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Twin Disc, Inc.

Fiscal Second Quarter 2022 Earnings Conference

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John Batten, *Chief Executive Officer*

Jeffrey Knutson, *Vice President of Finance, Chief Financial Officer, Treasurer & Secretary*

CONFERENCE CALL PARTICIPANTS

Josh Chan, *Robert W. Baird & Co.*

Noah Kaye, *Oppenheimer*

Robert Fetch, *Private Investor*

PRESENTATION

Operator

Greetings. Welcome to the Twin Disc, Inc. Fiscal Second Quarter 2022 Earnings Conference.

Please note this conference is being recorded.

I will now turn the conference over to your host, Stan Berger, you may begin.

Stanley Berger

Thank you, Shomali. 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 2022 second quarter and first half financial results and business outlook.

Before introducing Management, I would like to remind everyone that certain statements made during this conference call, especially those statements that represent 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. Information concerning factors that could cause actual results to differ materially from those in the forward-looking statements are 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 John Batten, Twin Disc Chief Executive Officer, and Jeffrey Knutson, the Company's Vice President of Finance, Chief Financial Officer, Treasurer, and Secretary.

At this time, I will now turn the call over to John Batten. John?

John Batten

Thank you, Stan, and good morning, everyone. Welcome to our Fiscal 2022 second quarter conference call. As usual, we will begin with a short summary statement, and then Jeff and I will be happy to take your questions. Before we go over the results, I will touch on some of the operational highlights from the quarter.

Looking at demand, as we mentioned in the press release, demand improved nicely across most of our markets. The biggest impact we saw was at our North American operations, where our orders improved in industrial and transmission product lines. Our global marine demand for our North American produced models remained flat at the factory as we still work through some of the inventory at our distributors, but the market activity in our marine product lines improved nicely in the quarter, and we saw significant new orders at our European operations for those models.

We also saw—looking at the market in particular—continued elevated high demand in the Australian Marine market, particularly pleasure craft. Nice unit orders for our marine transmissions and some other product lines that they sell into the market.

As I mentioned, we had a growing number of projects in the Asian, European, and North American work boats markets, continued application growth for our product line, primarily in some new markets for them to expedition-style mega yachts, that activity increased. The one activity—the one market that still is a little slow is the inland passenger vessel market, but as COVID wanes, we should see that market start to pick up in the calendar year.

We did see some initial inquiries for some offshore vessels in Asia. That would be the first time in a long time that we've seen new project activity in any offshore market. As you shouldn't be surprised, the steady flow of hybrid and electrification projects for our marine transmissions.

With respect to oil and gas, we received good unit orders from Asia for both the 7600 and the 8500, and a significant amount of aftermarket parts order for the North American fleet. Quoting activity for new units also improved in December and January, and we believe that new rig construction should improve this calendar year.

Our operation in Lufkin weathered significant supply chain issues on parts coming from India, and it's turned the quarter on their past due amount, and we've continued to see significant growth in demand on new unit orders for our industrial products based in Lufkin. The supply chain continues to be a challenge as you should not be surprised. Lead times have extended significantly, but they're more predictable.

In the quarter, we saw significant inflationary cost increases from our suppliers, and those are reflected in our second quarter margins, and Jeff will cover that. The most significant increases came from castings, forgings, and machine parts, anything related to steel prices continued to rise in the second quarter. The momentum of these increases continued throughout the quarter.

We had previously announced the 4.5% price increase on July 1, 2021, and this fall, we announced the 5.5% increase effective January 1, but we've also implemented a 4.9% surcharge on products shipping after January 1 to combat some of these inflationary increases that we've seen. In this quarter, we will be evaluating every inflationary input and deciding on future increases to be implemented in the fourth quarter.

