KAYDON CORP

Moderator: Rick Mosteller
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Rick Mosteller: Welcome to the Kaydon Corporation Second Quarter 2009 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 made are reasonable, actual results could differ materially since the statements are based on the company's current expectations, and are subject to risks and uncertainties beyond the control of the company. Listeners are cautioned to refer to the company's 2008 Form 10-K for a list of risk factors as updated in the company's first quarter 2009 Form 10-Q, that could cause its results to differ from those anticipated in any forward-looking statement.

The company does not undertake and expressly disclaims any obligation to update or alter its forward-looking statements, whether as a result of new information, future events or otherwise, except as required by applicable law.

During this conference call, Kaydon spokespersons will refer to certain non-GAAP measures. To assist you in understanding these non-GAAP measures, as well as to comply with SEC requirement, the company has included in its press release a reconciliation of these non-GAAP measures to the most directly comparable GAAP measures.

Today's conference is being recorded. Now we would like to turn the call over to Mr. Jim O'Leary, Chairman and Chief Executive Officer of Kaydon Corporation. Jim, please go ahead.

James O'Leary: Sure. Thanks a lot, Rick. Good morning and thanks for joining Peter Dechants, our CFO; Don Buzinkai, our Controller; Rick and myself to review our second quarter results.

Before we get into the true nitty-gritty of the quarter, I thought it might be worthwhile to provide a few high level comments to add a little bit of color and a little bit of context to our discussion, and these are things we usually leave to Q&A.

But you know in light of the recent quarter, and in light of the general uncertainty of the economy, and to provide, again, a little bit of context and a little bit of framework to look at how we're thinking about where we are today in the cycle, and how we're viewing the results, particularly in light of recent dividend increase. I thought it would be good to do some of these first, rather than leaving them to Q&A. That is not an invitation to have fewer questions, but I would ask you to try to keep it to one question at the end, then get back in the queue.

Now first on the industrial side of our businesses, remember, the industrial side of the businesses is virtually everything except for wind. While I'm not calling it upturn, or suggesting that further worsening isn't a possibility, the outright worsening that we've seen in past quarters, in North America at the end of last year and Q1, and Europe a bit more recently, as that's worsening, if not freefall, really didn't start until the beginning of this calendar year. It seems to have subsided, and there are anecdotes of improved sentiment, particularly in quotation activity and some one-off (order) releases. Now again, whether these are head stakes or not, or modest inventory replenishment, we can only be discerned with time with the outright plunge that we've seen earlier seems to be behind us.

On the wind side of the business, we've had no cancellations this quarter, but we did continue to experience deferrals on customer receipts, especially at quarter end. Some of this was driven by trade finance issues, and there big points will be letters of credit. But much of it was driven by the lack of visibility the industry has experienced on the policy front.

On the policy front, on a positive note, again, anecdotal as it's too early to see an impact, if any, there's much greater clarity on the tax issues, and the mechanisms for obtaining cash grants for qualified projects. This came out at the end of the quarter, so any impact on the general turbine inventory build-up is pretty much right throughout the supply chain, impacting our sales and other suppliers, in addition to our customers. Any impact from that's probably further on down the road, but is a pretty absolutely positive statement to say having clarity on this front is better than not having clarity.

As I said a number of times, however, the more important issue strictly in my opinion, especially in what continue to be challenging economic times is the need for clarity on the renewable electricity standard. With this through the House and awaiting a trip to Senate, we and our customers are clearly monitoring this closely. As an (RES), it provides some clarity for the much longer term, it's really what's needed to provide the framework the industry needs for what we hope are going to be, many good decades instead of a couple of quarters.

From a macro perspective now, when we look at our results, they've clearly been impacted by this harsh industrial recession. However, when we look at our performance relative to past cycles, the actions taken to date impact future cash flows, and our general fiscal position, we and our board clearly have a great deal of confidence in the market position, the cash generating ability of our businesses, as evidenced by a recent dividend increase.

When we look at EBITDA, EBIT and free cash flow, there are two interesting points, not only worth mentioning, but I think are very important in the analysis when you look at Kaydon relative to past cycles, and how you model the cash flows, and the business prospectively.

First, the disproportionate impact to depreciation on the largest capital program in any 10-year history in the company's history, let alone the 24-month snapshot, remember, in the last 18 to 24 months, we spent more on CapEx in any 10-year period in the company's history, and when you strip out the last major project in 1998 to erect the facility in Mocksville, North Carolina, it is darn close to a 20-year period. That has a pronounced impact on your margins if you're looking at EBIT rather than EBITDA, that's why we'd encourage you to look at EBITDA margins a bit more prominently.

Now on free cash flow, with that spending complete, CapEx will drop down south of $20 million, so the impact on free cash flow is pronounced. Second, the huge impact of pension where the GAAP costs on what after this quarter's funding is again a fully funded plan, is about $4 million of P&L expense higher than the comparable (trowel) in the last recession, and this is largely due to the interest rate assumptions, and the actual rate of return assumptions. Again, an absolute legitimate P&L there from a GAAP perspective, but now with a $14 million made this quarter, which a company in our fiscal position with cash generating businesses can do comfortably, we're back to a fully funded status, and now the P&L impact relative to the cash flow impact is obviously a bit out of steel.

Now when we stand back and look at these items, the margin comparisons are a bit less stark, unless you believe the next major move in volume is down, as volume and capacity are the biggest issues of decremental margins after these two easily isolatable factors.

And now we'll go through the details in our normal fashion. Sales in the second quarter were 98.3 million, compared to 139.9 in the second quarter of last year. Operating income was 13.2 million in the second quarter, as compared to 32.1 in the second quarter of 2008.

However, EBITDA, a non-GAAP measure, was 20.6 million in the second quarter, as compared to 38.9 in the prior year's second quarter. Net income for the second quarter was 8.4 million, or 25 cents per share on a diluted basis, as compared to the second quarter net income of 19.6, or 63 cents per share on a diluted basis.

Business conditions worldwide remained extremely challenging, with lower sales volumes at each of our businesses through the second quarter. Operating income in total, and to a varying degree in each segment, was adversely affected by lower volume, higher pension costs, product mix issues, and increased year-over-year depreciation associated with our now complete Mexican expansion. With the reduced volume, we continue to be impacted by lost absorption in our plants, as we are below optimal capacity levels at the present.

A stronger dollar on a year-over-year basis also negatively impacted both export volume and translated foreign results, and interest income remained at negligible levels.

