Twin Disc, Inc.
2010 Third Quarter Financial Results
April 20, 2010

Operator: Good afternoon ladies and gentlemen and thank you for standing by. Welcome to the Twin Disc Inc. 2010 Third 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 have a question, please press the star followed by the one on your touchtone phone. Please press star zero for operator assistance at any time. For participants using speaker equipment, it may be necessary to pick up your handset before making your selection. This conference is being recorded today, Tuesday, April 20th 2010.

I'd now like to turn the conference over to our host, Mr. Stan Berger. Please go ahead sir.

Stan Berger: Thank you Christina. On behalf of the management of Twin Disc, we are extremely pleased that you have taken the time to participate in our call. Thank you for joining us to discuss the company's fiscal 2010 Third Quarter and Nine Month 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 a copy to you.

Hosting the call today are Michael Batten, Twin Disc's Chairman and Chief Executive Officer; John Batten, President and Chief

Operating Officer; and Christopher Eperjesy, the company's Vice President of Finance, Chief Financial Officer and Treasurer.

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

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

We are pleased to report that we posted a profit in the third quarter, and our financial results continue to show sequential improvement. Year-to-date cash flow from operations reached 23.1 million, and total debt has been reduced 15.6% to 35.1 million, and our outlook for the balance of the year is for continued improvement.

Now, let's turn to the details of the third quarter. Revenues for the current three months were $61 million, down 12% from the fiscal 2009 third quarter, but up 10% from the 2010 fiscal second quarter. The year ago comparisons continue to reflect weakness in the mega yacht market; however, strengthening demand from our customers in the oil and gas market and continued demand from the airport rescue firefighting and land and marine based military, and Pacific commercial marine markets, drove the sequential improvement from the second quarter. Year-to-date, revenues totaled 163.2 million compared to 223.6 million posted last year.

Our gross margin as a percent of sales was 27.1% in the current third quarter compared to 27.6% in the comparable period last year, and 26.8% in the 2010 fiscal second quarter. Gross margins have continued to improve sequentially during the year as a result of increased sales volumes and a slight improvement in sales mix. Year-to-date, gross margin as a percent of sales was 25.1% compared to 27.8% for the fiscal 2009 nine month period.

For the fiscal 2010 third fiscal quarter, our ME&A expenses were 14.6 million compared to 14.5 million a year ago. In the prior three -- prior year's three months there was a 733,000 reversal of corporate bonus expense that reduced ME&A expenses in that period. In addition, a year-over-year changes in foreign exchange had a net translation effect of increasing ME&A expenses by 484,000 in the current quarter compared to the same three months last year. As a percent of sales, ME&A expenses for the current fiscal year were 23.9% compared to 21% for the same period last year, while the current nine months were 25.9% compared to 21.4 for the same period a year ago.

Net earnings for the current quarter were $1.5 million or $0.13 per diluted share compared to net earnings of 2.9 million or $0.26 per diluted share a year ago, and a net loss of 490,000 or $0.04 per diluted share for the fiscal 2010 second quarter. Year-to-date, the company reported a net loss of 1.4 million or $0.13 per diluted share compared to net earnings of 8.7 million or $0.78 per diluted share for the first nine months of fiscal 2009.

During the first nine months of the fiscal year, we generated 23.1 million in cash from operations. Total debt has been reduced by 16% to 35 million, and total debt to capital now stands at 25.2% compared to 33.2% at the same time last year. Our financial condition remains strong and we have flexibility for the future.

Turning to our outlook, our six month backlog at the end of the third fiscal quarter was 72.8 million compared to 60.6 million at June 30, 2009 and 70 million at December 25th, 2009. Our backlog continues to strengthen as order rates from customers in the oil and gas markets are increasing, and we expect sequential improvements to continue in the fiscal 2010 fourth quarter. We remain optimistic about our long term business prospects as well as a result of the introduction of our world-class new product offerings, our customer service and our significantly improving financial position.

That concludes my prepared remarks. Now, John, Chris and I will be happy to take your questions. Christina? Christina?

