Twin Disc, Inc.
Second Quarter Fiscal 2013 Financial Results Conference Call
January 22, 2013

Operator: Good day, ladies and gentlemen. Thank you for standing by. Welcome to the Twin Disc, Inc. Second 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 opened up for questions. If you have a question, please press the star, followed by the one on your touchtone phone. Please press star, zero for Operator assistance at any time. For participants using speaker equipment, it may be necessary to pick up your handset before making your selection. This conference is being recorded today, January 22nd, 2013.

I would now like to turn the conference over to Stan Berger. Please go ahead.

Stan Berger: Thank you, Ian. 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 second quarter and first half 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 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 today are Michael Batten, Twin Disc Chairman and Chief Executive Officer; John Batten, President and Chief Operating Officer; and Christopher 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 Second Quarter Conference Call. I will begin with a brief summary statement and then John, Chris, and I will be ready to take your questions.

Our second quarter results reflect continuing weakness in the oil and gas industry, offset somewhat by improving conditions in the global commercial marine markets. Our near-term outlook remains challenging as we work through the bottom of the energy cycle, although we anticipate that demand will resume for our fiscal year 2014.

Looking at the results for the quarter, sales for the second fiscal quarter of 2013 were 72 million, down from a record 83 million for the same period a year ago. Sales for the first six months were 141 million, compared to 164 million for the prior year. The decrease in sales was primarily the result of lower demand from customers in the pressure pumping sector of the North American oil and gas market. Offsetting those weaknesses in this market was higher demand from customers in the North American and Asian commercial marine markets. Sales to customers serving in the global mega-yacht remained at historical lows for the quarter, while demand remained steady for equipment used in airport, rescue, and firefighting and military markets.

Our gross margin for the second fiscal quarter was 30.8%, compared to 35.6% in the same period last fiscal year, and 28.2% in the fiscal 2013 first quarter. The anticipated decline in gross margin was the result of lower sales volumes and less profitable mix of business. Year-to-date gross margin was 29.6%, compared to 36.7% for the first half of fiscal year 2012.

Our marketing, engineering and administrative expenses for the second quarter of fiscal 2013 were 23.2% of sales, compared to 24.2% of sales for the same period a year ago. ME&A expenses decreased 3.3 million in the quarter due primarily to reduced stock-based compensation and annual bonus expenses compared to the previous year. On a year-to-date basis, ME&A expenses decreased 2.6 million from the same six months the prior year, primarily as a result of reduced stock-based compensation and bonus expenses, offset somewhat by increased R&D activities, wage inflation, and additional headcount.

The effective tax rate for the first half of fiscal 2013 is 38.3%, which is slightly higher than the prior-year rate of 35.6%. The current year rate is somewhat inflated due to the non-deductibility of the losses in certain foreign jurisdictions during the first half, due to an ongoing valuation allowance determination. The favorable impact of the recently extended R&D tax credit, estimated to be approximately $500,000, will be recorded in the third fiscal quarter.

Net earnings attributable to Twin Disc for the fiscal 2013 second quarter were 3.4 million, or $0.29 per diluted share, compared to 5.8 million, or $0.50 per diluted share, for the fiscal 2012 second quarter. Year-to-date net earnings attributable to Twin Disc were 4.6 million, or $0.40 per diluted share, compared to $15.5 million, or $1.34 per diluted share, for the fiscal 2012 first half.

EBITDA for the second quarter was 8.2 million, compared to 12.3 million for the same period a year ago. For the first six months, EBITDA was 13.5 million, compared to 30.1 million last year.

Our balance sheet and liquidity continued to improve during the second quarter, despite elevated inventory levels required to support growing markets. We generated 12.1 million in cash from operations in the quarter to increase our overall cash position to 20.6 million.

During the quarter, the Company and a European subsidiary entered into a $15 million multi-currency revolving credit agreement with Wells Fargo Bank that will provide our global operations with greater borrowing flexibility.

Also during the second quarter, we repurchased 185,000 shares of our common stock at an average price of $16.59 per share for a total cost of 3.1 million. We have 315,000 shares remaining under our current authorization.

Capital expenditures through the first six months totaled 3.5 million, and we anticipate 10 million in capital expenditures for the fiscal year.

Turning now to our outlook; as we stated last quarter, our fiscal 2013 results will be challenged by a decline in market activity in North America for our pressure pumping transmissions. Despite the lack of demand from this market, we were able to keep the second quarter gross margin above 30% and maintain our overall profitability. This is a testament to our end market and geographic diversity, and flexible manufacturing operations.

