Twin Disc, Inc.
2009 Second Quarter Financial Results
January 22, 2009

Operator: Good afternoon ladies and gentlemen. Thank you for standing by. Welcome to the Twin Disc, Inc. 2009 Second 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 touch-tone 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, Thursday, January 22, 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 call, and thank you for joining us to discuss the company's fiscal 2009 second quarter and six 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 could cause actual results to differ materially from those in 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'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 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. Michael?

Michael Batten: Thanks, Stan, and good afternoon everyone, and welcome to our second quarter conference call. As Stan has mentioned, I will start with a brief statement, and then Chris, John, and I will be available to answer your questions.

Sales for the second quarter were 81.6 million compared to 81.9 million for the same three months a year ago. Foreign currency translation negatively impacted the current quarter sales figure by 2.4 million, and adjusted reported sales would've been just under 3% higher without that impact.

Second quarter sales benefited from shipments that had been delayed due to the implementation of the new ERP system at the company's domestic manufacturing facilities. Issues related to the domestic implementation of that ERP system have been successfully addressed, and we are currency working on installing the system throughout our global operations.

We're pleased that second quarter results improved on those reported for our first fiscal quarter, even though we were not able to match the record operating performance of the second fiscal quarter of fiscal year 2008.

In addition to the continuing softness in our oil and gas markets, we are now seeing softer demand in the mega yacht segment of the pleasure craft marine market. However, activity in our commercial marine and industrial markets continued at or above year ago levels.

Gross margin, as a percent of sales for the current quarter, was 28.1% compared to 30.9% in last year's comparable period. Profitability for the current three months was impacted by unfavorable product mix, higher material cost, and an increase in domestic pension expense.

Marketing, engineering, and administrative expenses, as a percent of sales, were 20.8% for the current quarter, compared to 21.2% for the same period a year ago. ME&A expense benefited from a decrease in stock-based compensation expense, as well as reduced accruals for domestic incentive programs. However, these benefits were offset by other costs related to severance, increased IT spending, and higher pension expense.

Net earnings for the fiscal year 2009 second quarter were 3.4 million, or $0.31 per diluted share, compared with 4.2 million, or $0.37 per diluted share for the same period in the prior year. Year-to-date earnings were 5.9 million, or $0.52 per diluted share, compared to 9.3 million, or $0.81 per diluted share for the first six months of last fiscal year.

Twin Disc continues to maintain a strong financial balance sheet, with excellent liquidity. The company has 11.2 million in cash, maintains a total debt to capitalization ratio of 31.1%, and has existing credit facility of $11 million available until October 2010.

Although we have experienced cancellations and re-timing of orders, our six month backlog at December, 2008, was 106.3 million, compared to 120.8 million at June 30th, 2008, and 121.3 million at December 31st, 2007.

Like many industrial manufacturers, we are experiencing softness in certain of our core markets, specifically the oil and gas, and mega yacht segments. We now expect demand from the mega yacht segment of the pleasure craft market to continue to weaken for the balance of the year. This will impact the company's propulsion and boat management systems product lines.

Given the decline and the price of oil, future demand for land-based transmissions for the oil and gas markets remains uncertain, while demand for vehicular transmissions for airport rescue and fire fighting, as well as military markets continues stable. Demand for the company's industrial product lines has improved year-over-year, and activity in the commercial marine market is expected to remain steady.

That concludes the prepared remarks for today, and Chris, and John, and I are ready to take your questions. Brandy, will you please open up the lines please.

Operator: Yes, thank you. We will now begin the question and answer session. As a reminder, if you have a question, please press the star followed by the one on your touch-tone phone. If you would like to withdraw your question, press the star followed by the two. And if you're using speaker equipment today, you will need to 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.

John Haushalter: Good afternoon. It's actually John Haushalter on for Pete. Just have a couple questions for you guys. First off, just with the ERP system being deployed, kind of worldwide, is there potential for it to have similar disruptions to what happened in the US, I guess, in the first quarter, if you're kind of looking towards the third or fourth quarter of this year?

