Twin Disc, Inc.
2010 Fourth Quarter Financial Results Conference Call
August 3, 2010

Operator: Ladies and gentlemen, thank you for standing by and welcome to the Twin Disc, Inc. 2010 Fourth Quarter Financial Results. During today's presentation, all parties are in a listen-only mode. Following the presentation, the conference will be open for questions. If you have a question, please press the star, followed by the one on your touchtone phone. If you would like to withdraw your question, please press the star, followed by the two. If you are using speaker equipment, please lift the handset before making your selection. As a reminder, this conference is being recorded today, Tuesday, August 3rd, 2010.

And now, I would like to turn the conference over to Stan Berger of SM Berger. Please go ahead, sir.

Stan Berger: Thank you, Barbara. 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 2010 fourth quarter and full-year financial results and business outlook.

Before I introduce management, I would like to remind everyone that certain statements made during the course of this conference call, especially those that state management's intentions, hopes, beliefs, expectations, or predictions for the future are forward-looking statements. It is important to remember that the Company's actual results could differ materially from those projected in such forward-looking statements. Additional information concerning factors that could cause actual results to differ materially from those in the forward-looking statements is contained in the Company's annual report on Form 10-K, copies of which may be obtained by contacting either the Company or the SEC.

By now, you should have received a copy of the news release which was issued this morning before the market opened. If you have not received a copy, please call Annette Mainaki at 262-638-4000 and she will send you a copy.

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

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

Michael Batten: Thank you, Stan, and good day, everyone, and welcome to our fourth quarter and year-end conference call. As Stan has indicated, I will start out with a brief statement, and then John, Chris, and I will be available to take your questions.

It is gratifying to report that, with solid sequential improvement in the fourth quarter, we were able to report a profit for the full year. Considering where we started at the beginning of the year, we are pleased with the outcome. At the same time, we generated 35 million in operating cash flow, lowered our debt 39% to 31 million, and finally, our outlook for the coming fiscal year is for continuing improvement.

Let's turn now to the summary details of the fourth quarter. Revenues for the final three months were $64 million compared to 72 million posted last year. Orders and shipments of oil and gas transmissions, along with stable demand for our ARFF, land and marine-based military, and Asian-Pacific markets offset continuing softness in the mega yacht and European markets. Total revenues for fiscal 2010 totaled 228 million compared to 296 million for fiscal 2009.

Our gross margin as a percentage of fourth quarter sales was 30.2% compared to 26.7% for the same period last year. The improvement reflects the benefits of our cost reduction efforts, higher volumes, as well as favorable mix in our business. Year-to-date gross margin as a percentage of sales was 26.6% compared to 27.6% and reflects the narrower margins experienced earlier in the fiscal year.

Our ME&A expenses as a percentage of sales for the quarter were 22.8% compared to 17.5% last year. For the current fiscal year, they were 25% compared to 20.5% for the previous fiscal year. Overall, ME&A expenses were down 3.6 million year-over-year, reflecting a netting of increased expenses in pension and stock-based compensation, and reduced expenses resulting from across-the-board cost reduction initiatives in wages and salaries, including executive compensation, the elimination of the bonus plans, and changes to certain benefits.

The Company's tax rate for the fourth quarter was 54.4% compared to 46.9% in the comparable period last year. For the full year, the effective rate was 57.6% compared to 34.7% in the prior fiscal year. The relatively high tax rates for the current period reflect operating at a loss or near breakeven, where small adjustments can have a relatively larger impact on the tax rate.

Net earnings for the fourth quarter were $2 million, or $0.18 per diluted share, compared to 2.7 million, or $0.25 per diluted share, for the same period last year. For fiscal 2010, net earnings were $597,000, or $0.05 per diluted share, compared to 11.5 million, or $1.03 per diluted share, for last fiscal year.

We ended fiscal 2010 with a strong balance sheet. As indicated earlier, we generated 35 million in operating cash flow during the year and reduced our debt 39% to 31 million. Our total debt to capitalization at June 30th, 2010, stood at 26%.

