

KAYDON CORP

Moderator: Jim O'Leary
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Operator: Welcome to the Kaydon Corporation third-quarter 2007 earnings conference call. Before the conference begins, the company would like to make the legal disclaimer that certain information in this formal discussion and that may be included in the question and answer session is forward-looking within the meaning of the federal securities laws.

These forward looking statements are only predictions based on the company's current expectations about future events. While the company believes that any forward-looking statements may be reasonable, actual results could differ materially since the statement are based on the company's current expectations and are subject to risks and uncertainties beyond the control of the company.

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During this conference call, Kaydon spokespersons will reference certain GAAP measures. To assistance in understanding such non-GAAP measures as well as to comply SEC requirements,

the company has included in their press release reconciliations of non-GAAP measures to their most directly compatible GAAP measures. Today's conference is being recorded.

Now I would like to turn the call over to Mr. James O'Leary, Chairman and Chief Executive Officer of Kaydon Corporation. Mr. O'Leary, please go ahead.

James O'Leary: Thank you very much, Delia and good morning and thank you all for joining us today.

I'm pleased to be reporting on a healthy quarter, but one which requires a lot more heavy lifting than usual when making comparisons to last year's extremely strong third quarter. This is principally due to investment spending and a number of discrete ups and downs which we'll take you through later. But again, we apologize there's a big more heavy lifting this quarter, but we'll do our best to walk you through it in regrettably painstaking detail.

We are extremely excited and pleased to be discussing our progress on several longer-term initiatives aimed at accelerating long-term shareholder value. Notably, the acquisition of Avon Bearings Corporation, which was announced this morning, and the acceleration of our share repurchase program, which is aimed at optimizing our approaches to both capital allocation and the use of free cash flow.

I'm joined this morning by Ken Crawford, Senior Vice President and Chief Financial Officer, and Peter DeChants, Senior Vice President Responsible for Corporate Strategy and Development.

During the quarter we had record third-quarter order entry of 117.3 million, up almost 26 percent year over year, leaving us with record quarter-end backlog of 211 million going into the fourth quarter, reflecting continued strength across most of our businesses. Assuming this trend continues, this position does extremely well for the remainder of 2007 and into 2008.

During the quarter, Kaydon had record third-quarter sales of 107.4 million, up 7.7 over last year's strong third quarter. Operating income, which included about one million of relocation and ramp-up costs, equaled 24.5 million, or 22.8 percent of sales, as compared to 24.9 million, or 25 percent of sales, in last year's third quarter. Last year's quarter benefited from about 800,000 in one-time operating income benefits, while this year suffered from some one-time detriments, mostly associated with the ramp-up in (Knoxville) and our wind energy expansion.

Now, to provide you with an apples-to-apples comparison, I'll briefly discuss some non-GAAP information. On a non-GAAP basis, backing out the one million of ramp-up and relocation costs incurred this year and adding back the 800,000 of one-time benefits last year, our margins would have been 23.7 percent this year as compared to 24.1 percent last year. And remember, last year was an extremely robust performance in what's usually a slow quarter. Again, that comparison was non-GAAP. The slight dip on a apples-to-apples basis of about 40 basis points was largely attributable to a challenging comparison with an extremely strong performance by our higher-margin military segment last year which was not fully repeated into this year's third quarter.

In addition, we saw some shipments slip from the end of this year's third quarter into this year's fourth quarter because we had some challenges in receiving customer supplied raw materials and delayed outside vendor deliveries. These items in particular are timing and should be caught up early in the fourth quarter.

Net income equaled 17.1 million, or 16 percent of sales, as compared to 17.6 million, or 17.6 percent of sales, last year. Diluted EPS equaled 54 cents compared to 55 cents in last year's third quarter. And again, the comparison to the prior year third quarter was affected by the expenses just mentioned and by a one-time tax benefit totaling 500,000 in the third quarter of 2006, which was related to the disposition of an idle facility which gave us a non-repeatable tax benefit.

Gross profit for the third quarter was 43.3 million, or 40.3 percent of sales, as compared to 40.9 million, or 41 percent of sales during last year's third quarter. Comparisons again affected by the pre-tax items just discussed. In particular, gross margin was impacted by about \$600,000 of costs to ramp up our wind energy business and to relocate certain sealing products business lines. During the fourth quarter we anticipate that these items will negatively impact gross margin by about one million. Again, this was discussed in prior quarters and that should complete most of these charges for investment and relocation.

SG&A expenses included 300,000 related to the wind energy ramp-up and were 18.8 million, or 17.5 percent of sales, during the third quarter. This compares to 16 million, or 16.1 percent of sales, during the third quarter of 2006. During last year's third quarter an insurance refund and a reduction in environmental reserves contributed about 800,000 of favorable SG&A impact. In the fourth quarter of this year we expect additional SG&A of about 500,000 related to the wind energy ramp-up.