During the quarter, we incurred about a million dollars of costs, or 2 cents per share associated with redundancies, severance and other restructurings during the quarter. Much of these were in locales such as United Kingdom and Mexico where much of the business slowdown didn't occur until early 2009, and it made sense to go a bit slower on the redundancies as the cost benefit associated with letting workers go is a bit different due to the high upfront costs of letting people go.

That said, while business conditions are no longer in a freefall, they're also not clearly improving by the anecdotes we talked about before. This left us with the obvious need to make those cuts in these markets, notably United Kingdom, where the cost benefit is a bit more challenging, but started to make sense during this quarter.

Also during the quarter, we realized a pretax gain of about a million dollars, or 2 cents per share related to changes in our post retirement employee benefits, which we began restructuring or eliminating with formal communications primarily being made in this quarter or the next. These changes will benefit future cash flows and earnings, in addition to resulting in additional, more significant curtailment gains in the third quarter. That calculation is still being actuarially determined, however, the current estimate for third quarter pretax curtailment gain is a number not to be less than about 4.5 million.

We're also continuing to review opportunities to further reduce structural capacity, should business remain at this low level for a protracted period of time. And while this is ongoing, there's a possibility that asset meaningful improvement we'd have (actionable) plans by the end of 2009.

Now let's review our segment operating performance, and give some color on how our principal end markets are faring at this stage in the downturn. Friction control sales totaled 64.2 million, as compared to 86.8 in the second quarter of last year. Second quarter 2009 operating income was 9.8 million, compared to 22.1 last year.

During the 2009 second quarter, our international businesses, principally those in Europe and the United Kingdom declined similarly to the decline we saw in North America in the latter half of 2008. And again, to address this drop, we took action similar to what we did last year in North America, resulting in much of the redundancy, much of that million dollars, probably more than half, as previously discussed.

Our sales to the industrial markets, principally to and through distribution channels, and the semiconductor markets were down year-over-year due to continued weak business conditions. Both these end markets show no clear signs of impending improvement, however, neither is getting worse at the present, and both appear to have (sailed) at the lower levels that we've seen in some time.

Sales to the defense market were below prior year for the quarter and year-to-date, and last year's MRAP production and shipments have thus far not been replaced by this year's combined MRAP and M-ATV shipments. The recent award, however, for M-ATV program have resulted in orders to result in shipments in the second half of 2009 with additional potential orders as the program continues to ramp up.

The wind energy market in the near term continues to be impacted by issues in the general economy, as well as credit availability. Recent steps taken by the government to improve this through the stimulus package should eventually improve visibility and end user confidence to proceed with previously planned projects. Notably, the recent clarification of the rules to obtain stimulus funding, particularly the cash grant program in lieu of tax incentives, could improve near-term activity.

Through the second quarter, however, they have yet to translate meaningful, visible improvement; however, they only came out at the end of the second quarter.

Wind energy sales were 19.8 million in the second quarter, an increase of 600,000, compared to the second quarter of 2008. Although there were no further wind energy cancellations during the quarter, shipments did continue to be impacted by quarter end deferrals as wind energy customers continue to be challenged by difficulties in trade finance, and as I said before, think letters of credit, and their own high inventory levels.

In the longer term recent activity in Congress, and policy statements regarding a sustained, committed policy toward an increasing renewable electricity usage in the United States supports our long-term confidence in this market. However, the near term will continue to be impacted by issues around visibility and financing.

In velocity control, second quarter sales totaled 10.2 million, as compared to 20 million in the prior second quarter, really just due to lower volumes across the board. Operating income declined to about a million due principally to the effects of lower sales volume.

Our velocity control business, both in the U.S. and in Europe is highly correlated with the level of industrial activity, and is probably our business most tied to distributor stock levels. Obviously this business dropped fastest and more severely as the economic crisis set in and spread. That said, the direction is comparable to that experience in the last turn – downturn, but now on a much bigger and more international business, and if the past is an indicator of future trends, when distributors begin restocking at meaningful levels, this business should be one of the first to benefit.

In sealing products, sales were 9.6 million, as compared to 11.7 last year, with operating income declining to 800,000 due to lower volume and ((inaudible)) friction control additional pension costs, in addition to a relatively significant severance cost during the quarter, a bit over 200,000.

Other businesses, finally, sales in our other segment totaled 14.3 million during the second quarter, as compared to 21.4 in the 2008 quarter. Operating income decreased from 3.3 to 1.1, as most of the businesses, principally the filtration businesses, were adversely affected by the general slowdown in industrial activity.

Backlog for the company was 242.8 million, compared to 324 at June 28, 2008, with wind backlog 124 million at the end of this quarter. The drop in the backlog from the second quarter of 2008 is attributable primarily to shipments in excess of new orders as the effects of the globally weak economy translated into lower orders and continued deferrals of push outs in our longest cycle markets.

Also, we saw pricing adjustments, but we have pricing mechanisms tied to raw material benefits, either realized or incurred, related to the wind energy backlog, reflecting the contractual pass-throughs. These amounts totaled approximately 12 to 13 million spread over the total wind energy backlog that rolls out over the – over the next 18 months.

We also experienced about $5 million of residual cancellations during the quarter, most of which was concentrated in the heavy equipment business. If you think about the cranes, the mining equipment, that's where some of our customers cancelled during the recent quarter. There were no further cancellations in the wind energy business.

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

Peter Dechants: Thanks, Jim, and good morning everyone.

During the second quarter of 2009, interest income totaled 109,000 on our average investment balances of 213.4 million. This compares to 1.7 million of interest income in last year's second quarter, when we earned approximately 2.4% on average investment balances of 282 million. The lower average investment balances resulted from our capital expenditure program, increased working capital, our stock repurchase actions, pension plan contributions, and an enhanced dividend.

The reduction of 1.6 million in second quarter interest income, compared to the prior second quarter, was about 3 cents per share on a diluted basis. While our investment balances continue to provide us with significant liquidity when liquidity is at a premium, we're currently earning very little interest. Our current cash and cash equivalent investments today are principally in money market funds invested in short-term treasury securities, which provide the highest level of safety. We expect that interest income in the third quarter of 2009 will continue at the level achieved during the second quarter.

Interest expense during the second quarter of 2009 was 61,000, which represents the amortization of fees on our revolving credit, as we completed the conversion of our long-term debt into equity in the third quarter of last year. Interest expense in the second quarter 2008 adjusted to reflect the required retrospective application of a financial accounting standards board staff position was 3.5 million.

