

KAYDON COROPORATION

Moderator: Brian Campbell
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During this conference, Kaydon spokespersons will reference certain non-GAAP financial measures to assist you in understanding such non-GAAP measures as well as to comply with SEC requirements, and the company has included in their press release reconciliations of the non-GAAP measures to the most directly comparable GAAP financial measures.

Today's conference is being recorded.

Now I'd like to turn the call over to Mr. Brian Campbell, Chairman of Kaydon Corporation. Mr. Campbell; please go ahead.

Brian Campbell: Great. Thank you, operator. Good morning everyone and welcome to Kaydon's first quarter 2007 conference call. I am joined this morning by Jim O'Leary, Ken Crawford, and Peter DeChants.

In late February, as you know, we announced that as part of a leadership transition I planned to depart Kaydon on May 1 and will not stand for re-election as a director at the company's May 17 annual shareholders meeting.

On March 21, we announced the appointment of Jim O'Leary to the positions of President and Chief Executive Officer effective March 26. Jim will continue, of course, to serve as a member of the Kaydon Board of Directors which he joined in 2005.

I'm delighted that Jim has joined Kaydon as its new President and Chief Executive Officer. I have known Jim for several years and have always been impressed by his well-honed intellect and broad and diverse skill-set. Jim brings a wealth of business, operations and financial experience to Kaydon as well as extensive knowledge of the company from his service as a director. And the Bboard and I enthusiastically welcome his forthcoming contributions to Kaydon. Jim is uniquely qualified to lead Kaydon to continue the outstanding growth and shareholder returns which the company has achieved.

And now, Mr. O'Leary, it's all yours.

James O'Leary: Thank you very much, Mr. Campbell. And thanks to all of you for joining us this morning.

It's been my pleasure to work with Brian, our team, and our board as a director over the last few years and I'm excited to be assuming the leadership of Kaydon at a unique time for the company. I'm equally excited about the opportunity to work with you and for you in the future to continue to drive shareholder value.

Now let's dive into the results. I'm pleased to report that during the first quarter of 2007 Kaydon achieved record first-quarter sales of 106.9 million. As compared to a strong first quarter last year, this year's operating income increased 11.3 percent resulting in an operating margin of 24.6 percent. Net income increased 9.9 percent to 18.2 million and diluted earnings per share equaled 57 cents, up 9.6 percent over last year's first quarter.

During the quarter, we booked large orders for specialty bearing utilized in the wind energy industry achieving record quarterly order entry of 141.7 million. This leaves us with a quarter-end backlog of 186.3 million as we head into the second quarter. This positions us to increase sales in 2007 and assuming continued economic strength across our many businesses into 2008. Gross profit for the first quarter equaled 44.8 million, or 41.9 percent of sales, as compared to 41.5 million, or 40.9 percent of sales, during last year's first quarter. The improvement in gross profit and gross margin resulted primarily from increased sales and the positive impact of operating leverage as a majority of our business units achieved higher sales volumes.

Selling, general and administrative expenses equaled 18.5 million, or 17.4 percent of sales, during the first quarter of 2007 as compared to 17.9 million, or 17.6 percent of sales, in the first quarter of 2006. That's a lot of 17s. The one thing I would point out is that's beneath our target of 18 percent. So we're continuing to focused on costs as well as growth.

Something that should be factored into your analysis of the next quarter is some additional costs associated with Brian's retirement. The second quarter will include additional costs of about 1.5

million associated with our leadership transition, including a brief period of duplicate of salaries and divesting a certain previously awarded equity awards.

Operating income during the first quarter of 2007 was 26.3 million, or 24.6 percent of sales, as compared to 23.6 million, or 23.3 percent of sales, in 2006, an increase of 11.3 percent.

Now let's go into our segment operating results. Sales of our largest segment, friction and motion control products, increased 3.6 million to 60.7 million, or 6.3 percent when compared to last year. The was positively affected by increased demand for specialty bearings utilized in the wind energy, medical and defense markets. We also experienced increased demand for split roller bearing products from international markets, namely South African and China, which we've targeted as growth areas. These positive factors more than offset weaker sales to manufacturers of (semi con) equipment which were below levels attained in prior years. Operating income of friction and motion control products increased 16.3 million, or 2.6 percent, over the first quarter of 2006. Operating margin equaled 26.9 percent as compared to 27.9 percent attained in the prior year's comparable quarter. A couple of notes about that.

This year over year drop in segment operating margin is attributable to a mix shift driven by growth in a lower by still high margin split roller bearings business and by higher period costs as we've invested some dollars to increase muscle in the sales and marketing efforts. And I'm going to talk more about this under the caption organic growth a bit later.

Looking forward, orders in this segment increased 36.8 million to 90 million primarily due to large orders received for the wind energy market. We'll discuss this in our expanded capital expenditure program underway to accommodate our organic growth in both the wind energy and medical technology areas a bit later.

Velocity control. First-quarter sales of velocity control products increased 1.2 million to 15.7 million, or 17.9 percent, when compared to the first quarter of last year as a result of continued strength across all major market categories at our distribution facility in Germany. Operating income increased to 4.1 million, or 10.9 percent higher than the first quarter of last year. Operating margin rose from 25.4 percent to 26.1 percent due to increased operating leverage. Orders increased in both North America and in Europe.