Operator: I apologize. Ladies and gentlemen, we will now begin the question-and-answer session. 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. And if you are using speaker equipment, please lift the handset before making your selection.

One moment please for our first question.

Our first question comes from Peter Lisnic with Robert W. Baird. Please go ahead.

Josh Chan: Hi, good morning. This is Josh Chan filling in for Pete. It sounds like you guys are expecting better demand trends out there. My question is, as your sales improve, how much leverage do you think you can get out of the ME&A base? You know, for example, can you hold it relatively flat if there's a gradual improvement in end markets?

John Batten: Josh, it's John Batten here. Yes, to some extent that is true. We've been running at this rate throughout the year and certainly heading into next year, we're going to try to control those expenses as best as possible. Obviously, there are other things that were mentioned, you know, some of the noise, the pension expense going back and forth, but as far as the run rate and what we're spending on promotion, travel, entertainment and things like that, and staffing, we're going to be very mindful of that heading into the next fiscal year.

Josh Chan: Okay. And then switching to sales, you've alluded to some sort of sequential improvement in the fourth quarter, and if you look back in the last couple of years, you know, you typically run a 4-5% increase, but if you go back a little farther you get bigger increases than that. Can you talk about maybe which camp that you guys are expecting this time around?

John Batten: Well, I think looking at the market -- I do think we're going to have sequential improvements going into this fourth quarter. Certainly there's the growing demand in oil and gas, recovering demand in after markets in our industrial product, so I do expect the improvement to continue, whether it's the traditional 4% or something more -- it's going to be a good quarter.

Josh Chan: Okay, gotcha. And if we think about your gross margin for fiscal '11, you hopefully get higher volume and then mix could be favorable, anything that worries you on gross margin, any commodity concerns, pension or anything like that?

Christopher Eperjesy: No, I mean -- Josh, this is Chris. At this point, I would say no. I mean obviously there's, you know, as John and Mike both alluded to, we do have some momentum in terms of volume, so obviously that comes with some benefits. We have, you know, some mix considerations that are coming into play, but at this time, you know, I don't expect any major impact from, in particular, the pension that you talked about in terms of expense. So, no, there's nothing on the radar as of right now.

Josh Chan: Anything on commodities?

Michael Batten: It's always the concern of some of the raw material prices coming up, especially where we're competing against other industries, it seemed to be improving, you know, mainly auto, and we're always watching that to say ahead of it.

Josh Chan: Okay. And then final question on, you'd talked about 25 million cost reduction, cost avoidance program before, how are you thinking about those costs going into fiscal '11? Are any of those coming back in any sense?

Michael Batten: We may see some of those expenses coming back on a marginal basis, but -- this is Mike, Josh. A large measure of the cost reductions will remain in effect as long as, especially the European operations, remain as soft as they have. And we do see that Europe is probably going to be the area, in our portfolio, that is going to take the longest to recover. So those employees who are on [unintelligible] are likely to remain that way, whereas the demand that we are seeing is affecting our US operations and our Pacific markets, so, where we would see potential recovery of some of the cost would be here in the States.

Josh Chan: Okay. Thanks for your time and good luck.

Michael Batten: Thank you.

Operator: And our next question comes from the line of Paul Mammola with Sidoti & Company.

Paul Mammola: Hi, good afternoon everyone.

Male Speakers: Good morning, Paul.

Paul Mammola: You guys, what's going on with 7500, is that on track? Do you think that that has an impact on 4Q '10 backlog?

John Batten: Sorry, what was the last part, Paul, on the fourth -- on the current backlog?

Christopher Eperjesy: The fourth quarter backlog, what it looks like.

John Batten: Oh. Paul, it is on track. It is finishing the lab (sp?) test and we're headed out to the field in the next two months. We do have -- it's part of the current backlog, but not a significant amount of the six month backlog. It will have more of an effect on the fourth quarter as we are shipping the first units at the end of this calendar year into the field. But, yes, we are moving into the field for some testing early in this quarter.

