Twin Disc, Inc.
2011 Third Quarter Financial Results Call
April 19, 2011

Operator: Good day, ladies and gentlemen. Thank you for standing by. Welcome to the Twin Disc, Inc. 2011 Third Quarter Financial Relations [sic] Conference Call. During today's presentation, all parties will be in a listen-only mode. Following the presentation, the conference will be opened for questions. If you do have a question, please press the star, followed by the one on your touchtone phone. Please press star, zero for operator assistance at any time. For participants using speaker equipment, it may be necessary to pick up your handset before making your selection. This conference is being recorded today, Tuesday, April 19, 2011.

I would now like to turn the conference over to our host, Mr. Stan Berger of S. M. Berger. Please go ahead, sir.

Stan Berger: Thank you, Christina. On behalf of the management at Twin Disc, we are extremely pleased that you have taken the time to participate in our call, and thank you for joining us to discuss the Company's fiscal 2011 third quarter and nine month financial results and business outlook.

Before I introduce management, I would like to remind everyone that certain statements made during the course of this conference call, especially those that state management's intentions, hopes, beliefs, expectations, and positions for the future, are forward-looking statements. It is important to remember that the Company's actual results could differ materially from those projected in such forward-looking statements. Additional information concerning factors that could cause actual results to differ materially from those that—from those in the forward-looking statements is contained in the Company's annual report on Form 10-K, copies of which may be obtained by contacting either the Company or the SEC.

By now you should have received a copy of the news release which was issued this morning before the market opened. If you have not received a copy, please call Annette Mianecki at 262-638-4000 and she will send a copy to you.

Hosting the call today are Michael Batten, Twin Disc's Chairman and Chief Executive Officer; John Batten, President and Chief Operating Officer; and Chris Eperjesy, the Company's Vice President of Finance, Chief Financial Officer, and Treasurer. At this time, I will turn the call over to Michael Batten. Mike?

Michael Batten: Thank you, Stan, and good day, everyone. Welcome to our third quarter 2011 conference call. I will start with a brief statement and then John, Chris, and I will be ready to take your questions.

We assume that you have already seen our press release as Stan has indicated, so I will try to be brief. Twin Disc posted financial results that continue to show sequential and year-over-year improvement. Diluted earnings per share of $0.40 per share, was up 14% sequentially, and more than tripled the $0.13 per share for the year ago quarter. Our backlog is at an all time high of 18% sequentially, and we expect improved results in our fourth fiscal quarter ending June 30th.

Sales for the third quarter of fiscal 2011 totaled 76 million, compared to 61 million for the same three months in fiscal 2010. Year-to-date sales rose to 213 million compared to 163 million for the first nine months of fiscal 2010. Again, most of the increased volume came from the oil and gas market, although we did experience modest growth from our aftermarket and industrial product areas. We also saw a stable demand in our other market areas.

We recorded gross margins 36.3% in the current third fiscal quarter resulting from increased volumes, improved manufacturing efficiencies absorption, and a more profitable mix of business. This compared to 31.6% in the second fiscal quarter of 2011, and 27.1% for the same quarter a year ago. Year-to-date gross margins were 33.6% compared to 25.1% for the first nine months of fiscal 2010.

Turning to ME&A, our marketing, engineering, and administrative expenses, as a percentage of sales were 22.3% compared to 23.9 for the same quarter last year. While quarterly ME&A expenses rose 2.5 million year-over-year, the majority of the increase was due to stock-based compensation due to a higher share price and bonus expense, both of which were largely absent from the fiscal 2010 third quarter. Year-to-date ME&A expenses rose primarily for the same reason.

Looking at taxes, the effective tax rate for the first nine months of fiscal 2011 was 40.4%, significantly lower than 52.4% for the prior year. The current year rate benefitted from previously announced favorable second quarter adjustments to the deferred tax assets related to the pension liability, as well as the favorable impact of the second quarter reinstatement of the R&D credit. These adjustments were offset by an unfavorable third quarter deferred tax valuation allowances recorded at one of the Company's foreign jurisdictions. Chris will be available at the Q&A session to elaborate further on this latter item.

Net earnings for the third fiscal quarter of 2011 were 4.5 million, or $0.40 per diluted share, compared to 1.5 million, or $0.13 per diluted share for the same quarter last year. Net earnings were negatively impacted by the aforementioned 2.4 million valuation allowance, or 21.—$0.21 per diluted share. Year-to-date net earnings totaled 11.2 million, or $0.98 per diluted share, compared to a net loss of 1.4 million, or $0.13 per diluted share for the same period a year ago.

Looking at our financial condition, we continue to maintain a strong balance sheet. Working capital at the end of the current quarter stood at 111 million, compared to 84 million at the same time last year, reflecting the buildup in inventory primarily to support robust demand from the oil and gas sector. Total debt, net of cash, totaled 12.3 million, up from 6 million—up 6 million from December, and about equal to that of 2010—the June month of 2010.

Looking at our outlook now, our backlog of orders to be shipped in the next six months was $140 million at the end of the third quarter, compared to 118 million at the end of December, 2010, and 73 million a year ago. We continue to benefit from very positive demand from oil and gas exploration and development, as well as modest growth in orders from several of our other end markets.