One of the other things that we had to deal with, as did everyone in the quarter, was the COVID impact. Certainly had a demand impact from some of our customers, but it was also the most significant in supply chain. Many parts were delayed from suppliers due to labor shortages, and we had a noticeable impact in December due to illnesses and quarantines. Thankfully, the situation has improved in January. We're hopeful that that trend continues throughout the balance of the calendar year.

Now, I'll turn it over to Jeff to talk about the financials.

Jeffrey Knutson

Thanks, John. Good morning, everyone. I'll briefly run through the Fiscal ’22 second quarter and year-to-date numbers. Sales of just under $60 million for the quarter were up $11.3 million, or 23.3%, from the prior year, second quarter; and up $12.1 million, or 25.4%, from the previous quarter. The sales increase reflects continued growth in demand across our markets, as John mentioned, with shipment performance limited somewhat by supply chain challenges across all our locations. As noted last quarter, we've experienced a significant increase in lead times from our suppliers, unpredictable vendor delivery performance, and difficulty in getting shipping containers.

Despite supply chain challenges, strong demand and improved operational performance have resulted in a 46% increase in industrial product shipments, a 14.5% increase in marine and propulsion shipments, and a 13.4% increase in off-highway transmission sales for the second quarter. By region, sales in North America were up 30%, sales in Asia Pacific were up 17%, and sales in Europe up 5%, while foreign currency exchange was a net negative million-dollar impact to sales in the second quarter. Through the first half, we are now 13.6%, or $12.9 million, ahead of the prior year.

The second quarter margin percent was 22.5%, compared to 18.3% in the prior year second quarter. The improved margin in the current year is the result of increased revenue and a more profitable mix of product, partially offset by the impact of inflationary pressures on cost as we have seen significant price increases across our supply base. We have taken action, as John detailed, to implement price increases and surcharges to offset these inflationary pressures going forward and will continue to monitor this area very closely to identify any additional required pricing actions.

Spending on marketing, engineering, and administrative costs for the Fiscal ’22 second quarter increased $1.9 million, or 14%, compared to Fiscal ’21. The increase in the quarter is primarily due to increased salaries and benefits, the return of a global bonus program, professional fees, marketing expenses, and other inflationary increases, essentially a return to somewhat normalized level of spending in areas of activity that had been dormant for some time. These increases partially offset by the favorable impact of a Dutch COVID relief subsidy recorded in the quarter.

As a percent of revenue for the second quarter, ME&A (phon) expenses were 25.5% compared to 27.5% in the prior year second quarter. For the first half, ME&A expenses were 26.3% of revenue compared to 27.2% in the first half of Fiscal ’21.

We recorded restructuring charges of $1.2 million during the quarter, primarily related to the final negotiated settlement related to the Belgian Restructuring Program announced this past June. The total cost of this program is now approximately $3.3 million and is expected to drive annualized savings of approximately $1.6 million once complete.

Including the restructuring charge, the operating loss for the quarter was $3 million compared to an operating loss of $4.6 million in the prior year second quarter. The first half operating income of $200,000, which includes a $2.9 million gain on the sale of our Swiss facility, recorded in the first quarter, is nearly $8 million improved from the Fiscal 2021 first half.

The effective tax rate for the first half of Fiscal ’22 was negative 131% compared to 30.3% in the prior year first half. The current year rate is quite unusual and was impacted by the domestic full valuation allowance, which results in no tax benefits being recognized on current domestic losses. The net loss for the second quarter of Fiscal ’22 is $3.8 million, or $0.29 per diluted share, compared to a net loss of $4.3 million, or $0.33 per diluted share in the prior year first half.

EBITDA of $200 million for the quarter was improved from a loss of $3.6 million in the prior year second quarter, and for the first half, EBITDA improved by $10.4 million from the prior year, from an EBITDA loss of $5.2 million to positive EBITDA of $5.2 million in the current year.