Operating income during the third quarter of 2007 was 24.5 million, or 22.8 percent of sales. And, again, the non-GAAP apples-to-apples operating margin comparisons are roughly 23.7 million this year as compared to 24.1 percent of last year.

Now I'll spend a little bit of time on our business segment performance starting first with friction control products. Sales of friction control products increased 2.5 million to 60 million, or 4.3 percent, when compared to the third quarter of 2006. This increase was driven by strong sales of split roller bearings in almost every market we sell into, but notably what we term distant markets, which is driven principally by China and India.

This segment was also positively affected by increased demand for specialist bearings utilized in the machinery, wind energy, and wind and medical equipment markets, offset by lower sales to

military, non-wind, heavy equipment, and semiconductor markets, all relative to levels achieved last year's third quarter. Remember, last year's third quarter enjoyed particularly strong business in our military segment.

Operating income of the friction control product segment decreased to 50 million, impacted by the ramp-up costs and the absence of a 500,000 insurance refund recorded in the third quarter of last year. As compared to the current period, the third quarter of 2006 benefited from extremely strong performance in our military business, while this year was negatively impacted by what should be a timing issue in which some shipments slipped from the end of this year's third quarter into next – into this year's fourth quarter due to delays in receiving customer supplied raw materials and delayed outside vendor deliveries.

Operating margins equaled 25 percent as compared to 29.3 percent last year, the lower operating margin driven by the higher proportionate growth of lower margins but still high margin split rolling bearing and lower sales in our military business, which was exceptionally high in the last year's third quarter. The wind energy ramp-up and the absence of the \$500,000 refund last year also created some static in making clean comparisons. Again, applying the same logic to the items just reviewed result in an apples-to-apples non-GAAP comparison of about 26 percent this year compared to about 28.4 percent last year. Third-quarter orders in this segment increased 22 million, or 44 percent, to 72 million. Our wind energy orders almost tripled while non-wind orders in this segment experienced strong 20-percent growth.

As we've noted before, we typically receive extremely large discrete orders for specialty bearings utilized by the wind energy industry resulting in an uneven order of flow – and uneven order of flow of when orders are booked.

Now moving to the velocity control segment. Third-quarter sales of velocity control products increased 1.9 million to 16.5 million, or 13 percent, over the prior third quarter with strong sales by

both our German and U.S. operations. Operating income from velocity control products increased to 4.5 million, or 28.8 percent, when compared to the third quarter of 2006, while operating margin rose from 23.8 percent to 27.1 percent primarily as a result of strong operating leverage experienced on higher incremental sales. Orders increased more than 18 percent over the prior third quarter with double-digit growth achieved by both the U.S. and the German operations.

In sealing products. Sealing product sales increased 1.7 million to 12 million, or 16.4 percent higher in the third quarter of 2006. Operating income in the sealing product segment increased 32 percent to 2.2 million with operating margin rising to 18.2 percent from 16 percent last year. This improvement was driven by leverage from higher sales and extremely strong market conditions in both our hydrocarbon processing and aerospace segments. Orders increased during the third quarter of 2007 – or excuse me, orders during 2007 totaled 9.8 million as compared to 12.4 million in the prior year and the decline was principally due to the timing of when orders are received. On a year-to-date basis, segment order activity has grown. Recently, certain customers have reduced their larger, long-term orders in favor of multiple shorter term orders. For example, in the prior quarter, a customer placed a single large long term order which is now being replaced by smaller short-term orders impacting clean quarter-to-quarter comparisons.

In our other product segment, sales in other businesses equaled 18.8 million during the third quarter, an increase from the third quarter of 2006 of 1.6 million, or 9.3 percent, principally due to higher demand in our liquid and air filtration businesses. Operating income for the company's remaining businesses improved to 2.2 million in the third quarter compared to 800,000 during the third quarter of 2006. Third-quarter operating margin for these businesses equaled 11.5 percent as compared to 4.6 percent last year. The improvement in absolute and marginal profitability came largely from the benefits of a plant consolidation at our liquid filtration business and the

absence of consolidation costs associated with it that were incurred in the third quarter of last year.

Now I'll turn it over to Ken to cover some additional financial items.

Ken Crawford: Thanks, Jim.

We earned 5.2 percent on average cash and short-term investments of \$326.5 million during the quarter of 2007, generating \$4.8 million of interest income. Last year, we earned 5.1 percent on average cash investments of \$342.9 million generating \$4.4 million of interest income. Interest expense during both the third quarters of 2007 and 2006 was \$2.4 million with the only long-term debt outstanding being our \$200 million of convertible debt.

