likely than not that all state tax credits will be used before they expire. Management believes that it is more likely than not that the results of future operations will generate sufficient taxable income and foreign source income to realize the remaining deferred tax assets.

During the third quarter of fiscal 2010, the Company completed and filed its 2009 Federal and State income tax returns. Subsequently, the Company completed its return-to-provision reconciliation to determine differences between positions taken per the year-end fiscal 2009 book tax provision and the actual positions taken per the 2009 returns. This reconciliation identified an error in the fiscal 2009 tax provision, which resulted in understating fiscal 2009 earnings by \$188,000. To correct this error, the Company reduced tax expense by \$188,000 in the third quarter of fiscal 2010.

During the fourth quarter of fiscal 2010, the Company determined the deferred tax liability surrounding fixed assets at a foreign location was incorrectly recorded. To correct for this, the Company booked a \$392,000 deferred tax liability (additional tax expense) in the fourth quarter. Of this amount, \$458,000 should have been recorded in prior fiscal periods. In addition, the Company made a correction to the current tax accrual at another foreign location during the fourth quarter. This correction resulted in a \$298,000 tax benefit in the fourth quarter which should have been recorded in prior fiscal periods.

The Company believes that the above errors were not material to the current or any previously issued financial statements.

Following is a reconciliation of the applicable U.S. federal income taxes to the actual income taxes reflected in the statements of operations (in thousands):

| | <u>2011</u> | <u>2010</u> | <u>2009</u> |
|---|-----------------|--------------|----------------|
| U.S. federal income tax at 35% | \$11,163 | \$540 | \$6,135 |
| Increases (reductions) in tax resulting from: | | | |
| Foreign tax items | 419 | 587 | 219 |
| State taxes | 129 | 160 | (267) |
| Valuation allowance | 2,491 | 48 | 212 |
| Change in prior year estimate | (157) | (216) | (52) |
| Research & development tax credits | (387) | (184) | (300) |
| Section 199 deduction | (735) | - | (34) |
| Other, net | 141 | 57 | 344 |
| | <u>\$13,064</u> | <u>\$992</u> | <u>\$6,257</u> |

The Company has not provided additional U.S. income taxes on cumulative earnings of consolidated foreign subsidiaries that are considered to be reinvested indefinitely. These earnings relate to ongoing operations and were approximately \$6.2 million at June 30, 2011. Such earnings could become taxable upon the sale or liquidation of these foreign subsidiaries or upon dividend repatriation. The Company's intent is for such earnings to be reinvested by the subsidiaries or to be repatriated only when it would be tax effective through the utilization of foreign tax credits.

Annually, we file income tax returns in various taxing jurisdictions inside and outside the United States. In general, the tax years that remain subject to examination are 2003 through 2010 for our major operations in the U.S., Italy, Belgium and Japan. It is reasonably possible that at least one of these audit cycles will be completed during fiscal 2012.

The Company has approximately \$0.9 million of unrecognized tax benefits as of June 30, 2011, which, if recognized would impact the effective tax rate. The Company has negotiated a proposed audit settlement in the U.S. for fiscal years 2003 through 2007. The Company does anticipate that upon final settlement, the net amount of unrecognized tax benefits will decrease by approximately \$0.4 million during the next twelve months. The Company's policy is to accrue interest and penalties related to unrecognized tax benefits in income tax expense.

Below is a reconciliation of beginning and ending amount of unrecognized tax benefits (in thousands):

| | <u>June 30, 2011</u> | <u>June 30, 2010</u> | |
|--|----------------------|----------------------|--------------|
| Unrecognized tax benefits, beginning of year | | \$ 808 | \$ 797 |
| Additions based on tax positions related to the prior year | 6 | | - |
| Additions based on tax positions related to the current year | 136 | | 116 |
| Reductions based on tax positions related to the prior year | | - | - |
| Subtractions due to statutes closing | | (60) | (90) |
| Settlements with taxing authorities | (37) | | (15) |
| Unrecognized tax benefits, end of year | | <u>\$ 853</u> | <u>\$808</u> |

The amounts reflected in this reconciliation do not include interest and penalties totaling \$136,000.