Turning to the balance sheet. Inventory was up $9 million in the first half driven primarily by supply chain imbalances. Despite a significant increase in inventory, operating cash was only slightly negative at $1 million. Capital spending at $1.8 million for the half is well behind schedule, impacted by the lead times on machine tools. Given a slower start in capital spending, we now anticipate that we will invest in the $7 million to $10 million range in Fiscal ’22.

With that, I'll turn it back to John for some final comments.

John Batten

Thanks, Jeff. I’ll just spend a quick moment on the outlook. Obviously, our backlog and project activity has improved significantly, both year-over-year and sequentially versus the first quarter and the end of the prior fiscal year. We are also anticipating improving conditions in North American oil and gas. Our challenge will be to match our internal and supply chain capacity to meet this improving demand. We have the inventory to meet the improving oil and gas trends in North America, and we will be building in advance when possible, to get ahead of this wave.

Hopefully, in one of the next calls, we can highlight more hybrid and electrification applications that we've been working on with our customer base as they are testing it in their prototype process. The R&D and engineering activity has continued in earnest this fiscal year, and we are extremely excited about the future developments in all of our markets with respect to hybridization electrification.

That concludes our prepared remarks, and now, Jeff and I will be happy to take your questions. Shomali, can you open up the line for questions now? Thanks.

Operator

Sure. At this time, we'll be conducting a question-and-answer session.

Our first question comes from the line of Josh Chan with Baird. Please proceed with your question.

Josh Chan

Good morning, John and Jeff, thanks for taking my questions.

John Batten

Thanks, Josh.

Josh Chan

I guess first question on oil and gas, clearly the backdrop has improved, but I think this Capex discipline is kind of the phrase for the industry in this cycle, and so I guess I was wondering, John, if you could talk about some of the conversations that you're having with the customers and how you think about the trajectory of when you might see orders within this calendar year?

John Batten

Yes, so the conversations and the quoting activity with the OEMs is going on. Certainly, before we've ever historically looked back at every cycle before we've had new rig construction, there's been a rebuild. And why we had seen a trickle of spare parts orders last—I would say, the first quarter of this Fiscal year and in Fiscal '21, that activity has clearly picked up in the last couple of months. If I go by empirical evidence from prior cycles, that would mean that there would be new unit orders and building in the next three to six months.

I think that we should—I would expect to see new unit orders this fiscal year for us, whether or not they come soon enough that we deliver them, or the units are going to Asia this Fiscal year. But certainly, I see what we will see orders improving within a quarter or two.

Josh Chan

Okay, that's encouraging. I think you mentioned in the press release that you have some completed products, right? So, I guess, would you be able to serve some demand immediately or how does that work?

John Batten

Yes, we would be able to—for the first few dozen, Josh, we would be able to react very quickly because we have somewhat of a very balanced inventory. Once we get out the lead times, they won't go to 12 months, but there'll be a few months lead time once we get past the initial amount. As orders are improving in China, that ability to react quickly in North America—it won't be a month or weeks, it'll be a couple months on lead times.

Josh Chan

Okay.

John Batten

That really, Josh, is driven by our internal capacity here on assembly and test, and some parts we need from suppliers, but we are on top of it.

Josh Chan

Absolutely. No, that's encouraging. I guess on the price increase and the surcharge side, historically, we haven't talked too much about it, so could you just talk about how that works? Is it broadly across all your portfolio? Does it hit immediately? Then maybe if you could fold in how much impact do you think that can have on your gross margin improvement in the second half that you can allude it to.

John Batten

Typically, historically, for anyone, I would say, 60 or under, it's an annual price increase. We're no different than anyone, we have one price increase per year. You'd have to go back to the early 80's to find something similar where you are raising prices multiple times per year. Typically, we like to do it and give everyone advance notice that—a two-month notice that our price is going to go up July 1, so we would announce that by May 1. We did that this year for a price increase in July.