Looking ahead, our six-month backlog at June 30th, 2010, was $84 million, up 39% from the same date a year earlier. The improvement in our backlog reflects the strengthening of orders for our 8500 series transmission from the oil and gas sector. The 7500 series transmission has entered the field test phase and is expected to be in production in the second half of fiscal 2011. We anticipate more modest growth in demand from our ARFF land and marine-based military and Asian marine customers that will offset the continuing weakness in the industrial, pleasure and European markets.

That concludes my prepared remarks. And now, John, Chris, and I will be happy to take your questions. Barb, we're open for questions now.

Operator: Thank you, sir. Ladies and gentlemen, we will now begin our question and answer session. As a reminder, if you have a question, please press the star, followed by the one on your touchtone phone. If you would like to withdraw your question, please press the star, followed by the two. If you are using speaker equipment, you will need to lift your handset before making your selection.

And our first question comes from the line of Paul Mammola with Sidoti & Company. Please go ahead.

Paul Mammola: Hi. Good afternoon, everyone.

Michael Batten: Hi, Paul.

Paul Mammola: Would you guys say that your cost structure is such that, at around 64 million in sales, you can keep gross margin near 30%? Or would you say what you saw in the fourth quarter was really more mix-related than anything else?

Michael Batten: Well, that's a good question, and I think that we have hopes moving forward to have gross margins in the 30% plus range.

Paul Mammola: Okay, fair enough. Can you give us a general sense of how much off-highway, or how off-highway did in the quarter relative to marine?

Michael Batten: John, would you like to respond to that?

John Batten: Well, it was, I would say, an improving quarter for off-highway. It had been improving throughout the year, and marine had been relatively flat and stable throughout the year. So, as far as quarters go, it was the best, I'd say, mix of off-highway to marine.

Paul Mammola: Okay. And when you separate pleasure craft and mega yacht, is it fair to say that mega yacht is really weighing things down and maybe you might be seeing some improvement on the pleasure craft side for, say, service drives or steering systems?

John Batten: I would say of, you know, where our products end up, the pleasure craft area is by far the weakest still. And we had good activity, good growth in the patrol boat market, which happens to use the same marine transmissions, drives, propellers, and hydraulics. So we're very fortunate that those markets picked up throughout the year.

Paul Mammola: Okay, that's helpful. And then, finally, is the 7500 series making up a meaningful piece of backlog yet, of that 84 million?

John Batten: It's not making—it is—we have, I would say, for this point, a good backlog, but our backlog has grown, so much so that I don't know if I would consider it significant at all at this point.

Paul Mammola: Okay. Fair enough. Thanks for your time, guys.

Michael Batten: Part of that, Paul – Mike again – is that obviously we reported a six-month backlog, and the orders that we have in the backlog right now are primarily for field test units. With production starting outside of the frame of the six-month backlog, that's where we would expect to see meaningful improvements going forward. And right now, the 8500 series is in great demand and is a proxy, both for 8500 and 7500.

Paul Mammola: Okay. So, when you look at your backlog mix this year, would you say it's substantially different compared to last year at this time, meaning, I would guess, that there's more 8500 series in there? Is that fair to say?

Michael Batten: Mike again, Paul. Yes, the backlog in oil and gas is significant. And because it is a longer lead time product, what you're seeing is the benefit in the first six months for orders entered during the second half of this fiscal year, but you aren't seeing the significant growth in the backlog that is occurring beyond what we report.

Paul Mammola: Okay. Thanks again.

Michael Batten: Yes.

Operator: Thank you. And our next question comes from the line of Bo McKenzie with Global Hunter. Please go ahead.

Bo McKenzie: Hey, guys.

Michael Batten: Hi, Bo.

Bo McKenzie: I don't know if it was my system or your system, but in the start of the call, I could hear you talking a little bit about what was going on with the 7500 tests but I couldn't make it all out. How are the tests going so far on that? And what are you hearing back from the customers in terms of their satisfaction, the smaller size, you know, whatever the criteria would be?

Michael Batten: Well, the lab testing went great. We've moved on to field testing and are really installing it at rigs now for testing in the field, whether at a test wellhead or at a job site. I would say, overall, the impression when they get the unit, it is obviously smaller and lighter than the 8500, so they are pleased with that, and it fits in a more standard design of a frac rig between the frame rail (sp?). So, that's about what we have. In the next six months, we're going to be doing a lot of testing out in the field and at well sites.