The effective tax rate for third quarter 2007 was 36.1 percent, which is expected to be the rate for all of 2007. The effective tax rate for the third quarter last year was 34.6 percent, primarily because of a \$500,000 tax benefit related to the disposition of an idle facility. Net income for the third quarter was 17.1 million, or 54 cents per share on a diluted basis, as compared to the third quarter of 2006 net income of 17.6 million, or 55 cents per share on a diluted basis.

EBITDA is a non-GAAP liquidity measure that we consider an important indicator of financial health. During the quarter, EBITDA was \$29.3 million as compared to EBITDA during the third quarter a year ago of 29.1 million. EBITDA for the last 12 months ended September 29 of '07 totaled \$123.1 million as compared to EBITDA for the last 12 months ended September 30 of 2006 of \$111.5 million.

Free cash flow is another non-GAAP liquidity measure that we consider to be an important indicator of the company's health and as it reflects our ability to generate cash in excess of both growth and maintenance capital investment. Free cash flow during the third quarter of this year

was a negative \$6.7 million due to the company's \$23.2 million contribution to fully fund our qualified pension plans. The net after-tax impact of this contribution was a \$14.9 million use of cash from operating activities. This contribution will substantially eliminate future contributions and should modestly – and should be modestly accretive to future periods. Capital expenditures were \$9 million higher during this year's third quarter as we continued our investment in capacity expansions announced in prior quarters. Free cash flow was \$9.6 million during the third quarter of last year. Free cash flow for the last 12 months ended September 29 of 2007 totaled \$34 million as compared to free cash flow for the last 12 months ended September 30 of last year of \$44.3 million.

The third quarter pension contribution along with the higher capital expenditures associated with our capacity expansion programs more than offset our improved cash generation from other operating activities. Again, EBITDA and free cash flow should be viewed as supplemental data rather than as substitutes or alternatives to the GAAP measures. We've included in our earnings release a reconciliation of these two metrics to the most comparable GAAP measures for your reference.

Cash and cash equivalents plus short-term investments totaled 350.3 million at the end of the third quarter of 2007 as compared to 370.8 million at the end of 2006. Long-term debt remains unchanged at 200 million, equal to 30.2 percent of total capitalization. During the third quarter of 2007 the company paid dividends of \$3.4 million. That dividend payment was at a rate of 12 cents per share and the latest dividend which we paid early in this fourth quarter was at a rate of 15 cents per share and equaled \$4.2 million. We also purchased a total of 295,800 shares of company common stock for \$15.4 million and invested a total of 16.8 million in net capital expenditures.

In the third quarter of 2007 the company invested \$90 million net in auction rate securities, a short-term investment vehicle offering superior interest rates to cash and cash equivalent

investments. These assets are considered available for sale and the purchase and sales activity are shown in the investing section of our statements of cash flows.

As Jim mentioned earlier, order entry was strong during the third quarter of 2007, achieving a third quarter record of \$117.3 million, an increase of 25.9 percent over last year's third quarter. The variability and size of orders of large diameter bearings for the wind energy market affects quarterly year-over-year comparisons and creates challenges in assessing a normalized run rate.

That said, we are obviously very pleased with our third quarter order entry and the resultant backlog at the end of the third quarter which equaled a record \$211.4 million. This is a 36.4 percent increase compared to the backlog of \$155 million at the end of last year's third quarter.

As discussed in previous conference calls, it's worth a reminder that our wind energy orders will ship later than our typical pattern. The overall timing of when we expect our backlog to ship has changed from being approximately 50 percent during the next subsequent quarter, approximately 35 to 40 percent during the next two subsequent quarters, and 10 to 15 percent over the final three subsequent quarters to being approximately 40 percent during the next subsequent quarter, 35 percent the next two, and the final 25 percent over the final three subsequent quarters. This shift in timing is tied to both demand and to when we expect our capacity under the construction for large diameter bearings too come on-line.

In addition to sales shipped from backlog, the company also generates approximately 25 to 40 percent of its quarterly sales on a book and ship basis, where both the order and the sales occur in the same quarter. Because of summer shutdowns in several of our customers, particularly in Europe during the long end of summer holidays, our booking and ship business is historically the slowest during the third quarter of each year.

As I mentioned in our last conference call, this seasonal slow-down and the approximately 600,000 of expenses related to wind energy expansion ramp-up and the relocation costs incurred in our sealing products business was expected to and did result in third quarter margins that are lower than our normal run rate. In addition, we did not experience the benefit of some of the profitable large military business that we recorded in the prior third quarter. Therefore, we experienced our normal seasonal dip in the third quarter and experience margins to recover in the fourth quarter, which is seasonably a stronger quarter.

Finally, I would like to remind everyone that last year's fourth quarter effective tax rate of 32.7 percent reflected \$800,000 of reductions to the tax provision related to deductions recognized for financial reporting purposes after examinations by taxing authorities or after the expiration of applicable review periods.

Now I'd like to turn the call back over to Jim.