The conversion of the debt and the related reduction in interest expense had no impact on diluted EPS due to the accounting treatment of the underlying convertible debt. The effective tax rate during the second quarter of 2009 equal 37%, compared with 35.4% in the prior second quarter. The effective tax rate for the full year of 2009 is expected to be approximately 36%.

Net income for the second quarter was 8.4 million, or 25 cents per share on a diluted basis, as compared to adjusted second quarter 2008 net income of 19.6 million, or 63 cents per share on a diluted basis.

Second quarter 2008 results have been adjusted to reflect the required retrospective application of the two financial accounting standards board staff positions, which were effective January 1 of this year. And this resulted in recording additional non-cash interest expense of 1.1 million, or 700,000 after tax. These required adjustments reduced previously reported second quarter 2008 basic earnings per share by 4 cents, and diluted earnings per share by 1 cent.

During the quarter, EBITDA was 20.6 million, compared to second quarter 2008 EBITDA of $38.9 million. Second quarter 2009 EBITDA margins were 20.9%, as compared to 27.8% in the prior second quarter. Free cash flow during the second quarter was a net use of cash totaling $6.1 million, after $2.2 million of capital expenditures, and contributions of $14.8 million to fully fund our qualified pension plans on an actuarial basis.

We currently expect 2009 capital expenditures to be less than $20 million, substantially lower than our original plans for the year at about $30 million, as we review all capital spending projects in light of the current economic environment.

Again, EBITDA and free cash flow are non-GAAP measures, which should be viewed as supplemental data rather than – rather than as substitutes or alternatives to the comparable GAAP measures. We've included in our earnings release a reconciliation of these metrics to their most comparable GAAP counterparts.

Cash and cash equivalents totaled $210.7 million at the end of the second quarter 2009, compared to $233 million at the end of 2008. And the company has no outstanding debt.

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

James O'Leary: Thanks, Peter.

Well the current economic environment remains challenging. We've taken the necessary steps to improve our results and our position for the longer term. Now having taken these steps, a strong balance sheet and leadership positions in fundamentally sound end markets will allow us to emerge from the current period stronger.

With unrestricted cash totaling 210.7 million, 295 in available credit, and no debt, we are exceptionally well positioned for the longer-term. During the second quarter, the company paid common stock dividends of 17 cents per share, or 5.7 million, and for the third quarter of 2009, the company declared a dividend of 18 cents per share payable on October 5. This 5.9% increase reflects the company's confidence in the fundamental strength and cash generating ability of our businesses.

While current business conditions have no doubt been challenging, our board and management share confidence in the fundamental strength of our businesses. They're demonstrating cash flow – cash flow generating ability, together with our fortress balance sheet are reflected by this enhanced return to our shareholders.

Lastly, I'd like to thank each of our Kaydon employees for their efforts thus far and prospectively to what's been a challenging 2009 to date.

That concludes the formal presentation. Yolonda, I'd like to turn it over to you to moderate questions.

Operator: Certainly. At this time if you would like to signal for a question, please do so by pressing the star key followed by the digit 1 on your telephone keypad. If you are using a speakerphone, please insure that your mute function is turned off to allow your signal to reach our equipment. Once again, that is star 1 if you do have a question at this time.

We'll take our first question from Eli Lustgarten with Longbow Research.

Eli Lustgarten: Good morning.

James O'Leary: Hey, hi, how are you?

Eli Lustgarten: Not too bad. Tough environment, but you're managing through. Couple of technical questions. One, the 14 million pension contribution, did that – how much flowed through the income statement of that? And where was it …

James O'Leary: None.

Eli Lustgarten: None of it?

James O'Leary: … let Peter handle that.

Peter Dechants: That doesn't flow through the income statement, Eli, you'll see a shift on the balance sheet where some of the long-term liabilities have flipped. But that is not an income statement item. It affects the effective tax rate though as a deduction for 2008, and that reduces some credits we get, and that was the reason for the higher (ETR) in the quarter.

Eli Lustgarten: OK. So there's no impact today? See during the – during the commentary, the segment you talk about the higher pension costs at one point.

James O'Leary: Eli, remember …

Eli Lustgarten: … ((inaudible)) ceiling …

James O'Leary: Yes, with …

Eli Lustgarten: … pension.

James O'Leary: … pension funding and accounting, there's a detachment between the actions you take and when they show up in the numbers. I mean I'd analogize funding, the pension plan is planting seeds in the winter. Our plan is now fully funded, but the increased pension costs you see this period is a result of where the assets were again the last year, the actuarially determined expected rate of return. And probably the biggest piece is the low level of interest rates when you discount the liabilities.

So when you put the money in for funding up the plan, an investing in assets prospectively, you don’t see those benefits until a couple years down the road. And where I talked about the $4 million, in the last downturn, which not coincidentally followed the last really severe stock market decline, our pension expense today is about $4 million higher than that, that reflects two things you know a comparable drop in assets that we saw previously, but probably more significantly just the unbelievably low level of interest rates you’re discounting the liabilities.

Eli Lustgarten: OK.

James O’Leary: But we fund up the assets, and as interest rates go back to normal levels, you’ll see that in the pension expense, so that takes – it takes a little bit longer to flow through due to the actuarial mechanism.

Eli Lustgarten: All right. Now and then the wind business with the ((inaudible)) deferrals. Can wind shipments stay relatively flat for the rest of the year at these levels? And the maybe the more quite important question, you saw the expanded capacity in anticipation of what should be a very good market over the longer term. That means you’re probably running at 50% capacity utilization, so are we seeing profitability pressures on that portion of the business also at this point, particularly as we go through the year?

James O’Leary: Yes. Absolutely, and you know we’re a bit higher than 50%, probably a bit higher than 60% in our – in our Mexican facility. But to answer your question too, yes, and you’re seeing it, and that’s why again, probably more prominently than ever in the company’s history, we’d encourage you guys to look at bit more at EBITDA. And I – and we don't want to get into EBITDA and free cash flow numbers all over the press release, because you'll have more GAAP to non-GAAP reconciliations than we have press release. But it isn't going to look at the depreciation, that is pressuring the profitability relative to prior cycles.

You know I'm not apologizing about it, saying I think 20% EBITDA margins aren't terrible.

Eli Lustgarten: Oh no, they're fine, I just you know I just think what they could be ((inaudible)) got any business, but …

James O'Leary: Oh, absolutely. And on your second question you know at about a $19 to $20 million level off where we are, yes, we think we're going to be at at least that level for the balance of the year.

Eli Lustgarten: So it'll be flat for the year roughly in shipments?

James O'Leary: Yes, we said that's what our you know our base case was, right now there's nothing to tell us if that'll be different, we could do better, if things don't improve, we could do worse, but that's our base case.

