Twin Disc, Incorporated
First Quarter Fiscal 2012 Financial Results
October 25, 2011

Operator: Good day, ladies and gentlemen and thank you for standing by. Welcome to the Twin Disc Incorporated First Quarter Fiscal 2012 Financial Results 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 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 lift the handset before making your selection. This conference is also being recorded today, Tuesday, October 25th of 2011.

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

Stan Berger: Thank you, Patricia. 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 2012 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 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 Mike Batten. Mike?

Michael Batten: Thank you, Stan, and good day, everyone. Welcome to our first quarter fiscal '12 conference call. I will begin with a brief summary as usual and then John, Chris, and I will be ready to take your questions.

As you've already seen in our press release, Twin Disc had a great first quarter with record net earnings on a 33% year-over-year increase in that sale. Our six-month backlog rose again to an all time high and we are encouraged that fiscal year '12 will be another strong year for the company.

Turning to the numbers for the quarter, net sales improved to 81 million from 61 million for the same three months a year ago. The key driver of the improvement in sales was strong demand from our oil and gas market. However, we also saw a growing demand in our aftermarket industrials and ARFF sectors. Demand was stable and our land and marine-base military markets and order activity in both the commercial and pleasure markets showed improvement versus a year ago.

Gross margins for the quarter was 37.8% compared to 32.6% of the fiscal 2011 first quarter. The improvement was the result of continuing increased volumes, improved manufacturing efficiency and absorption, and a more profitable mix of business.

While marketing, engineering, and administrative expenses rose by 1.1 million in the quarter compared to last year, as a percent of sales they declined to 19.6% from 24.1% last year. As noted in the press release, the net increase in spending was impacted by foreign exchange rates, increased R&D, wages and salaries, as well as stock-based compensation.

As indicated earlier, Twin Disc reported record net earnings for the fiscal 2012 first quarter of 9.6 million or $0.83 per diluted share compared to 2.7 million or $0.24 per diluted share for the same period a year ago.

As is previously mentioned, our six-month backlog at September 30th, 2011 was a record 165 million compared to 147 million three months ago and 100 million a year ago. We continue to benefit from demand from our oil and gas customers as well as from improving order rates for our Express Joystick System in the marine market. We are encouraged that fiscal year '12 will be another strong year for Twin Disc.

Recently, we announced a series of agreements with Caterpillar to provide innovative technology solutions to the global marine pleasure craft market. For vessels equipped with a conventional shaft arrangement, we will be providing QuickShift and Joystick technology systems that will be available for delivery in 2012. For vessels that will utilize an innovative POD system featuring Twin Disc's patented QuickShift transmission technology, these systems will be available for order in 2014.

We are very pleased to have formed this strategic partnership with Caterpillar and look forward to supplying the pleasure craft market with innovative technology-driven propulsion solutions.

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

Operator: Absolutely. Ladies and gentlemen, 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, please press the star, followed by the two. And again, if you are using speaker equipment you may need to lift the handset before making your selection.

One moment please for the 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.

Michael Batten: Hi, Pete.

John Batten: Hey, Pete.

Chris Eperjesy: Hi, Pete.

Peter Lisnic: I guess first question on the gross margin. I heard the commentary on what drove the increase. I'm just wondering if we could break that down a little bit more and help us understand exactly how much mix drove it. And then maybe more importantly, how sustainable that is going forward if indeed you're starting to see (inaudible) bottom or in fact the (inaudible) from a demand perspective?

Chris Eperjesy: Right, Pete, this is Chris. As we've talked about in the past and I think the comments still hold. Obviously, we're having the benefit, a significant benefit in volume with the volume being up 33%. So in terms of the actual dollars that's a big driver, but to your question in terms of the actual margin improvement, clearly there's some absorption benefit there. A big piece of it would continue to be the mix of business and particularly oil and gas, but I think now more so than previously, half the market in industrial business is also a part of that mix improvement. Regarding the sustainability, you know, a lot of it is heavily dependant upon the mix and, you know, so as we've said in the past, we think, you know, sustainable above 30% is realistic, but whether we'll be able to grow it from here as we've talked about in the past, you know, is highly dependant on a lot of those factors. So I would, you know, I would caution that it's going to be, you know—it won't be unusual for us to be above 30%, in that mid-30s, but in terms of sustaining it at these levels at 38, I don't know if we would go that far.

Peter Lisnic: Okay, got it. And then I just want to clarify your comment about aftermarket being a contributor there as well. From what I remember, I recall you saying on previous calls the aftermarket as a percentage of total revenue remains a relatively small piece of the pie. Is that the right way of phrasing it?

Chris Eperjesy: I don't know that we've ever said that. The aftermarket has tended to be, you know, I would say north of 20% and it's pretty consistently. In the first quarter it would have been more than what its historical high has been in terms of as the percentage of the total business, but it's always a significant portion of our business.

Peter Lisnic: Okay, and you're seeing aftermarket growth I assume from oil and gas, correct?

