Twin Disc, Inc.
Third Quarter Fiscal 2014 Financial Results
April 29, 2014

Operator: Good morning, ladies and gentlemen. Thank you for standing by. Welcome to the Twin Disc Third Quarter Fiscal 2014 Financial Results Conference Call. During today's presentation, all parties will be in a listen-only mode. Following the presentation, the conference will be opened for questions. If you have a question, please press 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.

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

Stan Berger: Thank you, Angel. 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 2014 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 Mianecki at 262-638-4000 and she will send a copy to you.

Hosting the call today are John Batten, Twin Disc's Chief Executive Officer, 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 John Batten. John?

John Batten: Thank you, Stan and good morning, everyone. Welcome to our Fiscal 2014 third quarter conference call. As usual, we will begin with a short summary statement and then Chris and I will be happy to take your questions.

Looking at our third quarter results, sales for the 2014 fiscal third quarter were 60.7 million, down 11% from 68.2 million for the same period a year ago. The lower level of shipments in our North American and European markets primarily drove the decline in sales. As we mentioned in the press release, and while hard to quantify, some of the slowness in our industrial aftermarket sales during the quarter can be attributed to the difficult winter conditions in parts of the US and Canada. However, we also feel that any delayed orders will be made up in the next couple of quarters.

On a more positive note, we continued to ship at record level sales into Asia, as demand for our pressure pumping transmissions and commercial marine transmissions throughout the region remained at robust levels in the quarter.

Turning to our broader product markets, global sales for Industrial, Marine, and Transmission products were all down in the quarter versus last year, but only our Transmission products saw a sequential decline when compared to the second quarter. This shortfall was primarily due to a lower level demand for our legacy transmission and parts transmission systems in the quarter.

Shipments for both our Marines and Transmission products saw improving trends throughout the quarter. We mentioned during the last conference call that we had seen a drop in Industrial demand during the last calendar quarter for 2013, and I'm happy to report that even with some of the effects from the frigid winter, our shipments of Industrial products did improve sequentially versus the second fiscal quarter.

New order trends also improved throughout the quarter, specifically in Asia and North America. While our Marine shipments are lower than year-ago levels, demand remains at high levels for the offshore and oil and gas markets, especially in the US Gulf Coast and Southeast Asia. There was also a lot of project activities for oil and gas transmission, and as we mentioned in the press release, a good portion of our new Pressure Pumping Transmissions orders came from the North American demand. Is this the beginning of a real recovery in rig construction? It is too early to tell, but there's a lot more optimism than there has been in the past.

Many of the orders that we received in March and April will be shipped by the end of our fiscal year as we are still maintaining three-month lead times for these transmissions.

Gross margins for the quarter were 27.4% compared to 25.9% a year ago and 29.3% the previous quarter. A better mix of products, specifically within our transmission products, primarily drove the gross margin improvement over last year, but the sequential decline in gross margins was primarily driven by lower level of sales.

Year-to-date gross margins are 29.3% versus 28.4% a year ago. Third quarter spending in marketing, engineering and administrative, or ME&A expenses, decreased slightly by 535,000 versus the same period last fiscal year, or from 17.4 million or 27.8% of sales to 16.9 or 25.5% of sales. Year-to-date ME&A spending decreased 1.2 million over year-ago levels from 50.8 million to 49.6 million.

As we mentioned in the press release, this reduction reflects continued spending controls in our North American and European operations, a reduction in stock compensations, which are partially offset by small increases in Asia and some increased spending on Corporate projects.

As I have mentioned in the last few calls, we continue to rationalize our resources and overhead in our European and North American operations. Even with the opening of the plant near Chennai, the adds to the Sales and Service organization in Asia, our net employment is down versus fiscal '12 and fiscal 2013 year-end levels, and we are constantly evaluating each subsidiary's spending and overhead.

Looking at the bottom line, fiscal 2014 third quarter net earnings were a net loss of 393,000 or $0.03 per share versus a net loss of 757,000 or $0.07 per share a year ago. Year-to-date net earnings are 1.4 million or $0.12 per diluted share versus 3.8 million or $0.34 per diluted share a year ago. EBITDA for the third quarter was 2.4 million compared to 2.9 million a year ago and year-to-date EBITDA stands at 13 million compared to 16.4 million for fiscal 2013.

Turning to the balance sheet, we ended the third quarter with a net cash position of 1.3 million, the second quarter in a row with such position.

Inventory in the quarter rose 2.5 million from 102.6 million to 105.1 and is 2.4 million higher than the start of the fiscal year. In general, inventory was down at our European operations, but offset by increases from our North American operations and Asian operations. Whether it's shipments on the water from the US to Singapore or China, or increased whip (ph) as we are converting raw to finished products, this is where the inventory increases lie. We are focused to keep inventory levels stable as we increase shipments in the fourth quarter.