Eli Lustgarten: OK. And are we seeing anything other than volume that's impacting profitability you know in most of the sectors, is you know is pricing basically relatively stable at this point except for the pass through of raw materials that this is strictly a volume you know decline in profitability that reverses with you know reversal in volume?

James O'Leary: Yes, and remember in the case of Kaydon, because our facilities are so end market specific product specific, just like in capacity on terms, it's mostly capacity relative to volume. And you know we obviously have every purchasing guy in the world is out there trying to make his bones and appear like this, but it's much more capacity in volume than price, and the contractual price pass-throughs you know we benefited from that on the way up, and it impacts sales and cost of sales on the way down. So that was expected.

Eli Lustgarten: And one final, can you give me some help on the second half of the year, is there any reason why the third quarter at this point probably the only one you have visibility, is anything materially different than the second quarter given current business conditions?

James O'Leary: Well we're thinking about how to answer that in light that we don't give guidance. But if business conditions don't change, you look at our needs – our normal season cyclical – what cyclical season ability, yes, it could be better. If wind orders that have been deferred come to fruition, but I think I've been kind of consistent in saying our biggest risk in the wind business is you run out of year, and some of these policy things don't come – don't come to play. So I think as a base case, factoring in normal seasonality, and making an assumption on the wind market really gets going, second quarter's a good starting point, it could be better.

Peter Dechants: We had wind shift mix slide from Q2 to Q3, which would be a positive for this quarter, but at this point you know we can't say it won't happen again.

Eli Lustgarten: Right, thank you very much.

James O'Leary: You're welcome, Eli, thank you.

Operator: We'll move to our next question from Nigel Coe with Deutsche Bank.

(Nicole): Yes, good morning, this is actually (Nicole) asking questions on Nigel's behalf.

James O'Leary: I will allow that.

(Nicole): Great, thanks. First of all, how did trends track through the quarter? So how did the 3 months go? Did you see stabilization? And then what about during July?

James O'Leary: Stabilization during the quarter, and I mean I said, North America stabilized a little bit sooner. Again you know at hatefully bad levels, but it did stabilize. Europe got a bit better, some of the headline numbers on industrial production, particularly in Germany I think were better than I've seen, and I've heard a lot of the companies that we comped against in your coverage universe, I think the macro numbers were better than some of the specific company numbers. But you have to believe that one is a precursor to the other. So Europe stabilized after a later plunge in North America.

And you know if I hadn't commented on it already, I'd pass on the question. But you know anecdotally, we're seeing a few more released, we're seeing a few more releases, we're seeing a few more positive trends in quotations and the like than we had in say April or January. But I think it's really too early to say it's not a head fake, but it's better than not having them, right?

(Nicole): Yes, certainly. And then with regards to the wind backlog, did any orders fall out of your typical 18-month window? And then what is your sense on inventory at the wind (OEs)?

Peter Dechants: No orders fell out of the 18-month window; it was principally, as Jim mentioned, some pricing reductions due to the material pass-throughs. And inventory at the (OEs), they've got inventory, so they're reluctant to commit to orders sooner than they have to with suppliers.

James O'Leary: Yes, and I think the transmission mechanism, (Nicole), was going to be you know if the cash grant program, and some of the nearer-term ability of the administration to impact the wind market come to fruition, and they have a positive impact, first thing you'll see is developers starting to get things that are already on the ground, and sites developed. Those will get going, that'll clear orders that were deferred at the – at the (OEs), and in our case the wind turbine manufacturers. And I think by you know probably the end of this quarter is too optimistic, but it's certainly possible. And maybe end of this year you start to see that flow straight on through the supply chain, including bearings, including towers, including you know the whole host of things that go into a turbine.

Right now, I wouldn't say they've improved this quarter, but you know the signs are better now, at least that you have a clear understanding as to how to access funds. You have a bill through congress; it still has to get on through senate. I hope there's a political will to do that, because I do believe there is – that is already going with some positives before we get to Copenhagen in December. There was a memorandum of understanding between the United States and China, which is a – I think an important political step to get all this going before December.

So again you know the tea leaves are a bit better than they were earlier this year, but you'll still need it to flow through to impact developers first, turbine manufacturers second, and then lastly ourselves and a lot of the other important component suppliers in the supply chain.

(Nicole): OK, that's helpful. And then lastly, if you could talk a little bit about competitor behavior, has it been rational? And are you seeing new entrants?

James O'Leary: Yes, I think it has been rational. Pretty much everybody has cut capacity, but I don't think exit the market or plan entering the market, but they've slowed down or scaled back their plans, and I'm thinking the two or three publicly held guys, in particular. I think we operate outside of wind in a space that's you know has a fair degree of price discipline, meaning you know nobody's trying to work for free here, it's a relatively low CapEx type business, custom ((inaudible)) business.

So I think we have good competition. The only thing that is outside of that normal you know that normal playing field is when you have non-traditional entrants, and I'm thinking particularly people who are vertically integrated, largely – principally in the large turbine part of the business, or the large bearing part of the business, crane manufacturers, particularly in Europe, you have some swing production that has come into the market. But I think that’s a temporary disruption, not a long-term competitor, because these guys sell out capacity when their own businesses are soft, and then pull it off the market right away. I don’t think the turbine producers consider them to be principal parts of their long-term supply chain strategy.

(Nicole): OK, great, thank you.

James O’Leary: OK, thank you very much, (Nicole).

Operator: We’ll take our next question from Steve Barger with KeyBanc Capital Markets.

(Joe Box): Hey, guys, this is actually (Joe Box) filling in for Steve.

James O’Leary: Oh, none of the – none of the main guys are around today? That’s what happens when you pick a Friday?

(Joe Box): This is the …

James O’Leary: We like you – we like you too, (Joe).

(Joe Box): I'm sorry, what was that, Jim?

James O’Leary: We like you too though.

(Joe Box): Oh, good, I appreciate that. This was the second quarter in a row where we were a little bit surprised that working capital is a use of funds. Can you just flush out some of the drivers behind why you know inventory was essentially flat, and maybe talk about your expectations for working capital over the next few quarters?

Peter Dechants: Yes, in the quarter, working – or inventory was a little bit down, but essentially flat. Some of the order push outs at the very end of the quarter, some shipment push outs had something to do with that. We're also we think sort of at the inflection point with the wind inventory and the ((inaudible)) we've got to support that business through the rest of the year, and are looking for those turns to improve through the second half.