John Batten: Yes, Pete, it's John. We're seeing aftermarket growth in all of the product areas, so oil and gas and industrial and marine as well.

Peter Lisnic: Okay, all right. And then if I could just shift over to backlog really quickly. I would assume the Cat agreement hasn't necessarily had any impact on that (ph) number, correct?

John Batten: That's correct.

Peter Lisnic: Okay, fair enough. And then in terms of the increase, 64% year-over-year and 12% or so sequentially, can you give us a little flavor as to what drove that? It sounds like it was relatively broad, but I'm wondering if there's some more granularly, if it was behind the increase?

Chris Eperjesy: And Pete, you're talking about the comparison to fiscal year-end or versus a year ago?

Peter Lisnic: Either way would be fine, actually.

Chris Eperjesy: Versus the end of the fiscal year, it's pretty—it's across all of the different markets, aftermarket as well as all the other business product market. If you go back versus last year it's a similar answer, but clearly the oil and gas would be a big part of it.

Peter Lisnic: Okay, all right. And then last question if I could, just can you help us understand in terms of the oil and gas demand, you know, to what extent is that being driven by onshore versus offshore and then North America versus international (inaudible) with the trends there are?

John Batten: Pete, it's John again. I would say—well, it's being driven by both onshore and offshore. Certainly, we've had continued growth in onshore activity for the 8500 and the 7500. A growing component is coming from Asia as far as what's in the backlog for those units. And, you know, also on the offshore, we continue to see activity in Asia and the Gulf Coast and a little bit coming back from Europe for the West Coast of Africa. Still concerned about the activity in the U.S. Gulf Coast and then we're going to get back to, you know, the daily rates and the activity that we saw just a couple of years ago before the spill. That's still a concern. I would like to see that part of the business come back stronger.

Peter Lisnic: Okay, that is very helpful. Thank you very much for your time.

John Batten: Thanks, Pete.

Chris Eperjesy: Thanks, Pete.

Michael Batten: Thanks, Pete.

Operator: Thank you. And our next question comes from the line of John Braatz with Kansas City Capital. Please go ahead.

John Braatz: Good afternoon, gentlemen.

John Batten: Hi, John.

Michael Batten: Hi, John.

Chris Eperjesy: Hi, John.

John Braatz: A couple of questions. Can we talk a little bit about the 7500. I know you mentioned that there's a little bit of 7500 revenue in the quarter, but how long will it take to get up to full production? And secondly, can we talk a little bit about maybe, you know, cannibalization. Are we seeing any cannibalization of the 8500 with the 7500?

John Batten: John, it's John here. Yes, we shifted a handful of units in the first quarter—sorry, in the fourth quarter, also in the first quarter. We are still in the, you know, application sensitive part of the whole process. You know, we're only shifting limited to those field test applications that have been proven. So to really make an impact of what I think you're driving at, it's still a quarter or two away, probably closer to two quarters away as we work through all of the field tests and the applications for each style of rig. And I'm happy to say that we have yet to see cannibalization of the 8500. That product is still in very strong demand.

John Braatz: Okay, okay. Can you give us any sense as to let's say in two or three quarters you're at sort of full production.

John Batten: Mm-hmm.

John Braatz: And there's no cannibalization. Can you give us a sense on relative production rates at 7500 versus 8500. For example, if you were generating x revenues in a quarter with the 8500, you know, what kind of revenues might you be able to generate with the 7500? How additive can it be?

John Batten: I would think that we would get to the same production rate as the 8500. So another way to say it is the potential there is to double, you know, our transmission shipment. How long that's going to take, you know, certainly it won't be six months, but it won't be three years.

John Braatz: Right, right.

John Batten: So it's going to be somewhere and a lot of factors to get there.

John Braatz: Okay.

John Batten: But we certainly see the potential to be equal.

John Braatz: Okay, okay. That's great. And then lastly, well, what about price realizations? What are you—have you been able to raise prices at all in the oil and gas market?

John Batten: Yes, we have.

John Braatz: Okay, above and beyond the cost?

John Batten: That would be a fair assumption.

John Braatz: Okay, okay. And then lastly, the deal with Caterpillar.

John Batten: Mm-hmm.

John Braatz: I don't know too much about the marine market, but is that something that can move the needle if it all goes well?

John Batten: Absolutely. As the pleasure craft markets recover, this will accelerate our recovery in the pleasure craft market.

John Braatz: Okay.

John Batten: Mm-hmm, absolutely. They are—Cat is a very strong player in the pleasure craft market.

John Braatz: Okay, all right. Thank you very much.

John Batten: Thank you.

Operator: Thank you. And our next question comes from the line of Robert Sussman with Bentley Capital. Please go ahead.

Robert Sussman: Hi, that was an incredible quarter by the way. Congratulations. I would like to ask you, I don't fully understand what your product adds to the Caterpillar marine product. And can you give us any idea looking at two to three years, how significant the volume could be from this area. And also differentiate the first product, which is going to be available in 2012, or should the one that's available later on. I'm not sure I understand the distinction.