In ceiling products, sales increased 1.2 million to 12 million, or 10.9 percent, as compared to the first quarter of last year. Strong demand from both industrial and aerospace markets along with recent selling price increases led to improved sales. Operating income increased 1.5 million to 2.5 million with operating margin rising to 20.5 percent from 9.2 percent. It's so good I stumbled. This improvement was driven by higher sales and favorable mix and pricing. Orders during the first quarter of 2007 rose to 14.9 million, 31.9 percent higher than last year, again driven by broad strength, particularly in the aerospace and hydrocarbon processing industries.

In our other product segments, sales of our remaining businesses equaled 18.5 million during the first quarter of 2007, a decrease from the first quarter of last year of 500,000 as higher sales of liquid filtration products, metal alloys and machine tool components were more than offset by lower sales of metal forming equipment and air filtration products. However, despite the lower sales, operating income for the businesses improved to 2.6 million in the first quarter compared to 1.9 million during the first quarter of 2006.

First-quarter operating margin for these businesses equaled 14.1 percent as compared to 10.1 percent last year. The improvement in both absolute and marginal profitability was driven by the benefits of a plant consolidation undertaken by a liquid filtration business in the first quarter of last year. The result, this year is improved by the profits we're gaining as the payback from that consolidation project flows through and from the absence of cost and distractions associated with

the plant closure last year in the first quarter. So the benefits of the payback and the absence of the negatives of the closure itself.

Going through the remainder of financial items on the P&L. During the quarter we earned 5.1 percent, on average cash investments of 366.9 million during the first quarter generating 4.6 million of interest income. Last year, we earned 4.3 percent on average cash investments of 318.2 million generating 3.4 million of interest income. Interest expense during both quarters was 2.4 million with the only debt outstanding being the 200 million convertible debt issuance.

The effective tax rate for the first quarter of 2007 was 36.1 percent which is expected to be the rate for the remainder of this year. The effective tax rate in the first quarter of last year was 32.6 percent which included a \$900,000 reduction to the provision for deductions recognized after a positive examination by the taxing authorities. This reduction to the tax provision improved first quarter of last year's earnings by about three percent on a diluted basis.

Net income for the first quarter was 18.2 million, or 57 percent – 47 cents per share, based on 34.8 million shares outstanding, an increase in diluted earnings per share of 9.6 percent when compared to the first quarter of last year, and last year's net income being 16.6 million, or 52 percent – 52 cents per share, on a diluted basis also based on 34.8 million shares outstanding.

I want to spend a couple of minutes on EBITDA and free cash flow, two non-GAAP measures but two critical measures which we look at and track closely in monitoring the fiscal health of our company. EBITDA, defined as earnings before interest, taxes, depreciation, and amortization, is an important gauge of financial and operational strength. EBITDA for the first quarter of 2007 was 30.7 million as compared to the first quarter of 2006 of 28 million. EBITDA for the last 12 months ended March 31, 2007, totaled 118.8 million as compared to EBITDA for the last 12 months of last year of 94 – or 95.7 million driven almost exclusively by the enhanced profitability.

Depreciation and amortization during the first quarter of 2007 equaled 4.5 million compared to 4.4 million during the first quarter of fiscal 2006. As you know, we're investing a lot of capital in the business which will increase depreciation going forward. With that in mind, depreciation and amortization for 2007 is expected to be approximately 22 million as compared to 17.4 million for all of last year ended 2006.

Free cash flow, another non-GAAP measure which we track closely, is defined as net cash from operating activities on the statement of cash flows in the GAAP financials less cap ex. It's another key indicator we look at as we look at our ability to generate excess cash above the levels required for both maintenance and growth capital. Free cash flow for the first quarter of 2007 was 10.7 million as compared to 10.9 million in the first quarter of last year with both the increase in net income and the increase in capital expenditures being 3.3 million roughly offsetting one another. And we're going to discuss the increased investment spending in a few moments.

Free cash flow for the last 12 months totaled 63.4 million as compared to free cash flow for the last 12 months ended April 1, 2006, of 36.4 million. The big jump is due to two large roughly equal items. First, the significant improvement in net income when comparing LTM periods, about 17 million and second, working capital changes, but really one significant one which was a \$17 million tax payment associated with the gain on our slip ring group. You never feel bad about paying taxes when you realize a big gain, and that was the biggest change in working capital last year, year over year.

EBITDA and free cash flow – here the (help line) – should be viewed as supplemental data rather than substitutes or alternatives to the GAAP performance measures. With that in mind we've included in our earnings release a reconciliation of these two metrics to the GAAP financial measures for your reference.

On to the balance sheet. Cash and cash equivalents totaled 375.2 million at the end of the first quarter as compared to 370.8 million at the end of 2006? Long-term debt remains unchanged at 200 million, (equal) of 31 percent of total capitalization, again three 200 million convertible debt issuance. During the first quarter we paid common stock dividends of 3.4 million, we purchased a total of 79,174 shares of company's common stock for about 3.2 million, and we invested 7.4 in cap ex.

Now, talking about orders and backlog. In aggregate, order entry was strong during the first quarter of 2007 equaling a record 141.7 million, an increase of 47.8 percent over last year's first quarter.

Brian, I'm not here if it's for me.

As discussed in the earlier calls over the years, Kaydon has received large orders for specialty bearings utilized by the wind energy industry resulting in a lumpiness in order flow. Now, a number of you have asked me off-line if there's been any tension with two CEOs in the transition. The only tension other than Brian getting phone calls during the conference call is he's been aggressively trying to patent the word lumpiness in these conference calls. And we've beat him off, so I'm pleased to announce we will still be able to talk about lumpiness, hopefully well into the future as we enjoy the benefits of our position in wind energy.