Looking forward, we are optimistic that favorable oil and gas market fundamentals will continue as backlog and shipments of the 8500 series remain at record levels. The 7500 transmission is in field testing and results to date are encouraging. We continue to believe we will be shipping initial units in the fiscal 2010—2011- excuse me – fourth quarter. We remain optimistic that the Company is positioned to achieve very good fiscal 2011 financial results, and that the outlook for fiscal 2012 is encouraging.

That concludes my prepared remarks, and now John, Chris, and I will be happy to take your questions. Christina, will you please open the line for questions.

Operator: Thank you. Ladies and gentlemen if you have a question, please press the star, followed by the one at this time. To withdraw your question, please press the star, followed by the two. And if you are using speaker equipment, please lift the handset before making your selection. One moment please for our first question.

And our first question comes from the line of Peter Lisnic with Robert W. Baird. Please go ahead.

Peter Lisnic: Good afternoon, gentlemen.

John Batten: Hi, Pete.

Michael Batten: Hi, Pete.

Chris Eperjesy: Hi.

Peter Lisnic: First question, I guess, if we could talk about gross margin a bit. Sequential gross margin up, something in the order of 470 basis points, and your revenue number is up 1.3 million. Then if I look at that gross margin of 36.3 adjusted for – or compared to volume in the past. I mean, it's significantly higher than previous peak quarter where you were at 90 million in revenue, or so, and the gross margin was 300 basis points lower. So, I guess first question: a) what sort of drove that gross margin upside? If you can give us details on mix, volume, price, and then, b) how do we think about that in the context of, as we go forward, what, you know, what new peaks on the gross margin line might be?

John Batten: All right, Pete. Well, I'll address the first part. The significant increase in gross margin, really, was driven by mix – higher percentage of oil and gas, both transmission, and now some of the industrial shipments. I guess the other piece would be a lot—an aftermarket and parts increase in the third quarter. In some instances maybe it's expensive unit shipments, so just a mix to oil and gas, and then another mix for aftermarket and spare parts is really the difference in the quarter as far as the sales. We've also had the first quarter of the Racine Plant consolidation where we moved all of the manufacturing operations in Racine into one plant. So we have had one quarter of that under our belt, and so the Racine op—the domestic operations saw an improved efficiency in the third quarter as well.

Peter Lisnic: Okay. And then longer term is, let's say the revenue line progresses closer to that previous peak of 90 million in a quarter. You know, should we think about the same sorts of incrementals as we progress there, implying gross margins like they could approach or exceed 40%, or is there anything that could cap off gross margins?

John Batten: Pete, we've set a very high bar now for us. I will say that. We're looking kind of—it's going to be—this is a result that even surprised ourselves. It's going to be closest—I don't see it going up in the fourth quarter any farther than that. It's just a very, very favorable mix that we had in the third quarter.

Peter Lisnic: Okay, so mixed gets a little worse in the fourth quarter than the fiscal 2012's.

John Batten: Yes.

Peter Lisnic: Okay. And so that would mean that what you are seeing in backlog is growth, not only in oil and gas, but marine, and ARFF, and some of the other markets. Correct.

John Batten: The backlog in every market increased in the third quarter. So you're correct.

Peter Lisnic: Would that…

John Batten: The backlog is, I mean, oil and gas still is a very large percentage of our backlog, but it's not the only growing piece.

Peter Lisnic: And then when you say it grew, does that mean year-over-year or sequentially?

John Batten: Both.

Peter Lisnic: Okay. Fine. All right, and then, I guess, last question if I could. Just on that backlog number more than double or close to doubling year-over-year, I guess, but outside of that six month window can you give us a sense as to what, sort of, the commentary or chatter is from customers, what you're kind of seeing, longer term than that six month window?

John Batten: Again, we've said it in the pre—in last quarter's call. I mean, we see fiscal '12—our fiscal '12 being another good year, and I don't see any of our markets going down. I see only improvements in all of them. So the issue is going to be getting, you know, getting everything out that is on demand for fiscal '12.

Peter Lisnic: And to this point, I would assume, you have not had any issues getting anything out. Are there any supply chain bottlenecks that you're dealing with, or no?

John Batten: Yes, I was, well I (unintelligible) differ a little bit. Steel, specialty, you know, high grade steel – getting castings and forgings. Bar stock is becoming an issue. There is a tightening in of supply, definitely, and we've had some issues with some specific suppliers on, you know, purchased products like bearings and clutch plates, getting supply from them, that they've moved manufacturing location. So there have been some pinch points, and we're through most of those now. They did affect the third quarter, but we see those being resolved going into the fourth quarter and fiscal '12.

Peter Lisnic: Can you guess on the revenue impact on the third quarter, if there was any, from supply chain?

Stan Berger: Yes. It probably would have been in the order of—what I spoke of with you, is the plant moves, and the specific suppliers, and then just the difficulty in getting castings, forgings, and bar stock. You know, it was in the neighborhood of 5 to 7 million.

Peter Lisnic: Okay. All right. That is perfect. Thank you for your time. I'll jump back in queue.

Stan Berger: Okay.

Operator: Thank you, and our next question comes from the line of Neal Miller with Fidelity Investments. Please go ahead.

Neal Miller: Hi, Michael. Good to say hi. I'd sure like to get a little better orientation in some of your horsepower fracking equipment. And, the first question is: Is your customer base fragmented or concentrated?

