Twin Disc, Inc.
First Quarter 2009 Financial Results Conference Call
October 21, 2008

Operator: Good afternoon, ladies and gentlemen. Thank you so much for standing by. Welcome to the Twin Disc Incorporated 2009 First Quarter Financial Results Conference Call. During today's presentation, all parties will be in a listen-only mode. Following the presentation, the conference will be open for questions. If you do have a question please press the star, followed by the one on your touchtone phone. Once you make that choice, if you decide you'd like to withdraw your question pressing the star, followed by the two will remove your line from the queue. Also, if you're using speaker equipment today, please note that you do need to lift up your handset prior to making that selection. As a reminder this conference is being recorded today on Tuesday, the 21st of October, 2008.

I'll now turn the conference over to Mr. Stan Berger. Please go ahead.

Stan Berger: Thank you, Michael. 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 2009 first quarter financial results and business outlook. Before I introduce management, I would like to remind everyone that certain statements made during the course of this conference call, especially those that state management's intentions, hopes, beliefs, expectations or predictions for the future are forward-looking statements.

It is important to remember that the Company's actual results could differ materially from those projected in such forward-looking statements. Additional information concerning factors that could cause actual results to differ materially from those in the forward-looking statements is contained in the Company's annual report on Form 10-K, copies of which may be obtained by contacting either the Company or the SEC. By now you should have received a copy of the news release which was issued this morning before the market opened. If you have not received a copy, please call--please call Annette Mianake (sp?) at (262) 638-4000 and she will send a copy to you.

Hosting the call today are Mike Batten, Twin Disk’s chairman and chief executive officer; John Batten, president and chief operating officer; and Chris Eperjesy, the Company's vice president of finance, chief financial officer, and treasurer.

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

Michael Batten: Thank you, Stan, and good afternoon everyone. And welcome to our first quarter conference call. As Stan indicated, I will start with a brief statement and then Chris, John and I will be available to answer your questions.

Sales for the first quarter were 72.7 million compared to 73.6 million for the same three months a year ago. Foreign currency translation favorably impacted the current quarter by $4 million. Demands from the commercial marina and mega yacht markets remained high during the quarter. However, first quarter sales included fewer oil and gas transmissions compared to the very robust demand for these products experienced in the same quarter last year.

Our international operations performed very well and partially offset the results we experienced at our domestic operation. Our Asian and European operations had strong quarters reflecting our geographic diversity. Shipments in the first three months were also impacted unfavorably by the implementation of a new ERP system at our domestic manufacturing operations that caused delays in shipments during July and August. The Company began shipping at normal rates in September.

Gross margins as a percent of sales for the current quarter were 27.6% compared to 32.4% in last year's comparable period. Profitability for the current three months was impacted by lower volumes, unfavorable product mix, higher material costs and higher pension expense, partially offset by pricing and expanded outsourcing. Specifically, margins were hurt due to fewer oil and gas transmissions being shipped versus last year and due to one-time shipping delays related to the implementation of the ERP system.

Marketing, engineering and administrative expenses as a percentage to sales were 22.5% for the current first quarter compared to nearly 20% in the same period last year. First quarter 2009 expenses were unfavorably impacted by foreign exchange translation, higher corporate IT expense, higher pension expense, and an overall increase in salaries and benefits. Net earnings for the fiscal 2009 first quarter were 2.5 million or $0.22 per diluted share compared to 5.1 million or $0.44 per diluted share a year ago. As a record--against a record first quarter performance last year, the current first quarter reflected unfavorable comparisons of both lower shipments of oil and gas transmissions as well as delayed shipments of product due to issues related to the implementation of the new ERP system.

Turning to our financial condition, Twin Disk maintains a strong financial balance sheet with excellent liquidity. The Company has 14.9 million in cash and 52--55.2 million of debt for a total debt to capitalization ratio (sp?) of 30.7%. The recent financial turmoil has not yet had an impact on our business and we are actively monitoring the situation. Our six-month backlog stands at 118.6 million compared to 112.3 million a year ago. We continue to have a good order intake and we continue to be cautiously optimistic about our prospects for the balance of the fiscal year.