During this year's first quarter the company booked 32.3 million of orders for these products to be delivered over the next 12 to 18 months. Now remember in 2006, we booked 23.5 orders during the second quarter. So there's that lumpiness that Brian's talked about extensively over the preceding few years. The variability in these orders created by the size and, again, the resulting lumpiness of the orders received affect quarterly year-over-year comparisons and creates some challenges in coming up with a normalized run rate.

So today as in the past and in the future, we'll make sure we flag when these big orders come in, because it does affect the run rate and it does affect the steady flow of orders because of our position in this industry.

That said, at the end of the first quarter backlog equaled a record 186.3 million, a 28.9-percent increase compared to backlog of 144.6 million at the end of the first quarter of 2006. As a result of the wind power orders which will ship later in our typical pattern, the overall timing of when we expect our backlog to ship has changed.

If you remember, historically we ship about 50 percent during the next subsequent quarter, approximately 35 to 40 percent during the next two subsequent quarters, and about 10 to 15 percent during the final three quarters. And, remember, we expect orders for the next 18 months. So over the next six quarters that was our distribution. Due to these large, again, lumpy orders for wind power in particular, we expect this to change.

Going forward, as of today we expect about 40 percent of our backlog to ship in the next quarter, about 35 percent over the next two, and the remainder over the balance of the three quarters pretty much evenly. The back-end loading of when these orders can ship is tied both to demand, but in Kaydon-specific circumstance now when we expect our capacity on-line under construction the large diameter about – the large diameter bearings to come on-line.

Let's talk a little bit about our organic growth initiatives and some of the many reasons why I'm excited to be joining Kaydon at this time. 2007 is an important investment year for Kaydon as we lay the groundwork for future expansion in key secular growth segments.

Last year, we began investments in two major growth initiatives supporting our specialty bearing business serving the rapidly growing wind energy market and the medical and security equipment market. Think in particular scanning technology. After an analysis of the current supply-demand

balance that exists, particularly in serving the growing wind energy market, and in response to the needs of our customers, we've made the decision to further expand the capital program this quarter. The additional capital expenditures committed to will help meet wind turbine manufacturers' requirements for advanced custom bearing assemblies of up to 11 feet in diameter, the new larger wind turbines with up to three megawatts of capacity. The company's total investment in these expansion programs will be approximately 60 million when completed.

For this year, we expect our capital expenditures to be approximately 51 million as compared to 26.3 million last year. With these expansion programs coming fully on-line during the remainder of 2007, we expect to incur ramp-up costs and additional fixed expenses of about \$2 million. These costs should be spread evenly over the next three quarters as we're working on relocating equipment, getting the facility in shape, and getting ready to be shipping these in the last quarter of this year.

As noted in our discussion on the friction and motion control segment a little earlier, we're also making important investments in people, adding sales and marketing resources to pursue growth opportunities in Asia and Europe, and to fortify our domestic distribution channels. This will affect SG&A in the near-term, but benefit is in the medium and long-term as we're adding muscle to our operations.

Finally, during the quarter, we made the decision to relocate a portion of our manufacturing capacity of our ceiling product segment from a high-cost facility in Baltimore, Maryland, to a lower-cost facility located in (Mottsville), North Carolina. This will – this relocation is expected to be completed by the end of 2007 and result in a significantly more efficient manufacturing process and resultingly significantly higher profitability.

During the remainder of 2007 as the relocation's being completed, we expect to incur about 1.6 million of additional costs, again related to severance, recruiting, training, duplicative labor costs

as we make the transition. These again will be incurred evenly over the next three quarters.

And if that changes over the next few calls we'll keep you posted.

Now in summary, we're very pleased with our first-quarter results. The 186.3 million backlog at the end of the quarter positions us well for improved operating performance through 2007 and beyond as we've expanded our internal capabilities to serve segments enjoying secular growth. This positioning combined with our strong balance sheet and tremendous financial flexibility provides considerable resources to support our strategic objectives which include commitment to growing sectors of the industrial markets we serve as well as opportunistic acquisitions of leadership companies that meet our acquisition criteria.

Now, I'd like to turn it over to Brian who like to make a few concluding remarks and we'll go to Q&A. Thank you. Brian.

Brian Campbell: Great. Thanks, Jim. I might comment as a side bar that the only friction that Jim and I have had is his criticism of my inability to turn off my cell phone. But we'll talk about that after this call is concluded.

James O'Leary: I'm going to leave here and I'll find out he's patented lumpiness.

Brian Campbell: Yes. My concluding remarks I think are very succinct and they're very heart-felt. The whole Kaydon team is extremely proud of all that we've accomplished as an organization since September of 1998. And through the tremendous effort and dedication of everyone at Kaydon we instilled a new bottom-up high-level performance oriented culture, substantially leveraged our competitive strengths to obtain further share of customer and share of market positions, and we made enormous strides in information and manufacturing technologies.

By the continuous leveraging of these strategic strengths we firmly believe that Kaydon has the essential elements in place to continue to produce: attractive long-term returns for our shareholders; well-defined, focused operating and financial strategies; above-average cash flow; a proven management team; and leader proprietary product positions in very attractive long-term growth markets.

