Twin Disc, Inc.
2008 Second Quarter Financial Results
January 22, 2008

Operator: Good afternoon ladies and gentlemen and welcome to the Twin Disc 2008 Second Quarter Financial Results conference call. At this time all participants are in a listen-only mode. Following today's presentation instructions will be given for the question and answer session. If anyone needs assistance at any time during the conference, please press star zero. As a reminder this conference is being recorded today, January 22nd, 2008.

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

Andrew Berger: Thanks Joshua (sp?). 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 2008 second 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. Some 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 10K. 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 Pauline Collins (sp?) at 262-638-4000 and she will send a copy to you.

Hosting the call today are Michael Batten, Twin Disc's Chairman, President and Chief Executive 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 Andy. Good afternoon everyone and welcome to our second quarter conference call. I will start with a brief statement and then both Chris Eperjesy and I will be available to answer questions.

Sales for the quarter improved 10.3% to 81.9 million from 74.2 million in the same period last year. Sales for the first six months rose

11.1% to 155.5 million from 140 million reported in the first half of fiscal 2007. Favorable foreign currency translation represented 5.1 million of the 7.7 million increase in sales for the first quarter, while the same factor represented 7.5 million of the 15.5 million increase in sales for the first half.

The remainder of the increase in sales for both the quarter and six months was mainly the result of strong sales of marine and propulsion products to the commercial marine and mega-yacht markets, as well as continued demand for land-based transmission products for airport, rescue and firefighting and military markets.

Gross margins in the fiscal 2008 quarter decreased 2.0 percentage points from 32.9% to 30.9%, compared to the same quarter a year ago. Year-to-date gross margins declined modestly from 31.9% to 31.6%, compared to the similar period last year.

Second quarter profitability was negatively impacted by reduced sales of higher margin products, higher sales of lower margin products and higher material costs. Partially offset by higher pricing, expanded outsourcing and lower pension expense. The fiscal 2007 second quarter and first six months included the impact of unfavorable purchase accounting adjustments to inventory in the amount of $489,000 and $1,223,000 before tax respectively.

Further, second quarter results were impacted by higher marketing, engineering and administrative expenses, which was a percentage, as a percentage of the sales, rose to 21.2% from 19.6% for the same three months a year ago. The higher ME&A expenses were due to approximately $1 million increase in stock-based compensation, primarily a result of the increase in the price of the Company’s stock, the impact of foreign currency translation from overseas operations and expenditures related to a new global ERP system. Year-to-date ME&A rose more modestly to 20.6% from 20.1% a year ago.

As a result, net earnings for the fiscal 2008 second quarter declined to 4.2 million, or $0.37 per diluted share, compared to 5.7 million or 48%, $0.48 per diluted share for the equivalent three months a year ago. Year-to-date earnings of 9.3 million were equal to the same period last year, although earnings per diluted share improved to $0.81 compared to $0.79 as a result of the repurchase of shares in the first fiscal quarter.

For the second three months, EBITDA totaled 9.6 million, down from 12 million reported in the same period a year ago. For the first six months EBITDA was 20.4 million, compared to 20.1 million for the first half last year.

As indicated in our press release, while demand for many of our products remains at a historical high, we've begun to experience a shift in our sales mix. Most notably we have begun to see a slowdown in demand for our oil and gas transmissions. In addition our industrial markets continue to experience a cyclical softening. However, despite a slowdown in these sectors, our commercial and mega-yacht segments of the marine market, and our airport, rescue and firefighting and military markets continue to grow. Looking ahead we continue to expect that fiscal 2008 will be another good year for Twin Disc. Our backlog of orders to be shipped over the next six months stands at 121 million, up 8% from 112 million reported a year ago, and up 10% from 110 million at the fiscal 2007 year end.

That concludes the prepared remarks for today and Chris and I are prepared to take questions at this point. So Josh, I'll hand it back to you to start the Q&A period.

