Twin Disc, Inc.
2009 Third Quarter Financial Results
April 21, 2009

Operator: Good afternoon, ladies and gentlemen. Thank you for standing by. Welcome to the Twin Disc 2009 Third Quarter Financial Results Conference Call. During today's presentation all parties will be in a listen-only mode. Following the presentation the conference will be open for questions. If you 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 21, 2009. I would now like to turn the conference over to Stan Berger. Please go ahead, sir.

Stan Berger: Thank you, Brandy. On behalf of the management of Twin Disc we are extremely pleased that you have taken the time to participate in our conference call, and thank you for joining us to discuss the company's fiscal 2009 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 or predictions for the future, are forward-looking statements. It is important to remember that the company's actual results could differ materially from those projected in such forward-looking statements. Additional information concerning factors that can cause actual results to differ materially from those in the forward-looking statements is contained in the company's annual report on Form 10K, copies of which may be obtained by contacting either the company or the SEC. By now you should've 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 you a copy.

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

Michael Batten: Thank you, Stan, and good afternoon everyone. Welcome to the third quarter conference call. As Stan has mentioned, I will start with a brief statement. Then John, Chris, and I will be available to answer questions.

Sales for the third quarter were 69.3 million compared to 85.8 million in the fiscal 2008 third quarter. Foreign currency translation negatively impacted sales by 2.9 million for the current three months. Going into the third quarter we knew that Twin Disc was not immune to the challenges facing the global economy. While we saw signs of softening in certain markets such as oil and gas as early as the first quarter, our overall business remained firm. However, beginning in February and accelerating during the remainder of the third quarter, we experienced a significant downturn in volumes and orders in the mega yacht market, and an order reversal in the industrial market that we had not experienced during the first six months.

As the slowdown developed in these markets, we began the process of aligning our global cost structure with the changing business levels, including reducing production primarily at our European operations, which are closely tied to the mega yacht marine markets as well as adjusting employee and inventory levels at our subsidiaries. We will continue to take appropriate actions to manage our cost structure to maintain a level of profitability that we feel the company can achieve during slowing sales.

On the other hand, our market diversity and niche market focus has helped us somewhat to insulate Twin Disc from the impact of the global slowdown as certain of our markets actually experienced growth in the third quarter. Sales to the patrol boat and commercial marine markets were up during the quarter. In addition, demand for airport, rescue, and firefighting vehicles has remained good and we continue to benefit from market share gains at one of our major ARFF customers, as well as from their increasing success in the global marketplace.

Gross margin as a percentage of sales was 27.6% in the current quarter, compared to 31% in last year's comparable period. Our gross margin was negatively impacted by lower sales volumes, unfavorable product mix, increased warranty and pension expense, as well as the impact of foreign currency translation.

Marketing, engineering, and administrative expense as a percentage of sales was 21% for the third fiscal quarter compared to 17.4% for the same three months a year ago. Due to a significant reversal of an accrual for stock based compensation in the third quarter of fiscal 2008, amounting to approximately 2.3 million, have reflected the decline of our stock price during that quarter a year ago. Stock based compensation expense for the current quarter was two million higher. This partially offset, was partially offset by a reduction of 1.5 million in accrued bonus compensation, and 824,000 for foreign currency translation.

Net earnings for the fiscal 2009 third quarter were 2.9 million or $0.26 per diluted share, compared with 7.9 million or $0.70 per diluted share for the same period last year. Our balance sheet and overall liquidity remains strong. The company has 12 million in cash, maintains a debt to total capitalization ratio of 33.2%, and has funds available under an existing credit facility of 35-million credit revolver until October 2010.

Our six-month backlog as of March 27, 2009 was 81.5 million, compared to 120.7 million at the beginning of the year, and 125.7 million at the end of March 2008. While expected to be down, the acceleration of the decline in our backlog during the past two months was disappointing. Although it is difficult to predict the extent of the downturn on our business we remain committed to serving our niche and global markets with exceptional products and services.

We're optimistic that once the global economy stabilizes we will be in an improved competitive position with differentiated products to offer our existing and new customers. We are introducing three new products for production in fiscal 2010. Specifically we have developed a new hybrid-ready marine transmission that helps lower the environmental and noise pollution the boat makes when operating at low RPM, a joystick control system combining Twin Disc electronic and BCS boat management technology that will complement our existing QuickShift® marine transmission, and finally a new 7500 series transmission designed for use in the oil and gas market for pressure pumping applications in the 1800 to 2250 horsepower range to complement our 8500 series transmission .