I have been honored to be part of this great Kaydon team, the greatest management team that I ever have been associated with. And as I mentioned in the shareholder letter in our annual report, the Kaydon team has what I call tribal knowledge, an instinctive focus and ability to produce extraordinary operating performance. The team's operational execution and the passion they bring to Kaydon are the foundation of our company's growth and success. And you may rest assured that your company remains in good hands.

Thanks again to all of you for your support and encouragement since 1998. And you all have my best regards and best wishes for everything you do in the future.

And with that I would like to turn the call back to Jim who will moderate the question and answer session. Jim.

James O'Leary: Thank you, Brian. And operator, let's go to the Q&A.

Operator: Thank you, sir. To signal for a question on the call, please do so by pressing the star key followed by the digit one on your touch-tone telephone. Once again, that is star one if you'd like to signal for a question. Please be sure your mute function is disengaged so your signal can reach us.

We'll go first to Ian Fleischer with Friedman Billings Ramsey.

Ian Fleischer: Hi. Good morning.

James O'Leary: Good morning, Ian. How are you?

Ian Fleischer: Good. Before I start I'd just like to say it's been a pleasure dealing with Brian and I wish you continued success. And, Jim, welcome aboard.

James O'Leary: Thank you, Ian. Appreciate it.

Brian Campbell: Thank you, Ian.

Ian Fleischer: Great. Now, in the wind business – obviously that's the focus – you guys have ramped up capacity yet again. And as you know, the production tax credit runs out at 2008, but we've heard that that's gaining momentum to be extended out possibly into 2012. Is your capacity expansion – is that – is that to support demand beyond 2008 at this point? Because your customer, if I understand it correctly, your primary customer is sold out more or less through 2008 at this point.

James O'Leary: Well, we don't talk about customers. And it's not to support a primary customer; it's to support the industry. And that does go out past 2008. We're committed to it; we are firm believers in the rationale for wind energy. I have not seen anything written recently that would detract that. Actually, Ian, I've talked about this pretty extensively. And I think the renewed and the additional capital reflects our commitment and our belief and confidence that this is going to be a growing market well into the future.

Ian Fleischer: And maybe touch on – touch on your opportunities internationally in wind energy.

James O'Leary: Obviously the last half a dozen articles I've read in the "Journal," which I'm sure you guys you have read as well, have been about producers and manufacturers in Europe, places

like Denmark, Spain, where it is not only accepted, the cost benefits have been demonstrated.

So we are looking overseas. Principally today we're in North America, but as we look at how to grow Kaydon and drive organic growth further we will be looking overseas as well. But right now it's principally North American.

Ian Fleischer: And could that – could that international growth come from customers that you already have currently that are in that business as well?

James O'Leary: Sure.

Ian Fleischer: OK and just touching on friction and motion control. The margin. Obviously you touched on that, it came down year over year partly over mix. How should – how should we think about that going forward? Is that mix shift going to – going to continue through the year? I mean, how do you – how do you see that?

James O'Leary: It should. You know, right now I expect it to improve back up towards 30 for the year. It may still be a little bit below what we realized last year, but not much. And I think, you know, it would be a high-class problem ((inaudible)) absolute profits were a lot higher and a margins were a bit down because the mix to split roller bearings continued to grow.

Now that said, listen, the long diameter bearings, we make a lot of money, the margins are very strong there as well. So it's almost an unanswerable question as to which I'd prefer as long as absolute profitability is going up and it's in our range of plus 20 percent margins. That said, based on what we know internal today, I'd expect it to pick up a bit, and you should see it at about 30 by the end of the year.

Ian Fleischer: OK, great. Thanks very much, gentlemen.

James O'Leary: You're welcome, Ian. Thank you.

Operator: We'll go next to Walt Liptak with Barrington Research.

Walt Liptak: Hi. Thanks. Good morning, guys.

James O'Leary: Good morning, Walt.

Walt Liptak: And I'd also like to say thank you to Brian for, you know, some very good years that he's been at Kaydon.

Brian Campbell: Great. Thank you, Walter.

Walt Liptak: And I'm especially going to miss you reading the four-page press release on these conference calls.

Brian Campbell: Well, I could dial in, in the future, you know, and do that.

James O'Leary: We may have a guest appearance every now and then just to keep Brian with us.

Walt Liptak: The guest star. OK.

James O'Leary: Right.

Walt Liptak: Well, thanks again. The question I have is, you know, if you X out the wind power, you know, it looks like your orders were still up 14 percent. Can you talk a little bit about, you know, the type of applications that they're going into and, you know, going back to the last question, what the margins look like in that.

James O'Leary: Sure. I think we're see broad strength across most of our – most of our segments. Now, obviously there were one or two notable that were in the press release, in the case of air filtration, semi con equipment. But when you look across the rest, ceiling products in particular, the aerospace industry, the hydrocarbon processing industry, military across the company, wind energy, medical, you know, more is going right than not, which resulted in, you know, both increased sales and the substantial increase in operating leverage. So pretty much every sector except those I mentioned were year over year improved.

Within other, liquid filtration is doing pretty well. We talked about the benefit year over year. Again, we're not just getting the bounce from closure costs last year, but also the payback on the project we approved originally in consolidating facilities. So again, more going right than wrong. I think the benefit of a strong economy. You know, we've read a lot about the mid-cycle slowdown. You know, certainly there could be some slowdown. There's been a lot of concerns about the slower cap ex. But where we're positioned today, our major markets, two of which are in a secular growth increase, that being wind energy and medical technology, and some of the others since as military we've yet to see a real slow-down. So more good than bad, and keeping my fingers crossed.