Our six-month backlog at December 28, 2012 was 68 million, compared to 82 million at the end of the first quarter, and 149 million a year ago. As discussed, the decline in backlog reflects continued weakness in demand from the oil and gas industry. While the near-term outlook from that market is going to be more challenging than originally expected, we continue to anticipate a recovery in 7500 and 8500 pressure pumping transmission sales in fiscal 2014, which will be augmented by growing demand from customers in the commercial marine, industrial, legacy military and ARFF markets. We are optimistic that we are well positioned to capitalize on the longer-term trends in all of our end markets.

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

Operator: Thank you, sir. As a reminder, if you'd like to ask a question on today's call, please press the star, followed by the one on your touchtone phone; if you'd like to withdraw your question, please press the star, followed by the two; and if you're using speaker equipment, you will need to lift the handset before making your selection. Just one moment for our first question.

Our first question is from the line of Josh Shan (ph) with Robert W. Baird. Please go ahead.

Josh Shan: Hi, good morning, Mike, John and Chris.

John Batten: Good morning, Josh.

Josh Shan: Good morning. I was just wondering about your view that the North American oil and gas outlook might improve in fiscal '14. I was wondering if there's anything that you're hearing specifically that gives you that confidence in terms of the timing.

John Batten: Yes, I guess the first thing that we're hearing is just, you know, initial discussions for projects and tentative orders, and knowing when these projects and orders would be, the first orders would fall into our fiscal 2014. So, we're starting to see some activity, some initial requests for timing. So, that's what's giving us hope that the recovery is going to start in 2014. We also have been very pleasantly surprised to hear that some of our equipment that's been sitting in North America in finished rigs has begun to shift to Argentina and Australia. So, it looks like that even though the market has been pretty slow as far as new rig construction, that some of that idle inventory is being used up and sent abroad.

Josh Shan: Okay, that's definitely a positive. When you talk about orders, timing being in fiscal '14, so does that mean that the translation into revenue probably occurs in the second half of fiscal '14? Is that the more likely outcome?

John Batten: It may start sooner than that, but it's certainly not going to have a big impact on the rest of fiscal '13.

Josh Shan: Okay, okay.

John Batten: I would anticipate, as we get farther into fiscal '14, oil and gas North America will be stronger.

Josh Shan: Okay, great. You alluded a little bit to international markets. Could you talk about international oil and gas and how that trended in the quarter for you?

John Batten: I would say almost all of the oil and gas in the second quarter was overseas and predominantly China. That's part of the problem that we ran into with the inventory. The inventory or manufacturing subs actually came down during the quarter, but there's a long transit time to get to Singapore and then into China. So, a lot of the inventory basically is on the water right now headed first to Singapore and then into China.

Josh Shan: Okay. Typically, your business, overall, is a bit stronger in the second half versus the first half. Do you think that's still a reasonable outlook this year, given the movement in the backlog?

John Batten: I think that is going to be harder this year. I think if you look at where our backlog has settled, and we think it is pretty much at the bottom—it kind of was bouncing around the bottom within the quarter. Any time the backlog bottoms out, the next quarter or two are going to be challenging. We're still optimistic that we could have a comparable second half as the first half, but it's going to be challenging, Josh. Just given where the backlog is right now, we know that any type of oil and gas drop in orders now really wouldn't be until fiscal 2014. So, we're running out of time to fill in the second half.

Josh Shan: Okay, that's make sense. I guess, the 30% gross margin that you guys achieved this quarter was certainly impressive, so assuming volume stays kind of the same, as you've alluded to, is the 30% sustainable, or is there anything unusual there?

John Batten: I think you're going to see margins in the third quarter more in the mid twenties to high twenties, something in that area, high twenties. It will be very tough for us in the third quarter to hold the 30% gross margin.

Josh Shan: Okay, great. Thank you for your time.

John Batten: Thanks, Josh.

Operator: Thank you. Our next question is from the line of Andrea Sharpey (ph) with Gabelli. Please go ahead.

Andrea Sharpey: Hi, good morning.

John Batten: Good morning, Andrea.

Andrea Sharpey: A lot of my questions were just asked, but maybe just a little bit more on the inventory, on the pressure pumping transmissions. I think last quarter you guys said there was about three to six months in excess inventory sort of in all the different channels. Is that about the same, or is that coming down a little bit now?