Michael Batten: Hi, Neal. It's Mike. Basically when you say concentrated or fragmented, I'm not quite sure what you mean.

Neal Miller: In other words there, you know, are maybe three main companies in the horsepower area; Halliburton, Schlumberger, and Baker Hughes, and I'm just kind of wondering for BJ's, excuse me—just kind of wondering whether those are your customers or whether you're dealing with kind of independent fleets that are out there.

Michael Batten: We're dealing with a great number of the frac builders, not necessarily including all of Halliburton's, though we have some of them…

Neal Miller: Mm-hmm.

Michael Batten: …underway there, but John why don't you name—point out some of the customer base that we have.

John Batten: Yes. I would say right now our largest would be Frac Tech, Cisco High-Lift, Trican, and then some of the independent builders who build for them as well: Interflow, M. G. Bryan in Texas. I would say are the large ones right now, and also B. J. and Baker Hughes is also a customer. I'm sorry. I skipped over them.

Neal Miller: Appreciate that. The next question would be: How does the growth and the number of stagings in the length of the laterals impact the horsepower requirement? In other words, I think Halliburton has been even dreaming, perhaps, of 96 stages, Whiting Petroleum and the Bakken is currently pursuing 41 stages. How does that impact the horsepower requirement?

John Batten: In short, it increases the horsepower requirement both in total horsepower at the site, and the horsepower per frac rate.

Neal Miller: Appreciate it. The other—the final question I got is there seems to be what I would call proprietary trends that are, you know, everyone wants to differentiate their service, and Schlumberger, for instance, is very proud of this approach that they have called the Highway which is all encompassing. That is, if you don't use their frac, their chemicals, their blah, blah, blah, you can't get people to join in. In other words, it's all Schlumberger or it's none of Schlumberger in that product line. Is that a concerning trend in the frac business for you all?

Michael Batten: Not really. It's Mike again, Neal. Basically we're just seeing unprecedented demands, and the demand for our higher horsepower 8500 is clearly winning the game in the marketplace. So we see that more stages and higher horsepower play into the product offering that we have, especially given the reliability that we have associated with our product line and, of course, with the 7500 coming on screen, that is going to play down the reliability. It's going to play down into the horsepower segment, so while there has been a definite paradigm shift from the 1500 to 2200 horsepower range, to the 2200 to 3000 horsepower, just because of the availability of the equipment to do that, we still see an attractive market in that lower horsepower range with our 7500. So, all in all, we've got the market covered with a reliable transmission and one that hits the peak horsepower which, as you're describing, more and more of the servicers are using higher horsepower as a part of their service plan.

Neal Miller: Thanks, Mike.

Michael Batten: You're welcome, Neal.

Operator: Thank you. Our next question comes from the line of Greg Garner with Singular Research. Please go ahead.

Greg Garner: Thank you for taking my question. You know, as a follow up to that last question about the 7500 versus the 8500. With the demand for this higher horsepower, does that get—what's your sense of how the market for the 8500 may be changing versus your original expectations for the market for the 7500?

Michael Batten: Well. It's Mike again. And basically what we see, as I've just mentioned, is a paradigm shift that given the availability of higher horsepower equipment, many of the rig users are going upstream. But that doesn't mean that the lower horsepower market is being knocked out entirely because the larger rigs require a roading permit, and equipment that physically is larger then can be brought into certain areas. The Marcellus, for example, needs to have roadable rigs of a certain dimension, and so those kinds of considerations still maintain a nice market opportunity for us. I will say that, as we discussed at these calls in the past, that the—that our outlook in the market has shifted. We used to see larger number—greater number of units in the lower horsepower range than there were in the upper horsepower range. That has tended now to equalize. So we are seeing as many units as an opportunity in the lower horsepower range than we originally did, but we're capturing a large percentage of the higher horsepower, and we're still coming into the market in the lower. So we still see a nice opportunity.

Greg Garner: Okay. In the way you mentioned with this shift towards the higher horsepower market, is this because there is not as much lower horsepower equipment even available, or is it just more the need for the drilling or the fracking characteristics are requiring higher horsepower?

Michael Batten: Well, you have the situation here where the historic market has been largely in the 1500 to 2200, 2250 size market. It has only been in the last four or five years that the 3000 horsepower opened up, specifically with our 8500 series transmission. So the market was, at that time, three to five years ago. Six to ten before that was largely dominated by the lower horsepower range. So you have that population out in the marketplace that has been existing for a long period of time. So you have those units, some of which are being retired and replaced with 3000 horsepower product, some of them will be replaced with 15 to 2200 product, because of the location of where they're going to work. So, there is a market in both areas. I think we are in a sweet spot of supplying the high horsepower plus having a more reliable transmission and more suited transmission in the lower horsepower, so we see that we're in a good spot for the future, especially given the expansion of the total market. There are more areas in the world that can do unconventional gas drilling and fracking now than there were known to be earlier. So with this technology we see the opportunities unfolding a great deal for us.