James O'Leary: OK. Thanks, Ken. As I noted in our second-quarter conference call, 2007 is an important investment year for Kaydon as we lay the groundwork for future profitable growth.

We've continued to accelerate investments in a major growth initiative supporting our specialty bearings business, servicing the rapidly growing wind energy market. Our capacity expansion is proceeding and will provide Kaydon with substantially increased manufacturing capacity to satisfy the rapidly growing wind turbine demand for advanced custom specialty bearing assemblies, up to 11 feet to diameter for new large wind turbines, up to three megawatts of capacity. This is supplemented by the Avon acquisition which we believe gives the capability to make the largest bearings in North America.

For 2007, Kaydon now expects total cap ex to approximate 61 million as compared to 26.3 million in 2006. Also, the relocation of our manufacturing capacity or a portion of our manufacturing

capacity in sealing products from a higher cost facility in Baltimore to a lower cost facility located in (Knoxville), North Carolina, is in progress. This will result in a significantly more efficient manufacturing process and substantially higher profitability, which will make us significantly competitive in competing for new business going forward. We've incurred additional costs related to severance, recruitment, training, duplicative labor, and operating expenses of 500,000 in the second quarter, a million in the third, and about a million and a half in the fourth, which should bring that to a conclusion.

I'd like to talk a little bit about capital allocation initiatives. As noted last quarter, we're confident in the ability of our businesses to generate high levels of cash flow in excess of cap ex required for both growth and maintenance. This and our strong balance sheet will allow us to prudently return capital to our shareholders in form of both share repurchases and periodically increased dividends while driving profitable organic growth. Our fourth quarter dividend paid earlier this month was 15 cents per share, an increase of 25 percent over the prior dividend. In addition, as Ken just noted, we repurchased approximately 295,000 shares, or 15.4 million, during the quarter, with year-to-date share repurchases totaling 455,000 shares for 22.6 million reflecting our commitment to an ongoing robust program of returning capital to our shareholders.

I'm very pleased with our acquisition of Avon Bearings Corporation which we announced this morning. The acquisition was a cash transaction valued at about 55 million and is expected to be accretive to Kaydon's earnings within the first full year of ownership. Avon is expected to add approximately 30 million to Kaydon's fiscal 2008 sales. Headquartered in Ohio, Avon is a leading custom designer and manufacturer of high precision, large diameter turntable bearings.

Avon also re-manufacturers bearings, sells replacement bearings, and is known globally for its focus on engineering support, product quality, and proprietary manufacturing capabilities. Avon's going to be an excellent addition to our marketing leading bearings business. It'll add immediate capacity to our growing wind energy platform while strengthening both existing customer

relationships and adding others. This acquisition compliments Kaydon's current and expanding manufacturing capabilities. Combined with the ((inaudible)) announced capital investment programs, it'll enable Kaydon to become the largest manufacturer of slewing ring bearings in North America.

In summary, we're pleased with our third quarter results. But more importantly, we're extremely pleased with our progress on certain long-term initiatives as evidenced both by the Avon acquisition and our enhanced activity in the share repurchase program. The 211.4 million quarter end backlog positions us well for the remainder of 2007 and beyond as we expand our internal capabilities to service segments, enjoying strong secular growth. This position combined with our strong balance sheet and tremendous financial flexibility provides us with the resources to drive internal growth while selectively evaluating external opportunities. Our strong financial position and free cash flow generation also allow us to prudently return capital to our shareholders in the form of both share repurchases and enhanced dividends.

Three final notes. First I'd like to welcome a new director to Kaydon's board, Bill Gerber. Bill joins us from Kelly Services, a Fortune 500 company, where he's been Chief Financial Officer for almost 10 years. Bill's recently announced his plans to retire from Kelly Services effective December 31 of this year to form a private investment fund and to focus on directorship assignments.

Prior to joining Kelly, Bill held several senior financial positions at (Delimited). Bill's a CPA and has previously held financial positions at Arthur Anderson, Gold Incorporated, and Caterpillar. He also serves on the board of directors of AK Steel and extremely excited to add to Bill to our board. His broad experience makes him an excellent addition and his extensive financial experience at Kelly Services during a period of domestic and international expansion will serve us particularly well. I'm confident that he'll play an important role and make meaningful contributions an independent member of our board, and most notably its audit committee.

I'd also like to take each of our Kaydon employees for their efforts this quarter. Our most valued and valuable assets are our many employees throughout Kaydon, and I'd like to thank them for the great work done this quarter in positioning us for strong results in the near future and prospectively for their efforts ahead.

And finally, we're very pleased to have the Avon Bearings Corporation people join the Kaydon team. Avon strengthens areas where we're already strong and provides us with many complimentary relationships and capabilities going forward. We're excited about welcoming the Avon management team and their devoted employees to the Kaydon family. What we will expect will be an extremely exciting future.