Paul Mammola: Okay. So, sorry, to clarify, the shipments, first shipments of the year will be towards the end of calendar '10.

John Batten: We would consider production, not prototype testing in the field with customers.

Paul Mammola: Okay. And then, Chris, made a good dent on inventory in the quarter, I would assume that's probably at the distribution level. Do you think there's more room to go there?

Christopher Eperjesy: You're correct that some of it at the distribution level and I think the answer is yes. I mean there's certainly, it's one of the areas we're always looking as inventory reduction. We're going to have to balance that with, you know, what we're seeing in terms of the backlog, you have the 7500 coming on, so certainly there'll be pressures in both directions but as always we're focusing on that inventory reduction.

Paul Mammola: Okay. On that thought, I guess, how many units do you think a distributor would hold or what would you push through to the distribution channel on, unit-wise, for the 7500? Do you have a sense of that?

Michael Batten: Paul, it's Mike. The distribution of these transmissions is largely direct from our corporate company to the supplier to the customer. We have one entity that is involved in sales three -- three -- excuse me, John, correct me. We have three that are -- that would hold inventory. John, why don't you finish.

John Batten: Yes. Paul, we would have -- there'd be three primarily, you know, the bulk of the business would be direct from Twin Disc or through three distribution entities. It all depends upon the size of their market. We would of course expect them to have swing units, and units in the inventory to deliver to their customers. How much that would be, I imagine it would be somewhere in the neighborhood of their business to their customers. They hold somewhere between 10-20% of what they expect to sell in their market.

Paul Mammola: Okay, that's helpful. On the pricing side, you guys talked a little bit about material cost, did you push anything through here in the first few months of the year in terms of price?

John Batten: No, we did not.

Paul Mammola: Okay. And then, finally, one thing we haven't talked about in a little while is, any action on the military side. I know you guys have some good legacy products there, is there anything stirring on the replacement side or anything for power takeoffs or transmissions for maybe some of the tanks that you've worked on before?

John Batten: We're still in the development stage of new projects, but the main one that we have continue (sp?) the XT. If I'm not mistaken, we are booked, I believe, into calendar 2012, and there are extensions to that coming up, so that one remains strong. But we are actively trying to put to bed some other ones that would fall into the category of legacy military.

Paul Mammola: Okay, thanks for your time guys.

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

John Braatz: Good morning, gentlemen.

Male Speakers: Good morning, John.

John Braatz: A little bit new to the company, but, going back to the 7500, if you could just touch on a little bit about the uniqueness and the difference between the 8500? And, when it becomes commercially available and you begin selling it in the latter half of this year, this calendar year, you know, does it cannibalize the 8500 product?

John Batten: John, it's John. What's unique about the 7500 is the transmission that is designed specifically for pressure pumping. Not a transmission that's come out of a vehicle application, so the ratios are evenly split and they are designed with the engine and the pumps in mind that are used in these applications. The difference between the 7500 and the 8500, while they're close in horsepower, the 7500 is considerably lighter, and it is able to fit within the frame rails of on-road frac rigs, so it can go on to rigs that don't need special permits to move from one field to another, so.

John Braatz: Okay.

John Batten: And it'll work in a range of 1500 horsepower to 2500 horsepower, which is a market that is considerably bigger than, you know, kind of the 2500 to 3000 horsepower application which is primarily limited to special permit applications. You have to take bridge (sp?) laws (sp?) into account.

John Braatz: Mm-hmm.

John Batten: They're used more in the remote areas. Certainly on, you know, shale applications that, you know, unique gap (sp?) applications, and then offshore at -- on the rigs. So, the more traditional high volume pressure pumping rigs are what the 7500 is aimed at.

John Braatz: So would that be -- as a point of clarification, mostly designed for the fracking industry?

John Batten: The 7500 was designed specifically -- it's not designed for any -- it has no other application. It's all for pressure pumping

John Braatz: Okay. All right. Okay. And that's a much larger market than you're selling into than the 8500.