O. CONTINGENCIES

The Company is involved in litigation of which the ultimate outcome and liability to the Company, if any, are not presently determinable. Management believes that final disposition of such litigation will not have a material impact on the Company's results of operations or financial position.

P. RESTRUCTURING OF OPERATIONS

During the fourth quarter of fiscal 2009, the Company recorded a pre-tax restructuring charge of \$948,000 related to a workforce reduction at its Racine, Canadian and Australian operations. The charge consisted of severance costs for 22 salaried employees and voluntary early retirement charges for an additional 16 manufacturing employees. During fiscal 2009, the Company made cash payments of \$180,000, resulting in an accrual balance at June 30, 2009 of \$767,000. The remainder of this balance was paid during fiscal 2010, resulting in no accrual balance at June 30, 2010 or 2011.

During the fourth quarter of fiscal 2007, the Company recorded a pre-tax restructuring charge of \$2,652,000 related to a workforce reduction at its Belgian operation that will allow for improved profitability through targeted outsourcing savings and additional focus on core manufacturing processes. The charge consisted of prepension costs for 32 employees: 29 manufacturing employees and 3 salaried employees. This charge was adjusted in the fourth quarter of fiscal 2008, resulting in a pre-tax benefit of \$373,000, due to final negotiations primarily related to notice period pay. Further adjustments were made in the fourth quarter of fiscal 2009 (resulting in a pre-tax expense of \$240,000 related to legally required inflationary adjustments to benefits) and fiscal 2010 (resulting in a pre-tax expense of \$342,000 primarily related to a Belgian legislation change surrounding the prepension costs and legally required inflationary adjustments). An additional adjustment was made during the fourth quarter of fiscal 2011, resulting in pre-tax expense of \$187,000 related to the annual legally required inflationary adjustments to benefits. During fiscal 2011 and 2010, the Company made cash payments of \$252,000 and \$152,000, respectively. The exchange impact in fiscal 2011 was to increase the accrual by \$413,000. Accrued restructuring costs were \$2,663,000 and \$2,315,000 at June 30, 2011 and 2010, respectively.

The Company recorded a restructuring charge of \$2,076,000 in the fourth quarter of fiscal 2005 as the Company restructured its Belgian operation to improve future profitability. The charge consists of prepension costs for 37 employees: 33 manufacturing employees and 4 salaried employees. An adjustment was made in the fourth quarter of fiscal 2010, resulting in a pre-tax expense of \$138,000 primarily related to a Belgian legislation change surrounding the prepension costs and legally required inflationary adjustments. An additional adjustment was made in the

fourth quarter of fiscal 2011, resulting in pre-tax expense of \$58,000 related to the annual legally required inflationary adjustments to benefits. During fiscal 2011 and 2010, the Company made cash payments of \$220,000 and \$192,000, respectively. The exchange impact in fiscal 2011 was to increase the accrual by \$161,000. Accrued restructuring costs were \$944,000 and \$945,000 at June 30, 2011 and 2010, respectively.

TWIN DISC, INCORPORATED AND SUBSIDIARIES
SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS
for the years ended June 30, 2011, 2010 and 2009 (in thousands)

