Crane Co.
Second Quarter 2006
Earnings Conference Call Script
July 25, 2006 - 10:00 AM (Eastern)

Richard Koch, Director of Investor Relations and Corporate Communications

Thank you, operator. Good morning everyone. Welcome to Crane's Second Quarter 2006 earnings release conference call. I am Dick Koch, Director of Investor Relations and Corporate Communications.

On our call this morning we have Eric Fast, our President and CEO, and Bob Vipond, our Vice President and CFO. We will start off our call with a few prepared remarks after which we will respond to questions.

Just as a reminder - the comments we make on this call may include some forward looking statements. We would refer you to the cautionary language at the bottom of our earnings release and also in our annual report, 10-K and subsequent filings pertaining to forward looking statements. Also during the call we will be using some Non-GAAP numbers which are reconciled to the comparable GAAP numbers in a table at the end of our press release, which is available on our website at www.craneco.com in the investor relations section.

Now let me turn this call over to Eric.

Eric Fast, President and Chief Executive Officer

Thank you, Dick.

I am pleased with the Company's performance in the second quarter. Earnings per share of $0.71 exceeded our guidance and were up 20% from the second quarter of 2005. Solid core sales growth of 4%, improving margins and good cash flow were all evidence of continued solid improvement. Our core sales growth consisted of about half price and half volume. We have made and will continue to implement price increases to reflect increases in raw material costs.

Operating profit increased 20% with strong performance in the Fluid Handling and Aerospace & Electronic segments. The increase in operating profit in the Merchandising Systems segment was a reflection of the acquisition of CashCode in January which offset a reduction in our vending solutions results.

In the first half we have spent $149 million for three important acquisitions in our Merchandising Systems segment. In January, we acquired CashCode Co., and in June we acquired certain assets of Automatic Products International and the stock of Telequip Corporation. We will have a second payment of approximately $12 million for Automatic Products at the end of the third quarter. We repurchased $12 million of our common stock in the first quarter and an additional $13 million in the second quarter. As a result, our net debt to capital ratio increased to 18% at the end of the second quarter of 2006 (including $100 million of cash on the balance sheet), compared to 13% at December 31, 2005. As I said at our December Investor Conference we feel we are in a position to more aggressively deploy our capital and we are doing what we said we would do.

Turning now to specific segment comments:

Aerospace & Electronics

In mid-May, we completed the sale of our Resistoflex Aerospace unit. Resistoflex Aerospace made high-performance hose and high pressure fittings. After careful study, we determined that the business did not have sufficient strategic links with our other product offerings and that it was more valuable to Parker Hannifin, who is a much larger competitor in those product lines.

In the Aerospace Group, both OEM and aftermarket sales were higher than their respective levels last year and contributed about equally to the 13% sales increase, excluding Resistoflex Aerospace. This represented an acceleration in the sales growth rate over the 5% experienced in the first quarter. The OEM / aftermarket mix was 62% / 38%, compared with last year's mix of 64% / 36% providing good margins.

Excluding Resistoflex Aerospace, bookings in the quarter were strong, up 35% overall, with OEM and aftermarket both contributing to the increase providing a solid base for future growth.

The Electronics Group sales increased $1.9 million and profit margins increased significantly over the prior year. While we have made progress in reducing past due orders and production costs on key programs, we still have significant opportunities for continued operating improvements in this business. We continue to focus on meeting customers' requirements on several large programs at low margins which are being delivered over the next nine months. Our year-to-date bookings are lower than last year principally due to delays in awards of several large customer orders that we expect to partially recover in the second half of the year.

Engineered Materials

In Engineered Materials, revenues increased 4% but operating profit was off $5.1 million, or 28%. Our sales were 9% higher in building products and 8% higher in recreational vehicles, more than offsetting a decline in international sales, particularly in Europe.

As we discussed on our April conference call, in the first half of this year we have been experiencing product support costs in the RV market and in addition we have increased our spending to support the growth of our newer products such as our decorative panels and Zenicon thermoplastic products. Our operating margin of 16% is a reflection of both these product support and, to a lesser extent, the new product development costs.

The expenses for product support costs are attributable primarily to two issues affecting our RV customers which we discussed at the end of the first quarter. The first issue, which was caused by process changes associated with the installation of new emission control equipment in our Jonesboro, Arkansas plant, resulted in some undercured FRP product being shipped to three customers. The second issue, which we call distortion, affects the exterior panels of RVs and has been caused, in our view, by either poor bonding of our FRP panels to the backing or substrate material, most often a plywood type material called lauan, or a higher than normal moisture content in the lauan. Based on what we know at this point, we do not believe the distortion has been caused by our FRP panels but we are attacking the issue on a number of fronts.