Walt Liptak: OK and then also going back to that last question. You know, you – or the last caller's question. The – are there some orders for wind power and medical that go out passed that 18-month period that are not in your backlog right now that provide visibility beyond, you know, the backlog numbers you just reported?

James O'Leary: There are.

Walt Liptak: OK. Can you – is it possible to quantify those?

James O'Leary: We'd prefer not to right now. You know, we talk about backlog in terms of 18 months has been our policy. Again, the lumpiness of the order, I don't know if it's a relevant data mark, but, you know, we committed the capital with the belief the orders are going to be there. And, you know, there are some passed 18 months.

Walt Liptak: OK. And then in your – in your remarks you were talking about a \$2 million relocation expense. Could you just go over that again? How does that split throughout the year and what exactly is it for?

James O'Leary: Sure. You know, if you don't mind, let me talk – there's three – I don't want ((inaudible)) I don't want to categorize them as non-recurring because that's a bad thing. But they're really unlikely to occur again in future years. You know, one is 1.5 million. That's for Brian in the second quarter. You know, ((inaudible)) result of two CEOs for a brief period, some transition costs, some accelerated equity that had been previously granted. That's all in the second quarter.

Walt Liptak: OK.

James O'Leary: In the second, third and fourth quarter I think you'll see probably evenly split about \$2 million for the relocation or the expansion of our wind energy business elsewhere from – principally in Mexico. And secondarily it's about a million and a half or a million six for the ring and (seal) relocation I talked about. That's where we're moving facility – we're moving part of our capacity from our Baltimore facility to (Mocksville), North Carolina.

And those two, the two million, the 1.6, includes things such as severance, relocation costs, training, there are some inefficiencies as you bring new facilities up and running and kind of debugging them. That 3.6 I would think is going to be pretty evenly through the year. But if we have the opportunity to kind of accelerate them, get the capacity aligned quicker, get ourselves to

(Mocksville) faster, we certainly would. I think that's something we'll continue to report on as the year progresses. But I think for modeling purposes, you'd assume about 1.2 per quarter.

Walt Liptak: OK. Got it.

James O'Leary: ((inaudible)) that.

Walt Liptak: OK. Thanks very much.

James O'Leary: Thank you very much, Walt.

Operator: We'll go to Peter Lisnic with Robert W. Baird.

Peter Lisnic: Good morning, gentlemen.

James O'Leary: Hey, Pete. How are you?

Peter Lisnic: I'm doing well. And of course I want to extend my thank yous to Brian as well and a welcome to Jim.

Brian Campbell: Thank you.

Peter Lisnic: And I'm guessing that phone call was right – was from Brian's wife right after she heard about the \$1.5 million payment in the second quarter. But we'll leave that be.

Brian Campbell: No, that was from her attorney.

Peter Lisnic: Still got the sense of humor, Brian. That's the good thing. Jim, I'm just wondering if we could talk about wind a little bit more. You've gone over – through it in pretty good detail at this point. But kind of the target that's been thrown around and talked about is this could be, you know, nine-digit business, \$100 million business kind of over the next five to seven years. And I just get the sense with kind of the orders picking up the way that they are and what people are talking about in terms of alternative energy that maybe this is a bigger opportunity than \$100,000 million or that it can occur faster. Can you give us a good sense as to – as to what you're thinking about the business at this point?

James O'Leary: Yes. Well, the – we have specifically talked about nine digits, you insert 100 million. And I don't disagree, that would be where we would stand at the end of this capacity expansion, which we committed to this quarter for all the reasons you just enumerated. This is an attractive, high-growth opportunity for ourselves.

Now to the second point, yes, it is absolutely possible (there's) a bigger opportunity than that. We recently reviewed with our bearings people the potential beyond that. We get together again during the summer for our strategic plan, kind of which is a first preview of next year's budget. And we're talking about, hey, is there more to be had here, do we run the risk of losing anything on the – leaving anything on the table. And we don't want to be too conservative to the point of, you know, finding there was a lot more business to be had than we led ourselves to believe. So I do agree with you, there's a real possibility that it's greater than that and we have our people looking at it as we speak.

Peter Lisnic: OK. Is that – is the opportunity, the way you look at it right now – I don't want to say confined, that's no the right word – but when you talk about that \$100 million and for the capacity that you're adding, is that – I mean, again, is that really just dedicated to what's happening here in North America?

James O'Leary: Yes, principally.

Peter Lisnic: OK. And so the opportunity overseas if you looked at it could be as significant potentially?

James O'Leary: Oh, right now it's more significant I'd say and it's further entrenched in places like Denmark, Spain, England. And if you look at the hydrocarbon issue world-wide, I don't know why it wouldn't be significantly greater once there's some accord on how these things should be handled in places like China and India. Brian.

Brian Campbell: Pete, there is a very interesting article in the May 7 issue of "The Nation" magazine.

Peter Lisnic: OK.

Brian Campbell: It's about renewable energy. And the emphasis is on the growth of wind energy. And rather than recap what's in that article I would encourage you to find that article. And it's a very – a very favorable article regarding the prospects for wind energy going forward.