That concludes my prepared remarks, and John, Chris, and I would be happy to take your questions now. Brandy, you can open up for questions.

Operator: Thank you, sir. We will now begin the question and answer session. As a reminder if you have a question please press the star followed by the one on your touchtone phone. If you would like to withdraw your question press the star followed by the two, and if you are using speaker equipment today you'll need to lift the handset before making your selection.

And our first question comes from the line of Paul Mammola with Sidoti & Company. Please go ahead.

Paul Mammola: Hi. Good afternoon, guys.

Michael Batten: Hi, Paul.

Paul Mammola: Can you quantify for us how much in cost you've taken out of the business thus far?

Michael Batten: Well it's difficult to quantify the specific costs, but what has been taking place is that in our European operations we've incorporated both Chomage and Cassa Integrazione. And John, you might want to speak to what's happening there.

John Batten: Paul, it's a variable staffing level in Italy. It's both for the hourly and the salary group, and in Belgium as of the moment it's just for the hourly group; and we can go up to 50% either Chomage or Cassa Integrazione where we pay for the time they're in the plant and the government picks up 80% of the remaining time out of the plant, both in Belgium and in Italy. We started that process during the third quarter, but to initiate the process you have to go through vacation time. Employees use their vacation time first. So it really didn't kick in that much in the third quarter at all. It's going to be a fourth quarter activity and then going forward. There were permanent reductions at some of the distribution subsidiaries of employees, but the real effect of all of these actions that were taken will be going into next quarter.

Paul Mammola: Okay. So am I correct to assume that the $2.5 million sequential tick down in ME&A is basically on lower sales rather than from any sort of cost cutting initiatives?

Michael Batten: Right, and we will be continuing to add the actions that are required in the face of a softening business, Paul. So we probably haven't seen the full extent of the actions of what John has described, probably not being the full extent.

Paul Mammola: Okay. That's helpful. On cap ex, I know you're planning on adding to some machinery. Is that still the case? Or is some of the events out there kind of curtailed the original plans?

Michael Batten: The softening economy has curtailed our plans. I think we announced at some point in the last quarter that we were adjusting our cap ex forecast from a level of about 16 to 17 million planned for the year down to the neighborhood of 12, and actually it could be a little bit softer than 12 as well.

Paul Mammola: Okay. Could you elaborate on the features of the new 7500 horsepower, or transmission I should say, and how you intend to approach that market? Also who's the biggest competitor there for that unit?

Michael Batten: John, you want to speak to that?

John Batten: Sure. The 7500 is going to be designed, it is designed specifically for the oil and gas market. We've, we're going to promote it based on technology. It is the ratios in this transmission that are designed specifically for pressure pumping; this is not a vehicular transmission that's being converted. It has, it's going to be significantly lighter than our 8500 and some of the other competitors in the high horsepower market. It has an aluminum housing. We've eliminated the torque converter, and we've introduced some of our clutching technology, which in this transmission is called the master clutch. We're going to be shifting in between the ratio steps without a torque converter, but with the master clutch in front of the transmission; and we're introducing more technology in the clutches, which we refer to as balanced clutches, which help the performance and the reliability of the clutches going in between you know the hard shifts of the transmissions.

The largest competitor in this market would be Allison, but in the size to weight package we would be very competitive. We'll be able to fit in the same rigs, the over the road rigs that don't require special permits as the Allison, very competitive in the weight range.

Paul Mammola: Okay. That's certainly helpful; and then finally, Mike. Given your experience how long do you think an energy cycle like we're in can persist in the trough with the reduction in rate count that we've seen in North America?

Michael Batten: Well that's a good question, Paul. I think that what we're (inaudible) going forward is that there is global demand that will drive the energy market, and that's one of the reasons why we have confidence that coming to market with the 7500 is that we believe unlike the last big crash in oil, which occurred in the early '80s, this time around there is more in the way of global demand that is going to support the oil markets than in the past. So I see while there is softness and no doubt about it, I see that the market will likely come back sooner rather than later.

