Twin Disc, Inc.
2010 First Quarter Financial Results Conference Call
October 19, 2009

Operator: Good afternoon ladies and gentlemen, thank you for standing by. Welcome to the Twin Disc Incorporated 2010 First 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 on a speakerphone, you may need to pick up the handset before making your selection. This conference is being recorded today Monday October 19 of 2009.

I now want to turn the conference over to Mr. Stan Berger with SM Berger. Please go ahead sir.

Stan Berger: Thank you Val. On behalf of the management team of Twin Disc, we are extremely pleased that you have taken the time to participate in our call, and thank you for joining us to discuss the company's fiscal 2010 First Quarter Financial Results and Business Outlook.

Before I introduce management, I would like to remind everyone that certain statements made during the course of this conference call, especially those that state management's intentions, hopes, beliefs, 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 could cause actual results to differ materially from those in the forward-looking statements is contained in the company's annual report on Form 10-K, copies of which may be obtained by contacting 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 Mainaki at 262-638-4000 and she will send a copy to you.

Hosting the call 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: Thanks Dan and good day everyone, and welcome to our First Quarter Conference Call. As Dan has indicated, I will start with a brief statement, and then John, Chris and I will be available to answer questions.

Sales for the first quarter were 47.1 million compared to 72.7 million for the same period last year, which was the second best first quarter in the company's history. The decline in the first quarter sales reflects the impact of the continuing global recession in our market, the seasonal weakness of the first three months, as well as the plant shutdowns in our Italian, Belgian and Racine manufacturing facilities.

Shipments to the mega yacht, industrial and oil and gas markets remained weak during the quarter. Partially offsetting this softness, we experienced good demand from the airport rescue and firefighting market, and stable demand from our land based and marine based military and Asia Pacific commercial marine market.

Gross profit as the percentage of sales for the first quarter was 28.7% compared to 27.6% last year. Gross margins were significantly impacted by our temporary plant shutdown for the equivalent of two months at our European facilities, as well as the one month closing of our domestic facilities. Adjusting our production levels to near term demand had a negative impact on our absorption rate, although tight controls on spending and other cost reduction initiatives helped offset the impact of the decline in volume.

Marketing, engineering and administrative expenses declined $3.5 million to 12.8 million for the first quarter, compared to 16.3 million last year as a result of previously announced cost reduction initiatives. As a percent of sales, ME&A expenses for the current three months were 27.2% compared to 22.5% a year ago.

The company recorded a net loss for the first quarter of 2.4 million or $0.22 per diluted share compared to net earnings of 2.5 million or $0.22 per diluted share last year. EBITDA was a loss of 800,000 for the first quarter compared to a gain of 6.8 million for the same period last year.

Turning to our financial condition, our liquidity and balance sheet continue to remain strong. Cash provided by operations for the first quarter was 8.1 million, and at quarter end we had 17.1 million in cash compared to 13.3 million at the end of the June 2009 fourth quarter.

Total debt stands at 49 million compared 50.8 million at June 30, 2009. Total debt-to-capital at the end of the current quarter was 31.4%.

The six month backlog at the end of the first quarter was 62.5 million compared to 60.6 million at the end of the fourth quarter of fiscal 2009. We are encouraged to see a slight improvement in our six month backlog. While demand from our pleasure craft and industrial markets remain depressed, trends in the commercial marine market, particularly in the Pacific Basin remained steady. Orders from airport rescue and firefighting and land based military sectors are also holding up well, while order intake from the military patrol boat market has been growing.

And finally, we have experienced an up tick in orders for pressure pumping transmissions and air clutches from the domestic and international oil and gas markets. We continue to expect our new 7,500 series transmission to be available to the market by fiscal year end. Our outlook is for improving quarterly trends for the balance of the fiscal year.

That concludes my prepared remarks, and now John, Chris and I will be happy to take your questions. Val?

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 withdrawal your question, press the star followed by the two. If you are on a speakerphone, you need to pick up the handset before pressing star one.