John Batten: The 8500 now is all pressure pumping, but it's such a small segment of the overall market.

John Braatz: Yes. Okay. The -- speaking about working -- inventories and working capital, you know, when I look at working capital in the last three months, or last three quarters, it's come down. Would you expect as the business begins to turn up that you're going to have to invest some money into working capital?

John Batten: We're -- of course we're going to have to. We've been very mindful to bring it down both at the factories and at the discrimination subs.

You know, the only -- the main area that's come up a little bit is just for the 7500 and the 8500 with the increase in demand. But we're going to be very mindful of that going into next year as the volume increases. We certainly don't want to miss sales opportunities. We're going to be very careful in how we bring the inventory in.

John Braatz: Okay. And then, lastly, in terms of the mega yacht category, based on your history in this area, how quickly can that business snap back?

John Batten: That is a very good question debated within the industry. It typically would mirror how the stock markets are doing, confidence levels, and it obviously does very well, in retrospect, bubble type economies. We see a good potential for us to grow even in a down market with some of our products that are coming out, the joystick docking system or EJS. We think it gives us a very good competitive advantage even at a lower market level, but certainly of all the markets that have come down since the financial crash, this one will probably be the last one to recover.

John Braatz: Have you seen any incremental improvement?

John Batten: Yes, we have. We have seen incremental improvement. There's a lot of news of boat yards actually hiring employees back, which is a good sign. But we certainly haven't seen significant improvement but it has at least shown a sign of where the bottom is.

John Braatz: Okay. All right, thank you very much.

Male Speakers: Thanks, John.

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

Shawn Boyd: Good morning. How are you all doing?

Michael Batten: Hey, John.

Shawn Boyd: Just a couple of follow-ups, if I could. Given the strength that we've had over the past couple of quarters with energy continuing to improve, and mega yacht, frankly continuing to stay weak, can you just give us sort of a point in time where we are at this point, and maybe as a percentage of revenues, how much energy is -- or as a percentage of gross profit, I know you get a little bit better margins there. And then, of course, the flip side, what are we down to on mega yacht?

Michael Batten: Well we don't, Shawn, normally break out that information specifically. But clearly our oil and gas is tending to consume more as a percentage of our sales as it recovers fairly strongly during the last quarters and as we see it moving out into fiscal '11. So we would see an increasing share of the revenues in oil and gas going forward and there is some gross margin leverage associated with those products.

On the mega yacht side of the business, again, we don't break out specific numbers. But we're in three major segments of the marine industry. Mega yachts is only one of them and at the time is the smallest. The other would be -- a larger segment would be commercial marine for offshore oil, fishing, tugboat kinds of use, as well as patrol boats where that market is doing very well for us. And so, the growth in those markets will tend to minimize the percent of mega yachts for us, but clearly mega yachts is down 50% year-over-year and continues to be in that kind of a weakness.

Shawn Boyd: Got it. Okay, that's helpful. And, so if we think about with the launch coming up on the 7500, is there a point down the road here, you know, let's say, within the next year or two, where given the strength that we're already seeing in the after market in energy of the existing products and then we bring in the new launch of the 7500, energy is 50 plus percent of the business, of the overall Twin Disc business at this point?

Michael Batten: I don't see that that numbers is going to be the case, but because we have other things that are coming to market that will help us. But the energy market is probably not going to consume more than 50% of our sales at this time.

Shawn Boyd: Got it. Okay. And then as we think about that launch hitting, if I'd heard it correctly, you expect first production shipments by the fourth calendar quarter of 2010. Is -- should we expect to see a backlog build ahead of that?

Michael Batten: Yes.

John Batten: Yes, I would expect to see the 7500, a noticeable effect on the six month backlog, really starting, you know, the first two quarters of next fiscal year.

Shawn Boyd: So September and December quarters.

John Batten: Correct.

Shawn Boyd: Got it.

Michael Batten: But really production in the second half of next fiscal year, fiscal '11.

Shawn Boyd: Okay. And was it your production capacity of the new 7500 series, by the way?