Operator: Thank you gentlemen. Ladies and gentlemen at this time we will now begin the question and answer session. If you have a question please press the star followed by the one on your pushbutton phone. If you would like to decline from the polling process, press the star followed by the two. Your questions will be polled in the order they are received. If you are using speaker equipment you will need to lift the handset before pressing the numbers. One moment please for the first question.

Our first question comes from the line of Sean Daley, THM Holdings. Please go ahead.

Sean Daley: Hi. You know I know you don't generally give forward-looking guidance, but you know stock's having the worst day in its history, down 45.6% (sp?). How do you feel about '08?

Michael Batten: Actually, I'm encouraged by the prospects for the second half of the year, as I've indicated in our general outlook in the press release and my remarks right now. We are seeing, obviously as reported, some slowing down of activity in oil and gas and in industrial, but our volume did increase despite that year-over-year and quarter-over-quarter and we see that continuing for the balance of the year. So our marine markets represented by propulsion products and marine transmissions going into commercial application and our transmissions going into military and our applications are still growing and we're comfortable about our outlook for the balance of the year.

Sean Daley: And how much do you have left on the repurchase? And is it accretive at this level?

Michael Batten: I'm sorry, I didn't understand (inaudible)…

Sean Daley: How many shares are left on your repurchase authorization? And…

Michael Batten: Oh I see, 140,000 shares are available under the repurchase authorization that we have.

Sean Daley: Do you expect to go to the Board to increase that?

Michael Batten: Well at this point in time we'll work with the 140 and to the extent that we need to go to the Board, or want to, we have that capability.

Sean Daley: Thanks very much.

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

Our next question comes from the line of TJ Carter with Outpoint Capital. Please go ahead.

TJ Carter: Hi Mike and Chris. I had a question, could you guys try, I guess, try to give us some more color on the oil and gas transition weakness that you're seeing. Is that any particular region or is that across the board?

Michael Batten: Hi TJ. Yeah, the oil and gas market during the second quarter did see some softening and it was largely here in North America that we saw it, both Canada and in West Texas. Some rescheduling or actually in some cases some cancellations of transmissions. We do see that activity does continue, not everybody was involved in that activity. We have customers that are hanging onto their schedules and we are planning to ship more in the second half.

The activity seems to have moved to Russia and to China, where we are active and selling transmissions directly. So in that regard we do supply our good North American customers, but we are also involved in supplying, for example, and have shipments going out this quarter to a new Chinese customer that we have acquired for application on their home built, or Chinese built rigs. We are also active supporting the population that has gone into Russia and see opportunities in that market area as they prepare to spend a lot of money to develop their oil and gas markets as well.

So yes, we hit a bump in the road in the second quarter, but that does mean that we still have order board and backlog for oil and gas transmissions going forward.

TJ Carter: Okay. The next, my next question, you guys have, I guess outsourcing initiatives to help improve the margins. I guess could you give a little bit more color on the progress there? And how much more you guys could do, or afford?

Michael Batten: Okay. Regarding our global outsourcing effort, we are, we're actually doing two things, one is we say global, but part of it is re-sourcing both here in the US and in Europe, where we can get a total cost that's lower, but we're also putting a heavy emphasis on our expansion into India and China for sourcing activities. We have two offices in China, we have one office in India staffed with people who are engineers, manufacturing engineers, quality and purchasing people, as well as we're staffing up in the design engineering as well in the office in India. The activity is more in the, not the third inning, so to speak in a baseball game. We have got our feet on the ground, we are actually sourcing parts from these locations and we've got plenty of room to grow in this area to improve our margins and/or offset, I mean granted we did see some material increases occurring, but our outsourcing is working on that.

TJ Carter: Okay. And my final question, could you update us on your acquisition pipeline and maybe how you view acquisition versus share buy-back, given where your stock is now?