Bo McKenzie: Then kind of, along that front, you know, down here is an oil patch. We keep hearing the E&P companies and the frac companies saying the Haynesville, the Eagle Ford, the Bakken, it's just eating equipment up. There are people who are taking 50,000 horsepower off to a 30,000 horsepower job because the pressures and the temperatures are such that it's just wearing the equipment out. Is there a big aftermarket for you guys on the existing 8500 installed base, or are you seeing customers having to come through and replace stuff that, you know, pumping 30,000 horsepower frac jobs is just wearing the equipment out faster?

Michael Batten: One of the differences this time versus a few years ago, Bo, is there is an aftermarket component because every rig manufacturer or operator we're talking to is, you know, the higher pressures, they're running longer, and they're basically operating, not 24/7, but they're operating a lot more per day than they had been. So, there is definitely an increased aftermarket component now.

Bo McKenzie: And could I ask one more question?

Michael Batten: Sure.

Bo McKenzie: You guys, I'm looking at the December, excuse me, September—dang it, I'll get this right in a minute. To June of '07, okay, and you guys peaked out at about 110 million of six-month backlog. You just reported 84 million of six-month backlog and I guess that the composition has changed quite a bit from '07 to now. I mean, is it fair to say that, you know, reading between the lines, or not even really that much between the lines in the press release, but the mix right now versus where you would've been at the end of '07, fiscal year '07, has got a lot more of the 8500 series stuff in there and a lot less of the mega yacht business, I would guess, huh?

Michael Batten: Yes, that's fair to say. And in '07, you know, every end market where we had product in was basically at or near a peak, which is not the same now. Pleasure craft is way down from 2007.

Bo McKenzie: So, you're at 80% of where you peaked out without that side working for you right now?

Michael Batten: Correct. We're still growing (sp?).

Bo McKenzie: All right. Well, it sounds good to me. Thanks.

Michael Batten: Good. Thanks, Bo.

Operator: Thank you. Ladies and gentlemen, if you'd like to ask a question, please press star, one on your touchtone phone. To ask a question, it is star, one.

And our next question comes from the line of Peter Lisnic with Robert W. Baird. Great. Please go ahead.

Peter Lisnic: Good afternoon, everyone.

Michael Batten: Hello, Pete. How are you?

John Batten: Hi, Pete.

Peter Lisnic: Good. How are you guys?

Michael Batten: Good. Doing well, thanks.

Peter Lisnic: I guess, first question, can you give us a little color commentary on what's happening with military end markets, what you're hearing from you customers in terms of budget pressures and kind of spending on some of those programs that would have an impact on your top and bottom line?

Michael Batten: Sure. I'd do the legacy first (unintelligible). We have a couple of projects within legacy military for the US military, and those projects are continuing on, kind of at stable volumes. These vehicles are in use everyday in Iraq and Afghanistan and there's a rebuild program going on, and we have a good backlog of orders going out quite a ways on those. The big change would be the patrol boat market, and that's global, more in Asia and India as far as growing market share, and that part of our military business is growing.

Peter Lisnic: And you mentioned market share, or is that—I mean, is it a function of A, market share and just market growth, or the latter of the two, I guess?

Michael Batten: Well, it's more of the market growth. There is a lot more activity and spend, particularly in patrol boat, marine-type applications for vessels that are in our size range, so it's a very good market for us.

Peter Lisnic: Okay. And just, if I could, how much visibility do you have in that business? In other words, I assume when you're talking to these customers, they're probably looking at more than a year out, if you will, in terms of what they might be ordering. Is that the right way of thinking about it?

Michael Batten: You get good—I mean, from the—when you first hear about a project to when the—a boat builder wins the tender, that can be measured in years. But usually once a project is awarded, it's probably 12 to 18 months visibility that you have on when you need to deliver.

Peter Lisnic: Okay. All right. And then on the 7500, I understand that that's not really all on the backlog yet. Can you give us a little bit of color on what you're at least experiencing from an order inquiry perspective on that product?

Michael Batten: Sure. We have customers that have 8500 orders in with us, and we expect that as we approve the 7500, their application for the 7500, that some of the 8500 orders will be converted to 7500. But we're also expecting growth with just the 7500 standalone.