Michael Batten: Well, we don't divulge those numbers specifically for competitive reasons, but we will be able -- we're building additional capacity beyond, obviously, the 8500 and we don't see any significant capacity constraints in that regard.

Shawn Boyd: Okay.

Michael Batten: We should be able to supply everything that we need.

Shawn Boyd: Okay, very good. You know, given where the rig count is today, there's a lot of speculation that perhaps that it could come off a little bit and really the kind of drilling needs to come off of some of the more shallow drilling. Are you guys -- so it doesn't seem like that would really cause any issue to you all in terms of your existing energy business. But let me just ask you straight up, are you seeing any moderation in the improvement that we've seen so far in the energy subsegment for you guys?

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

John Batten: Well, I think as far as, if you look at the offshore supply vessels and crew boats, I would say there's some cautiousness there on what actually is going to happen as far as more drilling or whether or not they're going to be able to drill more. So I would say they're cautious right now.

Michael Batten: But on the land base...

John Batten: On the land base side, obviously the demand is increasing and is showing signs of continuing, you know, in the foreseeable future.

Shawn Boyd: Got it. Okay. And how much of your business is offshore versus land based within energy?

Michael Batten: Again, we don't break out those numbers, Shawn. But a fair amount of our business is definitely in the offshore crew boats, supply boat business; however, with the combination of the 8500 and the 7500, we should perhaps reach parity in that regard.

Shawn Boyd: Got it. Okay, thank you so much.

Michael Batten: You're welcome.

Operator: Ladies and gentlemen, if there are any additional questions, please press star, followed by the one on your touch tone phone.

And we have a follow-up question from the line of John Braatz of Kansas City Capital. Please go ahead.

John Braatz: Thank you. Back to the 7500 -- would you envision the 7500 being a product for new rigs or sort of a replacement product for existing transmission products out there? How would you see that moving into the marketplace?

John Batten: It's John. John, it certainly can be in both retrofit and new applications. Obviously there is additional engineering involved in the retrofit because you're looking at a rig that was designed in one configuration and has to be on them. We're certainly -- we're looking at both.

John Braatz: Mm-hmm.

John Batten: But as far as testing and initially we're looking at new construction, so it's designed with the 7500 in mind from the get-go. But it -- to answer your question, it has applications certainly in both areas.

John Braatz: Okay. But there -- it's a little bit costlier to do it on a retrofit basis.

John Batten: Correct, there's more man-hours involved.

John Braatz: Yes. Okay. Do you get some payoff -- payback on that -- that cost?

John Batten: Absolutely. Depending upon the rig, in some instances we have seen you can retrofit in a 7500 and utilize half the amount of rigs to do an equivalent job.

John Braatz: Okay.

John Batten: So there is payback on the operators, depending upon the application.

John Braatz: Okay. And do these drilling companies, do they typically lease this equipment or do they own it?

John Batten: I don't know specific -- off the top of my head, most of our customers own the equipment. We're dealing in the cycles of their budgets and their capital purchase (sp?).

John Braatz: Yes.

John Batten: So I'm assuming that most of these are owned. A lot of -- we deal with customers who build the rigs and use them themselves and we deal with customers who buy their rigs from rig manufacturers, so...

John Braatz: Okay. All right. Thank you.

Operator: Ladies and gentlemen, if there are any additional questions, please press star, followed by the one on your touch tone phone.

Management, I'm showing there are no further questions. Please continue with any closing remarks you may have.

Michael Batten: Thank you, Christina. Again, everyone, thank you for joining our third quarter conference call. We appreciate your interest in Twin

Disc and hope that we've answered all your questions today. We look forward to speaking with you again at the close of the fiscal year, when we have our next conference call. Thank you.

Operator: Ladies and gentlemen. This concludes the Twin Disc Incorporated 2010 Third Quarter Financial Results Conference Call. If you'd like to listen to a replay of today's conference, please dial 1-800-406-7325 and entering the pass code 4282461. Thank you for participation. You may now disconnect.