Michael Batten: Well, good question. The acquisition pipeline has Canada's in it at various stages of the process. I'm not going to be definitive or project when we might do something, but we are actively in discussions and something could materialize or not materialize, you know how that works, but we are active in the acquisition front.

As it relates to stock buy-back, at this point in time if we were to have an acquisition come our way, I think I would prefer to put the cash into an acquisition because of the long-term growth in revenues and earnings possibilities that an acquisition would offer. But, that doesn't mean that along the way that we might not have some repurchase activity going forward.

It isn't going to be an either or situation. I think what we're going to see is possibly some of both.

TJ Carter: Okay, thanks.

Michael Batten: Yes. You're welcome.

Operator: Ladies and gentlemen if there are additional questions please press star one at this time.

The next question comes from the line of Sean Feng, NorthPointe Capital. Please go ahead.

Sean Feng: Hi Mike and Chris. Two questions, number one, could you comment on the luxury build mega-yacht market? Number two is could you tell us what's the compensation for the backlog, as far as what percentage is from oil/gas, what percentage is from the boats, et cetera? Thank you.

Michael Batten: Okay. Sean, good to talk to you. The mega-yacht market continues to do very well for us. Activity continues to be strong, the yards are optimistic about their outlook for the balance of this year and into next. So there's a lot of activity and we're very encouraged by it.

With respect to our backlog, we don't breakout the numbers by market, but the composition of backlog in our transmission business has been healthy. It's a combination of both oil and gas and military and our transmissions and the marine backlog, both for mega-yachts and commercial applications, that would be offshore oil related, both here domestically as well as overseas is very strong.

Sean Feng: Thank you.

Michael Batten: You're welcome.

Operator: The next question comes from the line of Joe Norton, Singular Research. Please go ahead.

Joe Norton: Thanks, good morning.

Michael Batten: Good morning, how are you?

Joe Norton: Good, how are you?

Michael Batten: Fine thanks.

Joe Norton: I'm just trying to get a sense and you know maybe you can say what you think, but I'm just trying to get a sense of what do you think is, you know why the disconnect, or why you know are you seeing continued strength or such good strength on the marine side and such a slowdown on the industrial and the oil and gas? Is that just a matter of where you are geographically? Or what do you think is accounting for that difference?

Michael Batten: Well in part they're entirely different marketplaces, I'm sure you understand in just phrasing the question. The industrial markets, by in large that we serve are domestic, although we do have a global exposure with our Italian company as well. And they are facing some of the slowdown that the US economy has been experiencing, along with some of the other markets, housing and automotive.

The marine market that we serve is unique. The, most of the press that one would read about the pleasure craft market here in the United States deals with the lower horsepower segment of boating and that, of course, is depressed and we're flexed some of the same issues of high fuel prices and interest rates, at least up until to date in that marketplace for buyers without a great deal of discretionary income.

Now when you talk about the mega-yacht market you're talking a completely different story in terms of geography and income, disposable income availability. These yachts are multi-million dollar yachts and a recession here in the United States, or even elsewhere, is not going to play as much a factor, if any at all in the purchase of these yachts.

The other thing, in terms of geography that is interesting is that many of these yachts are being purchased by people coming out of, I would say the non-industrialized countries that are making huge amounts of money from whatever they're doing. For example there is a huge influx of wealthy Russians that are in effect taking a great deal of the product that is being built in Italy or along the Mediterranean yacht market. So that kind of wealth isolation and new money coming from Russia, China, in addition to the Middle East and others continues to drive the yachting market. Does that respond to your question?

Joe Norton: Yeah, yeah that's helpful. And then you know historically have you seen, I mean is it normal that you'd see the slowdown in the industrial business first and then marine is just lagging? Or do you really just not think that there's any correlation between these two?

Michael Batten: Joe, the markets that respond to interest rates, such as the industrial and the lower horsepower pleasure craft do tend to be more leading cycle product market segments than some of our other product lines and marketplaces. So one, so historically yes, the industrial markets have tended to be a leading indicator, however the factors that continue to support us are in many cases, in some cases that's to say exogenous to the normal rule. And that is the wealth factor that we just talked about and the high-end boat segment. That doesn't necessarily mean that it has to follow any cycle at all.