Like many people, we thought that what we announced two months ahead of time for July would be enough. But it became obvious in August, September that inflationary pressures had increased past that. We had announced in—I think it was October timeframe that we'd have another price increase in January. But really in that November timeframe and into early December, the increase is particularly anything related—a lot of our products, obviously is steel, whether it's forgings, castings, parts that we outsource, steel prices went up dramatically.

In that October-November timeframe, we were getting more increases from parts suppliers that are providing us things that are just 100% metal that are high double digit, and that clearly had—and it was effective on time of shipments, so it was basically, we're getting it with a surcharge or a price increase, and you saw the impact of the timing of that in our second quarter.

So, our surcharge was effective on shipments as of January 1, and I know that that is a bit of a shock because that's coming on top of another price increase. But the inflationary pressures starting from steel mills to people who are making bearings, clutch plates, supplying us forgings or castings; they're getting steel increases, they have inflationary pressures, they're passing them on to us, we have to pass them on.

Honestly, Josh, what we've implemented is basically to get us to that gross margin—I would say, neutral. Our desire is that what we have passed on to our customers gets us back to where we were on those gross margins prior to the—I would say, rapid inflation that we saw in the middle to the late 2021. It's imperfect and that's why we're evaluating it. I will never say never that we won't do something additionally in the fourth quarter some time in the beginning of next fiscal year.

Josh, there will definitely be one for the beginning of Fiscal 2023. The question is, will it come sooner? Because it's one of these things that you for the past, whatever, however many years you would evaluate the cost increases coming in over your fiscal year, and you'd implement depending—historically in North America, it would be July 1 or October 1. Historically in Europe, it would be January 1. You'd have one price increase in a year to catch the inflation.

Right now, that's out the window. We're looking at it quarterly now, and we'll have to make adjustments because the steel mills and our suppliers are keeping their margins in check by passing on increases to us. We need to make sure that those increases are shared everywhere, and it's just not us taking the punishment.

Josh Chan

Right. Right. That makes sense. The 4.5% surcharge, does that mathematically get you back to the sort of the mid to high, maybe 20% gross margin in the back half? Is that a reasonable guess?

Jeffrey Knutson

Yes. That's where we're looking, Josh, is that we should be north of 25% the rest of the year. Obviously, the inflationary pressures will continue, so like John said, we'll need to continue to react to that. But that's what we're looking at is to get back to certainly north of 25%, in the 26%, 28% range for the rest of the year.

John Batten

Yes. Josh, some of the increases coming in, what we've implemented is—I would say, somewhat broad-based and surcharges on everything. I think we will be looking at specific product lines because the increases—it hasn't been on average. Some product lines have been hit harder than others, so we will be addressing that too in the next couple of months.

Josh Chan

All right, that's great. Thanks for the color and thanks for the time guys.

Jeffrey Knutson

Yes.

John Batten

Thanks, Josh.

Operator

Our next question comes from the line of Noah Kaye with Oppenheimer. Please proceed with your question.

Noah Kaye

Thanks for taking the questions. Just following up on price/cost commentary, you look at the six-month backlog, what is the price cost for that? Is that a headwind to margins? Is it about neutral? If you assume that sort of pricing initiatives you put in place are generally retained throughout the year, when does price/cost turn positive?

Jeffrey Knutson

Yes. Well, I think one thing to remember is that what's in the backlog or what's the reported backlog doesn't reflect the price increase. But when those products are shipped, the price increase will be impacting that shipment. Technically, that backlog is going to be shipped at a higher price. As of the 12-31 backlog will be shipped at a higher price, so I think generally, the backlog that we have would be a positive impact to current margins. It will be trending up once that starts shipping.

Noah Kaye

Right. Right. Steel prices are elevated year-over-year, it started to back off a little bit. When would you start to see potential just based off of what we're watching with commodity indices, when would you start to see, potentially, a little bit of relief or at least stability on some of your key input costs? I mean, maybe just given other supply constraints, suppliers may not be cutting prices; but certainly, if the raw input prices are starting to back off a little bit, what would that mean for your price (phon) profile?