John Batten: Okay, it's John again. For the Cat Joystick System, Caterpillar produces engines obviously. And to complete the Joystick System you need a marine transmission, which a marine transmission, thrusters, bow thrusters, stern thrusters, the control system to operate the engine, and transmission and thrusters, and obviously the joystick is a part of that. And then in some cases, you also have a propeller. And all the components that I just mentioned we've produced and would add to the Cat system. So Cat would be providing the engine, we would be providing the gearbox, the transmission, and the rest of the components to complete the Joystick System. And what Cat brings is, you know, by far and away one of the strongest dealer organizations in the world and selling arms to sell that product into the pleasure craft boat builders. So as this roles out over the next couple of years, it could have a substantial impact on the business.

Robert Sussman: Can you distinguish what the two different products are?

John Batten: Oh, I'm sorry, right.

Robert Sussman: (Inaudible) and one is later.

John Batten: Correct, I'm sorry. I missed that part of the question. Okay, the first part, the Bare Joystick System is going to be operated on boats that have a conventional propeller shaft type of arrangement, so engine transmission, propeller shaft out to a propeller, and then you steer the boat with rudders, and these are twin installation boats. What Caterpillar has announced that they're coming out with in a couple of years is a POD system, which is an engine transmission and POD shaft, a POD device that comes out through the bottom of the boat through the hull. And these POD units steer, they're kind of like outboard engines that come out through the bottom of the boat, or an IO coming out of the back of the boat. It's one complete system. Everything is sold together and installed together, engine, gearbox, POD, and propellers. So our Twin Disc QuickShift technology will be incorporated into those POD units. That program has just kicked off, but that's, you know, two years away from release.

Robert Sussman: Okay, and so I assume you're already supplying some of the components to Cat now. What is the additional volume per boat or per unit that you would get by adding these products to what you are already offering?

John Batten: We typically don't give that information out, but it will increase our volume, you know, as these programs roll out. There's no doubt about that.

Robert Sussman: I mean does it increase your volume per ship 20%, 40%, 60%? Is it significant? You know, you don't have to give me obviously a dollar amount, but is it a significant increase?

John Batten: It's a significant increase because it'll be more—we have these products, so I mean we have x percentage on different vessels. This is just giving us more vessels through—and content through the Cat dealer network.

Robert Sussman: Okay. And what is the earliest point we would see any impact from this in your revenues?

John Batten: I would—it's going to be a fiscal '13 impact.

Robert Sussman: Okay. Thank you.

John Batten: Thank you.

Operator: Thank you. And our next question comes from the line of Greg Garner with Singular Capital. Please go ahead.

Greg Garner: Thank you for taking my questions. First of all, congratulations on a great quarter.

John Batten: Thank you.

Greg Garner: And just as a follow-up from that last question regarding Caterpillar. First of all, I appreciate the clarification there, it was very helpful for me. But it sounds like initially that Caterpillar brings Twin Disc into their market and that will help you sell some of your transmission products with their engines, but—and a couple of years from now, this POD system, that is actually Caterpillar's transmission, so that may not be as beneficial as what—Cat being the first phase. Is that the right way to look at this?

Michael Batten: Both will be very beneficial.

John Batten: Both will be beneficial. Having our technology in the POD system will be very beneficial for us.

Greg Garner: So I guess that would be addressing a different type of vessel or different size, or—

John Batten: It would be addressing a slightly smaller vessel, that's correct. These POD systems—I mean, I guess I should have clarified in the previous question. The Joystick System is not limited in horsepower. I mean, Cat today goes up—I mean, they have a very successful engine line, pleasure craft, going up to, you know, almost 2000 horsepower. This is the—the Joystick System can go up to that and beyond as Cat really comes out with new engines. The POD system that they're coming out with will have some horsepower limitations, you know, somewhere in the 800 to 1,000 horsepower range, so per engine, so that is obviously a much smaller vessel. So yes, the POD systems are aimed at smaller vessels in the pleasure craft world and the Joystick System is aimed at much higher horsepower level engines.

Greg Garner: So teaming up with Caterpillar in the short term here expands the market for Twin Disc and who would you be replacing there?

John Batten: Well, we'd be replacing a) our competition that has sometimes been behind Caterpillar, but it's also replacing Cat's competition who generally chooses our competition, so we're winning on both ends. We're winning behind Caterpillar and we're winning in the engine transmission combinations as well.

Greg Garner: I think you already mentioned this, who the competitor is?

Michael Batten: Go ahead.

John Batten: Sure, the main—I would say the main competitor for Cat is MTU and ZF out of Germany. And Volvo IPS for the POD system.

Greg Garner: MTU and ZF you mentioned?

John Batten: Correct, yes.

