Twin Disc Inc.
Fourth Quarter Fiscal 2013 Financial Results
July 30, 2013

Operator: Good day ladies and gentlemen. Thank you for standing by, and welcome to the Twin Disc Incorporated Fourth Quarter Fiscal 2013 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, and if you have a question at that time, please press the star, followed by the one on your touchtone phone. If you would need assistance at any time during the call, please press star, zero for operator assistance. For participants using speaker equipment, it may be necessary to pick up your handset before making your selection.

I would now like to turn the call over to Mr. Stan Berger. Go ahead, sir.

Stan Berger: Thank you, Jo (ph). 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 2013 fourth quarter and full-year 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 the copy to you.

Hosting the call today are Michael Batten, Twin Disc's Chairman and Chief Executive Officer; John Batten, President and Chief Operating Officer; and Chris Eperjesy, the Company's Vice President of Finance, Chief Financial Officer and Treasurer.

At this time, I will turn the call over to Michael Batten. Mike?`

Michael Batten: Thank you, Stan, and good day everyone. Welcome to our fiscal 2013 fourth quarter conference call. As usual, I will begin with a short summary statement, and then John, Chris, and I will be happy to take your questions.

First, I would like to cover a few of the highlights of the quarter and fiscal year. It was a year of transition. As predicted and primarily due to continuing weakness in the North American oil and gas market, our financial results have had a hard time keeping pace with the record sales and earnings reported last year, but they are in line with our expectations. Partially offsetting these results, our sales to China have grown substantially to the point that it now ranks as our second-largest market outside of the United States. Also indicative of our emerging market strategy, we announced the opening of a new manufacturing facility in India. Our balance sheet remains strong and we continue to generate strong cash flow. Finally, our six-month backlog is showing signs of improvement.

Sales for 2013 fourth fiscal quarter were 75.9 million, down from 96.1 million for the same period a year ago. For the fiscal year 2013, sales were 285.3 million, compared to a record 355.9 million for fiscal year 2012. The decline in revenues was primarily a result of lower demand from the North American oil and gas sector, as well as softness in sales to our European customers. Partially offsetting the decline in sales was higher demand from the North American and Asian commercial marine markets, as well as steady, strong levels of demand from the China pressure pumping market. Meanwhile, demand from the mega-yacht market remained at historic lows throughout the fiscal year, while demand remains steady for equipment used in our airport rescue and firefighting and Legacy military market.

Our gross margin for the quarter was 27.2%, compared to 29.4% in the same quarter a year ago; and 25.9% for the 2013 third fiscal quarter. For the full fiscal year of 2013, gross margin was 28.1%, compared to 34.2% in fiscal 2012.

Spending for marketing, engineering, and administrative expenses declined both for the 2013 fiscal fourth quarter and for the fiscal year by 2.2 million to 17.1 million, and by 5.2 million to 67.9 million, respectively. These decreases are attributable primarily to stock-based and incentive bonus (ph) compensation.

In connection with preparing the financial statements for fiscal year 2013, the Company recorded an impairment of 1.4 million, or $0.12 per diluted share, which represents the remaining intangibles and fixed assets of an Italian distribution entity for which the Company expects to terminate the distribution agreement. In fiscal year 2012, the Company took an impairment charge of 3.7 million, or $0.32 per diluted share, for the write-down of goodwill at an Italian manufacturing operation due to softness in the Italian mega-yacht market.

The Company also recorded a $708,000, or $0.06 per diluted share, restructuring charge in the fiscal 2013 fourth quarter, representing the minimum legal indemnity for a targeted workforce reduction at the Company's Belgium operation, along with the costs associated with the elimination of a corporate officer position. With the Belgian negotiations completed in July, the Company will record an additional restructuring charge of approximately 1.1 million in the fiscal 2014 first quarter.

Moving to the bottom line, the Company reported net income of $47,000, or $0.00 per diluted share, for the fourth quarter compared to 1.3 million, or $0.11 per diluted share, for the same three months last year. For the fiscal year 2013, net earnings were 3.9 million, or $0.34 per diluted share, compared to 26.7 million, or $2.31 per diluted share, for fiscal 2012.

EBITDA for the fourth quarter was 4.7 million, compared to 8.8 million last year. For fiscal 2013, EBITDA was 21.1 million, compared to 56.8 million a year ago.

Positive changes in working capital due to reductions in receivables and inventories allowed the Company to generate 24.5 million of cash from operations. As a result, we reduced debt and invested in strategic capital expenditures.

As indicated above, fiscal 2013 was a transitional year for us. Our efforts to develop our geographic diversity have led to China becoming our second-largest market, accounting for more than 10% of our sales. Further, as for the last six years, our sales outside the United States have averaged above 50% of our total sales.

In addition to diversifying our sales geographically, after several years of developing our supply base, we expanded our manufacturing footprint with the commissioning of a facility near Chennai, India. This plant, which is already operating profitably, is producing industrial clutches and power take-offs for the global market. We expect to add other products in due course.

Looking ahead, our six-month backlog stood at 66.8 million at June 30, 2013, compared to 64.9 million at March 29, 2013, and 98.7 million at June 30, 2012. The sequential improvement represents the first increase in seven quarters. While we believe that our backlog has bottomed, we do not anticipate a demand curve similar to our last recovery; rather, the first half of fiscal 2014 will be influenced by the same dynamics that have affected our business during the past year; that is, demand from global commercial marine customers and international oil and gas opportunities will be somewhat offset by continuing weak demand from European and global mega-yacht customers. We are, however, cautiously optimistic about the improving prospects from the North American energy markets for the second half of the fiscal year.