John Batten: I think it's different. When I said three to six months, probably I meant North America.

Andrea Sharpey: Right.

John Batten: China is consuming as they need it. Andrea, I'm hopeful that it's a little bit less now, because I think some of the idle inventory has worked its way into production, into operation in North America, and what we've heard is that the rigs that are going to Argentina and Australia are from the North American fleet. So, hopefully, that's working down the unused inventory.

Andrea Sharpey: Okay.

John Batten: If it was three to six months last quarter, you know, maybe you're looking at two to four, average of about three now, but definitely the situation is getting better.

Andrea Sharpey: Okay, great, that's helpful. Then, you know, as you were saying that your backlog—you think your backlog has now bottomed. I guess, what gives you confidence that it's not getting any worse? Is it just that the North American orders and demand, that what's in your backlog now is pretty much nonexistent, or just that maintenance run rate and so there's really not much more that it can drop is that what's making you think that?

John Batten: I guess what's giving us confidence is that the backlog actually bottomed out during the quarter and we saw it come up within the quarter, and just the overall optimism in each one of our end markets about what's going to happen, and most of our customers deal in calendar '13, they're pretty optimistic on a very good calendar '13. So, you know, I expect to see that the backlog will not have gotten any worse. It may not get much better in the third quarter, but we've hit the bottom and it should start to come up. The one component that's been hard to tip is North American oil and gas, and that is pretty much down very significantly. So, that can't get much worse. I can only see that improving as we go forward.

Andrea Sharpey: Okay, great, that's helpful. Then, I don't know if this is maybe not important, but I've been seeing a lot of companies that are saying they're switching their pressure pumping trucks and their rigs to run on natural gas instead of diesel. Does that have any impact on your oil and gas transmissions, or your transmissions can just go on the trucks regardless?

John Batten: That has more impact on—I don't want to say a hundred percent it doesn't have much impact on our transmission, but that has more of an impact on the engine, and we certainly can run behind an engine that's running on natural gas.

Andrea Sharpey: Okay, great, and then maybe just one more on a different end market. I think I read something, that you guys are producing a next-generation transmission for the airport, rescue, and firefighting end market. I was just wondering if you can give us some details on that, what that is, how that's going in terms of customer adoption, and potential revenue growth and … (cross talking).

John Batten: Sure. As far as revenue, that wouldn't hit until probably the end of the fiscal '14, into 2015, and that is—this market, which started off as a niche market, is even becoming more of a niche market, because this is truly an off-road specialty vehicle, but it's being held to on-highway emission standards, and so it's a lot more challenging application on the engine, and a lot of engine manufacturers have dropped on-highway in this power range. It is a much challenging application for a transmission, because they have to meet certain acceleration requirements, and so a lot of transmissions that are being used today will not be able to use just because of the torque levels of the new engine. So, as we're coming out with the new transmissions, our 4000 series, we're going to have a pretty good place in the market with this, because there are going to be not many other competitive products that can handle this.

Andrea Sharpey: Okay, great. Thanks a lot.

Operator: Thank you. Our next question is from the line of Jon Braatz with Kansas City Capital. Please go ahead.

Jon Braatz: Good morning, gentlemen.

John Batten: Good morning, John.

Jon Braatz: Did I understand correctly that you said there were no sales to the—transmission sales to the North American oil and gas market in the quarter?

John Batten: No, there were some, but it was heavily weighed towards China.

Jon Braatz: Right, right, okay.

John Batten: There were a few, but a complete flip of what we've been seeing. As far as China being a small percentage and North American being the majority, it completely flipped in the quarter.

Jon Braatz: Okay. I'm trying to get a better idea of the size of change that we've seen here. During the peak period, a couple of quarters ago or a year ago, I think you had referenced that oil and gas was maybe about 30% of revenue, something of that magnitude.

John Batten: Mm-hmm.

Jon Braatz: Can you give us an idea of where that has fallen to?

John Batten: I mean, we're down—year-to-date, we're down more than half in oil and gas.

Jon Braatz: So, about 15%?

John Batten: More or less, that would be the order of magnitude, yes.

Jon Braatz: Okay. So, obviously, the North American segment even greater and that's offset by the increases in China?

John Batten: Yes. The second half of the year was incredibly—the second half of fiscal '12 was equally as strong, and we're not going to have a strong second half in oil and gas this year.