That concludes the formal presentation of the conference call. And Delia, I'd like to turn it back to you to moderate Q&A.

Operator: Thank you so much. If you would like to ask a question, please press the star key followed by the digit one on your telephone. If you are using a speakerphone, remember to turn off your mute function before signaling for a question. Once again if you would like to ask a question, please press star one now. Let's pause for just a moment.

The first question coming from Joel Tiss, with Lehman.

Joel Tiss: Good morning. How you doing?

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

Joel Tiss: All right. I wonder if you could give us a little bit more flavor of the change in the military business. I mean, you mentioned tough comps, but can you just give us a little bit of a flavor of what the trends are so we can start to frame out 2008 as well.

James O'Leary: That is a very good question. I'm glad you asked. The tough comps are largely due to extremely favorable absorption we had last year in the third quarter when one of our facilities in Sumpter was up and running, you know, on all cylinders during what is usually a somewhat slower quarter.

As far as the trends in the business, I think it's worth noting that our backlog in the military business is up today as compared to last year. But some unexpected orders (that were) book and ship, particularly in the third quarter, really benefited us with respect to absorption. But year-over-year our backlog is up in our military segment and replacement programs, particularly (MRAP), are coming on now. So we view this as more an absorption and a timing issue, not a commentary on the health of the military business. Again, still strong, up year over year, and we feel very good about our position there.

Joel Tiss: OK. And the follow-up question. I'm going to try to glue two together here. Can you explain a little bit more for us your change in your strategy for lower pricing to be able to get more volume? And related to that, can you also give us the sense of if this growth in backlog is coming, you know, part and parcel with the lower pricing, like is the backlog going to be as profitable as the current business you have today, less or more. That's what I'm trying to get at. Thank you.

James O'Leary: Well, there's absolutely nothing in this quarter that reflects a strategy of lower pricing. I think what we said is in certain segments and as expand internationally we may be willing to accept somewhat lower margins. But is not reflected in this quarter. There is no lower pricing. The only issue that I think stems from lower pricing per se is a mix issue. Split roller bearings in

our friction control segment have inherently a lower margin. Although I will tell you they're up from low to mid teens last year to high, almost 20 percent operating margins this year.

But the bottom line is split roller bearings, which are experiencing unbelievable growth, particularly in the distant market segment, which is China and India, has been growing faster than our traditional custom bearing business. And part of that has to do with the fact that wind energy (isn't) up and running. So it isn't a strategy of lower pricing. That has nothing to do with this quarter. It's a question of mix, timing, and phenomenal growth in our split roller bearing business, which, you know, at high teens and 20s I think a great many of our competitors would kill for margins like that.

Joel Tiss: I would, too. Thank you.

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

Operator: And next with a question, from Barrington, we have Walt Liptak.

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

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

Walt Liptak: Good. I wonder if you could, you know, you called out three kind of product categories, in friction, semiconductor, heavy equipment and defense. Of those three product categories, which ones had the, you know, were down the most year over year.

James O'Leary: I think the only one I'd say that is genuinely weak is semiconductor. Military, again, I think it's largely timing. Backlog is up year over year. And a lot of the impact that business can have on your absorption, which, you know, it does drive margins to a significant extent, has to do

with the timing of when a very robust program last year hit us and carried through to the second and a little bit into the third quarter of this year, then tailed off, and when that will be replaced, principally by programs such as (MRAP).

In heavy equipment, not down materially. That's a business actually that we think will be benefited significantly by the Avon acquisition. You know, there are many sizes of bearings, considerably higher than what we do, even in what we do in wind energy, where Avon is uniquely positioned. And if you look at the business of (Manatoak, Terrix), a lot of the heavy equipment producers who are shipping cranes all over the world, you know, with backlogs going out to 2009 and '10, we think we're pretty well positioned and the Avon acquisition positions us to do even better in the heavy equipment segment.

Walt Liptak: OK, could you ...

James O'Leary: I think semiconductor being the only – the only truly weak segment.

Walt Liptak: OK. Could you quantify that headwind in semiconductor – I mean, in millions of dollars?

James O'Leary: Let me come back to you on that, Walt. We'll figure it up for you. It's not significant, but we'll get that for you.

Walt Liptak: OK. And then on the defense part, you said that the back – the orders in the backlog were up, you know, year over year. So that's not slowing. But, you know, the (MRAP) is a, you know, that's a huge spending program. Are there other orders that are not in backlog that you expect? You know, what could we look at, you know, when would you start shipping for (MRAP) related product?

James O'Leary: Yes, that'll be next year. And there absolutely are orders that probably would not be in inventory, (although I can) tell you that a PO has been cut. You know, our position on the program, even if a PO were cut for the entire thing and if you think about our bearings business with respect to wind energy, because we only include things that are 18 months and out, it might not necessarily reflect our full position there.