First, as the industry leader, we continue to work with our customers and outside experts to determine the root cause of distortion. Because different OEMs and laminators use different bonding technologies and materials there can be a number of different factors involved. In addition to our one-on-one discussions, we have conducted three user group meetings with our customers to share information on this issue.

Second, because we are a leader in the industry and therefore committed to maintaining our long-term relationships, we have provided customer assistance to help offset the costs of rectifying these issues.

Third, we have developed a more robust FRP panel which will be significantly stronger than existing panels for this market, and it is currently being tested by several OEM customers with excellent results.

We are also moving to sell all of our product directly to RV OEM's and component suppliers rather than through distribution. In addition, as part of this effort we have opened a warehouse and service center in the Elkhart, Indiana area, the heart of RV manufacturing. Before we began this effort in late 2005 about 60% of our sales to RV OEMs were through distribution. We have effectively completed this transition and are now selling direct to all our RV customers. Going direct has solidified our relationships with the OEM community and substantially improved our customer intimacy.

We believe that the majority of these issues are behind us and that our product support and warranty costs will be lower during the second half of 2006, with margins improving over the 16% experienced in the second quarter.

Merchandising Systems

In the second quarter, the overall performance of our payment solutions business has offset substantially weaker sales and earnings from our vending business.

In the second quarter of 2006, we continued to see weak orders for our vending machines. The weak demand is caused by route operators' higher costs for gasoline and confectionary. Our vending machine sales in the second quarter of 2006 were $7 million, or 18%, below 2005, with substantial sales declines in both North America and Europe. We believe that what we are seeing is a vending industry trend and that we are maintaining market share. In spite of softness in our end markets, we remain confident about our business model and the longer term outlook for the industry.

As we said in our last conference call, we expected additional severance costs associated with our opt-out program at our St. Louis facility. In the second quarter we had severance of approximately $1 million which was similar to the first quarter. As a result of the weak demand experienced in the second quarter we also reduced our work week to 4 days for 2 weeks in April and took a 1 week shutdown as well.

The integration of Automatic Products, or AP, into our vending machine facility in St. Louis and the sourcing of our third quarter production from AP's facility in St. Paul will result in one-time transitioning costs that will depress our profits in the third quarter. Once these transitioning costs are behind us we are expecting that the fourth quarter will show substantial improvement from the third quarter. These trends are factored into the third quarter and total year guidance included in our press release.

I would like to spend a few minutes to put in perspective the three acquisitions we have made in Merchandising Systems this year. While the vending market has been declining due to depressed operator cash flows, we believe long term it remains a $22 billion consumer product channel and we want to be positioned as a leader. In North American vending we have been the industry leader with strong market share across the food, coffee and snack offerings with a direct sales and service model. AP has been a good competitor in the snack segment selling through a strong distribution network with a large installed base. Our plans are to continue to utilize the strong AP brand and distribution network as part of a dual channel to the vending operators. We are not buying AP's manufacturing facility and over the next three months we will be consolidating the manufacturing into our St. Louis facility. As many of you know our lean activities have substantially improved this facility and created the physical space to effect the consolidation. As we mentioned in the first quarter call the St. Louis facility also has a new union contract which freezes existing wages for three years and provides for new hires at 70% of current wages.

Now let me turn to Payment Solutions. This is a $1 billion addressable market comprised of five separate end markets – the two largest are vending and gaming at approximately $400 million each, with Retail, Transportation, and Amusement accounting for the balance.

National Rejectors, Inc., or NRI, has had a long presence, primarily in Europe, in coin validation serving many of these end markets. In January, we acquired CashCode, a bill validation business, which allows us to offer both coin and bill payment solutions. The CashCode business had historically been focused in the gaming industry and the combination with NRI will now give us a more complete payment solutions offering to each of the five end markets.

In 2005, we began selling our payment solutions with our vending machines. It is noteworthy that Crane was the first vending company to offer a payment system capable of giving change in bills and coins. We are pleased with our progress in penetrating this part of the market.

While a considerably smaller end market today, we believe the retail channel for payment solutions has considerable potential particularly in self checkout. The Telequip acquisition gives us strong retail market presence in coin dispensing in each of the major self checkout manufacturers as we look to develop and provide a fully integrated system utilizing the coin and bill validation capabilities of CashCode and NRI.

These three acquisitions fit our strategy as highly engineered products serving a niche market, that leverage and strengthen our existing businesses. While we are looking for very strong growth from these acquisitions in 2007, our 2006 results will be held back by substantial integration activities and costs.

Fluid Handling

Fluid Handling, representing 45% of Crane’s sales, had a very good quarter, following on strong first quarter results. Every major unit contributed to the growth in operating profit.