Jon Braatz: Okay. When you look out towards 2013—sorry, 2014, and maybe beyond, the oil and gas market in North America probably won't be as heady (ph) as it once was, but when you sort of look at what some of your customers are telling you, how much do you think that could ratchet back if—I mean, is there an environment where we can get back to that 30% level just because of the strength of China and some resumption of growth in the United States, or, you know, what kind of recovery do you think could you envision at this point?

John Batten: I'm going to answer it a couple of ways. I think we can get back to our peak.

Jon Braatz: Okay.

John Batten: It's going to be with the addition of the 7500 coming on and sustained levels in Asia, meaning that I don't see the peak in North America necessarily coming back to its previous peak. I see us having a bigger market share with the 7500 and then ongoing growing business outside of the

U.S. I don't—in retrospect, looking back at the last bubble in North America, it is clear that everybody overbuilt, and maybe a lesson was learned and that won't happen next time, but I think we can get back to close to those peaks with the two different components, the 7500 and Asia.

Jon Braatz: With a more balanced environment, and maybe pricing won't be as strong, I'm not sure, but with a more balanced environment, do you think you could return to the same margin level?

John Batten: Yes.

Jon Braatz: Okay. Thank you.

John Batten: Thanks, John.

Ian, are you there?

Operator: Yes, I apologize; our next question is from the line of Brian Uhlmer with Global Hunter. Please go ahead.

Brian Uhlmer: Hey, good morning.

John Batten: Hi, Brian.

Brian Uhlmer: I have quick questions. What was the manufacturing and distribution revenue breakdown this quarter?

Christopher Eperjesy: You know, Brian, I apologize, I don't have those at my fingertips. We're still finalizing our segment disclosures to the Q. My apologies, I don't have those exact figures.

Brian Uhlmer: No worries, but even I was doing relatively flat … (cross talking).

Christopher Eperjesy: Distribution had a relatively strong quarter, for a lot of the reasons John was talking about, with Asia and Singapore.

Brian Uhlmer: Okay, got it, which implies that orders were up sequentially Q1 to Q2; is that correct?

Christopher Eperjesy: No, I don't think that would be correct, because we reduced our backlog by about 14 million.

Brian Uhlmer: Okay, and of your orders in Q2, if I'm doing this right, around the 40, 50 million range, what percentage of that do you believe was oil and gas? I mean, can you break down the various segments between oil and gas, ARFF and mega-yacht, your segments a little bit in more detail?

Christopher Eperjesy: No. As I think we've talked about in the past, we don't generally break down revenue by those end markets. I'll leave it kind of where John said, that in the quarter, certainly year-over-year, that market's down more than 50%, the oil and gas market, and we have seen some pretty significant growth in the commercial marine market, but we don't disclose further than that.

Brian Uhlmer: Sure, okay. Can you give us a little update on Caterpillar, on the JV, and if you have started to receive—where we are in that process, and when we're going to start seeing orders and revenue flow through from that?

John Batten: First of all, Brian, just to clarify, it's not a JV, it's a supplier arrangement.

Brian Uhlmer: Right, yes.

John Batten: We've completed a handful of CAT360 vessels, which our application teams have signed off on, so we've got about three to six CAT dealers that are out now actively selling and can sell the Joystick System®. So, we'll start to see orders in the second half of the year and into fiscal '14. The other project which is supplying our QuckShift® and Joystick technology into their product, we're still probably a year-and-a-half away from when we would see revenue from that. They're probably a year-and-a-half, 18 to 24 months from production. So, we wouldn't see that impact, really, until late fiscal '15. But, we will start to see some impact the later part of this year and fiscal'14 for the Joystick component.

Brian Uhlmer: Okay, that's very helpful, thanks. Then, a final one, just before we talk about your margins, I think they've outperformed my expectations by several hundred basis points this quarter, so when we look at that, how much of that breakdown do you think was operating leverage, how much was mix, and kind of what were the various constituents that led to kind of that outperformance versus your expectations and our expectations?

John Batten: Sure. I guess maybe part of it was we had the fewest number of—not few, but we had a lot of shutdowns in the first quarter, and we had more or less the same type of mix of business from the first and second quarter, but we had more working days and more shipping days; and so the relative strength within the quarter, not versus last year or the year-ago quarter, oil and gas was still—there were still some good shipments during the quarter, so that helped. What's going to hurt in the third quarter is we do have fewer shipping days and we just have a lot lower mix of oil and gas in the third quarter. So, that's why we're saying that holding 30% for the third quarter is going to be difficult, and from what your expectation was of the second quarter, I'm guessing the third quarter is going to be more in line with what you're expecting in the second quarter.