Walt Liptak: OK. And then last one. You mentioned the vendor related issues. Can you quantify the kind of sales that, you know, you couldn't ship this quarter because of the vendor issues?

James O'Leary: It's less than 10. You know, is it fivish or so? Probably around that. And, you know, that is – I guess that's the other edge of we're in a great position as far as being a component supplier to something that has taken off like nobody envisioned a few years ago, or even a few quarters ago with respect to wind energy. There are supply chain shortages all throughout the supply chain. But unfortunately that does impact us a little bit on certain of the forgings and certain of the things we outsource. And our supply chain guys, our purchasing guys are just like some of our customers, scrambling all over the world to offset that. That's largely a timing item. Should come back next year – excuse me, next quarter.

Walt Liptak: OK. I understood the second part of what you said. But you said less than 10. Did you mean less than 10 million?

James O'Leary: Less than 10 million in sales, yes.

Walt Liptak: There might have been five to 10 million in sales that got pushed out from this quarter to fourth quarter or '08.

James O'Leary: Yes.

Walt Liptak: OK. All right, thank you.

James O'Leary: OK. You're welcome.

Operator: And next up from Robert W. Baird, we have Peter Lisnic.

Peter Lisnic: Good morning, gentlemen.

James O'Leary: Good morning, Pete.

Male: Good morning.

Peter Lisnic: Jim, I may have missed this, but did you give the – the wind order number for the quarter?

James O'Leary: I did not. And I will turn you over to Mr. Crawford.

Ken Crawford: \$18 million in the quarter, this quarter. And last year – last year third quarter was five million.

Peter Lisnic: OK, 18 million?

Ken Crawford: Yes.

James O'Leary: Yes.

Peter Lisnic: All right. So that puts your orders non-wind at up like 6.5 percent I'm doing the math right?

Ken Crawford: On a consolidated basis – within the – within the segment, though, where wind is it was up more than that.

Peter Lisnic: OK, yes, that's fine.

Male: I thought it was 20 percent, wasn't it.

Male: Yes.

Peter Lisnic: I guess I don't – on the heavy equipment side and in friction, I was somewhat surprised that it was down. Was last year such a strong year or was that where – or was that the end market where a lot of this pushed out sales may have occurred.

James O'Leary: Remember, heavy equipment is not among our biggest segments. And when we say down, I doubt it's more than five million. I think it's largely to do with timing and largely to do with where we're positioned. I mean, some of the businesses that are doing extremely well, you know, particularly cranes, we just were not well positioned or have not done until the acquisition of Avon.

You know, where we are positioned well, man lifts, you know, orders where we expected, you know, maybe not to have done as well with some of the consolidation going on there. You know, we're still doing well; it's just a little bit off relative to last year. I don't know if we necessarily have enough business to say – or until Avon, I don't know if we necessarily had enough business to say we're representative of any weaker trend there. I think it's a timing issue.

Peter Lisnic: OK. All right. And then can you give us some sense of what Avon's end market exposure's like in comparison to yours? And what I'd specifically wonder is how much wind exposure they have now.

James O'Leary: Sure. Next we think it's going to be about 30 million of total sales, about a third of that you should think would be wind. Longer term we think it's about 40 million. And let's say that's a run rate that annuitizes in, you know, two, three-plus years. You know, if it's about 40 million and half is wind with a split between two to three customers and with the balance being heavy equipment, you know, that would be representative of where they are today on a \$40 million run rate. What that doesn't reflect is some of the things we think we can do with it, particularly with Avon and the position created in the repair-refurbishment market. It – just the history is Avon was a small family business run extremely well by three, you know, very good guys who we hope will stay with us for a while. In fact, we expect at least two of them will.

The Walsh brothers. They have been taking orders as they've promised. Been a traditional family business where you're a little bit resource constrained, but they've invested well, they've invested in a great reputation, the repair-refurbishment market world-wide. But they're in a position really where they've been taking orders for the last few years. You know, we expect to have a much more robust marketing effort around that business, particularly repair-refurbishment. And we expect it to be globally orientated. Because as we mentioned before with the crane business, and I read the other day that (Manatalick) has backlog going out to 2009, large cranes going other China and India, that's where we expect a lot of our efforts to be focused in the long-term as we change Avon really from being in a position to wait for the orders to come in to, you know, one of the Walshes was responsible for that, to maybe where he'll be working on our behalf going out and kind of traveling the globe helping that business come to us more proactively that's not in the 40 million. So we think there's considerable up-side there over the longer term.

Peter Lisnic: OK. And then the natural question would be up-side or kind of what – what the profitability profile of the business is now.

James O'Leary: Yes. It'll be consistent with our existing business, Pete.

Peter Lisnic: Is it consistent right now?