And, our first question comes from the line of Bo McKenzie with Global Hunter Securities. Please go ahead.

Bo McKenzie: Hey guys. Congratulations on the up tick in orders. I'm sort of surprised, although pleasantly that you guys are seeing an up tick in the new transmission side. I guess you're referring to the 7,500's? Could you give us a little bit more of an update on exactly what's going on with the 7,500's? And, what the selling point is on those right now when you've got the domestic pressure pumping market, you know, a little bit weak right now? Thanks.

John Batten: Bo, it's John. The up tick is actually for the 8,500 and air clutches, and the up tick as you point out, given the domestic flatness has actually been for Asia. So, the increased order – we've had increased order activity both in North America and Asia, with the majority of our new orders are actually going into Asia. The 7,500 is still on schedule for release and production in the fourth quarter. We're completing lab testing and preparing to do the field test on rigs right now. So, the order up tick hasn't been the 7,500 yet. It's strictly the 8,500.

Bo McKenzie: And John, on that with the 7,500, when you say the fourth quarter, you mean the fourth calendar quarter right?

John Batten: No, I'm sorry Bo. It would be the second calendar quarter of 2010. Our fiscal 2010.

Bo McKenzie: Your fiscal fourth quarter.

John Batten: Correct. Yes.

Bo McKenzie: And, you know, I know that you've made this specifically designed to go for the pressure pumping business as opposed to modifying an existing transmission. Can you describe, kind of you know, where you stand in terms of weight or torque or whatever the kind of key things are that you're going to be able to offer as a value as opposed to, you know, people that might have either an Allison or an existing 8,500 installed on their equipment?

John Batten: Sure. We've actually done a lot of work on that. The transmission is rated at its release for, will be 2,600 horsepower. It's comparable in weight to the competition for, you know, horsepower per pound. The advantage really is that it's completely designed for frack pumping, and the ratio splits are such that even competing against transmissions at a lower horsepower, operators will be able to operate more efficiently and potentially take fewer rigs out to do a job. So, while they may have to spend more money for our transmission, they'll use less assets at any given sight to do the job.

So, that's how we're positioning it and we think we have a very good chance to do that.

Bo McKenzie: So, does that imply then, when you look at some of these markets, like the Marcellus and the Appalachian Basin, that you're going to be able to get them into sights that they might not have been able to get to before because of a lower equipment need?

John Batten: It's a smaller footprint.

Bo McKenzie: Yes. Okay.

John Batten: And, we're doing application studies at each of the main horsepower breaks, 1,500, 2,250 and 2,500. We plan to be in the market at all of those horsepower ranges.

Bo McKenzie: All right. And then one final question if it's all right. I know you guys have talked at least with me in the past about – I know I'm going to get the name wrong, is it slip shift that you were marketing to a DPT kind of applications?

John Batten: Correct.

Bo McKenzie: How is that coming?

John Batten: It's going very well. We have applications running now in all of the major theaters of offshore oil, Europe, off the coast of Africa, the Gulf Coast and in Southeast Asia. And, it's just, you know, we're not rushing. We're taking our time in making sure that we have each combination, each application correct. But, it does offer significant improvement in doing the job at the rig.

Bo McKenzie: And, just to follow that and than I'll turn it back over, have you guys gotten that up to the horsepower to where you can deal with some of the 245 foot, 265 foot vessels?

John Batten: No.

Bo McKenzie: Or, is that still a goal out there somewhere?

John Batten: That's a goal for the future. Right now, we're kind of in the 200 foot range.

Bo McKenzie: All right. Great. Thanks a lot.

John Batten: You're welcome.

Operator: Thank you. And, our next question comes from the line of Paul Mammola with Sidoti and Company. Please go ahead.

Paul Mammola: Hi. Good afternoon everyone.

Michael Batten: Hi Paul.

Paul Mammola: Was an extended shutdown in Europe part of the plan at the beginning of the quarter? Or, did that sort of evolve as the quarter went on?