Paul Mammola: Okay. That's helpful, Mike, and then last one for me. Do you supply anything for BJ Services for their offshore drilling operations?

Michael Batten: Not at the moment, but I'll say, we'll leave it at that.

Paul Mammola: Okay. Thanks for your time.

Michael Batten: Thank you. Brandy, next question?

Operator: Thank you. Our next question comes from the line of Peter Lisnic with Robert W. Baird. Please go ahead.

Peter Lisnic: Good afternoon, everyone.

Michael Batten: Hi, Peter.

Peter Lisnic: I guess first question if we could maybe talk a little bit more about profitability. It sounds like you've pulled some levers here in the quarter in the first, or in the third quarter I should say, in response to the demand environment. I'm trying to get a better sense as to just how much more can you do? And given what you've done, what sort of decrimental margins should we be thinking about for the business?

Michael Batten: Wow. That's a lot of questions. Mostly where we have responded is where the demand at this point we've seen the demand fall. We just (inaudible) largely in this quarter concentrated at our subsidiaries in Europe, primarily focused on the mega yacht market, and as John described the actions taken there. Clearly if softening continues we'll need to address that elsewhere throughout the company, and clearly we'll be, and are, looking at all of the options that we have. Obviously looking at all areas of the company in terms of cost reductions, both variable as well as fixed, and we will, are in the process of evaluating what further actions are required.

Peter Lisnic: And is there a way that you can maybe give us a sense as to given what you saw at the end of the quarter, maybe give us a sense as to how significant those levers might be in terms of both cost that would run through the income statement, and then what the benefits would be?

Michael Batten: Well we've got a number of different possibilities, and Peter at this point we're not going to be specific about what kinds of actions that we're contemplating or going to take. Sorry about maybe not being responsive in that regard, but at this point also have to think about what actions are telegraphed before they're actually taken. So we are looking very clearly at our margins with respect to what is required to maintain levels of profitability that we know that we are going to have to generate. Clearly we are looking at our covenants, and fully intend to make sure that under any demand scenario we continue to make those covenants with a good cushion (inaudible) being able to make that.

So that's what's really driving our decision making at the present time, to work from the bottom up so to speak, and say at any given demand level what have we got to do? What is the number? What are the actions? What is the art of the possible to make sure that we generate the right kind of margins to give us cushion on the covenant?

Peter Lisnic: Okay. All right, and no need to apologize. I totally understand not being able to give us all the granularity that sometimes we need; but the other thing I wanted to ask or pursue was pricing in terms of what you're seeing there by end market. Can you maybe talk about what you're seeing on the pricing front?

Michael Batten: Okay. I'm going to turn that to John.

John Batten: You mean pricing as in our pricing out, or pricing as we're receiving material and goods in?

Peter Lisnic: Well we always want the complete answer, so how about both?

John Batten: I would say, as you can probably imagine the marketplace is not very receptive to pricing in this current atmosphere. We have been very aggressive over the last 12 months in pricing, particularly when we were seeing the levels of surcharges not decreasing. Those have been starting to subside dramatically in some places. As far as the forward market, not very receptive to price increases. We will continue to look at that going forward. Material increases coming into the plant have, into all of our operations, with possible exceptions in some specialty forgings and key components like bearings. Everything else seems to have calmed down over the last (inaudible).

Peter Lisnic: Okay. Okay, that is helpful; and then just since it was brought up in terms of the covenants my guess is that just looking at it you have a two and a half times leverage ratio coming that you have to meet, but even if things I think get markedly worse my impression is that you're not really pushing the envelope on that one all that much. Can maybe, can maybe one of you comment on some of the stress testing you've done and how bad things could get before you actually tripped that leverage covenant?

Michael Batten: Well it's Mike, Peter. What we are not (inaudible) at this time that we are going to run afoul of those covenants. We're just here in the boat so to speak to make sure that under any kind of demand scenario that we make sure that we don't trip the covenant. On the leverage side of it clearly we have got working capital reduction programs under way. The working capital has peaked. We're seeing that now beginning to work down, got pretty aggressive plans to reduce inventory so of course receivables in a softening environment. So we see cash coming in.

Clearly what we need to do from a margin point of view is to maintain margin to cash flow as well. So we don't see it as a major concern. I only point that from, we're looking very much at the bottom up to make sure that we do our job, get cash outstanding, maintain our cost structure, as well as to create the EBITDA that we need.