John Batten

Yes. No, I think we've—I'm crossing my fingers and knocking on wood. I'm hopeful that the increases have stabilized and that we're flat. I agree with you, what I've been reading is hopefully, that steel prices will start to—steel and fuel may start to back off a little bit and that we'll see some. But I haven't seen evidence of any price decreases, or I should say, surcharge easing for us. Haven't seen that yet.

That's why a surcharge for us—it's the first time in memory that we've done a surcharge. We typically just do pricing. But I think we recognize that some of these inflationary costs may be easing in calendar 2022, so that's why we elected to go with the surcharge. We think that it might turn back. We have that variable that we can ratchet back as we start to see those inflationary prices ease on us. But we've seen it stabilize, Noah. We haven't seen it improve as far as actual dollar costs coming down.

Noah Kaye

Great. Helpful. I guess, John, maybe a little bit of historical context around (inaudible) spend in the oil and gas market in North America particularly would be maybe helpful for the folks here. You've seen over the cycles, obviously, a varying mix of new builds versus repair versus replace in the field. Obviously, we got to some points over this past cycle, where there was almost no new construction-related activity. I guess, just how do you see kind of the mix of spend trending as you're looking at these improving activity levels? How does that kind of compare to past periods?

John Batten

I would say, anecdotally, we have been told by several customers in different regions that they like to rebuild, let's just say in the 25% to 30% range of their fleet. If they're buying—let's say, they're buying—if there are going to be 100 rigs being built, they want to repair 25 to 30. I think in an ideal situation, we've heard that. I don't know if we've ever seen that because we see the rebuild activity start and then a wave of new rig construction because it's faster, they're spending time and dollars on something that's brand new, so we'll see this time.

I mean, whatever the percentage is, it's very good to see the rapid increase in aftermarket parts. That means that they are bringing rigs back online that were sitting idle, and we'll see. Usually, what happens is that demand of getting sideline rigs back online is not enough capacity for what's needed, and my sense is that's going to happen again. What's the amplifier from our aftermarket parts order to what our new rig orders? I don't want to predict it, but it's certainly—when you're coming off of several quarters of no new units going into North America, you know that this rebuild activity is signaling that they're going to be ordering new units soon for new rig construction.

Noah Kaye

All right. Helpful. Thanks so much.

John Batten

Thanks, Noah.

Operator

Our next question comes from the line of Robert Fetch (phon), who is a private investor. Please proceed with your question.

Robert Fetch

Hi. Good morning.

John Batten

Good morning.

Robert Fetch

If you can just elaborate on that last comment, what is your content per new rig, just in general ballpark?

John Batten

If a rig is $1 million to $1.2 million, and there's probably—I'm going from a year ago, so we're going to have inflationary pressure in there, a pressure-pumping transmission is going to be $175,000 to $200,000 of that. So, not quite 20%, but the big components are the engine, the pump—the engine, the cooling system, the pump, and then the transmission.

Robert Fetch

Okay. Can you talk also generally about the transition in your product lines, serving various end markets of the transition from diesel to electric, and what the opportunity is there? Or, is it cannibalizing some of the diesel products to a greater extent?

John Batten

We're exclusively off-highway. The challenge for us in the hybrid and electrification is just the number of projects that you have to do to satisfy that. We're not like an automotive manufacturer where you can design one electric powertrain or hybrid powertrain for a number of different vehicles. So, what we do for one OEM on a crane, the solution may be different for what we do for a different OEM on a crane and those will be 10 to 12 per year, and then what we do for one boat manufacturer is going to be different for A, B, and C. So, there's a lot more engineering and effort required to get it.

But the opportunity is—Robert, the opportunity is huge because our markets have been doing the same thing, relatively the same way for decades. A diesel engine, a gearbox—the gearbox could be a manual gearbox with a clutch, it could be an automatic transmission with a torque converter. But by and large, it's been a diesel engine, a transmission, clutch, torque converter, and then the driveline. The engine has been the primary focus of whatever application it is.