The military markets have been very good for us and that outlook continues to be healthy from our perspective. And then of course the oil and gas, while we hit a bump in the road in the second quarter, as mentioned previously, the longer-term outlook for oil and gas is unlike what we've seen before and I've been through the boom and the bust of the 70's and 80's and even though there is a, as I say a bump in the road, the underlying demand cycle for oil and gas, given the demand from China and India, the long-term demand suggests to us at when this, that this cycle is going to have some, perhaps some cycling, but that it isn't going to be a boom and bust kind of cycling, it's going to be more of a moderation and then continued acceleration as these countries are industrializing and using more and more oil as the US, Europe and Japan are using.

Joe Norton: And just to follow on the oil and gas business, you made a comment about the, you know the geographic, I don't know, sort of the moving geographic of that business. I mean are you guys well penetrated in those markets? Or are you saying that that's opportunity for you to sort of go where that business is moving?

Michael Batten: Well we are already in China. We are getting more active in Russia and so we understand that we have to be there. We're doing two things, one is that our good customers are taking our product over into these markets and those need to be supported in terms of repair, if need be, or additional trucks or fracturing rigs for demand expansion in that market, in those marketplaces. We also see the opportunity, the Chinese for example have come to us, we've gone to them to develop their own fracturing rig business and they see that while they can produce the truck, they don't have the pumps and the transmissions and the engines of the horsepower required to do the fracking (sp?). So they come to us and others to provide that part of the truck, but they will develop and assemble the under carriage and the cab and so on for the basic truck. And we are actively developing local players in both markets.

Joe Norton: Okay and then finally, I don't think I saw this in the press release, but you usually in your Q tell us domestic versus international sales. Can you just give me those figures?

Chris Eperjesy: We generally disclose it at the time of the Q, so we haven't disclosed it yet.

Joe Norton: Okay.

Chris Eperjesy: But I don't know if there was a significant shift off of what you would have seen in the 10K from last year.

Joe Norton: Okay. And just kind of anecdotally, I mean are the growth rate, are you seeing a slowing in growth rates in both of these regions? Or is, you know just trying to get a sense of you know how the international markets are doing relative to the US.

Michael Batten: The international markets are relatively doing better off of their own basis than the US and the reason for that being is that much of our industrial business is US based and that is softening. So, and the oil and gas is largely been a US sold activity. The units may be going offshore, but it's our customers who are doing that, so we would record it as a US sale and activity.

But, so those are the two areas that have seen some softening. The marketplaces, the products and markets that are growing are generally the mega-yacht, the commercial marine and the military and ARF (sp?) markets and with exception, well the military is a combined offshore and domestic business, as is the ARFs. We're penetrating Europe very well, as well as the Far East with our ARF transmissions.

Joe Norton: Okay good, that helps a lot. Thanks very much.

Michael Batten: You're very welcome, Joe.

Operator: Our next question is from the line of Wei Li, Whitebox Advisors. Please go ahead.

Wei Li: Hi Michael.

Michael Batten: Hi Wei, how are you?

Wei Li: Good, good. I've got a few questions here. Sorry I jumped on the call a little bit late, so if you comment on this, I apologize. My first question is on the slowdown in demand for oil and gas transmission in the US. We're seeing oil right now, like basically at a historic high and there's certainly a little bit of a disconnect there. So are you saying there's an oversupply of rigs out there right now? Or…

Michael Batten: What is happening Wei, is that the North American, just to start with a little bit broader, the North American market is seeing a bump in the road and that the market has reached a point where costs of equipment have accelerated and there's more competition occurring at the price level, at the rental level of these rigs. So the margin for the investor to invest and get a return has been narrowing. So that is the factor that is being dealt with here.