Michael Batten: John, the ERP system, next implementation will occur at the beginning of our new fiscal year, 2010, and I'll let John pick up on that.

John Batten: We don't anticipate nearly the types of interruptions that we had at our domestic operations. We learned a lot with that implementation, and are taking extra time with people that have been involved in the first implementation as we roll it out at our other manufacturing locations, and then distribution operations. So the most complicated and comprehensive implementation was the first one, and the next one should be much smoother.

John Haushalter: Okay, so there is a true learning curve there, where you guys are much more comfortable kind of approaching the implementations than fiscal 2010?

John Batten: Absolutely. The internal team will remain the same, so they've had quite a learning curve in the last six months.

John Haushalter: Okay. And then just, I guess, one more on the cost side before shifting to demand. But just on the material cost front impacting you guys on the quarter, are you still seeing, kind of, cost pressure there? And just kind of given the inventory turns, I know it's going to take awhile to kind of flow through, if you're getting kind of lower purchase prices right now? And just what's your outlook for kind of the commodity cost, or just kind of cost picture there?

John Batten: We had, a lot of the material cost increases that slowed into the second quarter are attributed to, a lot of the surcharges and cost increases that we actually received physically in the first quarter, some slipped into the second quarter as we were getting all of those things through the system. We had, as far as surcharges and commodity costs; they came down steadily in the second quarter. We had a bit of a blip in December, which we will be circling around to tackle, but we see, hopefully, that certainly surcharges on seals and other metals has started to come down quickly.

John Haushalter: Okay. And then just on the demand front, because you guys report kind of six month backlog, but you also have a bit of visibility in some of the businesses for periods beyond that, and just perhaps to the extent there's been kind of this re-timing or cancellations, has it all been basically push-outs, or has kind of the backlog beyond the six month period been affected also?

Michael Batten: The backlog, this Mike again, the backlog as, in both cases, has, is moderated somewhat, both on the six month, which is reported, as well as our total backlog. As you recall, most of our backlog beyond six months falls into the longer lead time items that include primarily vehicular, I mean, industrial kinds of transmissions, both industrial and vehicular, as well as some longer lead time marine. So we're seeing some moderation long-term in both components of the backlog.

John Haushalter: Okay, and then just I guess one final one and then I'll let other people ask questions. But just on the reduced, kind of, cap ex forecast that you put out there, just what, is it just kind of your anticipation and demand being a bit slower given the softening in the marine market, or what kind of are you changing there in terms of kind of cutting the cap ex forecast?

Michael Batten: Well we have been looking at where we need to have our cap ex closer in, and what we have commitments on, and that's where we're going to be spending our money in the short-term, and that reflects what we indicated in the press release. What was cut back really reflects some longer-term thoughts on some spending, and by and large, they have just been moved out rather than cancelled.

John Haushalter: Okay, that…

Michael Batten: (Inaudible) the next fiscal year or, and so on.

John Haushalter: Okay, so it's just in response to kind of the current end market of push out of cap ex than more to most manufacturers at this point?

Michael Batten: Right. We're watching our cash flow, and moderating spending based upon that.

John Haushalter: Okay, thank you. I'll get back in queue.

Michael Batten: Okay, thanks John.

Operator: Thank you. And our next 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: First, can you give us a sense what sales trends were year-over-year for, I guess, marine versus the industrial markets? I guess were, more specifically, were the oil and gas transmission sales significant lower, and then marine, I guess, making up that shortfall? Is that fair to say?

John Batten: That's fairly accurate. The commercial marine, globally, whether it's related to oil and gas or transportation, was stronger year-over-year. There has been a moderation down on the oil and gas; the pressure pumping transmission. But the make up, that's accurate. Our industrial markets and commercial marine market helped make up in the second quarter.