What's different now is—and we'll see where the market takes us, but now it's the diesel engine for hybrid is still a significant part of it being able to generate the power and the electricity, but the other components are equally as important. The gearbox has to take multiple inputs, whether it's from an electric motor or a battery pack or an engine. The control system is more complicated to manage all of that.

It's exciting. It's redesigning the commercial off-highway markets and marine markets. But it's challenging, because there's only so many motor suppliers, there's only so many battery suppliers. Automotive is just driving—they're driving the demand and taking that up a lot, so it's developing supply chains to take care of the off-highway markets, developing the control systems.

But it's a big opportunity for companies like Twin Disc, who are in the power transmission business because, effectively, you are rethinking every type of application. If we develop the right partnerships and the right system solution, our content would—for a crane that is driven by a diesel engine and transmission and one of our products. The potential for our content goes up if we go into hybrid and electrification.

Some of the challenges we face are—when are the markets ready to handle that extra cost? Because one of the (inaudible), you have lower emission with hybrid and electrification, but the cost of providing that is higher than a traditional application.

There's a big demand out there, and it's just trying to shake that through the sifter and figure out what markets will take off first and when and how it's all going to happen. But it's a huge opportunity for Twin Disc.

Robert Fetch

Understood. With your broad customer base though, do they pay you for the engineering for products that may be custom to their needs?

John Batten

Yes, Robert, it's different in each market. A lot of it right now—and that's a model that you're trying to perfect is how you get paid for that. Some of the first—I would say we've been all over the map, but we've been paid for engineering. A lot of these initial applications, they're joint development projects, so we're learning as the OEM is learning. It depends on the application. If there's significant volume on the backside, you just amortize those engineering costs over what you ship.

But one of the things that's also important is picking the right customer. You got to pick the winners, so you got to pick—know our customers, know our markets and being able to analyze what they're trying to do and work with the customers and the OEMs and their products that you know are going to be a market success. That's also one of the challenges that everyone's facing right now—is the timing of when certain markets will accept the increased cost of these hybrid and electric systems.

Robert Fetch

Did you mention what level of cash flow you expect this year and next?

Jeffrey Knutson

We've been trying to stay free cash flow positive. The second quarter was a little short of that. Year-to-date, we're a little short of that. So, we expect to be cash flow positive—free cash flow positive in the second half despite what should be a ramp-up of capital spending as some of the things that are on order start to arrive. In the single-digit millions, free cash flow positive, in the next few quarters.

Robert Fetch

(Multiple speakers) I was going to say, is working capital the greatest pressure on how much is free or not in the next 12, 18 months?

Jeffrey Knutson

Yes. I mean, a lot of it has to do with—that number could get significantly better depending on the level of North American or 8500 demand for fracking rigs and transmissions. We can liquidate and turn a lot of inventory into cash if that demand ramps up. We have demand. The demand we have would support what I just projected. But yes, inventory is really the one lever that can make that number better.

Robert Fetch

Should you begin to approach a couple of turns of inventory annually again?

Jeffrey Knutson

Yes. Yes. Certainly, as we exit this year, I think we should be there.

Robert Fetch

And do you have a variable outlook related to your U.S. versus non-U.S. business?

Jeffrey Knutson

They're such different businesses, it's hard to give a quick answer to that. They're very different markets. Obviously, the Asian oil and gas market has been stable and consistent through the last two years, probably our most stable market. The Australian pleasure craft market has been growing, I think it's up 40% over the prior year, so it's a little bit all over the map I think, but everything is going in the right direction, just at varying degrees.

I think the North American marine is probably the one that isn't hitting where we think it should be yet, I think because of the buildup of inventory at our distribution locations, but I think we expect that to start catching up as well. I don't know if that answers your question.