Greg Garner: Okay. Okay, thank you for that. In the 7500, is there any way—I'm just looking to see what was for prior guys who have mentioned that 7500 would probably have a negative impact on margins in the first half of the year due to the low volumes. And we're just seeing some very high margins, so I presume very little of the 7500 was part of revenues in the first quarter. And so it makes—does that mean that as the 7500 ramps up that that would be reasonable to expect some lower margins there? I'm just trying to get a better understanding of how this gross margin being so high in some of the explanations that were given previously? Sort of factoring that into what the 7500 may still be affected.

John Batten: Yes, everything went right in the quarter, even on the 7500s that we did ship. I don't—as the 7500 comes more and more online, it may have a slight negative effect on the gross margins, but not a significant one.

Greg Garner: Okay.

John Batten: There would be other factors that would have a much bigger impact on that than the 7500.

Greg Garner: Okay. And what's the current delivery time for current orders for 7500 versus an 8500?

John Batten: We're looking at actually for either one, the 7500 is still—I mean, you're looking at a six-month timeframe and the 8500 is actually not much longer. We're kind of in the seven to eight-month range.

Greg Garner: Okay. And can you give us any insight into the level of interest in the 7500 being a new product and might be shown to new customers or new—how is it being received?

John Batten: It's being very well received, but everyone is also—I mean, understands the need for testing, not only our field testing and product testing, but also testing in their application because, you know, the horsepowers are essentially the same, but engines are different, pumps are different, pump strokes are different, so they are—the rig manufacturers are being very diligent in their testing before they, you know, release out into production. So it's been a very thorough process. But I would say that the 7500 has been very well received.

Greg Garner: So based on whatever kind of additional products that need to work with the 7500 on the rig, that's all being thoroughly tested right now, and is that—

John Batten: It's being—each application is being tested, that's correct.

Greg Garner: Okay. All right, thank you.

John Batten: Thank you.

Operator: Thank you. And our next question comes from the line of Matthew Dodson with Edmonds White Partners. Please go ahead.

Matthew Dodson: Can you just talk a little bit about—you guys did a great job on your SGNA and engineering costs, et cetera. You know, you really leveraged that. Help us understand how that has to grow as you go through the year in dollar terms? Does it grow sequentially from the first quarter or not necessarily?

Chris Eperjesy: Yes, I think one thing to point out first is in the first quarter is we announced is (inaudible) pointed out in the press release. There was the benefit of the stock-based comp adjustment as the stock price went down in the first quarter. If you adjust that out then I would say—and don't, you know, I guess as a disclaimer, not knowing what's going to happen with the stock-based comp in the last three quarters of the year, I don't expect a significant increase in ME&A, but yes, historically, the second, third, and fourth quarters had to be a little bit higher than the first quarter.

Matthew Dodson: Got it. And how much was the stock-based comp benefit for you in Q1?

Chris Eperjesy: I believe it was 1.1 million. I'm just going to confirm it here. Yes, it was a 1.1 million.

Matthew Dodson: Got it. So what we should do is just take that number and add 1.1 million and that's kind of the real run-rate, is that fair?

Chris Eperjesy: That's fair, but with a caveat that I just gave in terms of not knowing what potentially could happen to the stock-based comp based on the stock movement in the last three quarters of the year. And then also there tends to be a slight increase in the last three quarters of the year versus the first quarter.

Matthew Dodson: Got it. And then also can you just talk a little bit about the seasonality of revenues? Is there any seasonality to the business, or do you think you can continue with what you've seen in your orders and your backlog to grow revenues sequentially?

John Batten: Yes, historically, it's been a fairly substantial growth from quarter-to-quarter throughout the year. I would say the oil and gas component has leveled that out a little bit, so it's not as big as maybe it has been when oil and gas was a much smaller component. I'm talking specifically about land-based oil and gas. But still the demand increases throughout the year and it's a function really of how many production days do we have in each of the quarters to deliver on that demand.

Matthew Dodson: Got it. And the other question just relative to the 7500. Is the 7500 a bigger ASP for you, or a bigger ticket, so you'll actually get more dollars per—

John Batten: In bigger units. It gets—in comparison to the 8500?

Matthew Dodson: Yes, sir.

John Batten: No, it's lower horsepower than the 8500 and it's also a lower price than the 8500 system.

Matthew Dodson: Okay, I got it.

John Batten: But, you know, probably our second highest product price.

Matthew Dodson: And then just one more question. Relative to the marine, you seemed in this quarter more bullish about the outlook for the yacht market, et cetera. Is that just because what you've seen in the order book and if that starts to happen or materialize like maybe you think it could, does that have positive implications for gross margin? In other words, is marine a better than corporate average gross margin?

John Batten: I have to answer your last question first, so I don't forget it. It's average. It is the average more or less of the corporate gross margin and I would say that we are optimistic, but it's coming off of an incredibly low level and that optimism is being driven by—you know, some manufacturers are able—they're selling both. And we are doing well with our Joystick System, the Express Joystick, the EJS. So I mean, we're optimistic because where—what few sales there are out there, we're able to capitalize on them. That's on the pleasure craft side. But I would say yes, we are more bullish now on the commercial markets, the work boat markets than we were last quarter or, you know, two quarters ago.