Our core sales in Fluid Handling increased 3%, before foreign exchange and acquisitions, reflecting stable demand due to the late cycle nature of our markets which include the chemical process industry, power and non-residential construction. Operating profit was $30 million, up 50% from the second quarter of 2005. Excluding Westad, Fluid Handling cash flow provided from operations was $21 million in the quarter; more than double the $10 million generated in 2005, and continued the strong improvement we experienced in the first quarter.

All three major groups of the Fluid Handling segment showed improved operating profit in the second quarter. In our first quarter conference call, I noted that margins approaching 10% and strong cash flow generation were a testament to our progress. Our performance in the second quarter was even stronger with margins of 11.8% versus 8.1% in the second quarter last year. Let me restate what I have said in the past. Our progress in Fluid Handling has been a journey reflecting strengthened management teams, improving markets, excellent brands, reduced physical footprint, low-cost country sourcing, and improved planning and manufacturing processes. These broad-based improvements and orders (excluding Westad) which were up approximately 15% in the quarter provide a solid foundation for future growth.

As we noted in our April call, during the second quarter we sold our Westad Valve business, located in Norway. This sale is consistent with our strategy of trimming the portfolio where we have a small business that cannot be leveraged in a larger unit. The sale generated cash proceeds of about $3 million and a modest loss.

Now let's turn to the businesses in the Fluid Handling segment. In the Valve Group, sales excluding Westad are up 5%. Operating profit increased 48% over the second quarter of 2005 and margins increased from 8% last year to 12% this year, reflecting higher sales and improved operating performance.

In Crane Pumps & Systems, profits nearly doubled and margins increased from 6% to 10% due to the productivity gains realized from the Salem, Ohio plant closure last year.

Crane Supply continues to post solid results with stronger sales and improved low cost country sourcing helping to offset higher prices for steel pipe and copper tube.

Controls

Briefly, our Controls business continues to grow. Excellent markets in oil and gas and transportation, strengthened management teams, and a real focus on customer metrics and new products are driving the improved results.

Company Guidance

Now turning to our third quarter guidance, we expect our earnings per share to be in the range of $0.68 to $0.74, including $.02 for option expense, versus $0.66 in the third quarter of 2005. Based on the strength of our first half performance and our overall view of the businesses, we are increasing our total year earnings per share guidance from the range of $2.50 - $2.65, to a range of $2.60 - $2.70. This is the second time this year that we have raised our guidance and we are on track to comfortably exceed our record earnings per share we posted last year. Based on our confidence in the future prospects of the Company, we have increased the dividend by 20%.

Now let me turn the call over to Bob Vipond, our CFO.

J. Robert Vipond, Chief Financial Officer

Thank you, Eric.

As Eric mentioned, we were pleased with our second quarter results. Let me discuss a few other items impacting our financial performance.
The Miscellaneous Income line was $2.6 million higher than the second quarter of 2005. The principal driver was the previously announced sale of Resistoflex and Westad which resulted in a gain of $8.3 million which was partially offset by the sale of unused property from a plant closure and legal costs associated with previous divestitures. The pre-tax gain was $4.1 million in this quarter. During the second quarter of 2005 there were gains on a few smaller transactions and therefore the year over year increase was $2.6 million.

Our tax rate for the second quarter was 32.5%, above the 30% guidance we had given for the quarter, and higher than the 30.2% tax rate in the second quarter of 2005. The rate was higher than our guidance solely because the Congress did not renew the Federal research and development credit. We continue to anticipate passage of this legislation during the second half which is reflected in our guidance for the full year tax rate of 31 – 32%. We have assumed that as in the past, the legislation will be retroactive to January 1, 2006, and the quarter in which the legislation is passed we will be required to record a year to date adjustment which will result in a lower tax rate for that quarter. So our quarterly rate will vary.

Our Corporate expenses increased about $3 million to $10.7 million in the second quarter 2006 primarily due to expensing stock options, which we began in 2006, higher provisions for incentive compensation, and increased staffing levels.

I want to remind everyone that, as is our practice, we do not intend to comment on our estimate of the company's asbestos liability, beyond what we have said in our Form 8-K. I encourage you to read the disclosures carefully, as we are making every effort to make them complete and informative. I do want to comment briefly on our asbestos related payment trends that were disclosed in our 8-K last night. First, we have been reaching agreements in coverage-in-place arrangements and other policy settlements with our excess insurers, and we received payments of $6.3 million in the second quarter from these insurers. Second, there was a transition lag in our cash payments for settlements and defense costs as we moved to a third party firm specializing in processing reimbursements. As a result, our net cash requirement for asbestos-related matters in the second quarter was a net inflow of $200,000. Payment outflows are expected to increase in the third quarter as we return to normalized payments, which will be partially offset by insurance recoveries. Our overall disclosure included in the footnote released with the press release provides additional details. We continue to expect that the total year net cash outflow will be $45 million.

Now back to you, Dick.

<u>Richard Koch</u>

Thank you, Bob. This marks the end of our prepared comments.