John Batten: Yes, Greg. It's John. Just to add to that, and we don't want to minimize the—what we see as the market potential for the 7500, because if you think of mountainous terrain in Pennsylvania, or Eastern Europe, or in India and parts of Asia, a tractor trailer, a big semi rig with a 3000 horsepower engine and transmission, is just not going to fit into a lot of these areas. The road and infrastructure doesn't exist, so a smaller flatbed style, you know, body load frac rig is going to be the frac rig of choice, solely because of the size. So they'll take more smaller horsepower rigs out to a site to get the same effective horsepower. So, unless you're in West Texas and the plains of the U.S., or in Western Canada, or parts of China, you know, you just don't have the physical room to maneuver the large 3000 horsepower rig.

Greg Garner: Okay and thank you. I appreciate that clarity. Is there any—are there any 7500s in the backlog right now?

Michael Batten: Not in the six months.

Greg Garner: None of those are in the six months. Wow. And the testing still leads you to believe that the first order will be delivered towards the end of this fiscal year, I suppose.

Michael Batten: Correct. We're finishing up field tests right now. Based on the hours per week that we are getting, we should be done in the second week of June, which allows us to bring the transmissions back for engineering sign off. And we should be able to ship the first units the last couple weeks of the quarter.

Greg Garner: And just one last question just regarding capacity utilization for the 8500 and the 7500. Can you talk about where you are with utilization on the 8500, and what capacity you have for the 7500, and what kind of capital expenditures may be associated there?

Michael Batten: Yes. I would put it like this. We're—from where we were three years ago in our max seat, we're—have effectively reached double our capacity from three years ago. We are continuing to add capacity through capital investments, specifically right now for housings. We've added additional assembly lines, we're adding—and we've added additional testing capacity, and we're also obviously adding another—more assembly lines and more testing areas for the 7500. So, as the 7500 comes on, we will be expanding to capacity of the two in total, additionally, in the fourth quarter and into next fiscal year. So we're continuing to add capacity but, just as a benchmark of where we were three years ago, we're at double our capacity of where we were.

Greg Garner: And any sense on your utilization rate in the last quarter?

Michael Batten: We could have—had we had some parts, some key parts from some suppliers, we would have been able to ship more, but we're probably 85 to 90% of the, you know – we're catching (sp?)—as soon as we create additional capacity we utilize it pretty quickly because the demand, the customers aren't bashful. They're calling us for the units.

Greg Garner: Yes, and could you just refresh my memory on the cap ex plans for the next year.

Chris Eperjesy: This is Chris. Next year we're looking, you know, close to the $15 million range, and I think on the last call Mike and John both talked about the investment that's being made in the fourth quarter with, you know, China has just alluded to totaling (sp?) the capacity.

Greg Garner: Yes.

Chris Eperjesy: That's the investment that's being made this year with the new Makino that's coming in.

Greg Garner: Okay. All right. Thank you. I'll get back in the queue.

Operator: Thanks. Ladies and gentlemen, as a reminder, if there are any additional questions, please press the star, followed by the one, at this time. And our next question comes from the line of Jon Braatz of Kansas City Capital. Please go ahead.

Jon Braatz: Good afternoon, gentlemen. A couple of questions. What about pricing within the 7500 market? Are you receiving 8500? Are you able to - have you been raising prices?

John Batten: Jon, it's John. We raised prices last fall and we'll be going out with another round of pricing here in the next month and a half.

Jon Braatz: Is that…

John Batten: For next fall. Correct. For next fall. Effective essentially second quarter of next fiscal year.

Jon Braatz: Okay. Can you tell – well two things. Number one was regarding price, and is it to recapture some higher costs, or is it going to reflect just higher demand and you can—you have the ability to raise prices?

John Batten: It's going to affect the higher costs, and the trends of the surcharges that we are beginning to see in the last part of the third quarter, and what we've already seen in which is now the fourth quarter. The materials seem to have – usually we see the surcharges in concert with the shortage of, you know, the difficulty in getting castings and forgings…

Jon Braatz: Mm-hmm.

John Batten: ...but with all the difficulty in actually getting the supply before the surcharges started to kind of mirror that, and now with the rising fuel prices we're hearing from our suppliers that the surcharges and the price increases are going to start to come in in the fourth quarter.

Jon Braatz: Well, do you think you will be able to pass all these costs on in a timely manner?

John Batten: Yes.

Jon Braatz: Okay. Okay. And what type of price increase are we talking about? Are you willing to say that now?

John Batten: We won't give it now, but it will cover what we're seeing in the cost increases.

John Braatz: Okay. Okay. Secondly, in your press release you noted that you're seeing increased orders from—for industrial products. The industrial sector has been pretty strong for, you know, the last year, year and a half. What markets are those products going into? Those transmiss - I assume they're transmission systems. Am I correct?

John Batten: No, they're small PTO's,…

John Braatz: Okay.

John Batten: Small gearboxes in Italy, pump drives. It's kind of – it's really a reflection of all markets having bottomed out inventory and the entire chain being drained down, and the market in general just starting to pick up, whether it has been in Europe or here in North America.

John Braatz: Okay. Okay. And then lastly, I think some of the new capital equipment that you are installing are—is coming from Japan. Am I correct?

Unknown Speaker: Makino.

John Batten: Yes. The Makino, but it was in - when we signed the purchase order it was already in country. It was in the U.S.

John Braatz: Okay. So you had no issues with the earthquake over on Japan.

John Batten: No.

John Braatz: Okay. Very good. Thank you.

John Batten: You're welcome.

Operator: And our next question comes from the line of Shawn Boyd with Westcliff Capital Management. Please go ahead.