The biggest reason it was a source was payables during the quarter, you can see payables were 19 million at the end, and that reflects largely the reduction in incoming goods for the quarter.

(Joe Box): What about on the accounts receivable side, should we look into that at all?

Peter Dechants: Well accounts receivable were at about 60 days, which is while historically for us a couple of days high, I think is reflective of the economic environment we're in, and I can tell you it's something we'll watch pretty closely.

James O'Leary: Yes, we – when we talked about working capital, we pretty consistently said it would start coming down in the back half of the year. I think payables is a precursor that the incoming is down, order deferrals, especially given – this is a business that Kaydon was never in before in this type of economic environment. And it is a meaningful amount of high dollar, low volume items that a couple of weeks, as far as order receipts on the part of our customers matters a lot. But on the receivables front, we're really not materially different than where we've been in the past. Payables again is a precursor reflecting what is likely to be the direction going forward.

We still expect working capital to be a source of funds before the end of the year.

(Joe Box): That's fair, so it should go in the other direction next quarter. My next question's on the wind business. I know it's been only a few weeks since the guidelines for the investment tax credit's been released. But are you hearing anything from your customers you know in late July about you know where your capacity levels could be at, and you know any just overall inquiries about you know future activity that you know might be a precursor to orders?

Peter Dechants: Well from our customers, we hear the same things that we're collectively reading. Anecdotally, developers are a bit more positive, at least they understand how to access the funds, there are clear guidelines. And you know this sounds – it would sound like minutia if not for the fact it doesn't happen, just having people who could administer these programs is a not unimportant detail. So we're hearing anecdotes about the developers being a bit more positive.

As I said on I think (Nicole's) question, it's too early for that to have transmitted through the meaningful reduction to the turbine level or all level. But again, the anecdotes are more positive. And as far as inquiries, where our production schedules are, again, we're comfortable with year-over-year level comparable to last year, and if things keep going the way they are, could be better. But obviously you got to balance that with the – you'll run at a year scenario where even though backlog's not going down, you run out of shipment dates, as you stare at 9/30 and 12/31, and that's all a function of when people will take receipts.

(Joe Box): OK and the last question I have for you is in relation to China. There was another company out that was talking about a forecast for 20,000 towers in China and just generally saying that the process for putting on wind capacity is essentially progressing much more quickly than other parts of the world. I said did you guys have some open capacity right now? Is there anything that you could do to satisfy the demand in that market?

James O'Leary: Ship them like crazy. We are – our second biggest customer is a Chinese customer, and we are spending not a disproportionate, because I think it's proportionate to the opportunity, we're spending a fair bit of time figuring out how to access and do more business in a market which you know you're 100% right, as far as effective stimulus you know you got to say that China pretty much is leading the pack right now as far as stimulus is translated into what the government wanted. The naysayers can obviously say but it's a banking issue behind that, sure, but the stimulus is doing what it was intended to do.

On the renewable electricity or renewable energy front, boy, in China right now in terms of megawatts installed, now and prospectively has taken over the lead as number 1 market in the world, which is a pretty compelling statement from where we were a year ago, that's on the one hand.

On the other hand, it's still a very hard market for people to access unless they're indigenous producers, so the workarounds are find the right market, figure out a way to access it as an importer, and you know a partner in some fronts. I still don't know if I have the guts to be a guy who'd commit $50 to $100 million of capacity to that market on our own, but there are plenty of ways to do it when you have good customers and good partnerships. And we are spending a proportionate amount of time on that today.

(Joe Box): That's great color, thank you.

James O'Leary: You're welcome, (Joe), thanks.

Operator: As a reminder, that is star 1 if you do have a question at this time. We'll hear next from Peter Lisnic with Robert W. Baird.

Peter Lisnic: Good morning.

James O’Leary: Hey, Pete.

Peter Lisnic: My tee time was actually cancelled, so that’s why I'm on.

James O’Leary: I was wondering what you were doing on today.

Peter Lisnic: Yes, not a typical Friday. I just want to go back to that working capital question. If I look at the numbers that you’ve done historically as a percentage of sales on that working capital front, we’ve crept into the 30’s, and you’ve typically been you know call it mid 20’s or high 20's. Is it safe to assume you get back to that kind of ratio by the end of the year with the implication being you throw off $30 or $40 million of free cash just from the working capital side then?

Peter Dechants: Well I mean without putting a specific target out there, so what we’re looking for, we are looking for inventory turns that were you know in this quarter about 2.3 if you get back to where they were last year, and receivables as well to pull a couple of days down off of that.

Peter Lisnic: OK. All right, that helps on that. And then Jimmy alluded to the fact that things are tough, and if they do get tougher, there could be some structural changes. It – or at least that’s the way I read it. Can you maybe give us a sense as to what would have to happen for you to maybe take more or incremental actions, and what that might mean in terms of, A, costs, and, B, benefits going forward?

James O’Leary: Yes, consistently – nothing consistent ((inaudible)) what I've said in the past, but the company’s history you know our factory footprint, our facilities you know our overall capacity management has been you have market focus and product specific facilities, well you just can't say we’re going to go from ten facilities down to five, and eliminate half your – half your overhead cost structure, in a downturn where your revenue goes down. Unfortunately we have to have every market, and you always have the issue where you may be walking away from markets.

At this level of volume, this is principally by the way the friction controls and the bearings business. At this level of volume, we're looking at very hard at whether or not adding a little bit of capacity here may let you exit a facility or two in a few other places, where you'd be eliminating overhead, which again, when you run market specific factories, the overhead that comes from individual units that stand alone is an important consideration. So leveraging the overhead, leveraging the group, but you're always better off having two shifts in one place than one shift in two places.

The one thing that we are very confident of, though, and you have to be careful about, is we don't want to inadvertently exit a market that has benefited us well in the past. Semi-conductors is a great one to think about. You know with the benefit of hindsight, you could say that in 1998, we never should have erected the semiconductor market facility we have, that's with the benefit of hindsight.

But we're dealing now, again, taking advantage of the fact that when the tide is low, you see a lot of this stuff, is looking at where if we add a little bit of capacity in certain places, we could exit a facility or two elsewhere. And other than we're cognizant of it, we get the need to do it if this doesn't improve, but we're sensitive about taking away the up side has benefited the company historically considerably is probably a little bit premature to give you benefits. But it's something we're looking at.