Our six-month backlog rose slightly from 56.2 million to 57.6 million, and as we mentioned in the press release, this does include new unit orders for the North American oil and gas market.

Further, while we continue to receive new orders for the 8,500 oil field transmissions in China, we also had a very good quarter for the 7,500 transmission systems as well. With respect to our Marine and Industrial products, the slightly stronger Industrial backlog was offset by slightly weaker Marine backlog, which reflects continued market weakness in the lower horsepower range of our Marine transmissions.

All in all, our backlog both six months and total took a positive step in the quarter. The 2014 fiscal third quarter results reflected the same dynamics that have affected our business during the past several quarters, and like fiscal 2013, third quarter proved to be the most challenging quarter of the year. However, the new order activity in oil and gas resulted (ph) 8,500 and 7,500, leaves Management slightly more optimistic about improving trends.

We continue to see strong demand from our global Commercial Marine customers and international oil and gas markets, which is somewhat offset by continuing weak activity from most of the European marine market. We do see improving prospects for our larger Pleasure Craft Marine Transmissions and there are more conversions to both our Express Joystick System and the CAT 360 Joystick System in the pipeline.

Looking at our outlook, while we feel positive about the change in our backlog, which includes the increase in North American oil and gas, we are well aware of the increased efficiencies being realized by the frac service companies and hesitate to predict that this is in fact the turning point in the domestic market. Given our historically short lead time to both our land-based and marine transmissions, our customers are placing orders just when they need them, and this is allowing us to fill more orders within the quarter.

The negative effect of this is that it also shortens some of our visibility on when the demand will actually occur. Middle to longer-term, we feel we are well-positioned with products, people, and the strategy and a healthy balance sheet to take advantage of the global opportunities ahead of us.

That concludes my prepared remarks and now Chris and I will be happy to take your questions. Angel, please open up the line for questions.

Operator: Thank you. We will now begin the 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, press the star, followed by the two. If you are using speaker equipment, you will need to lift the handset before making your selection. One moment please for your first question.

Your first question comes from the line of Josh Chan from Baird. Please go ahead. Mr. Chan, your line is live.

Joshua Chan: Hi. Good morning John and Chris.

John Batten: Morning, Josh.

Christopher Eperjesy: Hey, Josh.

Joshua Chan: Hi. Just a question about the oil and gas potential improvement there; could you talk a little bit more about what exactly you saw improving? I mean, obviously you've got some new orders. Are you seeing service parts improving? Are you seeing customers talking to you about, you know, shipments further down the line as well?

John Batten: Josh, it's all of the above, but finally, I think people are starting to address some of the rigs that need rebuilding, and so I think it's a balance of building new rigs or they are, you know, replacing components on existing rigs. But definitely, as far as the quarter, the strongest quarter in a long, long time for new unit orders for North America.

Joshua Chan: Okay, and then if we think about sort of the pace or timing of this recovery, you said that you shipped some units by the end of your fiscal year, but when do you think we might see sort of a noticeable uptick in terms of revenue or margin? Would it be maybe into calendar year '15?

John Batten: Well, no. I think you'll see we are—if our lead times for oil and gas transmissions are under—well just about three months. So we can fill in a quarter; so all of the orders that we received, the majority of those are going in the fourth quarter, and there'll be some spillover, of course, into the first quarter. So the impact on the new orders will be in the next two quarters as far as the margins.

Joshua Chan: Okay. Okay. That's great to hear.

John Batten: Again, I hesitate. You know, this is—it's the first real, I would say, blip for us that there is increased activity and I'm hopeful and hope that the trends have been positive in this quarter as well, but let's see how the quarter finishes (cross talking) quarter.

Joshua Chan: Got it. Yes, that makes sense. If I could ask about some of the non-oil and gas market, I mean your backlog total is up slightly and oil and gas is part of that, and if you had some disruption in the quarter that you can't ship too much orders, would it imply that the non-oil and gas orders have been kind of soft in the quarter?

John Batten: It's a balance. You know, our Marine backlog for the offshore vessels and the large workboat is very good. The weakness in Marine is reflected more in the lower horsepower range, which has been either small workboats, small fishing boat, or pleasure craft. That was, you know, kind of the weakness. But Industrial, you know, given kind of the slow down at the end of 2013 calendar year, Industrial, I would say, you know, picked up and improved. So really, if there's one area that was weaker at the end of the quarter than the start it would be Marine, but it's not driven by our large transmissions. It's more driven by the lower horsepower.

Joshua Chan: What's your view on how that market might develop over the smaller Marine market?

John Batten: I think it's—I honestly do believe it's starting to improve, certainly with the trends at the end of the quarter, but not enough to make up the trends that were happening at the beginning of the quarter.