Shawn Boyd: Good afternoon. How are you doing, gentlemen?

Michael Batten: Hey Shawn. Fine thanks.

Shawn Boyd: Just a couple. If you can go back for a second on the 7500 launch. As you start to ship the initial units, does this help or hurt gross margin?

Michael Batten: Well, we expect the margin to be reflective of oil and gas, but the first year of production of any new model is typically a lower gross margin than once you get up and running. So, in the first year the gross margin is not going to be where we expect it to be in the second year and third year. So, as you—the initial ramp up of the 7500, I guess, would hurt gross margin. We don't see it having a huge impact on the gross margin though.

Shawn Boyd: Do the first – as you start shipping units, it's not like you're going to have such a big bolus of first units to go out. It wouldn't be a significant headway.

Michael Batten: Correct. You know it's not – we're not going to be up at the 8500 production levels in the first quarter or two, at all.

Shawn Boyd: Got it, okay. And then on industrial and aftermarket. Correct me, but is this the first quarter where we talked about those products, you know, picking up and helping here on the revenue line?

Michael Batten: Yes. This – we've had some good order months in previous quarters and I think I've spoken to that. But this, I would say, would be the first sustained quarter where we can say that the trends are definitely improving.

Shawn Boyd: Okay, and just can you give us anything here on how broad and how sustainable that that feels to you, Michael.

Michael Batten: How broad and sustainable that the industrial markets are going to be?

Shawn Boyd: Yes, in terms of industrial and aftermarket, and maybe we can talk about revenue levels, you know. What—are we at 50% of previous peak, are we at 20%? You know, where are we versus peak and trough here? We're just starting to see this business improve.

Michael Batten: Yes. We're coming off the bottom, and clearly I think there are two segments that are happening here, and John referred to both of them, but I'll elaborate. The service parts reflect equipment getting back to work and that, generally speaking, is the bell weather sign that—as service parts business picking up. That is a good sign that the equipment that has been shut down or parked is now getting back to work, and we're seeing the beginnings of a recovery. The demand increase in the general industrial product can be both a combination of, and this is what it is, a combination of our distributors and/or end customers having worked down their inventories are now at a point where they've got to order on a selective basis or somewhat broader basis to begin satisfying and improving demand, and to the extent that some of this is restocking or reflecting pass through demand. I'm not sure that we have a good read on right at the moment, because we're right at the beginning of that process. Given another quarter or so, we'll get a better reflection of what is happening. Is it restocking or is it full reflection of final demand coming back? You have to think that, you know, equipment that is being used in housing related markets and light construction, it has got a long way to go. And so, what we're probably seeing is outside of that area of activity, and I think that's about where we are on that.

Shawn Boyd: Got it. Very helpful. And same question here on gross margin. It sounds like that picking up, from your commentary earlier, actually helped you give you a little bit of a tail wind on gross margin in this quarter. Would you expect that to continue here?

Michael Batten: Yes, we would expect that. The combination of our industrial business and the aftermarket both would help our gross margins going forward.

Shawn Boyd: Got it. Okay, and going back to the question about capacity utilization. If I heard you right, you mentioned that you've doubled the capacity of three years ago. So three years ago this company ran peak revenues in the 90 million a quarter range. Should I – should the takeaway here be that you're – you think you can outrun 180 million a quarter?

Chris Eperjesy: No. This is Chris. John has questioned, or answer to the question was specific to the oil and gas transmission. So, if you go back to what you were talking about, that included a pleasure craft business that was at all time highs, and that's one of the markets that's near its' bottom right now. So John was specifically addressing the capacity for the oil and gas transmission.

Shawn Boyd: Got it. Okay. Appreciate the clarification. And, last question from me is, in terms of the use on high grade steel and, that being tight in the quarter, but it sounds like maybe that's been since then, but let's just broaden this out and let me give you an open ended question here. What are the biggest bottlenecks for you, or where is the biggest tightness that holds back you being able to deliver on that backlog?

Michael Batten: For next quarter and going into the fiscal year, number one would be raw material supply, and the second would be if demand continues to grow, you know, contract machining. It's really the supply of raw material, one, and then the machine parts and stuff to go along and to meet our growing demand - are the two biggest ones.

Shawn Boyd: And the tightness there is just due to the strength in the overall economy and things picking up as opposed to particular supply chain issues out of Japan.

Michael Batten: Correct. This is – yes. If Japan's, thankfully, you know, terrible situation, but it does not seem that it's going to affect us for the next three to six months, maybe longer term as they sort out all of the problems there. But really you have, you know, a sector of the economy going after the same suppliers. I mean, we share our steel suppliers, castings, forgings with a lot of the people who make construction equipment, mining, and we're all battling for the same raw material supply.

Shawn Boyd: Got it. Okay, and that's - actually I lied. One last one I'm going to throw in here. On just oil and gas, are lead times still increasing and how long are they right now?

Michael Batten: I would say they haven't increased since the last quarter. We're somewhere between 9 to 11 months. That's about where we are right now…

Chris Eperjesy: On oil and gas.

Michael Batten: On oil and gas.

Chris Eperjesy: Yes.

Shawn Boyd: Got it. Okay. I'll turn it over. Thank you very much, gentlemen. Congrats.