Peter Lisnic: OK. Well, I appreciate that and I'll take a look at that. The one other thing I'd like to ask about wind is we – I mean, we understand in terms of installed capacity what's happening and what's forecast to happen. But what about the replacement market. I mean, these are moving parts, it is a bearing. So over time I have to believe that this is not sort of a one and done kind of situation, that you've got a pretty good recurring revenue base that's being established here as well. Can you talk about what kind of – if when you look at that \$100,000 million, what's the contributor from recurring revenue or for replacement versus kind of new or one-time sort of production.

Brian Campbell: Pete, obviously, you know, we're still moving rapidly into the early stages of wind energy expansion. And as you know, our products are mission critical and they're built to last for a long

time. However, these products, these specific bearing assemblies have to be serviced and maintained. And we would expect going forward that we will start to see some revenue growth from servicing the bearing assemblies. So we cannot at this time, you know, give you an accurate forecast on that.

Peter Lisnic: OK. And what – I mean, what's kind of the useful life, do you think, of the bearing, five years, 10 years?

Brian Campbell: Oh, no, I think a bearing before it is pulled down for maintenance is probably seven to eight years.

Peter Lisnic: OK. All right. And then – not to go back to the \$1.5 million for humorous purposes, but where's that going to be recorded in the income statement?

James O'Leary: In SG&A in the second quarter.

Peter Lisnic: OK. Great. All right, I'll jump back in queue. Thank you very much.

James O'Leary: Thanks, Pete.

Operator: We'll go next to Steve Barger with Key Bank Capital Markets.

James O'Leary: Hello, Steve.

Steve Barger: Good morning. We've talked about in the past about there being \$40,000 in content on a one and a half megawatt tower. And I – it seems like the industry's moving towards larger towers. So is there a linear relationship between bearing content and tower capacity, or how should we think about that?

James O'Leary: The bearing content's going to move up, obviously, because if you're talking about a three megawatt turbine you're obviously increased cost. So there will be a move-up in that content value as the three megawatts become more and more popular.

Steve Barger: But potentially twice the content?

James O'Leary: I wouldn't say twice, but I would say it could increase by at least 50 to 70 percent.

Steve Barger: OK. And talking about the international opportunities that were brought up earlier, can you ship an 11-foot diameter bearing or at some point would you need to put a plant in Europe to take advantage of that market.

James O'Leary: We will be exploring opportunities to put a plant in Europe. I think the shipping costs overwhelm the benefit absent the big shortage. So we're looking at and we're sensitizing what would happen if we put capacity overseas.

Steve Barger: OK, thanks and one last one. Jim, you know you have some big shoes to fill there.

James O'Leary: I do.

Steve Barger: Knowing that you're just settling in, can you kind of talk about what you're focusing on in the near-term, the top couple of things that you feel like you need to do to complete this transition?

James O'Leary: Sure. It's really three things, all of which – well, three things many of which have been going on for about two years, not expecting this to happen but just being an active and committed

director. And one thing which I think is critical which is getting out to divisions, spending time with our operating people and understanding where they think the growth is.

The first thing, we've been visiting every division, getting out to them on reviewing their budgets, talking about strategic planning, looking at capital opportunities, talking about, you know, the very thing you just asked about, should we be exploring capacity, expansion overseas, should we be adding sales and marketing people, how do we bolster our distribution capabilities in the United States for off the shelf product and overseas. So I think that's the key thing. And that never ends. I mean, that starts and ((inaudible)) habitat has got to – you do it at least semi-annually at your reviews, you do it probably quarterly as part of your operating reviews. And that is a live, robust process. It never stops.

The second thing which I think ((inaudible)) started two and a half years ago, happens at every board meeting and happens regularly in between, is to review the acquisition pipeline. We have a lot of cash. That's not lost on me. One of the things that Peter DeChants and I have been doing is kind of reviewing all the deals we have in house, all the deals we've looked at the last two to three years.

And interestingly enough, a lot of them didn't happen for good reasons. I think on the last conference call we talked specifically about a deal that didn't happen because of the terms and conditions that were needed in the contact that we were willing to do. A lot of them didn't happen because the seller didn't get his price, a lot of them didn't happen for social reasons. You know, so looking at those and kind of going back and, you know, kissing the frogs one more time to see if any will turn into a prince, reviewing the acquisition opportunities for – I think bolt-on is the wrong expression given the market size we've got in some of the niches we are. But market expansion through tangential and adjacent product offerings is something I think is not bolt-on but certainly an opportunity for something between organic growth and acquisition opportunity.

So again, something that started a few years ago but again is a robust process we're looking at now is revisiting the acquisition pipeline in addition to looking at anything new that comes in. And I think the third thing which is going to fall out of those two is we have a lot of cash I know our shareholders are sensitive to.

Well, if preferred alternative – and to me the preferred alternative is accretive value-creating acquisitions. But if that doesn't happen, what else do we do in the interest of capital efficiency? And I think that's something we'll be revisiting and looking at over the next few quarters. And I think that's the evolution of, you know, how you capitalize on the company's success to date, not just in generating cash on a day-to-day basis. You know, a phenomenal sale last year with the (slip ring) group and just the fact that the company has a lot of debt capacity and cash generating ability that we have to tap into for your benefit.

Steve Barger: Right. So when you're saying you're going to revisit, you know, obviously acquisitions are what you want to do first, but when you – if you revisit the other things that can be done, does that mean you would open the door to a special dividend or is that more reinvestment buy-back, that sort of thing.