However, the markets in China and Russia continue to grow and some of the North American companies, frack (sp?) companies have been moving equipment, unutilized equipment over into these overseas markets to take advantage of the opportunities in those territories. So we still see that some of our domestic customers are still ordering and buying oil and gas. It's not like demand has dried up 100%, but we have seen moderation occurring in the form of either, in some cases cancellations, in other cases pushing out the order board. But overall the market continues to exist, both on a domestic and an overseas basis.

Wei Li: Okay, great, great. And what's the mix right now between US and overseas revenue?

Michael Batten: That, we just discussed that. It is not too different, we don't publish it until the Q and that won't be for…

Chris Eperjesy: At least a couple more weeks.

Michael Batten: A couple more weeks.

Chris Eperjesy: Yeah and the 10K, the mix was roughly a little less than 60/40. So a little less than 60% domestic and a little more than 40% international. I wouldn't expect that to change significantly.

Wei Li: Okay. And with the US dollar going still down against major currencies right now, would that be a net benefit for you guys going forward?

Michael Batten: Well in terms of translation, it's a negative. In terms of stimulus for US product overseas, it's a positive. So we've got a foot in, one foot in each canoe, so to speak. We're conflicted there. But on a net basis, the financial statements, Chris, are positive for a weaker dollar.

Wei Li: Okay, all right. Thank you, that's all I have. Good luck guys.

Michael Batten: Okay, fine Wei, thanks.

Wei Li: Thanks.

Operator: Our next question is from the line of Joe Norton, Singular Research. Please go ahead.

Joe Norton: Hi, sorry I forgot to ask one other question, if you don't mind.

Michael Batten: Sure, Joe. Go ahead.

Joe Norton: On the gross margin, is the 30, I guess it was closer to 31%, is that kind of the barometer we're looking at now? Or is there anything you guys can do to get that back to, you know prior year levels in the second half?

Michael Batten: Well we're working real hard on that, Joe and that is an area that has got our attention as well, to find ways to do that. Now we anticipate shipping more higher margin products in the second half, but we are also experiencing issues of material cost increases. Steel prices have gone up, surcharges are at very high levels relative to where they were, even just a few months or a year ago. So we're doing everything we can to expand our outsourcing efforts to offset what's happening there and have a net addition to margin. We are also accelerating pricing activity to make sure that we're covering the increases that we are experiencing. So we're working very hard on that, to get those margins back up.

Joe Norton: Okay, thank you.

Michael Batten: You're welcome, Joe.

Operator: Our next question is from the line of Jeffrey Matthews, RAM Partners. Please go ahead.

Jeffrey Matthews: Hi. I apologize for the redundant question, but I'm new to this story and I just want to make sure I understand the nature of the order cancellations in the US. The type of company that is canceling an order is what type of company? And they're canceling because costs have run up to high? Or they're cutting their budgets in response to cost increases? I'm not quite sure I understand the link.

Michael Batten: Okay. We're talking about oil and gas and we're talking about specifically the fracturing rig market and what we do is we sell our transmissions to fracturing rig builders and they in turn sell them to operating people who rent or lease their vehicles to oil companies to do the fracturing. And so there's a day rate associated with that at that activity, that leasing day rate activity.

What is happening in the industry, what is the feedback that we're getting is that part of the slowdown is due to the fact that the cost of the rigs themselves, along with the other costs associated with doing the fracturing have risen over the last several quarters to squeeze the margins of those people who are renting out the vehicles for fracturing. Given that situation they're saying, we're not going to invest in new vehicles because we're not getting our rates of return.

Jeffrey Matthews: Got it. Okay.

Michael Batten: That's the issue. There is another factor and that is that with more vehicles out there, there's more competition on the day rate, but…

Jeffrey Matthews: Okay.

Michael Batten: Those are things that are happening in the marketplace.

Jeffrey Matthews: Got it. Thanks very much.