Joshua Chan: Okay. Great. That makes sense and thanks for your time and I'll hop back in the queue.

John Batten: Okay. Thanks, Josh. Operator?

Christopher Eperjesy: Hello?

John Batten: Hello? Angel? I think—Stan, I think we got disconnected.

Stan Berger: Oh no.

John Batten: Well, let's just wait. Or we can't hear.

Stan Berger: We couldn't…

John Batten: No, Stan. Chris thinks we're actually—they may be able to hear us, but we can't hear them.

Stan Berger: There's something wrong with the line then.

Christopher Eperjesy: Let's hold on a sec.

Stan Berger: Let's hold—yes, Chris. That's correct. Let me run over to the other office and call them. I'll be right back.

Christopher Eperjesy: Okay. I think investors can still hear us. So this is John and Chris. We're just trying to figure out why we can't hear you or the Operator, so please just hold on a second.

Operator: We apologize. Your Operator is having some technical difficulties. Everyone can still hear you though, and your next question will come from the line of Walter Liptak of Global Hunter. Please go ahead.

John Batten: Walt?

Operator: Mr. Liptak, maybe you're on mute, but your line's open.

Okay. Let's try Doug Dyer of Heartland Advisors.

Christopher Eperjesy: Perfect. Thank you.

Doug Dyer: Good morning. Can you guys hear me?

Christopher Eperjesy: Yes. Can you hear us?

Doug Dyer: Hey, all right. All right.

John Batten: All right. Sorry about that.

Doug Dyer: Yes. We've been able to hear you the whole time.

John Batten: Okay.

Doug Dyer: Listening to some of the pressure pumping providers with their conference calls last week, they're ordering new equipment and they're taking delivery or it seems like they're taking delivery late this calendar year and into early next year. Is that a function—are they able to control when they take those deliveries or is it your capacity to—and other equipment providers do they have to wait that long, the six months to get it out?

John Batten: I'd say each one—each situation is different. I'm sure that a lot of it is going to be the anticipation of getting their orders in to make sure they get the equipment in the timeframe that they need. So I'm guessing that when they're placing orders for is slightly longer than the lead time and I'm sure they're allowing for a little bit of, I would say, drift in the delivery schedule. But a lot of that—I mean, trying to coordinate the schedule of engine transmissions and pumps and getting in line to build the rigs. So I think a lot of us are going to have to do is reassemble crews, get some of the rig manufacturers to get back into production. So I mean, as I said, I'm hopeful that this was the first lift in the turnaround, but, you know, for a trend line I'd like to see, you know, two—kind of two quarters in a row.

Doug Dyer: Okay, and if I recall correctly you did have some inventory on-hand to build several transmissions. Are you currently ordering more parts for future use?

John Batten: Yes, absolutely.

Doug Dyer: Okay.

John Batten: Absolutely.

Doug Dyer: Can you give us any guidance as to the number of units that you can produce with current inventory and how many units you're ordering for?

John Batten: You know, we—it's not exactly balanced, but if you go back to our peak productions we probably have somewhere in the neighborhood of, you know, two to three months of inventory as far as, you know, the units that we—we obviously have to bring in some parts to finish, but that kind of gives you a ballpark of where we are.

Doug Dyer: All right. Thank you very much.

Operator: Once again, ladies and gentlemen, if you have a question, please press the star, followed by the one on your touchtone phone. Please ensure you lift the handset if you're using a speakerphone before pressing any keys.

Christopher Eperjesy: Angel, this is Chris from Twin. Just—why don't we give—wait a little bit of time just because we got disconnected from some people.

Operator: Absolutely. No problem, and my apologies, sir.

Christopher Eperjesy: No problem.

Operator: We do have a question from Josh Chan from Baird. Please go ahead.

Joshua Chan: Yes. Just a follow-up. I think in the press release you talked about 4Q being sequentially better than 3Q, but I was just wondering if you have any more color around that. You know, is it possible that with all the improvement that 4Q becomes the best quarter of the year?

John Batten: That is certainly—our goal is to have it be the best quarter of the year. So I think that's possible for sure.

Joshua Chan: Great. Thank you.

Operator: Again, ladies and gentlemen, if you have a question at this time, please press star, one on your touchtone phone.

We have no further questions at this time.

John Batten: Okay. Thank you for joining our conference call today. We appreciate your continuing interest in Twin Disc and hope that we have answered all of your questions. If not, please feel free to call Chris or myself. We look forward to speaking with you again in August following the close of our fourth quarter.

Angel, now I'll turn the call back to you.

Operator: Thank you very much, gentlemen. Ladies and gentlemen, this concludes the conference call for today. Thank you for participating and please disconnect your lines.