James O'Leary: I am probably more of a reinvestment and buy-back guy, and a lot of that depends on where you're trading on a given date and what you think your prospects are. But that's one I'd kind of like to say I'm appreciative of it, I'm a fan of it, but I don't know if there's anything I'd commit to, you know, just now. I think we've got to look first and foremost at how we grow the company, not just organically but through good accretive acquisitions.

Steve Barger: All right, thanks very much. Brian, we're going to miss you. And, Jim, look forward to working with you.

James O'Leary: Thanks a lot, man. Be good.

Steve Barger: Bye.

Operator: We go next to Nigel Coe with Deutsche Bank.

Nigel Coe: Oh, thanks. Good morning.

James O'Leary: Good morning, Nigel.

Nigel Coe: Yes, sorry, I missed the order numbers for wind this quarter. Could you just recap that, maybe talk about where the backlog is right now for the wind segment.

James O'Leary: Ken, you got that at your fingertips?

Ken Crawford: Yes. The orders for wind were \$32.3 million ...

Nigel Coe: OK.

Ken Crawford: ... for the quarter. And last year I believe in the second quarter we booked – 23?

James O'Leary: 23.5 ...

Ken Crawford: Yes, 23.

James O'Leary: ... for the second quarter of last year.

Nigel Coe: OK.

James O'Leary: And you missed a very humorous dissertation on lumpiness ((inaudible)) continue to be a hallmark of our conversations. But backlog, order entry records driven to a large extent by (that) large order, but the large order of ((inaudible)) recurring on a more regular basis. It's just the timing of when they happen, when they can ship will be a bit different than our historical mark.

Nigel Coe: OK.

James O'Leary: OK?

Nigel Coe: OK. And then one Q '06 there was – there was nothing on wind in that quarter.

James O'Leary: No.

Nigel Coe: Right and the backlog? So the backlog would be roughly \$55 million, I'm assuming.

James O'Leary: We don't comment on that, but you can pretty much get there yourself.

Nigel Coe: OK. And the orders you had this quarter, did – were, you know, you referenced the, you know, the larger diameter bearings for the – for the three megawatt turbines. Have any of these orders include some of those or will come through going forward?

James O'Leary: No, I don't think so. It'll come through coming forward.

Nigel Coe: OK, OK. And, you know, you're talking about this could be, you know, \$100 million - \$100 million per annum revenue opportunity. You know, a seeming number of turns on the bearings side (and, you know, tax) that. It's implies, you know, a return of about 30 percent. Is that sort of the right – the right way to think about that return on the cap ex you're putting in for that?

James O'Leary: I think that's right. And it's consistent with the – you know, the return criteria we have for all our capital investments, particularly in a business that is amongst our highest margin segments. So, yes.

Nigel Coe: Right. Great. Thanks a lot.

James O'Leary: ((inaudible))

Nigel Coe: And Brian, good luck with your next move.

Brian Campbell: Great. Thank you.

Operator: As a reminder to our participants, it is star one for questions. We'll go to Joel Tiss with Lehman Brothers.

Joel Tiss: Well, thank you. First I'd like to thank Brian for solving my one puzzle that I had, finding out who the only subscriber to "The Nation" magazine was. Thanks for that. I wonder if you could talk a little bit free cash flow targets in 2007.

Male: Give us one second.

James O'Leary: One hesitancy I give is if we give that out with having given out the capital, we basically give you the net income number. And we also gave you the depreciation number. So I'm a little reluctant to give that out. I think it'll be consistent with our growth targets factored onto last year. Because we have given out the D&A number, we've given out the cap ex number, and I think backing into net income is essential the forecast. So Joel, I'm going to – I'm going to pass on that one.

Joel Tiss: All right. I think you're giving us too much credit. But anyway –

James O'Leary: Joel, if you can't do that one –

Joel Tiss: I'm just kidding.

James O'Leary: All right. But it was a nice try.

Joel Tiss: All right. And can you talk a little bit about, you know, if – just from a philosophical standpoint – now that Brian's leaving you can lower the standards a little bit on acquisitions – can you just talk about if there's, you know, are we likely to see more of – more action in that area or you think, you know, you're going to kiss the same frogs the same way and maybe, you know, not really get anywhere.

James O'Leary: Well, I don't know if I want my legacy to be I lowered Brian Campbell's standards. I think – we have criteria and we have looked at a lot of deals in a market that has, you know, on an EBITDA multiple – and, boy, I ((inaudible)) remember – this is not the relevant benchmark. But, you know, things were going for five or six times EBITDA back in 2000 to 2002.

Obviously, that was an anomaly. You know, I think the eight to 10 now is a bit on the rich side. Although, you know, I do think you've got to look at a couple of things which tie directly into the capital allocation question – cost of funds are low. You know, if you have debt capacity and you don't use it, it is very challenging to compete with some of the financial buyers out there when there's as much liquidity and money is as reasonably priced as it is today. You've got to remember our criteria.

You know, while we're looking for things with margins consistent with ours, you know, we do look at deals in the 15-percent margin and higher. I think if there's any – and I would not say it's

relaxing of standards – it would be an evolution from what our, you know, very strict criteria now.

I might be – and this might be a little bit of departure from what Brian has looked at before – I might be willing to take on something that is not a turnaround but a little bit more of a fixer-upper if it was adjacent to our existing businesses and kind of fit with what we do in terms of distribution and manufacturing capability. So I don't think that's a departure, it's an evolution, a recognition of the deal market. You know, I think if you look at where we're trading, where the industrial sector in general is trading, I think to get anything done you'd have to look at the slightly higher end of the range we've talked about. I don't think that's a departure from what Brian's talked about in the past. I think that's an evolution and recognition of the market.