Michael Batten: That basically, as we looked at it, both the shutdown in the US and the equivalent shutdown in Europe is by the number of people that are working. We didn't actually close the facility 100% except for the normal summer shutdown, but they're running at a Somaj rate or a Cassa Integrazione rate of 50% or better.

John Batten: Yes. Paul, it's John. I'll just add a little bit of color. We had our normal summer shutdown in the two plants in Italy. We had one in Switzerland, a roll out that we didn't have the previous year, and we had a lot of yard who kind of varied and took different shutdowns just based on volume. So, the – our Somaj or Cassa Integrazione rate was higher than planned just because during the first quarter, there were a lot of customers who were also taking shutdowns that, you know, they didn't take the pervious year.

Paul Mammola: Okay. Fair enough. And, by any chance, do you know what the shutdowns cost you in terms of absorption on an EPS basis in the quarter? Does Chris have that?

Chris Eperjesy: No, we don't have that specific information Paul.

Paul Mammola: Okay. So, in October so far, you're running at a more normal utilization rate in those facilities, the three facilities?

John Batten: Yes we are Paul.

Paul Mammola: Okay. And then finally Mike, how long do you think it will take for the inventory luxury marine to make its way through the channel, if you had to take a best guess?

Michael Batten: That's a good question. It's going to be several months for that to work its way out. The large yachts, some of them are still being built and taking inventory. It's the smaller yachts, up into the middle class, up to the 70 meter yachts that are the problem.

Male Speaker: 70 feet.

Michael Batten: 70 feet. Sorry. 70 foot yachts that are the problem. That's going to take a while to work through Paul.

Paul Mammola: Okay. Thanks for your time guys.

John Batten: Paul, it's John again. Just to – I mean, we have been pleased with some of the fall shows in Europe, that some of the really high end 130 foot plus yachts have been selling. So, there is, you know, ongoing demand and there's ongoing production at the yard.

Paul Mammola: John, would you expect back log growth do you think for the next calendar year? Or, do you think that's too aggressive?

John Batten: For…

Paul Mammola: For the yards?

John Batten: Back log growth for the yards?

Paul Mammola: Yes.

John Batten: The ones that are building the high end mega yacht have the best chance, but it's too early to tell.

Paul Mammola: Okay. Thanks again.

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

Josh Chan: Hi. Good afternoon. It's actually Josh Chan (sp?) on for Pete. You talked about October production rate being kind of normal. Do you have any other planned shutdowns within the near future?

Male Speaker: John, go ahead.

John Batten: Yes Josh, it's John. Yes we do. We have – in the domestic operations, we're seeing a one week shutdown for the week after Thanksgiving, and then a one week shutdown for the week following the Christmas New Year's week, and that's all we have scheduled at this moment. In Europe, we're just going to be operating with the flexible staffing through the programs in Belgium, Italy and Switzerland.

Josh Chan: Okay. So, with that and kind of taking into account your cost reduction initiatives, do you think you can kind of hold gross margin flat for the year?

Michael Batten: What do you mean by flat for the year Josh?

Josh Chan: Flat in '10 versus '09.

Michael Batten: Well, I think that looking at the first quarter, that will be probably the bottom of the gross margin dip for us. I'm not sure that we're going to get back up to the same level of gross margins for a year-over-year basis at the end of the fiscal year. We may see Josh, in the second half of the year, our margins approaching year ago levels and hopefully carrying beyond 2010.

Josh Chan: Okay. Great.

Michael Batten: So, it's going to be an upward slope from here.

Josh Chan: Okay.

Michael Batten: Through the balance of the year.

Josh Chan: So, you just may not get there for the full year. I got you.

Michael Batten: Yes.

Josh Chan: And then in your outlook, you talked about improving quarterly trends for the rest of the year. I'm just wondering how quickly you think that will come? You know, can we still expect double digit negative comps in say the fourth quarter? Or, do you think it will be better than that?