Michael Batten: Thank you.

Chris Eperjesy: Thank you.

Operator: And our next question comes from the line of Neal Miller of Fidelity Investments. Please go ahead.

Neal Miller: Hi. A follow-up question, and that is how do you plan to deal with the ups and downs of the fracking in the oil service business? I'm just kind of wondering if, is the management of Schlumberger, you know, everyone seems to be on record that it's – it goes until it doesn't go, and then you have a pause and prices go down, et cetera. How do you plan to deal with that inevitable correction and, I guess just as a backdrop, everyone is saying for the next 12 months everything, all the horsepower, is sold out so I'm not trying to anticipate anything near term.

Michael Batten: Oh Neal, it's Mike again. And yes, the oil and gas industry is historically cyclical and there's a possibility, probability that at some point we will see a swap scene. I think at this point we're positioned, and certainly in the higher horsepower segment we're coming to position ourselves in the lower horsepower segment – sorry - and the question is going to be how broad is this market growing within the total oil and gas market, and where is it growing, and is going to continue? There are two aspects of your question. One is the aspect relating to the capacity of fracturing rigs to the market place. Is the demand greater than the supply, and then is the supply greater than the demand, and that's one question. The other question is the broader market question, is what is the real demand in terms of opening up new territory such as John spoke about in Europe or in Asia, and let demand continue to offer opportunities that dampen perhaps, not eliminate, the volatility of the cycle that you point to. We're trying to get as good a read as we possibly can on that and, of course, we have seen a softening in this market before. Just a couple of years ago there was a softening and we rode that down, and it has come back up. We would be prepared as a company to do that as the market goes through its' cycle. From our planning point of view obviously we are looking at other areas of our business, other than oil and gas, to pick up: 1) by either natural recovery of the market, such as marine business, which is another cyclical business off the cycle of oil and gas, and at the same time doing our corporate development work either internally by releasing new products that have an impact on our market, or other corporate development work that adds revenue and gross margin in a different business or a different geography. So, these are the things that we're working with. Much of the conversation today has been really zeroed in on oil and gas, but I thank you for the question because it does allow us to speak to the fact that oil and gas is not our only focus and we are working in several different areas of the business to, in a way, protect ourselves from any kind of a softening in oil and gas.

Neal Miller: Sure appreciate that comprehensive answer. I'll just add there is another component which is that the development of shale liquids and gas. We really haven't tested yet the refracking, and that might renew – in other words – we could duplicate what we've already done so that the old areas are still a frontier in that sense.

Michael Batten: Yes. Yes. Good. Well thank you, Neal.

Neal Miller: Yes. Bye.

Operator: Thank you, Neal. And our next question comes from the line of Adriano Almeida with Cramer Rosenthal. Please go ahead.

Adriano Almeida: Hi, gentlemen.

Michael Batten: Hi Adriano.

Adriano Almeida: A couple of my questions were stolen already, but 1) I just wanted to understand a little more what this aftermarket business is. Is this aftermarket in transmissions?

Michael Batten: It's aftermarket. It's our service parts for all of our products.

Adriano Almeida: Now I would imagine these just like the pressure pumps. I read a lot about them getting chewed up pretty quickly. Does the transmission participate in that chewing up process?

Michael Batten: Yes, aftermarket. It would imply aftermarket for marine transmissions, frac transmissions, ARFF transmissions, PTO clutches, absolutely.

Adriano Almeida: So no particular strength in oil and gas endmarkets for aftermarket?

Michael Batten: No different than any other market. You know, there's a healthy aftermarket component in all of ours.

Adriano Almeida: Okay. And what's the install base of your 8500? How many of these things are out there?

Michael Batten: We simply, Adriano, we don't disclose that information.

Adriano Almeida: Yes. Okay, I'm still learning the ropes of what you do disclose here. What's your percentage of revenues in oil and gas? Is that another one you don't disclose?

Michael Batten: Yes.

Adriano Almeida: Okay.

Michael Batten: Sorry, Adriano.

Adriano Almeida: All right. What was the currency impact in the quarter?

Chris Eperjesy: When it's material I list it. So, it wasn't material, it was – I'm just going on recollection here – it's a sale that was less than 0.5 million.

Adriano Almeida: Okay. Okay. And then, kind of conceptually here, is – just in terms of this conversation about horsepower, what's the bottleneck in these pressure pumping systems? Is it the case where the—there's, the majority of the high end pressure pumping can actually take the 7500 can step down a little bit on horsepower because they're, you know, they're over specced from the transmission perspective, or is that not the case?

Michael Batten: I'm not sure that I'm reading the question right, but the…

Adriano Almeida: Last conference call you mentioned that there was no transmission designed specifically for pressure pumping. So I assume they are going into transmissions that exist for other heavy duty applications.

Michael Batten: Right.

Adriano Almeida: So when their – when they buy an 8500 are you giving them more horsepower than they need for their application?

Michael Batten: Okay. Now I understand your question. There is, when again going back to last quarter, the bottleneck was, you know, for fracking in general right now. The bottleneck, depending upon what the customer is, where they're going, it could be an engine, it could be a transmission, or it could be a pump. Kind of the three main components of a frac rig. In transmissions and in engines, most transmissions and all of the engines obviously, can be used in other markets, whether it's mining, rail, construction. So, depending upon the manufacturer of the engine or the transmission, there's competing interest and demand for those components. Our 8500 now only goes into the frac market, and the 7500 was designed for the frac market. So, these transmissions don't have a competing interest other than they're going into fracking. And in my comments in the last one were some of – and the pumps, by and large, are only for fracking. My comment last time was that engines and other transmissions have a competing interest. They could be going into vehicles where our transmissions are not going into vehicles.