Peter Lisnic: Okay. All right. And then, I guess, last question, and I guess, Chris, maybe you can help here. But the—in terms of the gross margin, you made a comment earlier about that 30% clip and being able to run above that. My guess is part of that is due to mix as the backlog, I guess, skews more toward oil and gas. A, is that correct? And then, B, how should we think about how some of the cost savings that you've talked about in the past, how those flow through incrementally in 2011? Any changes on that cost savings front?

Chris Eperjesy: Right. I mean, clearly, the margin from the third quarter to the fourth quarter and the growth throughout the year was a combination of the volume and also the mix that the 8500 picked up throughout the year. So, to answer that question, yes, mix was a part of it.

Regarding B, you also started to see the effect of some of that. I understand that the percentage of sales, it was up, but clearly you saw, you know, when you adjust for some of the, what I'll call noise, the stock-based comp, the pension, and some other one-time items last year, you know, there was a reduction. So, in the ME&A line, which I know was below gross margin, you'll see some benefit. But also, there's things that were done as part of that cost reduction effort last year that affected fixed cost that certainly will have an effect as we increase volume throughout 2011.

Peter Lisnic: Okay. And are there any changes in terms of engineering expense for this year? Realizing now that you've got the 7500 in testing phase, I would assume there's new products that are on the books but just wondering if there's any big change in spending that we should sort of think about modeling.

Michael Batten: No. We have some key projects coming up this fiscal year as well and beyond.

Chris Eperjesy: That was one of the areas, Pete, last year where we didn't do—you know, we continued with the plans that we're on, so it wasn't as if there were major cuts in that area. So, I guess to answer it differently, we're going to continue moving forward with those types of projects that technologically differentiate our product.

Peter Lisnic: Okay. That is very helpful. Thank you for your time.

Michael Batten: Yes.

Operator: Thank you. And our next question comes from the line of Shawn Boyd with Westcliff Capital Management. Please go ahead.

Michael Batten: Hi, Shawn.

Shawn Boyd: Hi there. How are you guys doing?

Michael Batten: Good, thanks.

Shawn Boyd: A couple of quick ones for you. What is your manufacturing capacity on the 8500, and also on the 7500, once we go into commercial production on that?

Michael Batten: It's—we don't break out, Shawn, the exact capacity, but we have ample capacity through internal production capabilities, as well as expanding our subcontracting source of supply.

Shawn Boyd: Okay. So, what would lead times look like right now for the 8500, Michael?

Michael Batten: They're six, seven months, say. Seven to eight months.

Shawn Boyd: Okay. And what was that, say six months ago?

Michael Batten: Six months ago, it probably would have been in the four to six-month range. There were very few orders. It's been the last quarter plus a couple of months getting all of the supply base back up into production.

Shawn Boyd: Got it. Okay. And on the gross margin question – now I might be making you repeat something here – but I heard the earlier comment regarding shooting for over 30%. And I'm also thinking about a mix here that is dominated by energy, and I'm kind of going back to the days of sort of 35% gross margin. So, I don't want to push too hard, but is there any chance that we could see something more into the mid-30s, given our backlog mix right now?

Michael Batten: Well, we answered the question the way we answered it, but obviously we're pushing ourselves to grow our margin and to get back to what we demonstrated, which was about 33, 34% on an annual basis in '07 and '08. So, but at this point in time, I think, and looking out for this fiscal year, at a start, I think the 30% is a reasonable number but we're going to be pushing to do better.

Shawn Boyd: Okay. Very good. And on the backlog, we talked about the—you guys gave us a six-month backlog, and there were a couple of comments earlier that made me think a little bit more about that. You're looking at a total backlog and then just reporting the six-month. So, given that we're at the cusp of going into commercial production on the 7500, it seems like your total backlog could be growing at a faster rate right now than the six-month. Is that correct?

Michael Batten: That's a good observation.

Shawn Boyd: Okay. And I got to try. Can you give us a little bit of magnitude on how much (unintelligible)?

Michael Batten: Well, it was a good try, Shawn, but at the moment, that's not a number that we fully disclose. But rest assured that the content outside of the six-month timeframe has been growing nicely.

Shawn Boyd: Okay. (Unintelligible).

Michael Batten: Just putting two and two together with our lead time and where our incoming orders for 8500s have to be placed, or 7500s, and the demand has been very good.