That concludes the prepared remarks for today and Chris, John and I are ready to take your questions. Michael?

Operator: All right, thank you. Ladies and gentlemen, at this time we will begin our question and answer session. As a reminder if you do have a question at this time please press the, star followed by the one on your touchtone phone. Once you make that choice, if you decide you'd like to withdraw your question pressing the star followed by the two will remove your line from the queue. And as a further reminder, if you are using speaker equipment today, please note you will need to lift up your handset prior to making that selection.

Our first question is from the line of Peter Lisnic with Robert Baird. Please go ahead.

John Helsalter: Good morning--or good afternoon. Actually, John Helsalter (sp?) on for Pete. Just question for you guys with the margin and the ERP--the ERP system. But is it safe to say that the gross margin improved in September once shipments kind of resumed their normal rate?

Michael Batten: That's correct.

John Helsalter: And would those on a year on year basis when you guys close the books for September, was there just--was there degradation there or was it really pretty comparable year on year?

Michael Batten: Fairly comparable.

John Helsalter: Okay, thank you. And then turning over to the oil and gas transmission business, if I remember right that's a longer kind of production time business where it doesn't initially in order (sp?)—doesn't initially go into your backlog I think. How much--I mean you said orders were up. But I mean how much business did you book there that is going to happen in kind of the fourth quarter of fiscal '09 or fiscal 2010?

Michael Batten: Well the--we are seeing order intake. Some of the orders for the oil and gas transmissions are falling into this fiscal year. But some are falling out into fiscal '10.

Chris Eperjesy: John, this is Chris Eperjesy. The number that we reported in the press release would only relate to the six-month backlog. So it would not relate to the stuff that Mike referred to that was beyond (sp?) that.

John Helsalter: Okay. And it's safe to say that's probably the majority of the orders you took for oil and gas transmission that fall outside that six-month backlog number?

Michael Batten: We are prepared to ship before the six-month period for certain opportunistic orders. But normal lead times would have them fall outside going forward, outside of the six-month backlog number.

John Helsalter: Okay. And then just following up on that a little bit, my last question, just with the kind of the falling oil prices in the last kind of 40 days or so, have you seen a difference in kind of quoting activity or just interest from customers in kind of upgrading their fleets to higher horsepower transmission?

Michael Batten: John, do you want to take that?

John Batten: No, no, we haven't. We actually in the last, I would say, three to four weeks we've seen an uptick in the order activity. Basically request the quote, lead times and things like that; there's actually been an increase.

John Helsalter: Okay. And is there--I mean it seems a little counterintuitive. Is there any reason you would attribute to that or is it just kind of just people are busier than you would think? Any thoughts behind why that is?

John Batten: Well, it's a global activity and I think people--my opinion is that people think that this--the downturn in oil prices is a temporary phenomenon. How long that temporary phenomenon is, no one's sure. But it's just temporary.

John Helsalter: Okay, thank you. I'll get back in queue.

Operator: Thank you. Our next question is from the line of Rob McKenzie with Lafitte Capital. Please go ahead.

Rob McKenzie: Hey, guys. First I'd like to congratulate you on what--I think it was a lot stronger revenue quarter than I would have expected. You talked about mix some in the quarter. Is there a way that you could quantify the differential in the mix Q1 versus say the mix in Q1 of last year, what the percentages were amongst the oil and gas business versus, you know, the marine business?

Michael Batten: Hi, Bo. Nice to have you on this call. The--we don't normally breakout the specific mix information other than to call attention to it. Clearly last first quarter of 2008, a year ago, we had a lot more oil and gas transmission shift than we obviously did in the first quarter this year. So that fall off in a comparison works adversely, of course, in the current quarter. But having said that, the order activity has increased in oil and gas as John has spoken.