Chris Eperjesy: And to piggyback on John's comments, all of the other transmissions that are presented for use in the frac rig market are typically transmissions that were designed for a different use, different application. They've been designed as truck transmissions. And so what makes ours different is that a truck transmission is designed to spend so many hours in first gear. Very few, in fact, because you're just overcoming inertia of the truck and then you're shifting into second gear and third gear, and the purpose of the transmission is to move the truck from A to B over a period of time. A frac transmission is used in a different way. The guys who are using a frac transmission are pumping, and what they're doing is they're matching the horsepower to the pressure that's needed to go down the hole, and depending upon how the frac rig is set up, they may want to use third gear, fourth gear, or fifth gear, and it could be different in each application. It could be all sixth gear, but they may – typically they'll use one gear, and then they'll just run the hell out of that rig 100% of the time in that year.

Adriano Almeida: Okay. Get it.

Michael Batten: Yes.

Adriano Almeida: Well, okay, another question and moving on. So pressure pumping capacity is pretty much sold out for the next year. That read is coming from all different directions. You guys are talking about a 9 to 11 month lead time on your transmissions. I assume that applies to the 8500 for oil and gas. So, while you don't disclose backlog beyond six months, it's safe to assume there is a backlog beyond six months, right?

Michael Batten: Yes. Yes.

Adriano Almeida: Okay. Fine. And then, I have one more on this—the trends in SG&A – I guess you guys call it something different, but the X stock compensation which is partly driven by, you know, the stock having gone up so much. How is that cost trending? Like, how did it trend sequentially? Are you still adding people? Because that was a big discussion on the last call as well.

Michael Batten: No. If you go back, Adriano, to the June quarter of '09, we went through a pretty extensive cost cutting effort in preparation to what we knew was going to be a challenging fiscal 2010. So, we were at pretty, what I would call, lean ME&A levels or SG&A levels. What you're seeing in terms of an increase really represents – also, though, I would state that we did see things that were forward-looking, engineering, R&D activities, and things like that, but we haven't really added any heads to speak of, certainly nothing significant. So you are primarily seeing, year-over-year, types of cost of living increases, restoration of wages and salaries, and then the stock based compensation, and the bonus expense. I mean, those are the primary increases on the ME&A.

Adriano Almeida: Okay.

Michael Batten: We're not adding people back. We're not significantly change (unintelligible). Yes. It primarily the restoration that had been taken away almost two years ago now.

Adriano Almeida: All right, and the commentary last call. Someone asked about, you know, whether it was unreasonable if revenues keep trending higher that the SG&A would go back down to 20% of revenues. That still holds, right. Nothing has really changed in the model?

Michael Batten: That's a hold. Yes.

Adriano Almeida: Okay. I have one final one, if I may, here. Yes. This is also more conceptual as to how the model works in terms of – so you're developing this 6500 and I assume there is some added costs in these fuel tests, and so forth, that are not being covered by the revenues of the 7500. So, is there a little bit of a margin gain? I understand that how it goes in with lower margin because you're still ramping up, but the fact that this is incremental revenue, shouldn't it have an overhead absorption kind of effect there, that helps your margins?

Chris Eperjesy: The answer is yes. I wouldn't say that those costs that you are alluding to are significant.

Adriano Almeida: Okay.

Chris Eperjesy: The figures I'm talking about a significant number.

Adriano Almeida: Okay. Very good. That's it from me, guys. Thank you very much.

Chris Eperjesy: Thank you, Adriano.

Michael Batten: Thank you.

Operator: And we do have a follow-up question from the line of Greg Garner with Singular Research. Please go ahead.

Greg Garner: Thank you. I just wanted to ask about the marine transmission business. In your comments on the backlog you mentioned increases in all businesses. Are you—how would you characterize that? Is it still just bouncing along bottom, or is there any other flavor you could provide?

John Batten: Well, the marine market – the marine backlog did increase last quarter at all manufacturing locations. So, the pleasure craft market is still down at very low levels, but we see the trend improving. The commercial markets, which we see mostly here in Racine with a backlog. They had a very good quarter of incoming orders. We released to production, to the market, the joystick system at Miami in February, and we have good orders out of Australia, and we have a lot of projects going on both in Europe and North America for customers. So we are seeing, even in a down market, we're seeing a demand for our components which are hydraulics, power and steering clusters, and transmissions, and controls. So it was actually, in retrospect, a very good quarter for marine as far as, you know, the overall markets aren't that great, but we saw our incoming orders doing pretty well in the quarter.

Greg Garner: Could you clarify what you mean by "projects are ongoing", or is this the joystick transmission?

John Batten: Developing customers for the EJS system.

Greg Garner: Okay.

John Batten: Going through the initial installation and, of the first boat at Pacific Yards.

Michael Batten: You may want to think of it in terms of application.

John Batten: Yes, first applications at different customers.

Michael Batten: Rather than a product project.