| <u>Description</u> | <u>Balance at Beginning of Period</u> | -----Additions----- <u>Charged to Costs and Expenses</u> | <u>Net Acquired</u> | <u>Deductions⁽¹⁾</u> | <u>Balance at End of Period</u> |
|--|---|---|-------------------------|---------------------------------|---|
| 2011: | | | | | |
| Allowance for losses on accounts receivable | <u>\$1,792</u> | <u>\$1,078</u> | <u>\$ -</u> | <u>\$ 777</u> | <u>\$2,093</u> |
| Reserve for inventory obsolescence | <u>\$6,072</u> | <u>\$2,157</u> | <u>\$ -</u> | <u>\$2,010</u> | <u>\$6,219</u> |
| Deferred tax valuation allowance | <u>\$ 260</u> | <u>\$2,751</u> | <u>\$ -</u> | <u>\$ 260</u> | <u>\$2,751</u> |
| 2010: | | | | | |
| Allowance for losses on accounts receivable | <u>\$ 1,623</u> | <u>\$ 412</u> | <u>\$ -</u> | <u>\$ 243</u> | <u>\$1,792</u> |
| Reserve for inventory obsolescence | <u>\$5,406</u> | <u>\$1,401</u> | <u>\$ -</u> | <u>\$ 735</u> | <u>\$6,072</u> |
| Deferred tax valuation allowance | <u>\$ 212</u> | <u>\$ 48</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 260</u> |
| 2009: | | | | | |
| Allowance for losses on accounts receivable | <u>\$ 1,219</u> | <u>\$ 524</u> | <u>\$ -</u> | <u>\$ 120</u> | <u>\$1,623</u> |
| Reserve for inventory obsolescence | <u>\$ 4,311</u> | <u>\$2,627</u> | <u>\$ -</u> | <u>\$1,532</u> | <u>\$5,406</u> |
| Deferred tax valuation allowance | <u>\$ -</u> | <u>\$ 212</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 212</u> |

(1) Amounts primarily represent accounts receivable written-off and inventory disposed of during the year, along with other adjustments (primarily foreign currency translation adjustments).

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

September 13, 2011

TWIN DISC, INCORPORATED

By: /s/ MICHAEL E. BATTEN
Michael E. Batten
Chairman and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

September 13, 2011

By: /s/ MICHAEL E. BATTEN
Michael E. Batten
Chairman, Chief Executive Officer and Director

September 13, 2011

By: /s/ JOHN H. BATTEN
John H. Batten
President, Chief Operating Officer and Director

September 13, 2011

By: /s/ CHRISTOPHER J. EPERJESY
Christopher J. Eperjesy
Vice President-Finance, Chief Financial Officer and Treasurer

September 13, 2011

By: /s/ JEFFREY S. KNUTSON
Jeffrey S. Knutson
Corporate Controller (Chief Accounting Officer)

September 13, 2011

Michael Doar, Director
Malcolm F. Moore, Director
David B. Rayburn, Director
Michael C. Smiley, Director
Harold M. Stratton II, Director
David R. Zimmer, Director

By: /s/ THOMAS E. VALENTYN
Thomas E. Valentyn
General Counsel and Secretary (Attorney in Fact)