Matthew Dodson: Okay, great. And thank you for your time.

John Batten: Thank you.

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

Neal Miller: Hi, all. I'm looking forward to seeing you in Chicago. A couple of questions on oil and gas, in that arena. The first question I have is who controls the transmission decision? Is it—maybe you can help me out. In other words, I'm wondering who you're selling the product to?

John Batten: We are—we sell to the rig manufacturers who actually build the rig, and unfortunately there's no one answer as to who makes the decision. Some rig manufacturers make the decision, but a lot of operators make the decision as to what transmission is behind, you know, on their rig, so—but between the operators and the rig manufacturers, that's where 99% of the decisions are made.

Neal Miller: Does that mean that over time there might be less duplication in terms of marketing effort, or because your equipment might be more reliable or become more accepted in a competitive profile?

John Batten: Yes, Neal. I guess market reputation and performance, you know, is your biggest asset. So—and again thankfully the market has been shifting to higher horsepower.

Neal Miller: And then a clarification comment. You mentioned rig, but I thought the transmission—I have a picture in your annual report, one on a truck for fracking

John Batten: Correct. Maybe it—the same thing, two different words. When we talk about a frac rig, it is essentially the back of a semi-tractor trailer.

Neal Miller: Ah, that's helpful because when you say rig or at least in the oil patch, you think of a derrick or something, so.

John Batten: No, maybe I should be more clear. The term that we used and a lot of people use in the industry, when they say frac rig, it really is a semi-tractor trailer arrangement with the engine transmission pump cooling on the semi-trailer, and that gets the name rig, frac rig.

Neal Miller: I appreciate it. And going on with a couple more questions. But in terms of aspiration or goal line or hope, are you close to, you know, the three major companies, Schlumberger, Halliburton, Baker Hughes, or I'm just kind of wondering whether—

John Batten: Well, we're—yes, we're in one of them and we've had meetings with the other two in the last quarter.

Neal Miller: Wow, that's excellent. The last question would be it seems to me the trend is towards higher horsepower and I think you just referenced it rather than lower. And based on that, do you think your 8500 has a longer life and will outdistance the 7500? I guess another perspective on this would be is the 7500, you know, a different type of shale than the 8500, et cetera, so the market segmentation. But I guess the basic question is will the 8500 continue to outdistance because of the higher horsepower requirement?

John Batten: Well, if they're using 3,000 horsepower engines, then the answer is yes because the 7500 is 25 to 2,600 horsepower, so as long as the trend continues at 3,000 horsepower, the 8500 will continue to distance itself. And the 8500 has a very good reputation and that's what we aspire to have, the 7500—you know, the 7500 to have the same reputation. And that's what we're shooting for, but yes, there's still a market. And it goes back to really the size of the frac truck. You know, Marcellus Shale, anything in mountains with winding roads whether it's in Asia, Europe, you're going to need a smaller rig. You're just not going to be able to get a 3,000 horsepower frac rig into these sites, so the 7500 still has a great market potential.

Neal Miller: Boy, that's really helpful. Thanks, see you in Chicago.

John Batten: All right, see you then.

Operator: Thank you. And our next question comes from the line of Rand Gesing with Neuberger Berman. Please go ahead.

Rand Gesing: Good afternoon.

John Batten: Hi, Rand.

Chris Eperjesy: Hi.

Rand Gesing: What should we think about for the tax rate for this year?

Chris Eperjesy: It's still pretty consistent with what I've said in the past. I mean it should be in that mid-30s range. There could be some noise in any given quarter that may take it, you know, plus or minus a percent or two.

Rand Gesing: Okay.

Chris Eperjesy: But in that mid-30s is a pretty reasonable number to use.

Rand Gesing: Okay. And you mentioned lead times on the 8500. Have they changed in any way over the last quarter? And lengthened or gotten a little shorter?

John Batten: As we've expanded monthly production rates, we've brought the lead times down I would say in about two months.

Rand Gesing: You brought them down, okay.

John Batten: Mm-hmm.

Rand Gesing: And have you seen any—obviously, it's been a hyper growth market. Have you seen any, you know, sort of weakness in demand, you know, from the rig perspective of pushing down that may be heading towards you guys over the next couple of quarters?

John Batten: No, we haven't seen it over the next couple of quarters. I think people are still wondering—I think everyone's still confident on 2012 being a very good year calendar.

Rand Gesing: Yes.

John Batten: And I think people are very hesitant to make bold predictions for 2013 and beyond, but—

Rand Gesing: Yes.

John Batten: Macro-economically, I think Shale is here to stay.