John Batten: Yes.

Greg Garner: Okay, and so then this would be used as a – I'm think of the word pilot, but really more of a sample, live, demonstrable product.

John Batten: At each one of the – at different yards.

Greg Garner: Okay.

Michael Batten: As each boatyard comes on and begins to apply this product, it takes a project for us to work with them to install—apply and install this new product on their boats, and they get comfortable with it, and so on. Once several of those installations have been made, then we back off and they take over themselves.

Greg Garner: And how long is that process? Do you expect it to occur 'til you do that backoff? Is that a couple of months or a couple of quarters?

John Batten: I would say each one you've got for each yard you have to budget about six months worth of the time. It's not that many hours of work. It's just coordinating schedules.

Greg Garner: Yes.

John Batten: 'till it gets done. It's not incremental cost, it's some cost. It's what we do normally, and so we're just out there assisting our customers in the application of a new product. So that's the way it works.

Greg Garner: Okay. So if the timing of that were to, if that end market were—demand were to increase. I mean, that product really wouldn't be available for delivery for at least six months or so. That's what I'm reading into that. Is that a correct way of looking at it?

John Batten: No. We can deliver the product before that. It's just getting with the different boat builders, just getting the system designed into their vessels, and the first system installed in one of their vessels for them to test.

Greg Garner: Okay.

John Batten: Products come quicker. It's just getting them to sign off on the approval at each different boatyard.

Greg Garner: Yes. Okay. Thank you.

Operator: Thank you, and our next question comes from the line of Shawn Boyd with Westcliff Capital Management. Please go ahead.

Shawn Boyd: Hi. I know we're getting along here, so just a quick follow-up on the – you mentioned earlier the tightness of steel, how they impacted revenues by about 5 to 7 million in the quarter. Were there any other pushouts or anything incremental besides that that impacted the quarter?

John Batten: Nothing out of the ordinary shipyards being behind building on a patrol boat schedule, but those are kind of – I would say they are normal quarter-to-quarter. So, but really nothing that—those were the, I would say, the highlights of the quarter.

Shawn Boyd: Okay, and the 5 to 7 million that you mentioned, I would assume that business was not lost and that it probably snaps back this quarter, but…

John Batten: No, the customers are still waiting for those products.

Shawn Boyd: Got it. Okay, so if all works like it ought to then hopefully we see that get shipped this quarter.

John Batten: Correct.

Shawn Boyd: We have the business. Okay, and last question from me is, I know you don't release orders and you certainly have the terms within the quarter, but we kind of have to work off the information we're given and, you can kind of look at an implied order number, just this one thing to look at on the growth of the Company and, bottom line is orders are growing 50% year-over-year for the last four quarters here. Is there any, and I'm talking overall company here, not just oil and gas, on a combined corporate basis, we've had a very high level of demand growth or, excuse me, order growth and my question is, are you seeing any signs? I'm hearing an awful lot on the call about things picking up even further. Have you seen any signs of this flowing?

John Batten: No.

Shawn Boyd: Good enough, gentlemen. Thank you.

John Batten: Okay.

Operator: Thank you, and our next question comes from the line of Adriano Almeida with Cramer Rosenthal. Please go ahead.

Adriano Almeida: Hey, a follow-up from me. Again, referring back to the last conference call, when you were talking of the 7500 you said that you had stockpiled some forgings and some inventory to be able to deliver quickly on those, right, once those orders flowed in.

John Batten: Correct.

Adriano Almeida: So I'm thinking here, just kind of connecting the dots, you've had no orders on the 7500 yet. Obviously you anticipate…

John Batten: Adriano, we have orders. We just—we haven't brought them into our six month backlog until we've signed off on the unit for production.

Adriano Almeida: I see.

John Batten: So, when we sign off on—anticipating when we sign off in June, the orders that were six months out we will bring in to when the customers want them, and there'll be some coming immediately into the six month backlog.

Adriano Almeida: Okay. My question was, given that you're kind of sitting there ready to deliver, the lead time on the 7500 is going to be significantly shorter, right, than the 9 to 11 months.

John Batten: For the first units you are correct. They will be significantly shorter. Some lead times can be three weeks.

Adriano Almeida: Three weeks. Okay. Now that'll actually let you gain some share, right, to the extent someone needs a transmission. It fits their specific—it fits what they need from a specification standpoint. They'd much rather take it from someone who can deliver in three weeks than in 11 months.

John Batten: That is absolutely the case.

Adriano Almeida: Okay. Thank you. Just wanted to clarify it. All right, guys. Thank you.

John Batten: Thank you.

Michael Batten: Thank you, Adriano.

Operator: And I'm showing no further audio questions at this time. I'll now turn the call back over to management.

Stan Berger: Okay. Thank you, Christina. Again everyone, we thank you all again for joining our conference call today. We appreciate your continuing interest in Twin Disc and hope that we've answered all of your questions. If not, and you have any follow-on questions, please feel free to give Chris, John, or myself a call. We look forward to speaking with you again in July following the close of our fourth quarter.

That's it, Christina, and we'll turn the call back to you.

Operator: Ladies and gentlemen. That does conclude our conference for today. If you would like to listen to a replay of today's presentation, please dial 1-877-870-5176 and enter in the access code 4432000. We'd like to thank you for your participation. You may now disconnect.

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