EXHIBIT INDEX

TWIN DISC, INCORPORATED
10-K for Year Ended June 30, 2011

| Exhibit | Description | Included Herewith |
|-------------------|--|------------------------------|
| 3a) | Restated Articles of Incorporation of Twin Disc, Incorporated (Incorporated by reference to Exhibit 3.1 of the Company's Form 8-K dated December 6, 2007). File No. 001-07635. | |
| 3b) | Restated Bylaws of Twin Disc, Incorporated, as amended through January 19, 2010 (Incorporated by reference to Exhibit 3.1 of the Company's Form 8-K dated January 21, 2010). File No. 001-07635. | |
| 4 | Description of Shareholder Rights Plan and Form of Rights Agreement dated as of December 20, 2007 by and between the Company and Mellon Investor Services, LLC, as Rights Agent, with Form of Rights Certificate (Incorporated by reference to Item 3.03 and Exhibit 4 of the Company's Form 8-K dated December 20, 2007). File No. 001-07635. | |
| Exhibit 10 | Material Contracts | Included Herewith |
| a) | Director Tenure and Retirement Policy. | X |
| b) | The 1998 Incentive Compensation Plan (Incorporated by reference to Exhibit A of the Proxy Statement for the Annual Meeting of Shareholders held on October 16, 1998). File No. 001-07635. | |
| c) | The 1998 Stock Option Plan for Non-Employee Directors (Incorporated by reference to Exhibit B of the Proxy Statement for the Annual Meeting of Shareholders held on October 16, 1998). File No. 001-07635. | |
| d) | The 2004 Stock Incentive Plan as amended (Incorporated by reference to Exhibit B of the Proxy Statement for the Annual Meeting of Shareholders held on October 20, 2006). File No. 001-07635. | |
| e) | The 2004 Stock Incentive Plan for Non-Employee Directors as amended (Incorporated by reference to Exhibit 99 of the Company's Form 10-K for the year ended June 30, 2007). File No. 001-07635. | |
| f) | The 2010 Long-Term Incentive Compensation Plan (Incorporated by reference to Appendix A of the Proxy Statement for the Annual Meeting of Shareholders held on October 15, 2010). File No. 001-07635. | |
| g) | The 2010 Stock Incentive Plan for Non-Employee Directors (Incorporated by reference to Appendix B of the Proxy Statement for the Annual Meeting of Shareholders held on October 15, 2010). File No. 001-07635. | |
| h) | Form of Performance Stock Award Agreement (Incorporated by reference to Exhibit 10.2 of the Company's Form 8-K dated August 2, 2007). File No. 001-07635. | |
| i) | Form of Performance Stock Unit Award Agreement (Incorporated by reference to Exhibit 10.1 of the Company's Form 8-K dated August 2, 2007). File No. 001-07635. | |
| j) | Form of Performance Stock Award Grant Agreement (Incorporated by reference to Exhibit 10.1 of the Company's Form 8-K dated July 30, 2008). File No. 001-07635. | |
| k) | Form of Performance Stock Unit Award Grant Agreement (Incorporated by reference to Exhibit 10.2 of the Company's Form 8-K dated July 30, 2008). File No. 001-07635. | |
| l) | Form of Restricted Stock Grant Agreement (Incorporated by reference to Exhibit 10.3 of the Company's Form 8-K dated July 30, 2008). File No. 001-07635. | |
| m) | Form of Performance Stock Award Agreement (Incorporated by reference to Exhibit 10.1 of the Company's Form 8-K dated August 5, 2009). File No. 001-07635. | |
| n) | Form of Performance Stock Unit Award Agreement (Incorporated by reference to Exhibit 10.2 of the Company's Form 8-K dated August 5, 2009). File No. 001-07635. | |
| o) | Form of Restricted Stock Grant Agreement (Incorporated by reference to Exhibit 10.3 of the Company's Form 8-K dated August 5, 2009). File No. 001-07635. | |
| p) | Form of Performance Stock Award Grant Agreement for targeted award of performance shares on July 29, 2010 (Incorporated by reference to Exhibit 10.1 of the Company's Form 8-K dated August 4, 2010). File No. 001-07635. | |
| q) | Form of Performance Stock Unit Award Agreement for targeted award of performance stock units on July 29, 2010 (Incorporated by reference to Exhibit 10.2 of the Company's Form 8-K dated August 4, 2010). File No. 001-07635. | |
| r) | Form of Restricted Stock Grant Agreement for restricted stock grants on July 29, 2010 (Incorporated by reference to Exhibit 10.3 of the Company's Form 8-K dated August 4, 2010). File No. 001-07635. | |
| s) | Form of Performance Stock Award Grant Agreement for targeted award of performance shares on July 28, 2011 (Incorporated by reference to Exhibit 10.1 of the Company's Form 8-K dated August 3, 2011). File No. 001-07635. | |
| t) | Form of Performance Stock Unit Award Agreement for targeted award of performance stock units on July 28, 2011 (Incorporated by reference to Exhibit 10.2 of the Company's Form 8-K dated August 3, 2011). File No. 001-07635. | |
| u) | Form of Restricted Stock Grant Agreement for restricted stock grants on July 28, 2011 (Incorporated by reference to Exhibit 10.3 of the Company's Form 8-K dated August 3, 2011). File No. 001-07635. | |
| v) | Twin Disc, Incorporated Supplemental Executive Retirement Plan, amended and restated as of July 29, 2010 (Incorporated by reference to Exhibit 10.4 of the Company's Form 8-K dated August 4, 2010). File No. 001-07635. | |
| w) | Pension Promise Agreement between Twin Disc International, S.A. and Henri Claude Fabry (Incorporated by reference to Exhibit 10.5 of the Company's Form 8-K dated August 4, 2010). File No. 001-07635. | |
| x) | Forms of Change in Control Severance Agreements (Incorporated by reference to Exhibits 10.3, 10.4 and 10.5 of the Company's Form 8-K dated August 2, 2007). File No. 001-07635. | |
| y) | Form of Indemnity Agreement (Incorporated by reference to Exhibit 10.5 of the Company's Form 8-K dated August 2, 2005). File No. 001-07635. | |
| z) | Amended and Restated Loan Agreement for \$40,000,000 Revolving Credit Dated May 13, 2011 (Incorporated by reference to Exhibit 10.1 of the Company's Form 8-K Dated May 13, 2011). File No. 001-07635. | |
| aa) | Note Agreement for \$25,000,000 of 6.05% Senior Notes due April 10, 2016 (Incorporated by reference to Exhibit 4.1 of the Company's Form 8-K dated April 12, 2006). File No. 001-07635. | |
| bb) | Amendment 1 to Note Agreement for 6.05% Senior Notes (Incorporated by reference to Exhibit 10p of the Company's Form 10-K for the year ended June 30, 2007). File No. 001-07635. | |
| cc) | Amendment 2 to Note Agreement for 6.05% Senior Notes (Incorporated by reference to Exhibit 10q of the Company's Form 10-K for the year ended June 30, 2007). File No. 001-07635. | |
| dd) | Amendment 3 to Note Agreement for 6.05% Senior Notes (Incorporated by reference to Exhibit 10w of the Company's Forms 10-K and 10-K/A for the year ended June 30, 2009). File No. 001-07635. | |
| ee) | Amendment 4 to Note Agreement for 6.05% Senior Notes (Incorporated by reference to Exhibit 10x of the Company's Forms 10-K and 10-K/A for the year ended June 30, 2009). File No. 001-07635. | |
| ff) | Amendment 5 to Note Agreement for 6.05% Senior Notes. | X |
| Exhibit | Description | Included Herewith |
| 21 | Subsidiaries of the Registrant | X |
| 23 | Consent of Independent Registered Public Accounting Firm | X |
| 24 | Power of Attorney | X |