Now outside of – outside of friction controls, you got to remember, we got one, two – we got seven businesses if you include other ceiling products and velocity control, we got seven businesses in eight facilities. So there's a lot you can do unless you say I'm exiting a business, and I have said before you know there's one or two or another where once they go cash flow negative, or P&L negative for a sustained period of time, we revisit whether or not we should be in it, they haven't done that yet. Every one of our businesses is pretty much cash flow positive and P&L positive. And even though the numbers, I think largely because of the timing, are a bit disappointing this quarter, everything's making money, and everything's P&L positive, which there aren't that many companies who can say that.

Peter Lisnic: OK, all right. That helps.

James O'Leary: ((inaudible)).

Peter Lisnic: The – I guess my last question is on the pension funding of I guess almost $15 million, from what I remember, is markedly higher than I thought what you disclosed in the K. So can you maybe describe, I would imagine a piece of that is related to curtailment, and a piece is related to actually bringing the plan up to being fully funded, so maybe go through the mechanics of that. And then what does that mean in terms of cash contributions potentially next year, and then what the income statement impact might be next year as well.

Peter Dechants: OK, breaking it down a little bit, Pete, the comment in the 10-K was that we expected to make required pension contributions of two point something million. Those were the required minimums for the year on an actuarial basis you know to keep us funded at a correct funding status. We made one of those contributions 700,000, so the 14.8 is a – is a 14.1 sort of incremental voluntary contribution that brings us up to fully funded status. So we'll have no more – we don't expect any more pension contributions this year, and we expect them to be reduced next year. And I can't completely forecast 2010, but they'll be significantly reduced from what they would have been had we not done this.

And working through the actuarial calculation, the benefit from just this particular funding would be the assumed earnings, assumed expected return on the incremental contribution.

Peter Lisnic: OK.

Peter Dechants: And …

James O'Leary: The GAAP disclosure in the – or not sure if even the GAAP disclosure, but the disclosure in the 10-Q is this is what we have to put in, we put in more than we have to put in. And you know the same health warning too, I'm not in any way, shape or form saying the market's turning or can't get worse you know there can't be a double dip. The same caveat applies to this, because if you knew how well I've done investing in stocks, you would shut your ears off immediately. But you know when cash is earning nothing, we've got plenty of liquidity in terms of our revolver, and the impact on pension has been prospectively.

And if you look at the history, companies that contributed to their pension plans, including a company like General Motors and a lot of the companies that are dealing with you know more challenging issues than we today, companies that made contributions to their (DB) plans after you know market disruptions like early 2000, I want to think after today we're happy about it. Remember, we had pension income only 2 years ago, a lot of companies had pension income, where we probably have a lesson learned is maybe at some point the next time the stock market's doing better as we look to a ((inaudible)) more retirees, look at other investment strategies.

But what we've done isn't the required, we're back again to fully funded over and above what we had to, and a little bit of it is if our alternative use of cash absent a great acquisition is sitting there with you know 1-ish% returns, or you can meaningfully impact your pension plan, I don't want to say it's market timing, but it's a little bit opportunistic, and it's a position we have financial flexibility, you can (dip).

Peter Lisnic: Now do the curtailments meaningfully lower your structural pension funding requirements going forward?

James O’Leary: ((inaudible)).

Peter Dechants: Yes, the curtailments are on our post retirement benefit plans, rather than the pension itself, Pete.

Peter Lisnic: OK.

Peter Dechants: And so what we’ve done is some of the post retirement plans for different groups of employees we’ve modified and tailored and reduced in a number of places. And when we completely eliminate a benefit for a group of people, there’s a curtailment where we take the liability for that obligation off the balance sheet.

Peter Lisnic: OK, that is very helpful, thank you both.

James O’Leary: You're welcome, Pete, thanks.

Operator: We’ll take our next question from Peter Thompson with Coho Partners.

Peter Thompson: Morning, guys. Most of mine have been – most of mine have been answered. Just was curious, the one thing nobody talked about today was deal flow. And I was just curious if you maybe could comment on whether or not you're seeing anything, you usually do comment on that? And …

James O’Leary: Yes, we usually comment on it when somebody asks, so you’re right on queue.

Deal flow is not great today, but I want to talk about it quantitatively and qualitatively. Quantitatively you know investment bankers look to be positive guys, but you could line up 100 of them, every one of them would say deal flow is about as bad as they've seen in their careers in terms of volume of deals, auctions, teasers on the street. And I think a lot of it's a function of you know if you don't have to sell, why would you? It's something I've commented on on previous calls you know the banking covenants, the way some of the terms and conditions on revolvers and the like, and financing mechanisms change structurally over the last few years means we're not yet at the point where our people have to sell.

And at the end of last year, if you really thought the market was going to be at the valuation levels of you know S&P at the dreaded 666 numbers, or wherever the Dow was at the end of the fourth and beginning of the first quarter. You know unless you thought that was it forever, now that the market's rebounded a bit, people have held off, and if you're thinking about deal flow, there's chance it'll pick up by the end of the year. But quantitatively, I've never seen it this low, and I think 100 out of 100 investment bankers would tell you the same.

Now qualitatively, we are looking at one or two things that I think are more actionable and promising in terms of you have sellers that are possible sellers, but we're I say you know not early, but mid stages there. And in some cases, it's companies that can sell, and you know strategically looked at their portfolio, and are thinking about things. You know great example would have been (Manitowoc) again the last year with the business that for antitrust reasons we had to sell. There are examples of businesses like that.

And in terms of discussions you know I think smart private equity guys are trying to think about you know how do you deal with an environment where (IPOs) may continue to be slow, you may have financing issues? So there's a lot of good companies out there that you know between willing sellers and willing and financed partner, you could put something together.

They are real, and I think you know substantive conversations there, but nothing that's actionable anytime in this quarter. So quantitatively, really bad, but I suspect that'll pick up by the end of the year. Qualitatively you know there are real conversations between people that think pricing has come down to a more realistic level. But even that takes a fair bit longer to develop.

Peter Thompson: Great and then just one just quick one. I don't know, did anybody tell us what the wind orders were? I know they were obviously almost non-existent last quarter. Were they equally non-existent this quarter?

James O'Leary: They were non-existent, but they were low, five …

Peter Dechants: About 6-plus million in the quarter net.

James O'Leary: Yes.

Peter Thompson: OK. And total orders for the quarter, just industrial as well as wind?

Peter Dechants: Total orders in the quarter were 67.8.

Peter Thompson: Great, super. Well thanks so much, you guys, good luck.

James O'Leary: Well they weren't great or super, but we hope they're going to get better.

Peter Thompson: OK.

James O'Leary: All right, thank you very much, Peter.

Operator: As a final reminder, that is star 1 for any questions at this time. We'll hear next from Walt Liptak with Barrington Research.