James O'Leary: It won't be right away largely because of the purchase accounting. You know, the reason it's not immediately accretive on an EPS basis based on what we're entering at – and I think it – you know, we're entering at a price to sales. And if you impose our margins over the longer term, you know, the only reason it's accretive to earnings immediately is purchase accounting where you mark up the backlog and take away some of the immediate benefit. On a cash flow accretion basis, it's pretty much immediately accretive out of the box.

Peter Lisnic: OK. Can you put a box around the accretion?

James O'Leary: Since we don't give forecasts, I don't know if that would be something we'd do. It'd probably add a penny or so to next year.

Peter Lisnic: All right. Well, at least I could try. Then the last question on Avon if I could, just on the ...

James O'Leary: ((inaudible))

Peter Lisnic: ... their wind customer exposure. Is there overlap or are they brand new customers for you?

James O'Leary: Both.

Peter Lisnic: OK. Thank you.

James O'Leary: You're welcome.

Operator: Thank you. And our next question now comes from Keybanc Capital Markets Steve Barger.

Steve Barger: Hi, good morning.

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

Steve Barger: I'm doing all right. Back to the Avon a little bit. Previously you thought you could get to \$100 million run rate for wind by the end of FY '08. This should accelerate the process. But how are you thinking about that, you know, how much business you can support now towards the end of '08.

James O'Leary: Well, it'll be about – maybe on a run rate of about 115.

Steve Barger: OK. So it's fair to say that your capacity expansion ex Avon is on track? Are you seeing any puts or takes there?

James O'Leary: You know, it should – it's on track with what we talked about externally. We still expect to be shipping in December. You know, we ate into a little of our own internal contingencies. We'd like to have been shipping a big sooner, but nothing ever works out perfectly.

I think, again, the dark side of business being so darned good in that sector in particular is, you know, we've seen some delays in forging in components that are important for us. So I can't tell you that, you know, you won't have another couple weeks of slippage. But right now we don't expect it to. We expect to be shipping in December. And we should be at that 100 million plus run rate – tight now it's 110 to 115 plus with the addition of Avon – by the next year. And I think if you took 40, you know, 50 percent of that being wind, by the end of two years plus out, you know, the 125 is more like 145 to 150.

Steve Barger: Excellent. And for customer negotiations in the wind market, I think you were talking to a couple of people that you (are) currently selling to. Could you update us on where you are in negotiations?

James O'Leary: Yes. We are highly confident by the end of this year we're going to have two of the major, you know, the top tier wind energy people. And again, at some point we have to address the fact that it'll become a meaningful enough number where we'll have some disclosure issues. But today, we're still bound by confidentiality. We will be with two of the major global guys. We will be what we think are a healthy representation of the comers. And the comers would be that next level of people who are, you know, not quite in the – and I'll just throw out all the names. (Vesta, Schemasa), GE, (Seslon). You know, kind of a notch below that volume. But we will be very well positioned with them to service their needs.

And the reason why, you know, we kind of have to stratify it and take a very strategic approach to how we allocate our capacity is we want the top guys that we're with – or the big volume guys that we already have commitments on to be extremely happy if not ecstatic with our performance, because that's our lifeblood. We also want to be with a few growing guys, comers, that we can add some value to, and also keep them equally happy. So unfortunately, we can't be all things to everybody. But we can do the best we can for the limited number of forces that are willing to let us select and select us.

Steve Barger: Sure, OK. And last one. It's – I'm sure it's a competitive market, but is there a – is there margin expansion opportunities for that second tier of wind customers over what you'd get with your primary large volume customers?

James O'Leary: Longer term, but that would be delving into some of the contractual stuff that probably wouldn't be appropriate on this call.

Steve Barger: OK. Very good. Thanks.

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

Operator: With one question remaining, once again if you would like to ask a question, please press the star key followed by the digit one. Next we go to Ian Fleischer with FBR Capital Markets.

Ian Fleischer: Hi, good morning.

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

Ian Fleischer: Good. Can you – can you provide some color or quantify the asset stepups that go through the P&L in the fourth quarter?

James O'Leary: I probably can't. I hope – it's largely associated with the existing backlog. The asset stepups will probably take – I don't want to speak out of turn – somewhere between 90 days, you know, it'll be into our first quarter before you know what gets allocated to fixed assets, what gets allocated to good will. I think in our next call we'll be a little bit more conversant in that because that requires the work of appraisers that really couldn't start until today. You know, most of the stepup immediately goes against backlog. That's why you have this divergence between cash accretion and EPS accretion.

Ian Fleischer: OK and just turning to your (seal) segment. Can you provide some color on the timing and impact of – on margins of the (seal) facility relocation?

James O'Leary: Sometime by the middle of next year that'll be fully completed, we'll have most of our sealing products relocated. And it'll be 100 plus basis points of improvement.