Rand Gesing: Mm-hmm. In terms of the backlog composition, you know, we were talking about, you know, mixed in terms of, you know, margin mix in the quarter, but is there any reason—I guess my assumption is that if I think of the backlog makeup, it probably is somewhat similar to how your revenues were in the first quarter. Is that somewhat fair, or is there any material difference to the backlog makeup versus the revenues, you know, mix you had in the first quarter?

Chris Eperjesy: This is Chris now. In any given quarter there will be a difference just because of the lead times of the various products are different. Industrial products have the shortest lead times and then the longest lead time would be on the oil and gas transmission, so, you know, it's not going to be an exact year of what revenue will be in any quarter any year. As we've been saying for the past few quarters, a big driver of the growth in the backlog has been oil and gas, and in the last couple of quarters it started to—and the growth started to include aftermarket and the other businesses as well. So oil and gas in the last quarter represents a smaller portion of the growth, but still represents a big portion of the backlog.

Rand Gesing: Mm-hmm, okay. All right, I guess that's all the questions I had. Thanks.

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

Shawn Boyd: Hi, congrats on the quarter and thanks for taking the question.

Chris Eperjesy: Thanks, Shawn.

John Batten: Thanks, Shawn.

Shawn Boyd: Just a couple here. If I could Chris on a comment earlier about stock-based compensation. I want to make sure I'm counting this right. I was looking at the press release looking at a $1.1 million reduction on a year-over-year basis. So that puts me at about 800,000 on an absolute basis in the quarter. Is that correct?

Chris Eperjesy: I don't think so. My recollection and I think I'm pretty close on this, is the movement in the stock price had an impact of about 1.4 million in the quarter. The offset to that was just the increase in the underlying awards in the achievement of those awards. So that would take it back to the 1.1, but in reality the stock—the movement in the stock price had a benefit of about 1.4 million.

Shawn Boyd: Okay, so going back to that 15.9 million in ME&A, you know, back in that (inaudible) we've got about 14.5 million in non-stock-based comp expenses?

Chris Eperjesy: Well, and then there was some increase. The 1.1 is still a good number for the quarter of what the effect was. And I'm just seeing 1.4 of it was I use the word good guy. A good guy or a favorable adjustment or reduction in the expense I should say. 1.4 is the result of the movement in the stock price. That was offset by about a $300,000 increase in actual stock bid comp for awards or achievement of awards.

Shawn Boyd: Gotcha, okay. So—

Chris Eperjesy: So the net 1.1 is still what I would (inaudible).

Shawn Boyd: Okay, as the absolute level in the quarter?

Chris Eperjesy: Yes.

Shawn Boyd: Okay, that's helpful. And going to backlog for a second. In terms of the correction that we've seen in the commodity prices, can you talk about the backlog a little bit in how fluid that is. In other words, if we had any (inaudible) cancellations on the 8500, I would think that 7500 is way too young to even think about that. But any kind of shifting of or swapping of delivery schedules, or—

John Batten: No, this is John. No, we have not seen any of that yet, none.

Shawn Boyd: Okay, and on the comment about price increases passing through cost and maybe a little more. Has that plateaued in any way or is that all still pretty fresh?

John Batten: No, it's still pretty fresh and we were watching obviously inflation and surcharges pretty closely to see, you know, if we have to make another move coming up in the near future.

Shawn Boyd: Got it, okay. So the buys is still to the upside there?

John Batten: Yes.

Shawn Boyd: Okay. And we haven't had anybody coming back that's currently in the Q looking for any kind of concession or negotiation on existing price points?

John Batten: No, we haven't.

Shawn Boyd: Okay. The last question from me and I probably ask this every quarter, but there's a reason behind that. Manufacturing capacity, we just did 81 million in the quarter and we did 97 million in the quarter before, but refresh us again on how you look on manufacturing capacity both in the, you know, oil and gas and the other markets as we see improvement outside of oil and gas as well?

John Batten: Yes. Well, I mean, obviously if you look back at the fourth quarter and this quarter, you know, we did not achieve manufacturing capacity in this quarter. I mean, we still can handle growth in all of our facilities. I'm not saying there's not a lot of hard work involved. It involves a lot of outsourcing, duplication of suppliers, and some capital spend inside, you know, our four walls with assembly in test equipment, but we're constantly looking at ways to improve the—increase the capacity at our facilities, and we're not at the limit yet.

Shawn Boyd: Okay, would you venture to say you're at 70% utilization, 80, 90%? Give us anything there to help us on that. And I'm coming at this, I don't mean to really harp on it, but we're beyond those '08 quarters. So that's what really is bringing me to the (inaudible).

Chris Eperjesy: Yes, Shawn, this is Chris. You know, I think, you know, it's a difficult question to answer because there's different manufacturing facilities that provide products for different markets. We have as John was talking about, we have new machinery coming on at expanse capacity. We're adding suppliers with expanse capacity the first quarter versus the fourth quarter. As you know we talk about through the year the number of production days available to us grows, so the first quarter generally is going to be lower than the fourth quarter. So I don't know that we can pin down a number as to what our capacity utilization is. As John says, you know, we have a lot of room for growth. We're adding the capacities we talked about in the past and the keynote with respect to the transmission business as well as just the overall investment program that we've had in the past couple of years, so there's definitely room for continued growth.