| | |
|-----|--|
| 31a | Certification |
| 31b | Certification |
| 32a | Certification pursuant to 18 U.S.C. Section 1350 |
| 32b | Certification pursuant to 18 U.S.C. Section 1350 |

| |
|---|
| X |
| X |
| X |
| X |

SUBSIDIARIES OF THE REGISTRANT

Twin Disc, Incorporated, the registrant (a Wisconsin Corporation) owns directly or indirectly 100% of the following subsidiaries:

1. Twin Disc International, S.A. (a Belgian corporation)
2. Twin Disc Srl (an Italian corporation)
3. Rolla Sp Propellers SA (a Swiss corporation)
4. Twin Disc (Pacific) Pty. Ltd. (an Australian corporation)
5. Twin Disc (Far East) Ltd. (a Delaware corporation operating in Singapore and Hong Kong)
6. Twin Disc (Far East) Pte. Ltd. (a Singapore corporation)
7. Mill-Log Equipment Co., Inc. (an Oregon corporation)
8. Mill-Log Marine, Inc. (an Oregon Corporation)
8. Mill-Log Wilson Equipment Ltd. (a Canadian corporation)
9. Twin Disc Southeast, Inc. (a Florida corporation)
10. Vetus Italia Srl (an Italian corporation)
11. Boat Equipment Limited (a Maltese limited liability corporation)
12. Twin Disc Japan (a Japanese corporation)
13. Twin Disc Power Transmission Private, Ltd. (an Indian limited liability corporation)

Twin Disc, Incorporated also owns 66% of Twin Disc Nico Co. LTD. (a Japanese corporation).