And again, I think it's tough to do either of those two things until you look at your debt capacity and, you know, what the after-tax of money would be if some of these were a little bit more debt financed. You know, we've got a high-class problem. We've got \$400,000 million, you know, almost of money to spend net of the convert, and I do think I would encourage you to look at it as net of the convert because, you know, I'd like to factor all this into kind of the broader solution of what do you do when that's addressed. You've got still substantial capacity in terms of free cash flow. But I don't want to give you the forecast it's going to be better than last year. And, you know, you've got a lot opportunity.

So a long way of answering your question. I'm not going to change the criteria. I think in recognition of the market and where we're trading at I'd probably gravitate towards the (higher end of multiples) for deals that I think are not going to become eight to nine times today and 11 to 12 times tomorrow because numbers are going down. But, you know, that's what due diligence is for.

Joel Tiss: OK. And last, do you have a number for us on how many windmills are in place now and how many are on the drawing board for, you know, over the next two or three years?

James O'Leary: I do not. Our, you know, what we've looked at (our) capital improvements on and improved our capital expenditure requests on is based on, you know, our specific universe of people we serve. So I don't have a number I can give you for them and I wouldn't give you a number on the whole industry. I think there's a pretty good body of knowledge out there on that.

Joel Tiss: OK, thank you.

James O'Leary: Thank you, Joel.

Operator: And once again, that is star one to signal for a question. We'll go to Holden Lewis at BB&T.

Holden Lewis: Good morning, guys. And ditto all the other positive sentiments and congratulations and all that to everybody involved.

James O'Leary: Thank you.

Holden Lewis: The – I guess not to – (it's amazing we could) possibly beat the wind power horse any further, but just a couple of questions. You know, you had mentioned that you not only – last quarter, I think, you had mentioned that you not only had your traditional customer but that you had another customer maybe placing an order and maybe there was a third one in there as well. Can you just sort of update us on sort of, you know, how that's progressed, are we there. And are – if there is more than one customer, are the other ones also for the U.S. or is that sort of a foray into the – into the international market.

James O'Leary: It's still North America. And, you know, Brian's comments about the additional customer are intact and accurate. There is an additional customer. And we do, you know, we are looking at other people all the time, where we'd expand capacity, whether it's here or overseas. Right now, it's North America and there are other customers.

Holden Lewis: OK. But so far you've got orders booked for two and you're – you would pursue others as you add capacity. Is that the way to look at it?

James O'Leary: Yes.

Holden Lewis: OK. And then in terms of the lumpiness of the business – and obviously you've booked 32 million this quarter. I mean, do the sales go out in a similarly lumpy way so that, you know, by the time we get into fourth quarter or first quarter you'd see the revenues act in a bizarre fashion, or do they tend to bleed out more smoothly.

James O'Leary: I think we taking orders that in some respects really can't be shipped until the capacity is on-line. I think once we have the capacity online you'll see a return to our normal distribution. I think if we have the capacity today we could ship everything we made.

Holden Lewis: OK. OK.

James O'Leary: I think this is a – this is a transitory issue as we work towards having the capacity fully on-line.

Holden Lewis: OK. So the only – the only reason you can't ship the full 32 million when it's requested to be shipped is because of the capacity issue?

James O'Leary: No, I wouldn't say people have requested it to be shipped. I mean, they recognize we were putting the capacity in as we speak. And you can only ship it as fast as you can build it, and there's recognition that we're putting it in place as we speak.

Holden Lewis: OK. But ((inaudible)) just bleed through. OK and then on general pricing conditions.

Obviously, your raw material costs are still high. You talked about some pricing in the smaller seal business. But I think it's been a while since we talked about any meaningful pricing in sort of the key bearing business. Can you talk about what you're seeing in terms of raw material impact and the ability to pass that on?

James O'Leary: When we look at our raw material as a percentage of sales this quarter compared to last quarter and compared to last quarter of prior year, it's pretty consistent. So for the most part any raw material increases we see coming through we're either realizing price increases to cover and then some. I think you pointed out ring seal is ((inaudible)). We're also seeing that in other businesses. So we have a strong pricing environment. But, you know, I think we're doing it judiciously and respectfully of our customers. And the material price increases right now are exactly consistent with where we've been in the last few quarters.

Holden Lewis: OK. So some quarters ago you announced – you had sort of made a public announcement of a large increase which clearly impacted the gross margin. No more of those on the horizon. It's more of sort of incremental tick-ups here and there as you adjust to raw materials?

James O'Leary: I think that's right, yes.

Holden Lewis: OK. OK. That is what I needed.

James O'Leary: Thank you, Holden.

Holden Lewis: Thanks, guys.

Operator: And at this time, there are no other questions. I'd like to turn the call back over to management for any additional or closing comments.

James O'Leary: I have one closing comment. As new President and CEO, I would like to take Brian Campbell on behalf of myself as both a friend and a fan, on behalf of our board as a director. And while I've been an employee for a month I know there's a tremendous affection on the part of the employees for Brian and everything he's done here. So Brian, thank you.

Brian Campbell: Great. Thank you, Jim.

James O'Leary: Thank you very much and with that, operator, I think we are done. Thank you very much.

Operator: Thank you, sir. And that does conclude today's conference call. Again, thank you for your participation. Have a good day.

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