Shawn Boyd: Got it, okay. Thanks a lot for the color and congratulations once again.

John Batten: Thanks, Shawn.

Michael Batten: Thank you.

Operator: Thank you. And our next question comes from the line of Dick Kindig with Keeley Asset Management. Please go ahead.

Dick Kindig: Hi, gentlemen. Can you hear me?

John Batten: Yes.

Michael Batten: Yes.

Chris Eperjesy: Yes.

Dick Kindig: Have you ever talked about your market share relative to Cat and Allison?

John Batten: No, we haven't, not in specific numbers. Other than—I would—you know, Allison is in all of the frac transmissions produced, I would say Allison is number one, we're number two. But in the high horsepower, you know, the 3,000 range, I would say that we're number one, Cat is number two.

But in that lower horsepower range, you know, kind of the 2,250 and below, Allison is still the major player.

Dick Kindig: And is it fair to say that with longer laterals and more frac (audio interference) a higher horsepower now, so that there would be a trend towards the 3,000 and up?

John Batten: I would—that is absolutely a fair statement to make. The shift in the market has been towards building the high horsepower rigs.

Dick Kindig: And the 7500 is really introduced to get you into difficult places like Marcellus?

John Batten: Correct. But also, you know, when we started the 7500 project, you know, the horizontal drilling was not as popular or as common as it is now. I mean, it was still designed to get us into that lower 2,250, you know, the big huge market. Body load style rigs, which aren't necessarily a tractor-trailer set up. It's, you know, a 20-foot truck that has the frac pack on the back of it, but certainly now we see the 7500 being used in horizontal drilling.

Dick Kindig: And who are your major customers? Are they people like Stewart & Stevenson or rig builders like that, I don't know who they all are now, but (inaudible).

John Batten: No, Stewart & Stevenson has a pretty tight relationship with Allison. You know, there's Trican in Canada. There's other players in Texas and Canada, and now a growing customer-base in Asia.

Dick Kindig: Does National Oilwell make any of these rigs?

John Batten: Not National Oilwell. I don't believe so.

Dick Kindig: And one other question. Is there—do you have an advantage with your transmissions that others don't? Like it seems to me that there's something about the variable speed ability that transmissions have where Allison for example may just have a constant speed?

John Batten: I think, you know, the advantages with the 7500 are even stepped ratios. It's the transmission that was never designed for a vehicle, and so we designed the ratios and the ratio splits with pressure pumping in mind. We've designed out the torque converter, which is an extra component, extra expense, and we've used our clutch technology to do all of the shifting. And we take great pride in our control system and being able to control the engine and the transmission more precisely and better for the pressure pumping. And then certainly with respect to the 8500, you know, the 7500 is a lot lighter and lets you get on smaller rigs for, you know, the overall frac vehicle size, smaller sizes.

Dick Kindig: So you can't apply those same technologies to the 8500?

John Batten: I don't know if our next step would be to change the 8500 into, you know, the same design criteria as the 7500, or we would add a different model of frac transmission. The 8500 certainly is a proven commodity in its marketplace.

Dick Kindig: Okay, thank you very much.

John Batten: Thank you.

Operator: Thank you. Ladies and gentlemen, if there are any additional questions, please press star, one at this time. As a reminder, if you are using speaker equipment, you may need to lift your handset before making your selection.

And our next question comes from the line of Andrea Sharkey with Gabelli & Company. Please go ahead.

Andrea Sharkey: Hi. I was curious if you could give me a sense at all of how much the 7500 is in your backlog? I believe last quarter it wasn't in your six-month backlog at all, but I was wondering if it's been added and included, and maybe give us a sense of, you know, either in percentages or dollar amounts of how much that is.

John Batten: Yes, Andrea, it's John. We don't disclose the specific amounts, but it is in the backlog now and it's, you know, it's one of the products responsible for, you know, the jump in the six-month backlog.

Andrea Sharkey: Okay. Just to push a little bit further on that, could you give us a sense of, you know, if there was I guess, I think it was a 17 million bump or a 12% increase. You know, was that, you know, 5% of the increase or 10% of the increase sort of arranged?

Chris Eperjesy: You know, this is Chris. I think I'd stick with John's comment and what I said earlier. You know, of that increase that you just quoted, the 17, 18 million increase, you know, it was across the board, it was in the 8500 to 7500 marine products, industrial products, aftermarket, so that you can assume that if all of those things were involved, it wasn't, you know, a $17 million number, but it was a part of that. And I would say all of them, you know, within a reasonable range were very similar.

Andrea Sharkey: Okay, and then just one other question. I think in the past you guys have said that some of the oil and gas transmission orders actually extend beyond the six-month backlog number that you report, and I was just curious if that's still the case and if that's changed at all, either increased or decreased?