Shawn Boyd: Okay. Sounds good. The only other question, I guess, for me is on the airport rescue and firefighting and land and marine-based military strength that you're seeing. Is that—is there anything one-time in nature or is there anything that you expect to fall off there? I mean, how would you characterize demand going forward, say versus the last, versus the June quarter (unintelligible)?

Michael Batten: You listed airport rescue, firefighting, and land and marine-based military?

Shawn Boyd: Yes.

Michael Batten: Okay. With ARFF and land-based military, I see it being very stable going forward. Marine military, just by the nature of the projects, that's always a little bit more erratic, but overall, we see the market continuing to be good. I guess that one's a little bit harder to predict quarter-to-quarter because of when projects fall.

Shawn Boyd: Got it. Got it. Okay. And I lied; one last one that just popped in. We mentioned the strength, obviously, on the 8500 and then coming on the 7500. Would you say energy, at this point, is over 50% of the backlog?

Michael Batten: No, it wouldn't be. But it's the fastest growing part of the backlog.

Shawn Boyd: Right. But I assume, you know, higher than your kind of average that it's been in the (unintelligible)?

Michael Batten: Well, we have, in the backlog we have continuing ARFF and the land-based and the military marine that we spoke about. We do have work boat and crew boat kinds of orders from around the world that continue to come in. So, they still account for the majority of the business but, clearly, the run-up in the backlog is largely attributable to the 85 and, forthcoming, the 7500 series.

Shawn Boyd: Got it. Very good. Congrats on the quarter and congrats on that growth in orders.

Michael Batten: Good. Thank you.

Operator: Thank you. And our next question comes from the line of John Braatz with Kansas City Capital. Please go ahead.

John Braatz: Good afternoon, gentlemen.

Michael Batten: Hi, John.

John Batten: Hi, John.

John Braatz: As I was doing some homework on the Company a couple of months ago, I was working under the impression that the 7500 product was distinctly different than the 8500 and will be serving a different market, and as you mentioned in your prepared comments, that you've got some 8500 series products that would probably be replaced by the 7500 when it is available. How much cannibalism might there be as we look forward to the introduction of the 7500? And how distinctly different marketplace are we—is the 7500 going to serve?

Michael Batten: Well, I don't think they're very different markets. I mean, they're both oil and gas, primarily gas and shale fields. The 8500 has a higher horsepower rating, with 3,000 horsepower versus 2,600 horsepower. The 7500 weighs a lot less, it's less expensive, it's dimensionally smaller so it can fit in, what we say, rotable (sp?) rigs, frac rigs that don't need special permits to move from one area to another.

John Braatz: Mm-hmm.

Michael Batten: So, just by the nature of organization and planning, those types of rigs are easier to have on hand, to move where you have the demand.

John Braatz: Mm-hmm.

Michael Batten: We see some cannibalization. I don't think it will be much because there are a lot of rig producers who are producing at the 3,000 horsepower level so the 7500 cannot fit on that.

John Braatz: Right.

Michael Batten: But we are applying some 8500s into the 2,200 horsepower range, and we expect those to go to the 7500. But we don't expect to introduce the 7500 and have the overall oil and gas backlog remain flat. We do expect growth with it.

John Braatz: So, is there a way you can quantify the new market, the rotable rigs that you might be entering with the 7500, how sizeable that is compared to what your current market size is and what the 8500 is selling into?

Michael Batten: Well, you know, if I go back a few years, the horsepower range, from 1,500, say to 2,250 could be anywhere, in a given year, five to 10 times larger than what the 8500 would be, just at the higher horsepower.

John Braatz: Okay.

Michael Batten: I think, in this latest ramp up, I think that the high horsepower segment may have grown faster than the lower horsepower segment, so I don't know if that would still hold right now.

John Braatz: But it'd still be—you think it would still be larger?

Michael Batten: Yes. Absolutely.

John Braatz: Okay. Just not of that multiple. Okay. You talk about the weakness in the pleasure craft and the mega yacht area. Is it worsening or just flattening out and remaining weak? Or do you see the trend a little bit, worsening a little bit?

Michael Batten: I would say it hit bottom, but it's certainly not noticeable improvement.