The other component of which could be mixed is the fact that we had the ERP system shipment delays that impacted first quarter shipments. And these were largely service parts and industrial products that were impacted by the shipping delays because of the new system. So we had, unfortunately, the margins associated with service parts are larger than normal and in our unit side of the business and that contributed to the adverse product mix in the quarter.

Rob McKenzie: Well, everything else being equal then, you know, kind of looking at your service stuff (sp?) which I'm not sure whether or not that goes through backlog. But if it slipped out of Q1, well I'm going to assume it slipped into Q2. And with the six-month backlog as strong as it is, would that indicate, you know, without forcing you to give guidance, but if you look at Q2 at least from a revenue perspective, you ought to be looking at a stronger performance than in Q1 or in Q2 of last year?

Michael Batten: Well, one could say that. And actually we are, as we say in our outlook, generally cautiously optimistic. Our optimism derives from the fact that we do see our backlog strengthened. We see the point that you just made that some of the shipments that were not shipped in the first quarter will be shipped in the second quarter and beyond. And so there are obviously as well inquiries on our order intake for oil and gas. And as we pointed out in the press release, our marine markets remain strong and activity outside of the United States remains strong. So a number of things are going--continue to go well for us and that's why we maintain the outlook that we have.

Rob McKenzie: Did--I know this is hard data to get but I'm sure you guys look at it. But do you look at the international ship yards that are building the mega yachts? Have you guys heard anything that would lead you to believe that the turmoil that's going on out there for the average Joe is having any impact on the billionaires that are building these boats? Any kinds of signs of cancellations or any flags for alarm that we should be watching?

Michael Batten: Well, I'm going to turn it to John.

John Batten: Hi, Bo. We haven't heard of any specific issues. I know that ship yards--they're moving their schedules around. About the only thing that we see is that the--you know, the pleasure craft worry has kind of maybe crept up a little bit in the horsepower side. But as far as specifics through a shipyard or customers based on the financial crisis, we haven't seen anything in the last three weeks, four weeks that would say it's any worse. There were pleasure craft yards in trouble before the financial crisis just on the general downturn.

Rob McKenzie: Right.

John Batten: But we don't have any specifics based on this current crisis, not to say that there might not be something out there and we're actively looking. But we haven't come across anything yet.

Rob McKenzie: But would a fair conclusion be the main yards that you guys are dealing with are still out there backlogged for several years?

John Batten: We believe so. The Feredi Group (sp?), Adamate (sp?) in Italy are well-positioned. I think they're very financial stable. We don't see anything in those big yards, Sunseekers, you know.

Rob McKenzie: All right. Well, thanks a lot, guys.

Michael Batten: Thanks, Bo. Michael?

Operator: All right, thank you. Our next question is from the line of Paul Mammola with Sidoti & Company. Please go ahead.

Paul Mammola: Hi, good afternoon, guys.

Michael Batten: Hi, Paul.

Paul Mammola: Could you give us a sense in order of magnitude a few things that you listed in terms of materials, product mix and volume, which was the most adverse or which had the most adverse effect on cost of goods sold?

Michael Batten: In terms of all of volume, mix and so on?

Paul Mammola: And materials, yeah.

Michael Batten: Yeah. Well, I think that when you--you're going to compare the first quarter this year versus last year. Is that correct?

Paul Mammola: Yes. But I guess it would be interesting to hear what you have to say on 4Q fiscal '08 as well just because you would expect higher marine sales to have an effect on margin but not to the extent of, you know, 200 basis points.

Michael Batten: Yeah. The major impact on our profitability or our gross margin came from the adverse comparisons of having oil and gas transmissions out of the mix or reduced in the mix in the first quarter. That was impact number one. Impact number two was the second component of the product mix and that was the delayed shipments of profitable aftermarket parts and other industrial products. Number three would be the volume impact. It's a little bit slower in the summer. And then material charges or price increases had an impact but that we see is now beginning to moderate.