Walt Liptak: Hi, thanks, good morning, guys.

James O'Leary: Good morning.

Walt Liptak: OK, just a couple of them. To go over the inventory again you know you talk about drawing down inventory. Without incremental orders, does that mean that you're going to have to lower your production level over the next couple of quarters?

Peter Dechants: The inventory reduction's going to come from a variety of things. A certain amount of this, as we say, orders have been pushed out, and some orders slid from Q2 to Q3. So a portion of this is done, or is in work in process. A lot of – a portion of the inventory we have is sitting in rings, and that has yet to be you know manufactured, and so we're still going to have to produce a good portion of it. It's a mixture of things.

Walt Liptak: OK, so there – but there is some finished goods that you …

Peter Dechants: Yes.

Walt Liptak: … kept production ((inaudible)) finished goods inventory?

Peter Dechants: It's unfortunate.

James O'Leary: When shipments fall out of the last 2 weeks, because the letters of credit issue, they're finished.

Walt Liptak: OK, right. Would we expect in the next couple of quarters that as a result of the inventory drawdown that your margins might be lower, like gross margins?

Peter Dechants: There'll be some effect from absorption in some of the – some of the sectors, some of the segments as we're doing planned strategic inventory reductions, we're looking at some absorption effect.

Walt Liptak: OK.

Peter Dechants: So …

James O'Leary: Which assumes no rebound in business whatsoever.

Peter Dechants: Right.

Walt Liptak: OK. You know on the wind power part of the business, you talked about you know – you know I guess 80 million roughly for the year, 20 million per quarter. I wonder if you could give us some help on the revenue for the rest of the businesses, the rest of the industrial. And you know just a ballpark you know do – are we going to be at sort of this – a similar revenue level throughout the rest of the year? You know or you know something around 100 million per quarter?

James O'Leary: That's kind of in the forecasting you know I think it's a little bit more of a granular forecast than we ever give. I mean we gave you some color on you know a general sense of how the markets are performing, anecdotally there seems to be a bit better. There is a little bit of seasonality associated with Kaydon that we finished the year better than we started. So this is different, I think you know how you model that's going go be your assumption, so.

Walt Liptak: OK, all right, fair enough. Well let me ask about M-ATV, is there M-ATV in backlog at this point, or does that come after the quarter?

James O'Leary: Yes, OK, that one I think is fair game. Defense is – defense is lower this year relative to last year and you know the year-to-date, but a lot of it has to do with the ramp up last year, and the assets of ramp up thus far this year. M-ATV orders have been received – excuse me, M-ATV orders have been received, and I think you know consistent with what I said on prior call and presentations you know since last year was about 80, this year it's going to be in the you know 70-ish range, almost exclusively due to timing. You know when you read something like – I think it was yesterday or the day before you know I mean the government is putting a full court press on receipt of orders this year. I don't think we've seen the impact of that yet, given that we're a couple of – couple of notches down on the supply chain food chain, but you know there's a possibility you could do better.

But remember, the orders – the order that Oshkosh received was only the end of the quarter you know the subcontracting out, and further orders ((inaudible)) the government will have future rewards to the principal supplier between Oshkosh and the vehicle manufacturers. That has yet to be felt, but you know we do have M-ATV orders, doesn't change our overall forecast. There's a timing issue on when one program started, and when the other you know it would be great for these programs to start on January 1 and end on December 31, make everyone's life easier, but it's not the world, right?

Walt Liptak: Yes. So do you get the – you got the award from the DOD, or do you get a subcontract from Oshkosh?

James O'Leary: We get a subcontract and then subcontractors.

Walt Liptak: From there subcontractors, OK. So you received it for the 2200 trucks so far?

James O'Leary: Not sure we're releasing that, but yes.

Walt Liptak: OK. And so you're sole source on it, on M-ATV so far?

James O'Leary: We've gotten most of the work, I do not believe we are the only people who are sourced and capable of doing it.

Walt Liptak: OK, great.

James O'Leary: That's the way – by the way is exactly the same dynamic in the – for the MRAP.

Walt Liptak: OK, and any commentary on margin or what these – or what the size in revenue we would be thinking of for the M-ATV?

James O'Leary: No, I just gave you our overall defense business …

Walt Liptak: OK, right.

James O'Leary: … programs competitively not great.

Walt Liptak: OK. And then lastly on the – you mentioned the $5 million worth of industrial cancellations for heavy machinery. You know what's going on there, is that – is that the end of cancellations, is it the beginning of cancellations? How should we think about that?

James O'Leary: I hope it's the end, but I think you'd have to look at the crane business, the heavy equipment business, the industrial mining equipment business. A couple of them you cover, so it you know while it’s – I'd like to think you’re closer to the end in the beginning of this, but as companies like crane manufacturers and earth movers go, that segment of the business will go.

Walt Liptak: Yes, OK. All right, thanks, guys, have a good day.

James O’Leary: You’re welcome, Walt, thank you. Yolonda, we’re getting close to the end, I don’t know how many more we have.

Operator: We actually have three more questions in our queue.

James O’Leary: All right, we’ll take three more, then wrap it up.

Operator: Sounds good. We’ll move next to Edward Marshall with Sidoti & Company.

Edward Marshall: Hi, guys. I was wanting you to clarify if you could when you discussed the you know the trends in the business throughout the quarter, and into July, were you characterizing the core business, or were you characterizing the book and ship business? And if you didn’t do the book and ship, can you kind of talk to that a little bit?

James O’Leary: Well the core business and the book and ship I would almost view as behaving the same way. It wasn’t one of our – a couple of anecdotes were in our book and ship factories. And if you got an order or a release and it went out that same quarter, it’s book and ship you know I don’t think you can separate that from our core business. The core business includes book and ship. So I distinguish between that and wind, that’s why we presented it that way.

Edward Marshall: I see. And then inventory that we discussed the push outs that you saw in the quarter. Is that push outs that ultimately we’d see as kind of order – sales rather coming down to the next couple of quarters?

James O'Leary: It's sales, not orders. So …

Peter Dechants: Yes, sales.

James O'Leary: Yes.

Edward Marshall: That's what I meant, right, sales. I mean are we looking – is there a timing on the – on the actual realization of those sales hitting that were pushed out?

Peter Dechants: I think the expectation is it'll be in Q3.

Edward Marshall: And then – and then following up you know just lead times on your actual wind product, when – if we start to see the food chain get – or the faucet get turned back on, when will the sales start to flow for you guys? Where are you in the food chain there?