John Batten: That is still the same. There's still a very sizeable amount outside the six-month backlog.

Andrea Sharkey: Okay, great. Thanks a lot.

Chris Eperjesy: Thanks, Andrea.

Operator: Thank you. And our next question comes from the line of Robert Zelten, a Private Investor. Please go ahead.

Robert Zelten: Thank you very much. Two quick questions. The last conference call I remembered just a slight cautionary statement about the supply chain, your raw material sources. I'm wondering if you foresee any problems in that area?

John Batten: This is John. No, it actually—the first quarter went very well in that respect and I'm more confident now than I was in, you know, the last—the fourth quarter call. We're working hard to duplicate suppliers, so we have, you know, more than one source. And we've seen some capacity adds in some key components both in North America and in Europe, so I'd say the situation is a little bit better today than it was three months ago.

Robert Zelten: Great, thank you. And this may be a naïve question, not being real familiar with your technology. Does the switch to natural gas as a fuel source by drillers from diesel fuel have any impact on you at all?

John Batten: Well, it does. They're burning natural gas what they're drilling for, but, you know, it's probably a negligible. In the overall demand for natural gas, that's probably a very small component.

Robert Zelten: Okay, thank you.

John Batten: Yes, you're welcome.

Operator: Thank you. And we do have a follow-up question from the line of Robert Sussman with Bentley Capital. Please go ahead.

Robert Sussman: Yes. There's been a number of points made about the benefit of the 1.1 million from the stock price depreciation rates, but on the other hand, you mentioned that there's a $792,000 hit from foreign currency. Can you give us a sense of, you know, what currency is moving against other currency are causing this? And whether this charge may come down in future quarters?

Chris Eperjesy: I'm not going to predict whether foreign—where foreign currency is (inaudible).

Robert Sussman: Yes, I understand that.

Chris Eperjesy: But what I will take the first—this is Chris, I'll take the first part of that question.

Robert Sussman: Okay.

Chris Eperjesy: The majority—our foreign currency that we deal with first, it would be the Euro in terms of just magnitude. And then you have the Asian currencies and Australia which—also the Asian Pacific. So it's all of those currencies I just said, and all of them had an impact in the quarter.

Robert Sussman: Does the dollar strengthening or weakening against these currencies help you?

Chris Eperjesy: Well, both in some respects because we—you know, you have the translation effect of a higher bureau or other foreign currency, but we also manufacture in some of those currencies and ship to the U.S. So, you know, there's somewhat of a natural hedge in place there, but, you know, there are places that we prefer a certain exchange rate versus others.

John Batten: Robert, it's John. I'd just like it to be stable.

Chris Eperjesy: I would agree with that.

Robert Sussman: Wow. I don't think they care what we hope for.

John Batten: Yes, exactly.

Robert Sussman: One other thing, can you give us some sense of the price difference, the ASP of the 8500 versus the 7500? Not in specific dollars, but is it a 20% premium, a 30% premium?

John Batten: It's about—the 8500 is about 20% higher than the 7500.

Robert Sussman: Okay.

John Batten: And 25.

Robert Sussman: Should the margins be relatively similar between these products, or will a slower ramp-up in the 8500 mean lower margins at first?

John Batten: Well, the ramp-up will be in the 7500. Eventually, they will be, you know, within single digits of each other.

Robert Sussman: Okay.

John Batten: But anytime you bring, you know, the product into production, your gross margins will be lower for the first year or so.

Robert Sussman: Okay. Okay, thank you very much.

John Batten: Thank you, Robert.

Operator: Thank you. And we do have another follow-up question from the line of Rand Gesing with Neuberger Berman. Please go ahead.

Rand Gesing: Hi, can you hear me?

John Batten: Yes, that's fine.

Rand Gesing: My question was answered, but I thought of another one that I don't think you're going to answer, but anyway can you give us the number of 8500's you shipped the last fiscal year?

Chris Eperjesy: You're right, we're not going to answer that one.

Rand Gesing: I thought it was late in the call, you were all (inaudible) anyway. All right, thank you.

John Batten: Thanks, Rand.

Operator: Thank you. Ladies and gentlemen, if there are any additional questions, please press star, one at this time. And management, I'm seeing no questions in the queue at this moment. Please continue with any closing remarks.

Michael Batten: Thank you, Patricia. Thank you again everyone 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 you have any follow-on questions, however, please feel free to contact Chris, John, or me. We look forward to speaking with you again in January following the close of our second quarter. Patricia, we'll now turn the call back to you.

Operator: Thank you. Ladies and gentlemen, this does conclude the Twin Disc Incorporated First Quarter Fiscal 2012 Financial Results Conference Call. This conference will be available for replay after 4:00 p.m. Eastern Standard Time today. You may access the replay system at anytime by dialing 1-877-870-5176 and entering the access code of 4480206. Thank you for your participation and you may now disconnect.