Paul Mammola: Okay, thank you. That's very helpful. So I guess would it be fair to say that, you know, given the strength in the marine going forward, is it fair to say this really is a 30% gross margin business and that most of this is one-time in nature? And if so, is there anything in this quarter that we can quantify as one-time?

Michael Batten: I'll ask Chris to comment on the one-time. But to your first part of your question, the business is still moving forward at a 30% gross margin basis. Chris, do you want to comment?

Chris Eperjesy: Yeah, and then regarding the one-time comment, I think the only item that I would classify as one time is the disruption that was caused by the implementation of the ERP in July and August.

Paul Mammola: Okay. Is there any--

Chris Eperjesy: (Inaudible) typical first quarter versus another typical first quarter.

Paul Mammola: Is there any number on that by any chance, Chris, in terms of ERP effect?

Chris Eperjesy: We haven't quantified it but it had a significant impact.

Paul Mammola: Okay. And just one more thing. If you look back to '01, '03 or the last slow manufacturing period in the U.S., you know, sales are pretty stable for you guys which is certainly positive. When you see costs start to creep, I guess is there anything that you could mention that could help you cut costs, besides ERP? I guess more on the lines of ME&A going forward?

Michael Batten: Well, we are watching very carefully our ME&A expenses, Paul. And the key things there that impact us are obviously we had some FX impact, we had some increase in pension expense impact, we are probably going to see an offset on stock-based compensation of--in that regard. I did mention also a delta on Corporate IT expense. So the bad guys are FX, IT expense and expense--pension expense. The offset to that going forward would probably be stock-based compensation of--and Chris am I--

Chris Eperjesy: No, you're right on.

Michael Batten: Yeah, okay. So we do have some modest increase--inflationary increase in the salaries and benefits. But we are looking very closely at our spending in this, you know, financial environment and doing everything to control our costs to make sure that we aren't overspending in that regard.

Paul Mammola: Okay. So phrased differently, I guess, do you think this business should be running at around 22.5, 23% ME&A of sales or do you think that maybe that's the high watermark for the year?

Michael Batten: That's a higher number, we think, Paul.

Paul Mammola: Okay.

Michael Batten: We should be running under that.

Paul Mammola: Okay. Thanks for your time.

Michael Batten: You're welcome. Michael?

Operator: All right, thank you. Elliott Blonde with RBC Wealth Management. Please go ahead.

Elliott Blonde: Good morning. Most of my questions have been answered. Maybe I can ask this in a different way. If we were to quantify the ERP, would $0.10 to $0.12 out of this quarter be a reasonable assumption?

Michael Batten: Elliott, that would be in the ballpark.

Elliott Blonde: Thank you. Otherwise, I'm fine. Thanks.

Michael Batten: Okay. Thanks for your input.

Operator: Thank you. If there are any additional questions at this time again please press the, star followed by the one now. If you're listening via speaker equipment, you will need to lift your handset prior to making that selection.

Abbott Keller with Kestrel Investment Management, please go ahead.

Abbott Keller: Yes, I was wondering about what your thoughts were on share repurchase going forward.

Michael Batten: At this point in time, of course, the window is still closed and will be for most of this week. We do have some freeboard (sp?) in our lines of credit. And we will be looking at the markets and whether we should be in the market or not as we go forward. We also want to make sure that we have freeboard for our external growth program which maintains on an active status. So it will be a balance between those two items.

Abbott Keller: Okay, thank you.

Michael Batten: You're welcome.

Operator: All right, thank you. And I'm not registering any further questions at this time. Once again it's a final opportunity if you do have a question please press the, star followed by the one now.

We do have a follow-up to the line of Paul Mammola with Sidoti. Please go ahead.

Paul Mammola: Hi, guys, sorry. Has there been any correspondence with Marshall and Eisley (sp?) in terms of the Revolver? Any color there, I guess?

Michael Batten: I'll turn it to Chris.