Brian Uhlmer: Perfect, perfect, thanks. My final quick question is—you were talking about Argentina and Australia. I'm just clarifying that those were units that were already built that were sitting in North America and were shipped over there.

John Batten: That's correct.

Brian Uhlmer: Do you have any idea on the count, on the number of units? Are we talking 10, 20, 30, any … (cross talking).

John Batten: I don't. I think we're talking about—it's for both places—more than 10, fewer than 50. I think we're probably looking at maybe two to three spreads for each country, and then I think what we're waiting for is for them to get them up and operational and then more spreads would follow.

Brian Uhlmer: And was that a variety of customers or just one?

John Batten: It's been two customers.

Brian Uhlmer: Two, yes, got it. Thank you. I really appreciate that.

John Batten: Thanks, Brian.

Operator: Thank you. Our next question is from the line of Tim Fronda with Sidoti & Company. Please go ahead.

Tim Fronda: Good morning. Just a couple of follow-up questions. With the slowdown in the oil and gas market, what would you say sets you apart from competitors and may make you better able to handle the current weakness there?

John Batten: I think what's been coming out of this which is really good is the feedback we're getting on our life, particularly the 8500s, because those are the most units out there, and that the 8500 is far surpassing expectations on time between overhauls, and so I'm very hopeful that we're building up more loyalty as we head into the next ramp-up. So, you know, it's been slow for everybody, but it's nice when you visit with customers and you hear positive things about your transmissions in the field.

Tim Fronda: Okay. Can you explain a little bit more, just the actions you're taking now in anticipation of a recovery in fiscal '14?

John Batten: Sure. I mean, we—when you go back to fiscal 2010, heading into 2010, it was a much different outlook, a lot more uncertainty, so we were getting rid of any inventory that we could, including oil and gas. That is not the case this time. We are well positioned both with raw materials, some finished bearings, clutch plates and, you know, agreements with our suppliers, that we feel that we'll be able to react much quicker than we even did the last run-up, when it comes. So, we're much better prepared this time than we were last time for the next run-up.

Tim Fronda: Great. Thanks for you time.

John Batten: Thanks, Tim.

Operator: Thank you. Our next question is from the line of Rand Gesing with Neuberger Berman. Please go ahead.

Rand Gesing: Hey, good morning.

John Batten: Good morning, Rand.

Rand Gesing: As it relates to oil and gas, what are you guys seeing in terms of international orders that are sort of incoming? Is it still mainly China, or what other geographies?

John Batten: Well, I'd say China, because China seems to be the farthest along as far as building the rigs in-country with either American and German engines or American transmissions and pumps. So, they're building their own rigs. So, we are getting orders from China and we're delivering to rig manufacturers in China. What seems to be the case—and just following on Australia and Argentina—is that they are, at least for now, buying rigs that are being produced by North American producers. So, you know, will Argentina and Australia start to build their own frac rigs? I can see Australia getting into frac rig production sooner than Argentina. So, for the next year or two, I foresee any demand going to Argentina or Australia being produced in North America. Does that help, Rand?

Rand Gesing: Would your assumption be that that equipment would be equipment that was already built for North America …

John Batten: Yes.

Rand Gesing: … instead of having any new build activity?

John Batten: I think they would use up existing inventory in North America, and then continue to buy from those same suppliers. That's what I see right now, but that can change, and Australia has such an advanced, you know, marine industry as far as boat building. I mean, they could easily build the frac rig if they wanted to. It would not be a stretch at all. It's just do they want to do that or do they—the Australian dollar is so strong right now that they are probably getting a pretty good deal importing from the U.S.

Rand Gesing: Right. I was trying to get a sense for, you know, you guys actually having the manufacturing heat back up backup from those markets versus just soaking up excess capacity that's already out there, but it sounds like for the next year or so we're going to still be soaking … (cross talking).

John Batten: Well, I think it'll be the first part of 2013, they'll be helping to use up the existing inventory in North America.

Rand Gesing: Yes, okay. Any of the other markets—it sounds like, you know, from your earlier comments that things are still pretty solid. I was just wondering are there any other markets, key markets that are somehow gone a little more cautionary yellow in your mind? It didn't sound like that from the commentary, but I just wanted to ask the question.