Robert Fetch

Yes, that's good. Outside of oil and gas, what kind of end markets do you feel best in or most visible about as you kind of look out in the intermediate term?

John Batten

I would say, the most positive is just our global marine markets. Our orders on our European operations improved significantly, both in the first quarter and the second quarter. Industrial with the operation in Lufkin has seen a tremendous increase in new unit orders. We have a team down there focused on that market.

Robert, feeling good about all our markets. The one that—and I mentioned it at the beginning, is just offshore oil and gas has been very, very slow. But I'm hoping to see some activity, and then there's been an announcement of some wind farm activity down in the Gulf. I'm hopeful that there will be activity there for vessels going out.

Jeff said it, everything is pointing in the right direction. It's just some are moving faster than others, but I would say most confident in the recovery of our global marine market, and just beyond the transmissions that are produced here in North America, our industrial business is seeing strong demand growth, and I do think we're going to—there'll be another wave of North American oil and gas sometime this calendar year, so feeling good about that.

Robert Fetch

Okay. Just last two questions. Should we expecting growth in the next year to be principally or solely organic?

John Batten

Certainly, in the next—I would say, this fiscal year in the next few quarters, the growth will be almost exclusively organic. By organic, I could also—things that we are buying from partners to include in our hybrid and electrification systems. Beyond just—and organic, we don't manufacture it inside but it's part of the system that we're buying and reselling. I think you might have to go out beyond that window a little bit to see something more in the M&A activity.

Robert Fetch

Okay. Lastly, just on the labor front. Are there constraints to your growth either at the manufacturing or at the, say, admin and engineering level?

John Batten

I'd say definitely a concern is being able to grow the workforce here in Racine, in Southeastern Wisconsin, finding—sometimes, we feel like a duck swimming upstream. There's a lot of activity on the feet going underneath the water, just replacing retirements here. But we also have Lufkin. Yes, it's the challenge, and then the ones that are just one step removed is—it's hard to express the supply chain issues with quarantines and people being out sick, everything, finding out last minute. I think that's getting better, Robert.

But if there's one—yes, the one that we have to work on the hardest is making sure that we have the people in the shop to make it all happen and get product out the door, and that will be—and it's really being sure that we have everyone available 100% of the time. I think we've (inaudible) there and that's getting better, it's being able to add workforce, both here and in Lufkin. It doesn't seem to be as much of an issue at the global operations. It's been, honestly, more of an impact here in North America than it has been in other parts of the world.

Robert Fetch

Okay. I guess I wasn't honest, I got one more question. Obviously, you guys have been quite cyclical over the years. But can your assets and staff—can you largely support sales and revenue levels that you've had any time in the last 10, 15 years without meaningful capital spend?

John Batten

It will take—I would say, if we can get the machine tools that we've planned for this year and next year, I think our capital spend can do it. We're spending more time on developing supply chain strategies on partners outside of our four walls to supply key components. But, to support growth back to our prior level, and it is a very good question, we will need more internal capacity on assembly and test, and primarily in North America. So, we'll need to find those resources either in Racine or in Lufkin to get back.

Yes, we need to increase both capital, and we need to increase headcount within our four walls—are two things that we have to do.

Robert Fetch

I appreciate your frank responses. Thank you very much.

John Batten

Thanks, Robert.

Operator

We have reached the end of the question-and-answer session, and I'll now turn the call back over to CEO John Batten for closing remarks.

John Batten

Thank you, Shomali, and thank you, everyone, for joining our conference call today. We truly appreciate your continuing interest in Twin Disc and hope that we have answered all of your questions. If not, please feel free to call either Jeff or myself, and we will get your question answered as quickly as possible. We look forward to speaking with you again following the close of our Fiscal 2022 third quarter.

Shomali, I'll turn the call back to you.

Operator

Thank you, John. This concludes today's conference, and you may disconnect your lines at this time. Thank you for your participation.