Chris Eperjesy: I mean it's business as usual I would say. I mean we've had conversations with them, you know, obviously as the crisis has been ongoing. But our Revolver continues in place and exists or the expiration date is another two years out. At this point, as Mike mentioned, we continue to have capacity on that Revolver so nothing's really changed as a result of what we're seeing in the marketplace.

Paul Mammola: Okay, that's helpful. And then just lastly on cap ex, what's the expectation for that for fiscal '09 and does that come down a bit due to ERP finally getting wrapped up?

Michael Batten: Well, the actual planning for this fiscal year is probably about the same level as we spent last year, roughly $15 million. We are watching that as events unfold. But at this point in time, we're looking at that kind of spending level, Paul.

Paul Mammola: And what are the main uses there, Mike, because it's running quite a bit ahead of D&A.

Michael Batten: What we are doing is quite frankly investing in our core competencies and our factories both here and abroad. And I'll just leave it at that for the moment. But it's basically assisting us to improve our productivity.

As you know, when you walk through the plant, we had a number of significant new machine tool purchases which basically with one machine taking two, three, even four older machines out of production, it's that kind of productivity improvement that we're investing in both here and our plants overseas.

Paul Mammola: Okay, good enough. Thanks again.

Michael Batten: Yep.

Operator: All right, thank you. And a follow-up from the line of Rob McKenzie. Please go ahead.

Rob McKenzie: Yeah, how much is left in the Revolver and correspondingly given the massive declines in valuations of everything in the course of the last month or so, are there things out there that maybe you might be able to add.

Michael Batten: Bo, you are talking about how much is left on the Revolver?

Rob McKenzie: Um-hmm.

Michael Batten: It's a $10 million that we have freeboard at this point, right.

Rob McKenzie: Is there anything else that you've got lined up in available credit facilities? For example, say, like an attractive $50 million transaction were to come up, are facilities in place that could do something with that or--

Michael Batten: Yeah, I'm sorry to interrupt you. Go ahead and complete.

Rob McKenzie: No, you know, if given the math (inaudible) and valuations of everything in the world in the last month or so, what could you raise in the way of liquidity without having to go out and originate new debt or equity?

Michael Batten: Well, it would require our going out and looking to talk to our lenders. We have very good relations with our vendors both the MNI Bank in Milwaukee as well as Prudential who has our long-term debt. And at this point in time, we would think that we would have access for additional capital, albeit at a higher rate of interest, but at this point in time we don't have the specific need. But should a specific need come up, I'm sure we could get access to the capital.

Rob McKenzie: All right. And have you guys seen or have you even looked yet to see if some of the things you might have had on your want list have seen the valuations come down somewhat? Or is the private market not really connected with what's happened to public valuations yet?

Michael Batten: Well, that's a good question. We tend to look more, as you know, from our history at private companies. And rather than the marketplace being the mechanism to instantly tell you what the current value is, you tend on dealing with people's perception of their own Company's worth. And so there's usually some delay in that occurring.

Rob McKenzie: Right. All right. Well, listen, thanks a lot, guys.

Michael Batten: Okay. Thanks, Bo.

Rob McKenzie: Bye.

Operator: All right, thank you. Gentlemen, there are no further questions at this time. Please continue with any closing comments.

Michael Batten: Okay, thank you. That's it. We'd like to thank you very much for attending this afternoon's conference. We appreciate your interest in Twin Disk and your following our company. Again, if you have any follow-up questions that you think of after the call, please feel free to contact us at our offices in Racine. In the meantime, please enjoy your day and thank you very much--thank you, Mike.

Operator: All right, thank you. Ladies and gentlemen, this does conclude the Twin Disk Incorporated 2009 First Quarter Financial Results Conference Call. If you would like to listen to a replay of today's conference please dial 1(800) 406-7325 or (303) 590-3030, use the access code 3930325. Those numbers again (800) 406-7325 or (303) 590-3030, access code to utilize on either number 3930325. ACT would like to thank you very much for your participation. You may now disconnect. Have a very pleasant rest of your day.