John Batten: No, I mean, there's nothing—the markets, the two that are moving are oil and gas, North America obviously slowing way down, but in the flip side we've seen nice growth for commercial marine markets, particularly in North America and Asia. The rest of the markets are kind of, you know, just, you know, they're not coming—in any one month they could be going down a little bit and coming back up, but no real exciting movements either way. It's been North American oil and gas coming way down, but on the flip side commercial marine, you know, going way up.

Rand Gesing: Okay, all right. In the quarter, we had a nice operating cash flow. What are your expectations for the second half? Shall we see that in each of the next quarters?

John Batten: I would see a little bit more cash generated from a reduction in inventories. As we finally move out the product that is shipped to Asia, we'll see some good cash generation there.

Christopher Eperjesy: Rand, this is Chris. Just to repeat what John said, I would expect a continuation of the same. And just to answer an earlier question, because I now have the figures, the manufacturing was down roughly 15% in that segment, distribution was up roughly 15% year-over-year. Now, manufacturing is much larger, that's why you see a net reduction. So, some of what we'll see, as John's talking about, with respect to inventory, will be as a result of what's going on with the distribution operations, in particular, in Asia.

Rand Gesing: Okay, that's it for me. Thanks, guys.

Operator: Thank you. Our next question is from the line of Jay Foley, who's a Private Investor. Please go ahead.

Jay Foley: Yes, good morning, gentlemen.

John Batten: Good morning, Jay.

Jay Foley: Staying here in North America just for a second, is Twin Disc withdrawing from the old mechanical Power Take-Offs or (inaudible) clutch market? I ask that because when I'm at trade shows, I see very few new equipment using Twin Disc PTOs.

John Batten: No, we're not withdrawing with it. Part of this thing that you see are the products that have been produced in China, you know, very price sensitive. We're seeing—the market is fracturing a little bit—very price sensitive on the mechanical PTOs, but then there's also a trend towards higher-technology products, whether it's hydraulically controlled dry clutches type PTO or hydraulic PTO, meaning a wet clutch like you'd see in our marine transmission. More and more of our business has been migrating to the higher-technology component of the industrial market. But, having said that, we continue to work with outsourcing and trying to find more cost-competitive suppliers so that we can make our baseline technology, the simple mechanical clutch PTO, more competitive.

Jay Foley: Thank you.

John Batten: You're welcome.

Operator: Thank you. Once again, if you'd like to ask a question on today's call, it is star, one on your touchtone phone. Press star, one to ask a question.

We do have a question from the line of Tony Gikas with Allerion Asset Management. Please go ahead.

Anthony Gikas: Good morning, guys. Just a couple of little follow-ups on the inventory. Could you just give us a little more detail about the—you know, just characterize the inventory, what parts of the business are you supporting there, and then should we see the inventory come in, you know, in the next three to six months and trend more in line with sales; and then the last question, in the second half, should we expect to see those ME&A expenses continue to be in a prudent zone, if you will?

Christopher Eperjesy: This is Chris. I'll take the inventory questions—I guess I'll take both of them. On the inventory that John was talking about, a lot of the inventory that you've seen an increase, particularly in the quarter and year-to-date, is going to be inventory that's going through our Asian operation, which, from a sales standpoint, it was at record levels last year and the year before, and again is at near record levels, so a lot of that, as John was describing, is sitting on a boat or working its way through that channel. So, the answer is, yes, you will definitely over the next six months start to see that come down. Some of the inventory that's sitting here in North America, as John was also describing, it's somewhat intentional, and that when the North American oil and gas market comes back, we feel like we're better positioned to address that recovery as it ramps up.

On the ME&A front, I think the answer is, yes, certainly, we will expect to see it in line, but, however, you're not going to see the significant adjustment in stock-based compensation expense in the third and fourth quarter, which benefited this quarter. We will continue to invest in things, particularly in Asia, as John was describing. So, you're not going to see a significant ramp-up, but you're also not going to see significant reversals of stock-based compensation expense and things like that, as well.

Anthony Gikas: Okay, thanks. Good luck, guys.

Christopher Eperjesy: Thank you.

John Batten: Thanks, Tony.

Operator: Thank you, and we have no further questions at this time.

Michael Batten: Okay, thank you, Ian, and we'd like to thank everyone who participated in the conference, for joining today. We appreciate your continuing interest in our Company and we hope that we've answered all of your questions. If not, please feel free to call Chris or John or me. We look forward to speaking with you again in April, at the close of our third quarter.

And with that, Ian, I'll turn back to you for closing the call.

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