John Braatz: Okay.

Michael Batten: That would be the fair statement. And again, it depends on the area and the builder and what inventory they have and what they're trying to move.

John Braatz: Right. Okay.

Michael Batten: It's not a very yacht-friendly marketplace right now.

John Braatz: I understand. One last question. When I go back and look at sales, revenues by quarters, it always looks as though the first quarter seasonally is lower than the fourth quarter. But given the ramp up you're seeing in the 8500 in the oil and gas market, will that trend be the same this year?

Michael Batten: Well, we have—last year we had a month shutdown in the US manufacturing operations as well as the shutdown in Europe, which is traditional there.

John Braatz: Right.

Michael Batten: Plus, Europe was also basically at—the days that they were shifting, we were at a 50% manning level.

John Braatz: Mm-hmm.

Michael Batten: There's no month-long shutdown in the US this year; similar situation still in Europe so…

John Braatz: Right.

Michael Batten: I think you will see just, it's the number of shipping days that we have in the first quarter.

John Braatz: Okay. But it would—the number of shipping days will, relatively speaking, will be greater this year than last year?

Michael Batten: Greater this year than last year but not as many as the fourth quarter.

John Braatz: Right, right. Okay. All right. And as we look forward, the tax rate expectations for 2011?

Michael Batten: Chris?

Chris Eperjesy: Well, I mean, clearly it's going to go back to a more historical norm. I think, you know, just like you have mix with products, you also have mix with the tax rate by the jurisdictions…

John Braatz: Sure.

Chris Eperjesy: (Unintelligible) jurisdictions it comes from. But my expectation would be it'd be more in the normalized 36 to 38% range.

John Braatz: Okay. All right. Thank you very much.

Chris Eperjesy: Yes.

Michael Batten: Thanks.

Operator: Thank you. And we have a follow-up question from Bo McKenzie with Global Hunter. Please go ahead.

Bo McKenzie: Thanks. Hey, guys. Are you able to track where the transmissions are going? Some of our friends over at the frac business say that a lot of the international markets, predominantly cement equipment, that there is a number of European shales that seem to be getting some interest on—this cycle might have a fair amount of frac equipment built for the European market that the last cycle might not have.

Michael Batten: I can't, Bo. I don't—I know that our equipment is going right now into the familiar places; Canada, Western United States, and some going to Russia. I have not heard specifically of any of the new construction, or old construction going into some of the European fields yet.

Bo McKenzie: All right. And are there any signs that you guys are seeing, over on the workable rig side a pick-up in the (inaudible) converters of (sp?) the clutches yet?

Michael Batten: Yes, we are seeing, we are seeing a lot of spare parts, aftermarket parts, for the converters that are in those rigs.

Bo McKenzie: All right. And then one last one. I guess it's been a while since I've thought about this, but I think you guys were taking, what was it called, Slip Shift (sp?), Quick Shift?

Michael Batten: Quick Shift.

Bo McKenzie: I forget the name. Yes.

Michael Batten: Yes.

Bo McKenzie: And you were going to try to adapt it, I think you were going to try to adapt it for dynamic positioning work. I guess I lost track of what happened with that. Is there anything new that's going on on that front?

Michael Batten: No. We've done quite a bit of DP (sp?) work with Quick Shift, and then also DP-2 (sp?).

Bo McKenzie: Right.

Michael Batten: We have applications, I think, in all the major areas, operating off of Africa and Southeast Asia, and certainly in the Gulf Coast.

Bo McKenzie: But has it gained much commercial traction yet or…?

Michael Batten: Well, we—it's—the market certainly is, I'd say it's flattened out on that type of build. Yes, but we are gaining—we are selling more of our crew boat transmissions with Quick Shift, absolutely.

Bo McKenzie: All right. Well, great. Thanks.

Operator: Thank you. And our next question comes from the line of Rick Whiting with Broadview Advisors. Please go ahead.

Rick Whiting: Thank you. I just wanted to talk about the ARFF business a little bit and see—I mean, the characterization I've heard so far on this call is that you feel like it's fairly stable at this level, not necessarily growing much but at least stable. And is that, would that be a downtick from how you saw it, say six or nine months ago?