Michael Batten: In the fourth fiscal quarter or the fourth calendar quarter?

Josh Chan: Fiscal quarter.

Michael Batten: Fiscal quarter. Are you talking revenues?

Josh Chan: Revenue, correct.

Michael Batten: Yes. Well, I think by that time, it will be a toss up as to – we won't be seeing negative comparisons, significant negative comparisons. In fact, we may be even seeing some positive comparisons depending upon how the second half growth rates occur. But, I wouldn't say double negative – double digit negative in the fourth quarter, no.

Josh Chan: Okay. And then finally, could you comment a little bit about your cap ex plan for the year?

Michael Batten: Yes. It's Mike again Josh. We're moderating off of last fiscal year a great deal. We're going to see probably cap ex in the range of somewhat minus – somewhat less than depreciation for the year.

Josh Chan: Okay. Great. Thanks for your time.

Michael Batten: Yes sir.

Male Speaker: Thanks Josh.

Operator: Thank you. And, our next question is a follow up question from the line of Bo McKenzie with Global Hunter Securities. Please go ahead.

Bo McKenzie: Yes hi. Two things. Is there a way you can quantify, you know, with the plant shutdowns and stuff about what the impact was on the quarter?

Michael Batten: Well, the plant shutdowns probably accounted for half or slightly more of the loss that we incurred.

Bo McKenzie: Okay. And, with the two weeks coming in Q2 between Thanksgiving, do you usually shutdown in Thanksgiving and Christmas in Racine or no?

John Batten: Bo, it's John. The one week will be in Q2 and one week will be in Q3. It's the first week of the next two quarters.

Bo McKenzie: Okay.

John Batten: Yes. And, we usually are shutdown for Christmas, the Christmas New Year's week, but we do have the three days at Thanksgiving too where the plants also shutdown.

Bo McKenzie: Okay.

John Batten: Historically.

Bo McKenzie: And…

Michael Batten: And Bo, let me just jump in. What John indicated earlier is in addition to that normal schedule. So, that normal shutdown of a few days at Thanksgiving and several days over the Christmas break, that's normal. What is different this time is a week in addition following Thanksgiving, and a week in addition following the Christmas shutdown, which actually falls in the first part of the third fiscal quarter.

Bo McKenzie: Okay great. Thanks for clearing that up.

Michael Batten: Yes.

Bo McKenzie: I know you guys have had a handful of good acquisitions under your belt historically. Obliviously, with things off in the yacht business, one would expect that the private company valuations have come in quite a bit. This is kind of a two-fold question. Are you seeing much out there, number one? And number two, what have the banks confirmed in terms of your credit facilities?

Michael Batten: Well, they answer the second question first. I mean, we do have a $35 million credit facility that is only partially being used at the moment. About half of the facility is being used. And, we think that given the right acquisition, we certainly have access to capital going forward. We have not asked nor have they given us any indication of what additional amount we would qualify for. We tend to look at it, and they too on an as needed basis. So, I'm fairly comfortable, Chris is too that if we were to find the right deal, we could get it financed.

Now, moving back to your first part of the question, we – valuations, you know, tend to lag actual fact. In other words, expectations are diehard for valuation, especially in a private owners mind. So, I think at this point in time, they're beginning to soften and we may find something that fits our requirement at a reasonable price for our shareholders. We tend to have pretty stringent acquisition criteria. We want to be accretive and we also want to be able to earn our cost to capital on the acquisition. So, those are two pretty stringent criteria or hurtle rates to get to.

We've been fortunate in finding opportunities, as you pointed graciously in the past, and that's our goal going forward, is to make good acquisitions for our shareholders.

Bo McKenzie: Are you seeing opportunities out there where people are perhaps being forced to sell where they over-leveraged, over-extended themselves or credit facilities have been withdrawn or anything like that that might make it even more of a buyers market? Or, is that just not occurring, particularly in the mega yacht business?