James O'Leary: If you count releases, pretty much immediately, we have – we have capacity in our facility in Mexico, it can be turned down pretty quickly. The gaining factor is bringing people back if we don't have sufficient workers, but I don't think in this economy you have a real risk that a lot of them have found other jobs, it's going to be hard to get back. It's – I don't think it's months, but it's probably a month or two.

Edward Marshall: I see. OK, thank you, guys.

James O'Leary: You're welcome, Ed, thanks.

Operator: We'll hear next from Holden Lewis with BB&T.

Holden Lewis: Good afternoon, thank you.

James O'Leary: Hi, Holden.

Holden Lewis: Can you just talk a little bit, the gross margin stepped up nicely on a sequential basis. Can you speak about some of the reasons behind that? Because I guess I would have sort of anticipated maybe that getting a little bit weaker. So I don't know if there's mix or what have you that's playing a role in that. And then sort of following on that, what are the moving pieces as you go into Q3 or Q4? It sounds like one is maybe production and under absorption might be something of a – of an incremental negative, but what are the other moving pieces we should be considering in forecasting out the gross margin in upcoming quarters?

James O'Leary: I'll do the second one first, and I'll let Peter do the first question, because the second question's easier. You know I mean the – at this stage, X things that we just – we tell you about, meaning any further charges you know for redundancies and the like, or capacity reduction. Or you know we'll tell you exactly what the curtailment number is, we gave you an estimate, and this press release will tell you exactly what it is next quarter.

But you know the only movement ((inaudible)) volume right now, I mean that is the single biggest driver when you have ten facilities, each one specific, and you get to a level where you've eliminated every variable cost, you're controlling your spending, you've reduced your CapEx I think to a pretty reasonable level off of where we've been, and where we've been even before the wind energy ((inaudible)) itself.

Once you're controlling all the variable costs, and your headcount – or headcount down – you know down well over 20% if you factor in temporary over time, all the other variable pieces of the variable labor. So the one single driver as it has been historically is going to be capacity, and if you think of you know we’re seeing 60% capacity in our wind energy facility, every dollar of volume you put through there has a beneficial impact on margins.

Holden Lewis: OK.

James O’Leary: The question one?

Peter Dechants: Yes, quarter-over-quarter on the gross margin that was largely realized in you know overhead spending, and it was focused efforts really on just controllable costs. And if you look at the change year-over-year going back to last year’s second quarter, the decline there is explained by volume for the …

Holden Lewis: Right.

Peter Dechants: … most part.

Holden Lewis: But I guess I'm also wondering, what is the impact on the margin just from either mix between your businesses, was that a net positive, net negative? And I guess the impact of you know sort of the price cost pass-throughs on the wind business, is that sort of a net negative, net positive on the margin lines?

Peter Dechants: If you’re looking at Q1 to Q2, the mix was approximately the same, and if you’re looking year-over-year, the mix tends to be more negative this year. Where you will see a mix impact if you're looking at Kaydon consolidated, rather than one of the segments, is when you're seeing you know wind sales growing disproportionately to the rest of our say book and ship business, or industrial distribution business, which is our – some of our highest margin business. And when you’ve got declines in velocity control or the book and ship business in friction products that are greater than the wind growth sales, you’re going to get margin decline, but probably more – probably more margin dollars if it’s going the right direction.

Holden Lewis: OK. And then just to quickly follow up, on the SG&A side, are the declines that you’re seeing in SG&A primarily a function of lower volumes? I know that you have a relative thick structure you know so I guess I'm trying to get a sense of how much of the SG&A improvement that you’ve seen is a function of sort of you know the impact of restructuring? And I guess on top of that, this you know what you’re doing with these million dollars of costs of restructuring and streamlining, when can we expect that to impact going forward?

James O’Leary: I think you'll see it next year when you’re at a normal run rate. And take it SG&A, the S piece, if it’s commissions or headcount related, you're probably down to a level that you can’t reduce much more without a – without another step down, or a significant step down in volume. So the absolute number probably pretty close to where it should be, it only starts going up again when you're adding people, paying greater commissions, i.e. big positive, or paying bonuses to people who are delivering much higher profits, which is ((inaudible)).

Holden Lewis: OK, sure, which is a nice problem to have. But you also think you have the costs kind of out to the point that as long as volumes kind of stay in this 90 to 100 range, that the 19 million level’s kind of like the level you think?

James O’Leary: Yes, and all of this isn’t – I'm glad you asked, I'm sorry that a lot of people are probably off to lunch, that’s not a hint that you shouldn’t ask anymore questions. But you know one of – one of the things that I don’t think Kaydon gets a lot of credit for, which I think you start to see now you know a lot of companies can beat the profitability numbers now, because their cost reductions have been greater in an environment when revenues are still coming in below where people thought. You – I'm pretty sure you’ve been to our offices, a lot of you have, you look at our – you certainly can look at our profits and you can see that you know we have pretty aggressive bonus targets you know it's not – there are no lay-ups here.

There's not a lot of costs to take out of Kaydon, we run this thing like it's our own money you know and I think historically my predecessor, his predecessor, you go back 20 plus years, this is a pretty clean cost environment, and that makes it harder to take off the variable stuff, we're always very SG&A focused. So there just ain't a lot of fat to take out of here, and I – kind of weird that you sometimes feel like you're apologizing for that, but that's you know that is our culture. And you know we'll see the benefit of that in the upswing, but it means there's just a lot less to take out on the down swing.

Holden Lewis: All right, thanks.

James O'Leary: OK, thank you.

Operator: And we'll take our final question, a follow-up from Eli Lustgarten with Longbow Research.

Eli Lustgarten: Just a clarification. You mentioned your defense shipments going from 80 to 70 million over the year. Has most of that decline already happened in the first half of the year?

James O'Leary: Yes, and that is mostly timing, Eli, yes.

Eli Lustgarten: Yes, so it's all behind you. So basically second half shipments are going to be relatively you know flat with last year at this point, plus maybe some benefit from the M-ATV?

James O'Leary: Yes, that's what we're forecasting.

Eli Lustgarten: Yes ((inaudible)) OK. All right, thank you very much.

James O'Leary: OK, thank you, Eli. Yolonda, is that it?

Operator: That is all the questions that we have in our queue, gentlemen.

James O'Leary: OK, great. Thank you very much if you stuck with us through the dreaded lunch time bell. We appreciate your support, and your time on the call. And as always, we're available for questions if you have any. Thank you.

Operator: That does conclude today's conference. Thank you all once again for your participation, you may now disconnect.

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