Paul Mammola: Okay, that's helpful. And then on commercial marine, John, what are the contributing factors that are making that end market stable for you guys? Are there, are there any specific examples you can give us?

John Batten: I think, one, I think, I believe we're gaining market share, specifically in Southeast Asia. We have a fairly strong market share in North America. I'd' also add I think we're gaining market share in the European market. But with respect to oil and gas, I still think there's a positive attitude that the current price of oil, it'll be here for the short-term rather than the long-term.

Paul Mammola: I agree. But given that, how about the Canadian markets on the oil side? Have you seen any material change there, or are things still pretty depressed?

John Batten: No, we haven't seen any – correct, there's been no uptick there.

Paul Mammola: Okay. Okay, that's fair. And then have there been any discussions with M&I (sp?) on the revolver at all in the interim or last time we talked?

Christopher Eperjesy: Paul, it's Chris. No. I mean the agreement's in place until October of 2010. And as we noted in the press release, you know, we have available borrowings under that, and the, obviously the interest rate right now is very attractive, so we don't intend to do anything for the foreseeable future on that.

Paul Mammola: Okay, that's fair. And then finally, do you anticipate any further price action in the year, or was the 6% increase all that's going to go on here?

John Batten: Well we did, we had a price increase July 1. We had the 6% in North America, and a price increase in Europe. We'll see where the balance of the year goes, but we anticipate any pricing actions in the remainder of this fiscal year being much more challenging.

Paul Mammola: Okay, and then finally, just one more thing, sorry. Oshkosh (sp?) has seen increased military action as of late, or military orders I should say. Is there any chance you guys get anything incrementally from that? And then also, could you quickly outline, I guess, what could happen if we do withdraw from Iraq, and maybe anything you might get from that?

Michael Batten: Well I think on the military front, Paul, we continue to receive orders for, what, as you know, we call the legacy kinds of equipment. We haven't seen anything specifically out of Oshkosh that I'm aware of. John - no. And with, to your question about Iraq, I think there, the scenario that is likely there is that, to the extent that we would withdraw from Iraq, it is very likely that the equipment that is there will be left there more or less. That doesn't we wouldn't bring some of it home. That would put the US military in a position of having fewer vehicles than they would want to have for any other ongoing support. So we would expect that there will be some continuing demand. How much, we can't predict, but there would be continuing demand for military transmission.

Paul Mammola: Okay, thanks for your time.

Michael Batten: Yes. You're welcome, Paul.

Operator: Thank you. Ladies and gentlemen, if you have any additional questions, please press the star followed by the one at this time. One moment please.

And our next question comes from the line of David Ehlers with Las Vegas Investment Advisors. Please go ahead.

David Ehlers: Good morning guys, and congratulations on a, (inaudible) an excellent quarter given the atmosphere that the world is involved in.

Michael Batten: Well thank you, David.

David Ehlers: Just curious to know, have you looked at, or have you been in any contact with (inaudible) can tell you with regard to our new President's programs, and how these might impact business for Twin Disc?

Michael Batten: We are looking at what President Obama's program is going to be and where it might impact our product line or future product planning. A lot depends upon where Congress will fund, and how much they'll fund, and how quickly that money will get into the marketplace, of course. But we are actively looking at what we can on his initiatives, and looking at directing ourselves to take advantage of anything that we can.

David Ehlers: Well thank you very much, and again, congratulations guys on the, this quarter was excellent given the, as I said, the worldwide economic scenario.

Michael Batten: Well thank you. We appreciate it. Thanks, David.

David Ehlers: Yes.

Operator: Thank you. And at this time, we have no further questions in the queue.

Michael Batten: Okay, well thank you very much everyone for your participation, and taking time today out of your schedules to visit with us on our results and outlook. We look forward to chatting with you again in three months time. Thank you.

Operator: Thank you. Ladies and gentlemen, this concludes the Twin Disc, Inc. 2009 Second 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 passcode of 3961116. Thank you for your participation. You may now disconnect.