Michael Batten: Actually, it's holding at—I guess in terms of relative growth rate, you're correct, we aren't growing at the same pace that we were, but we are holding at a higher level of activity.

Rick Whiting: And particularly on the airport, rescue, firefighting side of it, would that be a business that's going to be constrained as long as governments remain constrained in terms of their own budgets? I mean, where does the funding generally come from for that equipment?

Michael Batten: It definitely comes from—where it ultimately comes from is from the government, but it usually comes through airport authorities. And a lot of the market activity, really, is driven outside of North America, in the EU, in countries where they need to upgrade their safety equipment for international flights. So, we see these developing countries, if they want to have intercontinental, international flights, they have to upgrade their equipment.

Rick Whiting: Is that an upgrade that is because the equipment they have is getting old and not as reliable, or is that because of the new mandate or some sort of…?

Michael Batten: It's safety standards, but it's really going to, you know, what an ARFF vehicle is versus a traditional fire truck in a lot of places. I mean, it goes, Rick, to the point of safety and the ability to do the mission. Acceleration rates play into this, payload, and the amount of time that it takes to empty the payload on a crash, in the event that it happens.

Rick Whiting: Well, okay. Thank you for that clarification. And as you look at your backlog, which has grown very nicely, is there any point in your supply chain that gives you any pause for concern that might stretch that backlog out?

Michael Batten: No one area. I mean, the—what we've been battling the last three to six months is getting the suppliers for oil and gas back up to, really, from zero to 100 in a pretty short order. There is, in some areas, there is less capacity in steel, for bearings and forgings. A lot of capacity was shut down over the last 18 months, and I think there's a wait-and-see attitude before there's added capacity back into the system.

Rick Whiting: Okay. Well, listen, thank you and congratulations on a nice quarter.

Michael Batten: Thank you.

John Batten: Thank you.

Operator: Thank you. And we have a follow-up question coming from the line of Shawn Boyd with Westcliff Capital. Please go ahead.

Shawn Boyd: Hi, guys. Just one follow-up on Europe. If you could, you mentioned that that area is weak. Just remind us what percentage of the business that is, maybe for the last quarter so we can kind of get a feel for where it is at this depressed level.

And then, also, are there other areas besides mega yacht? You know, what are the European sales? I understand from the earlier question with Bo that we don't really have any oil and gas there yet, but maybe the other product areas would help us.

John Batten: Shawn, I missed the first part of your….

Michael Batten: Yes, you're coming through a little bit quiet. Was it, what are our sales in Europe? What type of end markets are there?

Shawn Boyd: Yes. So, what percentage of revenues is Europe at this point, given that it's probably lower than it used to be, with the weakness? And then also, what type of end markets do those European sales represent?

John Batten: Well, Shawn, we don't give out the geographic numbers that way. We do break out domestic and Italy and the rest of the world, I believe, but the end markets that we serve in Europe largely relate to pleasure craft, the Italian and the UK, primarily, mega yacht markets, which were down on the order of about 40% year-over-year, and then, industrial markets that have languished a bit because of the European recession. So, that's the order of magnitude that we've seen over there.

Michael Batten: I would kind of—I would also add, Sean, that we also—the same products that are produced in Europe for pleasure craft are the ones going to the patrol boat markets, so they have an export component even though their domestic markets, their internal markets, may be slowing. And we have a lot of business for ARFF into Europe, which are taken care of by our European operations.

Shawn Boyd: Got it. Okay. And so, for, say the mega yacht and the industrial, are those areas still weakening on you? Or would you say those are at a low level that is just kind of waffling? How would you characterize the…?

Michael Batten: I would say any—all of the end markets in Europe are waffling and not doing as well as any other region in the world.

Shawn Boyd: Right. Okay, good enough. Thank you.

Operator: Thank you. And there are no further questions in the queue. I'll turn it back to management for any closing statement.

Michael Batten: Thank you, Barb. Again, thank you, everyone, for joining our conference call today. We appreciate your interest in Twin Disc and hope that we've answered all of your questions. If you have follow-on questions, please do not hesitate to call Chris or John or myself, and we look forward to speaking with you again at our conference call at the close of the first quarter in October. Thank you.

Barb?

Operator: Thank you, ladies and gentlemen. This does conclude our conference call for today. Thank you for your participation and you may now disconnect.