Michael Batten: You're welcome, Jeff.

Operator: Ladies and gentlemen, if there are additional questions please press star one at this time. One moment for our next question.

The next question is from the line of Scott Archer, Oaks and Palms LLC. Please go ahead.

Scott Archer: Yes. In your, on your website in the description of the Company it makes the statement that the Company has become a major player, if not a market leader in each of its market segments and has added new technologies. And given your, the businesses that you're in, I saw it surprising, like Jeff Matthews I'm relatively new to the story, but I'm surprised at your overall revenue base wouldn't be a lot bigger, you know given your international and all the big markets that you serve. Could you comment on that?

Michael Batten: Sure Scott. I think that in the markets that we're serving, which is largely the marine-based markets behind diesel engines and the transmission markets, again behind diesel engines, but in vehicles that are high horsepower and specialty vehicles, and then industrial products which are largely clutches, the disconnect products for again off-highway heavy-duty industrial application, the, while the names like transmissions and marine might suggest a much larger market, we have fairly significant shares of markets in each of the activities that we're in. And so we are in huge global markets, at least as we define them. We're looking at our served segments, so we participate in marine, for example, in pleasure craft, in commercial, and in military. And we have excellent shares of market in all three of those areas of the marine market.

In the transmission market we are the Pluto (sp?) we say of the universe because so many transmissions are built around the world, but our segment is 300 horsepower up to 3,000 horsepower. That reduces the size of the market available to us and we have a very good representation in that off-highway 300 plus horsepower market.

And then in the industrial markets, again it's how you cut the cookie, but the industrial products that we sell are largely heavy-duty disconnect products and we have a major share of market here in the US and an excellent share overseas. I don't know if that answers your question, but that's how we look at it.

Scott Archer: Yes it does. Then as you define and clarify your segments a little bit more, do you have kind of an overall market size target in terms of dollars? You know if you add all those markets that you feel are really yours together and how big that market is and you know what your penetration to date is?

Michael Batten: We tend to look for markets that may not been billions of dollars, but rather more in the 100 to low hundreds of millions of dollars because we think that our potential competitions are the Allison's (sp?) or the ZF's (sp?) of the world, or people that have got much more critical mass than we do. So while we tend to be the standard of the market in marine and industrial in the segments that we serve, we also recognize that for us to succeed, we have to be able to be more nimble and design flexible to compete in the market areas that we serve. So that's our approach, is to be more niche oriented, or smaller market oriented than larger market oriented.

Scott Archer: But you've never really sat down and added all those up and say, well here's the size of a potential market, in terms of dollars that we're looking at?

Michael Batten: Oh we look at that, yes we do.

Scott Archer: But you don't disclose the number?

Michael Batten: That's correct.

Scott Archer: I see. Is there anything new on the competitive scene, either domestically or overseas?

Michael Batten: Well what is new on the competitive scene…

Scott Archer: Should I say, any new threats in terms of market share competition?

Michael Batten: There is one thing that is occurring in the marine area, which is presently in the lower horsepower segment, and this is, they're called pods (sp?). One is being introduced by Volvo and the other is being introduced by Mercury. Volvo is called the IPS system and the Mercury is the Zeus system. But they're in the, starting out in the sub-500 segment of the market. We're watching that closely and looking at what our competitive response is to be there.

Scott Archer: Thank you very much.

Michael Batten: You're quite welcome.

Operator: Ladies and gentlemen, if there are any additional questions please press star one at this time.

At this time gentlemen, there are no further questions. Please continue with any closing remarks.

Michael Batten: Well we'd like to thank you all for joining today. I appreciate your interest in Twin Disc and we're eager to continue the job that we're doing and look forward to discussing our results at the end of next quarter. Thank you.

Operator: Ladies and gentlemen, this concludes the Twin Disc 2008 Second Quarter Financial Results conference call. AT&T would like to thank you for your participation. Have a pleasant day, you may now disconnect.