Michael Batten: Well, our scope goes beyond the mega yacht business, both in marine and in the land base side of our business. So, we aren't only focused on marine, and I know that wasn't your direction to your question, but I wanted to clarify for others who are listening.

The opportunities, if we could call them that that we have seen in that group tend to have more turnaround component than we would want to buy into. We've seen a number of situations where companies are available, but the point is, do we want to get involved with it because they're on the bank of financial collapse? Can we do something with that company and still meet our criteria? And so, there's where the rubber meets the road for us. Is, we don't want to buy distressed merchandise. If there is a modest turnaround component and we can bring to bear the global reach that Twin Disc has for a geographically challenged company, that may work for us and we may see a way to do something.

Bo McKenzie: Right. That's fair enough. One last thing. You know, receivables – not receivables. Inventories, any chance of having to write anything off? Or, is that something we should expect to come down and be kind of a continuant source of cash through the year at the lower level of sales that you're at this quarter and then likely in the next quarter? Or what?

Male Speaker: Well, I'll give you my thoughts and then I'm going to turn it over to John who has got the responsibility of making sure that that doesn't happen, that we don't have write-offs. We're naturally very aggressive in looking at our inventories, even in good times to make sure that things don't happen at other times. So, with that as a preface, John why don't you comment on what we're doing?

John Batten: No Bo. The inventories would have come down more in the quarter. It's just that we didn't have enough shipping days to get it all out. And, we're going to work hard on that through the balance of the year. So, I anticipate further reductions through the remaining quarters.

Bo McKenzie: All right. Great. Thanks a lot again.

Male Speaker: Okay Bo. Thanks.

Operator: Thank you. And, our next question is a follow up question from the line of Peter Lisnic with Robert W. Baird. Please go ahead.

Josh Chan: Hi. This is Josh again. Thanks for taking my question. I'm just wondering in terms of your sequential backlog improvement, is that due to existing orders kind of falling into the six month timeframe? Or, is it due to some kind of improving, you know, order situation?

John Batten: Josh, it's John. It's improving situations in some of our markets, particularly here in North America. It wasn't a huge up tick but you can definitely sense a change.

Josh Chan: Okay. And then, you know, if you had to guess, would you kind of say that the $60 million of backlog is near the trough this cycle?

Michael Batten: We would hope so Josh, it's Mike. We would hope that we are at the bottom. It's nothing to say that it couldn't spike up and drop back down again, but we're encouraged by what's been happening, especially overseas in Asia. We're getting a lot of activity in terms of oil and gas, military patrol boats for countries like India, China, some in the Middle East, Turkey. So, there are – we tend to, because of where we live here in the US to view us in the scope of US economy, but we're very fortunate in having that global reach. So, we're cautiously optimistic that we are seeing a turnaround, and that the rate of change in terms of orders and backlog is turning positive.

Josh Chan: Great. Thank you very much.

Michael Batten: You're welcome Josh.

Operator: Thank you. Once again ladies and gentlemen, if you would like to ask a question, please press the star followed by the one at this time. If you are on a speakerphone, you need to pick up the handset before pressing star one.

And, I'm showing there are no further questions in the queue. Please continue.

Michael Batten: Thank you Val and thank you all for attending the conference call today. We appreciate your interest in Twin Disc.

As we look forward to the balance of the year and beyond, we're encouraged by the actions that we have taken to address the soft or near term demand by a geographic diversity and development of our global market, particularly in Asia as we mentioned, and by our product development pipeline that is brining innovative products and technologies to our marketplace.

So again, thank you for your attention and please have a good day.

Operator: Thank you sir. Ladies and gentlemen, that does conclude today's Twin Disc Incorporated 2010 First Quarter Financial Results Conference Call. If you'd like to listen to a replay of today's call, please dial 303-590-3030 or 1-800-406-7325. Enter the pass code 4168638. Once again those numbers are 303-590-3030 or 1-800-406-7325. Enter the pass code 4168638.

Thank you for your participation. You may now disconnect.