Longer term, we are well positioned to take advantage of the global opportunities ahead of us. Our leading position in the markets we serve, our innovative product development, and our geographic diversity reflect a sound strategic plan for the future.

Finally as previously announced, at its June board meeting, our Board of Directors elected John Batten to the position of President and Chief Executive Officer, effective November 1, 2013. I will retire as an employee effective December 31, 2013 and assume the position of non-executive Chairman of the Board of Directors. We have an experienced and strong management team, and the Board and I have full confidence that they will take the Company to new levels of achievement in terms of growth and creation of shareholder value.

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

Operator: Thank you, sir. Ladies and gentlemen, at this time we will begin the question and answer session, and 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. If you are using speaker equipment, you will need to lift the handset before making your selection. One moment for our first question.

Our first question comes from the line of Peter Lisnic with Robert W. Baird. Go ahead, sir.

Josh Chan: Hi, this is Josh Chan filling in for Peter. Good morning Mike, John and Chris.

Michael Batten: Hi Josh.

Josh Chan: Hi, good morning. Just first question on your comment about the North American oil and gas market, how it could potentially improve in the second half of '14, just wondering how you are formulating that view on timing. Was it based on discussions with customers? Have you actually received orders? Just some color on how you are thinking about the timing of the recovery there.

John Batten: Well, it's a couple things. We've talked to some of our key customers. There's no commitment at that point of coming back, but if we look at the last gap, depending upon the customer, 18 to 24 months, that would indicate a recovery sometime in the first half of calendar 2014. But we're also starting to have more dialogue on what lead times are and things like that; so, nothing has hit the backlog yet obviously but that would be our indication of when the first signs of some new construction would occur.

And again, just to echo on the comments from Mike, not necessarily anticipating the rapid rise in construction that we saw two years ago, but I'm confident that we'll start to see some new construction in calendar 2014.

Josh Chan: Okay, and what would be the lead time, at least initially, if demand starts to recover on the new construction side?

John Batten: We're well under six months for both the 8500 and 7500 – you know, probably right now in the range of four to six months. Don't know how long that lead time would last. It's depending upon on how many orders come in, but we certainly can react within six months.

Josh Chan: Okay, great. And then moving onto China, just based on your mix of products there, would it be safe to conclude that maybe oil and gas is more than half of what you sell there? Just trying to get a sense of what kind of products you're selling there and what's the mix.

John Batten: No, still the largest segment for us in China is commercial marine.

Josh Chan: Okay, okay. And then on gross margin, you have been negatively impacted by both volume and mix in the recent quarters, so as we look into the next year, have we gotten to the point where mix is no longer a drag or an issue, and maybe volume becomes the primary driver of gross margin for at least the near term? Is that the right way to look at it?

Chris Eperjesy: Well, I guess the way to answer that, Josh, is if mix doesn't change, then correct.

John Batten: Yes.

Chris Eperjesy: So in other words, if we don't expect to see a recovery of North American oil and gas, then correct, volume would be the primary driver.

Josh Chan: Okay, but there's no necessarily negative comparison of North American oil and gas remaining, I guess?

Chris Eperjesy: There may have been some shift in the first quarter of last year, but it wouldn't be significant.

Josh Chan: Okay, great. Okay, thank you for your time, and congrats, Mike, on your upcoming retirement, and John, your promotion.

John Batten: Thanks Josh.

Michael Batten: Thank you, Josh.

Operator: Our next question comes from the line of Peter van Roden with Spitfire Capital. Go ahead, please.

Peter van Roden: Hey guys.

John Batten: Hi Peter.

Michael Batten: Hello, Peter.

Peter van Roden: Just a quick question on the pressure pumping side. How much of your demand, and I know there's not really a normal year but let's just try to find a normal year, will come from replacement demand versus new machines?

John Batten: Oh boy. You know, I would say—your comment is right. It's hard to find a normal year. The vast majority has been for new construction; so you can have—I would say for replacement on existing rigs, maybe—it ranges from 5 to 20%, given the year. There really is no real good trend there.

Peter van Roden: Okay, and do you expect that to, sort of, tick up as these—

John Batten: I expect—yeah, going forward I think the trend might be higher. There will be a higher percentage of replacement as opposed to complete new rig construction.

Peter van Roden: Yes, okay. And then just in terms of trying to size the opportunity, or if you have an opportunity for the whole company, if all of your segments are sort of going at a normal pace, what would be, kind of, max capacity, max revenue that you guys think you could do?

John Batten: Wow. If everything were going max, with the addition of India, I mean, we're certainly over 500 million.

Peter van Roden: Okay, that's helpful. And then just one quick question, and I don't know if you guys can answer this, but who is making the transmission for the new Halliburton (ph) pressure pumping unit?

John Batten: I believe that is Allison.

Peter van Roden: Okay. All right, guys, that's all I have. Congratulations on a good quarter.

John Batten: Thank you.

Operator: Once again ladies and gentlemen, if you wish to ask a question, it is star, one on your touchtone phone at this time. Star, one if you wish to ask a question.

Gentlemen, it appears we have no questions at this time. I'll turn it back to management at this time.

Michael Batten: Okay, thank you, Jo. We'd like to thank you again for joining our conference call today, and we appreciate your continuing interest in Twin Disc. We hope that we've answered all of your questions, and if not and you've got follow-ons, please feel free to call Chris, John, or myself. We look forward to speaking with you again in October following the close of our first quarter.

Jo, I'll turn it now back to you to terminate the call.

Operator: Thank you, sir. Ladies and gentlemen, this does conclude the Twin Disc Incorporated Fourth Quarter Fiscal 2013 Financial Results Conference Call. Thank you for your participation. You may now disconnect.