Ian Fleischer: OK and turning to your – your capital allocation. In the – in the absence of the acquisitions, you know, how should we think about a share buy-back? Are you in a position where you would – you would back a large piece of stock, like five million shares, something like that? Am I thinking about that right in the absence of acquisitions?

James O'Leary: I think over time that would be right if you had a absolute drought of acquisitions for a long period. We're not going to go out and do a big Dutch auction. I think we'll evaluate opportunistically things in the market. When I walked away from the Bloomberg a little while ago it was a better deal today than it was Friday. I'd expect we'd be, you know, more aggressive on dips over the next several months. But, you know, in the absence of acquisitions, you know, something nobody asked me was about the acquisition pipeline. And I would have told you I have no comment on it.

If Avon hadn't closed this weekend, I would have had – still had no comment on it. I don't think it's really appropriate to talk about an acquisition pipeline until deals get done.

Look, Avon came along, it was opportunistic, it fits us perfectly, it fits, you know, what I think is one of the three tiers of our acquisition program. We'd like to add bolt-on-site to our flagship bearings business if they can be, again, accretive within 12 months, add value, add to our capabilities, do all the things that Avon does. You know, the second type of acquisition we'd like to do are things that we can bolt into, some of our stand-alone segments that need critical mass and product breadth, like sealing products and velocity controls. And we're looking for a second leg. And that will come as the market presents itself. We have to be opportunistic.

But before I start thinking about big share repurchase programs in the absence of acquisitions, you know, I'm very pleasantly surprised we're talking about an acquisition today. And I'm hoping to be very pleasantly surprised over the next couple of quarters. I think what you should be looking to us – and, again, I think this quarter demonstrates what we've been talking about for

several months – is in the absence of acquisitions we'll devote a substantial amount of free cash flow and eat into the cash balance if, you know, if deals don't present themselves as rapidly as we'd like. I think over the longer term you should expect at least 50 percent of free cash flow to be devoted to share repurchase. And I think on an annual basis we'll look at the dividend, you know, as a way of keeping us on a budget and providing, you know, some return to our shareholders who value dividend through thick and thin. So I think on all three, you know, on all three points, share repurchase stepped up meaningfully this quarter, and I think you've heard an articulated commitment from management to continue doing that last quarter but evidenced by the payment this quarter. You know, we're going to continue to look at our dividend.

And as evidenced by Avon, you know, we are being a little bit more broad on the types of acquisitions. This is absolutely not a turnaround. But this is something that's a little bit more operationally intensive where we think we can add a lot of value to its operations beyond our stand-alone criteria historically. So, you know, I think on all three fronts of capital allocation coupled with the growth aspect of Avon, you know, this quarter kind of embodies that. You know, it was a little bit of a messy quarter in terms of the ins and outs and the margin issue which we flagged for you last quarter.

But I think when you stand back and look at record orders, record backlog, strength in two secular, you know, secularly strong segments, particularly wind and military, you know, I think when you look through the static there's a lot more good than bad.

And I think more importantly for our long-term shareholders, grow our biggest business, position it in the sector that I have yet to hear anything – in fact, today there's a great article on (Seslon) in the FT I'd encourage you guys to take a look at. You know, position ourselves well. And, you know, we're in a position with our liquidity and our debt capacity where – I'm not saying we're going to be all things to all people, but for at least for the foreseeable future we can be a lot of things to many people like.

Ian Fleischer: That's helpful. One final quick one.

James O'Leary: I thought I talked for like 10 minutes. How can you possibly have ...

Ian Fleischer: Yes. On your friction and motion control segment, when I think about the operating margin there's a lot of moving pieces there. Should I – should – is the 29 percent that you did in the – in 2006, should I think about that as your high water point or can you do better than that in '08?

James O'Leary: I think for the foreseeable future, Ian, that's a high water point. There was unbelievable absorption before the capacity really got going, no investment cost. That's a tough one to replicate. I think once we're another quarter or so in and we see how wind and how the other segments of the business – the only thing that, you know, I think we gotta keep an eye on as we go into '08 – and we're just starting our budget process now – in a global economy that shows no sign of slowing down, you know, what's the impact of raw material going to be and what's the impact of further supply chain issues. And right now we think what hit us this quarter is to discrete.

But, you know, I listen to a lot of the same calls that you guys do as far as industrial peers, and, you know, the one thing I'm kind of holding my breath on – and I don't know if we'll know till we're a little bit further into next year – is the impact of raw material pricing in a robust global economy on domestic manufacturers. That's a to be visited probably on our next conference call.

Ian Fleischer: Thanks. I appreciate it.

James O'Leary: You're welcome. Operator, other than to say thank you very much and thank you all for listening to us, and thank you Kaydon employees, and welcome to Avon employees, I think we're pretty much done.

Operator: That does conclude today's conference call. Thank you for your participation, and have a good day.

James O'Leary: Bye-bye.

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