The registrant has no parent nor any other subsidiaries. All of the above subsidiaries are included in the consolidated financial statements.

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the Registration Statement on Form S-8 (Nos. 333-99229, 333-119770, 333-119771, 333-69361, 333-69015, 333-169965, 333-169963 and 333-169962) of Twin Disc, Incorporated of our report dated September 13, 2011 relating to the financial statements, financial statement schedule and the effectiveness of internal control over financial reporting, which appears in this Form 10-K.

PricewaterhouseCoopers LLP
Milwaukee, Wisconsin
September 13, 2011

POWER OF ATTORNEY

The undersigned directors of Twin Disc, Incorporated hereby severally constitute Michael E. Batten and Thomas E. Valentyn, and each of them singly, true and lawful attorneys with full power to them, and each of them, singly, to sign for us and in our names as directors the Form 10-K Annual Report for the fiscal year ended June 30, 2011 pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, and generally do all such things in our names and behalf as directors to enable Twin Disc, Incorporated to comply with the provisions of the Securities and Exchange Act of 1934 and all requirements of the Securities and Exchange Commission, hereby ratifying and confirming our signatures so they may be signed by our attorneys, or either of them, as set forth below.

/s/ MICHAEL DOAR)
Michael Doar, Director)
)
)
/s/ MALCOLM F. MOORE)
Malcolm F. Moore, Director)
)
)
/s/ DAVID B. RAYBURN)
David B. Rayburn, Director)
)
)
/s/ MICHAEL C. SMILEY)
Michael C. Smiley, Director)
)
)
/s/ HAROLD M. STRATTON II)
Harold M. Stratton II, Director)
)
)
/s/ DAVID R. ZIMMER)
David R. Zimmer, Director)

July 29, 2011



CERTIFICATIONS

I, Michael E. Batten, certify that:

1. I have reviewed this annual report on Form 10-K of Twin Disc, Incorporated;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this annual report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of this annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: September 13, 2011

/s/ MICHAEL E. BATTEN
Michael E. Batten
Chairman and Chief Executive Officer

EXHIBIT 31b
CERTIFICATIONS

I, Christopher J. Eperjesy, certify that:

1. I have reviewed this annual report on Form 10-K of Twin Disc, Incorporated;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this annual report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of this annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: September 13, 2011

/s/ CHRISTOPHER J. EPERJESY

Christopher J. Eperjesy

Vice President – Finance, Chief Financial Officer and Treasurer

EXHIBIT 32a

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Twin Disc, Incorporated (the "Company") on Form 10-K for the fiscal year ending June 30, 2011, as filed with the Securities and Exchange Commission as of the date hereof (the "Report"), I, Michael E. Batten, Chairman and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

- (1) the Report fully complies with Section 13(a) of the Securities Exchange Act of 1934, and
- (2) the information contained in the report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: September 13, 2011

/s/ MICHAEL E. BATTEN
Michael E. Batten
Chairman and Chief Executive Officer

EXHIBIT 32b

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Twin Disc, Incorporated (the "Company") on Form 10-K for the fiscal year ending June 30, 2011, as filed with the Securities and Exchange Commission as of the date hereof (the "Report"), I, Christopher J. Eperjesy, Vice President – Finance, Chief Financial Officer and Treasurer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

- (1) the Report fully complies with Section 13(a) of the Securities Exchange Act of 1934, and
- (2) the information contained in the report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: September 13, 2011

/s/ CHRISTOPHER J. EPERJESY
Christopher J. Eperjesy
Vice President – Finance, Chief Financial Officer and Treasurer