Peter Lisnic: Yes. It didn't look like too much of a concern here either. So just I wanted to clarify. Thank you very much for your time and help.

Michael Batten: Fine, Peter. Thank you. Brandy, next one?

Operator: Thank you. Our next question comes from the line of Andrew Cash with Point Clear Value Management. Please go ahead.

Andrew Cash: Hi. Good afternoon.

Michael Batten: Hi, Andrew.

Andrew Cash: Hi. I was just wondering, I know this is kind of a moving target question, but at these lower levels of business conditions I was wondering if you could take a stab at, give me a rough idea of how much cash flow do you think you can generate for the repair and replacement market?

Michael Batten: Well the after market is a significant market for us, and it typically it is a, it varies a bit by product line, but in general it runs 25 to 30, maybe a little bit over 30% of our typical sales. That can vary. The percentage can vary by how much new business in the cycle we're generating on the forward pricing, but it's a sizable cash and profit generator for us.

Andrew Cash: Well obviously during a slowdown, I mean I would assume that number goes up during a business slowdown.

Michael Batten: On a percentage basis --

Andrew Cash: Yes, on a percentage basis.

Michael Batten: Right.

Andrew Cash: So maybe the 25 to 30 would be more representative of what happened in 2008?

Michael Batten: Typically yes.

Andrew Cash: Okay. How much capital spending would be associated with that level of business activity?

Michael Batten: In the after market?

Andrew Cash: Yes, in the after market.

Michael Batten: The after market basically feeds off of the forward markets. The same machines that generate the in-house product generate also the parts for the after market. So we don't do specific capital expenditures for the after market.

Andrew Cash: Okay. So it should be a lot of, that should be a lot of free cash flow associated with the repair, replacement, or the aftermarket business as you call it.

Michael Batten: As an incremental basis, yes.

Andrew Cash: Okay. Other question I have, just kind of a big picture here. I mean the stock market acts like you know kind of the worst is over here. Do you think that that's just mere speculation? Or do you think there's a fundamental reason for the recent investor enthusiasm?

Michael Batten: Well that's a good question. I mean the stock market tends to anticipate, doesn't it, what it feels the economy is going to do.

Andrew Cash: Or it's guessing.

Michael Batten: Yes. Well that's right, or guess. It starts to guess at what the stock market is going to do, but clearly I don't know really. It's a question of how far out ahead does the market get to the real recovery in the economy? And of course the economy tends to cycle with the beginning of the cycle kinds of activities and late cycle kinds of activity. So the marketplace I think right now looking at some optimism that the current recession isn't going to be as deep or protracted as it might be and could recover late 2009 or early 2010.

Andrew Cash: Well as far as your visibility you've got your backlog that you track. Do you think that you're nearing the bottom on your backlog? Or do you have some sort of indication that there may be an up tick by the end of the year?

Michael Batten: Well I think that our backlog could (inaudible) a little bit further. We're going into a seasonal situation where historically if you look at our numbers, our backlog numbers, we tend to now begin to show the summer months, which is the slow quarter for us seasonally. The six months starting in July, or starting in March, I'm sorry, at the end of March through the fourth quarter and our first quarter next year; and so that first quarter July to October through September is always a softer backlog period for us, but we're going to have backlog numbers that are going to be softer than we'd normally have at the other times of the year.

Andrew Cash: Okay. Thank you very much.

Michael Batten: You're welcome, Andrew. Brandy?

Operator: Thank you. Ladies and gentlemen, if you wish to ask any additional question please press star, one at this time. As a reminder if you are using speaker equipment today you will need to lift the handset before making your selection. One moment, please. And at this time there are no further questions in the queue.

Michael Batten: Okay. Thank you, Brandy. Everyone I appreciate, we all do, the management team, and Stan, appreciate your attending this conference call; and we look forward to speaking to you again in three months, and in the meantime we hope you have a good day. Thank you.

Operator: Thank you. Ladies and gentlemen, this concludes the Twin Disc 2009 Third Quarter Financial Results Conference Call. This conference will be available for replay. You may access the replay system at any time by dialing 303-590-3030 or 1-800-406-7325 and entering the access code of 4055769. Thank you for your participation. You may now disconnect.